Secretary of State

State of Oregon

SAIF CORPORATION

Salem, Oregon

For the Years Ended December 31, 2000 and 1999

Audits Division

Contract Auditor: Deloitte & Touche LLP

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SAIF CORPORATION

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For the Years Ended December 31, 2000 and 1999

Audits Division

No. 2001-43

October 10, 2001

OFFICE OF THE
SECRETARY OF STATE

Bill Bradbury
Secretary of State

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Auditing for a Better Oregon

The Honorable John Kitzhaber, M.D.
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This report on the audit of SAIF Corporation contains audited financial statements and a report on SAIF's compliance with laws, regulations, contracts and grants and on internal control over financial reporting. This audit was performed by Deloitte & Touche LLP for the Audits Division, and covers the years ended December 31, 2000 and 1999.

The *Overview of SAIF Corporation Financial Reporting* presented on page 1 was prepared by SAIF Corporation and is not part of the required financial statements. SAIF Corporation presents this information to explain the differences between financial statements presented in accordance with generally accepted accounting principles, as set forth in this report, and financial statements prepared in conformity with statutory accounting practices. In financial reports prepared for regulatory and management purposes, SAIF follows the statutory accounting practices which are also used in financial reporting by other insurance companies.

OREGON AUDITS DIVISION

Bill Bradbury
Secretary of State

Fieldwork Completion Date:
June 29, 2001
(July 30, 2001 as to Note 11)

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Overview of SAIF Corporation Financial Reporting
(Prepared by SAIF Corporation)

SAIF Corporation is a public corporation created by an act of the Oregon Legislature. It traces its origins to 1914 when its predecessor organization commenced business.

SAIF is authorized to write workers' compensation and surety coverage in Oregon and certain other jurisdictions as required by the Department of Consumer and Business Services to service accounts in the assigned risk pool.

SAIF Corporation prepares financial statements in conformity with statutory accounting practices, which are prescribed for use in reporting accounting transactions for insurance companies. These practices arise from state laws and from rules adopted by the State Insurance Commissioner and, for Oregon, are the practices promulgated by the National Association of Insurance Commissioners (NAIC). Statutory accounting practices are conservative in nature and are designed to protect policyholders and claimants to ensure that, in the event of liquidation, sufficient amounts will have been set aside to provide for the outstanding claims of injured workers and their dependants, whereas generally accepted accounting principles (GAAP) are based on the going-concern concept and place more emphasis on assigning income and disbursements to their proper period.

At the request of the Oregon Secretary of State's Audits Division, SAIF has prepared the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. As a component unit of the State of Oregon, SAIF is subject to the pronouncements of the Governmental Accounting Standards Board. Under accounting principles generally accepted in the United States of America as applied to governmental entities, SAIF accounts for its activities as an enterprise fund. Accordingly, SAIF follows the accrual basis of accounting. Revenues are recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid.

There are significant differences between the statutory statements which SAIF prepares for regulatory and management purposes and the accompanying financial statements. They include:

- Statutory accounting requires the majority of our invested assets to be recorded at amortized cost, whereas investments are stated at fair value in the accompanying statements with the corresponding change in the fair value for the year recorded as investment income.

- Statutory accounting does not allow the accrual of policyholder dividends until declared by the Board of Directors. Generally accepted accounting principles require the accrual of estimated policyholder dividends.

- Cash collateral and collateral due to borrowers for securities lending activity are reflected on the accompanying balance sheet. Statutory accounting does not require the reporting of such items as assets and liabilities.

- Certain reimbursements and assessments are reflected as revenue and expense in the accompanying financial statements and are netted on SAIF's statutory statements.

- Statutory accounting requires that certain assets not readily available for the payment of claims be "non-admitted" and removed from the balance sheet. Those assets, such as property and equipment are included on the GAAP financial statements.

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INDEPENDENT AUDITORS' REPORT

The Board of Directors of
SAIF Corporation

The Secretary of State Audits Division,
State of Oregon

We have audited the accompanying balance sheets of SAIF Corporation ("SAIF") as of December 31 2000 and 1999, and the related statements of operations, changes in policyholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of SAIF's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of SAIF as of December 31, 2000 and 1999, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued a report dated June 29, 2001, on our consideration of SAIF's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Deloitte + Touche LLP

June 29, 2001
(July 30, 2001 as to Note 11)

SAIF CORPORATION

Balance Sheets
December 31, 2000 and 1999
(In thousands)

