

**VIRGINIA BIRTH-RELATED NEUROLOGICAL
INJURY COMPENSATION PROGRAM**

Financial Statements

For Years Ended
December 31, 2002 and 2001

**VIRGINIA BIRTH-RELATED NEUROLOGICAL INJURY
COMPENSATION PROGRAM**

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Report of Independent Auditors

The Board of Directors
Virginia Birth-Related Neurological Injury Compensation Program
Richmond, Virginia

We have audited the accompanying statement of financial position of the Virginia Birth-Related Neurological Injury Compensation Program as of December 31, 2002, and the related statements of activities and cash flows for the years then ended. These financial statements are the responsibility of the Program's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of the Virginia Birth-Related Neurological Injury Compensation Program as of December 31, 2001, were audited by other auditors whose report dated August 13, 2002, expressed an unqualified opinion on these statements.

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. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Virginia Birth-Related Neurological Injury Compensation Program as of December 31, 2002, and the changes in its net assets and its cash flows for the year 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 May 1, 2003 on our consideration of Virginia Birth-Related Neurological Injury Compensation Program's internal control over financial reporting and our tests on 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.

Cherry, Bekaert & Holland, LLP

Richmond, Virginia
May 1, 2003

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Financial Position

	December 31,	
	2002	2001
Assets		
Current assets		
Cash and cash equivalents	\$ 6,544,130	\$ 18,682,097
Accrued income	570,635	601,730
Other receivables	2,709	2,709
Prepaid expenses	-	35,558
Total current assets	6,917,474	19,322,094
Investments	92,957,185	64,904,716
Real estate held in trust	6,226,617	5,458,725
Property and equipment, net	35,224	30,521
Other assets		
Security deposits	3,009	3,009
Total assets	\$ 106,139,509	\$ 89,719,065
Liabilities		
Current liabilities		
Accounts payable	\$ 159,874	\$ 300
Accrued liabilities	54,079	57,567
Deferred revenue	14,708,429	11,628,760
Total current liabilities	14,922,382	11,686,627
Estimated claims reserve	173,100,000	159,200,000
Net assets		
Unrestricted	(88,109,490)	(86,626,287)
Board designated real estate held in trust	6,226,617	5,458,725
Total net assets	(81,882,873)	(81,167,562)
Total liabilities and net assets	\$ 106,139,509	\$ 89,719,065

See notes to financial statements.

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Activities

	Year Ended December 31,	
	2002	2001
Revenues		
Participating hospitals	\$ 2,256,000	\$ 1,891,950
Participating doctors	1,554,790	1,775,050
Mandated physician fees	3,252,200	-
Insurance fees	8,042,558	-
Interest income	3,604,251	3,381,669
Unrealized gain (loss) on investments	(2,751,566)	1,167,166
Gain on sale of investments	1,912,858	972,593
Dividend income	499,933	399,839
Loss on sale of real estate	(20,506)	(5,145)
Total revenue	18,350,518	9,583,122
Expenses		
Increase in estimated claims reserve	13,900,000	12,500,000
Claims cost	4,287,761	5,715,946
Investment & Fiduciary fees	214,386	205,351
Salaries and benefits	333,577	130,598
Professional fees	80,733	51,528
Advertising and brochures	54,139	45,826
Rent	48,397	36,688
Other	39,919	13,222
Postage and mailing	49,130	12,541
Payroll taxes	1,168	12,462
Computer services	13,123	12,325
Depreciation and amortization	10,458	9,405
Printing	8,459	9,010
Telephone	16,124	8,841
Office	8,455	4,503
Total expenses	19,065,829	18,768,446
Change in unrestricted net assets	(715,311)	(9,185,324)
Unrestricted net deficit at beginning of year	(81,167,562)	(71,982,238)
Unrestricted net deficit at end of year	\$ (81,882,873)	\$ (81,167,562)

See notes to financial statements.

