Secretary of State

State of Oregon

PROFESSIONAL LIABILITY FUND

January 1, 1996, to December 31, 1996

Audits Division

Secretary of State

State of Oregon

PROFESSIONAL LIABILITY FUND

January 1, 1996, to December 31, 1996

Audits Division

No. 97-39

May 20, 1997

Secretary of State Audits Division

Auditing for a Better Oregon

The Honorable John Kitzhaber
Governor of Oregon
Salem, Oregon 97310

Board of Governors
Oregon State Bar
5200 SW Meadows Road
P. O. Box 1689
Lake Oswego, Oregon 97035

Board of Directors
Professional Liability Fund
5200 SW Meadows Road
P. O. Box 1600
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As requested by management of the Professional Liability Fund (PLF), we audited the financial statements of the PLF as of and for the years ended December 31, 1996, and 1995. Our Independent Auditor's Report and the financial statements are included in the FINANCIAL SECTION of this report.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

As also required by those standards, we reviewed the PLF's internal control structure and compliance with applicable laws and corporation bylaws. Our reports on the results of those reviews are included in the AUDIT RESULTS section of this report.

OREGON AUDITS DIVISION

Sam Cochran
Acting State Auditor

Fieldwork Completion Date:
March 28, 1997

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TABLE OF CONTENTS

SUMMARY

The Professional Liability Fund (PLF) provides mandatory basic and optional excess legal malpractice insurance for all attorneys engaged in private practice whose principal office is in Oregon. Annual mandatory assessments along with investment earnings provide the revenue to support this activity. The mandatory assessments and the activities related to the basic malpractice insurance coverage are accounted for in the Primary Fund. For the year ended December 31, 1996, revenues of $15 million and expenses of $12.7 million were reported in this fund. The liability for the mandatory coverage is fully retained by the PLF and is evidenced by the estimated liabilities for indemnity and loss adjustment expenses reported in the financial statements.

Effective for 1991, the PLF established an optional plan to underwrite insurance coverage in excess of the mandatory coverage. All claims filed under the excess plan are covered by reinsurance. Total coverage, including excess coverage, is limited to a maximum of $2 million.

The audit was conducted for the purpose of reporting on the PLF's financial statements for the years ended December 31, 1996, and 1995, and on PLF's internal control structure and compliance with applicable laws and corporation bylaws. The audit resulted in an unqualified opinion, which is a conclusion that the financial statements taken as a whole are presented fairly.

INTRODUCTION

ORGANIZATION AND FUNCTIONS

The Professional Liability Fund (PLF), a separate but integral unit of the Oregon State Bar, is a legal malpractice insurance program created in 1977 under the provisions of *Oregon Revised Statutes* (ORS) 9.080.

The PLF is administered by a nine-member Board of Directors. PLF Board members are appointed by the Oregon State Bar's Board of Governors. The PLF Board of Directors appoints a Chief Executive Officer to supervise and administer the PLF.

The Oregon State Bar is a public corporation and an instrumentality of the Judicial Department of the state of Oregon.

FINANCIAL ACTIVITIES

All attorneys engaged in private practice whose principal office is in Oregon are required to have PLF insurance coverage for at least a portion of the year. Annual assessments (insurance "premiums") are established by the Oregon State Bar Board of Governors upon recommendation by the PLF's Board of Directors. Revenues from the assessments and investment earnings pay for the defense and settlement of claims made against covered attorneys. A consulting firm of independent actuaries advises on the sufficiency of estimated liabilities for claim settlements.

Primary PLF coverage is limited to $300,000 for both indemnity and defense costs with a separate $25,000 limit solely for defense costs in addition to the $300,000 aggregate limit. Effective in 1991, the PLF established an optional plan to provide insurance coverage in excess of $300,000. All claims filed under the excess coverage plan are covered by reinsurance. Total coverage, including basic and excess coverage, is limited to a maximum of $2 million.

All PLF financial activities are accounted for in enterprise funds. That is, they are accounted for in a manner similar to private business enterprises where the intent is to recover all expenses through charges for services.

AUDIT RESULTS

REPORT ON INTERNAL CONTROL

We have audited the financial statements of the Professional Liability Fund (PLF), as of and for the years ended December 31, 1996, and 1995, and have issued our report thereon dated March 28, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

The management of the PLF is responsible for establishing and maintaining a system of internal control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of controls. The objectives of an internal control system are to provide management with reasonable assurance regarding the reliability of financial reporting, the effectiveness and efficiency of operations, and compliance with laws and regulations. Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the effectiveness of the design and operation of controls may deteriorate.

