Secretary of State

State of Oregon

PROFESSIONAL LIABILITY FUND

For the Years Ended December 31, 1997, and 1996

Audits Division

-

Secretary of State

State of Oregon

PROFESSIONAL LIABILITY FUND

For the Years Ended December 31, 1997, and 1996

Audits Division

No. 98-15

May 22, 1998

OFFICE OF THE
SECRETARY OF STATE
Phil Keisling
Secretary of State

AUDITS DIVISION
John Lattimer
Director

(503) 986-2255
FAX (503) 378-6767

Auditing for a Better Oregon

The Honorable John Kitzhaber
Governor of Oregon
State Capitol
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
PO Box 1600
Lake Oswego, Oregon 97035

As requested by the Professional Liability Fund (PLF) management, we have audited the financial statements of the PLF as of and for the years ended December 31, 1997, and 1996. 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. 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 and compliance with applicable laws and corporation bylaws. Our report on the results of those reviews are included in the AUDIT RESULTS section of this report.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork Completion Date:
April 6, 1998

255 Capitol Street NE • Suite 500 • Salem, Oregon 97310
INTERNET: Audits.hotline@state.or.us • http://www.sos.state.or.us/audits/audithp.htm

TABLE OF CONTENTS

SUMMARY

BACKGROUND

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, 1997, revenues of $17.8 million and expenses of $14.2 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. Through December 31, 1997, total coverage, including excess coverage, was limited to a maximum of $2 million.

AUDIT PURPOSE

The audit was conducted for the purpose of reporting on the PLF's financial statements for the years ended December 31, 1997, and 1996, and on the PLF's internal control structure and compliance with applicable laws and corporation bylaws.

AUDIT RESULTS

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. Through December 31, 1997, total coverage, including basic and excess coverage, was 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

OFFICE OF THE
SECRETARY OF STATE
Phil Keisling
Secretary of State

AUDITS DIVISION
John Lattimer
Director

(503) 986-2255
FAX (503) 378-6767

Auditing for a Better Oregon

The Honorable John Kitzhaber
Governor of Oregon
State Capitol
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
PO Box 1600
Lake Oswego, Oregon 97035

INDEPENDENT AUDITOR'S REPORT ON INTERNAL CONTROL AND COMPLIANCE BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

We have audited the financial statements of the Professional Liability Fund (PLF), as of and for the year ended December 31, 1997, and have issued our report thereon dated April 6, 1998.

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.

Internal Control

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

255 Capitol Street NE • Suite 500 • Salem, Oregon 97310
INTERNET: Audits.hotline@state.or.us • http://www.sos.state.or.us/audits/audithp.htm

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 year ended December 31, 1997, 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.

Compliance

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*.

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

April 6, 1998

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 during the course of the audit were very commendable and sincerely appreciated.

AUDIT TEAM

Joel Leming, CPA, Audit Administrator
Ann Waterman, CPA
Jason Stanley, CPA
Ronald Forehand
Heidi Kolibaba

FINANCIAL SECTION

OFFICE OF THE
SECRETARY OF STATE
Phil Keisling
Secretary of State

AUDITS DIVISION
John Lattimer
Director

(503) 986-2255
FAX (503) 378-6767

Auditing for a Better Oregon

The Honorable John Kitzhaber
Governor of Oregon
State Capitol
Salem, Oregon 97310

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

Board of Directors
Professional Liability Fund
5200 SW Meadows Road
PO Box 1600
Lake Oswego, Oregon 97035

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, 1997, and 1996. These financial statements are the responsibility of the PLF management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits 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 audits 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 audits provide a reasonable basis for our opinion.

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

255 Capitol Street NE • Suite 500 • Salem, Oregon 97310
INTERNET: Audits.hotline@state.or.us • http://www.sos.state.or.us/audits/audithp.htm

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, 1997, and 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

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

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

April 6, 1998

EXHIBIT A

STATE OF OREGON
OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
BALANCE SHEETS
December 31, 1997, and 1996

