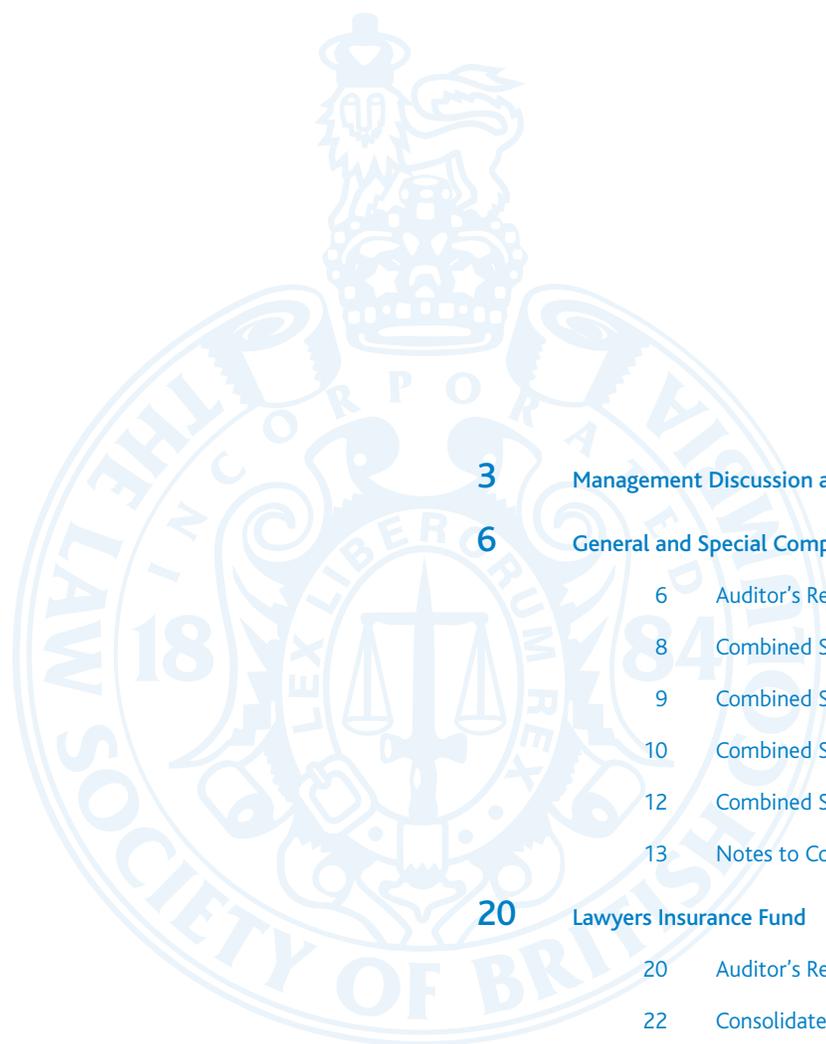




**THE LAW SOCIETY  
OF BRITISH COLUMBIA**

Financial Statements  
December 31, 2014



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The Law Society of British Columbia accounts for its financial activities through three separate funds: the General Fund, the Special Compensation Fund and the Lawyers Insurance Fund (LIF). Society management has the responsibility for assisting the Benchers in fulfilling the Society's mandate, while ensuring that operating expenditures are closely controlled and that appropriate accounting and internal controls are maintained. The 2014 audited financial statements for the three funds are set out in this report. The statements are presented in accordance with the presentation and disclosure standards of the Chartered Professional Accountants of Canada.

During 2014, in addition to the general oversight by the Benchers, the Finance and Audit Committee assisted the Benchers in ensuring that management and staff properly managed and reported on the financial affairs of the Society. The oversight by the Benchers and the Finance and Audit Committee included:

- Reviewing periodic financial statements of the General, Special Compensation and Consolidated Lawyers Insurance Fund
- Reviewing investment performance as managed by the appointed investment managers
- Reviewing with the Law Society's auditors their approach, scope and audit results
- Reviewing the annual Audit Committee Report prepared by the Law Society auditors
- Recommending the 2015 practice fees and assessments, and reviewing corresponding budgets

### General Fund

#### Overview

Overall, the 2014 results for the General Fund were more favourable than expected, resulting in an operating surplus of \$1.7 million.

#### Revenues

General Fund revenue was \$26.0 million, \$2.4 million higher than 2013 with growth in the number of lawyers and an increase in the 2014 practice fee. The increase is also attributed to the increase in the Trust Administration Fee from \$10 to \$15 per transaction, as well as an increase in the number of trust account transactions in 2014. During 2014, net growth in the number of full-time equivalent practising lawyers was just below 2% resulting in a total of 11,114 full fee paying equivalent lawyers for the year. The increase in the 2014 practice fee provided for market-based staff salary adjustments, along with enhancements to privacy practices and lawyer support and advice. Professional Legal Training Course (PLTC) enrolment revenue was higher in 2014, with 470 PLTC students attending during the year, as compared to 442 students in 2013. Additionally, there was an increase in interest income and other income due to higher interest rates and additional recoveries, particularly in the areas of discipline and legal defense. Application fees increased due to an increase in transfer fees and incorporation fees. Rental revenue increased due to two new leases in the 835 Cambie Street building. Offsetting these revenue increases was a decline in electronic filing fee revenue of \$73,000 compared to 2013.

The Lawyers Insurance Fund contributed \$2.1 million to the General Fund for co-sponsored programs and for general program and administrative expenses attributable to operations.

#### Expenses

The 2014 General Fund expenses increased by \$1.8 million (7%) to \$26.5 million, compared to \$24.7 million in 2013. The increase was due to market-based staff salary adjustments, along with higher external counsel fees in the professional conduct and discipline areas. Also, costs related to the Trinity Western University (TWU) law school application process amounted to \$432,000.

Bencher Governance expenses increased due to increased meeting costs, mainly related to the TWU law school application process (\$198,000). These additional costs included costs associated with the Special General meeting, webcasting and other costs associated with the April and September Bencher meetings, and the member referendum in October.

Communication and Information Services costs overall were very similar to 2013, with an increase due to costs associated with market-based staff salary adjustments and increased computer hardware and software maintenance costs being offset by lower printing costs as publications move from print to online.

Education and Practice expenses were very similar to 2013, with increases due to market-based staff salary adjustments and increased external professional fees for credentials matters, being offset by savings in other areas.

General and Administrative department costs increased \$115,000 (3%) due to market-based staff salary adjustments and higher recruiting costs.

Policy and Legal Services expenses increased \$421,000 over 2013. There were market-based staff salary adjustments, plus additional external counsel fees for legal defense cases. External counsel fees related to the TWU law school application process amounted to \$233,000.

The Regulatory departments had increased operating expenses from 2013 levels, mainly due to market-based staff salary adjustments and higher external counsel fees in professional conduct and discipline (\$280,000) and forensic accounting fees (\$87,000). The additional counsel fees increased due to a higher percentage of very complex files, including 4-43 files, an increase in the number of hearing days, along with an increase in the number of files handled by external counsel due to staff vacancies.

### Net Assets

Overall, the General Fund continues to remain financially sound. As of December 31, 2014, net assets in the General fund were \$11.6 million. The General Fund net asset balance (before capital funding) is \$9.8 million, which is mainly invested in capital assets including the 845 Cambie Street building. The net assets balance also includes \$1.8 million in capital funding for planned capital projects related to the 845 Cambie Street building as well as workspace improvements for Law Society operations.

## Special Compensation Fund

### Overview

Previously, the Special Compensation Fund was maintained pursuant to Section 31 of the *Legal Profession Act*, was financed by members' annual assessments, and claims were recorded net of recoveries when they had been approved for payment.

In 2012, the *Legal Profession Amendment Act, 2012* repealed section 31 of the *Legal Profession Act*. In addition, Section 23 of the *Legal Profession Act* was amended to remove the requirement that practising lawyers pay the Special Compensation Fund assessment. Section 50 of the *Legal Profession Amendment Act, 2012* provides for the transfer of unused reserves that remain within the Special Compensation Fund to the Lawyers Insurance Fund for the purposes of the insurance program, which will occur when all recoveries are received.

Effective May 1, 2004, Part B of the BC Lawyers' Compulsory Professional Liability Insurance Policy provides defined insurance coverage for dishonest appropriation of money or other property entrusted to and received by insured lawyers.

### Revenues

The Special Compensation Fund assessment has not been charged since 2013.

### Expenses

Since 2004, the Lawyers Insurance Fund has been providing coverage for dishonest appropriation of funds by lawyers. There were no claims costs in 2014. During the year, administrative costs of \$6,000 were incurred, offset by \$22,000 in cost recoveries and \$32,000 in interest income.

### Net Assets

At the end of 2014, the Special Compensation Fund net assets were \$1.3 million.

### Lawyers Insurance Fund

#### Overview

The Lawyers Insurance Fund (LIF) remains in a strong financial position at the end of 2014. Annual assessments were slightly higher due to additional insured members, and overall investment returns were slightly below the benchmark.

