VIRGINIA BIRTH-RELATED
NEUROLOGICAL INJURY
COMPENSATION PROGRAM

A lifetime of help

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9100 Arboretum Pkwy
Suite 365
Richmond, VA 23236
www.vabirthinjury.com

February 8, 2005

Bruce F. Jamerson
Clerk of the House of Delegates
House of Delegates
P.O. Box 406
Richmond, VA 23218

Dear Mr. Jamerson:

In compliance with Virginia statute 38.2-5015, paragraph B and 38.2-5016, paragraph F, please find enclosed a complete report regarding the investments of the Virginia Birth-Related Neurological Injury Compensation Fund and a copy of our most recent audit.

For the year 2004, the Program's reserves grew by approximately $20 million to just over $141 million. Unfortunately, as you may already be aware of, the Program is still considered actuarially unsound. The Board of Director's is working hard to correct this situation through the following actions:

- Improvement of investment returns through working with an independent investment advisory group.

- HJ646 – a study resolution directing a funding study by the Program in conjunction with the State Corporation Commission, other key agencies and the medical community;

- HB 1505 - legislation that would clarify the definition of a qualifying birth-injury to assure the Program's original intent is maintained.

If you have any questions please feel free to contact our executive director, George Deebo, or myself.

Sincerely,

Melina Dee Perdue ct

Melina Dee Perdue, R.N., M.B.A., C.N.A.
Board Chair
Virginia Birth-Related Neurological Injury Compensation Program

Enc: Merrill-Lynch report, 2003 Audit

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February 8, 2005

Susan Clarke Scharr
Clerk of the Senate
P.O. Box 396
Richmond, VA 23218

Dear Ms. Scharr:

In compliance with Virginia statute 38.2-5015, paragraph B and 38.2-5016, paragraph F, please find enclosed a complete report regarding the investments of the Virginia Birth-Related Neurological Injury Compensation Fund and a copy of our most recent audit.

For the year 2004, the Program's reserves grew by approximately $20 million to just over $141 million. Unfortunately, as you may already be aware of, the Program is still considered actuarially unsound. The Board of Director's is working hard to correct this situation through the following actions:

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Board Chair
Virginia Birth-Related Neurological Injury Compensation Program

Enc: Merrill-Lynch report, 2003 Audit

VIRGINIA BIRTH-RELATED NEUROLOGICAL INJURY COMPENSATION PROGRAM

Financial Statements

For Years Ended
December 31, 2003 and 2002

CHERRY
BEKAERT&
HOLLAND

CERTIFIED PUBLIC
ACCOUNTANTS &
CONSULTANTS

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 (the "Program") as of December 31, 2003 and 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 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, the financial statements referred to above present fairly, in all material respects, the financial position of the Program as of December 31, 2003 and 2002, and the changes in its net assets 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 May 3, 2004 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 audits.

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

Richmond, Virginia
May 3, 2004

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Financial Position

	December 31, 2003	December 31, 2002
Assets		
Current assets		
Cash and cash equivalents	$ 23,739,498	$ 6,344,130
Accrued income	545,196	570,635
Other receivables	-	2,709
Total current assets	24,284,694	6,917,474
Investments, at market value	97,447,010	92,957,185
Real estate held in trust	6,226,617	6,226,617
Property and equipment, net	26,632	35,224
Other assets		
Security deposits	3,009	3,009
Total assets	$ 127,987,962	$ 106,139,509
Liabilities		
Current liabilities		
Accounts payable	$ 119,954	$ 159,874
Accrued liabilities	54,079	54,079
Deferred revenue	16,616,628	14,708,429
Total current liabilities	16,790,661	14,922,382
Estimated claims reserve	187,700,000	173,100,000
Net assets- unrestricted		
Undesignated	(82,729,316)	(88,109,490)
Board designated real estate held in trust	6,226,617	6,226,617
Total net assets- unrestricted	(76,502,699)	(81,882,873)
Total liabilities and net assets	$ 127,987,962	$ 106,139,509

See notes to financial statements.

