UNIVERSITY OF VIRGINIA MEDICAL CENTER

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2008

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

AUDIT SUMMARY

Our audit of the University of Virginia Medical Center, for the year ended June 30, 2008, found that the financial statements are presented fairly, in all material respects.

-TABLE OF CONTENTS-

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, 2008, with comparative information for the year ended June 30, 2007. 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 the 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 589-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

	2008	2007
Operating revenues	$970.9	$920.3
Operating income	$ 47.4	$ 51.0
Net non-operating revenue	20.2	53.5
Capital appropriations	(22.1)	25.0
Transfers to the University	(0.1)	(25.0)
Increase in net assets	$ 45.4	$104.5
Cash and investments	$736.2	$758.3
Other assets	556.8	514.3
Liabilities	(410.7)	(435.7)
Net assets	$882.3	$836.9

* in millions

Operating income decreased by $3.6 million. Stable demand for inpatient services, increased demand for outpatient services, and increased charge rates resulted in an increase in operating revenues of $50.6 million (5.5 percent) while operating costs increased by $54.1 million (6.2 percent). Net non-operating revenue decreased by $33.3 million, primarily because the State suspended access to $22.1 million of the $25.0 million Clinical Cancer Center appropriation in fiscal year 2008.

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 Health Care 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 Statements of Net Assets.

Statement of Net Assets
As of June 30, 2008 and 2007

			Increase/(Decrease)	
	2008	2007	Amount	Percent
Assets:				
Current assets	$137.4	$383.3	$(245.9)	(64.2)%
Capital assets	424.1	389.2	34.9	9.0%
Other non-current assets	731.5	500.1	231.4	46.3%
Total assets	1,293.0	1,272.6	20.4	1.6%
Liabilities:				
Current liabilities	173.3	265.3	(92.0)	(34.7)%
Non-current liabilities	237.4	170.4	67.0	39.3%
Total liabilities	410.7	435.7	(25.0)	(5.7)%
Net assets:				
Invested in capital assets, net of related debt	271.9	228.9	38.2	16.7%
Restricted for:				
Nonexpendable	53.1	53.1	0.0	0.0%
Expendable	53.8	73.6	(19.7)	(26.8)%
Unrestricted	503.5	481.3	26.9	5.6%
Total net assets	$882.3	$836.9	$ 45.4	5.4%

* in millions

During fiscal year 2008, the Medical Center's financial position remained stable. Net assets increased by $45.4 million as a result of the Medical Center's positive operating performance. The decrease in current assets is the result of transferring cash from the Commonwealth to the University of Virginia investment program, which is a long term investment and shown as other non-current assets. The other significant decrease relates to a $58.5 million decrease in securities lending transactions executed by the State Treasurer's Office in fiscal year 2007 with a corresponding decrease in current liabilities. As the Medical Center no longer holds cash with the Treasurer of Virginia, they no longer participate in the State Treasurer's securities lending program. Finally, the Commonwealth suspended access to the remaining balance of Clinical Cancer Center appropriation of $22.1 million in fiscal year 2008.

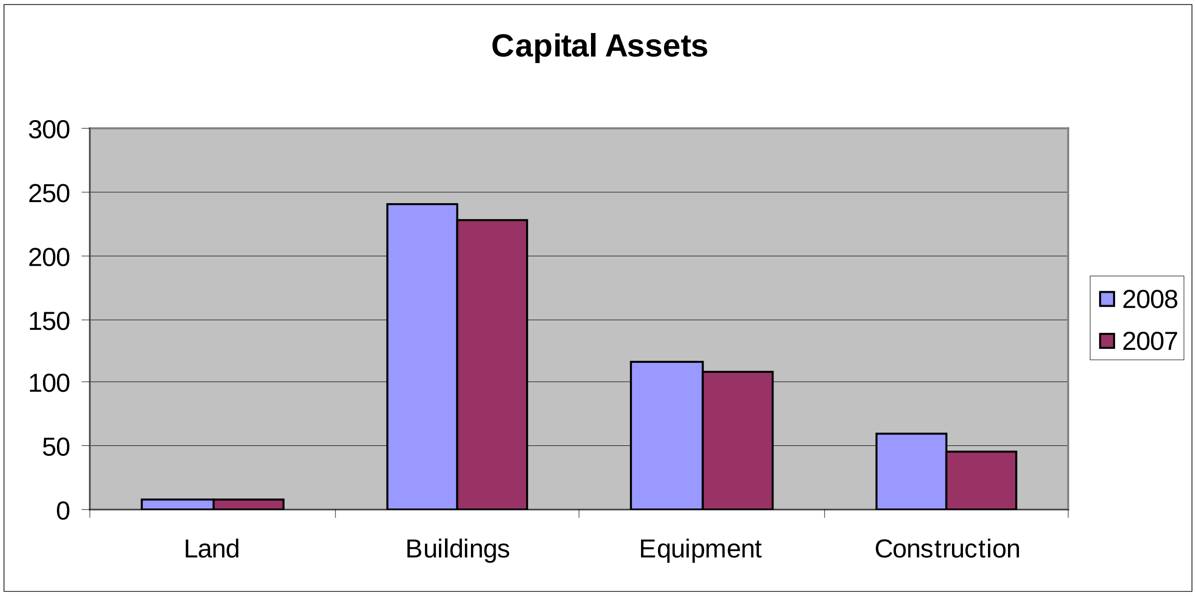
Two significant items increasing non-current assets include the transfer of Medical Center operating cash to the investment program of $137 million, and the Bed Expansion Project debt issuance of $80.2 million. The value of capital assets net of depreciation increased $34.9 million. Shown below are the major capital additions made in the past two fiscal years.