#### Revenues

The 2014 insurance assessment remained at \$1,750 per insured member, resulting in total revenue of \$14.1 million, compared to \$13.9 million in 2013.

During 2014, the long-term investment portfolio performed below expectations, earning a return of 9.6%, compared to a benchmark return of 10.5%. All increases in the market value of the investment portfolio have been recognized through the statement of revenue and expenses in accordance with Canadian accounting standards for not-for-profit organizations.

#### Expenses

In 2014, LIF general operating costs, including the \$2.1 million contribution to the General Fund, but excluding claims payments and unallocated loss adjustment expenses (ULAE), were \$6.15 million, compared to \$6.17 million in 2013.

The net actuarial provision for settlement of claims in 2014 was \$12.8 million, a decrease from \$14.1 million in 2013, based on claims experience during the year. The provision for claims on the balance sheet at the end of 2014 was \$52.6 million, compared to \$53.3 million in 2013.

#### Net Assets

As of December 31, 2014, the LIF net assets were \$65.8 million, which includes \$17.5 million internally restricted for Part B claims, leaving \$48.3 million in unrestricted net assets.

#### Other Matters

During the 2014 year, the Law Society received inquiries from the Financial Institutions Commission (FICOM) regarding insurance licensing issues pursuant to the *Financial Institutions Act* (British Columbia) and the *Insurance (Captive Company) Act*. Following discussions with FICOM, it was decided that the Law Society would pursue an exemption from certain statutory requirements. The exemption request to the Minister of Finance is proceeding and no decision has been made yet. It is our view that the outcome is likely to be favorable. The Law Society also sought an exemption from the *Insurance Premium Tax Act*. See note 15 of the Lawyers Insurance Fund financial statements for additional information regarding premium tax. The FICOM inquiry does not affect the provision of insurance through the Lawyers Insurance Fund.



March 6, 2015

## **Independent Auditor's Report**

### **To the Members of The Law Society of British Columbia**

We have audited the accompanying combined financial statements of The Law Society of British Columbia - General and Special Compensation Funds, which comprise the combined statement of financial position as at December 31, 2014 and the combined statements of revenue and expenses, changes in net assets, and 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 combined financial statements**

Management is responsible for the preparation and fair presentation of these combined 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 combined 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 combined 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 combined financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the combined financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the combined 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 combined 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 combined 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 combined financial statements present fairly, in all material respects, the financial position of The Law Society of British Columbia - General and Special Compensation Funds as at December 31, 2014 and the results of their operations and their cash flows for the year then ended in accordance with Canadian accounting standards for not-for-profit organizations.

*PricewaterhouseCoopers LLP*

**Chartered Accountants**

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# The Law Society of British Columbia – General and Special Compensation Funds

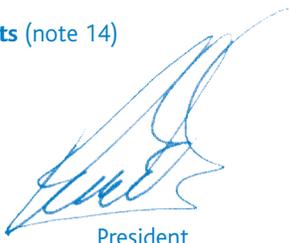
Combined Statement of Financial Position

As at December 31, 2014

	2014		2013 (note 3)	
	General Fund \$	Special Compensation Fund \$	Total \$	Total \$
<b>Assets</b>				
<b>Current assets</b>				
Cash (note 2)	110,651	500	111,151	179,290
Unclaimed trust funds (note 2)	1,780,867	-	1,780,867	1,808,056
Accounts receivable and prepaid expenses (note 4)	1,493,729	-	1,493,729	1,105,280
Courthouse Libraries BC Fund (note 2)	568,567	-	568,567	504,863
Due from Lawyers Insurance Fund (note 9)	24,126,610	1,334,551	25,461,161	23,500,316
	28,080,424	1,335,051	29,415,475	27,097,805
<b>Non-current assets</b>				
Cambie Street property - net (note 5)	12,691,113	-	12,691,113	12,720,761
Other property and equipment - net (note 5)	792,776	-	792,776	893,368
Intangible assets - net (note 5)	538,447	-	538,447	544,920
	42,102,760	1,335,051	43,437,811	41,256,854
<b>Liabilities</b>				
<b>Current liabilities</b>				
Accounts payable and accrued liabilities (notes 2 and 6)	5,638,551	-	5,638,551	5,589,269
Liability for unclaimed trust funds (note 2)	1,780,867	-	1,780,867	1,808,056
Current portion of building loan payable (note 8)	500,000	-	500,000	500,000
Deferred revenue (note 2)	18,806,871	-	18,806,871	17,979,934
Deferred capital contributions	34,391	-	34,391	46,995
Courthouse Libraries BC Fund (note 2)	568,567	-	568,567	504,863
Deposits	59,205	-	59,205	32,208
	27,388,452	-	27,388,452	26,461,325
<b>Building loan payable</b> (notes 8 and 9)	3,100,000	-	3,100,000	3,600,000
	30,488,452	-	30,488,452	30,061,325
<b>Net assets</b>				
Unrestricted (note 7)	11,614,308	1,335,051	12,949,359	11,195,529
	42,102,760	1,335,051	43,437,811	41,256,854

## Commitments (note 14)

Approved by



President



Chair of Finance and Audit Committee

The accompanying notes are an integral part of these combined financial statements.

## The Law Society of British Columbia – General and Special Compensation Funds

Combined Statement of Changes in Net Assets

For the year ended December 31, 2014

			2014	2013
	General Fund - Unrestricted \$	Special Compensation Fund - Unrestricted \$	Total \$	Total \$
<b>Net assets - Beginning of year</b>	9,908,287	1,287,242	11,195,529	9,769,514
Net excess of revenue over expenses for the year	1,706,021	47,809	1,753,830	1,426,015
<b>Net assets - End of year (note 7)</b>	<u>11,614,308</u>	<u>1,335,051</u>	<u>12,949,359</u>	<u>11,195,529</u>

The accompanying notes are an integral part of these combined financial statements.

## The Law Society of British Columbia – General and Special Compensation Funds

Combined Statement of Revenue and Expenses

For the year ended December 31, 2014

	2014		2013 (note 3)	
	General Fund \$	Special Compensation Fund \$	Total \$	Total \$
<b>Revenue</b>				
Practice fees	17,982,384	-	17,982,384	17,373,286
Trust administration fees	3,500,090	-	3,500,090	2,165,619
Enrolment fees	1,173,250	-	1,173,250	1,106,000
Interest and other income (note 9)	960,553	-	960,553	794,883
E-filing revenue	743,562	-	743,562	816,435
Fines and penalties	378,541	-	378,541	410,901
Application fees	507,650	-	507,650	410,265
Rental revenue	789,957	-	789,957	557,586
	<u>26,035,987</u>	<u>-</u>	<u>26,035,987</u>	<u>23,634,975</u>
<b>Expenses</b>				
Bencher Governance				
Bencher, AGM and other committees	1,213,610	-	1,213,610	990,264
Communication and Information Services				
Communications and publications	1,008,599	-	1,008,599	1,090,670
Information services	1,288,220	-	1,288,220	1,197,078
Education and Practice				
Credentials	772,120	-	772,120	664,219
Ethics	79,495	-	79,495	189,350
Member services	715,332	-	715,332	693,264
Membership assistance programs	201,930	-	201,930	236,190
Practice advice	627,378	-	627,378	582,902
Practice standards	611,194	-	611,194	598,395
Professional Legal Training Course and Education	1,730,047	-	1,730,047	1,773,812
General and Administrative				
Accounting	746,010	-	746,010	725,166
Amortization of other property and equipment	456,210	-	456,210	464,421
General administration	1,597,485	-	1,597,485	1,597,656
Human resources	947,731	-	947,731	885,177
Records management and library	340,533	-	340,533	300,057
Policy and Legal Services				
Policy and tribunal counsel	1,564,751	-	1,564,751	1,515,491
External litigation and interventions	452,416	-	452,416	101,250
Unauthorized practice	341,244	-	341,244	320,102
Regulation				
Custodianship costs	1,342,462	-	1,342,462	1,257,090
Discipline	1,505,922	-	1,505,922	1,260,243
Professional conduct - intake and investigations	4,243,363	-	4,243,363	3,722,345
Forensic accounting	489,021	-	489,021	407,742
Trust assurance	2,065,138	-	2,065,138	1,917,807
Occupancy costs, net of tenant recoveries	2,116,342	-	2,116,342	2,166,383
Carried forward	26,456,553	-	26,456,553	24,657,074

The accompanying notes are an integral part of these combined financial statements.

