

# ALBERTA RISK MANAGEMENT FUND

## Financial Statements

MARCH 31, 2006

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## AUDITOR'S REPORT

### To the Minister of Finance

I have audited the balance sheet of the Alberta Risk Management Fund as at March 31, 2006 and the statement of operations for the year then ended. These financial statements are the responsibility of the Fund's management. My responsibility is to express an opinion on these financial statements based on my audit.

I conducted my audit in accordance with Canadian generally accepted auditing standards. Those standards require that I plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In my opinion, these financial statements present fairly, in all material respects, the financial position of the Fund as at March 31, 2006 and the results of its operations and its cash flows for the year then ended in accordance with Canadian generally accepted accounting principles.

*[Original Signed]*

Fred J. Dunn, FCA  
Auditor General

Edmonton, Alberta

May 19, 2006

*The official version of this Report of the Auditor General, and the information the Report covers, is in printed form.*

## ALBERTA RISK MANAGEMENT FUND

**BALANCE SHEET**

As at March 31, 2006

	2006	2005
	(\$ thousands)	
<b>ASSETS</b>		
Cash and cash equivalents (Note 3)	\$ 22,215	\$ 19,970
Receivable from Province of Alberta	39	52
Accrued recoveries (Note 4)	189	390
	<u>\$ 22,443</u>	<u>\$ 20,412</u>
<b>LIABILITIES AND NET LIABILITIES</b>		
Liabilities		
Accounts payable (Note 5)	\$ 392	\$ 529
Liability for accrued claims (Note 6)	28,049	25,729
	<u>28,441</u>	<u>26,258</u>
Net liabilities	(5,998)	(5,846)
	<u>\$ 22,443</u>	<u>\$ 20,412</u>

The accompanying notes are part of these financial statements.

## ALBERTA RISK MANAGEMENT FUND

**STATEMENT OF OPERATIONS**

Year Ended March 31, 2006

	2006		2005
	Budget	Actual	Actual
	(\$ thousands)		
<b>Revenues</b>			
Insurance services			
Province of Alberta			
departments, funds			
and agencies	\$ 8,035	\$ 8,048	\$ 7,243
Other entities	962	389	419
Subrogation and salvage	250	167	348
Interest	550	685	522
	<u>9,797</u>	<u>9,289</u>	<u>8,532</u>
<b>Expenses</b>			
Insurance claims	4,000	6,564	4,089
Insurance premiums to insurers	2,900	1,351	2,524
Administration	1,277	1,254	1,226
Other services	215	272	348
	<u>8,392</u>	<u>9,441</u>	<u>8,187</u>
Net revenue (expense)	<u>\$ 1,405</u>	(152)	345
<b>Net liabilities at beginning of year</b>		(5,846)	(6,191)
<b>Net liabilities at end of year</b>		<u>\$ (5,998)</u>	<u>\$ (5,846)</u>

The accompanying notes are part of these financial statements.

## ALBERTA RISK MANAGEMENT FUND

**NOTES TO THE FINANCIAL STATEMENTS**

March 31, 2006

**NOTE 1 AUTHORITY, PURPOSE AND FINANCIAL STRUCTURE**

The Alberta Risk Management Fund (the Fund) operates under the authority of the *Financial Administration Act*, Chapter F-12, Revised Statutes of Alberta 2000.

The Fund provides risk management and insurance services to government departments, funds and agencies, members of the Legislative Assembly and others by assuming general and automobile liability and the risk of losses due to automobile physical damage, property damage and crime in exchange for premiums related to the level of risk assumed.

In the ordinary course of business, the Fund insures certain risks for the purpose of limiting its exposure to large or unusual risks. As such, the Fund enters into excess of loss contracts with only the most credit-worthy insurance companies and is required to pay for all losses up to certain predetermined amounts. The insurance companies compensate the Fund for any losses above the agreed predetermined amounts.

**NOTE 2 SIGNIFICANT ACCOUNTING POLICIES AND REPORTING PRACTICES**

These financial statements are prepared in accordance with Canadian generally accepted accounting principles. The accounting policies of significance to the Fund are as follows:

- (a) Claims provisions, including provisions for claims incurred but not reported, are based on estimates made by management. The provisions are adjusted in the period when more experience is acquired and as additional information is obtained.
- (b) In preparing these financial statements, estimates and assumptions are used in circumstances where the actual values are unknown. Uncertainty in the determination of the amount at which an item is recognized in financial statements is known as measurement uncertainty. Such uncertainty exists when there is a variance between the recognized amount and another reasonably possible amount, as there is whenever estimates are used.

Measurement uncertainty that is material in these financial statements exists in the estimation of the Fund's liability for accrued claims. Uncertainty arises because the Fund's actual loss experience may differ, perhaps significantly, from assumptions used in the estimation of the Fund's liability for accrued claims. (see Note 6(b)).

Liability for accrued claims, recorded as \$28.05 million (2005 \$25.73 million) in these financial statements, is subject to measurement uncertainty. This is because the ultimate disposition of claims incurred prior to the financial statement date is subject to the outcome of events that have not yet occurred, and any estimate of future costs has inherent limitations due to management's limited ability to predict precisely the aggregate course of future events. Based on an actuarial sensitivity analysis, an estimate of claim liabilities at the high end of a reasonable range is \$33.66 million as at March 31, 2006, or \$5.61 million higher than the recognized amount. It is possible that actual claims could be even higher than this other probable amount (see Note 6(b)).

