The University of Virginia

Management's Discussion and Analysis (Unaudited)

Introduction

This report, Management's Discussion and Analysis (Unaudited), provides an overview of the financial position and results of activities of the University of Virginia (the "University") for the year ended June 30, 2002. It has been prepared by management and is required supplemental information to the financial statements and the footnotes that follow this section. Comparative information for the year ended June 30, 2001, has been provided in a few select instances.

The referenced financial statements were prepared in accordance with Governmental Accounting Standards Board (GASB) principles. During fiscal year 2002, the University adopted GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* as amended by subsequent GASB Statements Nos. 37 and 38.

These GASB statements establish standards for the preparation of public college and university financial statements that focus on aggregate operations, versus the previous model, which focused on accountability of individual fund groups. As a result, the financial statements for fiscal year 2002 are not comparable to the financial statements produced for previous fiscal years.

The University of Virginia is an agency of the Commonwealth of Virginia and is governed by the University's Board of Visitors. The Commonwealth of Virginia issues its own financial statements, which include the University as a component unit.

The University is a comprehensive public institution of higher learning with approximately 19,200 students and 2,000 instructional and research faculty members. The University's ten schools offer a broad range of degrees, including forty-eight baccalaureate programs, ninety-four master's programs, six educational specialist programs, and fifty-five doctoral programs, as well as the J.D. degree in law and the M.D. degree in medicine.

Dedicated to the four primary missions of instruction, research, public service, and patient care, the University is recognized internationally for the quality of its students, faculty, and programs. It consistently ranks among the nation's top universities, both for its overall academic offerings and for its strengths in specific disciplines. Cutting-edge research is a hallmark of all areas of the University, including the University Health System, which maintains a tradition of excellence in teaching, advancement of medical science, and clinical care. With a network of some 550 physicians, the University's academic medical center has been named one of the Top 100 Hospitals for the third year in a row.

Financial Highlights

The University's financial position remained strong at June 30, 2002, with total assets of $3.94 billion and liabilities of $710 million. Net assets, which represents the residual interest in the University's assets after liabilities are deducted, are $3.23 billion. This is a 1.2 percent increase over last fiscal year's restated net assets of $3.19 billion. The increase in net assets is primarily attributable to a large endowment gift to the Medical Center. This offsets the academic division's reduction in net assets, which resulted from the downturn in the financial markets and implementation of our endowment income distribution policy. For fiscal year 2002, the Medical Center's net assets increased by $72.2 million, or 16.1 percent from the previous year.

Using the Financial Statements

The University'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. As stated earlier, these financial statements are prepared in accordance with Government Accounting Standards Board (GASB) principles.

Adopting the new GASB standards resulted in the following changes to the financial statements:

- Revenues and expenses are now categorized as either operating or non-operating. For example, state appropriations, gifts, and investment income (loss) are now considered non-operating revenues (expenses). These non-operating revenues totaled $289 million for the fiscal year. Non-operating expenses, which consist of interest expense and a one-time loss on the sale of an affiliated company, totaled $25 million.
- Depreciation expense and accumulated depreciation have been recorded for the first time.
- A statement of cash flows is now required.
- Scholarships and fellowships applied to student accounts are now shown as a reduction of student tuition and auxiliary fee revenues, while stipends and other payments made directly to students continue to be presented as scholarship and fellowship expenses. Previously, all scholarships and fellowships were presented as expenses. This year scholarship allowances are $34 million.

Statement of Net Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities of the University. The difference between total assets and total liabilities—net assets—is one indicator of the current financial condition of the University, while the change in net assets is an indicator of whether the overall financial condition has improved or worsened during the year. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

SUMMARY OF THE STATEMENT OF NET ASSETS (in thousands)		
TOTAL UNIVERSITY		2002
Current assets	$	591,445
Non-current assets:		
Endowment & other long-term investments		2,021,568
Capital assets, net		1,198,072
Other		126,183
Total assets		3,937,268
Current liabilities		370,766
Non-current liabilities		339,606
Total liabilities		710,372
Net assets	$	3,226,896

Current assets. Current assets, which consist primarily of cash, operating investments, and accounts receivable, totaled $591 million. Total current assets cover current liabilities 1.6 times, an indicator of good liquidity. The $591 million also represents coverage of approximately 4.9 months of total expenses (including depreciation). Excluding depreciation increases coverage to 5.3 months of expenses.

Current liabilities. Current liabilities consist primarily of accounts payable, accrued compensation, and deposits held in custody for others. Total current liabilities are $371 million. It should be noted that deposits held in custody increased this year as affiliated foundations invested more of their funds with the University's endowment pool.

Endowment

The endowment is the largest of the non-current assets.

Performance. As outlined in the footnotes, the major portion of the University's endowment is maintained in a single investment pool named the University Pooled Endowment Fund. The annual return for the Pooled Endowment Fund this year was –0.1 percent, essentially a breakeven performance, which is particularly notable given the decline in value of the financial markets. Included in the calculation of this performance figure are realized and unrealized gains and losses, along with investment income.

Distribution. The University distributes endowment earnings in a way that balances the annual support required for operational needs against the requirement to preserve the purchasing power of the endowment for the future. The endowment spending rate policy is approved by the Board of Visitors and is based on total return and not annual earnings. The total distribution for the Pooled Endowment Fund was $78.8 million, consisting of $23.8 million in current year's investment income and $55 million in investment asset appreciation.

Balance. The total endowment investment balance on the Statement of Net Assets is $1.8 billion. The University's portion is approximately $1.7 billion, while the difference of $100 million comprises endowment assets held on behalf of affiliated foundations.

From a net assets perspective, earnings from the endowment, while expendable, are mostly restricted as to use by the donor. It is important to note that of the University's endowment funds, only $502 million, or 29 percent, can be classified as unrestricted net assets. From this unrestricted endowment, a significant portion of the unrestricted income is internally designated by the University for scholarships, fellowships, professorships, research efforts, and other important programs and activities.

As of June 30, 2002, the remainder of the endowment (71 percent) was restricted as follows: $282 million of restricted non-expendable net assets, $902 million of restricted expendable net assets, and $33 million of restricted life income funds.

Capital and Debt Activities

One of the critical factors in maintaining the quality of the University's academic and research programs and residential life is the development and renewal of its property, plant, and equipment. The University continues to implement its long-range plan to modernize its older teaching and research facilities, balanced with new construction.

Capital additions. Capital additions, net of retirements, were $150 million in 2002. Capital additions primarily comprise replacement, renovation, and new construction of academic, research, and health care facilities, as well as significant investments in equipment, including information technology. Examples of new additions were the Darden School expansion and the new medical research facility, MR-5.

Work in progress. At June 30, 2002, work in progress included construction of the Special Collections Library, renovation of Clark Hall, and renovation of the Miller Center.

The University takes seriously its role of financial stewardship and works hard to manage its resources effectively, including the prudent use of debt to finance capital projects. Moody's Investors Service has assigned the University its highest credit rating (Aaa) for bonds backed by a broad revenue pledge. Another service, Fitch, Inc., has also assigned the University its highest rating (AAA). In addition to being an official acknowledgment of the University's strong financial position and financial management, these ratings enable the University to obtain future debt financing at optimum pricing.

Long-term debt. The University's long-term debt decreased from $351 million to $337 million this year, a drop of $14 million, or 4 percent.

Net Assets

Net assets represent the residual interest in the University's assets after liabilities are deducted. The University's net assets at June 30, 2002, are summarized below.

NET ASSETS (in thousands)		2002
Invested in capital assets, net of related debt	$	868,783
Restricted:		
Non-expendable		282,440
Expendable		1,201,241
Unrestricted		874,432
Total net assets	$	3,226,896

Net assets invested in capital assets, net of related debt, represent the University's capital assets net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.