## The Law Society of British Columbia – General and Special Compensation Funds

Combined statement of Revenue and Expenses ...continued

For the year ended December 31, 2014

	2014		2013 (note 3)	
	General Fund \$	Special Compensation Fund \$	Total \$	Total \$
Brought forward	26,456,553	-	26,456,553	24,657,074
Special Compensation Fund				
Recoveries	-	(22,131)	(22,131)	(54,612)
General and administrative costs	-	6,412	6,412	26,185
Loan interest income from Lawyers Insurance Fund (note 9)	-	(32,090)	(32,090)	(32,619)
	<u>26,456,553</u>	<u>(47,809)</u>	<u>26,408,744</u>	<u>24,596,028</u>
<b>Costs recovered from Special Compensation and Lawyers Insurance Funds</b>				
Co-sponsored program costs	(828,975)	-	(828,975)	(808,602)
Program and administrative costs	(1,297,612)	-	(1,297,612)	(1,578,466)
	<u>(2,126,587)</u>	<u>-</u>	<u>(2,126,587)</u>	<u>(2,387,068)</u>
	<u>24,329,966</u>	<u>(47,809)</u>	<u>24,282,157</u>	<u>22,208,960</u>
<b>Net excess of revenue over expenses for the year</b>	<u>1,706,021</u>	<u>47,809</u>	<u>1,753,830</u>	<u>1,426,015</u>

The accompanying notes are an integral part of these combined financial statements.

## The Law Society of British Columbia – General and Special Compensation Funds

Combined Statement of Cash Flows  
For the year ended December 31, 2014

	2014		2013 (note 3)	
	General Fund \$	Special Compensation Fund \$	Total \$	Total \$
<b>Cash flows from operating activities</b>				
Net excess of revenue over expenses for the year	1,706,021	47,809	1,753,830	1,426,015
Items not affecting cash				
Amortization of Cambie Street building and tenant improvements	776,062	-	776,062	699,682
Amortization of other property and equipment	271,512	-	271,512	293,941
Amortization of intangible assets	184,692	-	184,692	170,473
Amortization of deferred capital contributions	(12,604)	-	(12,604)	(11,378)
Loss on disposal of capital assets	1,259	-	1,259	320
	2,926,942	47,809	2,974,751	2,579,053
(Increase) decrease in current assets				
Unclaimed trust funds	27,189	-	27,189	(136,528)
Accounts receivable and prepaid expenses	(388,449)	-	(388,449)	(123,593)
Courthouse Libraries BC Fund	(63,704)	-	(63,704)	1,982,478
Increase (decrease) in current liabilities				
Accounts payable and accrued liabilities	51,990	(2,708)	49,282	2,846,147
Liability for unclaimed trust funds	(27,189)	-	(27,189)	136,528
Deferred revenue	826,937	-	826,937	(244,982)
Courthouse Libraries BC Fund	63,704	-	63,704	(1,982,478)
Deposits	26,997	-	26,997	1,309
	3,444,417	45,101	3,489,518	5,057,934
<b>Cash flows from financing activities</b>				
Decrease in building loan payable	(500,000)	-	(500,000)	(500,000)
<b>Cash flows from investing activities</b>				
Purchase of property and equipment	(918,597)	-	(918,597)	(2,273,841)
Purchase of intangible assets	(178,215)	-	(178,215)	(74,807)
	(1,096,812)	-	(1,096,812)	(2,348,648)
<b>Interfund transfers</b>	(1,915,744)	(45,101)	(1,960,845)	(2,702,264)
<b>(Decrease) increase in cash</b>	(68,139)	-	(68,139)	(492,978)
<b>Cash - Beginning of year</b>	178,790	500	179,290	672,268
<b>Cash - End of year</b>	110,651	500	111,151	179,290
<b>Supplementary cash flow information</b>				
Interest paid	88,086	-	88,086	100,657
Interest income received	332,805	32,090	364,895	338,673

The accompanying notes are an integral part of these combined financial statements.

### 1. Nature of operations

The Law Society of British Columbia (the Society) regulates the legal profession in British Columbia, protecting public interest in the administration of justice by setting and enforcing standards of professional conduct for lawyers.

The General Fund comprises the assets, liabilities, net assets, revenue and expenses of the operations of the Society other than those designated to the statutory Special Compensation Fund and the Lawyers Insurance Fund (including its wholly owned subsidiary, LSBC Captive Insurance Company Ltd.).

The Special Compensation Fund is maintained by the Society pursuant to Section 31 of the Legal Profession Act (LPA). The Special Compensation Fund claims are recorded net of recoveries from the Special Compensation Fund's insurers when they have been approved for payment by the Special Compensation Fund Committee as delegated by the Benchers and the settlement has been accepted by the claimant. The LPA provides that the assets of the Special Compensation Fund are not subject to process of seizure or attachment by creditors of the Society.

Effective January 1, 2013, the Legal Profession Amendment Act, 2012 repealed Section 31 of the LPA. The legislation was changed pursuant to Section 50 of the Legal Profession Amendment Act, 2012 (SBC 2012, C16), to initiate the transfer of unused reserves that remain within the Special Compensation Fund, after all recoveries are received and expenses and claims are paid, to be used in the Lawyers Insurance Fund. Additionally, Section 23 of the LPA was amended to remove the requirement that practising lawyers pay the Special Compensation Fund assessment. Accordingly, for 2014, the per member Special Compensation Fund assessment remained at \$nil (2013 - \$nil).

Effective May 1, 2004, Part B to the B.C. Lawyers' Compulsory Professional Liability Insurance Policy provides defined insurance coverage for dishonest appropriation of money or other property entrusted to and received by insured lawyers in their capacity as barrister and solicitor and in relation to the provision of professional services. Part B (Trust Protection Coverage) is recorded in the Lawyers Insurance Fund.

The Society is a not-for-profit organization and the Funds are considered to be non-assessable under current income tax legislation.

Separate consolidated financial statements have been prepared for the Lawyers Insurance Fund, including LSBC Captive Insurance Company Ltd.

### 2. Significant accounting policies

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

#### Allocated administrative expenses

Administrative expenses are recovered by the General Fund from both the Lawyers Insurance and Special Compensation Funds. Recoveries are based on amounts derived either on percentage of use, the proportion of the Lawyers Insurance Fund's staff compared to the Society's total staff costs, or a set amount.

#### Courthouse Libraries BC Fund

The Society administers funds held on behalf of the Courthouse Libraries BC. Such funds are held in trust and the use of the funds is not recorded in the combined statement of revenue and expenses of the General Fund. The Society collects fees for the Courthouse Libraries BC through its fees per lawyer assessments.

#### Cash

Cash comprises cash on hand and held with a Canadian chartered bank.

#### Claims liabilities

In accordance with the absolute discretionary nature of the Special Compensation Fund arrangements, the claims become a liability only when approved by the Special Compensation Fund Committee and accepted by the claimant.

#### Deferred capital contributions

Contributions restricted for the purchase of capital assets are deferred and recognized as revenue on the same basis as the capital assets are amortized.

#### Fair value of financial instruments

The fair values of cash, accounts receivable and prepaid expenses and accounts payable and accrued liabilities correspond to their carrying values due to their short-term nature.

#### Intangible assets

Intangible assets comprise computer software. Software is recorded at cost and amortized on a straight-line basis at 10% - 20% per annum.

#### Property and equipment

Property and equipment, including leasehold improvements, are recorded at cost less accumulated amortization.

The Society provides for amortization on a straight-line basis as follows:

Buildings	40 years from purchase date
Computer hardware	10% - 20% per annum
Furniture and fixtures	10% per annum
Leasehold improvements	10% per annum
Building improvements and equipment	10% per annum
Tenant improvements	over lease period

The Society recognizes a full year's amortization expense in the year of acquisition, with the exception of building improvements and equipment and leasehold improvements which are amortized from their date of completion.

#### Revenue recognition

The Society follows the deferral method of accounting for annual fees and assessments. Fees and assessments are billed and received in advance on a calendar-year basis. Accordingly, fees and assessments for the next fiscal year received prior to December 31 have been recorded as deferred revenue for financial reporting purposes and will be recognized as revenue in the next calendar year. Revenue will be recognized on a monthly basis as earned. Surplus funds are invested in the Lawyers Insurance Fund's investment portfolio.

All other revenues are recognized when earned if the amount to be received can be reasonably estimated and collection is reasonably assured.

#### Unclaimed trust funds

The General Fund recognizes unclaimed trust funds as an asset as well as a corresponding liability on the statement of financial position. If these funds are claimed, the owner of the trust fund balance is entitled to the principal balance plus interest at prime rate minus 2%. Due to the historically low collection rates on these balances, the General Fund does not accrue for any interest owing on the trust fund amounts held and recognizes income earned from the unclaimed trust fund investments in the combined statement of revenue and expenses. Unclaimed funds outstanding for more than five years are transferred to the Law Foundation of British Columbia.

#### Use of estimates

The preparation of combined financial statements in accordance with ASNPO requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of certain revenues and expenses during the year. Actual results could differ from these estimates.

### 3. Allocated rent and external organization funding

The Society treats the 845 Cambie Street property as a separate cost centre. Historically, allocated rental revenue, which represented an estimated market rent, was allocated to rental revenue. The corresponding rental expense was included within the relevant functions.

