Secretary of State

State of Oregon

PROFESSIONAL LIABILITY FUND

For the Years Ended December 31, 1998, and 1997

Audits Division

-

Secretary of State

State of Oregon

PROFESSIONAL LIABILITY FUND

For the Years Ended December 31, 1998, and 1997

Audits Division

No. 1999-17

May 10, 1999

OFFICE OF THE
SECRETARY OF STATE
Phil Keisling
Secretary of State

AUDITS DIVISION
John Lattimer
Director

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Auditing for a Better Oregon

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

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5200 SW Meadows Road
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This report presents the results of our annual audit of the Oregon State Bar’s Professional Liability Fund (PLF).

As required by auditing standards, we performed the audit to obtain reasonable assurance about whether the financial statements and accompanying notes have been presented fairly by management. Our Independent Auditor's Report and the financial statements for the years ended December 31, 1998, and 1997, are included in the Financial Section of this report. We concluded the financial statements are fairly presented in accordance with generally accepted accounting principles.

Auditing standards also require us to review the PLF’s internal control and compliance with applicable laws and corporation bylaws. Our report on the results of those reviews is included in the Audit Results section of this report. We did not note any material weaknesses in internal control or instances of noncompliance.

We appreciate the cooperation and assistance of PLF management and staff during the course of this audit.

OREGON AUDITS DIVISION

John N. Lattimer
Director

Fieldwork Completion Date:
April 9, 1999

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T A B L E   O F   C O N T E N T S

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, 1998, revenues of $17 million and expenses of $13.7 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. Until 1998, the PLF offered total coverage up to a maximum limit of $2 million. In 1998, the PLF expanded its excess coverage options to allow total coverage of up to $5 million.

AUDIT PURPOSE

The audit was conducted for the purpose of reporting on the PLF's financial statements for the years ended December 31, 1998, and 1997, 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. 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, 1998, total coverage, including basic and excess coverage, was limited to a maximum of $5 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

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INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING 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, 1998, and have issued our report thereon dated April 9, 1999, which was unqualified. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the PLF's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, and corporation bylaws, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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Internal Control Over Financial Reporting

In planning and performing our audit, we considered the PLF's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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 misstatements 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 noted no matters involving internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Board of Directors of the Professional Liability Fund, the Board of Governors of the Oregon State Bar, the management of the Professional Liability Fund and the Oregon State Bar, the governor of the state of Oregon, and the Oregon Legislative Assembly and is not intended to be and should not be used by anyone other than these specified parties.

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

April 9, 1999

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 E. Leming, CPA, Audit Administrator
Jason M. Stanley, CPA
Ronald H. Forehand

FINANCIAL SECTION

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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, 1998, and 1997. 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

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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, 1998, and 1997, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The Year 2000 supplementary information on page 35 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and do not express an opinion on it. In addition, we do not provide assurance that the PLF is or will become Year 2000 compliant, that PLF's Year 2000 remediation efforts will be successful in whole or in part, or that parties with which the PLF does business are or will become Year 2000 compliant.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 9, 1999, on our consideration of the PLF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and corporation bylaws. That report is separately presented in the Audit Results section of this report.

OREGON AUDITS DIVISION

Sharron E. Walker, CPA, CFE
Deputy Director

April 9, 1999

STATE OF OREGON

OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
BALANCE SHEETS
December 31, 1998, and 1997