Restricted non-expendable net assets comprise the University's permanent endowment funds. These are stated at original cost and exclude earnings and gains and losses.

Restricted expendable net assets are subject to externally imposed restrictions governing their use. This category of net assets includes earnings from permanent endowment funds that can be spent, but only in accordance with restrictions imposed by external parties.

Although unrestricted net assets are not subject to externally imposed stipulations, a portion of the University's unrestricted net assets has been designated for various academic and research programs and initiatives, as well as capital projects, and built into the ongoing budget.

Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the University's results of financial activity for the year.

One of the University's strengths is its diverse streams of revenues, which allow it to weather difficult economic times. On the following page is a graphic illustration of revenues by source (both operating and non-operating), which were used to fund the University's operating activities for the year ended June 30, 2002. As noted previously, GASB Statement No. 35 requires state appropriations, gifts, and other significant recurring revenues to be treated as non-operating revenues. However, these revenues do support operating expenses. Therefore, they are included in the chart.

SUMMARY OF THE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS (in thousands)

TOTAL UNIVERSITY		2002
Operating revenues	$	1,117,007
Operating expenses		1,434,993
Operating income (loss)		(317,986)
Non-operating revenues (expenses)		
State appropriations		176,177
Gifts		65,016
Investment income		26,975
Other net non-operating expenses		(3,891)
Net non-operating revenues		264,277
Capital appropriations, gifts, and grants		28,104
Additions to permanent endowments		63,701
Increase in net assets		38,096
Net assets—beginning of year		3,188,800
Net assets—end of year	$	3,226,896

Patient services revenue accounts for 40 percent of the University's operating and non-operating revenues combined. Additionally, state appropriations and student tuition and fees, comprising 12 percent and 13 percent, respectively, of the University's total revenues, are used to fund current operations.

The University measures its performance both for the University as a whole and for the University without its Medical Center. The exclusion of the University's Medical Center allows a clearer view of the operations of the schools and colleges, as well as the central administration. On the following page is a graphic illustration of University revenues by source (both operating and non-operating), which were used to fund operating activities other than the hospitals and similar activities, for the year ended June 30, 2002.

Excluding the Medical Center, the chart illustrates the balanced revenue streams for the academic division. To highlight the major sources: 28 percent is comprised of federal, state, and local grants and contracts; 22 percent is net tuition and fees; and 22 percent is state appropriations.

The University continues to make revenue diversification an ongoing priority, along with cost containment. This is necessary as the University continues to face significant financial pressure with state budget reductions, increased compensation and benefit costs, and volatile technology, energy, and water prices.

While tuition and state appropriations fund a large percentage of University costs, private support has been, and will continue to be, essential to the University's academic excellence.

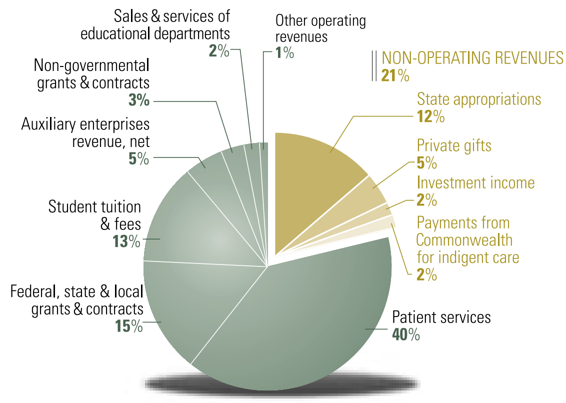
Revenues for sponsored research programs increased $15.2 million, or 6.2 percent, to a total of $261.8 million in 2002. While a number of schools are integral to the research mission of the University, the Medical School accounts for about 60 percent of grant awards.

A summary of the University's expenses, both with and without the Medical Center, for the year ended June 30, 2002, can be viewed at the top of the following page.

Compensation and benefits for the academic division continue to account for approximately 60 percent of total expenses. In the academic division, student aid comprises 4 percent of total expenses under the new GASB model. Depreciation is recorded this year for the first time and makes up 8 percent of the total. Notably, interest expense is only 1 percent of total expenses.

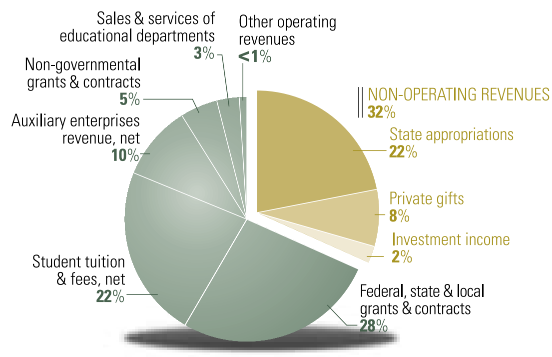
STATEMENT OF REVENUES (in thousands)

TOTAL UNIVERSITY		2002
OPERATING REVENUES		
Student tuition & fees, net	$	177,913
Federal, state & local grants & contracts		218,256
Non-governmental grants & contracts		43,558
Sales & services of educational departments		21,464
Auxiliary enterprises revenue, net		77,070
Other operating revenues		10,374
Patient services		568,372
Total operating revenues		1,117,007
NON-OPERATING REVENUES		
State appropriations		176,177
Private gifts		65,016
Investment income		26,975
Payments from Commonwealth for indigent care		21,195
Total non-operating revenues	$	289,363



Total revenues (in thousands): **$1,406,370**

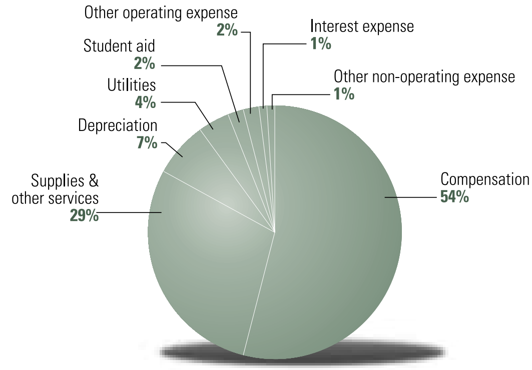
ACADEMIC DIVISION		2002
OPERATING REVENUES		
Student tuition & fees, net	$	177,913
Federal, state & local grants & contracts		218,257
Non-governmental grants & contracts		43,558
Sales & services of educational departments		21,464
Auxiliary enterprises revenue, net		77,070
Other operating revenues		9
Total operating revenues		538,271
NON-OPERATING REVENUES		
State appropriations		176,177
Private gifts		64,576
Investment income		16,737
Total non-operating revenues	$	257,490



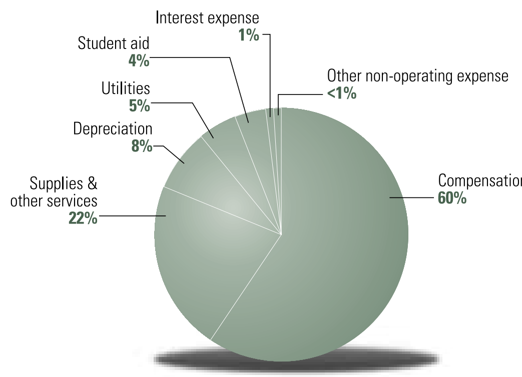
Total revenues (in thousands): **$795,761**

SUMMARY OF EXPENSES (in thousands)

TOTAL UNIVERSITY		2002
OPERATING EXPENSES		
Compensation	$	796,959
Supplies & other services		426,501
Student aid		34,156
Utilities		56,227
Depreciation		98,628
Other operating expense		22,522
Total operating expenses		1,434,993
NON-OPERATING EXPENSES		
Interest expense		12,038
Other non-operating expense		13,048
Total non-operating expenses	$	25,086



ACADEMIC DIVISION		2002
OPERATING EXPENSES		
Compensation	$	511,342
Supplies & other services		190,215
Student aid		34,156
Utilities		45,207
Depreciation		64,266
Total operating expenses		845,186
NON-OPERATING EXPENSES		
Interest expense		7,425
Other		1,402
Total non-operating expenses	$	8,827



In addition to their natural (object) classification, it is also informative to review operating expenses by function. A complete matrix of expenses, natural versus functional, is contained in the footnotes to the financial statements.