## The Law Society of British Columbia – General and Special Compensation Funds

Notes to Combined Financial Statements

December 31, 2014

In 2014, the Society stopped allocating estimated market rent to the functions within the General Fund so that the actual building costs would be a clearer representation of the true cost of occupancy. Rental revenue now only includes rental income from external tenants and the rental expense allocated to the Trust Assurance program (within the General Fund) and the Lawyers Insurance Fund. For comparative purposes, allocated rental revenue of \$1,460,160 has been reversed. The corresponding rental expense was reversed from the following functional departments:

	\$
Bencher Governance	112,000
Communication and Information Services	92,400
Education and Practice	466,326
General and Administrative	240,945
Policy and Legal Services	96,348
Regulation	452,141
	<u>1,460,160</u>

The Society collects funding from its members on behalf of several external organizations including, the Federation of Law Societies, CanLII and pro bono. In the years prior to 2014, these fees were included as part of the Society's practice fee revenue and payments of the fees to these external organizations were treated as an expense.

In 2014, the Society stopped including these fees as part of its practice fee revenue as these funds did not represent revenue to the Society, but continued to collect these funds on behalf of these external organizations. The Society believes that this is a better representation of the existing funding arrangements. The funds collected are paid out to the external organizations at various specified dates throughout the year. For comparative purposes for 2013, \$991,211 has been reclassified from deferred revenue to accounts payable and accrued liabilities on the combined statement of financial position. This change also resulted in \$855,441 being reversed from the 2013 practice fee revenue and the corresponding expenses in the following cost centres:

	\$
Federation of Law Societies' contribution	271,783
CanLII's contribution	382,809
Pro bono contribution	200,849
	<u>855,441</u>

#### 4. Accounts receivable

Accounts receivable are presented net of the allowance for doubtful accounts of \$615,722 (2013 - \$579,096).

#### 5. Property, equipment and intangible assets

a) 845 Cambie Street property

	2014		
	Cost \$	Accumulated amortization \$	Net \$
Land	4,189,450	-	4,189,450
Buildings and equipment	14,124,190	6,952,946	7,171,244
Leasehold improvements	6,137,256	5,201,425	935,831
Tenant improvements	826,619	432,031	394,588
	<u>25,277,515</u>	<u>12,586,402</u>	<u>12,691,113</u>

## The Law Society of British Columbia – General and Special Compensation Funds

Notes to Combined Financial Statements

December 31, 2014

2013

	Cost \$	Accumulated amortization \$	Net \$
Land	4,189,450	-	4,189,450
Buildings and equipment	13,777,397	6,449,201	7,328,196
Leasehold improvements	5,979,980	4,985,221	994,759
Tenant improvements	604,124	395,768	208,356
	<u>24,550,951</u>	<u>11,830,190</u>	<u>12,720,761</u>

### b) Other property and equipment

2014

	Cost \$	Accumulated amortization \$	Net \$
Furniture and fixtures	2,463,649	1,892,907	570,742
Computer hardware	1,058,420	840,141	218,279
Artwork and collectibles	49,159	45,405	3,754
Law libraries - at nominal value	1	-	1
	<u>3,571,229</u>	<u>2,778,453</u>	<u>792,776</u>

2013

	Cost \$	Accumulated amortization \$	Net \$
Furniture and fixtures	2,404,514	1,766,392	638,122
Computer hardware	1,011,271	759,779	251,492
Artwork and collectibles	49,158	45,405	3,753
Law libraries - at nominal value	1	-	1
	<u>3,464,944</u>	<u>2,571,576</u>	<u>893,368</u>

### c) Intangible assets

2014

	Cost \$	Accumulated amortization \$	Net \$
Computer software	1,457,497	919,050	538,447

	2013		
	Cost \$	Accumulated amortization \$	Net \$
Computer software	1,279,282	734,362	544,920

In 2014, intangible assets, consisting entirely of computer software, with an aggregate amount of \$178,215 (2013 - \$74,807) were purchased.

#### 6. Accounts payable and accrued liabilities

Accounts payable and accrued liabilities include the following amounts collected on behalf of external organizations, but not yet paid.

	2014 \$	2013 \$
Advocate	367,304	356,918
Courthouse Libraries BC	2,150,574	2,061,082
Lawyers Assistance Program	752,824	687,608
Pro bono	331,620	329,608
CanLII	407,961	390,454
Federation of Law Societies	330,958	271,149

#### 7. Unrestricted net assets

The General Fund unrestricted net assets include \$1,840,532 (2013 - \$1,481,350) which has been allocated to capital expenditures in accordance with the capital plan. The remaining General Fund net assets represent amounts invested in capital assets.

The General Fund unrestricted net assets also include \$1,037,184 (2013 - deficit of \$38,600) which has been appropriated for contribution to future trust administration fee related expenses. During the year, \$3.5 million (2013 - \$2.2 million) in trust administration fee revenue was collected, and \$2.4 million (2013 - \$2.3 million) in trust administration fee expenses were incurred.

#### 8. Building loan payable

In 1992, the Benchers authorized the borrowing of monies from the Lawyers Insurance Fund to fund the capital development of the Society's buildings at 845 Cambie Street, Vancouver, BC. The loan is secured by the buildings, has no fixed repayment terms and bears interest calculated monthly at a rate equal to the stated monthly bond yield to maturity earned on the Lawyers Insurance Fund investment portfolio. Interest paid on the building loan is disclosed in note 8. The outstanding building loan balance at the end of the 2014 year is \$3.6 million (2013 - \$4.1 million). It is the intention of the Benchers to require the General Fund to repay a minimum of \$500,000 of the principal each year. During 2014, principal of \$500,000 (2013 - \$500,000) was repaid. The loan will be paid off in total by 2022.

	2014 %	2013 %
Weighted average rate of interest	2.63	2.44

## 9. Interfund transactions

The operations of the General, Lawyers Insurance and Special Compensation Funds are controlled by the management of the Society. Balances between the funds generally arise from transactions of an operating nature and are recorded at the exchange amount at the dates of the transactions. Surplus funds are invested in the Lawyers Insurance Fund's investment portfolio.

Amounts due to and from the Lawyers Insurance Fund are due on demand and have no fixed terms of repayment. The Lawyers Insurance Fund has authorized a loan facility of up to \$1 million, of which \$nil has been drawn down at December 31, 2014 (2013 - \$nil), to the General Fund to fund capital expenditures in accordance with the capital plan. The Lawyers Insurance Fund has also authorized a loan facility of up to \$8 million, of which \$nil has been drawn down at December 31, 2014 (2013 - \$nil), to the Special Compensation Fund.

Monthly interest on the Lawyers Insurance Fund's net loan position with the General and Special Compensation Funds is earned at the rate equal to the stated monthly bond yield to maturity earned on the Lawyers Insurance Fund investment portfolio. The average bond yield for 2014 was 2.63% (2013 - average bond yield - 2.44%). The General Fund's net loan position includes the General Fund's building loan and other operating balances with the Lawyers Insurance Fund. The net loan position fluctuates during the year as amounts are transferred between the General Fund, the Special Compensation Fund and the Lawyers Insurance Fund to finance ongoing operations.

During 2014, interest of \$88,086 was paid on the building loan and interest revenue of \$300,715 was received from General Fund cash balances held by the Lawyers Insurance Fund and \$32,090 was received from Special Compensation Fund cash balances held by the Lawyers Insurance Fund for a net interest income of \$244,719.

During 2013, interest of \$100,657 was paid on the building loan and interest revenue of \$255,714 was received from General Fund cash balances held by the Lawyers Insurance Fund and \$32,619 was received from Special Compensation Fund cash balances held by the Lawyers Insurance Fund for a net interest income of \$187,676.

Other interfund transactions are disclosed elsewhere in these combined financial statements.

## 10. Special Compensation Fund claims and program changes

### a) Outstanding claims

Pursuant to section 31(6) of the Legal Profession Act, the payment of Special Compensation Fund claims is at the discretion of the Special Compensation Fund Committee as delegated by the Benchers. As at December 31, 2014, there were no remaining claims for which statutory declarations had been received. All claims for which statutory declarations were received have been reviewed by the Special Compensation Fund Committee.

For claims reported prior to May 1, 2004, the insurance bond provided that total claims attributable to the period in excess of \$2,500,000 were 100% reimbursed by a commercial insurer up to a maximum of \$15,000,000 for claims against one lawyer and in total, other than as noted in note 9(b). As set out in note 1, claims reported after May 1, 2004, are subject to Part B coverage by the Lawyers Insurance Fund.

### b) Wirick case

In May 2002, the Discipline Committee ordered an audit investigation, pursuant to Rule 4-43, of Martin Keith Wirick's practice.

At December 31, 2014, there were no remaining claims still under consideration.

Until May 1, 2004, the Special Compensation Fund carried insurance of \$15,000,000 for each bond period (\$17,500,000 total coverage with a deductible of \$2,500,000). The bond period is defined as the year in which the Society becomes aware of evidence indicating a member may have been guilty of an act or acts of misappropriation or wrongful conversion. All claims concerning Mr. Wirick fell into the 2002 bond period and, as such, the Special Compensation Fund had claims greater than its level of insurance. In early 2005, the final proof of loss that reached this limit was filed. In 2002, the Benchers agreed to allow the Special Compensation Fund Committee to exceed the \$17,500,000 cap they had imposed in the Society rules.