Major Capital Additions

	2008	2007
University hospital expansion	$ -	$ 6.0
UVA Outpatient Surgery Center	0.9	-
Radiology and imaging systems	7.5	10.5
Information systems and related hardware	9.3	7.4
Other health system renovations	26.0	25.7
Primary Care Building renovation	0.8	0.9
Core Lab Building and equipment	-	1.7
Kirtley property	-	8.1
Emily Couric Clinical Cancer Center	7.9	3.3
Hospital bed expansion	4.1	-
South Chiller	11.8	-
Total	$68.3	$63.6

* in millions

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



*millions

The largest component of the decrease in current liabilities resulted from the $57 million decrease to obligations under security lending transactions as discussed above. In addition, the Medical Center's payment to the School of Medicine, $25 million for its "Fund for the Future," occurred in fiscal year 2008; although, this program was expensed in fiscal year 2007. The net increase to non-current liabilities of $67 million resulted primarily from the debt issuance for the Bed Expansion Project of $80.2 million less the transfer of the current portion of debt $13.2 million.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets as presented in the Statements of Net Assets are based on activity shown in the Statements of Revenues, Expenses, and Changes in Net Assets. The purpose of these statements is to present the Medical Center's operating and non-operating revenues and expenses 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, 2008 and 2007 is as follows:

Statement of Revenues, Expenses, and Changes in Net Assets
For the years ended June 30, 2008 and 2007

	2008	2007	Increase(Decrease) Amount	Increase(Decrease) Percent
Net patient service revenue	$934.9	$882.4	$ 52.5	5.9%
University allocations	10.8	15.5	(4.7)	(30.3)%
Other	25.2	22.4	2.8	12.5%
Total operating revenue	970.9	920.3	50.6	5.5%
Salaries and benefits	407.5	376.8	30.7	8.1%
Other operating expenses	516.0	492.6	23.4	4.8%
Total operating expenses	923.5	869.4	54.1	6.2%
Operating income	47.4	51.0	(3.6)	(7.1)%
Non-operating revenue	20.2	53.5	(33.3)	(62.5)%
Income before other revenue and transfers	67.6	104.5	(36.9)	(35.3)%
Transfers to the University	(0.1)	(25.0)	24.9	(99.6)%
Capital Appropriation	(22.1)	25.0	(47.1)	(>100)%
Increase in net assets	45.4	104.5	(59.1)	(56.6)%
Net assets-beginning of year	836.9	732.4	104.5	14.3%
Net assets-end of year	$882.3	$836.9	$45.4	5.4%