Expenses for patient services, instruction, and research comprise 41 percent, 16 percent, and 14 percent, respectively, of total operating expenses. When combined, these major functions account for 71 percent of the total, which is consistent with the mission-critical nature of instruction, research, and patient services for the institution.

Statement of Cash Flows

The Statement of Cash Flows provides additional information about the University's financial results by reporting the major sources and uses of cash. GASB principles promulgate four major sources of cash flows: cash flows from operating activities, cash flows from non-capital financing activities, cash flows from capital and related financing activities, and cash flows from investing activities.

State appropriations, gifts, and investment income are reported as non-operating revenues. For higher education institutions, these cash inflows are critical to funding the operations of the University.

SUMMARY OF THE
STATEMENT OF CASH FLOWS (in thousands)

TOTAL UNIVERSITY		2002
Cash flows from operating activities	$	(191,681)
Cash flows from non-capital financing activities		314,211
Cash flows from capital and related financing activities		(160,072)
Cash flows from investing activities		56,955
Net increase in cash and cash equivalents	$	19,413

Future Economic Outlook

Executive management believes that the University is well positioned to maintain its strong financial condition and to continue providing excellent service to its students, patients, the research community, the state, and the nation. The University's financial position, as evidenced by its Aaa rating from Moody's Investors Service and AAA rating from Fitch, Inc., provides a high degree of flexibility in obtaining funds on competitive terms. This flexibility, along with ongoing efforts toward revenue diversification and cost containment, will enable the University to obtain the necessary resources to sustain excellence.

The University will continue to face competitive pressures related to attracting and retaining leading faculty and staff. Moreover, the cost of the University's health benefits has increased significantly and will probably continue to increase in the coming years with the rising cost of medical care and prescription drugs.

A major factor in the University's future will continue to be its relationship with the Commonwealth of Virginia. There is a direct connection between the decrease in state support and the University's ability to enhance, let alone protect, its core academic programs. As state appropriations decrease to record levels, the University must again turn to the generous support of its alumni and other supporters. Economic pressures affecting donors may influence the future level of support the University receives from corporate and individual giving. Also, the institution must now turn to increases in tuition to help offset the reductions. A mid-academic year tuition increase is being implemented for the first time in recent history to generate additional revenue. Because of the current state budget environment, the Board plans to look carefully at its long-term tuition pricing policy over the next few months. The University will continue to be a good value for students and parents in the higher education marketplace, but it is now clear that tuition must become a much more important revenue stream in the years ahead.

The University continues to execute its long-range plan to modernize and expand its complement of older teaching and research facilities with a balance of new construction. This strategy addresses the University's growth and the expanding role of technology in teaching and research methodologies. With the recent passage of the state's bonds for higher education construction, funds will be available to help the University meet these critical needs. Moreover, the University has debt capacity to issue its own bonds to build the facilities that will enable it to enhance its national standing.

The University's Medical Center is well positioned, although ongoing constraints on revenue are expected with the continued fiscal pressures on managed care and on employers and federal and state governments. After the sale of Blue Ridge Health Alliance (BRHA), the Medical Center was able to negotiate a new contract with Southern Health Services, Inc. The term of this contract is for five years and includes increased reimbursement rates more favorable to the Medical Center. In addition, the Medical Center plans to begin a major expansion of its University Hospital facility. The expansion project will increase the number of operating rooms and thereby increase the hospital's census and net revenue. Management believes that much of the financial pressure can be offset by growth in patient volume and continued efforts to contain increases in expenses.

The University will continue to employ its long-term investment strategy to maximize total returns, at an appropriate level of risk, while utilizing a spending-rate policy that insulates the University's operations from temporary market volatility.

Research continues to grow at 5 to 8 percent per year. Student demand for admission to the University's programs remains exceptionally strong.

As management wrestles with today's uncertain economic factors, the University's prudent use of resources, cost-containment efforts, and development of other sources of revenues will strengthen the institution and will ensure that it is well positioned to take advantage of the next upturn in the business cycle.

Management Responsibility

October 22, 2002

To the President and
Board of Visitors of the University of Virginia:

We are pleased to submit the annual Financial Report of the University of Virginia for the year ended June 30, 2002. Management is responsible for the objectivity and integrity of the accompanying financial statements, which have been prepared in conformance with the Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities.* The financial statements, of necessity, included management's estimates and judgments relating to matters not concluded by year-end. Financial information contained elsewhere in the annual Financial Report is consistent with that included in the financial statements.

Management is responsible for maintaining the University's system of internal control that includes careful selection and development of employees, proper division of duties, and written accounting and operating policies and procedures augmented by a continuing internal audit program. Although there are inherent limitations to the effectiveness of any system of accounting controls, management believes that the University's system provides reasonable, but not absolute, assurance that assets are safeguarded from unauthorized use or disposition and that the accounting records are sufficiently reliable to permit the preparation of financial statements that conform in all material respects with generally accepted accounting principles.

The Auditor of Public Accounts for the Commonwealth of Virginia, independent certified public accountants, provides an independent opinion regarding the fair presentation in the financial statements of the University's financial position. Their examination was made in accordance with generally accepted government auditing standards and included a review of the system of internal accounting controls to the extent they considered necessary to determine the audit procedures required to support their opinion. The Audit Committee of the Board of Visitors meets periodically and privately with the independent auditors, the internal auditors, and the financial officers of the University to review matters relating to the quality of the University's financial reporting, the internal accounting controls, and the scope and results of audit examinations. The committee also reviews the scope and quality of the internal auditing program.

Respectfully submitted,

Stephen A. Kimata
Assistant Vice President for Finance
and University Comptroller

Yoke San L. Reynolds
Vice President for Finance

Auditor's Opinion
October 22, 2002

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Kevin G. Miller
Chairman, Joint Legislative Audit
and Review Commission

The Board of Visitors
University of Virginia

We have audited the accompanying statement of net assets, statement of revenues, expenses and changes in net assets, and the statement of cash flows of the University of Virginia, a component unit of the Commonwealth of Virginia, as of and for the year ended June 30, 2002, which collectively comprise the University's basic financial statements. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these basic 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 basic financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia as of June 30, 2002, and the respective changes in financial position and cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in the notes to the financial statements, the University has implemented a new financial reporting model as required by the provisions of Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities* as of June 30, 2002.

In accordance with *Government Auditing Standards,* we have also issued our report dated October 22, 2002, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis presented on pages 44 through 49 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the University's basic financial statements referred to above. Other information in this *President's Report* is presented for the purpose of additional analysis and is not a required part of the basic financial statements of the University. This other information has not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on this other information.