In 2006, the Benchers approved a payment of \$7,543,528 to be paid to claimants over four years commencing in fiscal 2007 at \$1,885,882 per year. The final payment was made in 2010.

In December, 2012, the Benchers approved a further payment of \$162,399 that was paid to claimants in 2013.

In 2014, the Special Compensation Fund recovered \$400 (2013 - \$54,612) related to the Wirick case.

#### 11. Related parties

The elected Benchers include members drawn from law firms across the province. These law firms may at times be engaged by the Society in the normal course of business. During the year ended December 31, 2014, expenses of \$215,208 (2013 - \$177,087) recorded at carrying amount were incurred by the General Fund during the normal course of business with these law firms.

#### 12. Capital management

The Society defines its capital as the amounts included in its unrestricted net assets. Its objective when managing capital is to safeguard its ability to continue as a going concern so that it can continue to fulfil its objectives and meet its requirements.

#### 13. Financial instruments

The General and Special Compensation Funds' financial instruments consist of cash, accounts receivable and prepaid expenses and accounts payable and accrued liabilities.

The significant financial risks to which the Society is exposed are credit risk and liquidity risk.

##### a) Credit risk

Cash and accounts receivable expose the Funds to credit risk.

The maximum exposure to credit risk arising from the above-noted items is \$1,400,734 (2013 - \$1,164,416). Credit risk arises from the possibility that a counterparty to an instrument fails to meet its obligations.

##### b) Liquidity risk

Liquidity risk is the risk that the Funds will not be able to meet all cash outflow requirements. Financial instruments held by the Society are limited to cash, accounts receivable and accounts payable and accrued liabilities and, therefore, bear no significant liquidity risk.

#### 14. Obligations and commitments under operating leases

The Society has committed to payments under certain operating leases relating to vehicle costs. Future minimum lease payments required in each of the next five fiscal years and thereafter are:

	\$
For the year ended December 31	
2015	20,069
2016	17,158
2017	<u>1,911</u>
Total future minimum lease payments	<u>39,138</u>

For the year ended December 31, 2014, an amount of \$24,399 representing payments under operating leases was expensed (2013 - \$39,149).



March 6, 2015

## **Independent Auditor's Report**

### **To the Members of The Law Society of British Columbia**

We have audited the accompanying consolidated financial statements of The Law Society of British Columbia - Lawyers Insurance Fund, and its subsidiary, which comprise the consolidated statement of financial position as at December 31, 2014 and the consolidated statements of revenue and expenses, changes in net assets, and 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 consolidated financial statements**

Management is responsible for the preparation and fair presentation of these 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 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 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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the 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 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 consolidated financial statements.

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

*PricewaterhouseCoopers LLP*

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



**Opinion**

In our opinion, the combined financial statements present fairly, in all material respects, the financial position of The Law Society of British Columbia - General and Special Compensation Funds as at December 31, 2014 and the results of their operations and their cash flows for the year then ended in accordance with Canadian accounting standards for not-for-profit organizations.

*PricewaterhouseCoopers LLP*

**Chartered Accountants**

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*PricewaterhouseCoopers LLP*

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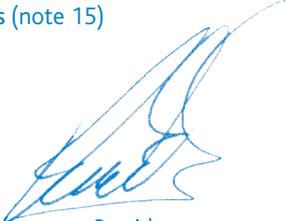
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## The Law Society of British Columbia – Lawyers Insurance Fund

Consolidated Statement of Financial Position

As at December 31, 2014

	2014 \$	2013 \$
<b>Assets</b>		
Cash	23,763,120	19,320,297
Accounts receivable - net of allowance (note 3)	1,425,353	532,829
Prepaid expenses	513,801	397,334
Short-term investments (note 5)	3,220,686	5,119,563
Members' share of provision for claims	1,191,735	1,034,638
General Fund building loan (note 7)	3,600,000	4,100,000
Investments (note 6)	<u>126,300,946</u>	<u>121,303,940</u>
	<u>160,015,641</u>	<u>151,808,601</u>
<b>Liabilities</b>		
Accounts payable and accrued liabilities (notes 4 and 8)	1,754,951	1,495,025
Deferred revenue	7,198,328	7,064,705
Due to General Fund (note 10)	24,126,610	22,210,866
Due to Special Compensation Fund (note 10)	1,334,551	1,289,451
Provision for claims (note 9)	52,559,565	53,274,766
Provision for ULAE (note 9)	<u>7,231,000</u>	<u>7,045,000</u>
	<u>94,205,005</u>	<u>92,379,813</u>
<b>Net assets</b>		
Unrestricted net assets	48,310,636	41,928,788
Internally restricted net assets (note 11)	<u>17,500,000</u>	<u>17,500,000</u>
	<u>65,810,636</u>	<u>59,428,788</u>
	<u>160,015,641</u>	<u>151,808,601</u>
Commitments (note 10)		
Subsequent event (note 14)		
Contingencies (note 15)		
Approved by		
		
President	Chair of Finance and Audit Committee	

The accompanying notes are an integral part of these consolidated financial statements.

## The Law Society of British Columbia – Lawyers Insurance Fund

Consolidated Statement of Changes in Net Assets

For the year ended December 31, 2014

	2014		2013
	Unrestricted \$	Internally restricted \$	Total \$
<b>Net assets - Beginning of year</b>	41,928,788	17,500,000	59,428,788
Excess of revenue over expenses for the year	6,381,848	-	6,381,848
<b>Net assets - End of year</b>	<u>48,310,636</u>	<u>17,500,000</u>	<u>65,810,636</u>

The accompanying notes are an integral part of these consolidated financial statements.

## The Law Society of British Columbia – Lawyers Insurance Fund

Consolidated Statement of Revenue and Expenses

For the year ended December 31, 2014

	2014 \$	2013 \$
<b>Revenue</b>		
Annual assessments	14,142,918	13,899,938
Investment income (note 6)	5,722,793	5,484,823
Other income	98,000	51,665
	<u>19,963,711</u>	<u>19,436,426</u>
<b>Insurance expenses</b>		
Actuary, consultant and investment manager fees	459,036	423,571
Allocated office rent from General Fund	211,294	147,663
Contribution to program and administrative costs of General Fund	1,298,910	1,581,283
Insurance	384,074	502,354
Office	391,554	268,937
Premium taxes	9,396	7,697
Provision for settlement of claims (note 9)	12,575,235	14,204,717
Provision for (recovery of) ULAE (note 9)	186,000	(110,000)
Salaries, wages and benefits	2,562,048	2,431,348
	<u>18,077,547</u>	<u>19,457,570</u>
<b>Loss prevention expenses</b>		
Contribution to co-sponsored program costs of General Fund	828,975	808,602
	<u>18,906,522</u>	<u>20,266,172</u>
<b>Excess (deficiency) of revenue over expenses before the following</b>	1,057,189	(829,746)
<b>Fair value changes in investments (note 6)</b>	<u>5,330,829</u>	<u>10,442,848</u>
	6,388,018	9,613,102
<b>Provision for income taxes</b>	<u>6,170</u>	<u>5,785</u>
<b>Excess of revenue over expenses for the year</b>	<u>6,381,848</u>	<u>9,607,317</u>

The accompanying notes are an integral part of these consolidated financial statements.

## The Law Society of British Columbia – Lawyers Insurance Fund

Consolidated Statement of Cash Flows  
For the year ended December 31, 2014

	2014 \$	2013 \$
<b>Cash flows from operating activities</b>		
Excess of revenue over expenses for the year	6,381,848	9,607,317
Items not affecting cash		
Unrealized gain on investments	(2,784,630)	(8,565,482)
Realized gain on disposal of investments	(2,546,199)	(1,877,366)
Pooled distributions from investments	(5,646,853)	(5,265,681)
Amortization of 750 Cambie Street building	439,188	439,188
Amortization of deferred tenant inducement	38,487	38,487
	<u>(4,118,159)</u>	<u>(5,623,537)</u>
Decrease (increase) in assets		
Accounts receivable	(892,524)	(41,508)
Prepaid expenses	(116,467)	100,892
Short-term investments	1,898,877	14,235,488
Members' share of provision for claims	(157,097)	59,250
Increase (decrease) in liabilities		
Accounts payable and accrued liabilities	259,926	(212,065)
Deferred revenue	133,623	117,440
Provision for claims	(715,201)	1,222,438
Provision for ULAE	186,000	(110,000)
Purchase of investments	(5,267,400)	(4,160,425)
Proceeds from disposal of investments	<u>10,770,400</u>	<u>6,660,426</u>
	1,981,978	12,248,399
<b>Cash flows from investing activities</b>		
Decrease in General Fund building loan	500,000	500,000
<b>Cash flows from financing activities</b>		
Interfund transfers (note 10)	<u>1,960,845</u>	<u>2,702,264</u>
<b>Increase in cash</b>	4,442,823	15,450,663
<b>Cash - Beginning of year</b>	<u>19,320,297</u>	<u>3,869,634</u>
<b>Cash - End of year</b>	<u>23,763,120</u>	<u>19,320,297</u>
<b>Supplementary cash flow information</b>		
Interest paid	<u>332,805</u>	<u>288,333</u>
Interest income received	<u>88,086</u>	<u>100,657</u>

The accompanying notes are an integral part of these consolidated financial statements.