*millions

Operating Revenue

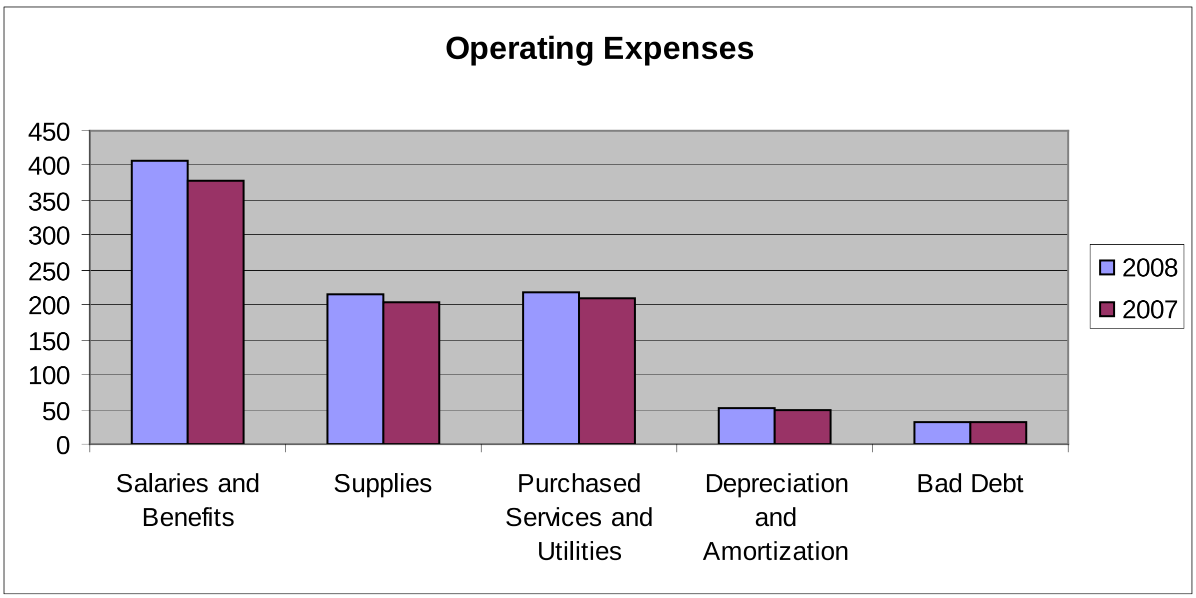
Total operating revenue for the fiscal year 2008 was 5.5 percent above the prior year. This increase resulted from patient volume increases and a rate increase. Although discharges decreased 2.1 percent over the prior year, patient days increased slightly by 0.7 percent as a result of a slight increase in the average length of stay (ALOS) from 5.69 days last year to 5.89 days. Inpatient services for neurology, pediatrics, obstetrics, psychiatry, and thoracic cardiovascular surgery experienced the most significant increase. Hospital admissions to family practice have declined from last year.

Operating Expenses

As a result of growth in patient volumes and inflation, operating expenses increased by 6.2 percent over the prior year. The following items contributed to this growth:

- Compensation cost increased by 8.1 percent, which results from salary increases and the increase in full time equivalent employees (FTEs). FTEs increased from 5,904 in fiscal year 2007 to 6,094 in fiscal year 2008. Average salary, wage and benefits per FTE increased from $63,819 to $66,869 in fiscal year 2008.

- Supply expense experienced a 6.8 percent cost increase. This was the result of volume increases and inflation as discussed above.



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, 2008 and 2007 is as follows:

Statement of Cash Flows
For the years ended June 30, 2008 and 2007

	2008	2007	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Cash flows from operating activities	$ 81.8	$102.8	$ (21.0)	(20.4)%
Cash flows from non-capital financing activities	(23.3)	17.6	(40.9)	(>100)%
Cash flows from capital and related financing activities	(48.8)	(49.4)	(0.6)	(1.2)%
Cash flows from investing activities	(269.5)	52.2	(321.7)	(>100)%
Net increase(decrease) in cash and cash equivalents	(259.8)	123.2	(383.0)	(>100)%
Cash and cash equivalents-beginning of the year	333.7	210.5	123.2	58.5%
Cash and cash equivalents-end of the year	$ 73.9	$333.7	$(259.8)	(77.8)%

* in millions

The cash generated from operating activities decreased by 20.4 percent from 2007 to 2008 primarily as a result of increased cash paid to employees and suppliers. Higher salaries are based on inflation and increases in full time equivalent employees. The increases in supply costs are based on inflation and increases in service volume.

The decrease of $40.9 million from non-capital financing activities in fiscal year 2008 resulted primarily from the $25 million dollar payment to the School of Medicine for the "Fund for the Future" and a reduction of gifts to the Medical Center by $20 million.

Cash provided from investing activities decreased $321.7 million from the prior year primarily as a result of restructuring with the Commonwealth as $224 million was transferred from cash and cash equivalents to investments. In addition, the investment balance decreased by $93.7 million.

Economic Factors Affecting the Future

The Medical Center is increasing its capacity for providing cancer treatment. A new Clinical Cancer Center will be constructed on its main campus and ground breaking occurred in April 2008. The new Center will consolidate the cancer clinics in one location, enhance the layout and amenities of the clinics, and allow for new therapeutic equipment. The Medical Center plans to invest $109.7 million in this project including related utilities and parking facilities. The Commonwealth has appropriated $25 million for the project, of which access to $22.1 million of the funds has been suspended in fiscal year 2008 due to Commonwealth mandates. Based on current legislation, the Medical Center expects these funds to be available in fiscal year 2010. The remainder of the cost for the Clinical Cancer Center will be financed through a combination of Medical Center funds, bonded indebtedness, and private philanthropy.

Increased capacity for inpatient care will result from a planned expansion, which will add 72 beds to the existing inpatient facility. The expansion is expected to cost $80.2 million. The entire project will be financed through the Pooled Bond Program with the University of Virginia.

The Medical Center is also planning to construct a Long Term Acute Care hospital at the Northridge property west of the main campus on highway U.S. 250. This new facility will provide for 40 long-term acute care beds for adults and another 10 long-term acute care beds for pediatric patients. Construction cost is expected to be $18.9 million and is expected to be completed in 2010.

