VIRGINIA BIRTH-RELATED NEUROLOGICAL INJURY COMPENSATION PROGRAM

Financial Statements

For Years Ended
December 31, 2004, 2003 and 2002

VIRGINIA BIRTH-RELATED NEUROLOGICAL INJURY COMPENSATION PROGRAM

Contents

CHERRY BEKAERT & HOLLAND

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

Independent Auditors' Report

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

We have audited the accompanying statements of net assets of the Virginia Birth-Related Neurological Injury Compensation Program (the "Program") as of December 31, 2004, 2003 and 2002, and the related statements of revenues, expense and changes in net assets and cash flows for the years then ended, which collectively comprise the Program's basic financial statements as listed in the table of contents. 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 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 opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Program as of December 31, 2004, 2003, and 2002 and the respective changes in financial position and 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 our report dated April 7, 2005 on our consideration of the Program's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and other matters. The purpose of that report is to describe the scope of testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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 audits.

Management's Discussion and Analysis on pages 3 through 8 and other required supplementary information on pages 20 through 22 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit this information and express no opinion on it.

Our audit was made for the purpose of forming our opinion on the basic financial statements taken as a whole. The information listed as supplementary information in the accompanying table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Cherry, Bekaert & Holland, L.L.P.

Richmond, Virginia
April 7, 2005

Virginia Birth Related Neurological Injury Compensation Program

Management's Discussion and Analysis

This section of the Virginia Birth Related Neurological Injury Compensation Program's (the "Program") annual financial report represents our discussion and analysis of the Program's financial performance during the fiscal years ended December 31, 2002, 2003, and 2004. Please read it in conjunction with the Program's financial statements and accompanying notes.

FINANCIAL HIGHLIGHTS

- The revenue from fees and assessments increased by $1,968,000 or (12%) in 2004. Fees assessed from participating physicians increased $350,000 or (19%), participating hospitals increased $373,000 or (16%), insurance companies increased $955,000 or (11%) and mandated physicians fees increased $288,000 or (9%).

- In 2003 the revenue from fees and assessments increased by $1,256,000 or (8%). Fees assessed from participating physicians increased $306,000 or (20%), participating hospitals increased $102,000 or (5%), insurance companies increased $951,000 or (12%), and mandated physicians fees decreased $104,000 or (3%).

- The Program's total net assets decreased by $22.7 million in 2004 primarily due to the $27.3 million increase in Provision for claims. In 2003 the total net assets increased by $5.4 million primarily due to the $9.7 million earned in investment income.

- Although total assets less total current liabilities does not cover the admitted claims portion of the unpaid claims reserve, the gap continues to close each year. This deficit changed from $21.3 million in 2002 to $11.7 million in 2003 to $5.9 million in 2004 showing a reduction of $9.2 million and $6.2 million respectively.

- Revenue from investment income decreased $2.5 million or (25%) due primarily to the lack of net appreciation on investments.

- The Program sold two of its trust homes in 2004. One located in Falls Church, VA, the other in Fairfax VA. The Program currently owns a total of 18 trust homes occupied by claimants.

- In 2004 the Program provided $4,300,000 in nursing care, $112,000 in therapy, purchased 15 handicapped accessible vans for $461,000, $328,000 for housing benefits, $277,000 for durable medical equipment and technology, $192,000 for hospitals and physician visits, and $174,000 for claimant legal fees. The approximate average value of nursing care provided to the 84 active claimants (99 admitted claimants less 15 deceased at December 2004) was $51,190.

- There are a total of 506 participating physicians in 2004, up 97 from 409 physicians in 2003. Participating Hospitals increased by 6 from 28 in 2003 to 34 in 2004.

- Ten claimants were admitted in 2004 and one claimant became deceased for a total of 99 admitted claimants at December 31, 2004 as compared with 89 at December 31, 2003.

OVERVIEW OF THE FINANCIAL STATEMENTS

The financial section of this annual report consists of three parts: management's discussion and analysis (this section), the basic financial statements and the notes to the financial statements, and other supplemental information.

In the past, the Programs financial statements were prepared according to recommendations of the Financial Accounting Standards Board in its' Statement of Financial Accounting Standards No. 117, Financial Statements for Not for Profits Organizations. After a study of the Program's organizational structure, management determined that the Program's financial statements should be presented in accordance with GAAP applicable to enterprise funds of local government units. This change was adopted January 1, 2004. This change in basis of accounting results in a change in reporting formats and has no significant effect on assets, net assets or changes in net assets reported in prior years.

The financial information for December 31, 2002 is included in the MD&A to show comparative summarized data as required by GASB. When discussing the financial information for 2004 and 2003, part of that analysis is related to the beginning balances from 2003 or December 31, 2002. The financial statements for 2003, as embodied in this report, were restated according to GASB standards and the auditors' opinion extends to the restated 2003 statements. The 2004 financial statements show a three-year comparison, 2002, 2003, and 2004.