## 1. Nature of operations

The Lawyers Insurance Fund (the Fund) is maintained by The Law Society of British Columbia (the Society) pursuant to Section 30 of the Legal Profession Act. The Society is a not-for-profit organization, and only the subsidiary, LSBC Captive Insurance Company Ltd. (the Captive), is considered assessable for income tax under current legislation. The Captive is subject to Financial Institutions Commission (FICOM) regulation. Effective January 1, 1990, the Fund began underwriting the program by which errors and omissions insurance is provided to members of the Society.

### Part A

The Society's members have limits of coverage for claims and potential claims arising from negligent acts, errors or omissions under Part A of the B.C. Lawyers' Compulsory Professional Liability Insurance Policy (the Policy) as follows:

	\$		\$
The Fund	995,000	or	990,000
Deductible - applicable to indemnity payments only	<u>5,000</u>	or	<u>10,000</u>
Limit per error or related errors			<u>1,000,000</u>
Annual aggregate limit for all errors per member			<u>2,000,000</u>

The amount of the member deductible is \$5,000 for each initial claim resulting in the payment of damages and \$10,000 for each additional claim within a three-year period resulting in the payment of damages.

For claims reported between 1990 and 1996, the Captive entered into reinsurance contracts under which all claim payments above a per claim limit and in excess of inner aggregate retentions were ceded to reinsurers. Reinsurance does not relieve the Captive of primary liability as the originating insurer. All losses on claims since 1997 are fully reimbursed by the Fund on behalf of the Society under agreement.

For the 2014 and 2013 policy years, the Society and the Captive have obtained stop-loss reinsurance in the amount of \$12,000,000 to cover aggregate payments over \$25,000,000 for Parts A and C of the Policy. This limit is co-insured 80/20 with the reinsurer paying 80% of losses over \$25,000,000 to a maximum of \$12,000,000 and the Fund paying 20%.

### Part B

Effective May 1, 2004, Part B of the Policy provides defined insurance coverage for dishonest appropriation of money or other property entrusted to and received by insured lawyers in their capacity as barristers and solicitors and in relation to the provision of professional services.

For the 2014 and 2013 policy years, there is a \$300,000 per claim limit and a \$17,500,000 profession-wide annual aggregate limit. The Society and the Captive have obtained insurance in the amount of \$5,000,000 to cover a portion of the annual aggregate limit. There is no deductible payable by the member. This insurance is subject to a \$3,000,000 group deductible and is co-insured 80/20 with the insurer paying 80% of losses over \$3,000,000 to a maximum of \$5,000,000 and the Fund paying 20%.

### Part C

Effective January 1, 2012, Part C of the Policy provides defined insurance coverage for trust shortages suffered by insured lawyers as a result of relying on fraudulent certified cheques.

For the 2014 and 2013 policy years, there is a limit of \$500,000 per claim, and per lawyer and firm annually, a profession-wide annual aggregate of \$2 million, and a deductible of 35% of the client trust fund shortage (reduced by the amount of any overdraft paid). Coverage is contingent upon compliance with the Society's client identification and verification rules.

## 2. Significant accounting policies

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

### Basis of consolidation

These consolidated financial statements include the accounts of the Fund and the Captive, a wholly owned subsidiary.

Separate combined financial statements have been prepared for the Society's General Fund and Special Compensation Fund.

### Allocated administrative expenses

Administrative expenses are recovered by the General Fund of the Society from the Fund. Recoveries are based on amounts derived either on percentage of use or the proportion of the Fund's staff compared to the Society's total staff cost, or a set amount.

### Cash

Cash comprises cash on hand and held with a Canadian chartered bank.

### Deferred tenant inducements

In 2006, the Fund provided one of its tenants in the 750 Cambie Street building with free gross rent of \$384,868 at the start of the lease. This free gross rent is amortized over the term of the lease.

### Fair value of financial instruments

The fair values of cash, accounts receivable, short-term investments and accounts payable and accrued liabilities correspond to their carrying values due to their short-term nature.

The fair values of the provision for claims payable correspond to their carrying values because they are discounted.

The interfund balances including the building loan receivable and other interfund transactions are recorded at their carrying amounts which approximate their exchange amounts.

### Short-term investments

Short-term investments consist of pooled money market funds, whose investments have original maturities of < 90 days, and the carrying amount approximates the fair value at the reporting date due to their short-term maturities.

### Investments

The Fund's investments consist of units in pooled equity and bond funds and are initially and subsequently measured at fair value. Changes in fair value are recognized in the consolidated statement of revenue and expenses in the year incurred. Transaction costs that are directly attributable to the acquisition of these investments are recognized in the consolidated statement of revenue and expenses in the period incurred.

In addition, the 750 Cambie Street building is a property that is held as an investment for the Fund. The property is recognized at cost. Amortization is provided on a straight-line basis as follows:

Building - 750 Cambie Street	2-1/2% per annum
Base building improvements	2-1/2% per annum
Tenant improvements	over lease period
Deferred tenant inducements	over lease period

### Investment income

Investment income and pooled fund distributions are recorded on an accrual basis. Dividends are recorded on the date of record. Gains and losses realized on the disposal of investments are taken into income on the date of disposal.

### Provision for claims

The provision for claims and unallocated loss adjustment expenses (ULAE) represent an estimate for all external costs of investigating and settling claims and potential claims reported prior to the date of the consolidated statement of financial position. The provision is adjusted as additional information on the estimated amounts becomes known during the course of claims settlement. All changes in estimates are expensed in the current period. The Fund presents its claims on a discounted basis.

### **Reinsurance**

The Fund reflects reinsurance balances on the consolidated statement of financial position on a gross basis to indicate the extent of credit risk related to reinsurance and its obligations to policyholders, and on a net basis on the consolidated statement of revenue and expenses to indicate the results of its retention of assessments retained.

### **Revenue recognition**

The Fund follows the deferral method of accounting for annual assessments. Assessments are billed and received in advance on a calendar-year basis. Accordingly, assessments for the next fiscal year received prior to December 31 have been recorded as deferred revenue for financial reporting purposes and will be recognized as revenue in the next calendar year.

All other revenues are recognized when receivable if the amount to be received can be reasonably estimated and collection is reasonably assured.

### **Use of estimates**

The preparation of financial statements in conformity with ASNPO requires management to make estimates and assumptions which affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and revenues and expenses for the period reported. The determination of the provision for claims and ULAE and the reinsurers' share of the provision for claims, and the fair value of the investment property, involves significant estimation. Actual results could differ from those estimates and the differences could be material.

### **Financial instruments**

The Fund's financial instruments consist of cash, accounts receivable, short-term investments, investments and accounts payable and accrued liabilities.

The significant financial risks to which the Fund is exposed are credit risk, market risk, price risk, and liquidity risk.

### **Credit risk**

Cash, accounts receivable, members' share of provision for claims and bond pooled funds indirectly expose the Fund to credit risk.

The maximum exposure to credit risk arising from the above-noted items is \$71,297,599 (2013 - \$63,117,780).

Credit risk arises from the possibility that a counterparty to an instrument fails to meet its obligations.

The cash deposits are held only with schedule 1 banks. The accounts receivable balances are spread across the broad membership base with no significant exposure to any one individual. The investment guidelines mitigate credit risk by ensuring the investments in the bond pooled funds have an adequate minimum credit rating and well-diversified portfolios.

### **Market risk**

Market risk is the potential for loss to the Fund from changes in the value of its financial instruments due to changes in interest rates, foreign exchange rates or equity prices.

The Fund manages market risk by diversifying investments within the various asset classes and investing in pooled funds as set out in the guidelines of the Society's statement of investment policies and procedures (SIPP).

### **Price risk**

Price risk is the risk that the fair value of the Society's investments will fluctuate due to changes in the market prices whether these changes are caused by factors specific to the individual financial instrument, its issuer, or factors affecting all similar financial instruments traded in the market. It arises primarily on pooled equity and bond fund investments.

To manage price risk, the Society has guidelines on the diversification and weighting of investments within pooled funds which are set and monitored against the Society's SIPP.

As at December 31, 2014, if pooled fund prices increased or decreased by 10% with all other factors remaining constant, net assets would have increased or decreased by approximately \$11.6 million (2013 - \$11.0 million).

### Liquidity risk

Liquidity risk is the risk that the Fund will not be able to meet all cash outflow requirements. At December 31, 2014, the sum of the Fund's cash, short-term investments and pooled fund investments, at fair value, which are available to settle the liabilities of the Society as they come due, exceeded the sum of the liabilities by \$48.4 million, or 51% (2013 - \$42.3 million, or 46%).

