UNIVERSITY OF VIRGINIA MEDICAL CENTER

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2005

APA

Auditor of Public Accounts

COMMONWEALTH OF VIRGINIA

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
(unaudited)

The following discussion and analysis provides an overview of the financial position and activities of the University of Virginia's Medical Center (Medical Center) for the year ended June 30, 2005, with comparative information for the year ended June 30, 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section.

The Medical Center is one of three operating divisions of the University of Virginia. The Vice President and Chief Executive Officer of the Medical Center provides overall leadership and management of the Medical Center. The Medical Center is an integrated network of primary and specialty care services ranging from wellness programs and routine checkups to the most technologically advanced care. The hub of the Medical Center is a 574-bed hospital with a state-designated Level 1 trauma center located on the Charlottesville campus. In addition, primary and specialty care is provided at clinic locations throughout central Virginia communities.

Financial Highlights

Operating Results

	2005	2004
Operating revenues	$810.3	$713.4
Operating income	$ 47.5	$ 42.4
Nonoperating income and other	16.0	3.5
Increase in net assets	$ 63.5	$ 45.9
Cash and investments	$520.0	$435.3
Other assets	457.8	424.4
Liabilities	309.3	254.6
Net assets	$668.5	$605.1

* in millions

The Medical Center's operating results for fiscal year 2005 compare favorably to fiscal year 2004. Increased demand for outpatient services resulting from the purchase of an outpatient surgical facility and dialysis facilities. Increased charge rates resulted in an increase in operating revenues of $96.9 million (13.6 percent) while operating costs increased by $91.7 million (13.7 percent). Increases in operating revenue over operating expenses for fiscal year 2005 resulted in an increase in operating income of $5.1 million. Nonoperating income increased by $12.5 million in fiscal year 2005 yielding a 10.5 percent increase in net assets as shown in the Statement of Net Assets.

Financial Statements

The Medical Center's financial report includes three financial statements: the Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows. These financial statements are prepared in accordance with the Governmental Accounting Standards Board

(GASB) Statement 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*; GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis of Public Colleges and Universities*; and with the Financial Accounting Standards Board requirements for healthcare organizations.

Statement of Net Assets

The Statement of Net Assets presents the financial position of the Medical Center at the end of the fiscal year, including all assets and liabilities of the Medical Center. Net assets are the difference between total assets and total liabilities and are one of the indicators used to evaluate the current financial condition of the Medical Center. In contrast, the change in net assets indicates whether the overall financial condition improved or worsened during the year. Shown below is a summary of the Medical Center's Statement of Net Assets.

Statement of Net Assets
As of June 30, 2005 and 2004

	2005	2004	Increase/(Decrease)	
Assets:				
Current assets	$272.6	$218.0	$ 54.6	25.0%
Capital assets	330.7	295.2	35.5	12.0%
Other noncurrent assets	374.5	346.5	28.0	8.1%
Total assets	977.8	859.7	118.1	13.7%
Liabilities:				
Current liabilities	176.9	120.1	56.8	47.3%
Noncurrent liabilities	132.4	134.5	(2.1)	(1.6%)
Total liabilities	309.3	254.6	54.7	21.5%
Net assets:				
Invested in capital assets, net of related debt	197.9	170.0	27.9	16.4%
Restricted for:				
Nonexpendable	53.1	53.1	-	-
Expendable	26.0	16.9	9.1	53.8%
Unrestricted	391.5	365.1	26.4	7.2%
Total net assets	$668.5	$605.1	$ 63.4	10.5%

* in millions

During fiscal year 2005, the Medical Center's financial position improved. Net assets increased by $63.4 million as a result of the Medical Center's positive operating performance. The increase in current assets includes $64.8 million increase in current cash of which $24.8 million resulted from securities lending transactions executed by the State Treasurer's Office. This transaction also resulted in a $5.3 million increase in short-term investments reflected in current assets. These amounts are offset by a $30.1 million security lending obligation in the current liabilities. Capital assets increased by $35.5 million as a result of significant investment in building and equipment. The largest component of this increase was $28.7 million for construction on an expansion to the Medical Center and $11.9 million for the purchase of information systems and related hardware. Shown next are the major capital additions made in the past two fiscal years.

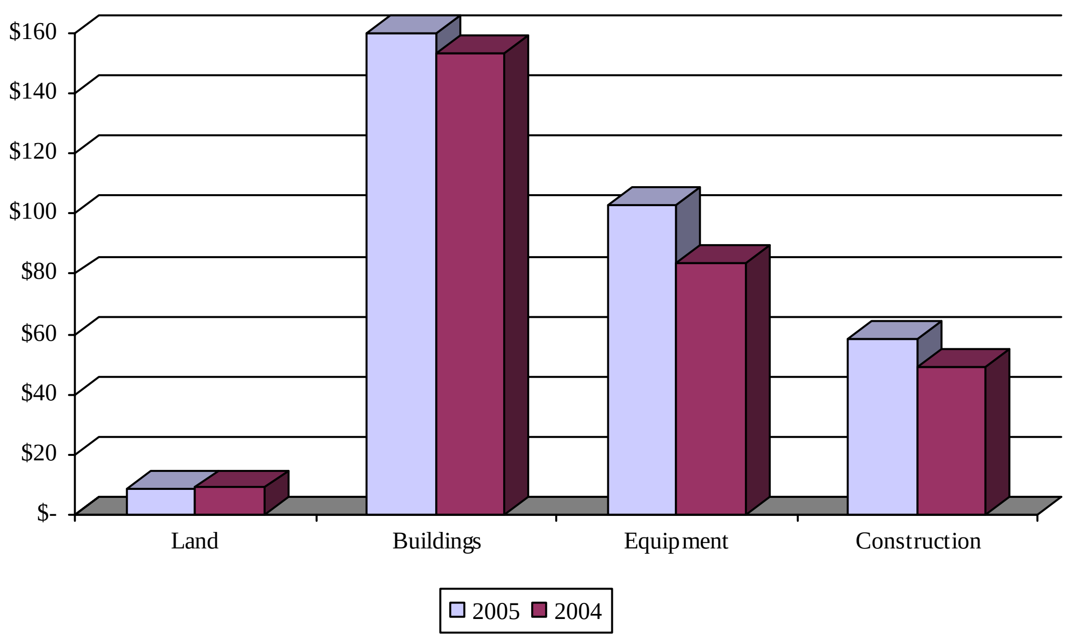
Major Capital Additions

	2005	2004
University hospital expansion	$28.7	$21.6
Information systems and related hardware	11.9	8.9
Core Lab Building and equipment	7.2	-
Jefferson Park Avenue renovations	2.6	2.5
Mobile operating rooms and equipment	2.7	1.3
Infusion and syringe pumps	2.2	-
Clinic renovations	2.1	3.4
Other health system renovations	2.0	2.2
VASI equipment purchase	1.7	-
Radiology and imaging systems	1.6	9.9
Lynchburg dialysis equipment	1.3	-
Cafeteria renovations	-	2.5
Patient monitoring system	-	1.2
Medical Office Building at Fontaine Research Park	-	13.7
Total	$64.0	$67.2

* in millions

Components of the Medical Center's capital assets are shown below.