	Primary Fund		Excess Fund		Totals	
Assets	1997	1996	1997	1996	1997	1996
Cash and Cash Equivalents (Note 2)	$ 814,915	$ 576,826	$ 101,306	$ 204,300	$ 916,221	$ 781,126
Investments, at Fair Value (Note 3)	35,046,255	31,087,199	5,428,976	4,250,015	40,475,231	35,337,214
Deferred Compensation Funds (Note 5)	714,516	570,630	–	–	714,516	570,630
Claim Receivables (Note 4)	100,256	112,355	–	–	100,256	112,355
Miscellaneous Receivables	4,865	3,925	1,093	1,650	5,958	5,575
Due from Excess Fund	1,496	–	–	–	1,496	-
Due from Primary Fund	–		–	7,291	–	7,291
Due from Reinsurance	–	–	–	27,721	–	27,721
Deposits and Prepayments	2,500	17,164	–	–	2,500	17,164
Fixed Assets, Net (Note 6)	122,394	154,835	–	–	122,394	154,835
Total Assets	$ 36,807,197	$ 32,522,934	$ 5,531,375	$ 4,490,977	$ 42,338,572	$ 37,013,911
Liabilities and Fund Equity						
Liabilities:						
Accounts Payable	$ 56,794	$ 54,990	$ 18,157	$ 17,239	$ 74,951	$ 72,229
Capital Leases Payable (Note 10)	–	20,527	–	–	–	20,527
Accrued Vacation Pay (Note 7)	152,415	119,894	–	–	152,415	119,894
Deferred Compensation Funds	714,516	570,630	–	–	714,516	570,630
Due to Primary Fund	–	–	2,020	–	2,020	-
Due to Excess Fund	–	7,291			–	7,291
Estimated Liabilities for Claims (Note 14):						-
Indemnity Settlements	13,088,000	13,730,000	–	–	13,088,000	13,730,000
Loss Adjustment Expenses	11,012,000	10,570,000	–	–	11,012,000	10,570,000
Deferred Revenues (Note 1)	5,017,258	4,298,515	500,447	448,331	5,517,705	4,746,846
Total Liabilities	$ 30,040,983	$ 29,371,847	$ 520,624	$ 465,570	$ 30,561,607	$ 29,837,417
Fund Equity:						
Retained Earnings (Deficit)	$ 6,766,214	$ 3,151,087	$ 5,010,751	$ 4,025,407	$ 11,776,965	$ 7,176,494
Total Liabilities and Fund Equity	$ 36,807,197	$ 32,522,934	$ 5,531,375	$ 4,490,977	$ 42,338,572	$ 37,013,911

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

EXHIBIT B

STATE OF OREGON
OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY
For the Years Ended December 31, 1997, and 1996

	Primary Fund		Excess Fund		Totals	
Revenues	1997	1996	1997	1996	1997	1996
Annual Assessments (Notes 11, 12)	$ 12,959,029	$ 12,554,508	$ 1,541,029	$ 1,580,764	$ 14,500,058	$ 14,135,272
Assessments Ceded to Reinsurers	–	–	(1,398,280)	(1,314,667)	(1,398,280)	(1,314,667)
Net Assessments	12,959,029	12,554,508	142,749	266,097	13,101,778	12,820,605
Investment Income (Note 15)	4,608,352	2,258,681	677,940	302,835	5,286,292	2,561,516
Other Income	219,193	216,752	325,087	311,256	544,280	528,008
Total Revenues	$ 17,786,574	$ 15,029,941	$ 1,145,776	$ 880,188	$ 18,932,350	$ 15,910,129
Expenses						
Liability Claims (Note 13):						
Provision for Indemnity	$ 6,220,039	$ 4,797,699	$ –	$ –	$ 6,220,039	$ 4,797,699
Provision for Claim Expenses	5,129,880	5,228,273	–	–	5,129,880	5,228,273
Total Claims Expenses	$ 11,349,919	$ 10,025,972	$ –	$ –	$ 11,349,919	$ 10,025,972
Administrative Expense:						
Salaries and Benefits	$ 1,945,757	$ 1,855,575	$ 113,307	$ 95,170	$ 2,059,064	$ 1,950,745
Services and Supplies	797,892	731,402	47,125	41,680	845,017	773,082
Depreciation	77,879	80,991	–	–	77,879	80,991
Total Administrative Expenses	$ 2,821,528	$ 2,667,968	$ 160,432	$ 136,850	$ 2,981,960	$ 2,804,818
Total Expenses	$ 14,171,447	$ 12,693,940	$ 160,432	$ 136,850	$ 14,331,879	$ 12,830,790
Net Income (Loss)	$ 3,615,127	$ 2,336,001	$ 985,344	$ 743,338	$ 4,600,471	$ 3,079,339
Fund Equity (Deficit) – Beginning of Year	3,151,087	815,086	4,025,407	3,282,069	7,176,494	4,097,155
Fund Equity (Deficit) – End of Year	$ 6,766,214	$ 3,151,087	$ 5,010,751	$ 4,025,407	$ 11,776,965	$ 7,176,494