## ALBERTA RISK MANAGEMENT FUND

**Note 2 (continued)**

While best estimates have been used in reporting the Fund's liability for accrued claims, management considers that it is possible, based on existing knowledge, that changes in future conditions in the near term could require a material change in the recognized amounts. Near term is defined as a period of time not to exceed one year from the date of the financial statements. Differences between actual results and expectations are adjusted in the period when the actual loss values are known.

- (c) The fair values of cash and cash equivalents, accounts receivable, accrued recoveries, accounts payable and liability for accrued claims are estimated to approximate their book values.
- (d) A statement of changes in cash flows is not provided as disclosure in these financial statements is considered adequate.

**NOTE 3 CASH AND CASH EQUIVALENTS**

Cash and cash equivalents consist of a deposit in the Consolidated Cash Investment Trust Fund (CCITF). The CCITF is managed with the objective of providing competitive interest income to depositors while maintaining maximum security and liquidity of depositors' capital. The portfolio is comprised of high quality short-term and mid-term fixed income securities with a maximum term to maturity of three years. As at March 31, 2006, securities held by the CCITF have an average effective market yield of 4.0% (2005 2.8%) per annum and an average duration of 120 days (2005 131 days).

**NOTE 4 ACCRUED RECOVERIES**

Accrued recoveries represent management's best estimates of amounts that will be recovered for subrogation or salvage. All amounts are considered to be good and recoverable when due.

**NOTE 5 ACCOUNTS PAYABLE**

	<b>2006</b>	<b>2005</b>
	(\$ thousands)	
Payable to Department of Finance	\$ 379	\$ 405
Other	13	124
	<u>\$ 392</u>	<u>\$ 529</u>

## ALBERTA RISK MANAGEMENT FUND

**NOTE 6      LIABILITY FOR ACCRUED CLAIMS**

	2006	2005
	(\$ thousands)	
Outstanding claims case reserves (a)	\$ 14,873	\$ 13,462
Incurred but not reported losses (b)	13,176	12,267
	<u>\$ 28,049</u>	<u>\$ 25,729</u>

**(a) Outstanding Claims Case Reserves**

Liability for outstanding claims case reserves represents management's best estimates of outstanding losses and related claims expenses which have been reported but not yet closed, net of participant deductibles and recoveries, if any. The amount reflects management's best estimate of the ultimate cost of settlement after consultation with legal counsel if required.

**(b) Incurred But Not Reported (IBNR) Losses**

Liability for IBNR losses is an estimate of liabilities for claims that have been incurred but not yet reported. In addition to a provision for claims that have occurred but are not yet reported, the amount includes a provision for development of outstanding case reserves, a provision for reopened claims, and a provision for claims that have been reported but are not yet recorded in the books.

An actuarial review of the Fund's liability for IBNR losses was carried out as at March 31, 2006 by KPMG LLP, taking into account the historical claims experience up to that date.

The actuarial review was determined using generally accepted actuarial practices in Canada, including the selection of appropriate assumptions and methods. The assumptions used were developed based on the actuary's best estimates of the Fund's expected loss experience. After consultation with the Fund's actuary, management approved these best estimates.

## ALBERTA RISK MANAGEMENT FUND

**Note 6 (continued)**

The major assumptions used were:

	2006	2005
<b>Trend rate</b>		
General liability	5%	5%
Automobile liability	5%	5%
Property	3%	3%
Auto physical damage	5%	3%
Crime	3%	3%
<b>Loss development factor</b>		
Based on the Fund's historical experience supplemented by insurance industry experience compiled by Insurance Bureau of Canada		
<b>Selected loss rate</b>		
General liability		
Loss per person (Alberta population)	\$ 1.35	\$ 1.20
Automobile liability		
Loss per vehicle	\$ 125	\$ 125
Property		
Loss per \$million property values	\$ 125	\$ 250
Auto physical damage		
Loss per vehicle	\$ 118	\$ 100
Crime		
Loss per class A and B employee	\$ 55	\$ 50

Liability for IBNR losses represents the difference between the actuary's estimated ultimate incurred loss and the amount of incurred loss reported on the effective date of review, adjusted for the portion of any individual large claims ceded to third party insurers.

The Fund's future experience will inevitably differ, perhaps significantly, from the actuary's estimate due to the unpredictable nature of new claim types, the random occurrence of large losses and the outcome of future contingent events. Any differences between the actuary's estimate and future experience will emerge as gains or losses in future reviews and will affect the financial position of the Fund.



## ALBERTA RISK MANAGEMENT FUND

**Note 6 (continued)**

The following is a summary of the impact of various sensitivity tests on the Fund's net liability at March 31, 2006:

<b>Sensitivity Tests</b>	<b>Increase in Net Liabilities</b>
	(\$ million)
Increase the confidence level of the liability for accrued claims estimate from 50% to 90%	\$ 5.6
Increase the loss development factor assumption by changing the tail factor by coverage to between 1.05 and 1.10, and increase the trend factor assumption by line of business to between 8 and 10% by coverage	4.8
Statistical analysis of general liability loss development factors instead of judgmentally selecting loss development factors	4.5

**NOTE 7 CONTINGENT LIABILITIES**

At March 31, 2006, the Province was named as defendant in various legal actions relating to insurance claims. The resulting loss, if any from these claims and other potential claims cannot be determined.

**NOTE 8 APPROVAL OF FINANCIAL STATEMENTS**

These financial statements were approved by the Deputy Minister of Finance.