Capital Assets



* in millions

The largest component of the increase in current liabilities was a $30.1 million obligation under security lending transaction. There also was a $16.6 million increase in the amount owed to the University of Virginia Health Services Foundation. In fiscal year 2005, the Medical Center irrevocably committed $15 million as a payment to the University of Virginia Health Services Foundation to fund medical leadership recruitment.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets as presented in the Statement of Net Assets are based on activity as presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of these statements is to present the Medical Center's operating and nonoperating revenues recognized and expenses incurred and any other revenues, expenses, gains, and losses. A summarized comparison of revenues, expenses, and other changes in net assets for the years ended June 30, 2005 and 2004 is as follows:

Statements of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2005 and 2004

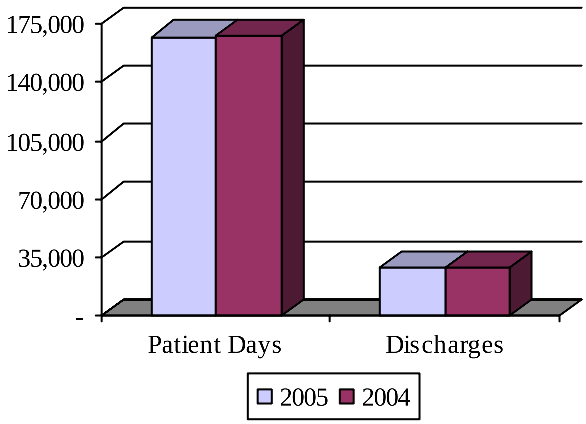
	2005	2004	Increase/(Decrease)	
Operating revenue:				
Net patient service revenue	$780.2	$686.6	$93.6	13.6%
University allocations	10.7	11.4	(.7)	(6.1%)
Other	19.4	15.4	4.0	26.0%
Total operating revenue	810.3	713.4	96.9	13.6%
Operating expenses:				
Salaries and benefits	334.8	305.7	29.1	9.5%
Other operating expenses	428.0	365.3	62.7	17.2%
Total operating expenses	762.8	671.0	91.8	13.7%
Operating income	47.4	42.4	5.0	11.8%
Nonoperating revenue	16.0	3.5	12.5	357.1%
Increase in net assets	63.4	45.9	17.5	38.1%
Net assets - beginning of year	605.1	559.2	45.9	8.2%
Net assets - end of year	$668.5	$605.1	$63.4	10.5%

* in millions

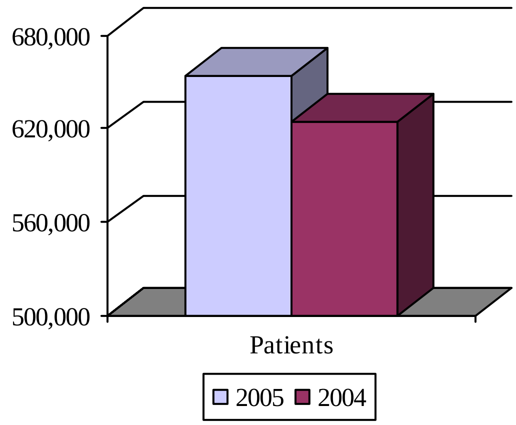
Operating Revenue

Total operating revenue for fiscal year 2005 was 13.6 percent above the prior year. This increase resulted from an outpatient volume increase and a rate increase. As shown in the following graph, both inpatient discharges and inpatient days were down slightly from the prior year.

Inpatient Volume



Outpatient Volume



Although there was a modest decline in inpatient services, there was substantial growth in outpatient visits over the prior year, including emergency room visits.

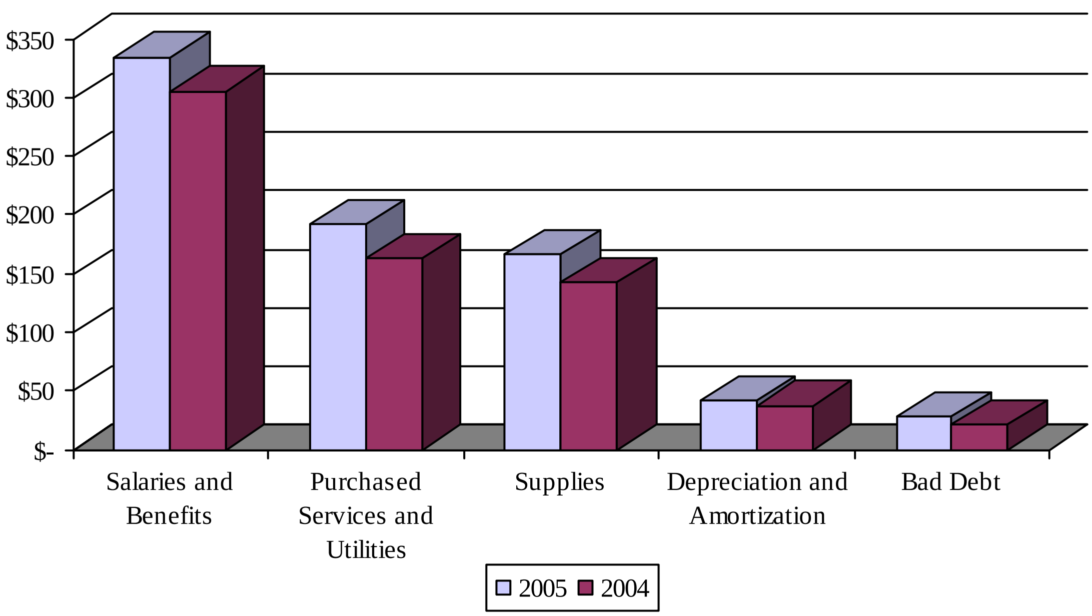
In addition to growth in outpatient clinic visits, the Medical Center also had significant growth in the outpatient procedure area as a result of the July 1, 2004, purchase of an outpatient surgical center and the November 1, 2004, purchase of additional kidney dialysis units in the Lynchburg, Virginia area. The outpatient surgical center provided 7,291 new surgical cases in 2005 and generated an additional $10.2 million in operating revenue. The new dialysis units provided an additional 40,282 dialysis procedures that yielded $10.3 million of operating revenue.

The other factor contributing to the increase in patient revenue was a nine percent charge rate increase on July 1, 2004.

Operating Expenses

As a result of growth in patient volumes and inflation, operating expenses increased by 13.7 percent over the prior year.

Operating Expenses



* in millions

There are two noteworthy issues regarding operating expenses:

- Compensation cost increased by $29.1 million. Contributing to this growth in personnel cost was an increase of 326 full time equivalent employees (FTE's) from June 30, 2004 to June 30, 2005. Most of this growth was in the outpatient surgical center, which added an average of 73 FTE's and the Lynchburg dialysis units, which added an average of 70 FTE's. There was also an increase of 27 FTE's in the peri-operative area because two additional operating suites became available in December 2004. In addition to FTE growth, there was an average salary increase of 3.5 percent.

- The supply expense increase was not only affected by the new entities discussed above, but were increased by five percent in surgical cases. A portion of the increase in surgical cases was caused by a 26 percent increase in transplants, which tend to be supply intensive. The case mix index (a measure of intensity and resource requirements) increased slightly.