FINANCIAL ANALYSIS

Net Assets:

The following table reflects the condensed Net Assets of the Program:

Table 1
Net Assets
As of December 31, 2004, 2003, and 2002
(In millions)

	2004	2003	2002
Current Assets	$ 12.3	$ 24.3	$ 6.9
Non current Assets	$ 134.6	$ 103.7	$ 99.2
Total Assets	$ 146.9	$ 128.0	$ 106.1
Current Liabilities	$ 17.3	$ 16.8	$ 14.9
Unpaid Claims Reserve			
Admitted Claims	$ 135.5	$ 122.9	$ 112.5
Incurred but not reported claims	$ 93.3	$ 64.8	$ 60.6
Total Unpaid Claims Reserve	$ 228.8	$ 187.7	$ 173.1
Total Liabilities	$ 246.1	$ 204.5	$ 188.0
Unrestricted Net Assets	$ (99.2)	$ (76.5)	$ (81.9)
Total Net assets	$ (99.2)	$ (76.5)	$ (81.9)

At December 31, 2004 and 2003, the total assets of the Program were $146.9 and $128.0 million, respectively; total liabilities were $246.0 and $204.5 million, respectively, while combined net assets were negative $99.1 and $76.5 million, respectively. Net assets are negative due to the fact that the amount of unpaid claims reserve exceeds total non current assets set aside to pay for future claims.

The decrease in current assets from 2003 of $24.3 million to 2004 of $12.3 million is due to excess cash being invested. The increase in non current assets consists of the $12.0 in cash from 2003 invested in January 2004, $7.0 million in investment income, and $11.0 million in assessments deposited and invested.

Current liabilities exceed current assets by $4.9 million in 2004. Current assets are comprised of cash and cash equivalents held in the investment brokerage account and checking account. To remain in compliance with the Investment Policy Statement cash in excess of the 5% target must be invested. However the policy states that approximately $1.0 million be held in liquid cash equivalents to meet the short term needs of the fund. The $24.3 million in current assets in 2003 is due to timing; the excess cash was invested in January 2004.

The total unpaid claims reserve for December 31, 2004 and 2003 were $228.8 and $187.7 million respectively. This represents the estimated cost for claimants currently admitted into the Program and an estimated number of not yet admitted claimants (Incurred but not reported, IBNR) with birth dates prior to fiscal year-end that will be admitted to the Program subsequent to fiscal year-end. This reserve is based on a mandated annual actuarial study. A portion of the admitted claims and a portion of the incurred but not reported claims liability remains unfunded. In 2005 a legislatively sanctioned funding study will be performed to study methods to fund the unfunded portion.

Comparison of IBNR to Net Assets

	2004	2003	2002
Incurred but not reported claims	$ 93.3	$ 64.8	$ 60.6
Total Net Assets (Deficit)	$ (99.2)	$ (76.5)	$ (81.9)
Unfunded Portion of Admitted Claims	$ (5.9)	$ (11.7)	$ (21.3)

The above chart shows the comparison of the IBNR claims to the deficit in the total net assets for 2004, 2003, and 2002. Each year there is a reduction in the amount of the unfunded portion of the admitted claims, $9.6 million in 2003 and $6.2 million in 2004. If IBNR was not included in the Statement of Net Assets the asset position related to the liabilities improves each year. The revenues are covering more of the admitted claims but the IBNR grows at a much greater rate.

Accounts payable as of December 31,2004 and 2003 is $691,000 and $120,000 respectively, showing an increase of $571,000. In addition claims expenses increased $900,000 from $6,900,000 in 2004 from $6,000,000 in 2003, (Note 5). The majority of the accounts payable is nursing expense and was paid in January 2005. This increase was, in part, attributed to the ten new claimants awarded into the program in 2004 increasing the number and amounts of invoices. It is important to note that the average monthly claimant expenses for 2004 was around $575,000 and it is not unusual to have one month expenses in accounts payable.

Changes in Net Assets:

The following chart shows the revenue and expenses for the current fiscal year:

Table 2
Changes in Net Assets
As of December 31, 2004, 2003, and 2002
(In millions)

	2004	2003	2002
Revenues			
Fees and Assessments	$ 18.3	$ 16.4	$ 15.1
Net Investment Income	$ 7.1	$ 9.6	$ 3.1
Other	$ -	$ 0.1	$ -
Total Revenues	$ 25.4	$ 26.1	$ 18.2
Expenses			
Provision for claims	$ 48.0	$ 20.6	$ 18.7
General and administration	$ 0.1	$ 0.1	$ 0.2
Total Expenses	$ 48.1	$ 20.7	$ 18.9
Change in net assets	$ (22.7)	$ 5.4	$ (0.7)
Beginning net assets	$ (76.5)	$ (81.9)	$ (81.2)
Ending net assets	$ (99.2)	$ (76.5)	$ (81.9)

REVENUES

Revenues consist of legislatively established assessments placed on participating and non-participating physicians, hospitals, and insurance companies and also investment income. For the fiscal years ended December 31, 2004 and 2003, revenues totaled $25.4 and $26.1 million, respectively. Assessments for 2004 for participating and non-participating physicians were $5,000 and $250 respectively. Participating Hospitals are assessed a fee of $50 per live birth for the prior year, as reported by the Department of Health, not to exceed $150,000. In 2004 liability insurers paid one quarter of one percent on the direct premiums written during the prior year.