	2000	1999
Assets		
Investments		
Bonds	$ 2,046,778	$ 1,780,769
Equity securities	526,433	596,941
Other invested assets	17,301	23,812
Mortgage loans on real estate	2,232	3,034
Total investments	2,592,744	2,404,556
Cash and cash equivalents	59,398	62,699
Securities lending cash collateral	298,619	301,289
Accrued investment income	22,019	29,055
Premiums receivable, net of allowance for uncollectible accounts of $1,336 and $846 in 2000 and 1999 respectively	77,377	75,477
Reinsurance recoverable on paid losses	72	63
Deposit with reinsurer	-	45,989
Due from Workers' Compensation Division	12,961	12,923
Property and equipment, net	29,134	29,901
Other assets	5,888	5,587
Total assets	$ 3,098,212	$ 2,967,539
Liabilities and Policyholders' Equity		
Reserve for loss and loss adjustment expenses	$ 2,092,699	$ 1,927,165
Unearned premiums	42,240	37,412
Reserve for retrospective rating plans	16,771	10,003
Reinsurance payable	2,833	297
Policyholders' premium deposits	5,243	3,450
Dividends payable to policyholders	667	75,437
Securities lending collateral due borrowers	298,619	301,289
Premium taxes payable	14,882	15,793
Due to brokers for security purchases	145,319	
Accounts payable and other liabilities	12,274	12,632
Total liabilities	2,631,547	2,383,478
Commitments and contingencies		
Policyholders' equity	466,665	584,061
Total liabilities and policyholders' equity	$ 3,098,212	$ 2,967,539

See accompanying notes to financial statements

SAIF CORPORATION

Statements of Operations

For the Years ended December 31, 2000 and 1999

(In thousands)

	2000	1999
Net premiums earned	$ 206,735	$ 201,554
Investment income	183,496	289,642
Other income	23,144	94,381
Total revenues	413,375	585,577
Loss and loss adjustment expenses incurred	360,136	341,035
Policyholders' dividends	84,652	156,525
Underwriting expenses	50,050	50,192
Investment expense	19,509	9,690
Other expenses	16,424	14,873
Total expenses	530,771	572,315
Net income (loss)	$ (117,396)	$ 13,262

See accompanying notes to financial statements

SAIF CORPORATION

Statements of Changes in Policyholders' Equity

For the Years ended December 31, 2000 and 1999

(In thousands)

	2000	1999
Policyholders' equity, beginning of year	$ 584,061	$ 570,799
Net income (loss)	(117,396)	13,262
Policyholders' equity, end of year	$ 466,665	$ 584,061

See accompanying notes to financial statements

SAIF CORPORATION

Statements of Cash Flows

For the years ended December 31, 2000 and 1999

(In thousands)

	2000	1999
Cash flows from operating activities:		
Net income (loss)	$ (117,396)	$ 13,262
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Net change in fair value of investments	(35,200)	(131,013)
Depreciation and amortization expense	3,563	4,128
Change in:		
Accrued investment income	7,036	4,005
Premiums receivable, net	(1,900)	5,514
Reinsurance recoverable on paid losses	(9)	14
Due from Workers' Compensation Division	(38)	4
Other assets	(301)	902
Reserve for loss and loss adjustment expenses	165,534	164,936
Unearned premiums	4,828	1,044
Reserve for retrospective rating plans	6,768	(7,407)
Reinsurance payable	2,536	(2,677)
Policyholders' premium deposits	1,793	(586)
Dividends payable to policyholders	(74,770)	(54,988)
Premium taxes payable	(911)	347
Accounts payable and other liabilities	(358)	327
Net cash used in operating activities	(38,825)	(2,188)
Cash flows from investing activities:		
Purchases of investments-		
Bonds	(3,292,407)	(711,976)
Equity securities	(183,914)	(328,969)
Mortgage loans on real estate	-	(171)
Purchases of property and equipment	(4,626)	(2,473)
Proceeds from sales and maturities of investments-		
Bonds	3,087,793	787,300
Equity securities	380,008	268,361
Other invested assets	166	7,559
Mortgage loans on real estate	685	967
Proceeds from sale of property and equipment	1,830	761
Net cash provided by (used in) investing activities	(10,465)	21,359
Cash flows from financing activities:		
Deposit with reinsurer	45,989	25,752
Net cash provided by financing activities	45,989	25,752
Increase/(decrease) in cash and cash equivalents	(3,301)	44,923
Cash and cash equivalents, beginning of year	62,699	17,776
Cash and cash equivalents, end of year	$ 59,398	$ 62,699

See accompanying notes to financial statements

SAIF CORPORATION

Notes to the Financial Statements
Years ended December 31, 2000 and 1999

(1) Description of Business & Regulatory Environment

SAIF Corporation (SAIF) is a public corporation created by an act of the Oregon Legislature. It traces its origins to 1914 when its predecessor organization commenced business.

SAIF is an insurance company authorized to write workers' compensation coverage in Oregon and certain other jurisdictions as required by the Department of Consumer and Business Services and to service accounts in the assigned risk pool. SAIF also provides incidental coverage governed by the Longshoremens' and Harbor Workers' Compensation Act, Jones Act, and Federal Employers Liability Law. SAIF's Board of Directors is appointed by the Governor of the State of Oregon (the State) and consists of prominent Oregon business and community leaders, not otherwise in the employ of SAIF.

SAIF writes business on a direct basis and through agents. During 2000 and 1999, 39% and 44% of gross premiums were written on a direct basis, respectively.

The Department of Consumer and Business Services enforces workers' compensation laws under Oregon Revised Statutes (ORS).