Statement of Cash Flows

The statement of cash flows provides additional information about the Medical Center's financial results by reporting the major sources and uses of cash. A comparative summary of the Statement of Cash Flows for the years ended June 30, 2005 and 2004 is as follows:

Statement of Cash Flows
For the Years Ended June 30, 2005 and 2004

	2005	2004	Increase/(Decrease)	
Cash flows from operating activities	$130.2	$ 79.0	$51.2	64.8%
Cash flows from noncapital financing activities	1.6	(4.3)	5.9	(137.2%)
Cash flows from capital and related financing activities	(85.8)	(78.0)	(7.8)	10.0%
Cash flows from investing activities	27.2	22.9	4.3	18.8%
Net increase in cash and cash equivalents	73.2	19.6	53.6	273.5%
Cash and cash equivalents - beginning of the year	100.8	81.2	19.6	24.1%
Cash and cash equivalents - end of the year	$174.0	$100.8	$73.2	72.6%

* in millions

The cash generated from operating activities increased by $51.2 million from 2004 to 2005 primarily as a result of improved collections from patients' accounts receivable. Although net patient revenue increased by $93.6 million in 2005, net accounts receivable decreased by $15.7 million during this same period. Cash required for capital and related financing activities required $7.8 million more cash than the previous year because less cash was received from debt proceeds than the previous year. Last year, $15.3 million was received as proceeds from debt and in 2005, only $4.1 million was received. Cash provided from investing activities increased by $4.3 million. Proceeds realized from transactions involving the purchase and sales of investments provided an additional $16.5 million in 2005. The acquisition of the Virginia Ambulatory Surgery Center and the Lynchburg Nephrology Dialysis required the use of $14.5 million.

Economic Factors Affecting the Future

The Medical Center continues to improve and upgrade its inpatient hospital services. During fiscal year 2003, the Medical Center began a major expansion of its University Hospital facility that will cost $87.2 million. This project was undertaken to expand and improve facilities for heart, perioperative and interventional radiology services. Included in the project are an addition of five operating rooms; complete reconstruction of 19 existing operating rooms; expansion and reconstruction of the Heart Center's diagnostic, interventional, and clinic facilities; relocation and expansion of Interventional Radiology; and the reorganization and modernization of hospital-based clinical laboratory functions. To ensure that the new facilities will have the capability to provide the most advanced care for patients well into the future, management has committed to a plan for making a major investment in the latest technology for the services located in the newly constructed spaces. In December 2004, 14 new operating rooms and support space were opened and 12 old operating rooms were closed for renovation. On July 1, 2004, there were 21 operating rooms in service and at the end of fiscal year 2005, there were 23 in service.

In the second quarter of fiscal year 2006, the Medical Center will pay $6.7 million to the University of Virginia Health Services Foundation (HSF) to purchase the land and building used by the outpatient surgery center, which the Medical Center purchased from HSF in July 2004.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2005
With Comparative Amounts as of June 30, 2004

	2005	2004
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 155,423,174	$ 90,550,428
Short term investments	5,267,427	-
Accounts receivable, net of estimated uncollectibles of $122,757,660 at June 30, 2005	90,060,920	105,727,319
Due from University of Virginia	4,648,894	4,178,723
Inventories and prepaid expenses	17,192,476	17,569,896
Notes receivable	18,490	24,154
Total current assets	272,611,381	218,050,520
Noncurrent assets:		
Cash and cash equivalents restricted (Note 2)	8,584,012	5,998,184
Due from the University of Virginia - noncurrent	-	112,297
Investments in pooled endowment funds (Note2)	111,912,132	101,604,904
Goodwill (Note 3)	14,658,077	895,064
Investments (Note 2)	6,557,728	6,435,032
Investments in affiliated companies (Note 4)	6,436,699	5,135,530
Land (Note 5)	6,975,246	6,971,931
Construction in Progress (Note 5)	58,475,708	48,981,126
Depreciable land improvements, buildings, and equipment, less accumulated depreciation of $370,126,343 at June 30, 2005 (Note 5)	265,185,798	239,240,838
Deferred bond discount and issue costs, net of amortization of $137,121 at June 30, 2005	614,405	647,579
Cash and cash equivalents (Note 2)	9,943,948	4,248,821
Investments (Note 2)	215,821,776	221,380,109
Total other assets	705,165,529	641,651,415
Total assets	977,776,910	859,701,935
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	105,488,314	87,624,731
Obligations under Security Lending (Note 2)	30,056,055	-
Due to third-party payors	25,458,401	18,314,066
Current installments of long-term debt (Note 8)	9,029,999	9,542,003
Grants payable - current portion	6,671,861	4,575,662
Bond premium - current amortization	109,847	109,847
Total current liabilities	176,814,477	120,166,309
Long-term liabilities:		
Long-term debt (Note 8)	124,798,263	126,866,758
Grants payable - noncurrent portion	5,000,000	5,000,000
Bond premium, net of amortization	759,902	869,750
Noncontrolling interest in subsidiary	1,861,660	1,733,206
Total long-term liabilities	132,419,825	134,469,714
Total liabilities	309,234,302	254,636,023

NET ASSETS		
Invested in capital assets, net of related debt	197,883,662	170,007,634
Restricted for:		
Nonexpendable	53,099,192	53,099,193
Expendable	25,994,260	16,914,436
Unrestricted	391,565,494	365,044,648
Total net assets	$ 668,542,608	$ 605,065,911

The accompanying Notes to Financial Statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
As of June 30, 2005
With Comparative Amounts as of June 30, 2004

	2005	2004
Operating revenue:		
Net patient service revenue (Note 11)	$780,197,093	$686,577,573
University allocations (Note 12)	10,671,490	11,436,436
Other	19,398,970	15,397,773
Total operating revenue	810,267,553	713,411,782
Operating expenses:		
Salaries and wages	268,241,061	245,944,583
Fringe benefits	66,586,617	59,759,769
Supplies	165,845,399	142,671,941
Purchased services and other expenses	179,722,048	151,450,198
Utilities	13,015,780	12,203,069
Provision for depreciation and amortization	42,008,125	37,655,652
Provision for bad debts	27,389,200	21,376,370
Total operating expenses	762,808,230	671,061,582
Income from operations	47,459,323	42,350,200
Nonoperating revenue/(expenses):		
Gifts	2,786,304	536,202
Investment income	14,783,415	10,009,986
Net increase in the fair value of investments	7,144,077	3,897,117
Net gain from investments in affiliated companies (Note 4)	2,445,331	2,264,481
Noncontrolling interest in subsidiary income	(1,591,856)	(1,078,371)
Interest expense	(4,815,973)	(4,338,040)
Loss on disposal of fixed assets	(184,995)	(1,213,409)
Gain sharing with the School of Medicine (Note 13)	(4,408,929)	(6,601,714)
Other	(140,000)	-
Net nonoperating revenues	16,017,374	3,476,252
Increase in net assets	63,476,697	45,826,452
Net assets - beginning of year	605,065,911	559,239,460
Net assets - end of year	$668,542,608	$605,065,911

The accompanying Notes to Financial Statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF CASH FLOWS
As of June 30, 2005
With Comparative Amounts as of June 30, 2004

	2005	2004
Cash flows from operating activities:		
Receipts from patients and third-parties	$ 772,360,983	$ 670,877,319
Receipts from other revenue	33,360,337	32,065,758
Payments to employees	(333,889,035)	(302,304,428)
Payments to suppliers	(328,622,771)	(309,441,092)
Payment for utilities	(13,015,780)	(12,203,069)
Net cash provided by operating activities	130,193,734	78,994,488
Cash flows from noncapital financing activities:		
Transfer/(to) from the University	-	(4,400,000)
Payments on grants	(1,135,427)	(424,338)
Gifts	2,786,304	536,202
Net cash provided/(used) by noncapital financing activities	1,650,877	(4,288,136)
Cash flows from capital and related financing activities:		
Purchase of capital assets	(77,368,043)	(81,827,229)
Principal paid on capital debt	(8,170,651)	(7,542,663)
Interest paid on capital debt	(4,815,973)	(4,314,801)
Proceeds from incurring loan from the University	4,102,411	15,265,678
Proceeds from sale of capital assets	365,966	382,351
Net cash used by capital and related financing activities	(85,886,290)	(78,036,664)
Cash flows from investing activities:		
Interest on investments	11,057,046	8,955,852
Purchase of investments	(88,868,214)	(129,170,182)
Proceeds from sale of investments	119,655,698	143,493,681
Other	1,346,637	898,804
Purchase of affiliate entities	(14,473,587)	-
Transfer to affiliate	(58,800)	(32,509)
Payment to affiliate	(1,463,400)	-
Investment in affiliate	-	(400,000)
Owner distribution to affiliate member	-	(831,887)
Net cash provided by investing activities	27,195,380	22,913,759
Net increase in cash and cash equivalents	73,153,701	19,583,447
Cash and cash equivalents - beginning of the year	100,797,433	81,213,986
Cash and cash equivalents - end of the year	$ 173,951,134	$ 100,797,433