	Primary Fund		Excess Fund		Totals	
Assets	1998	1997	1998	1997	1998	1997
Cash and Cash Equivalents (Note 2)	$ 730,144	$ 814,915	$ 462,620	$ 101,306	$ 1,192,764	$ 916,221
Investments, at Fair Value (Note 3)	36,535,664	35,046,255	5,794,487	5,428,976	42,330,151	40,475,231
Deferred Compensation Funds (Note 5)	722,523	714,516	–	–	722,523	714,516
Claim Receivables (Note 4)	188,791	100,256	–	–	188,791	100,256
Miscellaneous Receivables	1,025	4,865	781	1,093	1,806	5,958
Due from Excess Fund	–	1,496	–	–	–	1,496
Due from Primary Fund	–	–	63,322	–	63,322	–
Deposits and Prepayments	18,091	2,500	–	–	18,091	2,500
Fixed Assets, Net (Note 6)	202,045	122,394	–	–	202,045	122,394
Total Assets	$ 38,398,283	$ 36,807,197	$ 6,321,210	$ 5,531,375	$ 44,719,493	$ 42,338,572
Liabilities and Fund Equity						
Liabilities:						
Accounts Payable	$ 69,658	$ 56,794	$ 11,983	$ 18,157	$ 81,641	$ 74,951
Capital Leases Payable (Note 10)	59,200	–	–	–	59,200	–
Accrued Vacation Pay (Note 7)	164,949	152,415	–	–	164,949	152,415
Deferred Compensation Funds	722,523	714,516	–	–	722,523	714,516
Due to Primary Fund	–	–	–	2,020	–	2,020
Due to Excess Fund	63,322	–	–	–	63,322	–
Estimated Liabilities for Claims (Note 14):						
Indemnity Settlements	12,402,000	13,088,000	–	–	12,402,000	13,088,000
Loss Adjustment Expenses	10,098,000	11,012,000	–	–	10,098,000	11,012,000
Deferred Revenues (Note 1)	4,678,746	5,017,258	447,296	500,447	5,126,042	5,517,705
Total Liabilities	$ 28,258,398	$ 30,040,983	$ 459,279	$ 520,624	$ 28,717,677	$ 30,561,607
Fund Equity:						
Retained Earnings	$ 10,139,885	$ 6,766,214	$ 5,861,931	$ 5,010,751	$ 16,001,816	$ 11,776,965
Total Liabilities and Fund Equity	$ 38,398,283	$ 36,807,197	$ 6,321,210	$ 5,531,375	$ 44,719,493	$ 42,338,572

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

STATE OF OREGON

OREGON STATE BAR

PROFESSIONAL LIABILITY FUND

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND EQUITY

For the Years Ended December 31, 1998, and 1997

	Primary Fund		Excess Fund		Totals	
Revenues	1998	1997	1998	1997	1998	1997
Annual Assessments (Notes 11, 12)	$ 12,615,983	$ 12,959,029	$ 1,582,674	$ 1,541,029	$ 14,198,657	$ 14,500,058
Assessments Ceded to Reinsurers	–	–	(1,578,887)	(1,398,280)	(1,578,887)	(1,398,280)
Net Assessments	12,615,983	12,959,029	3,787	142,749	12,619,770	13,101,778
Investment Income (Note 3)	4,236,529	4,608,352	701,990	677,940	4,938,519	5,286,292
Ceding Commission (Note 13)	–	–	225,144	209,773	225,144	209,773
Other Income	204,887	219,193	98,534	115,314	303,421	334,507
Total Revenues	$ 17,057,399	$ 17,786,574	$ 1,029,455	$ 1,145,776	$ 18,086,854	$ 18,932,350
Expenses						
Liability Claims (Note 14):						
Provision for Indemnity	$ 7,386,230	$ 6,220,039	$ –	$ –	$ 7,386,230	$ 6,220,039
Provision for Claim Expenses	3,284,603	5,129,880	–	–	3,284,603	5,129,880
Total Claims Expenses	$ 10,670,833	$ 11,349,919	$ –	$ –	$ 10,670,833	$ 11,349,919
Administrative Expense:						
Salaries and Benefits	$ 2,027,554	$ 1,945,757	$ 124,382	$ 113,307	$ 2,151,936	$ 2,059,064
Services and Supplies	879,926	797,892	53,893	47,125	933,819	845,017
Depreciation	105,415	77,879	–	–	105,415	77,879
Total Administrative Expenses	$ 3,012,895	$ 2,821,528	$ 178,275	$ 160,432	$ 3,191,170	$ 2,981,960
Total Expenses	$ 13,683,728	$ 14,171,447	$ 178,275	$ 160,432	$ 13,862,003	$ 14,331,879
Net Income	$ 3,373,671	$ 3,615,127	$ 851,180	$ 985,344	$ 4,224,851	$ 4,600,471
Fund Equity – Beginning of Year	6,766,214	3,151,087	5,010,751	4,025,407	11,776,965	7,176,494
Fund Equity – End of Year	$ 10,139,885	$ 6,766,214	$ 5,861,931	$ 5,010,751	$ 16,001,816	$ 11,776,965