AUDITOR OF PUBLIC ACCOUNTS

UNIVERSITY OF VIRGINIA
STATEMENT OF NET ASSETS
As of June 30, 2002 (in thousands)

		2002
ASSETS		
Current assets		
Cash and cash equivalents (Note 2)	$	205,509
Short-term investments (Note 2)		205,096
Accounts receivable, net (Note 3a)		155,939
Prepaid expenses		6,940
Inventories		13,246
Notes receivable, net		4,712
Other		3
Total current assets		591,445
Non-current assets		
Restricted cash and cash equivalents (Note 2)		30,171
Endowment investments (Notes 1, 2)		1,801,066
Other long-term investments (Note 2)		220,502
Deposit with bond trustee		8,881
Appropriations available for plant		31,927
Notes receivable, net		22,263
Pledges receivable, net		30,529
Capital assets, net (Note 3e)		1,198,072
Goodwill (Note 3f)		1,983
Other		429
Total non-current assets		3,345,823
Total assets	$	3,937,268
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	$	122,007
Deferred revenue		57,690
Obligations under securities lending (Note 2)		3,853
Deposits held in custody for others		133,744
Long-term liabilities,current portion (Note 4)		53,151
Advance from Treasurer of Virginia		321
Total current liabilities		370,766
Non-current liabilities (Note 4)		
Long-term debt		318,967
Other non-current liabilities		20,639
Total non-current liabilities		339,606
Total liabilities	$	710,372
NET ASSETS		
Invested in capital assets, net of related debt	$	868,783
Restricted:		
Non-expendable		282,440
Expendable		1,201,241
Unrestricted		874,432
Total net assets	$	3,226,896

UNIVERSITY OF VIRGINIA
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the year ended June 30, 2002 (in thousands)

		2002
REVENUES		
Operating revenues		
Student tuition and fees (net of scholarship allowances of $34,115,874)	$	177,913
Patient services (net of charity care of $250,689,581)		568,372
Federal grants and contracts		210,624
State and local grants and contracts		7,632
Non-governmental grants and contracts		43,558
Sales and services of educational departments		21,464
Auxiliary enterprises revenue (net of scholarship allowances of $5,398,179)		77,070
Other operating revenues		10,374
Total operating revenues		**1,117,007**
EXPENSES		
Operating expenses (Note 8)		
Compensation and benefits		796,959
Supplies and other services		426,501
Student aid		34,156
Utilities		56,227
Depreciation		98,628
Other		22,522
Total operating expenses		**1,434,993**
Operating income (loss)		**(317,986)**
NON-OPERATING REVENUES (EXPENSES)		
State appropriations (Note 7)		176,177
Payments from Commonwealth for indigent care		21,195
Gifts		65,016
Investment income		26,975
Interest on capital asset-related debt		(12,038)
Losses on affiliated company sold		(12,113)
Other non-operating revenues (expenses)		(935)
Net non-operating revenues		**264,277**
Income before other revenues, expenses, gains, or losses		**(53,709)**
Capital appropriations		16,595
Capital grants and gifts		11,509
Additions to permanent endowments		63,701
Total other revenues		**91,805**
Increase in net assets		**38,096**
NET ASSETS		
Net assets—beginning of year		3,188,800
Net assets—end of year	**$**	**3,226,896**

UNIVERSITY OF VIRGINIA
STATEMENT OF CASH FLOWS
For the year ended June 30, 2002 (in thousands)

		2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$	176,115
Grants and contracts		265,354
Receipts from patients and third parties		535,901
Sales and services of educational activities		21,339
Sales and services of auxiliary enterprises		76,545
Payments to employees and fringe benefits		(783,610)
Payments to vendors and suppliers		(469,399)
Payments for student aid		(34,165)
Loans issued to students		(6,794)
Collection of loans to students		6,531
Other receipts (payments)		20,502
Net cash used by operating activities		(191,681)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
State appropriations		172,958
Payments from Commonwealth for indigent care		21,195
Additions to true endowments		63,701
Direct lending receipts, including PLUS		52,441
Direct lending payments, including PLUS		(52,441)
Receipts on behalf of agencies		71,244
Payments on behalf of agencies		(65,210)
Non-capital gifts and grants and endowments received		48,219
Other		2,104
Net cash provided by non-capital financing activities		314,211
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital appropriations		10,086
Capital gifts and grants received		14,756
Proceeds from capital debt		4,923
Proceeds from sale of capital assets		3,267
Acquisition and construction of capital assets		(188,184)
Principal paid on capital debt and leases		(19,685)
Interest paid on capital debt and leases		(12,038)
Reduction in deposit with trustee		26,803
Net cash used by capital and related financing activities		(160,072)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		2,307,116
Interest on investments		57,816
Purchase of investments and related fees		(2,309,543)
Other investment activities		1,566
Net cash provided by investing activities		56,955
Net increase in cash and cash equivalents		19,413
Cash and cash equivalents, July 1		216,267
Cash and cash equivalents, June 30	$	235,680
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(317,986)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		98,628
Provision for uncollectible loans and writeoffs		239
Miscellaneous non-operating income		(315)
Changes in assets and liabilities:		
Receivables, net		(4,660)
Inventories		(778)
Prepaid expenses		(1,028)
Notes receivable, net		(1,218)
Accounts payable and accrued liabilities		17,915
Non-cash adjustment to supplies and services		8,876
Deferred revenue		4,801
Accrued vacation leave—long term		3,876
Accrued vacation leave—current		(31)
Total adjustments		126,305
Net cash used by operating activities	$	(191,681)
Non-cash investing, capital, and financing activities:		
Assets acquired through assumption of a liability		8,799
Assets acquired through a gift		18,317
Change in fair value of investments		(81,095)
Increase in receivables related to non-operating income		68

NOTES TO FINANCIAL STATEMENTS

As of June 30, 2002

Summary of Significant Accounting Policies

Organization and Purpose

The University of Virginia is an agency of the Commonwealth of Virginia and is governed by the University's Board of Visitors. 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 general-purpose financial statements of the Commonwealth. The University consists of three divisions. The Academic Division and University of Virginia's College at Wise generate and disseminate knowledge in the humanities, arts, scientific, and professional disciplines through instruction, research, and public service. The Medical Center Division provides routine and ancillary patient services through a full-service hospital and clinics.

Reporting Entity

The financial statements and the accompanying notes of the University include all funds and organizations for which the Board of Visitors has oversight responsibility. There are currently nineteen affiliated foundations created and operated in support of the interests of the University. Affiliated foundations are not-for-profit corporations controlled by separate boards of directors and are not included in the basic financial statements of the University.

Condensed financial statements for the following foundations, whose boards include officers of the University, are disclosed in Note 6:

University of Virginia Health Services Foundation, an educational, scientific, and charitable organization established to assist the University in providing hospital and medical care services, medical education programs, medical research, and programs of public charity at the University.

University of Virginia Foundation and Subsidiaries, which includes the University of Virginia Real Estate Foundation, established to promote, support, and aid the University in matters pertaining to real estate, as well as to use and administer gifts, grants, and bequests for the benefit of the University.

Reporting Basis

The accompanying financial statements are presented in accordance with generally accepted accounting principles applicable to governmental colleges and universities as promulgated by the Governmental Accounting Standards Board (GASB) and, for pronouncements issued prior to November 30, 1989, the Financial Accounting Standards Board (FASB). It is the University's policy not to follow FASB standards issued after that date.

In accordance with GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* as amended by GASB Statement Nos. 37 and 38, the University has elected to report as an entity engaged in business-type activities. Entities engaged in business-type activities are financed in whole or in part by fees charged to external parties for goods and services.

GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and long-term debt attributable to the acquisition, construction, or improvement of these assets.

Restricted: Net assets, either expendable or non-expendable, subject to donor-imposed restrictions stipulating how the resources may be used. Expendable net assets are those that can be satisfied by actions of the University. Non-expendable net assets, consisting of endowments, must be maintained in perpetuity.

Unrestricted: Net assets are those net assets that are not properly classified either as capital assets, net of related debt or restricted net assets. Unrestricted net assets may be designated for specific purposes by management or may otherwise be limited by contractual agreements with outside parties.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University's policy is first to apply the expense toward restricted resources, and then toward unrestricted. Restricted funds remain classified as such until restrictions have been satisfied.