(2) Summary of Significant Accounting Policies

Basis of Accounting

At the request of the Oregon Secretary of State's Audits Division, SAIF has prepared the accompanying financial statements in accordance with accounting principles generally accepted in the United States of America. As a component unit of the State of Oregon, SAIF is subject to the pronouncements of the Governmental Accounting Standards Board. Under accounting principles generally accepted in the United States of America as applied to governmental entities, SAIF accounts for its activities as an enterprise fund. Accordingly, SAIF follows the accrual basis of accounting. Revenues are recognized when earned, regardless of when received, and expenses are recognized when incurred, regardless of when paid.

In accordance with Governmental Accounting Standards Board Statement (GASB) No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, SAIF only follows Statements of the Financial Accounting Standards Board issued prior to November 30, 1989.

Investments

SAIF reports certain investments at fair value in the balance sheet and recognizes the corresponding change in the fair value of investments in the year in which the change occurs as investment income. The fair value of debt and equity securities is determined using recognized pricing services or prices quoted by one or more independent brokers. Equity securities traded on a national exchange are valued at the last reported sales price. Debt securities are generally valued at the midpoint between the bid and asked prices. A small percentage of debt securities cannot be priced in this manner, and for these, a similar "benchmark" security is used. The benchmark has a coupon rate and maturity date comparable to the debt security being valued, and its market risk is similar considering current market conditions. Investments in leveraged buyouts representing private securities are valued at cost, or at fair market value as estimated by a recognized pricing service if a significant event has occurred which affects the value of the investment. Investments in leveraged buyouts representing publicly traded securities are stated at the quoted market price adjusted for a reasonable illiquidity discount. Mortgage loans on real estate and state agency loans are stated at the amortized unpaid principal balance.

Realized investment gains and losses are determined using the specific identification method and are included as a component of net investment income upon the maturity or disposition of the investment. During 2000 and 1999, SAIF realized a net gain of $196.5 million and $89.4 million from sales of investments, respectively. The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Realized gains and losses on investments held in more than one fiscal year and sold in the current year may have been recognized as a change in the fair value of investments reported in prior years. The net change in the fair value of investments during 2000 and 1999 was a $149.6 million loss and a $63.7 million gain, respectively. This takes into account all changes in fair value (including purchases and sales) that occurred during the year. The net unrealized gain on investments at December 31, 2000 and 1999 was $77.2 million and $261.6 million, respectively.

Cash and Cash Equivalents

SAIF places its temporary cash investments with the Oregon Short Term Fund. The Oregon Short Term Fund is a cash and investment pool that operates as a demand deposit account. By statute, the Oregon Short Term Fund may hold securities with maturities no greater than three years. The average maturity as of December 31, 2000 and 1999 was 130 days and 123 days, respectively.

Concentrations of Credit Risk

Financial instruments which potentially subject SAIF to concentrations of credit risk consist principally of temporary cash investments and debt securities. SAIF places its investment securities with high-credit quality financial institutions and limits the amounts of credit exposure to any one financial institution. Concentrations of credit risk with respect to investments in debt securities are limited due to the large number of such investments and their distribution among U.S. government bonds, many different industries and geographic regions.

Property and Equipment

Property and equipment are stated at cost, less accumulated depreciation. Maintenance, repairs and minor renovations are charged to expense as costs are incurred. Upon retirement or sale, any resulting gain or loss is included as a component of net income. Property and equipment is depreciated using the straight-line method over the estimated useful lives of the assets as follows:

Buildings and improvements	30 to 40 years
Furniture, equipment and machinery	3 to 7 years
Data processing software	3 to 5 years

At December 31, 2000 and 1999 property and equipment are comprised of the following (dollars in thousands):

	2000	1999
Land	$ 2,944	$ 2,944
Buildings and improvements	26,058	26,055
Furniture, equipment and machinery	17,682	19,513
Data processing software	9,075	9,075
Total	55,759	57,587
Less accumulated depreciation and amortization	(26,625)	(27,686)
Property and equipment, net	$ 29,134	$ 29,901

Depreciation and amortization expense for the years ended December 31, 2000 and 1999 was $3.6 million and $4.1 million, respectively. This charge includes both depreciation of purchased assets and amortization of assets accounted for as fixed assets under capital leases.

Premiums

Premiums are based on individual employers' reported payroll using predetermined insurance rates based on employee risk classifications and are recognized as income on a pro rata basis over the coverage period. Ceded premiums are recognized consistent with the underlying reinsurance agreement. The portion of premiums that will be earned in the future are deferred and reported as unearned premiums.

Policyholders' premiums due to SAIF are recorded as premiums receivable, net of the allowance for uncollectible accounts. Premiums receivable consists of both billed and unbilled amounts. Unbilled premiums receivable primarily represent an estimate of the difference between amounts earned ratably on installment-billed policies and the amount to be billed on the policy. Unbilled premiums receivable also include estimated billings on payroll reporting policies which were earned but not billed prior to year-end. SAIF uses its historical experience to estimate earned but unbilled amounts which are recorded as premiums receivable. These unbilled amounts are estimates, and while SAIF believes such amounts are reasonable, there can be no assurance the amounts ultimately received will equal the recorded unbilled amounts. The ultimate collectibility of the unbilled receivables can be affected by general changes in the economy and the regulatory environment due to the increased time required to determine the billable amount. SAIF considers these factors when estimating the receivable for unbilled premiums. Unbilled premiums receivable at December 31, 2000 and 1999 were $48.8 million and $43.7 million, respectively.