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, 1998, and 1997

	Primary Fund		Excess Fund		Totals	
Increase (Decrease) in Cash and Cash Equivalents	1998	1997	1998	1997	1998	1997
Cash Flows from Operating Activities:						
Cash Received for Assessments (Premiums)	$ 12,277,471	$ 13,677,772	$ 1,529,835	$ 1,593,702	$ 13,807,306	$ 15,271,474
Premiums Paid (Ceded) to Reinsurers	–	–	(1,585,061)	(1,397,362)	(1,585,061)	(1,397,362)
Dividends and Interest Received in Cash	3,750,034	3,273,066	624,145	487,045	4,374,179	3,760,111
Other Operating Revenues Received	208,728	218,253	323,678	352,808	532,406	571,061
Cash Payments for Liability Claims:						
Indemnity Settlements	(8,160,765)	(6,849,940)	–	–	(8,160,765)	(6,849,940)
Loss Adjustment Expenses	(4,198,603)	(4,687,880)	–	–	(4,198,603)	(4,687,880)
Cash Paid Employees for Salaries/Benefits	(2,015,020)	(1,913,236)	(124,382)	(113,307)	(2,139,402)	(2,026,543)
Cash Paid Vendors for Goods and Services	(817,835)	(790,211)	(119,235)	(37,814)	(937,070)	(828,025)
Net Cash Provided (Used) by Operations*	$ 1,044,010	$ 2,927,824	$ 648,980	$ 885,072	$ 1,692,990	$ 3,812,896
Cash Flows from Investing Activities:						
Purchase of Investments	$ (10,927,915)	$ (12,651,047)	$ (1,362,666)	$ (1,910,789)	$ (12,290,581)	$ (14,561,836)
Proceeds from Investment Sales	9,925,000	10,027,277	1,075,000	922,723	11,000,000	10,950,000
Net Cash Used in Investing Activities	$ (1,002,915)	$ (2,623,770)	$ (287,666)	$ (988,066)	$ (1,290,581)	$ (3,611,836)
Cash Flows from Capital Financing:						
Purchase of Equipment (Net)	$ (102,067)	$ (58,107)	$ –	$ –	$ (102,067)	$ (58,107)
Principal Payments on Capital Leases	(23,799)	(7,858)	–	–	(23,799)	(7,858)
Net Cash Used in Capital Financing	$ (125,866)	$ (65,965)	$ –	$ –	$ (125,866)	$ (65,965)
Net Increase (Decrease) in Cash and Cash Equivalents	$ (84,771)	$ 238,089	$ 361,314	$ (102,994)	$ 276,543	$ 135,095
Cash and Equivalents – January 1	$ 814,915	$ 576,826	$ 101,306	$ 204,300	$ 916,221	$ 781,126
Cash and Equivalents – December 31	$ 730,144	$ 814,915	$ 462,620	$ 101,306	$ 1,192,764	$ 916,221
* Reconciliation of Net Income to Net Cash Provided (Used) by Operating Activities:						
Net Income (Loss)	$ 3,373,671	$ 3,615,127	$ 851,180	$ 985,344	$ 4,224,851	$ 4,600,471
Add Depreciation Expense	105,415	77,879	–	–	105,415	77,879
Change in Fair Value of investments	(486,495)	(1,335,286)	(77,845)	(190,895)	(564,340)	(1,526,181)
Change in Net Receivables/Payables	(10,069)	51,361	(71,204)	38,507	(81,273)	89,868
Change in Estimated Claims Liabilities	(1,600,000)	(200,000)	–	–	(1,600,000)	(200,000)
Change in Deferred Revenue	(338,512)	718,743	(53,151)	52,116	(391,663)	770,859
Net Cash Provided (Used) by Operations	$ 1,044,010	$ 2,927,824	$ 648,980	$ 885,072	$ 1,692,990	$ 3,812,896

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, 1998, AND 1997

(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 1998, approximately 6,510 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 1998, 430 firms with 1,482 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 1998 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 that 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 1998 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, $1,700,000, $2,700,000, $3,700,000, or $4,700,000 as elected by the covered firm. Therefore, firms with excess coverage could increase their total limits to $1 million or up to $5 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, 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

For financial statement purposes, the PLF considers cash and cash equivalents to include cash on hand, cash in checking accounts, and short-term money market funds which are readily convertible to cash.

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, 1998, and 1997, the carrying amounts of the PLF's deposits in the Primary Fund were $730,144 and $814,915, respectively. Bank balances were $1,024,938 and $1,151,892, respectively. In the Excess Fund at December 31, 1998, and 1997, the carrying amounts of deposits were $462,620 and $101,306, respectively. Bank balances were $463,434 and $101,479, 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	
	1998	1997
Type of Mutual Fund		
Fixed Income:		
Short-term	$ 3,450,318	$ 4,330,592
Intermediate	22,650,689	21,985,853
Equities:		
Domestic	14,230,216	12,428,708
International	1,998,928	1,730,078
Total Investments	$ 42,330,151	$ 40,475,231
Allocation		
Primary Fund	$ 36,535,664	$ 35,046,255
Excess Fund	5,794,487	5,428,976
Total Investments	$ 42,330,151	$ 40,475,231

(3) Continued

The following table summarizes the composition and allocation by fund of investment income for the years ending December 31, 1998, and 1997.