Finally, the Medical Center expects to enter into a partnership with Culpeper Regional Hospital in January 2009. The Medical Center will occupy approximately 49 percent of the voting board seats for Culpeper Regional Hospital and strategic decisions require approval by the Medical Center members through super majority voting rights. Routine operating decisions requiring board approval can be made with a simple majority vote.

FINANCIAL STATEMENTS

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2008
With Comparative Amounts as of June 30, 2007

	2008	2007
A S S E T S		
Current assets:		
Cash and cash equivalents (Note 2)	$ 32,215,918	$ 222,324,882
Cash and cash equivalents - securities lending	-	11,844,107
Short term investments - securities lending	-	46,660,683
Accounts receivable, net of estimated uncollectibles of $208,819,972 at June 30, 2008 and $222,266,609 at June 30, 2007	73,241,799	76,627,319
Due from University of Virginia	10,459,408	4,658,610
Inventories and prepaid expenses	21,424,097	21,174,990
Notes receivable	10,900	12,587
Total current assets	137,352,122	383,303,178
Noncurrent assets:		
Cash and cash equivalents - restricted (Note 2)	28,813,426	48,547,796
Due from the University of Virginia - non current	2,757,584	419,164
Investments in pooled endowment funds (Note 2)	240,148,381	149,651,352
Goodwill (Note 3)	13,301,767	13,743,847
Investments (Note 2)	145,073,350	6,910,638
Investments in affiliated companies (Note 4)	9,470,282	7,901,433
Land (Note 5)	8,190,246	8,190,246
Contruction in Progress (Note 5)	59,594,602	44,786,145
Depreciable land improvements, buildings, and equipment, less accumulated depreciation of $472,456,719 at June 30, 2008 (Note 5)	356,278,157	336,261,130
Deferred bond discount and issue costs, net of amortization of $39,745 at June 30, 2008	2,111,873	548,058
Assets whose use is limited:		
Cash and cash equivalents (Note 2)	12,920,329	62,873,756
Investments (Note 2)	276,998,026	209,491,963
Total noncurrent assets	1,155,658,023	889,325,528
Total assets	1,293,010,145	1,272,628,706

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2008
With Comparative Amounts as of June 30, 2007

	2008	2007
L I A B I L I T I E S		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	$ 90,589,911	$ 106,314,193
Deferred revenue	18,732,735	18,758,120
Obligations under security lending (Note 2)	-	58,504,790
Due to third-party payors	44,660,085	65,034,807
Current installments of long-term debt (Note 8)	13,582,701	11,940,304
Grants payable - current portion	5,832,949	4,631,471
Bond premium - current amortization	110,148	109,847
Total current liabilities	173,508,529	265,293,532
Long-term liabilities:		
Long-term debt (Note 8)	228,868,844	160,571,555
Grants Payable- long term portion	7,000,000	8,073,334
Bond premium, net of amortization	429,759	540,208
Noncontrolling interest in subsidiary	891,976	1,200,770
Total long-term liabilities	237,190,579	170,385,867
Total liabilities	410,699,108	435,679,399
N E T A S S E T S		
Invested in capital assets, net of related debt	271,860,301	228,897,132
Restricted for:		
Nonexpendable	53,099,192	53,099,192
Expendable	53,867,708	73,602,078
Unrestricted	503,483,836	481,350,905
Total net assets	$ 882,311,037	$ 836,949,307

The accompanying notes to financial statements are an integral part of this statement.

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UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS
As of June 30, 2008
With Comparative Amounts as of June 30, 2007

	2008	2007
Operating revenue:		
Net patient service revenue (Note 10)	$ 934,967,323	$ 882,400,985
University allocations (Note 11)	10,820,247	15,473,585
Other	25,161,119	22,438,098
Total operating revenue	970,948,689	920,312,668
Operating expenses:		
Salaries and wages	324,611,514	301,798,710
Fringe benefits	82,911,048	74,988,737
Supplies	216,135,705	202,305,914
Purchased services and other expenses	201,444,418	195,722,143
Utilities	15,670,020	13,425,698
Provision for depreciation and amortization	51,272,980	48,267,336
Provision for bad debts	31,472,448	32,842,637
Total operating expenses	923,518,133	869,351,175
Income from operations	47,430,556	50,961,493
Nonoperating revenue (expenses):		
Gifts	858,136	5,820,588
Investment income	24,212,366	39,341,599
Net increase in the fair value of investments	7,739,165	17,740,628
Net increase from investments in affiliated companies (Note 4)	1,485,566	1,058,547
Noncontrolling interest in subsidiary income	(2,018,575)	(1,955,793)
State Appropriation	(22,123,000)	25,000,000
Interest expense	(8,214,045)	(5,953,921)
Loss on disposal of fixed assets	(1,064,959)	(429,171)
Other	(2,793,480)	(2,100,695)
Net nonoperating revenues	(1,918,826)	78,521,782
Income before other revenues, expenses, gains or losses	45,511,730	129,483,275
Transfers to the University of Virginia	(150,000)	(25,000,000)
Increase in net assets	45,361,730	104,483,275
Net assets - beginning of year	836,949,307	732,466,032
Net assets - end of year	$ 882,311,037	$ 836,949,307