In planning and performing our audit of the financial statements of the PLF for the years ended December 31, 1996, and 1995, we obtained an understanding of internal control. With respect to the internal control system, we obtained an understanding of the design of relevant controls and whether they have been placed in operation, and we assessed control risk in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

Our consideration of internal control would not necessarily disclose all matters affecting internal control that might be material weaknesses under standards established by the American Institute of Certified Public Accountants. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We found no matters involving internal control or its operations that we consider to be material weaknesses as defined above.

REPORT ON COMPLIANCE WITH LAWS AND CORPORATION BYLAWS

We have audited the financial statements of the Professional Liability Fund (PLF), as of and for the years ended December 31, 1996, and 1995, and have issued our report thereon dated March 28, 1997.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

Compliance with laws and corporation bylaws applicable to the PLF is the responsibility of PLF management. As part of obtaining reasonable assurance about whether the financial statements are free of material misstatement, we performed tests of the PLF's compliance with certain provisions of laws and bylaws. However, the objective of our audit of the financial statements was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

REPORT DISTRIBUTION

This report is a public record and is intended for the information of PLF management, the PLF Board of Directors, the Oregon State Bar Board of Governors, the governor of the state of Oregon, the Oregon Legislative Assembly, and all other interested parties.

COMMENDATION

The courtesies and cooperation extended by the officials and staff of the Oregon State Bar Professional Liability Fund were commendable and much appreciated.

AUDIT TEAM

Joel Leming, CPA, Audit Administrator
Ann Waterman, CPA
Jason Stanley

FINANCIAL SECTION

The Honorable John Kitzhaber
Governor of Oregon
Salem, Oregon 97310

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Board of Directors
Professional Liability Fund
5200 SW Meadows Road
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INDEPENDENT AUDITOR'S REPORT

We have audited the accompanying financial statements of the Professional Liability Fund (PLF) of the Oregon State Bar, as listed in the table of contents, as of and for the years ended December 31, 1996, and 1995. These financial statements are the responsibility of the PLF management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about 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. We believe that our audit provides a reasonable basis for our opinion.

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As discussed in Note 1, the financial statements present only the transactions and balances attributable to the activities of the Professional Liability Fund and are not intended to present fairly the financial position of the Oregon State Bar as a whole and the results of operations and cash flows of all its enterprise funds in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the PLF of the Oregon State Bar as of December 31, 1996, and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Reports in accordance with *Government Auditing Standards* on the PLF's internal control structure and compliance with applicable laws and corporation bylaws are separately presented in the AUDIT RESULTS section of this document.

OREGON AUDITS DIVISION

Sharron W. Goggins, CPA, CFE
Deputy State Auditor

March 28, 1997

Exhibit A

State of Oregon
OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
Balance Sheet
December 31, 1996, and 1995

	PrimaryFund		ExcessFund		Totals	
Assets	1996	1995	1996	1995	1996	1995
Cash and Equivalents (Note 2)	$ 576,826	$ 1,628,027	$ 204,300	$ 379,123	$ 781,126	$ 2,007,150
Investments, at Market Value (Note 3)	31,087,199	28,488,682	4,250,015	3,510,548	35,337,214	31,999,230
Deferred Compensation Funds (Note 5)	570,630	482,537	-	-	570,630	482,537
Claim Receivables (Note 4)	112,355	211,257	-	-	112,355	211,257
Accounts and Other Receivables	3,925	4,597	1,650	-	5,575	4,597
Due from Excess Fund	-	1,474	-	-	-	1,474
Due from Primary Fund			7,291	-	7,291	-
Due from Reinsurance	-	-	27,721	-	27,721	-
Deposits and Prepayments	17,164	151,439	-	-	17,164	151,439
Fixed Assets, Net (Note 6)	154,835	184,728	-	-	154,835	184,728
Total Assets	$ 32,522,934	$ 31,152,741	$ 4,490,977	$ 3,889,671	$ 37,013,911	$ 35,042,412
Liabilities and Fund Equity						
Liabilities:						
Accounts Payable	$ 54,990	$ 124,876	$ 17,239	$ 2,609	$ 72,229	$ 127,485
Capital Leases Payable (Note 10)	20,527	0 30,337	-	-	20,527	30,337
Accrued Vacation Pay (Note 7)	119,894	103,358	-	-	119,894	103,358
Deferred Compensation Funds	570,630	482,537	-	-	570,630	482,537
Due to Primary Fund	-	-	-	1,462	-	1,462
Due to Excess Fund	7,291	-			7,291	-
Estimated Liabilities for Claims (Note 14):					-	-
Indemnity Settlements	13,730,000	14,430,000	-	-	13,730,000	14,430,000
Loss Adjustment Expenses	10,570,000	9,820,000	-	-	10,570,000	9,820,000
Deferred Revenues (Note 1)	4,298,515	5,346,547	448,331	603,531	4,746,846	5,950,078
Total Liabilities	$ 29,371,847	$ 30,337,655	$ 465,570	$ 607,602	$ 29,837,417	$ 30,945,257
Fund Equity:						
Retained Earnings (Deficit)	$ 2,626,058	$ 304,829	$ 3,943,020	$ 3,196,505	$ 6,569,078	$ 3,501,334
Unrealized Gain (Loss) on Investments (Note 3)	525,029	510,257	82,387	85,564	607,416	595,821
Total Fund Equity	$ 3,151,087	$ 815,086	$ 4,025,407	$ 3,282,069	$ 7,176,494	$ 4,097,155
Total Liabilities and Fund Equity	$ 32,522,934	$ 31,152,741	$ 4,490,977	$ 3,889,671	$ 37,013,911	$ 35,042,412