	1998	1997
Investment Income:		
Dividends and Interest	$ 4,374,179	$ 3,760,111
Net increase (decrease) in the fair value of investments	564,340	1,526,181
Total Investment Income	$ 4,938,519	$ 5,286,292
Allocation		
Primary Fund	$ 4,236,529	$ 4,608,352
Excess Fund	701,990	677,940
Total Investment Income	$ 4,938,519	$ 5,286,292

(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, 1998, and 1997, claim receivables were valued as follows:

	1998	1997
Total Claim Receivables	$ 193,050	$ 104,515
Less Allowance for Doubtful Accounts	(4,259)	(4,259)
Net Claim Receivables	$188,791	$100,256

(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 any combination of three different plans. External investment managers administer two of these plans and the PLF administers the other plan on the participating employee's behalf.

Under new Internal Revenue Service regulations effective by January 1, 1999, all plan contributions, earnings, and rights thereunder, must be placed in trust for the benefit of participating employees and are no longer considered to be the property of the employer (PLF). Thus, once the new regulations take effect, the plan assets are no longer subject to the claims of creditors.

Under Governmental Accounting Standards Board (GASB) Statement No. 32, deferred compensation plans administered by the employer are to be reported in an expendable trust fund in the financial statements at the fair value of the assets and related liability. Plans administered by external entities would no longer appear on the employer's financial statements. This change in reporting is required when the plans have changed to the meet the new IRS regulations. As of December 31, 1998, the two plans administered by external entities had changed to meet the new requirements. The plan managed by the PLF had not yet changed. A trust fund was set up on January 1, 1999 to meet the deadlines imposed by the Internal Revenue Service. Since that plan had not changed by December 31, 1998, the assets and related liability are included in the PLF's financial statements. The following table shows the fair value of deferred compensation plan assets held in trust and held by the PLF for fiscal years 1998 and 1997:

Deferred Compensation Plans	12/31/98	12/31/97
Plan Assets Held by the PLF (reported in the PLF's financial statements)	$722,523	$714,516
Plan Assets Held in Trust (not reported in the PLF's financial statements)	211,710	-
Total Deferred Compensation Plan Assets	$934,233	$714,516

(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, 1998 and 1997:

1998

Asset	Cost	Accumulated Depreciation	Book Value
Data Processing Equipment	$ 303,165	$ 215,777	$ 87,388
Furniture and Equipment	402,973	313,819	89,154
Leasehold Improvements	106,311	80,808	25,503
Totals	$ 812,449	$ 610,404	$ 202,045

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

(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, 1998, and 1997, the value of vacation leave earned by all PLF employees totaled $164,949 and $152,415, 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 1998 and 1997.

(9)

DEFINED BENEFIT RETIREMENT PLAN

PLF employees participate in the Oregon Public Employees Retirement System (PERS), a cost-sharing multiple-employer defined benefit pension plan. All employees of the PLF are eligible to participate in the system after completing six months of service. PERS, which is administered by the Public Employees Retirement Board under the guidelines of Oregon Revised Statutes, chapter 238, 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. Statutes also require the employer to contribute actuarially computed amounts determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. Currently, the rate is 8.2 percent of each covered employee's salary. The PLF's contributions for the years ending December 31, 1998, 1997, and 1996 totaled $142,848, $131,679, and $137,055, respectively, which were equal to the required contributions for each year. No pension liability existed at December 31, 1998, 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

In addition to renting office space at the Oregon State Bar Center in Lake Oswego, the PLF also has been leasing office space for its Oregon Attorney Assistance Program in downtown Portland since 1989. Payments on the Portland lease, which has been extended through June 2000, totaled $21,842 in 1998. Rent payments for the Lake Oswego office space, which are determined by the OSB Board of Governors, totaled $135,393 in 1998.

In February 1998, the PLF began leasing office equipment for a term of 36 months. Lease payments during the year totaled $27,775. The lease obligation at December 31,1998 was $59,200, which represents the net present value of the remaining minimum lease payments.