The General Assembly has authorized increases in future years assessments according to the following:

Year	Participating	Non-Participating	Hospital
2005	$ 5,100.00	$ 260.00	$50/live birth not to exceed $160,000
2006	$ 5,200.00	$ 270.00	$50/live birth not to exceed $170,000
2007	$ 5,300.00	$ 280.00	$50/live birth not to exceed $180,000
2008	$ 5,400.00	$ 290.00	$50/live birth not to exceed $190,000
2009	$ 5,500.00	$ 300.00	$50/live birth not to exceed $200,000

Net Investment income decreased $2.5 million from $9.6 in 2003 to $7.1 in 2004. This decrease is primarily due to the lack of net appreciation in the value of the investments in 2004. At December 31, 2004, 2003 and 2002 net appreciation totaled $21,000, $7,600,000 and $3,600,000 respectively

(Note 2). Appreciation can fluctuate greatly depending on market conditions and 2003 was an unusual year with a $7.2 unrealized gain in equities. In 2004 both equities and fixed income investments were more stable in value.

EXPENSES

For the fiscal years ended December 31, 2004 and 2003 expenditures totaled $48.1 million and $20.7 million respectively. Expenses are comprised of general administrative and claims related expenses, the latter of which reflects both the increases in claims reserve and the claims paid during the year.

General administrative expenses include the portion of salaries, rent, cost of office equipment, and all other expenses not directly related to claims. Of the total Administrative expenses of $683,000 in 2004 approximately $546,000 or 80% is related to claims according to program management and $137,000 is related to program administration. In 2003 81% or $562,000 of a total of $692,000 in Administrative expenses was related to claims and $129,000 related to program administration.

Provision for claims includes the portion of general administration expenses related to claims and actual and future expenses related to claims. Claimant expenses include nursing, therapy, physician and hospital visits, prescriptions, housing, transportation, and durable medical equipment. Provision for claims increased from $20.6 million in 2003 to $48.0 million in 2004 primarily due to the changes in the assumptions reflected in the actuarial study completed and published in September 2004.

CAPITAL ASSETS

Capital assets consist of computer equipment, office equipment and automobiles. Depreciation is calculated on the straight-line method over the estimated lives of the related assets. The eighteen Trust Homes owned by the Program are recorded as investments because they are considered appreciable.

ECONOMIC FACTORS

On July 1, 2003 legislation became effective that has the potential to significantly increase the costs of the Program but not increase revenues. These changes may result in increased administrative expenses, increased number of claimants, and a new category of claimants eligible for awards up to $100,000. A summary of the legislation is as follows;

- The Office of the Attorney General (OAG) shall provide requested legal services to the Program. The Program shall compensate the OAG for the provision of such legal services.

- Every hospital shall provide for each infant hospitalized in neonatal intensive care an informational brochure prepared and approved by the board of directors of the Program.

- The Workers' Compensation Commission (The Commission) may make an award, at its discretion, for compensation for attorney's fees for unsuccessful claims.

- If The Commission determines an infant has sustained a birth related injury and was delivered by a participating physician or born in a participating hospital, and the infant dies within 180 days, the Commission may make an award up to $100,000 to the infants family.

As of December 31, 2004 there were no petitions submitted or awards granted for compensation for attorney's fees for unsuccessful claims or for any infants deceased within 180 days of birth.

The above legislation has a significant effect on the increase in provision for insured events of prior years, (see note 5). In 2004 the increase in provision for insured events of prior years equals $14.5 million. This provision is a combination of a decrease of $27.4 million due to the reduction in estimated cost per claim as determined by the actuaries and an increase the provision of $41.9 million due to the legislative changes. The increase in the claims reserve is primarily due to the legislative changes.

The legislation that became effective on July 1, 2004 has two effects. It removes the portion of the July 1, 2003 legislation regarding attorneys fees incurred in connection with filing unsuccessful claims and it results in increased assessment income beginning with 2005 program year as described in a previous section of this report.

To further fulfill their fiduciary responsibility to the Program and its recipients, the board of directors has employed CapGroup of Richmond as the Programs Investment Consultant as of February 2005. Maximizing investment income while maintaining acceptable levels of risk will be an important factor in the reduction of the actuarial deficit. The board believes that the advice and expertise provided by CapGroup will improve the overall investment strategy and financial position of the Program.

CONTACTING THE PROGRAM'S FINANCIAL MANAGEMENT

This financial report is designed to provide users (e.g. citizens, taxpayers, claimant families, service providers and creditors) with a general overview of the Program's finances and to demonstrate the Program's accountability for the funds it receives. Questions concerning this report or requests for additional information should be directed to the Deputy Director, 9100 Arboretum Pkwy. Suite 365, Richmond, VA 23236, 804-330-2471 or visit our website at http://www.vabirthinjury.com