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

Exhibit B

State of Oregon

OREGON STATE BAR

PROFESSIONAL LIABILITY FUND

Statement of Revenues, Expenses and Changes in Fund Equity

Years Ended December 31, 1996, and 1995

	Primary Fund		Excess Fund		Totals	
Revenues	1996	1995	1996	1995	1996	1995
Annual Assessments (Notes 11, 12)	$ 12,554,508	$ 12,247,124	$ 1,580,764	$ 1,877,476	$ 14,135,272	$ 14,124,6
Assessments Ceded to Reinsurers	-	-	(1,314,667)	(1,517,308)	(1,314,667)	(1,517,3C
Net Assessments	12,554,508	12,247,124	266,097	360,168	12,820,605	12,607,2
Investment Income	2,243,909	2,604,389	306,012	326,499	2,549,921	2,930,8
Other Income	216,752	196,242	311,256	97,284	528,008	293,5
Total Revenues	$ 15,015,169	$ 15,047,755	$ 883,365	$ 783,951	$ 15,898,534	$ 15,831,7
Expenses						
Liability Claims (Note 13):						
Provision for Indemnity	$ 4,797,699	$ 6,584,470	$ -	$ -	$ 4,797,699	$ 6,584,4
Provision for Claim Expenses	5,228,273	5,442,289	-	-	5,228,273	5,442,2
Total Claims Expenses	$ 10,025,972	$ 12,026,759	$ -	$ -	$ 10,025,972	$ 12,026,7
Administrative Expense:						
Salaries and Benefits	$ 1,855,575	$ 1,755,273	$ 95,170	$ 78,062	$ 1,950,745	$ 1,833,3
Services and Supplies	731,402	793,094	41,680	34,209	773,082	827,3
Depreciation	80,991	63,028	-	-	80,991	63,0
Total Administrative Expenses	$ 2,667,968	$ 2,611,395	$ 136,850	$ 112,271	$ 2,804,818	$ 2,723,6
Total Expenses	$ 12,693,940	$ 14,638,154	$ 136,850	$ 112,271	$ 12,830,790	$ 14,750,4
Net Income (Loss)	$ 2,321,229	$ 409,601	$ 746,515	$ 671,680	$ 3,067,744	$ 1,081,2
Fund Equity/(Deficit) - Beginning of Year	815,086	(2,060,525)	3,282,069	2,294,813	4,097,155	234,2
Change in Unrealized Gain (Loss) on Investments (Note 3)	14,772	2,466,010	(3,177)	315,576	11,595	2,781,5
Fund Equity (Deficit) - End of Year	$ 3,151,087	$ 815,086	$ 4,025,407	$ 3,282,069	$ 7,176,494	$ 4,097,1