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Cash Flows

	<u>Year Ended December 31,</u>	
	<u>2002</u>	<u>2001</u>
Cash flows from operating activities		
Change in unrestricted net assets	\$ (715,311)	\$ (9,185,324)
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation and amortization	10,458	9,405
Gain on sale of investments	(1,912,858)	(972,595)
Unrealized (gain) loss on investments	2,751,566	(1,167,166)
Loss on sale of real estate	20,506	5,145
Real estate valuation	(868,986)	(219,824)
Change in operating assets and liabilities		
Accrued income	31,095	22,710
Other receivables	-	54,585
Prepaid expenses	35,558	(20,867)
Accounts payable and accrued expenses	156,086	13,917
Deferred revenue	3,079,669	8,316,010
Estimated claims reserve	13,900,000	12,500,000
Net cash provided by operating activities	<u>16,487,783</u>	<u>9,355,998</u>
Cash flows from investing activities		
Purchase of property and equipment	(15,161)	(12,515)
Purchase of investment securities	(55,577,636)	(23,343,280)
Proceeds from sale and maturity of investment securities	26,686,459	24,614,432
Alterations/purchases of real estate	(48,906)	(14,276)
Proceeds from sale of real estate	129,494	181,355
Net cash provided by (used in) investing activities	<u>(28,825,750)</u>	<u>1,425,716</u>
Net (decrease) increase in cash and cash equivalents	(12,337,967)	10,781,714
Cash and cash equivalents		
Beginning of year	<u>18,682,097</u>	<u>7,900,383</u>
End of year	<u>\$ 6,344,130</u>	<u>\$ 18,682,097</u>

See notes to financial statements.

Virginia Birth-Related Neurological Injury Compensation Program

Notes to Financial Statements Years Ended December 31, 2002 and 2001

Note 1 – Summary of significant accounting policies

Nature of organization – The Virginia Birth-Related Neurological Injury Compensation Program (the “Program”) was established under the Virginia Birth-Related Neurological Injury Compensation Act (1987,c.540). The Program is a related organization for which the elected officials of the Commonwealth of Virginia are accountable as they appoint a voting majority of the board. The Act creates a compensation program that assures lifetime care of infants with severe neurological injuries. The Program is funded through annual assessments of participating physicians and participating hospitals. Liability insurers and non-participating physicians contribute to the fund, if necessary, based upon actual experience of the fund. The Program receives no federal government funding.

Basis of accounting – Financial statement presentation follows the recommendations of the Financial Accounting Standards Board in its Statement of Financial Accounting Standards (SFAS) No. 117, *Financial Statements of Not-For-Profit Organizations*. Under SFAS No. 117, the Program is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets. The financial statements reflect unrestricted amounts as those currently available at the discretion of the Program's Board of Directors. The Program's net assets are classified as unrestricted.

Board Designated Real Estate Held in Trust – The Board of Directors has designated a portion of unrestricted net assets for real estate held in trust. Real estate is carried at the lower of cost or market value. The adjustment to market value is reflected in claims cost for each year.

Cash equivalents – The Program considers all highly liquid instruments purchased with a remaining maturity of three months or less to be cash equivalents.

Concentration of Credit Risk – The Program's financial instruments subject to concentration of credit risk consist of cash, cash equivalents and investments. At times, cash balances at financial institutions are in excess of insured limits. The cash balances are maintained at financial institutions with high credit-quality ratings and the Program believes no significant risk of loss exists with respect to those balances. Investments are purchased in accordance with the Program's investment policy. These policies mitigate the concentration of credit risk.

Property and equipment – Property and equipment are recorded at cost. Depreciation is provided on the straight-line method over the estimated lives of the related assets. Maintenance and repairs are charged to expense as incurred; major renewals and betterments are capitalized. When items of property and equipment are sold or retired, the related cost and accumulated depreciation are removed from the accounts and any gain or loss is included in the results of operations.

Deferred Revenue – Deferred revenue results from the Program's policy of recognizing revenue from physician's assessments in the period to which the assessment is related. Accordingly, assessments received for the next year are deferred.

Income taxes – The Program is deemed to be an agency of the Commonwealth and, as such, is exempt from income taxes.

Virginia Birth-Related Neurological Injury Compensation Program

Notes to Financial Statements
Years Ended December 31, 2002 and 2001

Note 1 – Summary of significant accounting policies (continued)

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 certain estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of any contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Advertising costs – Advertising costs are expensed as incurred.

Note 2 – Investments

Investments are carried at market value. Investments at December 31, 2002 and 2001 consist of the following:

	December 31, 2002		
	Cost	Unrealized Gains (Losses)	Estimated Market Value
U.S. Government obligations	\$ 47,578,838	\$ (684,016)	\$ 46,894,822
Corporate bonds	16,058,037	974,756	17,032,793
Stocks	28,620,925	408,645	29,029,570
	\$ 92,257,800	\$ 699,385	\$ 92,957,185
	December 31, 2001		
	Cost	Unrealized Gains (Losses)	Estimated Market Value
U.S. Government obligations	\$ 22,675,349	\$ 913,682	\$ 23,589,031
Corporate bonds	20,164,601	150,202	20,314,803
Stocks	18,613,615	2,387,067	21,000,882
	\$ 61,453,565	\$ 3,450,951	\$ 64,904,716

Note 3 – Real Estate Held in Trust

Under guidelines established by the Board of Directors, the Program could, up until 1999, approve the purchase or construction of a home for the family claimant subject to certain restrictions. The home is held in a trust and remains the property of the Program, subject to use by the claimant's family during the term of the trust and subject to conditions imposed by the trust agreement. The trust expires upon the death or institutionalization of the claimant, and stipulates that during occupancy the family is responsible for the payment of utilities, general maintenance of the home, and certain other similar obligations.