Certain policyholders are required to remit deposits which represent premium expected to be payable to SAIF at the end of the month following the reporting period (monthly and quarterly), plus one additional month. Deposits are generally in the form of cash, and are recorded in policyholders' premium deposits. However, policyholders may pledge surety bonds and securities in lieu of cash deposits. At December 31, 2000 and 1999, there were no pledged bonds and securities.

In addition to its regular premium plans, SAIF offers employers retrospective premium rating plans under which premiums are adjusted annually for up to 4-1/2 years following the plan year based on policyholders' loss experience. Adjustments to the original premiums are paid to or collected from the policyholders six months following the expiration of the policy and annually thereafter for up to 4-1/2 years. The estimate of the net accrued premiums receivable for retrospective rating plans as of December 31, 2000 and 1999 is as follows (dollars in thousands):

	2000	1999
Accrued retrospective premiums receivable	$ 21,088	$ 24,015
Reserve for retrospective ratings plans	(16,771)	(10,003)
Net accrued premiums receivable for retrospective rating plans	$ 4,317	$ 14,012

These amounts are included in the accompanying balance sheets.

Reserve for loss and loss adjustment expenses

The reserve for loss and loss adjustment expenses is generally based on past experience, except for certain awarded claims which are determined on an individual case basis. The liability includes provisions for reported claims, claims incurred but not reported, and claims that are currently closed but which experience indicates will be reopened.

Management believes that the reserve for incurred but unpaid loss and loss adjustment expenses at December 31, 2000 is a reasonable estimate of the ultimate net costs of settling claims and claims expenses incurred. Actual claim costs depend upon such factors as duration of worker disability, medical cost trends, occupational disease and inflation, and other societal and economic factors. As a result, the process used in computing the ultimate cost of settling claims and expense for administering claims is necessarily based on estimates. The amount ultimately paid may be more or less than such estimates. Adjustments resulting from changes in estimates of these liabilities are charged or credited to operations in the period in which they occur (see note 4).

Currently, SAIF discounts the reserve for known unpaid fatal and permanent total disability losses. SAIF does not discount the reserve for unpaid fatal and permanent total disability loss adjustment expenses. Oregon Attorney General Opinion Number 6176 requires SAIF to use the discount rate that reflects the anticipated rate of return on investments taking into consideration the uncertainty inherent in long pay-out patterns. The discount rate used by SAIF is 3.5% at December 31, 2000 and 1999. Annually, the Board of Directors reviews the actuarial assumptions and discount rates utilized in determining the liability for such losses. The discounts reflected in the reserve for loss and loss adjustment expenses were $92.1 million and $94.4 million at December 31, 2000 and 1999, respectively.

Managed Care Organization Fees

SAIF contracts with managed care organizations (MCOs). MCOs manage claims by arranging to provide medical and health care services. The expense is based on the number of claims accepted and closed while managed by an MCO. During 2000 and 1999 policies covered by contracts with MCOs were approximately 86% and 87%, respectively, of total policies.

Premium Deficiency

At December 31, 2000 and 1999, no reserve for premium deficiency was required to be recorded. Premium deficiency is based upon an estimate of the amount by which the sum of anticipated claims costs, claims adjustment expenses and maintenance expenses exceeds expected premium income and earnings on investments.

Policyholders' Dividends

Substantially all of SAIF's business is written under various participating plans wherein a dividend may be returned to the policyholder. Estimated amounts to be returned to policyholders are accrued when the related premium is earned. Dividends may be paid to the extent that a surplus is accumulated from premiums, investment gains, or loss reserve reductions. Dividends paid to policyholders totaled $159.4 million and $211.5 million in 2000 and 1999, respectively.

In December of 1999, SAIF paid dividends of $81.8 million funded by the final settlement payment of 1995 Alsea Veneer, et al. v. State of Oregon, et al. According to the settlement agreement, the payment to SAIF was to be used exclusively for statutory workers' compensation purposes as determined by the manager or the Board of Directors of SAIF. In November 1998, SAIF's Board of Directors decided that the final settlement payment of Alsea Veneer, et al. v. State of Oregon, et al should be returned in the form of a dividend to policyholders who had been financially disadvantaged by the State's original unlawful taking of money from the Industrial Accident Fund.

Taxes and Assessments

The Oregon Department of Justice has determined that SAIF Corporation is exempt from federal taxes because it is an integral part of the State of Oregon and, alternatively, exempt under either or both sections 501(c)(27)(B) and 115(1) of the Internal Revenue Code.