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, 2008
With Comparative Amounts as of June 30, 2007

	2008	2007
Cash flows from operating activities:		
Receipts from patients and third-parties	$ 884,944,878	$ 865,055,264
Receipts from other revenue	19,868,135	19,621,804
Payments to employees	(405,404,488)	(384,523,915)
Payments to suppliers	(399,604,609)	(383,691,674)
Payment for utilities	(18,033,821)	(13,659,572)
Net cash provided by operating activities	81,770,095	102,801,907
Cash flows from non-capital financing activities:		
Payments on grants	961,478	(3,235,403)
Gifts	858,136	5,820,588
Transfer to the University of Virginia	(25,150,000)	-
Unearned Gift	-	15,000,000
Net cash provided (used) by non-capital financing activities	(23,330,386)	17,585,185
Cash flows from capital and related financing activities:		
State appropriation for construction	(22,123,000)	25,000,000
Purchase of capital assets	(87,417,413)	(75,908,967)
Principal paid on capital debt	(16,766,829)	(9,781,126)
Interest paid on capital debt	(8,239,441)	(5,135,283)
Proceeds from incurring loan from the University	85,324,797	16,369,939
Proceeds from sale of capital assets	482,629	71,000
Net cash used by capital and related financing activities	(48,739,257)	(49,384,437)
Cash flows from investing activities:		
Interest on investments	27,285,153	30,283,409
Purchase of investments	(249,079,103)	(136,369,626)
Proceeds from sale of investments	182,280,476	160,255,408
Transfer to endowment	(87,000,000)	-
Transfer to investments	(138,162,712)	-
Other	(2,793,480)	-
Transfer to affiliate	(133,280)	(4,800)
Payment to affiliate	(1,894,269)	(1,960,961)
Net cash provided by investing activities	(269,497,215)	52,203,430
Net increase in cash and cash equivalents	(259,796,763)	123,206,085
Cash and cash equivalents - beginning of the year	333,746,436	210,540,351
Cash and cash equivalents - end of the year	$ 73,949,673	$ 333,746,436

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF CASH FLOWS
As of June 30, 2008
With Comparative Amounts as of June 30, 2007

	2008	2007
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 47,430,556	$ 50,961,493
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	51,272,980	48,267,336
Change in assets and liabilities:		
Accounts receivables	(22,788,313)	17,672,781
Inventories and prepaid expenses	(2,587,528)	(1,935,674)
Accounts payable and accrued expenses	8,442,400	(10,063,334)
Net cash provided by operating activities	$ 81,770,095	$ 104,902,602

The accompanying notes to financial statements are an integral part of this statement.

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NOTES TO FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Mission

The Medical Center is a division of the University of Virginia. The Medical Center's mission is to enrich the quality of human life by improvement of health, advancement of medical and scientific knowledge, and by 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 non-operating.

A separate report is prepared for the Commonwealth 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 and is included in the basic financial statements of the Commonwealth.

B. Basis of Accounting

The Medical Center has adopted the 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.

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 College 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 payers, and others for services rendered. Net patient service revenue also includes funds from the Commonwealth's Department of Medical Assistance Services for disproportionate share and indirect medical education payments and funds from third-party payers 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 payers. 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 pooled under the University of Virginia Growth and Income Fund, the general endowment pool for the University. 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 non-operating 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, 2008, 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 has 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

Cash, Cash Equivalents and Investments:

The following risk disclosures are required by GASB Statement Number 3, *Deposits with Financial Institutions, Investments (including Repurchase Agreement), and Reverse Repurchase Agreements* as amended by GASB Statement 40, *Deposit and Investment Risk Disclosures*:

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 2008.

Credit risk - The risk that an issuer or other counterparty to an investment will not fulfill its obligations. GASB Statement 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 governments investment in a single issuer. GASB Statement 40 requires disclosure of any issuer with more than five percent of the Medical Center investments, which in 2008 are FHLB, FHLMC, FNMA, and the University of Virginia Growth and Income Fund. These investments represent 25 percent, 6 percent, 5 percent, and 65 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 2008.

The following information is provided with respect to the risks associated with the Medical Center's cash, cash equivalents, and investments at June 30, 2008.