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

Exhibit C

State of Oregon

OREGON STATE BAR

PROFESSIONAL LIABILITY FUND

Statement of Cash Flows

Years Ended December 31, 1996, and 1995

Increase (Decrease) in Cash and Cash Equivalents	Primary Fund 1996	Primary Fund 1995	Excess Fund 1996	Excess Fund 1995	Totals 1996	Totals 1995
Cash Flows from Operating Activities:						
Cash Received for Assessments (Premiums)	$ 11,506,476	$ 13,293,578	$ 1,423,914	$ 1,855,955	$ 12,930,390	$ 15,149,533
Premiums Paid (Ceded) to Reinsurers	-	-	(1,300,037)	(1,523,174)	(1,300,037)	(1,523,174)
Dividends and Interest Received in Cash	2,364,412	2,106,396	322,444	264,949	2,686,856	2,371,345
Other Operating Revenues Received	217,424 -	194,678	283,535	182,711	500,959	377,389
Cash Payments for Liability Claims:						
Indemnity Settlements	(5,398,797)	(6,035,335)	-	-	(5,398,797)	(6,035,335)
Loss Adjustment Expenses	(4,478,273)	(4,272,289)	-	-	(4,478,273)	(4,272,289)
Cash Paid Employees for Salaries/Benefits	(1,839,039)	(1,760,273)	(95,170)	(78,062)	(1,934,209)	(1,838,335)
Cash Paid Vendors for Goods and Services	(658,248)	(860,165)	(50,433)	(34,370)	(708,681)	(894,535)
Net Cash Provided (Used) by Operations*	$ 1,713,955	$ 2,666,590	$ 584,253	$ 668,009	$ 2,298,208	$ 3,334,599
Cash Flows from Investing Activities:						
Purchase of Investments	$ (16,487,340)	$ (11,165,449)	$ (4,584,087)	$ (3,158,263)	$ (21,071,427)	$ (14,323,712)
Proceeds from Investment Sales	13,783,092	9,421,549	3,825,011	2,578,451	17,608,103	12,000,000
Net Cash Used in Investing Activities	$ (2,704,248)	$ (1,743,900)	$ (759,076)	$ (579,812)	$ (3,463,324)	$ (2,323,712)
Cash Flows from Capital Financing:						
Purchase of Equipment (Net)	$ (51,098)	$ (95,877)	$ -	$ -	$ (51,098)	$ (95,877)
Principal Payments on Capital Leases	(9,810)	(9,241)	-	-	(9,810)	(9,241)
Net Cash Used in Capital Financing	$ (60,908)	$ (105,118)	$ -	$ -	$ (60,908)	$ (105,118)
Net Increase (Decrease) in Cash and Cash Equivalents	$ (1,051,201)	$ 817,572	$ (174,823)	$ 88,197	$ (1,226,024)	$ 905,769
Cash and Equivalents - January 1	$ 1,628,027	$ 810,455	$ 379,123	$ 290,926	$ 2,007,150	$ 1,101,381
Cash and Equivalents - December 31	$ 576,826	$ 1,628,027	$ 204,300	$ 379,123	$ 781,126	$ 2,007,150
* Reconciliation of Net Income to Net Cash Provided (Used) by Operating Activities:						
Net Income (Loss)	$ 2,321,229	$ 409,601	$ 746,515	$ 671,680	$ 3,067,744	$ 1,081,281
Add Depreciation Expense	80,991	63,028	-	-	80,991	63,028
Realized (Gain) Loss on Investments	120,503	(497,993)	16,432	(61,550)	136,935	(559,543)
Change in Net Receivables/Payables	189,264	(4,500)	(23,494)	79,400	165,770	74,900
Increase in Estimated Claims Liabilities	50,000	1,650,000	-	-	50,000	1,650,000
Increase (Decrease) in Deferred Revenue	(1,048,032)	1,046,454	(155,200)	(21,521)	(1,203,232)	1,024,933
Net Cash Provided (Used) by Operations	$ 1,713,955	$ 2,666,590	$ 584,253	$ 668,009	$ 2,298,208	$ 3,334,599

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

State of Oregon

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND

Notes to Financial Statements
For Years Ended December 31, 1996, and 1995

(1)

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization

The Oregon State Bar is comprised of the Oregon State Bar Fund and the Professional Liability Fund (PLF). The financial statements and accompanying notes presented herein are for the PLF only. The accounts of the Oregon State Bar Fund are not included in this presentation.

The PLF was created in 1977 under the provisions of Oregon Revised Statutes (ORS) 9.080. This legislation authorized the Board of Governors of the Oregon State Bar to establish a professional liability (legal malpractice) insurance program for all attorneys engaged in private practice whose principal office is in Oregon. Coverage is mandatory for all attorneys subject to the law. In 1996, approximately 6,332 attorneys were required to have coverage for at least a portion of the year. Any such attorney who fails to pay the annual assessment fee (premium) is suspended from membership in the Bar and is therefore ineligible to practice law in Oregon.

The PLF is a separate but integral unit of the Oregon State Bar. It is administered by a nine-member Board of Directors appointed by the Board of Governors. The Board of Directors appoints a Chief Executive Officer to supervise and administer the PLF. The PLF is not subject to the Insurance Code of the State of Oregon. As a public body, it is also exempt from federal and state income taxes.

B. Fund Structure

Accounting policies of the PLF comply with generally accepted accounting principles for governmental units. As a governmental entity, all financial activities of the PLF are accounted for as enterprise funds. This means that PLF financial operations are accounted for in a manner similar to private business enterprises where the intent of the governing body is to recover all expenses by appropriate charges for services.