SAIF is subject to levies by the Oregon Workers' Compensation Division of the Department of Consumer and Business Services. Such assessments constitute an in-lieu-of-tax relative to premiums.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Current Accounting Pronouncements

The Governmental Accounting Standards Board has issued Statements No. 33, *Accounting and Financial Reporting for Non-Exchange Transactions*, and No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*. SAIF believes the impact from adopting these statements will not have a material effect on its financial position or operations. The requirements of these statements are effective for the fiscal years ending December 31, 2001 and 2002, respectively.

Reclassifications

Certain reclassifications have been made to the prior year balances to conform with current year presentation. Such reclassifications do not affect previously reported net income.

(3) Cash, Cash Equivalents and Investments

Cash and Cash Equivalents

Cash on deposit in state banks is covered by federal deposit insurance or is secured by the State Treasury at a minimum of 25 percent as required by statutes. Amounts held in the Oregon Short Term Fund are insured or secured by securities held by the State Treasurer or by its agent in the Treasurer's name. Deposits at the custodian bank are neither collateralized nor insured, but are backed by the full faith and credit of the custodian bank. The difference between the carrying amount and bank balance consists primarily of deposits in transit and outstanding checks.

Investments

Oregon's State Treasurer acts as SAIF's investment officer, investing in any instrument in which persons of prudence, discretion and intelligence would invest for their own accounts. The Oregon Investment Council establishes SAIF's investment policy.

Cash collateral received in respect of security loans is invested in the custodial agent's short-term fund, an "external investment pool" for purposes of GASB No. 31. SAIF's participation in this fund is voluntary. The fair value of investments held by this fund is based upon valuations provided by a recognized pricing service. This fund is not registered with the Securities and Exchange Commission, but the custodial agent is subject to the oversight of the Federal Reserve Board and the Massachusetts Commissioner of Banks. The fair value of SAIF's position in this fund is not the same as the value of the fund's shares. No income from this fund was assigned to another fund by the custodial agent during the year.

Bond, mortgage-backed, and asset-backed security transactions are recorded on a trade basis, generally three business days prior to the settlement date. However, the number of days between trade and settlement dates for mortgage-backed securities can be up to 30 days or longer depending on the security. No amounts were due from brokers for security sales at December 31, 2000 and 1999. Due to brokers for security purchases at December 31, 2000 and 1999 was $145.3 million and $0, respectively.

SAIF's investments are classified in three categories of credit risk to give an indication of the level of risk assumed by SAIF at December 31, 2000 and 1999. The three categories of credit risk are:

1. Insured or registered, or securities held by the State of Oregon or its agent in the State of Oregon's name for SAIF;

2. Uninsured and unregistered with securities held by the counterparty's trust department or agent in the State of Oregon's name for SAIF; and

3. Uninsured and unregistered with securities held by the counterparty, or by its trust department or agent but not in the State of Oregon's name for SAIF.

SAIF's investments by category at December 31, 2000 are as follows (dollars in thousands):

	Category I	Not Required to be Categorized	Carrying Amount
Bonds:			
U.S. Government	$ 155,913	$ 270,897	$ 426,810
Corporate Bonds	798,044	5,711	803,755
International Bonds	170,090	4,412	174,502
Asset backed securities	641,711	-	641,711
Total Bonds	1,765,758	281,020	2,046,778
Equity Securities:			
Russell 3000 Pooled Equity Fund	-	441,020	441,020
Other Equity Securities	77,116	8,297	85,413
Total Equity Securities	77,116	449,317	526,433
Other Invested Assets	-	17,301	17,301
Mortgage Loans on Real Estate	-	2,232	2,232
TOTAL	$ 1,842,874	$ 749,870	$ 2,592,744

SAIF's investments by category at December 31, 1999 are as follows (dollars in thousands):

	Category I	Not Required to be Categorized	Carrying Amount
Bonds:			
U.S. Government	$ 560,644	$ 273,549	$ 834,193
Corporate Bonds	835,823	13,392	849,215
International Bonds	94,377	2,984	97,361
Total Bonds	1,490,844	289,925	1,780,769
Equity Securities:			
Russell 3000 Pooled Equity Fund	-	483,706	483,706
Other Equity Securities	112,691	544	113,235
Total Equity Securities	112,691	484,250	596,941
Other Invested Assets	-	23,812	23,812
Mortgage Loans on Real Estate	-	3,034	3,034
Total	$ 1,603,535	$ 801,021	$ 2,404,556

There were no Category 2 or 3 investments at December 31, 2000 or 1999.