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 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", Sections 2.2-4500 through 2.2-4516, Code of Virginia. 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

Type of Investment	Fair Value	Credit Rating	Concentration Risk
Cash equivalents:			
U.S. Government Securities			
STIF	$ 12,916,796	AAA	
Virginia College Building Authority 1999A pooled Bond Fund (SNAP)	74		
FHLB – Federal Home Bank D/N	74,922,083	P-1	
Total cash equivalents	87,838,953		
Investments:			
U.S. Government Securities:			
FHLB-Federal Home Loan Bank	65,254,850	AAA	12%
FHLB-Bond	25,390,750	AAA	7%
FHLMC-Federal Home Loan Mortgage Corporation	21,076,663	AAA	6%
FNMA	14,442,619	AAA	4%
FNMA-Step Up	5,059,400	AAA	1%
University of Virginia Growth and Income Fund	240,148,381		65%
Total investments	371,372,663		
Total cash equivalents and investments	$459,211,616		

Interest Rate Risk – Maturities

	Less than1 year	1 to 5 years	Total
U.S. Government Securities:			
FHLB-Federal Home Loan Bank	$ 45,175,150	$20,079,700	$ 65,254,850
FHLB-Federal Home Loan Bank Loan		25,390,750	25,390,750
FHLMC-Federal Home Loan Mortgage Corporation	16,013,813	5,062,850	21,076,663
FNMA	5,060,950	9,381,669	14,442,619
FNMA-Step Up	5,059,400	-	5,059,400
University of Virginia Growth and Income Fund	240,148,381	-	240,148,381
Total Investments	$311,457,694	$59,914,969	$371,372,663

Securities Lending Transactions

For fiscal year 2007 investments and cash equivalents held by the Treasurer 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 (CAFR). The Medical Center did not participate in the State Treasury's securities lending program for fiscal year 2008.

3. GOODWILL

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 of goodwill to be amortized over a period of 40 years.

In November 2004, the Medical Center purchased 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 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 Research 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 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 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 July 1, 2003; the Medical Center's investment totaled $1,560,000. During fiscal year 2004, the Medical Center made an additional investment of $250,000, bringing the total investment to $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 D. Gravely, Esq., 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 Health System Consortium (UHC)

In December 1986, the Medical Center became a member of the University Health System 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 UHC 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, 2008		
	Common Stock and Equity Contribution	Share of accumulated income (loss)	Net investment
UVA Imaging, LLC	$ 687,019	$ 1,541,372	$ 2,228,391
Community Medicine, LLC	1,810,000	(3,761,725)	(1,951,725)
Central Virginia Health Network, Inc.	232,500	(41,026)	191,474
Healthsouth, LLC	1,830,000	5,661,320	7,491,320
Valiance, LLC	350,000	791,383	1,141,383
University Health System Consortium	-	646,899	646,899

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, 2008, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 8,190,246	$ -	$ -	$ 8,190,246
Construction in progress	44,786,145	69,073,688	54,265,231	59,594,602
Depreciable capital assets:				
Land improvements	8,527,783	135,572	7,969	8,655,386
Buildings	465,866,673	30,755,134	1,518,673	495,103,134
Equipment-fixed	21,404,505	1,073,674	102	22,478,077
Equipment-movable	274,224,300	40,625,036	12,351,058	302,498,278
Total depreciable capital assets	770,023,261	72,589,416	13,877,802	828,734,875
Less accumulated depreciation:				
Land improvements	6,824,551	203,990	7,209	7,021,332
Buildings	240,089,214	17,399,385	1,110,487	256,378,112
Equipment-fixed	16,461,462	698,683	102	17,160,043
Equipment-movable	170,386,905	31,635,624	10,125,297	191,897,232
Total accumulated depreciation	433,762,132	49,937,682	11,243,095	472,456,719
Depreciable land improvements, buildings and equipment, net	$336,261,129	$22,651,734	$2,634,707	$356,278,156

6. ASSETS HELD BY TRUSTEES

Assets held by trustees consist of assets whose use is limited under indenture agreements. The Series 1998B, 1999A, 2003A, 2003B, 2006, and 2008 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, 2008:

Construction Fund Pooled*	$ 74
Bond Sinking Fund-1998B	3,081
Bond Sinking Fund-199A	8,469
Depreciation Reserve	218,070,578
Bond Sinking Fund-2003B	1,456,509
Bond Sinking Fund-2006	609,144
Bond Sinking Fund-2008	76,158,563

*The Medical Center also participates in the Commonwealth'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, 2008, the components of accounts payable and accrued expenses consist of the following:

Vendor accounts payable	$37,937,621
Due to the University	6,603,903
Accrued leave	26,310,220
Accrued allotments	6,628,745
Other accounts payable	3,669,258
Other accrued expenses	9,440,164
Total accounts payable and accrued expenses	$90,589,911