(1) continued

B. (Continued)

In 1990, the PLF established an optional underwritten plan to provide insurance coverage with policy limits in excess of the existing mandatory plan. The plan was effective on January 1, 1991. All assets, liabilities, revenues and expenses of the excess program are accounted for as a separate fund. The excess program reimburses the primary fund for services so that the cost of the excess program is not subsidized by the primary fund. A portion of salary, benefit and occupancy costs are allocated to the excess fund. The excess program offers coverage to legal firms including sole practitioners as opposed to individual members of a legal entity. Underwriting decisions are based upon the firm as a whole. In 1996, 354 firms with 1,326 attorneys elected to obtain excess coverage.

For financial reporting purposes, financial activities of the PLF are segregated between the mandatory plan ("Primary Fund") and the optional excess coverage plan ("Excess Fund").

C. Basis of Accounting

The PLF utilizes the accrual basis of accounting whereby revenues are recognized in the fiscal period when earned and expenses are recognized in the period incurred, whether or not paid. The accounting treatment of individual revenue and expense items is more fully described below.

As permitted by GASB Statement No. 20, the PLF has elected not to apply FASB pronouncements issued after November 30, 1989, unless GASB amends its pronouncements to specifically adopt FASB pronouncements after that date.

D. Assessment Revenue

Primary Fund:

The annual assessment (insurance "premium") is established by the Bar Board of Governors upon recommendation of the PLF Board of Directors. A special underwriting assessment may be imposed on attorneys with a history of claim losses and expenses. The special underwriting assessments vary in amount based on prior payments for indemnity and expenses made by the PLF on behalf of the covered attorney. In addition to the basic and special assessments (if any), a supplemental assessment may be imposed on all attorneys if the financial solvency of the PLF is threatened. This option, however, has never been exercised.

Assessments collected before the beginning of the coverage year are reflected as deferred revenues in the PLF balance sheet.

(1) continued

D. (Continued)

Excess Fund:

The assessment for excess coverage is established by the Bar Board of Governors upon the recommendation of the PLF Board of Directors. The assessment may include debits or credits for firms based on prior claims, practice specialties, the extension of prior acts coverage and other factors. A supplemental assessment may be imposed on program participants, including firm members. This option has never been exercised.

Like the primary fund, the period of coverage for the excess fund is the calendar year. Firms may elect coverage after the start of the year; however, the period of coverage always ends with the end of the calendar year. Excess coverage may be canceled during the coverage period. Assessments collected before the beginning of the coverage year are reflected as deferred revenues in the PLF balance sheet.

E. Claim Settlement and Defense Costs

Primary Fund:

Estimated liabilities (often called "reserves") to settle and defend a claim are established when a claim is reported to the PLF. These estimates are determined by PLF claims attorneys based upon historic experience and current trends and are continually reevaluated and changed as more information becomes available. Changes in estimates resulting from the continuous review process and differences between estimated and actual payments are reflected in financial operations of the period in which the estimates are changed.

The PLF also uses a firm of independent consulting actuaries to review its claims experience and liability estimates every six months. The estimated liabilities for indemnity and expense reported in the 1996 financial statements are based on this actuarial analysis.

In addition to the actuarial methodology used above, PLF cost estimates to defend and settle claims in the future include factors for Unallocated Loss Adjustment Expense (ULAE), Extended Reporting Coverage (ERC), and suspense files. ULAE represents the PLF's estimated future administrative costs for processing open and unresolved claims. ERC represents the estimated cost of future claims which may be filed against lawyers who have obtained such coverage upon leaving private practice. Suspense files represent the estimated cost of potential claims for which the PLF has been notified during a coverage year but formal claims have not yet been filed.

(1) continued

E. (Continued)

Management believes that its aggregate reserve for losses and loss adjustment expenses is reasonable and adequate to cover the ultimate net cost of losses on claims reported, but such provision is necessarily based on estimates, and the ultimate net cost may vary from such estimates. As adjustments to these estimates become necessary, the adjustments are reflected in current operations.

For financial statement purposes, amounts recoverable from other parties (such as subrogation receivables) relating to paid claims are reflected as assets, net of appropriate valuation allowances, in the balance sheet and as deductions from the provisions for claim settlement and defense costs in the PLF annual operating statement.

Excess Fund:

As described in Note (1) F below, 100 percent of the primary liability for any claim filed under the excess plan has been passed to other insurance companies through reinsurance. The possibility of the PLF incurring direct costs under the excess plan is considered remote. Therefore, no provision or liability for such claims has been established. If future operations of the plan indicate that the PLF will incur direct costs, appropriate estimated liabilities for such losses will be established based on plan experience.