RECONCILIATION OF OPERATING INCOME TO NET CASH PROVIDED		
BY OPERATING ACTIVITIES:		
Operating income	$ 47,459,323	$ 42,350,199
Adjustments to reconcile operating income to net cash provided		
by operating activities:		
Depreciation and amortization	42,008,125	37,655,652
Change in assets and liabilities:		
Accounts receivables	23,662,586	(12,803,303)
Inventories and prepaid expenses	377,420	(3,766,070)
Accounts payable and accrued expenses	16,686,280	15,558,010
Net cash provided by operating activities	$ 130,193,734	$ 78,994,488

The accompanying Notes to Financial Statements are an integral part of this statement.

UNIVERSITY OF VIRGINIA MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2005

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Mission

The University of Virginia Medical Center (Medical Center) is a division of the University of Virginia (University). The Medical Center's mission is to enrich the quality of human life by the improvement of health, advancement of medical and scientific knowledge, and creation of an environment for professional preparation of individuals dedicated to healthcare service. Only those activities directly associated with the furtherance of this mission are considered to be operating activities. Other activities that result in gains or losses unrelated to the Medical Center's primary mission are considered to be nonoperating.

A separate report is prepared for the Commonwealth of Virginia that includes all agencies, boards, commissions, and authorities over which the Commonwealth exercises or has the ability to exercise oversight authority. The University is a component unit of the Commonwealth of Virginia and is included in the basic financial statements of the Commonwealth.

B. Basis of Accounting

The Medical Center has adopted the economic resources measurement focus and full accrual basis of accounting in accordance with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB) and the Financial Accounting Standards Board (FASB) for providers of healthcare services. Revenues are recorded when earned and expenses are recorded when incurred and measurable, regardless of when the related cash flows take place. Non-exchange transactions, in which the Medical Center receives value without directly giving equal value in exchange include private donations. On an accrual basis, revenues from these transactions are recognized in the fiscal year in which all eligibility requirements have been satisfied, if measurable and probable of collection.

Pursuant to GASB Statement 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting,* the Medical Center has elected to apply the provisions of all relevant pronouncements of FASB, including those issued after November 30, 1989.

The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis of Public Colleges and Universities.*

C. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of 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.

D. Subsidiary and Affiliated Companies

The consolidated financial statements include the accounts of controlled subsidiary companies where ownership is greater than 50 percent. Investments in affiliates in which the Medical Center has a substantial interest (approximately 20 to 50 percent) or for which the Medical Center exercises significant influence, but not control, over policy decisions are accounted for by the equity method.

E. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Net patient service revenue also includes funds from the Commonwealth of Virginia's Department of Medical Assistance Services for disproportionate share and indirect medical education payments and funds from third-party payors for estimated retroactive adjustments under reimbursement agreements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

F. Indigent Care

The Medical Center accepts all patients regardless of their ability to pay. A patient is classified as indigent by reference to established Commonwealth policies. The criteria for identifying indigent patients are based on asset and income guidelines that are updated annually in accordance with the federal poverty income guidelines as provided by the federal Office of Management and Budget. Because the Medical Center does not pursue collection of amounts determined to qualify as indigent care, they are not reported as revenue.

G. Receivables From Third Parties and Contractual Adjustments

A significant portion of the Medical Center's services is rendered to patients covered by Medicare, Medicaid, or other third-party payors. The Medical Center entered into contractual agreements with these third parties to accept payment for services in amounts less than scheduled charges.

Certain annual settlements of amounts due for patient services covered by third parties are determined through cost reports that are subject to audit and retroactive adjustment by the third parties. Provisions for possible adjustments of cost reports have been estimated and reflected in the accompanying financial statements. Since the determination of cost reimbursement settlements of amounts earned in prior years has been based on reasonable estimation, the difference in any year between the originally estimated amount and the final determination is reported in the year of determination.

H. Cash, Cash Equivalents, and Investments

Cash and cash equivalents include cash and all highly liquid investments with maturity of three months or less when purchased.

Donated investments are reported at the fair market value at the date of receipt. The major portion of the investments of the Medical Center's endowment funds is held and invested by the University of Virginia Investment Management Foundation. Annually, endowment earnings on the consolidated endowment pool are distributed to the participating funds based on the participating share of each fund in the pool.

Investments are carried at fair value as determined by quoted market prices. Unrealized appreciation or depreciation of investments is included in the current period net earnings. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

Investments in affiliated companies are reported using the equity method of accounting.

I. Inventories

Inventories are valued at the lower of cost, generally determined on the weighted average method or market and consist primarily of expendable supplies held for consumption.

J. Property, Plant, and Equipment

Property, plant, and equipment are stated at cost, or if donated, at fair market value at the date of donation. The Medical Center capitalizes expenditures for equipment costing $2,000 or more and having a useful life of two years or greater in accordance with the *Medicare Reimbursement Manual*.

Depreciation on property, plant, and equipment, excluding land and construction-in-progress, is computed over the estimated useful lives of the assets using the straight-line method. The general range of estimated useful lives is 10 to 40 years for buildings and fixtures and 3 to 20 years for equipment.

The Medical Center utilizes the half-year convention for recognizing depreciation expense related to equipment, both fixed and moveable. A half-year of depreciation is recognized on all equipment in the fiscal year of acquisition. Likewise, a half-year of depreciation is recognized in the fiscal year at the end of the equipment's useful life. Depreciation on buildings is recognized from the date that the asset is placed in service to the date on which it is retired.

K. Deferred Bond Issue Costs

Deferred bond issue costs are amortized over the remaining life of the bonds.

L. Accrued Leave

The amount of leave earned, but not taken by salaried employees is recorded as a liability on the Statement of Net Assets. The amount reflects, as of June 30, 2005, all earned leave not taken and the amount payable under the catastrophic leave pay-out policy upon termination, which is the lesser of 25 percent of sick leave not taken or $5,000 per employee with five or more years of service. The liability is based on the probability that an employee with less than five years of service will eventually become vested and have a right to receive payment for sick leave benefits. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

M. Reclassifications

Certain amounts from prior year statements have been reclassified to conform to current year presentation.

2. CREDIT RISK UNDERLYING CASH, CASH EQUIVALENTS, AND INVESTMENTS

GASB Statement 40, *Deposit and Investment Risk Disclosures*, effective for fiscal periods beginning after June 15, 2004, amends GASB Statement 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreement), and Reverse Repurchase Agreements*. GASB Statement 40 eliminates the custodial credit risk disclosures required for Categories 1 and 2 deposits and investments, but maintains disclosures for category 3. The following risk disclosures are required by GASB Statement 40:

Custodial Credit Risk (Category 3 deposits and investments) - The custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, a government will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. The custodial credit risk for investments is the risk that, in the event of the failure of the counterparty to a transaction, a government will not be able to recover the value of investment or collateral securities that are in the possession of an outside party. The Medical Center has no Category 3 deposits or investments for 2005.