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Net Assets

	December 31, 2004	December 31, 2003	December 31, 2002
Assets			
Current assets			
Cash and cash equivalents	$ 11,473,661	$ 23,739,498	$ 6,344,130
Accrued interest	789,558	545,196	570,635
Other receivables	-	-	2,709
Total current assets	12,263,219	24,284,694	6,917,474
Investments	129,516,978	97,447,010	92,957,185
Real estate held in trust	5,052,551	6,226,617	6,226,617
Property and equipment, net	26,887	26,632	35,224
Other assets			
Security deposits	3,009	3,009	3,009
Total noncurrent assets	134,599,425	103,703,268	99,222,035
Total assets	$ 146,862,644	$ 127,987,962	$ 106,139,509
Liabilities			
Current liabilities			
Accounts payable	$ 691,137	$ 119,954	$ 159,874
Accrued liabilities	54,069	54,079	54,079
Deferred revenue	16,474,887	16,616,628	14,708,429
Total current liabilities	17,220,093	16,790,661	14,922,382
Unpaid claims reserve			
Admitted claims	135,500,000	122,900,000	112,500,000
Incurred but not reported claims	93,300,000	64,800,000	60,600,000
Total unpaid claims reserve	228,800,000	187,700,000	173,100,000
Total liabilities	246,020,093	204,490,661	188,022,382
Net assets			
Invested in capital assets, net of related debt	26,887	26,632	35,224
Unrestricted (deficit)	(99,184,336)	(76,529,331)	(81,918,097)
Total net assets	$ (99,157,449)	$ (76,502,699)	$ (81,882,873)

See notes to financial statements.

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Revenues, Expenses, and Changes in Fund Net Assets

	Year Ended December 31,		
	2004	2003	2002
Operating revenues			
Participating hospitals	$ 2,730,909	$ 2,357,975	$ 2,256,000
Participating doctors	2,211,184	1,860,843	1,554,790
Mandated physician fees	3,436,378	3,148,690	3,252,200
Insurance fees	9,948,858	8,993,616	8,042,558
Other	100	124,914	-
Total operating revenues	18,327,429	16,486,038	15,105,548
Operating expenses			
Provision for claims	47,963,625	20,621,718	19,600,653
General and administration	136,569	129,397	168,682
Total operating expenses	48,100,194	20,751,115	19,769,335
Operating loss	(29,772,765)	(4,265,077)	(4,663,787)
Nonoperating revenue (expense)			
Net investment income	7,195,687	9,645,251	3,051,090
Gain (loss) on sale of real estate	149,016	-	(20,506)
Revaluation of real estate	(226,082)	-	917,892
Loss on sale of assets	(606)	-	-
Net nonoperating revenue	7,118,015	9,645,251	3,948,476
Change in net assets	(22,654,750)	5,380,174	(715,311)
Net assets at beginning of year	(76,502,699)	(81,882,873)	(81,167,562)
Net assets at end of year	$ (99,157,449)	$ (76,502,699)	$ (81,882,873)

See notes to financial statements.

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Cash Flows

	Year Ended December 31, 2004	2003	2002
Cash flows from operating activities			
Receipts from hospitals	$ 2,519,709	$ 3,017,625	$ 2,119,250
Receipts from participating doctors	2,057,253	2,302,647	1,736,185
Mandated physician fee receipts	3,397,988	3,488,085	3,248,730
Receipts from insurance companies	10,210,638	9,460,966	11,081,052
Other receipts	100	127,623	-
Payments on behalf of claimants	(5,746,164)	(5,499,138)	(5,046,379)
Payments to suppliers of goods and services	(348,210)	(336,337)	(283,789)
Payments to employees	(323,111)	(344,567)	(333,577)
Net cash provided by operating activities	11,768,203	12,216,904	12,521,472
Cash flows used in capital and related financing activities			
Purchase of capital assets	(12,397)	(2,401)	(15,161)
Cash flows from investing activities			
Purchase of investment securities	(62,806,093)	(14,709,199)	(55,577,636)
Proceeds from sale and maturity of investment securitites	33,624,370	16,063,641	26,686,459
Earnings on investment securities	4,063,080	3,826,423	3,917,405
Proceeds from real estate investment properties	1,097,000	-	129,494
Net cash provided by (used in) investing activities	(24,021,643)	5,180,865	(24,844,278)
Net increase (decrease) in cash and cash equivalents	(12,265,837)	17,395,368	(12,337,967)
Cash and cash equivalents			
Beginning of year	23,739,498	6,344,130	18,682,097
End of year	$ 11,473,661	$ 23,739,498	$ 6,344,130
Reconciliation of operating loss to net cash provided by operating activities:			
Operating loss	$ (29,772,765)	$ (4,265,077)	$ (4,663,787)
Adjustments to reconcile operating loss to net cash provided by operating activities:			
Depreciation	11,536	10,993	10,458
Increase (decrease) in:			
Other receivables	-	2,709	-
Prepaid expenses	-	-	35,558
Accounts payable	571,183	(39,920)	159,574
Accrued liabilities	(10)	-	-
Deferred revenue	(141,741)	1,908,199	3,079,669
Claims reserve	41,100,000	14,600,000	13,900,000
Net cash provided by operating activities	$ 11,768,203	$ 12,216,904	$ 12,521,472
Noncash investing activities			
Net appreciation in fair value of investment securities	$ 20,631	$ 7,567,254	$ (2,751,566)

See notes to financial statements.