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting. 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 University receives value without directly giving equal value in exchange, include grants, state appropriations, and private donations. On an accrual basis, revenues from these transactions are recognized in the fiscal year in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection. The University does not capitalize works of art or historical treasures that are held for exhibition, education, research, or public service. These collections are neither disposed of for financial gain nor encumbered in any means. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Cash and Cash Equivalents

In addition to cash on deposit with private bank accounts, petty cash, and undeposited receipts, this classification includes cash on deposit with fiscal agents and short-term investments with the State Treasurer's Cash and Investment Pool (a governmental external investment pool). All other short-term investments are reported as investments.

Inventories

Inventories are valued at the lower of cost (generally determined on the weighted average method) or market value.

Investments

Investments in corporate stocks and marketable bonds are recorded at market value. Certain less marketable investments, principally real estate and private equity investments, are generally carried at estimated values as determined by management. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. Mortgages held for investment by the endowment fund are recorded at book value representing principal amounts due.

Fixed Assets and Depreciation

Fixed assets are stated at cost at date of acquisition or fair market value at date of donation in the case of gifts. In the case of buildings, the University capitalizes fixed assets that have a value or cost in excess of $50,000 at the date of acquisition and an expected useful life of one or more years. Both the Academic and Medical Center Divisions capitalize moveable equipment at a value or cost of $2,000 or greater and an expected useful life of one or more years. Maintenance or renovation expenditures of $50,000 or more are capitalized only to the extent that such expenditures prolong the life of the asset or otherwise enhance its capacity to render service.

Depreciation of buildings, of improvements other than buildings, and of infrastructure is provided on a straight-line basis over estimated useful lives ranging from ten to fifty years.

Depreciation of equipment and capitalized software is provided on a straight-line basis over estimated useful lives ranging from three to twenty years.

Depreciation of library books is calculated on a straight-line basis over ten years.

Fixed assets financed with debt proceeds are reported when expenditures are incurred. Projects that have not been completed as of the date of the statement of net assets are classified as Construction in Process. Construction period interest cost in excess of earnings associated with the debt proceeds is capitalized as a component of the fixed asset.

Fixed assets, such as roads, parking lots, sidewalks, and other non-building structures and improvements are capitalized as infrastructure and depreciated accordingly.

In accordance with AICPA Statement of Position 98-1, the University capitalizes computer software developed or obtained for internal use. Capitalization begins at the application development stage, which consists of the design, coding, installation, and testing of the software and interfaces.

Deferred Revenue

Deferred revenue represents revenues collected but not earned as of June 30. This is primarily composed of revenue for student tuition accrued in advance of the semester.

Deposits Held in Custody for Others

The University allows its affiliated foundations to participate in the University's endowment, such that the University invests funds on behalf of the foundations. As such, these funds are liabilities of the University to the foundations, and are reported on the Statement of Net Assets in deposits held in custody for others. At June 30, 2002, these liabilities amounted to $92.7 million of the $133.7 million total of deposits held in custody for others.

Accrued Compensated Absences

The amount of leave earned but not taken by non-faculty salaried employees is recorded as a liability on the statement of net assets. The amount reflects, as of June 30, 2002, all unused vacation leave, sabbatical leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave payout policy. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

Revenue Recognition

Revenues, as reflected on the Statement of Revenues, Expenses, and Changes in Net Assets, include all exchange and non-exchange transactions earned and in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection.

Student tuition and student auxiliary fees are presented net of scholarships and fellowships applied to student accounts.

Certain auxiliary operations provide goods and services to internal customers. These auxiliary operations include activities such as central stores, the print shop, and other auxiliaries with interdepartmental activities. The net effect of these internal transactions has been eliminated in the Statement of Revenues, Expenses, and Changes in Net Assets to avoid inflating revenues and expenses.

Medical Center Sales and Services

A significant portion of the Medical Center services is rendered to patients covered by Medicare, Medicaid, or Trigon Blue Cross Blue Shield of Virginia. The Medical Center has entered into contractual agreements with these third parties to accept payment for services in amounts less than scheduled charges. In accordance with these agreements, the difference between the contractual payments due and the Medical Center scheduled billing rates results in contractual adjustments. Contractual adjustments are recorded as deductions from Medical Center revenues in the period in which the related services are rendered.

Certain annual settlements of amounts due for Medical Center 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 basic financial statements. Since the determination of settlements 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 as an adjustment to Medical Center revenues.

Operating Activities

The University's policy for defining operating activities is based primarily on an activity's character as an exchange event. Exchange events generally involve payments or receipts for providing or receiving goods and services. With the exception of interest expense, all expense transactions are classified as operating, while some revenue transactions (i.e., state appropriations, gifts, and investment income) are classified as non-operating in accordance with GASB Statement No. 35.

Restatement of Beginning Net Assets

As a result of the implementation of GASB Statement No. 35, the following adjustments have been made to reflect the cumulative effect of this accounting change (in millions):

Fund balances reported at June 30, 2001	$3,975
Adjustments:	
Accumulated depreciation on capital assets at June 30, 2001, not previously recorded	(868)
Infrastructure assets not previously recorded	109
Federal loan program contributions previously recorded as fund balance in loan funds, now recorded as liabilities	(13)
Restatement of sponsored programs receivables	(12)
Restatement of library assets	(3)
Other	1
Beginning net assets at July 1, 2001, as adjusted	$3,189

NOTE 1: ENDOWMENT

The major portion of the University's endowment is maintained in a single investment pool named the University Pooled Endowment Fund. The University has adopted and met an investment objective of top-quartile performance, measured by a peer group of thirty-five other endowment funds, over rolling three-year periods. The annual return for the Pooled Endowment Fund was -0.1 percent. This percentage has been computed using realized and unrealized gains and losses and investment income. The rate of inflation plus the average level of spending from endowment income was 5.7 percent.

Virginia statutes prescribe that the Board of Visitors may prudently appropriate for expenditure, for the uses and purposes for which an endowment fund is established, the net realized and unrealized appreciation in the fair value of the assets of an endowment fund over the historic dollar value of the aggregate fund. The University's policy is to retain the endowment realized and unrealized appreciation with the endowment after the spending rule distributions. Exceptions to the retention policy require executive management approval within prescribed annual limits and Board of Visitors approval for amounts in excess of prescribed annual limits. At June 30, 2002, the Pooled Endowment Fund includes restricted non-expendable net assets of $282 million, restricted expendable net assets of $902 million, unrestricted net assets of $502 million, and life income funds of $33 million.

The Pooled Endowment Fund is pooled using a market value basis, with each individual fund subscribing to or disposing of units (permanent shares) on the basis of the market value per unit at the beginning of the calendar month within which the transaction takes place. A summary of endowment and similar funds at market value follows:

ENDOWMENT AND SIMILAR FUNDS AS OF JUNE 30, 2002 (in thousands)

	POOLED ENDOWMENT ASSETS*	SEPARATELY INVESTED ASSETS	TOTAL
Mutual and Money Market Funds	$ 548,410	$ 3,308	$ 551,718
U.S. Government Securities	243,460	496	243,956
Corporate and Municipal Bonds	5,030	451	5,481
Corporate Notes	-	-	-
Common and Preferred Stock	411,489	4,848	416,337
Advances to Foundations (Note 3d)	8,612	30,723	39,335
Real Estate and Other Tangible Property	-	330	330
Mortgages	3,297	-	3,297
Private Placement Investments	540,612	-	540,612
Total Assets	$1,760,910	$ 40,156	$1,801,066
*Includes $32.5 million of trust assets			
Investment Income	$ 22,122	$ 6,934	$ 29,056
Realized Net Gain	51,506	1,967	53,473
Unrealized Net Gain/(Loss)	(82,970)	(347)	(83,317)

POOLED ENDOWMENT FUNDS

Number of Permanent Shares	707,928
Number of Participating Shares	697,340
Market Value Per Share	$ 2,445.67
Earnings Per Share	$ 33.77
Distribution Per Share—Class A	$ 95.36
Distribution Per Share—Class B	$ 134.33

NOTE 2: INVESTMENT RISK

The relative risk associated with the University's financial assets is detailed below.