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

STATE OF OREGON

OREGON STATE BAR

PROFESSIONAL LIABILITY FUND

STATEMENTS OF CASH FLOWS

For the Years Ended December 31, 1997, and 1996

Increase (Decrease) in Cash and Cash Equivalents	Primary Fund 1997	Primary Fund 1996	Excess Fund 1997	Excess Fund 1996	Totals 1997	Totals 1996
Cash Flows from Operating Activities:						
Cash Received for Assessments (Premiums)	$ 13,677,772	$ 11,506,476	$ 1,593,702	$ 1,423,914	$ 15,271,474	$ 12,930,390
Premiums Paid (Ceded) to Reinsurers	–	–	(1,397,362)	(1,300,037)	(1,397,362)	(1,300,037)
Dividends and Interest Received in Cash	3,273,066	2,364,412	487,045	322,444	3,760,111	2,686,856
Other Operating Revenues Received	218,253	217,424	352,808	283,535	571,061	500,959
Cash Payments for Liability Claims:						
Indemnity Settlements	(6,849,940)	(5,398,797)	–	–	(6,849,940)	(5,398,797)
Loss Adjustment Expenses	(4,687,880)	(4,478,273)	–	–	(4,687,880)	(4,478,273)
Cash Paid Employees for Salaries/Benefits	(1,913,236)	(1,839,039)	(113,307)	(95,170)	(2,026,543)	(1,934,209)
Cash Paid Vendors for Goods and Services	(790,211)	(658,248)	(37,814)	(50,433)	(828,025)	(708,681)
Net Cash Provided (Used) by Operations*	$ 2,927,824	$ 1,713,955	$ 885,072	$ 584,253	$ 3,812,896	$ 2,298,208
Cash Flows from Investing Activities:						
Purchase of Investments	$ (12,651,047)	$ (16,487,340)	$ (1,910,789)	$ (4,584,087)	$ (14,561,836)	$ (21,071,427)
Proceeds from Investment Sales	10,027,277	13,783,092	922,723	3,825,011	10,950,000	17,608,103
Net Cash Used in Investing Activities	$ (2,623,770)	$ (2,704,248)	$ (988,066)	$ (759,076)	$ (3,611,836)	$ (3,463,324)
Cash Flows from Capital Financing:						
Purchase of Equipment (Net)	$ (58,107)	$ (51,098)	$ –	$ –	$ (58,107)	$ (51,098)
Principal Payments on Capital Leases	(7,858)	(9,810)	–	–	(7,858)	(9,810)
Net Cash Used in Capital Financing	$ (65,965)	$ (60,908)	$ –	$ –	$ (65,965)	$ (60,908)
Net Increase (Decrease) in Cash and Cash Equivalents	$ 238,089	$ (1,051,201)	$ (102,994)	$ (174,823)	$ 135,095	$ (1,226,024)
Cash and Equivalents – January 1	$ 576,826	$ 1,628,027	$ 204,300	$ 379,123	$ 781,126	$ 2,007,150
Cash and Equivalents – December 31	$ 814,915	$ 576,826	$ 101,306	$ 204,300	$ 916,221	$ 781,126
* Reconciliation of Net Income to Net Cash Provided (Used) by Operating Activities:						
Net Income (Loss)	$ 3,615,127	$ 2,336,001	$ 985,344	$ 743,338	$ 4,600,471	$ 3,079,339
Add Depreciation Expense	77,879	80,991	–	–	77,879	80,991
Change in Fair Value of investments	(1,335,286)	105,731	(190,895)	19,609	(1,526,181)	125,340
Change in Net Receivables/Payables	51,361	189,264	38,507	(23,494)	89,868	165,770
Change in Estimated Claims Liabilities	(200,000)	50,000	–	–	(200,000)	50,000
Change in Deferred Revenue	718,743	(1,048,032)	52,116	(155,200)	770,859	(1,203,232)
Net Cash Provided (Used) by Operations	$ 2,927,824	$ 1,713,955	$ 885,072	$ 584,253	$ 3,812,896	$ 2,298,208

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

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND

NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 1997, AND 1996

(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 1997, approximately 6,458 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 1997, 386 firms with 1,378 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 1997 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 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 1997 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. Additional coverage limits will be offered commencing with the 1998 plan year.