The amortized cost and fair value of debt and equity securities at December 31, 2000 is as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 418,708	$ 9,645	$ (1,544)	$ 426,809
Corporate bonds	784,439	38,162	(18,846)	803,755
International Bonds	172,443	4,452	(2,392)	174,503
Asset Backed Securities	632,593	9,840	(722)	641,711
Total Bonds	2,008,183	62,099		2,046,778
Equity Securities:				
Russell 3000 Pooled Equity Fund	416,060	24,960	-	441,020
Other equity securities	71,743	14,169	(499)	85,413
Total equity securities			(499)	526,433
TOTAL	$ 2,495,986	$ 101,228	$ (24,003)	$ 2,573,211

The amortized cost and fair value of debt and equity securities at December 31, 1999 is as follows (dollars in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. Government corporations and agencies	$ 854,351	$ 796	$ (20,954)	$ 834,193
Corporate bonds	746,215	124,017	(21,017)	849,215
International Bonds	98,895	488	(2,022)	97,361
Total Bonds	1,699,461	125,301	(43,993)	1,780,769
Equity Securities:				
Russell 3000 Pooled Equity Fund	345,148	138,559	-	483,707
Other equity securities	71,520	44,170	(2,456)	113,234
Total equity securities	416,668	182,729	(2,456)	596,941
TOTAL	$ 2 116,129	$ 308,030	$ (46,449)	$ 2 377 710

The amortized cost and fair value of debt securities at December 31, 2000, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties (dollars in thousands).

	Amortized Cost	Fair Value
Due in one year or less	$ 79,673	$ 87,311
Due after one year through five years	468,744	486,866
Due after five years through ten years	532,256	524,285
Due after ten years	927,510	948,316
TOTAL	$ 2,008,183	$ 2,046,778

Net investment income is comprised of the following for the years ended December 31, 2000 and 1999 (dollars in thousands):

	2000	1999
Bonds	$ 163,743	$ 134,772
Equity securities	(5,521)	137,964
Mortgage loans on real estate	113	128
Interest on deposit with reinsurer	-	2,579
Other	25,161	14,199
Investment income	183,496	289,642
Less investment expenses	19,509	9,690
Net investment income	$ 163,987	$ 279,952

Net realized gains and losses on sales of investments, which are included in net investment income, consist of the following for the years ended December 31, 2000 and 1999 (dollars in thousands):

	2000	1999
Gains:		
Bonds	$ 172,874	$ 77,238
Equity securities	100,858	40,133
Real estate	-	94
Other invested assets	-	7,195
Total	$ 273,732	$ 124,660
Losses:		
Bonds	$ (56,359)	$ (13,435)
Equity securities	(20,001)	(21,837)
Other invested assets	(907)	-
Total	$ (77,267)	$ (35,272)
Net:		
Bonds	$ 116,515	$ 63,803
Equity securities	80,857	18,296
Real estate	-	94
Other invested assets	(907)	7,195
Total	$ 196,465	$ 89,388

Proceeds from sales of investments in debt securities for the years ended December 31, 2000 and 1999 were $2,892.9 million and $689.3 million, respectively.

Securities Lending

In accordance with State investment policies, SAIF participates in securities lending transactions. The Oregon State Treasury has, through a Securities Lending Agreement, authorized State Street Bank and Trust Company ("State Street") to lend SAIF's securities to broker-dealers and banks pursuant to a form of loan agreement. Both SAIF and the borrowers maintained the right to terminate all securities lending transactions on demand.

During 2000 and 1999, State Street lent SAIF's fixed income and equity securities and received as collateral U.S. dollar-denominated cash. Borrowers were required to deliver cash collateral for each loan equal to at least 102% of the fair value of the loaned security, or 105% in the case of international equity securities. SAIF did not impose any restrictions during the year on the amount of the loans State Street made on its behalf. SAIF was fully indemnified by State Street against losses due to borrower default, and there were no losses during the year from the failure of borrowers to return loaned securities.

State Street is authorized by the Securities Lending Agreement to invest cash collateral received for securities loans in the State Street Bank and Trust Company Oregon Short-Term Investment Fund ("Fund). At December 31, 2000, the Fund had an average weighted maturity of 360 days. Since the securities loans are callable on demand by either the lender or borrower, the life of the loans at December 31, 2000, is effectively one day and consequently does not generally match the life of the investments in the Fund. On

December 31, 2000, SAIF had no credit risk exposure to borrowers. The collateral held and the fair value including accrued income of the SAIF securities on loan at December 31, 2000, were $298.6 million and $301.3 million, respectively.

Derivatives

In accordance with the investment policies of the State of Oregon, the Oregon State Treasury has invested through its outside investment managers on behalf of SAIF in the following types of securities which may be considered derivatives: asset-backed securities, including collateralized mortgage obligations and floating-rate bonds. Derivatives are generally used to enhance the return while managing the overall risk of investment portfolios. The Oregon State Treasury's direct investments in fixed income securities are not subject to any policies or rules which explicitly prohibit investments in derivative securities.

Below is a summary of derivative instruments held by SAIF at December 31, 2000. The credit risk, market risk, and legal risk for these investments were not above and beyond those risks that are apparent in the financial statements or otherwise disclosed in the notes to the financial statements. (Information regarding derivative holdings in mutual funds held by certain investment management firms as a component of their portfolios is not available.)

Asset-backed securities. The fair values of SAIF's holdings of asset-backed securities at December 31, 2000, are: mortgage-backed securities issued by agencies of the U.S. government, $438.5 million; collateralized mortgage obligations, $76.2 million; securities collateralized by the revenue streams from credit card and auto loan portfolios, $54.9 million; other asset-backed securities, $72.1 million.