Virginia Birth-Related Injury Compensation Program

Notes to Financial Statements
Years Ended December 31, 2004, 2003 and 2002

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 – The Program operates as an insurance enterprise fund subject to Governmental Accounting Standards Board Statement No. 10 (GASB 10), *"Accounting and Financial Reporting for Risk Financing and Related Insurance Issues,"* Governmental Accounting Standards Board Statement No. 30 (GASB 30), *"Risk Financing Omnibus – An Amendment to GASB Statement No. 10,"* and Financial Accounting Standards Board Statement No. 60 (FAS 60), *"Accounting and Reporting for Insurance Enterprises."*

The financial statements of the enterprise fund are presented on the accrual basis of accounting, using the economic resources measurement focus. Under this method of accounting, revenues are recognized when earned and expenses are recorded when liabilities are incurred without regard to receipt or disbursement of cash. Enterprise funds distinguish operating revenues and expenses from non-operating items. Operating revenues and expenses generally result from providing services and collecting fees in connection with the proprietary fund's principal ongoing operations.

In accordance with Governmental Accounting Standards Board (GASB) Statement No. 20, *"Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting,"* proprietary fund types may follow all applicable GASB pronouncements as well as only those Financial Accounting Standards Board (FASB) pronouncements and predecessor APB Opinions and Accounting Research Bulletins issued on or before November 30, 1989. Under paragraph 7 of GASB Statement No. 20, the Program has elected not to apply FASB pronouncements issued after November 30, 1989.

Use of estimates – The preparation of the financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from these estimates.

Cash equivalents – For purposes of the statement of cash flows, cash equivalents are defined as short-term, highly liquid investments that are both (a) readily convertible to known amounts of cash and (b) so near maturity that they present insignificant risk of changes in value because of changes in interest rates. Generally, the Program considers investments with original maturities of three months or less to be cash equivalents.

Investments - The Program's investments consist of U.S. Government obligations, corporate bonds, and equity securities and are reported fair value based on quoted market prices. The fair value of real estate investments is based on independent appraisals. Purchases and sales of investments are recorded on their trade date.

Note 1 – Summary of significant accounting policies (continued)

Capital assets – Capital assets with a cost of $1,000 or more (threshold implemented in fiscal year 2004) are recorded at cost. The costs of major improvements are capitalized while the cost of maintenance and repairs, which do not improve or extend the life of an asset, are expensed. Depreciation is provided over the assets' estimated useful lives of three to seven years using the straight-line method.

Deferred revenue – Deferred revenue represents amounts for which revenue recognition criteria have not been met. It is the Program's policy to recognize mandated assessments, participating doctor and hospital fees, and insurance fees in the period in which the assessment or coverage is related.

Estimated liability for unpaid claims – The liability for unpaid claims represents management's estimate, developed in conjunction with the assistance of the Program's actuary, of the Program's discounted 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 net assets that will be admitted to the Program subsequent to the date of the net assets. Changes in estimates of such costs are recognized in results of operations in the period in which the changes in estimate are made.

Management believes the estimate of the discounted liability for unpaid claims is adequate. The development of liabilities for future benefit requires management to make estimate and assumptions regarding mortality, morbidity, lapse, expense, and investment experience. Such estimates are primarily based on historical experience and future expectations of these assumptions. The Program's actual incurred losses may vary significantly from the estimated amount included in the Program's financial statements. Management monitors actual experience and, if circumstances warrant, revises its assumptions and the related future policy benefit estimates.

Reclassifications – Certain fiscal year 2003 and 2002 amounts have been reclassified for comparative purposes to conform to the fiscal year 2004 presentation.

Note 2 – Deposits and investments

Cash and cash equivalents at December 31, 2004, 2003 and 2002, consist of the following:

	2004	2003	2002
Cash on hand	$ 777	$ 609	$ 609
Deposits with financial institutions - demand deposits	75,019	166,012	258,749
Deposits with financial institutions - money market accounts	11,397,865	23,572,877	6,084,772
	$ 11,473,661	$ 23,739,498	$ 6,344,130

Deposits

A portion of the Program's deposits with financial institutions ($397,024, $425,871, and $491,229 at December 31, 2004, 2003, and 2002, respectively) is fully covered by federal depository insurance or collateralized in accordance with the Virginia Security of Public Deposits Act. Under the Act, financial institutions holding public deposits in excess of the amounts insured by the FDIC must pledge collateral in the mount of 50% of the excess of deposits to a collateral pool in the name of the State Treasury Board.

Note 2 – Deposits and investments (continued)

The State Treasury Board is responsible for monitoring compliance with the collateralization and reporting requirements of the Act and for notification of compliance by financial institution.

The carrying value of the Program's uninsured, uncollateralized deposits with financial institutions was $11,075,860, $23,313,018, and $5,852,292 at December 31, 2004, 2003, and 2002, respectively. The reported bank balance of these deposits was $11,181,827 at December 31, 2004, $23,414,009 at December 31, 2003, and $5,949,976 at December 31, 2002.