### 3. Accounts receivable

	2014 \$	2013 \$
Member deductibles	360,078	391,898
Allowance for doubtful accounts	(252,604)	(228,083)
Receivable for premium taxes under appeal (note 15)	1,087,025	-
Straight line rent receivable	57,475	124,563
GST/HST receivable	169,970	244,451
Other receivables	3,409	-
	<u>1,425,353</u>	<u>532,829</u>

### 4. Government remittances

The following government remittances are included in accounts payable:

	2014 \$	2013 \$
Ministry of Finance - PST	362	1,598
Receiver General - corporate income tax	6,171	1,102
Ministry of Finance - premium tax	9,396	7,697
	<u>15,929</u>	<u>10,397</u>

### 5. Short-term investments

Short-term investments comprise pooled money market funds with the following balances:

	2014 \$	2013 \$
Money market funds	<u>3,220,686</u>	<u>5,119,563</u>

## The Law Society of British Columbia – Lawyers Insurance Fund

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### 6. Investments

	2014 \$	2013 \$
Investments - at fair value	115,670,106	110,195,425
750 Cambie Street Building	<u>10,630,840</u>	<u>11,108,515</u>
	<u>126,300,946</u>	<u>121,303,940</u>

	2014			
	Carrying cost \$	Gross unrealized gains \$	Gross unrealized losses \$	Estimated fair value \$
Bonds				
Pooled Funds	<u>44,609,012</u>	<u>308,379</u>	<u>-</u>	<u>44,917,391</u>
Equities				
Canadian Pooled Funds	16,225,301	11,813,739	-	28,039,040
International Pooled Funds	<u>30,340,676</u>	<u>12,372,999</u>	<u>-</u>	<u>42,713,675</u>
	<u>46,565,977</u>	<u>24,186,738</u>	<u>-</u>	<u>70,752,715</u>
	<u>91,174,989</u>	<u>24,495,117</u>	<u>-</u>	<u>115,670,106</u>

	2013			
	Carrying cost \$	Gross unrealized gains \$	Gross unrealized losses \$	Estimated fair value \$
Bonds				
Pooled Funds	<u>43,624,016</u>	<u>-</u>	<u>(1,394,000)</u>	<u>42,230,016</u>
Equities				
Canadian Pooled Funds	17,367,734	10,466,396	-	27,834,130
International Pooled Funds	<u>27,493,187</u>	<u>12,638,092</u>	<u>-</u>	<u>40,131,279</u>
	<u>44,860,921</u>	<u>23,104,488</u>	<u>-</u>	<u>67,965,409</u>
	<u>88,484,937</u>	<u>23,104,488</u>	<u>(1,394,000)</u>	<u>110,195,425</u>

The effective yield on the investment portfolio was 2.25% (2013 - 2.39%).

#### Investment risk management

The Society has adopted policies which establish the guidelines for all investment activities. These guidelines apply to the investment funds controlled by the Fund.

The Society's overall investment philosophy is to maximize the long-term real rate of return subject to an acceptable degree of risk.

## The Law Society of British Columbia – Lawyers Insurance Fund

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The Society's long-term funding requirements and relatively low level of liquidity dictate a portfolio with a mix of fixed income and equity securities. The Society invests in bonds and equities through pooled funds.

### Investment income

	2014 \$	2013 \$
Interest on cash	4,932	5,055
Pooled distributions	5,693,074	5,375,138
Net interfund loan interest expense (note 10)	(244,719)	(187,676)
Building income - 750 Cambie Street (revenue of \$1,793,451 (2013 - \$1,744,585); net of expenses of \$1,523,945 (2013 - \$1,452,279))	269,506	292,306
Investment income	<u>5,722,793</u>	<u>5,484,823</u>

### Fair value changes in investments

	2014 \$	2013 \$
Realized gain on disposal of investments	2,546,199	1,877,366
Unrealized gain on investments measured at fair value	2,784,630	8,565,482
Fair value changes in investments	<u>5,330,829</u>	<u>10,442,848</u>

### 750 Cambie Street building (see note 14)

The 750 Cambie Street building is held as an investment for the Fund.

	2014		2013	
	Cost \$	Accumulated amortization \$	Net \$	Net \$
Land	4,299,850	-	4,299,850	4,299,850
Building	4,971,376	1,318,466	3,652,910	3,778,873
Base building improvements	3,143,555	744,007	2,399,548	2,482,278
Tenant improvements	2,314,520	2,074,475	240,045	470,540
Deferred tenant inducements	384,868	346,381	38,487	76,974
	<u>15,114,169</u>	<u>4,483,329</u>	<u>10,630,840</u>	<u>11,108,515</u>

## 7. General Fund building loan

In 1992, the Benchers authorized the lending of monies from the Fund to support the capital development of the Society's buildings at 845 Cambie Street, Vancouver, BC. The loan is secured by the building, has no fixed repayment terms and bears interest calculated monthly at a rate equal to the stated monthly bond yield to maturity earned on the Fund's investment portfolio. It is the intention of the Benchers to require the General Fund to repay a minimum of \$500,000 of the principal each year. During 2014, principal of \$500,000 (2013 - \$500,000) was repaid.

	2014 %	2013 %
Weighted average rate of return	<u>2.63</u>	<u>2.44</u>

8. Accounts payable and accrued liabilities

	2014 \$	2013 \$
Trade payables	1,245,174	1,142,537
Accrued trade expenses	489,850	242,384
Taxes payable	1,310	98,253
Premium taxes payable	9,396	7,697
Income taxes payable	6,171	1,102
Security deposit	3,050	3,052
	<u>1,754,951</u>	<u>1,495,025</u>

9. Provision for claims and unallocated loss adjustment expenses (ULAE)

The changes in unpaid claims recorded in the consolidated statement of financial position are as follows:

	2014 \$	2013 \$
<b>Part A and Part C Insurance Coverage</b>		
Provision for claims - Beginning of year	53,203,597	51,756,469
Provision for losses and expenses for claims occurring in the current year	13,649,000	16,225,000
Decrease in estimated losses and expenses for losses occurring in prior years	<u>(1,656,000)</u>	<u>(1,817,000)</u>
Provision for claims liability	65,196,597	66,164,469
Less:		
Payments on claims incurred in the current year	(919,445)	(2,095,337)
Payments on claims incurred in prior years	(12,754,419)	(10,938,968)
Recoveries on claims	317,735	132,683
Change in due to (from) members	<u>157,097</u>	<u>(59,250)</u>
Claim payments - net of recoveries	<u>(13,199,032)</u>	<u>(12,960,872)</u>
Provision for claims - End of year	51,997,565	53,203,597
<b>Part B Insurance Coverage</b>	<u>562,000</u>	<u>71,169</u>
<b>Total provision for Parts A, B and C Insurance Coverage</b>	<u>52,559,565</u>	<u>53,274,766</u>

The determination of the provision for unpaid claims and adjustment expenses and the related reinsurers' share requires the estimation of three major variables or quanta, being development of claims, reinsurance recoveries and the effects of discounting, to establish a best estimate of the value of the respective liability or asset.

The provision for unpaid claims and adjustment expenses and related reinsurers' share is an estimate subject to variability, and the variability, as with any insurance company, could be material in the near term. The variability arises because all events affecting the ultimate settlement of claims have not taken place and may not take place for some time. Variability can be caused by receipt of additional claim information, changes in judicial interpretation of contracts, significant changes in severity of claims from historical trends, the timing of claims payments, the recoverability of reinsurance, and future rates of investment return. The estimates are principally based on the Fund's historical experience. Methods of estimation have been used that the Society believes produce reasonable results given current information.

The provision for ULAE is an actuarially determined estimate of the Fund's future costs relating to the administration of claims and potential claims reported up to the consolidated statement of financial position date.

The Fund discounts its best estimate of claims provisions at a rate of interest 2.52% (2013 - 2.68%). The Fund determines the discount rate based upon the expected return on its investment portfolio of assets with appropriate assumptions for interest rates relating to reinvestment of maturing investments.

A 1% increase in the discount rate will have a favourable impact on the claims liability of \$1.746 million (2013 - \$1.760 million) and a 1% decrease in the discount rate will have an unfavourable impact on the claims liability of \$1.868 million (2013 - \$1.883 million).

To recognize the uncertainty in establishing these best estimates, to allow for possible deterioration in experience, and to provide greater comfort that the actuarial liabilities are adequate to pay future benefits, the Fund includes a Provision for Adverse Deviations (PFAD) in some assumptions relating to claims development and future investment income. The PFAD is selected based on guidance from the Canadian Institute of Actuaries.

The effects of discounting and the application of PFAD are as follows (in thousands of dollars):

	2014 \$	2013 \$
Undiscounted	53,982	54,884
Effect of present value	(4,117)	(4,436)
PFADs	<u>8,736</u>	<u>8,837</u>
Discounted	<u>58,601</u>	<u>59,285</u>

#### Claims development tables

A review of the historical development of the Fund's insurance estimates provides a measure of the Fund's ability to estimate the ultimate value of claims. The top half of the following tables illustrates how the Fund's estimate of total undiscounted claims costs for each year has changed at successive year-ends. The bottom half of the tables reconcile the cumulative claims to the amount appearing in the consolidated statement of financial position.