Credit Risk - The risk that an issuer or other counterparty to an investment will not fulfill its obligations. GASB Statement Number 40 requires the disclosure of the credit quality rating on any investments subject to credit risk.

Concentration of Credit Risk - The risk of loss attributed to the magnitude of a government's investment in a single issuer. GASB Statement 40 requires disclosure of any issuer with more than five percent of the Medical Center investments. Federal Home Loan Bank, Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, and the University of Virginia Growth and Income Fund investments represent 21, 21, 22 and 34 percent, respectively, of total investments.

Interest Rate Risk - The risk that changes in interest rates will adversely affect the fair value of an investment. GASB Statement 40 requires disclosure of maturities for any investments subject to interest rate risk. The Medical Center does not have an interest rate risk policy.

Foreign Currency Risk - The risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. The Medical Center has no foreign investments or deposits for 2005.

The following information is provided with respect to the risks associated with the Medical Center's cash, cash equivalents, and investments at June 30, 2005.

Cash and Cash Equivalents

Pursuant to Section 2.2-1800, et seq., Code of Virginia, all state funds of the Medical Center are maintained by the Treasurer of Virginia who is responsible for the collection, disbursement, custody, and investment of state funds. Cash deposits held by the Medical Center are maintained in accounts collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.2-4400, et seq., Code of Virginia. The Virginia Security for Public Deposits Act eliminates any custodial credit risk for the Medical Center's deposits. Cash and cash equivalents represent cash with the Treasurer, cash on hand, certificates of deposit and temporary investments with original maturities of 90 days or less, and cash equivalents with the Virginia State Non-Arbitrage Program (SNAP). SNAP is an open-end management investment company registered with the Securities and Exchange Commission (SEC). Cash and cash equivalents reporting requirements are defined by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*.

Additional disclosures required for cash equivalents under GASB Statement 40 are presented with the investments in the following tables.

Investments

The investment policy of the Medical Center is established by the Board of Visitors and monitored by the Board's Finance and Audit Committee. Authorized investments are set forth in the Investment of Public Funds Act of the Code of Virginia, Sections 2.2-4500 through 2.2-4516. Authorized investments include: U.S. Treasury and agency securities, corporate debt securities of domestic corporations, asset-backed securities, mortgage-backed securities, AAA rated obligations of foreign governments, bankers acceptances and bank notes, negotiable certificates of deposit, repurchase agreements, and money market funds.

Investments fall into two groups: short- and long-term. Short-term investments have an original maturity of over 90 days, but less than or equal to one year. Long-term investments have an original maturity greater than one year.

Credit and Concentration of Credit Risks

	FairValue	Credit Rating	Concentration Risk Percent
Cash equivalents:			
U.S. government securities:			
Short-term investment fund	$ 9,943,948	AAA	
State non-arbitrage program:			
Virginia College Building Authority			
1999A pooled bond fund	440,747		
Other	1,504,175		
Total cash equivalents	11,888,870		

	FairValue	Credit Rating	Concentration Risk Percent
Investments:			
U.S. government securities:			
Federal Home Loan Bank	70,181,641	AAA	21%
Federal Home Loan Mortgage Corporation	70,800,469	AAA	21%
Federal National Mortgage Association	71,966,535	AAA	22%
Government Home Loan Bank	7,485,937	AAA	2%
University of Virginia Growth and Income Fund	111,912,132		34%
Total investments	332,346,714		
Total cash equivalents and investments	$344,235,584		

Interest Rate Risk - Maturities

	Less than 1 year	1-5 years	Total
Investments:			
U.S. government securities:			
Federal Home Loan Bank	$ 60,180,041	$ 10,001,600	$ 70,181,641
Federal Home Loan Mortgage Corporation	51,036,006	19,764,463	70,800,469
Federal National Mortgage Association	52,049,323	19,917,212	71,966,535
Government Home Loan Bank	7,485,937	-	7,485,937
University of Virginia Growth and Income Fund	-	111,912,132	111,912,132
Total investments	$170,751,307	$161,595,407	$332,346,714

Securities Lending Transactions

Investments and cash equivalents held by the Treasury of Virginia represent the Medical Center's allocated share of cash collateral received and reinvested and securities received for the State Treasury's securities lending program. Information related to the credit risk of these investments and the State Treasury's securities lending program is available on a statewide level in the Commonwealth of Virginia's Comprehensive Annual Financial Report.

3. GOODWILL

In July 1994, the Medical Center and the University of Virginia Health Services Foundation (HSF) entered into a Memorandum of Agreement for the purpose of joint purchase and operation of a hyperbaric oxygen unit. The memorandum provided that HSF would own 67 percent interest and the Medical Center would own 33 percent. In December 2000, the Medical Center acquired from HSF its interest in the hyperbaric oxygen unit. Of the acquisition price, $1,166,615 was recorded as goodwill for the purchase of the assets and is being amortized over five years.

In May 2000, the Medical Center acquired from Augusta Health Care, Inc., the kidney dialysis assets in a transaction accounted for as a purchase. Accordingly, $987,188 was recorded as goodwill for the purchase of the assets and is being amortized over five years. An additional

$800,000 was recorded as goodwill for a non-competition agreement and is being amortized over its ten-year life.

In July 2004, the Medical Center purchased Virginia Ambulatory Surgery Center (VASI), now known as Virginia Outpatient Surgery Center. As a result of the purchase, the Medical Center recorded $6,980,198 as goodwill to be amortized over a period of 40 years.

In November 2004, the Medical Center purchased the Amherst and Lynchburg renal facilities. As a result of the purchase, the Medical Center recorded goodwill of $3,476,068 and $4,017,321, respectively, for the Amherst and Lynchburg facilities. The goodwill is to be amortized over a period of 40 years.

4. AFFILIATED COMPANIES

University of Virginia Imaging, LLC

On March 26, 2002, the Medical Center entered into an agreement with Outpatient Imaging Affiliates of Virginia, LLC (OIA) to establish University of Virginia Imaging, LLC (UVI). The limited liability corporation was formed to operate an outpatient diagnostic imaging center to help respond to the need for radiology services in the Charlottesville area.

The Medical Center currently operates an outpatient imaging department offering MRI, plain film radiography, fluoroscopy, and ultrasound in office space at the Fontaine Research Park. Although available to all Medical Center physicians, the site principally serves orthopedic physicians located at the Fontaine Office Park. UVI also provides services to outpatients from the Medical Center's primary and secondary service areas.

Since the Medical Center owns 80 percent of UVI, its financial activity is presented under the consolidation method.

Community Medicine, LLC

On November 14, 2000, the University of Virginia established the Community Medicine University of Virginia, LLC (Community Medicine). Community Medicine was established as a limited liability corporation (LLC) under the laws of the Commonwealth of Virginia to house physician practices. This model gives physicians an organizational structure that allows them the opportunity to practice independently in a virtual private practice environment with all the risks and gains associated with an independent model. As an LLC, which is a wholly-owned subsidiary of the University, Community Medicine is considered a disregarded entity for tax purposes and its financial activity is accounted for under the consolidation method.

Community Medicine commenced operations on July 1, 2001, and as of June 30, 2005, the Medical Center's investment totaled $1,810,000.

Central Virginia Health Network, Inc.