F. Reinsurance

Primary Fund:

Through 1985, the PLF carried "excess of loss" reinsurance with a private reinsurer. Reinsurance coverage has not been purchased for the Primary Fund since 1985; however, the prior coverage continued to generate reinsurance recoveries through 1994 and additional recoveries are expected in the future.

Excess Fund:

All losses under the excess plan are covered 100 percent by reinsurance. Although the PLF is ultimately responsible for the payment of successful claims filed under the excess plan, such payments are considered highly unlikely. It is the PLF's policy to diversify risk by choosing several reinsurance companies. In addition, the PLF selected reinsurance companies with an emphasis on financial solvency. The PLF will secure letters of credit and other means of financial protection when appropriate.

(1) continued

G. Basis of Coverage

PLF coverage is on a "claims made" basis. Under a "claims made" form of coverage, the attorney is covered for any claim made during a plan period in which he or she has professional liability coverage. Prior to 1992, attorneys who left private practice could obtain "extended reporting coverage" for an additional one time assessment. Payment of this assessment results in continuing coverage for covered acts committed prior to the end of the plan period. After December 31, 1991, no charge has been made for extended reporting coverage for the limits of coverage offered by the primary fund. Firms which request to have extended reporting coverage from the excess fund pay an additional assessment.

Under the 1996 Coverage Plan, primary coverage is limited to a maximum of $300,000 for both indemnity and defense costs with a separate $25,000 limit solely for defense costs in addition to the $300,000 aggregate limit. Optional coverage under the excess plan increases basic coverage by either $700,000 or $1,700,000 as elected by the covered firm. Therefore, firms with excess coverage could increase their total limits to either $1 million or $2 million at their option.

H. Budgets

The PLF operates under annual budgets which are adopted and approved by the Board of Directors and the Oregon State Bar Board of Governors.

I. Fixed Assets and Depreciation

Fixed assets (office and data processing equipment, furniture, and leasehold improvements) are recorded at cost and charged to expense over their useful lives by use of the straight line method of depreciation. Computer hardware and software are depreciated over a three-year period and all other equipment over either a five-year or ten-year period.

J. Investments

The PLF values its investment portfolio in accordance with the provisions of Statement of Financial Accounting Standards No. 60 (FASB No. 60), "Accounting and Reporting by Insurance Enterprises." Shares in diversified mutual funds are carried at market value. Unrealized gains or losses due to changes in market values are reflected as adjustments to fund equity.

K. Materials and Supplies

Expendable supplies are charged to expense when purchased. The estimated value of such supplies on hand at the end of the fiscal year is considered immaterial to fund operations and is not reflected in the financial statements.

(2)

CASH AND CASH EQUIVALENTS

For financial statement purposes, the PLF considers cash and cash equivalents to include cash on hand, cash in checking accounts, and other short-term investments which are readily convertible to cash ("cash equivalents"). Examples of short-term, highly liquid investments which are considered as cash equivalents are money market funds and accounts, and Treasury bills.

As of December 31, 1996, the following accounts were classified as cash and cash equivalents:

	Book Balance		
Account	Primary Fund	Excess Fund	Total
Petty Cash Fund	$ 100	$ -	$ 100
Cash in Bank - General Checking	131,168	204,300	335,468
Cash in Bank - Payroll Checking	10,691	-	10,691
Money Market Account	434,867	-	434,867
Total Cash and Cash Equivalents	$ 576,826$576,826.00	$ 204,300	$ 781,126

PLF checking accounts are insured by the Federal Deposit Insurance Corporation for amounts on deposit up to $100,000. All other accounts are uninsured and uncollateralized.

(3)

INVESTMENTS

PLF investments are made in accordance with policy guidelines adopted by the Board of Directors. The guidelines emphasize safety, liquidity and diversification. Investments are carried at market value for financial reporting purposes. Differences between cost and market are reflected as unrealized gains or losses to fund equity.

To better achieve the benefits of professional management, in late 1993 the PLF placed its investments portfolio in shares of widely diversified mutual fund companies.