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	$ 4,395	$ -	$ 315	$4,080	$ -	$ -
Series 1998B Refinance	4.5-6.00	2018	-	4,080	-	-	4,080	327
Series 1999A	4.5-5.25	2013	23,500	-	4,565	-	18,935	-
Series 1999A pooled	4.5-5.25	2019	585	-	185	-	400	195
Series 1999A pooled refinance	4.5-5.25	2020	2,925	-	10	-	2,915	15
Series 2003A pooled	4.5-6.00	2015	31,020	-	705	-	30,315	6,235
Series 1003B pooled	4.7-6.00	2023	33,249	-	1,426	-	31,823	1,493
UVA pooled debt	4.7-6.00	2024	15,478	-	720	-	14,758	798
Series 2006 pooled	4.5-6.00	2027	36,864	-	1151	-	35,713	1,205
Series 2007 pooled	4.5-6.00	2014	12,627	-	1,563	-	11,064	1,637
Series 2008 pooled	4.5-6.00	2028	-	81,858	15	-	81,843	377
Total bonds payable			160,643	85,938	10,655	4,080	231,846	12,282
Notes payable:								
UVA imaging			3,868	-	1,108	-	2,760	1,053
Capitalized leases			8,000	-	155	-	7,845	247
Total long-term debt			$172,511	$85,938	$11,918	$4,080	$242,451	$13,582

*In thousands

Future Debt Requirements

Fiscal Year	Principal	Interest	Total
2009	$ 13,582,374	$ 7,913,199	$ 21,495,573
2010	15,680,640	8,460,717	24,141,357
2011	14,617,595	9,198,495	23,816,090
2012	15,943,873	9,101,961	25,045,834
2013	16,951,517	8,355,125	25,306,642
2014-2018	65,473,237	30,436,637	95,909,874
2019-2023	54,626,615	17,850,528	72,477,143
2024-2028	41,945,373	6,147,750	48,093,123
2029-2033	796,051	1,574,322	2,370,373
2034-2038	731,740	2,016,172	2,747,912
2039-2043	672,625	2,512,959	3,185,584
2044-2047	1,429,903	2,377,713	3,807,616
Total	$242,451,543	$105,945,578	$348,397,121

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 $95.2 million and 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 Heart Center 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, with the remaining renovations completed at the end of 2007. 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 June 1, 2004. The funds required to complete the remainder of the project were 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 is 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. 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.

The Medical Center began construction on the Emily Couric Clinical Cancer Center during fiscal year 2008. The Emily Couric Clinical Cancer Center is expected to cost $109.7 million. This project was undertaken to expand and improve the facilities for the Cancer Center. Included in the project cost is the demolition of the West Parking Garage, the construction of the Parking Deck, construction, and equipment cost. The Emily Couric Clinical Cancer Center project is funded using philanthropy, bonds, appropriations and operating funds. The Medical Center expects to complete the Emily Couric Clinical Center by April 2010.

In addition to the Emily Couric Clinical Cancer Center, the Medical Center began the Hospital Bed Expansion Project. The Medical Center will add 72 beds over a period of three years. The expected cost of the project is $80.2 million funded using bonds issued under the University of Virginia Pooled Debt Program in May 2008. The Bed Expansion will include six 12-bed units on floors 3 through 8 of the Hospital. The expected completion is fiscal year 2010.

10. NET PATIENT SERVICE REVENUE

The Medical Center's patient service revenue is as follows for the year ended June 30, 2008:

Gross patient service revenue:	
Inpatient:	
Routine services	$ 328,845,062
Ancillary services	887,813,700
Outpatient services:	
Ancillary services	843,064,040
Clinics	42,112,405
Total gross patient service revenue	2,101,835,207
Allowances for indigent care and contractual adjustments	(1,166,867,884)
Net patient service revenue	$ 934,967,323

The Medical Center received $79,869,181 in fiscal year 2008 from the Commonwealth's Department of Medical Assistance Services. This payment is included in net patient service revenue as an adjustment to allowances for indigent care and contractual adjustments.

Of the payment received for disproportionate share, relating to the care provided to indigent patients, $17,381,908 was transferred to physician researchers for related physician services and is included in the purchased services expense.

The amounts written off for indigent care, net of the disproportionate share and indirect medical education payments, were $63,409,886 for the year ended June 30, 2008.

11. 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 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 by an equal amount in purchased services. The amount of this allocation for the year ended June 30, 2008 was $8,748,941.

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 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, 2008 was $2,071,306.

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

12. 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. As a result of the Medical Center not exceeding the minimum requirements established by the Board of Visitors, for fiscal year 2008, no gain sharing amount is required.

13. COMMITMENTS

Future minimum lease payments by year and in the aggregate under operating leases are:

Year Ending June 30,	Operating Leases
2009	$ 6,256,400
2010	4,255,711
2011	2,519,451
2012	903,300
2013	655,424
2014-2018	1,548,404
2019-2023	823,200
2024-2028	823,200
2029-2033	823,200
2034-2038	823,200
2039-2043	823,200
2044-2048	823,200
2049-2050	329,280
Total	$21,407,170

The total rental expense for operating leases for the year ended June 30, 2008, was $8,736,681.