SAIF participates in a short-term investment fund maintained by the custodial agent in which the cash collateral received from securities loans in invested. At December 31, 2000, SAIF's balance in the fund totals $299.6 million at fair value. Investments in asset-backed securities collateralized by the revenue streams from credit card and auto loan portfolios account for 24.175% of the total fair value of the fund at December 31, 2000.

Floating rate notes. SAIF holds $23.0 million in corporate bonds with floating interest rates at December 31, 2000. The coupon rates on these bonds are reset quarterly with reference to LIBOR (London Interbank Offered Rate). As of December 31, 2000, SAIF also holds $6.0 million in short term bonds with a floating rate that is reset monthly with reference to the Federal Reserve commercial paper composite rate.

(4) Reserve for Loss and Loss Adjustment Expenses

SAIF has established a reserve for both reported and unreported insured events, which includes estimates of future payments of losses and related loss adjustment expenses. In estimating the reserve for loss and loss adjustment expenses, SAIF considers prior experience, industry information, currently recognized trends affecting data specific to SAIF and other factors relating to workers' compensation insurance underwritten by SAIF.

The following table provides a reconciliation of the beginning and ending reserve for loss and loss adjustment expenses for the years ended December 31, 2000 and 1999 (dollars in thousands):

	2000	1999
Reserve for loss and loss adjustment expenses, beginning of year, discounted	$ 1,927,165	$ 1,762,229
Add: Discount of reserve for loss and loss adjustment expenses	94,394	94,832
Reserve for loss and loss adjustment expenses, beginning of year, undiscounted	2,021,559	1,857,061
Incurred losses:		
Provision for insured events of the current year	342,127	353,265
Provision for insured events of prior year	18,009	(12,230)
Total incurred losses	360,136	341,035
Loss payments attributable to:		
Insured events of the current year	(65,148)	(56,785)
Insured events of prior year	(131,776)	(119,752)
Total payments	(196,924)	(176,537)
Reserve for loss and loss adjustment expenses, end of year, undiscounted	2,184,771	2,021,559
Less: Discount of reserve for loss and loss adjustment expenses	92,072	94,394
Reserve for loss and loss adjustment expenses, end of year, discounted	$ 2,092,699	$ 1,927,165

(5) Reinsurance

In the ordinary course of business, SAIF assumes and cedes premiums for purposes of risk diversification and limiting maximum loss exposure from catastrophic events through contractual agreements with reinsurers. If such assuming reinsurers are unable to meet the obligations assumed under these reinsurance agreements, SAIF would be liable to pay the obligation. To minimize its exposure to significant losses from reinsurer insolvencies, SAIF evaluates the financial condition of its reinsurers and monitors concentration of credit risk.

Throughout 2000 and 1999, SAIF maintained coverage for loss occurrences involving one person subject to a limit of $5.0 million in excess of a $5.0 million retention. Reinsurance for loss occurrences involving two or more persons is subject to a limit of $190.0 million in excess of a $10.0 million retention and $140.0 million in excess of a $10 million retention respectively.

The following amounts have been deducted in the accompanying financial statements as a result of reinsurance ceded (dollars in thousands):

	2000	1999
Unearned premiums	$ 1,579	$ 707
Premiums written	3,448	3,321
Premiums earned	9,644	2,499
Loss and loss adjustment expenses incurred	13,049	9,656

In 1990, SAIF entered into a reinsurance contract with National Indemnity that is accounted for as a deposit. The deposit with reinsurer was $0 and $46.0 million at December 31, 2000 and 1999, respectively.

SAIF is authorized to write business on behalf of the Oregon Workers' Compensation Insurance Plan (the Plan), administered by the National Council on Compensation Insurance through the National Workers' Compensation Reinsurance Pool. The Plan provides a guaranteed source of workers' compensation insurance for employers unable to obtain coverage because of unstable financial condition, poor loss experience, or the inherently dangerous nature of the work. SAIF cedes such business to the Plan. In addition, SAIF is also required to assume its share of premiums and losses from the Plan based on voluntary market share.

The following amounts are included in the accompanying financial statements as a result of participation in the Plan (dollars in thousands):

	2000	1999
Assumed:		
Reserve for loss and loss adjustment expenses	$ 29,562	$ 31,960
Unearned premiums	859	1,423
Premiums written	7,068	5,730
Premiums earned	7,631	6,002
Loss and loss adjustment expenses incurred	3,578	2,532
Ceded:		
Reserve for loss and loss adjustment expenses	$ 48,350	$ 43,296
Unearned premiums	1,579	707
Premiums written	8,898	4,479
Premiums earned	8,027	4,570
Loss and loss adjustment expenses incurred	8,966	119

(6) Lease Commitments

SAIF leases office space in several locations under operating leases expiring during various years through 2005. SAIF's future minimum lease payments under operating leases at December 31, 2000 is as follows (dollars in thousands):

	Operating Leases
2001	$ 567
2002	402
2003	387
2004	383
2005	225
Total minimum lease payments	$ 1,964

Lease expenses were $607,000 and $679,000 for the years ended December 31, 2000 and 1999, respectively.