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### Part A insurance claims (in thousands of dollars)

Claims year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total
	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$	\$
Estimate of undiscounted ultimate claims costs											
At end of claims year	17,150	12,260	13,580	13,670	11,520	13,650	14,560	13,390	15,230	12,690	
One year later	14,730	12,770	14,980	13,230	11,310	12,990	13,550	13,080	15,100		
Two years later	12,470	11,530	15,250	13,470	11,500	12,610	11,570	11,970			
Three years later	11,080	9,960	14,940	13,360	13,470	13,210	10,920				
Four years later	10,500	9,650	14,820	13,170	13,960	13,920					
Five years later	10,320	8,960	14,610	13,060	14,540						
Six years later	9,910	8,560	16,190	12,780							
Seven years later	9,710	7,770	16,400								
Eight years later	9,920	7,970									
Nine years later	10,110										
Current estimate of cumulative claims	10,110	7,970	16,400	12,780	14,540	13,920	10,920	11,970	15,100	12,690	126,400
Cumulative payments to date	(8,826)	(7,087)	(15,522)	(10,808)	(12,432)	(9,199)	(6,906)	(4,043)	(6,633)	(902)	(82,358)
Undiscounted unpaid liability	<u>1,284</u>	<u>883</u>	<u>878</u>	<u>1,972</u>	<u>2,108</u>	<u>4,721</u>	<u>4,014</u>	<u>7,927</u>	<u>8,467</u>	<u>11,788</u>	<u>44,042</u>
Undiscounted unpaid liability in respect of 2004 and prior years											2,751
Undiscounted unallocated loss adjustment expense reserve											<u>6,665</u>
<b>Total undiscounted unpaid claims liability</b>											<b>53,458</b>
Discounting adjustment (includes Claim PFAD)											<u>4,581</u>
<b>Total discounted unpaid claims liability</b>											<b><u>58,039</u></b>

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### Part B insurance claims (in thousands of dollars)

Claims year	2005 \$	2006 \$	2007 \$	2008 \$	2009 \$	2010 \$	2011 \$	2012 \$	2013 \$	2014 \$	Total \$
Estimate of undiscounted ultimate claims costs											
At end of claims year	334	189	251	8	107	23	28	18	53	562	
One year later	134	229	250	7	196	19	24	13	82		
Two years later	109	222	274	9	197	22	23	12			
Three years later	12	221	322	9	197	26	23				
Four years later	15	279	353	9	197	26					
Five years later	16	297	375	9	197						
Six years later	16	336	121	9							
Seven years later	16	342	124								
Eight years later	16	351									
Nine years later	16										
Current estimate of cumulative claims	16	351	124	9	197	26	23	12	82	562	1,402
Cumulative payments to date	(16)	(351)	(121)	(9)	(197)	(26)	(23)	-	(82)	(52)	(877)
Undiscounted unpaid liability	-	-	3	-	-	-	-	12	-	510	525
Undiscounted unpaid loss adjustment expense reserve											-
<b>Total undiscounted unpaid claims liability</b>											<b>525</b>
Discounting adjustment (includes Claim PFAD)											37
<b>Total discounted unpaid claims liability</b>											<b>562</b>

The expected maturity of the unpaid claims provision is analyzed below (undiscounted and gross of reinsurance):

(in thousands of dollars)	Less than one year \$	One to two years \$	Two to three years \$	Three to four years \$	Four to five years \$	Over five years \$	Total \$
December 31, 2014	13,589	10,303	8,476	5,603	4,120	11,891	53,982
December 31, 2013	13,739	10,994	8,137	5,511	3,804	12,699	54,884

### **Role of the actuary**

The actuary is appointed to fulfill reporting requirements pursuant to the Insurance (Captive Company) Act of B.C. With respect to preparation of these consolidated financial statements, the actuary is required to carry out a valuation of the Fund's policy liabilities and to provide an opinion regarding their appropriateness at the date of the consolidated statement of financial position. The factors and techniques used in the valuation are in accordance with accepted actuarial practice, applicable legislation and associated regulations. The scope of the valuation encompasses the policy liabilities as well as any other matter specified in any direction that may be made by the regulatory authorities. The policy liabilities consist of a provision for unpaid claims and adjustment expenses. In performing the valuation of the liabilities for these contingent future events, which are by their very nature inherently variable, the actuary makes assumptions as to future loss ratios, trends, reinsurance recoveries, expenses and other contingencies, taking into consideration the circumstances of the Fund and the nature of the insurance policies.

The valuation is based on projections for settlement of reported claims and claim adjustment expenses. It is certain that actual claims and claim adjustment expenses will not develop exactly as projected and may, in fact, vary significantly from the projections. Further, the projections make no provision for new classes of claims or claims categories not sufficiently recognized in the claims database.

The actuary relies on data and related information prepared by the Fund. The actuary also analyzes the Fund's assets for their ability to support the amount of policy liabilities.

### **10. Interfund transactions**

The operations of the Fund, the General Fund and the Special Compensation Fund are administered by the management of the Society. Balances between the funds arise from transactions of an operating nature and are recorded at exchange amounts at the dates of the transactions. Surplus funds are invested in the Fund's investment portfolio.

Amounts due to and from the General Fund and the Special Compensation Fund are due on demand and have no fixed terms of repayment. The Fund has authorized a loan facility of up to \$1 million to the General Fund to fund capital expenditures in accordance with the 10-year capital plan. The Fund has also authorized a loan facility of up to \$8 million to the Special Compensation Fund. As of December 31, 2014, no amounts have been drawn on the facilities (2013 - \$nil).

Monthly interest on the Fund's net loan position with the General Fund and Special Compensation Fund is paid to the Fund at a rate equal to the stated monthly bond yield to maturity earned on the Fund's investment portfolio. The average bond yield for 2014 was 2.63% (2013 average rate - 2.44%). The Fund's net loan position of \$21,861,161 (2013 - \$19,400,316) includes the General Fund building loan, other operating balances with the General Fund and the loan with the Special Compensation Fund. This net loan position fluctuates during the year as amounts are transferred between the General Fund, the Special Compensation Fund and the Fund to finance ongoing operations.

During 2014, interest revenue of \$88,086 (2013 - \$100,657) was received on the General Fund building loan and interest of \$300,715 (2013 - \$255,714) was paid on General Fund cash balances held by the Fund and \$32,090 (2013 - \$32,619) was paid on the Special Compensation Fund cash balances held by the Fund for a net interest expense of \$244,719 (2013 - \$187,676).

Other interfund transactions are disclosed elsewhere in these consolidated financial statements.

### **11. Internally restricted net assets**

The Benchers have allocated \$17,500,000 (2013 - \$17,500,000) of the net assets to the Part B defalcation coverage.

### **12. Regulatory requirements and capital management**

The Captive is required to maintain a minimum of \$200,000 in shareholder's equity and \$100,000 in reserves under the regulations of the Insurance (Captive Company) Act of B.C. The Captive was in compliance with these regulations throughout the year and as at December 31, 2014.

### **13. Related parties**

The elected Benchers include members drawn from law firms across the province. These law firms may at times be engaged by the Society in the normal course of business. During the year ended December 31, 2014, expenses of \$275,196 (2013 - \$148,040) were incurred by the Fund with these law firms.

### **14. Subsequent event**

On February 16, 2015, the Fund sold its interest in the 750 Cambie Street property for \$21,500,000.

### **15. Contingencies**

During the 2011 year, the Ministry of Finance (the Ministry) informed the Captive that the Ministry contended that the annual assessments contributed by members to the Fund constituted premiums payable to the Captive for purposes of the Insurance Premium Tax Act and the Ministry proposed to adjust the Captive's net taxable premiums from 2005 to 2009 to reflect this. The Captive maintained that it is liable for premium tax only on amounts received by it from the Fund as a reimbursement of reinsurance premiums and general and administrative costs, and that premium tax has been paid in full. The Captive disputed the Ministry's proposal in 2011.

During the 2014 year, the Ministry sent a notice of Revised Assessment to the Captive assessing it for premium tax for 2008 and 2009, in the amount of \$1.087 million. The Captive has appealed this revised assessment. The Captive has accounted for this matter using the contingent liability method, whereby a provision is established only when it is considered likely that a liability will be incurred. The Captive does not consider the liability likely and a decision on the appeal has not yet been made. Accordingly the payment of the revised assessment has been posted to accounts receivable as it is expected to be refunded. If the appeal is unsuccessful, the \$1.087 million payment will be reversed from accounts receivable and expensed through the statement of earnings. The Captive has been advised that the Captive's returns for 2010 to 2013 are being audited. The additional disputed premium tax expense applicable to the 2010 to 2014 years is estimated between \$2.0 million to \$2.5 million in total. If any amounts become due, the Fund will reimburse the Captive.