Investments

The Program's investments are summarized below. The investments that are represented by specific identifiable investment securities are classified as to credit risk by the following categories:

(1) Insured or registered, or securities held by the Program or its agent in the Program's name.
(2) Uninsured and unregistered, with securities held by the counter-party's trust department or agent in the Program's name.
(3) Uninsured and unregistered, with securities held by the counter-party, or by its trust department or agent, but not in the Program's name.

		December 31, 2004		
	Risk Category	Cost	Unrealized Gains (Losses)	Market Value
U.S. Government obligations	2	$ 67,993,102	$ (267,572)	$ 67,725,530
Corporate bonds	2	21,777,576	244,059	22,021,635
Equity securities	2	31,459,030	8,310,783	39,769,813
		$ 121,229,708	$ 8,287,270	$ 129,516,978

		December 31, 2003		
		Cost	Unrealized Gains (Losses)	Market Value
U.S. Government obligations	2	$ 43,047,945	$ (229,615)	$ 42,818,330
Corporate bonds	2	17,367,488	817,676	18,185,164
Equity securities	2	28,764,938	7,678,578	36,443,516
		$ 89,180,371	$ 8,266,639	$ 97,447,010

		December 31, 2002		
		Cost	Unrealized Gains (Losses)	Market Value
U.S. Government obligations	2	$ 47,578,838	$ (684,016)	$ 46,894,822
Corporate bonds	2	16,058,037	974,756	17,032,793
Equity securities	2	28,620,925	408,645	29,029,570
		$ 92,257,800	$ 699,385	$ 92,957,185

Note 2 – Deposits and investments (concluded)

The Program's return on investments for years ending December 31, 2004, 2003, and 2002 is summarized as follows:

	2004	2003	2002
Interest income	$ 3,708,135	$ 3,260,441	$ 3,604,251
Dividend income	892,961	791,610	499,933
Realized gain (loss) on investments	2,867,614	(1,722,987)	1,912,858
Net appreciation in fair value of investments	20,631	7,567,254	(2,751,566)
Investment fees	(210,632)	(175,242)	(141,146)
Fiduciary fees	(83,022)	(75,825)	(73,240)
Net investment income	$ 7,195,687	$ 9,645,251	$ 3,051,090

Note 3 – Investments in real estate

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.

Investment properties are stated at original cost plus the cost of any improvements, but not in excess of appraised fair values. The carrying value of the real estate investments amounted to $5,052,551 at December 31, 2004 and $6,226,617 at December 31, 2003 and 2002.

Note 4 – Capital assets

Capital assets at December 31, 2004, 2003, and 2002, and the related changes for the years then ended were as follows:

	January 1, 2004	Increases	Decreases	December 31, 2004
Computer equipment	$ 53,311	12,397	(11,907)	$ 53,801
Office equipment	33,811	-	-	33,811
Automobiles	17,237	-	-	17,237
	104,359	12,397	(11,907)	104,849
Less accumulated depreciation	(77,727)	(11,536)	11,301	(77,962)
Capital assets, net	$ 26,632	861	(606)	$ 26,887

(continued)

Note 4 – Capital assets (concluded)

	January 1, 2003	Increases	Decreases	December 31, 2003
Computer equipment	$ 53,311	-	-	$ 53,311
Office equipment	31,410	2,401	-	33,811
Automobiles	17,237	-	-	17,237
	101,958	2,401	-	104,359
Less accumulated depreciation	(66,734)	(10,993)	-	(77,727)
Capital assets, net	$ 35,224	(8,592)	-	$ 26,632

	January 1, 2002	Increases	Decreases	December 31, 2002
Computer equipment	$ 47,295	6,016	-	$ 53,311
Office equipment	22,264	9,146	-	31,410
Automobiles	17,238	-	-	17,237
	86,797	15,162	-	101,958
Less accumulated depreciation	(56,276)	(10,458)	-	(66,734)
Capital assets, net	$ 30,521	$ 4,704	$ -	$ 35,224

Note 5 – Estimated liability for unpaid claims

The estimated liability for unpaid claims is the discounted 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 net assets, that will be admitted to the Program subsequent to the date of the statement of net assets. This discounted cost represents the amount that would need to be invested, as of the date of the statement of net assets, to pay the claimant expenses as they become due. The liability is determined based on an actuarial study, which is mandated to be performed no less frequently than biennially (done annually for 2004, 2003 and 2002). 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 liability for unpaid claims is determined as follows:

(1) The total number of claimants is estimated (actual number of admitted claimants plus estimate of the number of not-yet-admitted claimants).
(2) Future payments, by category of expense paid for each claimant, are forecast. 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, 2003, 2002, and 2001 (taking into consideration each claimant's insurance coverage and eligibility for Medicaid), as well as assumptions regarding future cost of inflation and future increases in the utilization of the benefits and services of the Program.