Cash: All cash of the University is maintained in accounts that are collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.1-359, et seq., of the Code of Virginia.

Investments: The investment policy goals, objectives, and guidelines are established by the Finance Committee of the Board. The University's cash equivalents and investments are categorized by levels of credit risk as described below:

Category 1—Insured or registered securities or securities held by the University of Virginia or its agent in the University's name.

Category 2—Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the University of Virginia's name. None of the University's investments are classified as category 2 investments.

Category 3—Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the University of Virginia's name. None of the University's investments are classified as category 3 investments.

Security Lending: Under authorization of the board of the University of Virginia Investment Management Company, the University of Virginia, through its agent, Deutsche Bank AG New York, lends U.S. government and equity securities to various broker-dealers on a temporary basis for collateral. All security loan agreements are collateralized by readily marketable and liquid securities, loans, or other obligations secured by a lien or similar interest on an asset, thereof totaling at least 102 percent of the market value of the loaned securities. The University of Virginia retains the right to pledge or sell these securities held as collateral at its discretion. All security loans can be terminated on demand by either the University or the borrower, and the average term of the security loans as well as collateral held is less than one week. No securities were on loan as of June 30, 2002. Collateral held for securities lending transactions represents the University'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)*.

CATEGORIZATION OF INVESTMENT RISK FOR ASSETS HELD AS OF JUNE 30, 2002 (in thousands)

	CATEGORY 1	NON-CATEGORIZED	FAIR VALUE	COST
U.S. Government Securities	$ 581,037	$ -	$ 581,037	$ 572,532
Corporate Bonds	33,256	-	33,256	32,987
Corporate Notes	-	-	-	-
Common and Preferred Stocks	416,337	-	416,337	318,140
Municipal Securities	225	-	225	25
Mutual and Money Market Funds	-	589,222	589,222	555,870
Real Estate and Other Tangible Property	-	39,665	39,665	39,665
Mortgages	-	32,818	32,818	33,091
Private Placement Investments	-	540,611	540,611	602,860
Other Intangible Property	-	2,374	2,374	2,374
Total	**$ 1,030,855**	**$ 1,204,690**	**$ 2,235,545**	**$ 2,157,544**

Derivative Financial Instruments: Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. A derivative instrument generally has one or more underlying investment, requires little or no initial net investment, and requires or permits a net settlement. In addition, some traditional securities can have derivative-like characteristics. Examples of common derivatives include, but are not limited to, futures, forwards, options, or swap contracts. Although the contract or notional amount of the derivative is not recorded on the financial statements, all derivative instruments are recognized as either an asset or a liability depending on the rights or obligations of the contract measured at fair value.

The University has indirect exposure to various derivative financial instruments that are used in the normal course of business to enhance returns on investments and manage risk exposure to changes in value due to fluctuations in market conditions. These investments may involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the financial statements. Credit risk is the possibility that losses may occur from the failure of a counterparty to perform according to the terms of the agreement. The University minimizes the credit (or repayment) risk in its direct derivative instrument by entering into transactions with high-quality counterparties and a legally enforceable master netting agreement. The "net" mark to market exposure represents the netting of the positive and negative exposures with the same counterparty. Market risk arises due to adverse changes in market price, interest rate, and foreign exchange rate fluctuations that may result in a decrease in the market value of a financial investment and/or increases in its funding cost. The University manages market risk by establishing and monitoring limits as to the type and degree of risk that may be undertaken.

Summary of the University's outstanding derivatives at June 30, 2002 (in thousands):

	NOTIONAL	FAIR VALUE
Indirect Derivative Exposure		
Fair Value Hedge	$ 10,159	$ 9,130
Cash Flow Hedge	51,487	(2,185)
Foreign Currency Hedge	24,646	(3,668)
Not Used for Hedging	2,522	1,932
Total Indirect Derivative Exposure	$ 88,814	$ 5,209

NOTE 3: STATEMENT OF NET ASSET DETAILS

a. Accounts receivable

Accounts receivable include the following (in thousands):

Patient Care	$ 153,533
Estimated Amounts Due from Third-Party Payors	13,815
Grants and Contracts	20,712
Pledges	16,455
Related Foundation	5,824
Other	22,716
Less Allowance for Doubtful Accounts	(77,116)
Total	$ 155,939

b. Notes receivable

Notes receivable are reported net of the allowance for uncollectible student loans, which amounted to $2.8 million.

c. Pledges

The University recorded $33.9 million in pledges receivable, of which $3.8 million relates to plant construction. These are reported net of the allowance for uncollectible pledges, which amounts to $3.4 million.

d. Advances to foundations

The University advances funds to affiliated foundations to enable the foundations to acquire real property in areas near the University and to enhance foundation operations. Foundations are expected to make principal repayments as funds become available. The Board of Visitors has authorized up to $48 million for advances to the University of Virginia Real Estate Foundation. At June 30, 2002, advances to foundations totaled $39.3 million.

e. Capital assets

Capital assets activity for the year ended June 30, 2002, is summarized as follows (in thousands):

INVESTMENT IN PLANT-CAPITAL ASSETS (in thousands)

	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 31,934	$ 2,642	$ -	$ 34,576
Improvements Other Than Buildings	132,603	19,856	-	152,459
Infrastructure	145,390	4,332	-	149,722
Buildings	965,957	115,852	1,972	1,079,837
Equipment	484,699	58,010	40,145	502,564
Software Capitalization	14,366	11,053	-	25,419
Library Books	76,654	4,993	-	81,647
Construction in Process	135,374	116,670	140,557	111,487
	1,986,977	333,408	182,674	2,137,711
Less Accumulated Depreciation	(867,984)	(98,415)	(26,760)	(939,639)
Total	**$ 1,118,993**	**$ 234,993**	**$ 155,914**	**$ 1,198,072**

Construction in Process additions, in the above table, represent expenditures for new projects net of the amount of capital assets placed in service.

f. Goodwill

On October 1, 1997, the Medical Center acquired from the University of Virginia Health Services Foundation the Medicine Clinical Laboratories in a transaction accounted for as a purchase. Accordingly, $1.8 million was recorded as goodwill and is being amortized over five years.

On May 12, 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.

On December 15, 2000, the Medical Center acquired from the University of Virginia Health Services Foundation (HSF) its interest in the Hyperbaric Oxygen Unit. In July 1994, the Medical Center and 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. Accordingly, $1,166,615 was recorded as goodwill for the purchase of the assets and is being amortized over five years.