In May 1995, the Medical Center joined the Central Virginia Health Network, Inc. (CVHN), a partnership of eight Richmond area hospitals. CVHN was formed to provide an efficient and coordinated continuum of care with services ranging from acute hospital treatment to primary physician care and home health services.

The Medical Center originally paid $100 for 10,000 shares of common stock and $109,900 as additional paid-in capital. In addition, the Medical Center is obligated for monthly dues to CVHN of $15,913. Complete financial statements can be obtained from the registered agent: Steven Gravely, Esquire, Mezzullo and McCandlish, Post Office Box 796, Richmond, Virginia 23206.

University of Virginia / HEALTHSOUTH, LLC

The Medical Center entered into a joint venture with HEALTHSOUTH Corporation to establish an acute rehabilitation facility located at the Fontaine Research Park to provide patient services to the region. The Medical Center made a capital contribution of $2,230,000 to the joint venture in May 1996, which represents a 50 percent interest. Complete financial statements can be obtained from the managing member: HEALTHSOUTH Corporation, 7700 East Parham Road, Richmond, Virginia 23294.

Valiance Health, LLC

In November 1997, the Medical Center became a participant with Rockingham Memorial Hospital and Augusta Health Care, Inc., in Valiance Health, LLC (Valiance), a joint venture integrating and coordinating the delivery of healthcare services in central and western Virginia. The Medical Center contributed $100,000 in initial capital, which entitles it to a pro-rata distribution of any profits and losses of Valiance. In October 2003, the Medical Center contributed an additional $400,000 in capital to Valiance, bringing the Medical Center's total investment to $500,000.

University HealthSystem Consortium

In December 1986, the Medical Center became a member of the University HealthSystem Consortium (UHC). Founded in 1984, UHC is an alliance of the clinical enterprises of academic health centers. While focusing on the clinical mission, UHC is mindful of and supports the research and education missions. The mission of the University HealthSystem Consortium is to advance knowledge, foster collaboration, and promote change to help members compete in their respective healthcare markets. In keeping with this mission, UHC helps members pool resources, create economies of scale, improve clinical and operating efficiencies, and influence the direction and delivery of healthcare. Accordingly, UHC is organized and operated on a cooperative basis for the benefit of its member health systems as patrons.

UHC is a not-for-profit organization. It is incorporated as a nonstock corporation and designated as a nonexempt cooperative which is taxable under Subchapter T, section 1382-1388, of the Internal Revenue Code. As such, UHC's bylaws provide for distributions of patronage dividends to its patrons. This allocation is based on the value of business done with or for each patron by UHC. The Medical Center records the portion of the patronage dividends that were held by UHC as patronage equity.

As of June 30, 2005

	Common Stock and Equity Contributions	Share of Accumulated Income/(Loss)	Net Investment
UVA Imaging, LLC	$687,019	$2,336,542	$3,023,561
Community Medicine, LLC	1,810,000	(2,400,427)	(590,427)
Central Virginia Health Network, Inc.	232,500	(41,024)	191,476
HealthSouth, LLC	2,230,000	2,583,431	4,813,431
Valiance, LLC	500,000	34,635	534,635
University HealthSystem Consortium	-	897,157	897,157

HealthCare Partners, Inc.

In May, 1995, HealthCare Partners, Inc., a non-stock, non-profit corporation, was established to support networking, external business relationships with neighboring hospitals and physicians groups, and expansion of primary care activities. The Medical Center and the Health Services Foundation are the primary contributors to the funding of the corporation. The corporation is governed by a board of directors composed of Health Sciences Center staff, community members, and University Board of Visitors appointees.

5. PROPERTY, PLANT, AND EQUIPMENT

A summary of the property, plant, and equipment accounts and the related accumulated depreciation as of June 30, 2005, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Property, plant, and equipment:				
Land	$ 6,971,931	$ 13,315	$ 10,000	$ 6,975,246
Land improvements	8,304,746	21,902	-	8,326,648
Building	346,634,102	21,741,234	128,217	368,247,119
Equipment - fixed	17,157,100	3,640,035	-	20,797,135
Equipment - movable	199,398,535	41,644,273	3,101,569	237,941,239
Construction-in-progress	48,981,126	40,410,885	30,916,303	58,475,708
Total property, plant, and equipment	627,447,540	107,471,644	34,156,089	700,763,095
Less: Accumulated depreciation:				
Land improvements	6,265,621	190,320	-	6,455,941
Building	193,096,088	14,599,032	12,003	207,683,117
Equipment - fixed	14,954,527	530,421	-	15,484,948
Equipment - movable	117,937,409	25,227,425	2,662,497	140,502,337
Total accumulated depreciation	332,253,645	40,547,198	2,674,500	370,126,343
Net property, plant, and equipment	$295,193,895	$ 66,924,446	$31,481,589	$330,636,752

6. ASSETS HELD BY TRUSTEES

Assets held by trustees consist of assets whose use is limited under indenture agreements. The Series 1998B, 1999A, 2003A, and 2003B bond resolutions require that deposits be made in a specific order to various accounts and funds held by the Treasurer of Virginia as follows:

A. to the credit of the Interest Account on a monthly basis, the amount of interest due and payable on the first day of the succeeding month with respect to the bonds of each series then outstanding;

B. to the credit of the Principal Account on an annual basis, the amount sufficient to pay maturing principal of all bonds on the next principal payment date;

C. to the credit of the Sinking Fund Account, the amount sufficient to retire all bonds to be called by mandatory redemption on the next ensuing mandatory redemption date;

D. to the credit of the Reserve Fund, the amount necessary to fund the Reserve Account Requirement, as defined by the bond resolution;

E. to the credit of the Depreciation Reserve Fund, commencing on December 1, 1988, and each December 1 thereafter, 100 percent of the Depreciation Reserve Fund requirement as defined by the bond resolution; and

F. to the credit of any other fund or account created pursuant to an applicable Series Resolution.

Funds held by the Treasurer and restricted by bond agreements consist of the following as of June 30, 2005:

Assets:	
Construction Fund	$ 237,450
Construction Fund - Pooled *	440,747
Bond Sinking Fund - 1998B	944
Bond Sinking Fund - 1999A	7,931
Depreciation Reserve	223,574,477
Bond Sinking Fund-2003B (Construction Fund)	1,504,175
Total assets	$225,765,724

* The Medical Center also participates in the Commonwealth of Virginia's Public Higher Education Financing Program, Series 1999A ("Pooled Bond Program"). The indenture of the series specifies the Bank of New York as trustee and the Medical Center is required to make debt service payments to the trustee in the amount billed by the trustee semi-annually.