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, software, and telephone systems are depreciated over a three-year period and all other equipment over a five-year period.

J. Cash and Cash Equivalents

Cash equivalents are defined as cash on hand and cash in the bank.

K. Investments

PLF investments are made in accordance with policy guidelines adopted by the Board of Directors. The guidelines emphasize safety, liquidity and diversification. To better achieve the benefits of professional management, in late 1993 the PLF placed its investments portfolio in shares of widely diversified SEC-registered mutual fund companies. Investments are stated and carried at fair value.

(2)

CASH AND CASH EQUIVALENTS

At December 31, 1997, and 1996, the carrying amounts of the PLF's deposits in the Primary Fund were $814,915 and $576,826, respectively. Bank balances were $1,151,892 and $853,806, respectively. In the Excess Fund at December 31, 1997, and 1996, the carrying amounts of deposits were $101,306 and $204,300, respectively. Bank balances were $101,479 and $204,300, respectively. The differences between carrying amounts and bank balances consisted primarily of deposits in transit and outstanding checks. PLF checking accounts are insured by federal depository insurance to $100,000. Remaining amounts are uninsured and uncollateralized.

(3)

INVESTMENTS AND INVESTMENT INCOME

The following table summarizes the fair value of PLF mutual fund investments held at year end by type of investment and as allocated to the Primary and Excess Funds.

	Fair Value	
	1997	1996
Type of Mutual Fund		
Fixed Income:		
Short-term	$ 4,330,592	$ 4,105,505
Intermediate	21,985,853	22,117,304
Equities:		
Domestic	12,428,708	9,114,405
International	1,730,078	–
Total Investments	$ 40,475,231	$ 35,337,214
Allocation		
Primary Fund	$ 35,046,255	$ 31,087,199
Excess Fund	5,428,976	4,250,015
Total Investments	$ 40,475,231	$ 35,337,214

As a result of implementing Governmental Accounting Standards Board (GASB) Statement No. 31, "Accounting and Financial Reporting for Certain Investments and for External Investment Pools," 1996 amounts for investment income have been restated to reflect the recognition of all changes in the fair value of investments as part of investment income. In prior years, the change in the fair value of investments represented by unrealized gains and losses was reflected as a separate component of fund equity rather than of income for the period. The effect of applying GASB No. 31 is that Primary Fund investment income for 1996 as previously reported has been increased by $14,772, and investment income in the Excess Fund was decreased by $3,177.

The following table summarizes the composition and allocation by fund of investment income for the years ending December 31, 1997, and 1996.

	1997	1996
Investment Income:		
Dividends and Interest	$ 3,760,111	$ 2,686,856
Net increase (decrease) in the fair value of investments	1,526,181	(125,340)
Total Investment Income	$ 5,286,292	$ 2,561,516
Allocation		
Primary Fund	$ 4,608,352	$ 2,258,681
Excess Fund	677,940	302,835
Total Investment Income	$ 5,286,292	$ 2,561,516

For informational purposes, the PLF realized a net gain of $129,617 from the sale of investments in 1997 and experienced a net loss of $136,935 in 1996. The calculation of realized gains is independent of the calculation of the net increase in fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year. The net increase in fair value takes into account all changed in fair value including purchases, redemptions and unrealized gains and losses. The unrealized gain on investments held at year end was $2,003,980 for 1997 and $607,416 in 1996.

(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.

(4) continued

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, 1997, and 1996, claim receivables were valued as follows:

	1997	1996
Total Claim Receivables	$ 104,515	$ 116,614
Less Allowance for Doubtful Accounts	(4,259)	(4,259)
Net Claim Receivables	$100,256	$ 112,355

(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 are reflected in the PLF balance sheet at year end. Plan assets are carried at fair value ($714,516 at December 31, 1997) 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, 1997 and 1996:

1997

Asset	Cost	Accumulated Depreciation	Book Value
Data Processing Equipment	$ 247,802	$ 160,134	$ 87,668
Furniture and Equipment	310,139	279,866	30,273
Leasehold Improvements	80,620	76,167	4,453
Totals	$ 638,561	$ 516,167	$ 122,394

1996

Asset	Cost	Accumulated Depreciation	Book Value
Data Processing Equipment	$ 209,665	$ 121,160	$ 88,505
Furniture and Equipment	353,690	296,159	57,531
Leasehold Improvements	80,007	71,208	8,799
Totals	$ 643,362	$ 488,527	$ 154,835

(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, 1997, and 1996, the value of vacation leave earned by all PLF employees totaled $152,415 and $119,894, 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 1997 and 1996.