(3) continued

The following table summarizes the cost and related market value of PLF investments at December 31, 1996, and 1995, by type of investment:

1996

Type of Mutual Fund	Market Value	Cost	Unrealized Gain (Loss)
Short-Term Fixed Income	$ 4,105,505	$ 4,102,785	$ 2,720
Intermediate-Term Fixed Income	22,117,304	22,240,162	(122,858)
Equities	9,114,405	8,386,851	727,554
Total Investments	$35,337,214.00	$34,729,798.00	$ 607,416
Allocation			
Primary Fund	$ 31,087,199	$ 30,562,170	$ 525,029
Excess Fund	4,250,015	4,167,628	82,387
Total	$ 35,337,214	$ 34,729,798	$ 607,416

1995

Type of Mutual Fund	Market Value	Cost	Unrealized Gain (Loss)
Short-Term Fixed Income	$ 3,179,901	$ 3,169,447	$ 10,454
Intermediate-Term Fixed Income	22,849,865	22,493,463	356,402
Equities	5,969,464	5,740,499	228,965
Total Investments	$31,999,230.00	$31,403,409.00	$595,821.00
Allocation			
Primary Fund	$ 28,488,682	$ 27,978,425	$ 510,257
Excess Fund	3,510,548	3,424,984	85,564
Total	$ 31,999,230	$ 31,403,409	$ 595,821

The differences between cost and market values at December 31, 1996, and 1995 — $607,416 and $595,821, respectively — are reflected in the financial statements as adjustments to Fund Equity.

(4)

CLAIM RECEIVABLES

Claim receivables represent the estimated value of noncash assets (such as real estate, promissory notes, and various subrogation rights) which the PLF may receive when it settles a claim on behalf of a covered party. The ultimate collectibility of such receivables ranges from excellent to highly doubtful.

Claim receivables are reflected in the financial statements as an asset, net of an allowance for doubtful receivables, and offset against the provision for claim settlements in the operating statement. At December 31, 1996, and 1995, claim receivables were valued as follows:

	1996	1995
Total Claim Receivables	$116,614	$215,516
Less Allowance for Doubtful Accounts	(4,259)	(4,259)
Net Claim Receivables	$112,355	$211,257

(5)

DEFERRED COMPENSATION PLANS

The Professional Liability Fund established a deferred compensation plan in 1987 which is available to all employees who elect to participate.

The deferred compensation program permits employees to defer a portion of their compensation until future years. Such compensation, as deferred, is nontaxable until actually received by the employee upon retirement, termination, death, or unforeseeable emergency. Employees may designate their contributions be invested in specific types of marketable securities.

Under Internal Revenue Service regulations, all plan contributions, earnings, and rights thereunder, remain the property of the employer (PLF) until actually received by the employee, subject only to the claims of general creditors. Therefore, to recognize this fiduciary relationship, plan assets and the related liability thereto are reflected in the PLF balance sheet at year end. Plan assets are carried at market value ($570,630 at December 31, 1996) as prescribed by governmental accounting standards.

(6)

FIXED ASSETS

The following table reflects the cost, accumulated depreciation/amortization, and net book value for each major type of equipment and furniture owned by the PLF at December 31, 1996 and 1995:

1996

Asset	Cost	Accumulated Depreciation	Book Value
Data Processing Equipment	$ 209,665	$ 121,160	$ 88,505
Furniture and Equipment	352,690	296,159	57,531
Leasehold Improvements	80,007	71,208	8,799
Totals	$ 643,362	$ 488,527	$ 154,835

1995

Asset	Cost	Accumulated Depreciation	Book Value
Data Processing Equipment	$ 166,807	$ 85,674	$ 81,133
Furniture and Equipment	350,610	262,222	88,388
Leasehold Improvements	78,497	63,290	15,207
Totals	$ 595,914	$ 411,186	$ 184,728

(7)

LIABILITY FOR COMPENSATED ABSENCES

PLF employees earn vacation leave at rates from 8 to 20 hours per month depending, in part, upon their length of service. Unused vacation leave is compensable to the employee upon termination of employment. At December 31, 1996, and 1995, the value of vacation leave earned by all PLF employees totaled $119,894 and $103,358, respectively, including the employer's share of social security taxes and other related payroll costs.

(8)

LIABILITIES FOR UNEMPLOYMENT BENEFITS

PLF employees who qualify are entitled to benefit payments during periods of unemployment. Like state agencies, the PLF does not pay unemployment insurance. The PLF is required to reimburse the Employment Department for actual benefit payments made to its former employees. Therefore, the potential liability cannot be determined. The PLF paid no unemployment expenses during 1996 and 1995.

(9)

DEFINED BENEFIT RETIREMENT PLAN

PLF employees may participate in the Oregon Public Employes Retirement System (PERS), a cost-sharing multiple-employer public employee retirement system. All employees of the PLF are eligible to participate in the system after completing six months of service. The PERS retirement plan offers 12 retirement benefit options. Options include annuities, survivorship benefits, and lump sum payments. PERS also provides death and disability benefits.