7. ACCOUNTS PAYABLE

As of June 30, 2005, the components of accounts payable and accrued expenses consist of the following:

Vendor accounts payable	$ 29,373,492
Accrued leave	21,155,798
Due to Health Services Foundation	16,801,137
Accrued payroll	9,067,311
Other accounts payable	7,045,708
Due to the University	5,863,847
Other accrued expenses	16,181,021
Total accounts payable and accrued expenses	$105,488,314

8. LONG-TERM DEBT

Description	Interest Rate	Maturity	Beginning Balance	Additions	Reductions	Refinance	Ending Balance	Current Portion
Bonds payable:								
Series 1998B	3.5-5.00	2018	$ 5,270	$ -	$ 280	$ -	$ 4,990	$ 290
Series 1999A	4.5-5.25	2013	36,820	-	4,225	-	32,595	4435
Series 1999A - pooled	4.5-5.25	2019	3,930	-	165	2,830	935	170
Series1993A pooled refinance	3.0-5.00	2020	-	2,970	-	-	2,970	35
Series 2003A pooled	4.5-6.00	2015	32,055	-	330	-	31,725	345
Series 2003B pooled	4.7-6.00	2023	37,165	-	1,248	-	35,917	1,306
UVA pooled debt	4.7-6.00	2024	17,562	-	663	-	16,899	694
UVA commercial paper	4.7-6.00	n/a	-	4,100	-	-	4,100	-
Total bonds payable			132,802	7,070	6,911	2,830	130,131	7,275
Notes payable:								
Helicopter			1,951	-	975	-	976	976
UVA imaging			1,656	1,350	285	-	2,721	779
Total notes payable			3,607	1,350	1,260	-	3,697	1,755
Total long-term debt			$136,409	$8,420	$8,171	$2,830	$133,828	$9,030

* in thousands

The following represent future debt requirements:

Fiscal Year	Principal	Interest	Total
2006	$ 9,029,999	$ 6,105,136	$ 15,135,135
2007	13,653,435	5,750,573	19,404,008
2008	7,975,546	5,378,289	13,353,835
2009	9,074,835	4,988,380	14,063,215
2010	9,529,077	4,558,006	14,087,083
2011-2015	52,834,700	15,577,063	68,411,763
2016-2020	19,121,048	5,674,113	24,795,161
2021-2024	12,609,622	1,311,185	13,920,817
Total	$133,828,262	$49,342,745	$183,171,017

During the fiscal year ended June 30, 2005, the Commonwealth of Virginia, on behalf of the University of Virginia, issued bonds to advance refund $2,830,000 of Series 1999A pooled bonds. The advance refunding resulted in an accounting loss of $140,000.

As of June 30, 2005, the University of Virginia had issued $4.1 million in commercial paper to the Medical Center to form bridge financing between the first and second issuances for the hospital expansion. In July 2005, the University issued General Revenue Bonds, Series 2005, a portion of which was used to refund outstanding commercial paper balance. To reflect this activity, the balance is shown as long term debt as of June 30, 2005.

9. FINANCING OF MAJOR CONSTRUCTION AND RENOVATION PROJECTS

Two major construction and renovation projects were initiated in fiscal year 2003. The first project is expected to cost $87.2 million. It includes an addition to the south side of the University Hospital that will add 120,000 square feet and the renovation of an existing 150,000 square feet on the first and second floors in that building. This project was undertaken to expand and improve facilities for Heart, Perioperative, and Interventional Radiology services. Included in the project are an addition of five operating rooms and the complete reconstruction of 19 existing operating rooms; expansion and reconstruction of the Heart Center’s diagnostic, interventional, and clinic facilities; relocation and expansion of Interventional Radiology; and the reorganization and modernization of hospital-based clinical laboratory functions. The addition was completed in July 2004 and the remainder of the renovations should be completed by March 2006. The cost of the project is being financed by a loan from the University’s Pooled Bond Program through which the University has issued bonds and made cash available to various University entities to finance construction projects. Amounts previously borrowed in fiscal year 2003 will be repaid over a 20-year period that began on June 1, 2004. The funds required to complete the remainder of the project will be borrowed from the University in the fall of 2005.

The second project increases and expands the facilities available for Cancer Services. Included in this project are the expansion and relocation of breast care services, construction of a new Infusion Center in the west wing of the Hospital West Complex, and the expansion of examination rooms and other support space. This renovation is scheduled for completion in the fall of 2005. The cost of this project is expected to be $5 million and was borrowed from the University’s Pooled Bond Program.

A third project was initiated during fiscal year 2004. The Clinical Office Building at Fontaine Research Park was purchased in April 2004. The Medical Center borrowed $17.6 million from the University's Pooled Bond Program to buy the building and complete its construction. The purpose of this building is to expand the outpatient clinic services for the Medical Center.

10. UNIVERSITY WORKING CAPITAL LOAN

In July 2002, the Medical Center secured a variable interest working capital loan of $3.9 million from the University with a four-year term and annual principal and interest payments to purchase a helicopter from Agusta Aerospace Corporation.

11. NET PATIENT SERVICE REVENUE

The Medical Center's patient service revenue is as follows for the year ended June 30, 2005:

Gross patient service revenue:	
Inpatient:	
Routine services	$ 196,766,032
Ancillary services	640,997,051
Outpatient:	
Ancillary services	566,579,204
Clinics	26,984,790
Total gross patient service revenue	1,431,327,077
Allowances for indigent care and contractual adjustments	(651,129,984)
Net patient service revenue	$ 780,197,093

The Medical Center received $73,769,649 in fiscal year 2005 from the Commonwealth of Virginia's Department of Medical Assistance Services for disproportionate share and indirect and direct medical education relating to the care provided to indigent patients. Of this amount, $15,966,953 was the payment of disproportionate share relating to the care provided to indigent patients. Additionally, $57,802,696 was a payment to reimburse the Medical Center for indirect and direct medical education. These payments are included in net patient service revenue.

Of the payment received for disproportionate share relating to the care provided to indigent patients, $7,391,418 was for physician services.

The amounts written off for indigent care, net of the disproportionate share and indirect and direct medical education payments applicable to the Medical Center, were $13,776,825 for the year ended June 30, 2005.

12. UNIVERSITY ALLOCATIONS

The School of Medicine faculty assists the Medical Center in its mission of providing healthcare and medical education. A survey is conducted annually to determine the value of this effort. An allocation is made on the Medical Center's Statement of Revenues, Expenses, and Changes in Net Assets to reflect the value of this effort as income. This allocation is offset in the operating expenses of the Medical Center by an equal amount in purchased services. The amount of this allocation for the year ended June 30, 2005 was $9,125,075.

Likewise, the University provides the Medical Center with various general and administrative support services. An analysis is prepared annually to determine the cost of providing these services. The same type of allocation as above is made to the Medical Center's Statement of Revenues, Expenses, and Changes in Net Assets to reflect the difference between the direct charge to the Medical Center and the actual cost of these services. The amount of this allocation for the year ended June 30, 2005 was $1,546,415.

Although these allocations have no direct effect on operating income, they do affect the Medical Center's reimbursement from third-party payors by increasing allowable costs.

13. GAIN SHARING WITH THE SCHOOL OF MEDICINE

Beginning with fiscal year 2003, the Medical Center and the School of Medicine entered into a Memorandum of Understanding for gain sharing. The amount of gain sharing with the School of Medicine is a tiered arrangement based on the Medical Center's income in excess of minimum requirements established by the Board of Visitors.

14. COMMITMENTS

The Medical Center has entered into numerous operating lease agreements for buildings, equipment, and clinical and office space. Future minimum lease payments by year and in the aggregate under these operating leases are:

Year Ending June 30,	Operating Leases
2006	$ 8,423,825
2007	5,379,313
2008	2,801,658
2009	2,147,783
2010	2,089,153
2011 - 2015	2,221,171
2016 - 2020	823,200
2021 - 2025	823,200
2026 - 2030	823,200
2031 - 2035	823,200
2036 - 2040	823,200
2041 - 2045	823,200
2046 - 2050	658,560
Total	$28,660,663

The total rental expense for operating leases for the year ended June 30, 2005, was $7,287,763.

The Medical Center was party to construction contracts and commitments for the year ended June 30, 2005, totaling $95,418,904 of which $69,918,495 was incurred as of June 30, 2005.