(9)

DEFINED BENEFIT RETIREMENT PLAN

PLF employees may participate in the Oregon Public Employees 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 8.2 percent of covered employees' salaries. PLF employee and employer contributions totaled $236,544 for 1997 and $224,465 in 1996. No pension liability existed at December 31, 1997, determined in accordance with statement No. 27 of the Governmental Accounting Standards Board.

A copy of the Oregon Public Employees Retirement System annual financial report may be obtained from PERS, PO Box 23700, Tigard, Oregon 97281-3700.

(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 $132,972 during 1997. 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 1997 totaled $20,350.

(11)

ANNUAL ASSESSMENTS – PRIMARY FUND

The following table summarizes assessment revenues for the Primary Fund by type of coverage for fiscal years 1997 and 1996:

Type of Coverage	1997	1996
Basic Annual Assessment	$12,487,122	$12,091,236
Special Underwriting Assessment (SUA)	463,015	452,281
No Arbitration Endorsement	8,892	10,991
Total Assessments Earned	$12,959,029	$12,554,508

(12)

ANNUAL ASSESSMENTS – EXCESS FUND

The following table summarizes assessment revenues earned by the Excess Fund for fiscal years 1997 and 1996:

Type of Coverage	1997	1996
$700,000 Limit	$ 607,179	$ 660,695
$1,700,000 Limit	930,161	916,681
No Arbitration Endorsement	3,689	3,388
Total Assessments Collected	$ 1,541,029	$ 1,580,764
Less Assessments Ceded to Reinsurers	(1,398,280)	(1,314,667)
Net Assessments Earned	$ 142,749	$ 266,097

(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 1997, the net provisions for settling and defending liability claims totaled $6,220,039 and $5,129,880, respectively, for a total provision of $11,349,919 at year end. This is an increase of $1,323,947 over 1996’s provision of $10,025,972.

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, 1997, and 1996:

Category	1997	1996
Claim Settlements	$ 11,400,000	$ 12,100,000
Defense Costs	8,900,000	8,300,000
Future ERC Claims	1,600,000	1,500,000
Suspense Files	1,100,000	1,100,000
Unallocated Loss Adjustment Expenses	1,100,000	1,300,000
Total Claim Liabilities	$ 24,100,000	$ 24,300,000
Allocation		
Indemnity Settlements	$ 13,088,000	$ 13,730,000
Loss Adjustment Expenses	11,012,000	10,570,000
Total Claim Liabilities	$ 24,100,000	$ 24,300,000

-

FACTS ABOUT THE SECRETARY OF STATE AUDITS DIVISION

The mission of the Audits Division is to "Protect the Public Interest and Improve Oregon Government." The Oregon Constitution provides that the Secretary of State shall be, by virtue of his office, Auditor of Public Accounts. The Audits Division exists to carry out this duty. The division reports to the elected Secretary of State and is independent of the Executive, Legislative, and Judicial branches of Oregon government. The division audits all state officers, agencies, boards, and commissions and oversees audits and financial reporting for local governments.

DIRECTORY OF KEY OFFICIALS

Director	John N. Lattimer
Deputy Director	Sharron E. Walker, CPA, CFE
Deputy Director	Catherine E. Pollino, CGFM

This report is intended to promote
the best possible management of public resources.

Oregon Audits Division
Public Service Building
Salem, Oregon 97310
503-986-2255 Hotline: 800-336-8218
Internet: Audits.Hotline@state.or.us
http://www.sos.state.or.us/audits/audithp.htm

If you received a copy of an audit and you no longer need it, you may return it to the Audits Division. We maintain an inventory of past audit reports, and your cooperation will help us save on printing costs.

We invite comments on our reports through our Hotline or Internet address.

Auditing to Protect the Public Interest and Improve Oregon Government