Note 5 – Estimated liability for unpaid claims (continued)

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

The estimated liability for unpaid claims is forecast based on actual information through the prior fiscal year. 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 for each fiscal year include:

	2004	2003	2002
Rate of claims inflation (varies based on category of expense)	1.26% - 5.09%	3.28% - 5.04%	3.27% - 5.00%
Investment earnings / discount rate	6.43%	6.34%	6.50%
Mortality:			
Average life expectancy of claimant at birth	19.2 years	18.7 years	18.2 years
Average life expectancy of claimant that attains the age of three	21.5 years	20.9 years	20.4 years
Average life expectancy of claimant that attains the age of four	21.6 years	N/A	N/A
Estimated number of claimants born on or before December 31, 2003 not yet admitted to the Program. Estimate is based on review of how long it takes for claimants to be admitted to the Program	47 claimants	31 claimants	31 claimants

The increase in the estimated claims reserve amount is based on projected increases for future claims payments due to expected increase in number of claimants as a result of House Bill No. 2048 (this bill provided for certain extended benefits and the payment of certain administrative costs including attorneys fees), which became effective July 1, 2003. The total number of claimants (admitted claimants and not-yet-admitted claimants) is estimated to be 148 as of December 31, 2004.

On February 16, 2004, House Bill No.1407 was enacted, and reduces the coverage of additional administrative costs. This legislature repealed a portion of the previous bill mentioned above. This bill is to be effective on January 1, 2005. Management estimates that the effect on the estimated claims reserve will be to reduce the reserve by approximately $28,600,000.

Virginia Birth-Related Injury Compensation Program

Notes to Financial Statements
Years Ended December 31, 2004, 2003 and 2002

Note 5 – Estimated liability for unpaid claims (concluded)

The following represents changes in the aggregate reserves for the Program during the past two years:

	2004	2003	2002
Unpaid claims and claim adjustment expenses at beginning of year	$ 187,700,000	$ 173,100,000	$ 159,200,000
Incurred claims and claim adjustment expenses:			
Provision for insured events of current year	20,733,333	14,000,000	13,661,290
Increase (decrease) in provision for insured events of prior years	14,485,462	(4,352,822)	(4,408,637)
Total incurred claims and claim adjustment expenses	35,218,795	9,647,178	9,252,653
Interest	12,744,830	10,974,540	10,348,000
Total claims provision	47,963,625	20,621,718	19,600,653
Payments:			
Claims and claim adjustment expenses attributable to insured events of the current year	-	-	-
Claims and claim adjustment expenses attributable to insured events of prior years	6,863,625	6,021,718	5,700,653
Total payments	6,863,625	6,021,718	5,700,653
Total unpaid claims and claim adjustment expenses at year end	$ 228,800,000	$ 187,700,000	$ 173,100,000

The total undiscounted unpaid claims and claim adjustment expenses amount to $723.6 million at December 31, 2004.

Note 6 – Employee benefits

The Program pays each employee an amount equal to 24% of his or her salary in lieu of a benefits package. This additional salary is to be used by the employee to acquire certain benefits, if they so choose, and is subject to income and payroll taxes. Additional benefits paid by the Program to their employees amounted to $62,687, $63,737 and $53,969 for the years ending December 31, 2004, 2003 and 2002, respectively. These benefits are included as salary and benefits expense on the Program's supplementary schedule of general and administrative expenses.

Virginia Birth-Related Injury Compensation Program

Notes to Financial Statements
Years Ended December 31, 2004, 2003 and 2002

Note 7 – Operating lease commitments

The Program leases its office space under an operating lease expiring on February 29, 2008. Rent expense under this lease amounted to $53,498 and $52,216 for fiscal years 2004 and 2003, respectively. Prior to March 2002, the Program leased office space on a month-to-month basis. Rent expense for 2002 amounted to $48,134.

The future minimum obligations under this lease are as follows:

2005	$	54,832
2006		56,206
2007		57,616
2008		9,642
	$	178,296

The Program leases office equipment on a month-to-month basis. Rent expense for this equipment amounted to $1,512, $1,482 and $1,027 at December 31, 2004, 2003 and 2002, respectively.

Note 8 – Liquidity

The actuarial study performed for the year ended December 31, 2004 determined that the Program was not actuarially sound. The forecasted information for the year ended December 31, 2005 indicates a larger deficit. This increase in deficit is a result of the two House bills mentioned in Note 5. 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.

Note 9 – Contingencies

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

Required Supplementary Information

Virginia Birth-Related Neurological Injury Compensation Program

Supplementary Schedule of Claims Development Information
As of December 31, 2004
(In Thousands)

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
1	Premiums and investment revenue:										
	Earned	$ 5,034	$ 3,736	$ 5,781	$ 8,477	$ 4,931	$ 6,001	$ 9,378	$ 18,136	$ 26,131	$ 25,445
2	Unallocated expenses	2,888	33,505	15	(199)	(148)	53	(203)	169	129	137
3	Estimated losses and expenses, end of birth year:										
	Incurred	8,078	9,674	4,249	4,676	6,880	7,336	12,871	13,661	14,000	20,733
4	Net paid (cumulative) as of:										
	End of accident year	-	-	-	-	-	-	-	-	-	
	One year later	115	112	78	91	142	143	119	143	159	
	Two years later	462	451	311	365	568	574	478	572	-	
	Three years later	736	718	495	582	905	914	761	-	-	
	Four years later	1,280	1,249	861	1,012	1,574	1,589	-	-	-	
	Five years later	1,355	1,323	912	1,072	1,667	-	-	-	-	
	Six years later	1,668	1,628	1,122	1,319	-	-	-	-	-	
	Seven years later	1,700	1,659	1,144	-	-	-	-	-	-	
	Eight years later	2,134	2,083	-	-	-	-	-	-	-	
	Nine years later	6,614	-	-	-	-	-	-	-	-	