The Medical Center entered into various contracts for services and equipment maintenance. These obligations mature as follows:

Year Ending June 30,	Maintenance Contracts
2006	$ 5,157,257
2007	3,074,494
2008	2,468,373
2009	1,519,127
2010	503,039
Total	$12,722,290

15. UNIVERSITY OF VIRGINIA HEALTH SERVICES FOUNDATION

The University of Virginia Health Services Foundation (HSF), a nonprofit, educational, scientific, and charitable organization, began operating with the approval of the Board of Visitors as of June 30, 1980, to assist the University in providing hospital and medical care services, medical education programs, and programs of public charity at the University.

On August 1, 2000, management of 63 outpatient clinics operated by HSF since July 1, 1994, transferred to the Medical Center. At that time, the Medical Center filed for provider-based status with the federal government and became responsible for all costs associated with the operations of these provider-based clinics except for physician's costs. On August 1, 2000, the Medical Center entered into leased employment agreements with HSF for limited personnel who remained HSF employees, but were performing Medical Center duties.

The Medical Center paid HSF $14,207,346 for supervisory and administrative services; $30,637,531 for other services; and $1,652,967 for rental of space for the year ended June 30, 2005.

HSF paid the Medical Center $8,381,305 for clinic facility fees and other services and $8,029 for the rental of space for clinics for the year ended June 30, 2005.

16. RISK MANAGEMENT AND SELF-INSURANCE

The Medical Center is a participant in the Commonwealth of Virginia's self-insurance program administered by the Department of Treasury, Division of Risk Management. Participation in this program provides the Medical Center with medical malpractice insurance on an occurrence basis with no aggregate limitation and with such limits of coverage equal to the statutory malpractice recovery limits as specified in Section 8.01-581.15 of the Code of Virginia. In the opinion of management, such coverage is adequate to provide for the ultimate liability, if any, which might result from the settlement of claims currently asserted against the Medical Center, as well as the potential liability for medical incidents of which the Medical Center has knowledge, but for which claims have not yet been asserted against the Medical Center. Accordingly, no provision is included in the financial statements for such potential liabilities.

Sufficient information has not been developed by the Medical Center to provide a reasonable basis for estimation of the potential liability for incurred medical incidents, which have not been reported to the Medical Center; however, in the opinion of management, any potential liability for unreported medical incidents is not expected to have a material effect on the financial position of the Medical Center.

The University sponsors a self-funded, comprehensive program of medical care benefits. The program covers all employees of the University and the Medical Center. Fringe benefit expenses include estimates for claims that have been incurred, but not reported. Additional information regarding the medical benefits program is available for the entire University only in the University's annual President's Report.

University employees are covered by a self-insured workers' compensation benefits program administered by the Commonwealth of Virginia's Department of Human Resources. Information regarding this plan is available at the statewide level only in the Commonwealth's Comprehensive Annual Financial Report.

Other risk management insurance plans are administered by the Commonwealth of Virginia's Department of Treasury, Division of Risk Management. Risk management insurance includes property, boiler and machinery, crime, employee dishonesty bond, general (tort) liability, professional liability, aviation and watercraft, and automobile liability. Detailed information relating to this policy is available at the statewide level only in the Commonwealth's Comprehensive Annual Financial Report.

The University is self-insured for the first $100,000 of each property and boiler and machinery loss, and for the first $20,000 of each vehicle physical damage loss. The University also maintains excess crime/employee dishonest and excess vehicle physical damage insurance coverages.

17. RETIREMENT PLANS

Employees of the Medical Center are employees of the Commonwealth. Substantially all full-time classified salaried employees participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). Information relating to this plan is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report. The Commonwealth, not the Medical Center, has overall responsibility for contributions to this plan.

Substantially all full-time faculty, including certain administrative staff and Health Care Professionals, participate in Faculty Optional Retirement Plans. These are fixed-contribution plans where the retirement benefits received are based upon the employer and employee contributions (all of which are paid by the Medical Center), and the interest and dividends. Individual contracts issued under the plans for full-time faculty, including certain administrative staff, provide for full and immediate vesting of both the Medical Center's and the participant's contributions. Health Care Professional's employer contributions fully vest after one year of employment.

Total pension costs under the plans were $9,309,055 for the year ended June 30, 2005. Contributions to the Optional Retirement Plans were calculated using base salaries of $138,963,173 for the year ended June 30, 2005. The contribution percentage amounted to seven percent for the year ended June 30, 2005.

18. POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance program that provides post-employment life insurance benefits to eligible retired and terminated employees. The Medical Center also provides retiree life insurance to certain retirees.

The Commonwealth provides healthcare credits against the monthly health insurance premiums of its retirees who have at least 15 years of state service and participate in the state health plan. Additionally, some employees receive healthcare credits for participation in the University of Virginia Health Plan. Information related to these plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

19. OIG DISPROPORTIONATE SHARE PAYMENT REVIEW

In May 2003, the U.S. Department of Health and Human Services' Office of the Inspector General (OIG) issued a report entitled, *Review of Medicaid Disproportionate Share Hospital Payments Made by Virginia's Department of Medical Assistance Services to the University of Virginia Medical Center for Fiscal Years Ending June 30, 1997 and June 30, 1998*. The objectives of the review were to determine if disproportionate share hospital (DSH) payments made to the Medical Center for fiscal years 1997 and 1998: (1) were calculated in accordance with the approved state plan; and (2) did not exceed the uncompensated care costs (UCC) as mandated by the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993). While finding that the Medical Center had calculated DSH in accordance with the state plan, the report concluded that the Medical Center overstated its UCC by including UCC for services furnished by the Medical Center's faculty physicians to Medical Center patients, which is considered faculty UCC.

On September 8, 2005, the Centers for Medicare and Medicaid Services (CMS) issued a disallowance notice to Virginia's Department of Medical Assistance Services (DMAS), with respect to the Medical Center, for $4,760,385, which is the federal government's payment to DMAS for faculty UCC at the Medical Center for 1997 and 1998. In its notice of disallowance, CMS stated its interpretation that neither the state plan nor the federal Medicaid statute permits inclusion of faculty UCC in a hospital's UCC. DMAS has appealed this disallowance.

CMS has obtained from DMAS information showing that inclusion of faculty UCC for the years 1999-2005 affects $1,231,842 in the federal share of Medicaid DSH payments to the Medical Center for 1999 when calculating Medicaid DSH payments to the Medical Center. The financial impact of the final resolution of this case on the Medical Center is not known at this time; however, based on the CMS disallowance for 1997 and 1998 and the data furnished by DMAS for 1999-2005, management has recorded adequate reserves for the potential recovery by CMS should the appeal be decided in favor of CMS and DMAS recovers the federal payments at issue from the Medical Center.

Commonwealth of Virginia

Auditor of Public Accounts
P.O. Box 1295
Richmond, Virginia 23218

Walter J. Kucharski, Auditor

October 20, 2005

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
University of Virginia

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of the **University of Virginia Medical Center**, a division of the University of Virginia, as of and for the year ended June 30, 2005 as listed in the Table of Contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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 University of Virginia Medical Center as of June 30, 2005 and the changes in its net assets and its cash flow for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 1 through 7 are not a required part of the basic financial statements, but is supplementary information required by the accounting principles generally accepted in the United States of America. We have applied certain 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 the information and express no opinion on it.

In accordance with Government Auditing Standards, we have also issued our report dated October 20, 2005, on our consideration of the University of Virginia's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. This report on the total operations of the University of Virginia for the year ended June 30, 2005, includes our consideration of the operations of the University of Virginia Medical Center. The purpose of that report is to describe the scope of our 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 along with this report and considered in assessing the results of our audit.

AUDITOR OF PUBLIC ACCOUNTS

JHS/kva