NOTE 4: NON-CURRENT LIABILITIES

NON-CURRENT LIABILITY ACTIVITY AS OF JUNE 30, 2002, IS SUMMARIZED AS FOLLOWS (in thousands):

DESCRIPTION	INTEREST RATES	MATURITY	BEGINNING BALANCE	ADDITIONS	REDUCTIONS	ENDING BALANCE	CURRENT PORTION
Long-Term Debt:							
Revenue bonds							
Medical Center series 1993A	4.1% to 5.2%	2015	$ 32,960	$ -	$ 290	$ 32,670	$ 300
Medical Center series 1998B	3.5% to 5.0%	2018	6,050	-	250	5,800	260
Medical Center series 1999A	4.5% to 5.25%	2011	48,435	-	3,705	44,730	3,870
University of Virginia series 1995A	variable	2014	4,120	-	480	3,640	221
University of Virginia series 1998A	4.0% to 5.125%	2018–2024	70,050	-	1,950	68,100	2,025
University of Virginia series 1993B	4.25% to 5.375%	2013–2020	49,925	-	2,075	47,850	2,180
U.Va.'s College at Wise 1973B	5.6% to 5.875%	2011	260	-	20	240	20
Commonwealth of Virginia bonds	3.8% to 9.25%	2003–2021	50,988	4,670	4,619	51,039	4,693
Notes payable to VCBA	3.75% to 5.0%	2018	4,145	-	165	3,980	170
Notes payable to VCBA	4.5% to 6.0%	2020	31,635	-	1,015	30,620	1,065
Notes payable to VCBA	4.25% to 5.75%	2021	47,480	-	1,090	46,390	1,495
Higher Education Equipment Trust Fund leases payable	3.85% to 5.0%	2003	5,371	-	3,941	1,430	1,430
Other	various	2007	128	253	84	297	90
Total Long-Term Debt			**351,547**	**4,923**	**19,684**	**336,786**	**17,819**
Other non-current liabilities:							
Accrual for compensated absences			37,388	42,376	37,432	42,332	35,332
Perkins loan program			11,773	649	-	12,422	-
Bond premium			1,309	-	110	1,199	-
Other			19	-	1	18	-
Total Other Non-Current Liablities			**50,489**	**43,025**	**37,543**	**55,971**	**35,332**
Total Non-Current Liabilities			**$ 402,036**	**$ 47,948**	**$57,227**	**$392,757**	**$ 53,151**

Maturities and interest on notes and bonds payable for the next five years and in subsequent five-year periods are as follows:

	PRINCIPAL	INTEREST
2003	$ 17,819	$ 17,486
2004	16,257	16,629
2005	16,950	15,862
2006	17,399	15,030
2007	17,844	14,125
2008–2012	109,123	53,607
2013–2017	83,730	26,944
2018–2022	49,800	7,805
2023–2027	7,864	595
	$336,786	$168,083

NOTE 5: AFFILIATED COMPANIES

Blue Ridge Health Alliance, Inc.

The Medical Center was a participant with the Health Services Foundation (HSF) in Blue Ridge Health Alliance, Inc. (Blue Ridge Health Alliance or the Corporation), a joint venture to develop and operate a managed health care organization in Central and Western Virginia and certain counties in West Virginia. Blue Ridge Health Alliance, a for-profit corporation, was formed in April 1994 to develop a regional network of physicians, hospitals, and other health care providers through which to deliver health benefits to insured and self-funded employers and other groups. QualChoice of Virginia Health Plan, Inc. (QualChoice), was a wholly owned subsidiary of the Corporation formed to operate a health maintenance organization (HMO) serving employers and other groups in the Commonwealth of Virginia. QualChoice commenced operations on January 4, 1995.

Blue Ridge Health Alliance had authorized capital stock consisting of one million two (1,000,002) shares of common stock, par value $0.01 per share (the "Common Stock"). The authorized shares of common stock consist of 1,000,000 shares of Class A Voting Common Stock and two shares of Class B Voting Common Stock. In 1994, the Medical Center and the HSF each executed a Shareholders Subscription Agreement under which each agreed to contribute $4,550,000 as equity capital. Subsequently, the Medical Center and HSF each were issued one share of Class B Voting Common Stock and shares of Class A Voting Common Stock. Except for the original obligations of the founding shareholders under the Founding Shareholders Subscription Agreements, no shareholder had an obligation to make any loans, advances, or additional equity contributions whatsoever to the capital of the Corporation. The shareholders acknowledged and agreed that the Corporation was expected to retain its earnings in order to finance growth and that there was no expectation that the Corporation would pay any cash dividends in the foreseeable future.

The Medical Center contributed a total of $15 million to Blue Ridge Health Alliance during the period ended June 30, 1998. Also, on April 6, 1998, the Medical Center loaned $3.8 million to the Corporation due on July 6, 1998, and bearing interest at 6.25 percent. In July 1998, the Board of Directors of the Corporation issued a capital call to HSF and the Medical Center for $5 million. HSF elected not to participate in this capital call in accordance with their rights prescribed in the Shareholders Agreement; accordingly, the Medical Center contributed the entire $5 million, by converting the $3.8 million loan to capital and contributing $1.2 million in cash. This contribution increased the Medical Center's percentage ownership to 52.05 percent. By agreement between HSF and the Medical Center, HSF relinquished its share of Class B Voting Common Stock to the Medical Center. Corporate actions enumerated in the Amended Articles of Incorporation require approval of the holders of all of the shares of the Class B Voting Common Stock. Except for this special voting requirement, the shares of Class A and Class B Voting Common Stock have equal rights, privileges, and dividend distribution rights. On November 25, 1998, the Medical Center provided a loan to the Corporation as evidenced by a promissory note in the amount of $6,678,595 due February 24, 1999, at 4.50 percent. This note was renewed on February 25, 1999, with a due date of March 26, 1999. The note was renewed again on March 27, 1999, and was structured to have an optional renewal each month. On March 5, 1999, the Medical Center loaned $250,000 to the Corporation, which was to be due December 31, 1999, bearing interest at 4.50 percent. Effective September 15, 1999, Blue Ridge Health Alliance revised its Shareholders Agreement to provide additional capital and to effect a transfer of shares among the shareholders. Under this agreement, the debt owed to the Medical Center was converted to capital. HSF contributed an additional $12,181,232, and Martha Jefferson Hospital contributed an additional $22,881. Once these additional contributions had been made, the Medical Center owned 48.08 percent of the Class A Stock, HSF owned 48.08 percent, and Martha Jefferson Hospital owned 3.84 percent. In addition, the University transferred to HSF one share of Class B Common Stock so that both HSF and the University each owned one of the two shares, which have been authorized.

On May 30, 2001, the Medical Center loaned $3 million to the Corporation due on May 30, 2004, bearing an interest rate of 6.19 percent.

On August 31, 2001, Coventry Health Care, Inc., acquired Blue Ridge Health Alliance, Inc., and its HMO subsidiary, QualChoice of Virginia Health Plan, Inc. The transaction was accounted for as a purchase in which Coventry paid $12.5 million. The Medical Center recognized a loss on the sale of $4.8 million. As part of the definitive agreement, Coventry will enter into a five-year provider contract with Blue Ridge's current majority owners, the University of Virginia Medical Center and the University of Virginia Health Services Foundation.

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. Central Virginia Health Network 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 Central Virginia Health Network of $15,913. The net investment in CVHN is summarized below. Complete financial statements can be obtained from the registered agent: Steven D. Gravely, Esq., Mezzullo and McCandlish, Post Office Box 796, Richmond, VA 23206.

University of Virginia/ HEALTHSOUTH L.L.C.

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

Valiance Health, L.L.C.

In November 1997, the Medical Center became a participant with Rockingham Memorial Hospital and Augusta Health Care, Inc., in Valiance Health, L.L.C. (Valiance), a joint venture engaging in the business of 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.

University HealthSystem Consortium (UHC)

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 health care. 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 non-stock corporation and designated as a non-exempt cooperative that 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. For fiscal year 2001, the Medical Center began recording the portion of the patronage dividends that were held by UHC as patronage equity.

HealthCare Partners, Inc.

In May 1995, HealthCare Partners, Inc. (HealthCare Partners), 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.

AFFILIATED COMPANIES AS OF JUNE 30, 2002 (in thousands)

	CENTRAL VIRGINIA HEALTH NETWORK	HEALTH SOUTH	VALIANCE	UHC
Common Stock and Equity Contributions	$ 232	$ 2,230	$ 100	$ -
Share of Income/(Loss)	(23)	(1,437)	48	489
Net Investment	$ 209	$ 793	$ 148	$ 489

Community Medicine, L.L.C.