Virginia Birth-Related Neurological Injury Compensation Program

Statements of Activities

	Year Ended December 31, 2003	Year Ended December 31, 2002
Revenues		
Participating hospitals	$ 2,357,975	$ 2,256,000
Participating doctors	1,860,843	1,554,790
Mandated physician fees	3,148,690	3,252,200
Insurance fees	8,993,616	8,042,558
Interest income	3,260,441	3,604,251
Unrealized gain (loss) on investments	7,567,254	(2,751,566)
Realized gain (loss) on sale of investments	(1,722,987)	1,912,858
Dividend income	791,610	499,933
Loss on sale of real estate	-	(20,506)
Cost reimbursement- real estate	46,953	
Other	77,961	-
Total revenue	26,382,356	18,350,518
Expenses		
Increase in estimated claims reserve	14,600,000	13,900,000
Claims cost	5,459,218	4,287,761
Investment & Fiduciary fees	251,067	214,386
Salaries and benefits	344,567	333,577
Professional fees	123,374	80,733
Advertising and brochures	27,308	54,139
Rent	52,216	48,134
Other	36,454	40,182
Postage and mailing	46,970	49,130
Payroll taxes	2,525	1,168
Computer services	16,159	13,123
Depreciation and amortization	10,993	10,458
Printing	11,264	8,459
Telephone	12,811	16,124
Office	7,256	8,455
Total expenses	21,002,182	19,065,829
Increase (decrease) in unrestricted net assets	5,380,174	(715,311)
Unrestricted net assets at beginning of year	(81,882,873)	(81,167,562)
Unrestricted net assets at end of year	$ (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, 2003	Year Ended December 31, 2002
Cash flows from operating activities		
Change in unrestricted net assets	$ 5,380,174	$ (715,311)
Adjustments to reconcile net change in unrestricted net assets to net cash provided by operating activities		
Depreciation and amortization	10,993	10,458
(Gain) loss on sale of investments	1,722,987	(1,912,858)
Unrealized (gain) loss on investments	(7,567,254)	2,751,566
Loss on sale of real estate	-	20,506
Real estate valuation	-	(868,986)
Change in operating assets and liabilities		
Accrued income	25,439	31,095
Other receivables	2,709	-
Prepaids	-	35,558
Accounts payable and accrued expenses	(39,920)	156,086
Deferred revenue	1,908,199	3,079,669
Estimated claims reserve	14,600,000	13,900,000
Net cash provided by operating activities	16,043,327	16,487,783
Cash flows from investing activities		
Purchase of property and equipment	(2,401)	(15,161)
Purchase of investment securities	(14,709,199)	(55,577,636)
Proceeds from sale and maturity of investment securities	16,063,641	26,686,459
Alterations/purchases of real estate	-	(48,906)
Proceeds from sale of real estate	-	129,494
Net cash provided by (used in) investing activities	1,352,041	(28,825,750)
Net (decrease) increase in cash and cash equivalents	17,395,368	(12,337,967)
Cash and cash equivalents		
Beginning of year	6,344,130	18,682,097
End of year	$ 23,739,498	$ 6,344,130

See notes to financial statements.

Notes to Financial Statements
Years Ended December 31, 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 – 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.* This provision is compatible with Statement of Position 78-10 for the Program's operations. 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.

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.

Reclassifications – Certain accounts in the prior year financial statements have been reclassified for comparative purposes to conform with the presentation in the current year financial statements.

Note 2 – Investments

Investments are carried at market value. Investments at December 31, 2003 and 2002 consist of the following:

	December 31, 2003		
	Cost	Unrealized Gains (Losses)	Market Value
U.S. Government obligations	$ 43,047,945	$ (229,615)	$ 42,818,330
Corporate bonds	17,367,488	817,676	18,185,164
Stocks	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	$ 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

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. Management has estimated the value of there homes to be $6,226,617 as of December 31, 2003.

Note 4 – Property and equipment

Property and equipment are summarized as follows by major classification:

	December 31, 2003	December 31, 2002
Computer equipment	$ 53,311	$ 53,311
Office equipment	33,811	31,410
Automobiles	17,237	17,237
	104,359	101,958
Less accumulated depreciation	(77,727)	(66,734)
	$ 26,632	$ 35,224

Depreciation expense amounted to $10,993 and $10,458 for the years ended December 31, 2003 and 2002, respectively.

Note 5 – 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 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 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, 2002 (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.

Note 5 – Estimated Claims Reserve (continued)

As of December 31, 2003, the estimated claims reserve is based on forecasted amounts included in the actuarial report for the year ended December 31, 2002. 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)	3.28% - 5.04%
Investment earnings rate	6.34%
Mortality:	
Average life expectancy of claimant at birth	18.7 years
Average life expectancy of claimant that attains the age of three	20.9 years
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	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 141 as of December 31, 2003 and 106 as of December 31, 2002.

On February 16, 2004, House Bill No.1407 (this bill reduces the coverage of additional administrative costs), was enacted. 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.

Note 6 – 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 2003 and 2002, additional amounts paid were equal to 24% of the employees' base salaries.

Note 7 – Lease Commitment

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

Note 7 – Lease Commitment (continued)

The future minimum obligations under this lease is as follows:

2004	53,494
2005	54,832
2006	56,206
2007	57,616
2008	9,642
	$ 231,790

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

Note 8 – Liquidity

The actuarial study performed for the year ended December 31, 2003, determined that the Program was not actuarially sound. The forecasted information for the year ended December 31, 2003 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 program benefits. Management believe's the Program's actuarial assumptions are adequate to provide for the ultimate resolution of these claims.

Accompanying Information

CHERRY BEKAERT & HOLLAND
CERTIFIED PUBLIC ACCOUNTANTS & CONSULTANTS

Report on Compliance and on Internal Control Over Financial Reporting 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 year ended December 31, 2003, and have issued our report thereon dated May 3, 2004. 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 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.*

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 assurance on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Program's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The general ledger account balances of cash, investments, revenue, and deferred revenue should be reconciled with the underlying records or reports on at least a monthly basis. These reconciliations are currently not performed promptly and are not subject to management review.

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. 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 reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, the reportable condition described above, we consider to be a material weakness. We also noted other matters involving the internal control over financial reporting, which we have reported to management of the Program in a separate letter dated May 3, 2004.

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
May 3, 2004