(7) Risk Management

The State of Oregon administers property and casualty insurance programs covering State government agencies through its Insurance Fund. The Insurance Fund services claims for: direct physical loss or damage to State property; tort liability claims brought against the State, its officers, employees, or agents; workers' compensation; and employees, elected officials, and members of commissions and boards for honesty and faithful performance. The Insurance Fund is backed by a commercial excess property policy with limits of $300 million and a blanket commercial excess bond with limits of $10 million.

As a state agency, SAIF participates in the Insurance Fund. The cost of servicing insurance claims and payments is covered by charging an assessment to each State entity based on its share of services provided in a prior period. The total statewide assessment of each coverage is based on independent biennial actuarial forecasts and administrative expenses, less carry-forward or equity in the Insurance Fund. Assessments for the years ended December 31, 2000 and 1999 were $317,000 and $317,000, respectively.

(8) Contingencies

During the ordinary course of business, SAIF becomes involved in litigation arising out of matters incident to the conduct of its insurance operations. SAIF is represented in these actions by the Attorney General of the State of Oregon. In the opinion of management, based upon information furnished by counsel, the ultimate disposition of these actions will not have a material adverse effect on SAIF's financial position.

(9) Deferred Compensation Plan

A deferred compensation plan (Plan) was authorized under Internal Revenue Code Section 457 and ORS 243.400 to 243.495. The Plan is a benefit available to all SAIF employees wherein they may execute an individual agreement with SAIF to defer a portion of their current income until future years so as to shelter such funds from federal and state taxation until withdrawal. Participants cannot receive the funds until certain circumstances are met. Funds accumulated by SAIF under the Plan have been invested with various financial institutions and insurance companies. Plan assets are held in a custodial account or an annuity contract by the Plan provider for the exclusive benefit of the participants or beneficiary. Participants' rights under the Plan are equal to the fair market value of the deferred account for each participant.

(10) Retirement Plan

SAIF's employees participate in the Oregon Public Employees' Retirement System (PERS); a cost-sharing multiple-employer defined benefit pension plan. PERS is administered by the Public Employees Retirement Board under the guidelines of ORS Chapter 238. The PERS retirement allowance, payable monthly for life, may be selected from twelve retirement benefit options. Options include survivorship benefits and lump sum refunds. The basic benefit formula is 1.67 percent of a member's final average salary multiplied by the member's number of years of service. Benefits may also be calculated under either a money match or an annuity-plus-pension computation if a greater benefit results. PERS also provides death and disability benefits. A copy of the Oregon Public Employees' Retirement System annual financial report may be obtained from PERS, P.O. Box 23700, Tigard, Oregon 97281-3700.

All SAIF employees are eligible to participate in PERS after completing six months of service. Covered employees are required by state statutes to contribute 6.0 percent of their salary to the plan. Current law permits employers to pay employee contributions to PERS and SAIF elects to do so. SAIF is required by statute to contribute actuarially computed amounts as determined by PERS. Rates are subject to change as a result of subsequent actuarial valuations. Currently the rate is 9.73 percent of each covered employee's salary. The amounts contributed by SAIF for the years ended December 31, 2000, 1999, and 1998 were $6.2 million, $5.7 million, and $5.2 million, respectively. SAIF employer contributions for the years ended December 31, 2000, 1999, and 1998 were $3.8 million, $3.5 million, and $3.0 million, respectively, which is equal to the required contributions for each year. Employee contributions paid by SAIF for the years ended December 31, 2000, 1999, and 1998 were $2.4 million, $2.2 million, and $2.2 million, respectively. In accordance with GASB Statement No. 27, no pension liability existed at December 31, 2000, or 1999.

(11) Subsequent Event (Unaudited)

Subsequent to December 31, 2000, SAIF reduced the Reserve for Loss and Loss Adjustment Expense $87.0 million in recognition of Senate Bill 485 (SB485) signed into law July 30, 2001. Among other changes to workers' compensation law, SB 485 changed in law in response to a previous Court decision rendered in Johannsen vs. SAIF. That Court decision had removed time limits for reopening claims for disability benefits. SB 485 makes claims filed more than five years after the date of the first claim closure reimbursable to the insurer from the Workers' Benefit Fund.

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED UPON THE AUDIT PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

The Board of Directors of
SAIF Corporation

The Secretary of State Audits Division,
State of Oregon

We have audited the financial statements of SAIF Corporation, as of and for the year ended December 31, 2000, and have issued our report thereon dated June 29, 2001 (July 30, 2001 as to Note 11). We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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 SAIF Corporation's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grants, 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*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered SAIF Corporation'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 the 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 Governor of the State of Oregon, the Oregon Legislative Assembly, the board of directors, management, and the Secretary of State Audits Division and is not intended to be and should not be used by anyone other than these specified parties.

Deloitte & Touche LLP

June 29, 2001

FACTS ABOUT THE SECRETARY OF STATE AUDITS DIVISION

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

Acting Director	Cathy Pollino, CGFM, MBA
Acting Deputy Director	Charles A. Hibner, CPA

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Auditing to Protect the Public Interest and Improve Oregon Government

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