Virginia Birth-Related Neurological Injury Compensation Program

Notes to Financial Statements
Years Ended December 31, 2002 and 2001

Note 4 – Estimated Claims Reserve

The estimated claims reserve is the present value of the estimated cost of payments for both claimants admitted to the Program and an estimated number of not-yet-admitted claimants with birth dates prior to the date of the statement of financial position, that will be admitted to the Program subsequent to the date of the statement of financial position. The present value represents the amount that would need to be invested, as of the date of the statement of financial position, to pay the claimant expenses as they become due. The reserve is determined based on an actuarial study, which is mandated to be performed no less frequently than biennially (done annually for 2002 and 2001). Eligible costs under the Program are costs not otherwise paid by private insurance or other government programs. Costs include nursing, housing, hospitals and physicians, physical therapy, vans, medical equipment, prescription drugs, various other incidental items, loss of earnings and claim filing expenses.

In very general terms, the estimated claims reserve is determined as follows:

Estimate of the total number of claimants (actual number of admitted claimants plus estimate of the number of not-yet-admitted claimants).

Forecast of future payments by category of expense, that will be made by the Program for each claimant. These estimates are based on the actual payments made by the Program on behalf of the claimants who had been in the program for three or more years as of December 31, 2001 (taking into consideration each claimant's insurance coverage and eligibility for Medicaid), as well as assumptions regarding future cost inflation and future increases in the utilization of the benefits and services of the Program.

Projected future payments to each claimant are adjusted to reflect an assumed life expectancy for each claimant and the time value of money.

For the year ended December 31, 2002, the estimated claims reserve is based on forecasted amounts included in the actuarial report for the year ended December 31, 2001. Actuarial assumptions represent estimates that are critical to reported operations. The assumptions used in the forecast are reasonable and management believes the indicated liability is adequate.

Significant actuarial assumptions include:

Rate of claims inflation (varies based on category of expense)	3.27% to 5.00%
Investment earnings rate	6.50%
Mortality:	
Average life expectancy of claimant at birth	18.2 years
Average life expectancy of claimant that attains the age of three	20.4 years
Estimated number of claimants born on or before December 31, 2002 not yet admitted to the Program. Estimate is based on review of how long it takes for claimants to be admitted to the Program	31 claimants

Virginia Birth-Related Neurological Injury Compensation Program

Notes to Financial Statements Years Ended December 31, 2002 and 2001

Note 4 – Estimated Claims Reserve (continued)

The increase in the estimated claims reserve amount is primarily attributable to the estimate of the total number of claimants (admitted claimants and not-yet-admitted claimants) being 106 claimants as of December 31, 2002 and 99 claimants as of December 31, 2001.

Note 5 – Salaries and Benefits

Included in salaries and benefits expense on the statements of activities is an additional amount paid to the employees in lieu of a benefits package. These funds are to be used by the employees to acquire certain benefits, if they so choose, and are subject to income and payroll taxes. For 2002 and 2001, additional amounts paid were equal to 24% of the employees' base salaries.

Note 6 – Lease Commitment

The Program leases its office space under an operating lease expiring on February 29, 2008. Rent expense under this lease amounted to \$48,357 for 2002. Prior to March 2002, the Program leased office space on a month-to-month basis. Rent expense for 2001 amounted to \$36,688.

The future minimum obligations under this lease is as follows:

2003	\$	52,192
2004		53,494
2005		54,832
2006		56,206
2007		57,616
Thereafter		9,642
	\$	283,982

Note 7 – Liquidity

The actuarial study performed for the year ended December 31, 2001, determined that the Program was not actuarially sound. The forecasted information for the year ended December 31, 2002 indicates a larger deficit. However, the actuarial study did point out that the Program is not in any immediate danger of defaulting on the payment of benefits and that the Program has sufficient assets to continue to pay for claimants' benefits.

At the request of the Commonwealth of Virginia, management is evaluating possible solutions for resolving the deficit over the long-term. Once the evaluation is complete, management will present its recommendations to the legislature.

Virginia Birth-Related Neurological Injury Compensation Program

Notes to Financial Statements
Years Ended December 31, 2002 and 2001

Note 8 – Contingencies

Various pending and threatened lawsuits, claim program benefits. Management believe's the Program's actuarial assumptions are adequate to provide for the ultimate resolution of these claims.