Virginia Birth-Related Neurological Injury Compensation Program

Supplementary Schedule of Claims Development Information
As of December 31, 2004
(In Thousands)

		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
5	Reestimated ceded losses and expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -
6	Reestimated net incurred losses and expenses										
	End of birth year	8,078	9,674	4,249	4,676	6,880	7,336	12,871	13,661	14,000	20,733
	One year later	8,608	6,344	4,416	6,495	7,368	11,827	12,357	13,244	15,333	
	Two years later	5,828	6,725	6,069	6,826	11,580	11,533	11,963	14,544	-	
	Three years later	6,146	10,488	6,370	9,689	11,305	11,309	13,188	-	-	
	Four years later	9,287	11,174	8,971	9,502	11,094	12,008	-	-	-	
	Five years later	9,861	17,096	8,801	9,359	11,749	-	-	-	-	
	Six years later	14,805	16,709	8,671	9,804	-	-	-	-	-	
	Seven years later	14,482	16,413	9,076	-	-	-	-	-	-	
	Eight years later	14,236	17,334	-	-	-	-	-	-	-	
	Nine years later	15,005	-	-	-	-	-	-	-	-	
7	Increase (decrease) in estimated net incurred losses and expenses from end of birth year	$ 6,927	$ 7,660	$ 4,827	$ 5,128	$ 4,869	$ 4,672	$ 317	$ 883	$ 1,333	$ -

Virginia Birth-Related Injury Compensation Program

Notes to Required Supplementary Information
Years Ended December 31, 2004 and 2003

Note 1 – Claims development information

The table on the preceding pages illustrates how the Program's earned revenue (net of reinsurance) and investment income compare to related costs of loss (net of loss assumed by reinsurers) and other expenses assumed by the Program as of the end of each of the previous ten years. The rows of the table are defined as follows: (1) This line shows the total of each fiscal year's gross earned premiums and reported investment revenue, amounts of premiums ceded, and reported premiums (net of reinsurance) and reported investment revenue. (2) This line shows each fiscal year's other operating costs of the Program including overhead and loss adjustment expenses not allocable to individual claims. (3) This line shows the Program's gross incurred losses and allocated loss adjustment expense, losses assumed by reinsurers, and net incurred losses and loss adjustment expense (both paid and accrued) as originally reported at the end of the year in which the event that triggered coverage occurred (called *birth year*). (4) This section of ten rows shows the cumulative net amounts paid as of the end of successive years for each birth year. (5) This line shows the latest reestimated amount of losses assumed by reinsurers for each birth year. (6) This section of ten rows shows how each birth year's net incurred losses increased or decreased as of the end of successive years. (This annual reestimation results from new information received on known losses, reevaluation of existing information on known losses, and emergence of new losses not previously known.) (7) This line compares the latest reestimated net incurred losses amount to the amount originally established (line 3) and shows whether this latest estimate of losses is greater or less than originally thought. As data for individual birth years mature, the correlation between original estimates and reestimated amounts is commonly used to evaluate the accuracy of net incurred losses currently recognized in less mature birth years. The columns of the table show data for successive birth years.

Supplementary Information

Virginia Birth-Related Neurological Injury Compensation Program

Schedules of General and Administration Expenses

	2004	2003	2002
Advertising and brochures	$ 11,980	$ 35,350	$ 54,139
Computer services	12,758	16,159	13,123
Depreciation and amortization	11,536	10,993	10,458
Office	6,785	7,256	8,455
Other	34,541	39,457	37,917
Payroll taxes	29,659	23,271	1,168
Postage and mailing	49,735	46,970	49,130
Professional fees	137,535	124,697	80,733
Printing	-	-	8,459
Rent	53,498	52,216	48,397
Salaries and benefits	323,111	322,717	333,577
Telephone	11,709	12,811	16,124
	682,847	691,897	663,682
Less claims administration (allocations)	546,278	562,500	495,000
Unallocated expenses	$ 136,569	$ 129,397	$ 168,682

CHERRY BEKAERT & HOLLAND

CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

Independent Auditors' Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

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

We have audited the financial statements of Virginia Birth-Related Neurological Injury Compensation Program (the "Program") as of and for the years ended December 31, 2004 and 2003, and have issued our report thereon dated April 7, 2005. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Program'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 an opinion 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 reportable 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 caused by error or fraud 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 report and its operation that we consider to be material weaknesses. We did note other matters involving internal control over financial reporting that we have reported to management of the Program in a separate letter dated April 7, 2005.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Program'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*.

This report is intended solely for the information and use of the Board of Directors, management, and others within the Program, and is not intended to be and should not be used by anyone other than these specified parties.

Cherry, Bekaert & Holland, L.L.P.

Richmond, Virginia
April 7, 2005