(11)

ANNUAL ASSESSMENTS – PRIMARY FUND

The following table summarizes assessment revenues for the Primary Fund by type of coverage for fiscal years 1998 and 1997:

Type of Coverage	1998	1997
Basic Annual Assessment	$12,116,124	$12,487,122
Special Underwriting Assessment (SUA)	491,759	463,015
No Arbitration Endorsement	8,100	8,892
Total Assessments Earned	$12,615,983	$12,959,029

(12)

ANNUAL ASSESSMENTS – EXCESS FUND

The following table summarizes assessment revenues earned by the Excess Fund for fiscal years 1998 and 1997:

Type of Coverage	1998	1997
$ 700,000 Limit	$ 462,257	$ 607,179
$1,700,000 Limit	421,528	930,161
$2,700,000 Limit	218,654	-
$3,700,000 Limit	50,921	-
$4,700,000 Limit	425,527	-
No Arbitration Endorsement	3,787	3,689
Total Assessments Collected	$ 1,582,674	$ 1,541,029
Less Assessments Ceded to Reinsurers	(1,578,887)	(1,398,280)
Net Assessments Earned	$ 3,787	$ 142,749

(12) Continued

In 1998, the PLF made changes to the excess coverage program. The PLF added three levels of coverage, which allow firms to purchase up to a combined total of $5 million of insurance coverage. As discussed in note 1 (f), like the previous plans, the three new levels of coverage are covered entirely by reinsurance. Thus the new levels of coverage do not pose any additional potential liabilities for the PLF.

The PLF also eliminated the capital contribution portion of the 1998 excess coverage assessments. In prior years, the PLF retained a small portion of assessments to accumulate capital reserves. By the end of 1997, the board had decided that the capital surplus was sufficient and decided to cease charging for the additional contributions. Thus, all assessments are now ceded to reinsurers, with the exception of the small amount collected for the no arbitration endorsement.

(13)

CEDING COMMISSION – EXCESS FUND

The PLF receives a ceding commission from the reinsurance companies for administrative expenses. These commissions range from just over 13% to 15% of the total amounts ceded to reinsurers (see note 12). In previous years, the ceding commission was included with Other Income on the Statement of Revenues, Expenses and Changes in Fund Equity. The 1998 statement reflects the ceding commission as a separate line item and reflects the total amount earned for fiscal years 1998 and 1997 as $225,144 and $209,773, respectively. The 1997 Other Income amount has been reduced by $209,773 to reflect the ceding commission now reported separately.

(14)

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.

(14) Continued

During 1998, the net provisions for settling and defending liability claims totaled $7,386,230 and $3,284,603, respectively, for a total provision of $10,670,833 at year end. This is a decrease of $679,086 over the total provision of $11,349,919 during 1997.

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.

(15)

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, 1998, and 1997:

Category	**1998**	**1997**
Claim Settlements	$ 10,600,000	$ 11,400,000
Defense Costs	7,900,000	8,900,000
Future ERC Claims	1,800,000	1,600,000
Suspense Files	1,100,000	1,100,000
Unallocated Loss Adjustment Expenses	1,100,000	1,100,000
Total Claim Liabilities	$ 22,500,000	$ 24,100,000
Allocation		
Indemnity Settlements	$ 12,402,000	$ 13,088,000
Loss Adjustment Expenses	10,098,000	11,012,000
Total Claim Liabilities	$ 22,500,000	$ 24,100,000

SUPPLEMENTARY INFORMATION

STATE OF OREGON
OREGON STATE BAR
PROFESSIONAL LIABILITY FUND
SUPPLEMENTARY INFORMATION
December 31, 1998

(UNAUDITED)

The following disclosure is required by the Governmental Accounting Standards Board and is subject to the provisions of the Year 2000 Information and Readiness Disclosure Act, Public Law 105-271.

The Year 2000 (Y2K) issue is the result of shortcomings in many electronic data processing systems and other electronic equipment that may adversely affect the PLF's operations as early as fiscal year 1999.

The Governmental Accounting Standards Board has identified the following stages as necessary to implement a Year 2000-compliant system:

Stages	Description
Awareness	Establish a budget and project plan for dealing with the Y2K issue.
Assessment	Identify the systems and components for which Y2K compliance work is needed.
Remediation	Make changes to systems and equipment.
Validation & Testing	Validate and test the changes that were made during the Remediation stage.

As of December 31, 1998, the PLF had completed the Awareness and Assessment Stages described in the table above. The PLF also completed the Remediation and Validation and Testing Stages for systems critical to its operations, such as the accounting, assessment, and claims systems. The PLF expects to perform some additional testing during 1999, which may identify further remediation necessary to avert century date change disruptions.

Because of the unprecedented nature of the Year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. The PLF cannot assure that it is or will be Year 2000 ready, that its remediation efforts will be successful in whole or in part, or that parties with whom the PLF does business will be Year 2000 ready.

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, which is a public record, is intended to promote the best possible management of public resources.

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