Covered employees are required by statute to contribute 6 percent of their salary to the plan. The employer is required to contribute actuarially computed amounts determined by PERS. Currently, the rate is 8.46 percent of covered employees' salaries. PLF employee and employer contributions totaled $224,465 in 1996 and $211,721 for 1995.

Historical trend information showing the PERS' progress in accumulating sufficient assets to pay benefits when due may be found in the latest Oregon Public Employes Retirement System annual financial report, which may be obtained from PERS, PO Box 73, Portland, Oregon 97207.

(10)

LEASE OBLIGATIONS

The PLF occupies leased space in the Oregon State Bar headquarters building in Lake Oswego, Oregon. Space rental to the Bar totaled $129,999 during 1996. Rent for future years has not been determined pending any adjustments for increases in operation and maintenance costs or revisions in the specific space to be occupied.

Beginning July 15, 1989, the PLF leased additional office space in downtown Portland. The lease was renegotiated as of December 1, 1993, for a term of 50 months with annual rentals to be adjusted for increases in the Consumer Price Index. Rent during 1996 totaled $18,427.

In January 1994, the PLF entered into capital lease obligations totaling $48,984 for the lease of four copy machines for a term of 60 months. Principal and interest payments total $947 per month. Payments during 1996 totaled $11,364 ($9,811 principal and $1,553 interest). Payments in 1997 will total $11,364 with final payments totaling $10,417 in 1998.

(11)

**ANNUAL ASSESSMENTS -
PRIMARY FUND**

The following table summarizes assessment revenues for the Primary Fund by type of coverage for fiscal years 1996 and 1995:

Type of Coverage	1996	1995
Basic Annual Assessment	$ 12,091,236	$ 11,823,074
Special Underwriting Assessment (SUA)	452,281	413,150
No Arbitration Endorsement	10,991	10,900
Total Assessments Earned	$ 12,554,508	$ 12,247,124

(12)

ANNUAL ASSESSMENTS - EXCESS FUND

The following table summarizes assessment revenues earned by the Excess Fund for fiscal years 1996 and 1995:

Type of Coverage	1996	1995
$700,000 Limit	$ 660,695	$ 776,085
$1,700,000 Limit	916,681	1,098,263
No Arbitration Endorsement	3,388	3,128
Total Assessments Collected	$ 1,580,764	$ 1,877,476
Less Assessments Ceded to Reinsurers	(1,314,667)	(1,517,308)
Net Assessments Earned	$ 266,097	$ 360,168

(13)

PROVISION FOR CLAIM SETTLEMENTS AND DEFENSE COSTS

Primary Fund:

As more fully described in Note (1), estimates to settle indemnity and defend liability claims are established when claims are reported to the PLF. Subsequent changes in estimates resulting from the case-by-case continuous review process and differences between estimates and ultimate payments are reflected in operations of the fiscal period when the changes occur.

Estimates are further adjusted based on studies performed by the PLF's independent consulting actuaries. For financial statement purposes, actual or estimated amounts recoverable from various claims related receivables (such as subrogation receivables) are deducted from estimated expenses in the PLF's operating statement. During 1996, the net provisions for settling and defending liability claims totaled $4,797,699 and $5,228,273, respectively, for a total provision of $10,025,972 at year end. This is a decrease of $2,000,787 over 1995’s provision of $12,026,759.

(13) continued

Excess Fund:

As described in Note (1) F, the primary liability for any claim filed under the excess plan has been passed to other insurance companies through reinsurance. The possibility of the PLF incurring direct costs under the excess plan is considered remote. Therefore, no provision or liability for such claims has been established. If future operations of the plan indicate that the PLF will incur direct costs, appropriate provision for such losses will be established based on plan experience.

(14)

ESTIMATED LIABILITIES FOR CLAIMS - PRIMARY FUND

As described in Note (1) E, estimated liabilities to settle (indemnity) and defend (loss adjustment expenses) claims are composed of various factors. The following table shows the composition of these factors by type and the total allocation between indemnity and loss adjustment expenses for the years ending December 31, 1996, and 1995:

Category	1996	1995
Claim Settlements	$ 12,100,000	$ 12,800,000
Defense Costs	8,300,000	7,750,000
Future ERC Claims	1,500,000	1,400,000
Suspense Files	1,100,000	1,200,000
Unallocated Loss Adjustment Expenses	1,300,000	1,100,000
Total Claim Liabilities	$ 24,300,000	$ 24,250,000
Allocation		
Indemnity Settlements	$ 13,730,000	$ 14,430,000
Loss Adjustment Expenses	10,570,000	9,820,000
Total Claim Liabilities	$ 24,300,000	$ 24,250,000