The Medical Center was party to construction contracts and commitments for the year ended June 30, 2008, totaling $177,829,608 of which $145,602,109 was incurred as of June 30, 2008.

14. 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.

The Medical Center manages 63 outpatient clinics with HSF and is responsible for all costs associated with the operations of these provider-based clinics except for physicians' costs. The Medical Center has provider-based status with the federal government and has leased employment agreements with HSF for limited personnel who are HSF employees, but are performing Medical Center duties.

The Medical Center recorded $14,953,309 as expense payable to HSF for the provision of supervisory and administrative services, $18,238,020 for other services, and $816,098 for rental of space for the year ended June 30, 2008.

The Medical Center recorded income from HSF of $11,047,598 for clinic facility fees and other services, and $71,690 for the rental of space for clinics for the year ended June 30, 2008.

15. RISK MANAGEMENT AND SELF-INSURANCE

The Medical Center is a participant in the Commonwealth'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 health 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's Department of Human Resources. Information regarding this plan is available at the statewide level only in the Commonwealth's Comprehensive Annual Financial Report (CAFR).

Other risk management insurance plans are administered by the Commonwealth'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 CAFR.

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 dishonesty insurance and insurance for vehicle physical damage insurance on vehicles valued in excess of $20,000.

16. 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 CAFR. 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 $10,933,395 for the year ended June 30, 2008. Contributions to the Optional Retirement Plans were calculated using base salaries of $186,840,838 for the year ended June 30, 2008. The contribution percentage amounted to seven percent for the year ended June 30, 2008.

17. 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 CAFR.

18. OIG DISPROPORTIONATE SHARE PAYMENT REVIEW

In May 2003, the U.S. Department of Health and Human Services' Office of the Inspector General (OIG) issued an audit 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 (faculty UCC).

On September 8, 2005, the Centers for Medicare and Medicaid Services (CMS) issued a notice to Virginia's Department of Medical Assistance Services (DMAS) disallowing with respect to the Medical Center $4,760,385, which is the federal government's payment to DMAS for faculty UCC at the Medical Center for fiscal years 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 appealed this disallowance and repayment was stayed pending the appeal. DMAS and CMS submitted their appellate briefs to the Departmental Appeals Board (DAB) in the United States Department of Health and Human Services and in May 2007, the DAB upheld the position of CMS. CMS withdrew the disallowed amount from the Virginia Federal Medicaid Grant. DMAS recovered $5,140,204 from the Medical Center in April 2008. In April 2008, the Commonwealth of Virginia, on behalf of DMAS, filed suit against the Secretary of Health and Human Services seeking to overturn the DAB ruling. On August 5, 2008, the Commonwealth filed a motion for summary judgment, which is pending at this time.

19. SUBSEQUENT EVENT

The University of Virginia Medical Center and Culpeper Regional Hospital plan to enter into a partnership agreement, whereby the Medical Center will obtain a 49 percent interest in Culpeper Regional Hospital. The appraised value of Culpeper Regional Hospital is $46.9 million. The Medical Center intends to make a series of annual payments to Culpeper Regional Hospital over a period of five years to acquire 49 percent of the appraised value. The Medical Center will use the equity method of consolidation in order to reflect the Medical Center's investment in Culpeper Regional Hospital and Culpeper Regional Hospital's financial activity. As a result of the Medical Center's investment, four of nine Culpeper Regional Hospital board seats are designated for Medical Center representatives. The Medical Center's representation will be a minority of the Culpeper Regional Hospital Board. However, designated issues will require a super majority vote. The agreement between the Medical Center and Culpeper Regional hospital is expected to be executed in January 2009.

Subsequent to June 30, 2008, the global financial and credit markets experienced some of the greatest turbulence in their history, resulting in significant reductions in equity values and available credit. University management estimates the effect of these declines on its investment portfolio, as it relates to the Medical Center, to include its endowment, to be a decrease of approximately $62 million, as of October 30, 2008. The endowments for the Medical Center are managed by UVIMCO.

Commonwealth of Virginia

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

October 30, 2008

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable M. Kirkland Cox
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, 2008, 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.

The basic financial statements of the University of Virginia Medical Center are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business type activities of the University of Virginia that is attributable to the transactions of the University of Virginia Medical Center. They do not purport to, and do not, present fairly the University of Virginia's overall financial position as of June 30, 2008, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center as of June 30, 2008, and the changes in its financial position, and its cash flows 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 one through eight is 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 30, 2008, on our consideration of the University of Virginia's internal control over financial reporting, which includes the University of Virginia Medical Center, and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. 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 effectiveness of 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 considered in assessing the results of our audit.

AUDITOR OF PUBLIC ACCOUNTS

HV/wdh