The University believed it was imperative to offer health care in the community that allowed the University primary care physician providers an alternative to the traditional model of healthcare delivery. This new 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.

On November 14, 2000, the University of Virginia established Community Medicine University of Virginia, L.L.C. (Community Medicine). Community Medicine was established as a limited liability corporation (L.L.C.) under the laws of the Commonwealth of Virginia to house physician practices. As an L.L.C., which is a wholly owned subsidiary of the University, Community Medicine is considered a disregarded entity for tax purposes. Because Community Medicine is a wholly owned subsidiary, its financial activity will be accounted for under the consolidation method.

An initial investment of $750,000 was made to Community Medicine in May 2001. Community Medicine commenced operations on July 1, 2001. An additional investment of $500,000 was made in July 2001.

NOTE 6: AFFILIATED FOUNDATIONS

The financial statements do not include the assets, liabilities, or net assets of the University of Virginia Health Services Foundation, the University of Virginia Foundation and Subsidiaries, nor any other foundation. These foundations are separately incorporated entities and the related financial statements are examined by other auditors. The University received gifts from these and other foundations amounting to approximately $34.8 million. The condensed summary below is based solely upon the reports of other auditors.

As a result of the issuance of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, the University is conducting a review of all affiliated foundations to determine whether they qualify as component units. If it is determined that any entities qualify as component units, they will be reported with the University's financial statement for the year ending June 30, 2004.

AFFILIATED FOUNDATIONS CONDENSED BALANCE SHEET (in thousands)

	Health Services Foundation June 30, 2001	University of Virginia Foundation June 30, 2001
Assets		
Current assets due from the University	$ 5,115	$ -
Other current assets	53,464	4,254
Other assets	58,862	180,530
Total assets	**$ 117,441**	**$ 184,784**
Liabilities and net assets		
Current liabilities due to the University	$ 7,295	$ 8,212
Other current liabilities	30,517	7,523
Long-term debt due to the University	-	36,875
Other long-term debts	50,672	66,102
Obligations to the University under trust agreements	-	11,833
Net assets	28,957	54,239
Total liabilities and net assets	**$ 117,441**	**$ 184,784**

AFFILIATED FOUNDATIONS CONDENSED STATEMENT OF REVENUES AND EXPENDITURES (in thousands)

	Health Services Foundation June 30, 2001	University of Virginia Foundation June 30, 2001
Revenues		
Professional and technical services provided by the University	$ 19,900	$ 28,608
Rental income from the University	-	2,025
Other	143,823	-
Total revenues	**$ 163,723**	**$ 30,633**
Expenditures		
Office space and administrative services provided by the University	$ 790	$ -
Clinical operations provided by the University	1	-
Gifts to the University	7,546	-
Other	161,085	29,921
Total expenditures	**$ 169,422**	**$ 29,921**

NOTE 7: APPROPRIATIONS

The University receives state appropriations from the General Fund of the Commonwealth. The Appropriation Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of the biennium. For years ending at the middle of a biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to the University for disbursements.

The following is a summary of state appropriations received by the University and the University's College at Wise, including all supplemental appropriations and reversions (in thousands):

Original Legislative Appropriation per Chapter 814	$177,087
Adjustments:	
Match Funds for Deferred Compensation Program	589
Retirees' Health Insurance Credit	(670)
VRS Rate Reduction	(3,674)
Miscellaneous E&G	5,457
Budget Cuts	(7,184)
Reappropriation FY 2001	4,639
Miscellaneous Appropriation	(67)
Adjusted State Appropriation	$176,177

NOTE 9: RETIREMENT PLANS

Employees of the University 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 (CAFR)*. The Commonwealth, not the University, has overall responsibility for contributions to this plan.

Substantially all full-time faculty, certain administrative staff, and Health Care Professionals participate in Faculty Optional Retirement Plans. These are fixed-contribution plans in which the retirement benefits received are based upon the employer and employee contributions (all of which are paid by the University), and the interest and dividends. Individual contracts issued under the plans for full-time faculty and certain administrative staff provide for full and immediate vesting of both the University's and the participant's contributions. Health Care Professionals' employer contributions fully vest after one year of employment. Total pension costs under the plans were approximately $33.3 million. Contributions to the Optional Retirement Plans were calculated using base salaries of $337.6 million. The contribution percentage amounted to 9.9 percent.

NOTE 8: NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION AS OF JUNE 30, 2002 (in thousands):

	COMPENSATION	SUPPLIES AND SERVICES	SCHOLARSHIPS	UTILITIES	DEPRECIATION	OTHER	TOTAL
Instruction	$ 213,120	$ 7,975	$ 3,781	$ 1,820	$ -	$ -	$ 226,696
Research	114,194	83,767	8,186	899	-	-	207,046
Public Service	8,645	7,689	262	186	-	-	16,782
Academic Support	62,714	29,168	551	548	-	-	92,981
Student Services	14,309	5,540	115	247	-	-	20,211
Institutional Support	52,729	3,188	24	2,300	-	-	58,241
Operation of Plant	4,718	14,287	7	37,301	-	-	56,313
Student Aid	531	2,584	21,114	-	-	-	24,229
Auxiliary	33,885	45,124	105	1,534	-	-	80,648
Depreciation	-	-	-	-	64,266	-	64,266
Patient Services	285,617	236,286	-	11,019	34,362	22,522	589,806
Other	6,497	(9,107)	11	373	-	-	(2,226)
TOTAL	**$ 796,959**	**$ 426,501**	**$ 34,156**	**$ 56,227**	**$ 98,628**	**$ 22,522**	**$ 1,434,993**

NOTE 10: POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Commonwealth of Virginia participates in the VRS-administered statewide group life insurance program, which provides post-employment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least fifteen years of state service and participate in the state health plan. Information related to these plans is available at the statewide level in the Commonwealth's *Comprehensive Annual Financial Report (CAFR).*

NOTE 11: SELF-INSURANCE

All University employees have an option to participate in the University's self-funded, comprehensive medical care benefits program. The cost of medical care is paid out of employee and employer contributions and is held in a separate bank account with a June 30, 2002, market value balance of $20 million. The estimated liability for outstanding claims was $7.7 million. The University has contracted with Southern Health Services, Inc., a third-party administrator, to provide administrative services for this healthcare benefits program.

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

The risk management insurance plans are administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, boiler and machinery, crime, employee faithful performance of duty bond, general (tort) liability, professional liability (includes medical malpractice), aviation and watercraft coverage, and automobile liability. 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 and vehicle physical damage insurance coverage.

NOTE 12: FUNDS HELD IN TRUST BY OTHERS

Assets of funds held by trustees for the benefit of the University are not reflected in the accompanying statement of net assets. The University has irrevocable rights to all or a portion of the income of these funds, but the assets of the funds are not under the management of the University. The market value of the funds held by trustees for the benefit of the University as of June 30, 2002, was $113 million, and income received totaled $6.5 million.

NOTE 13: COMMITMENTS

As of June 30, 2002, the University was a party to construction contracts totaling approximately $219 million, of which $142 million had been incurred. The University's commitments for equipment, leases, and services are as follows (in thousands):

YEAR ENDING JUNE 30	LEASE OBLIGATION
2003	$ 6,987
2004	4,994
2005	2,113
2006	1,446
2007	1,207
2008–2012	1,358
2013–2017	1,083
2018–2022	875
2023–2027	823
2028–2032	823
2033–2037	823
2038–2042	823
2043–2047	823
2048–2052	332
	$ 24,510

The total rental expense for all property and equipment was approximately $17.6 million.

NOTE 14: SUBSEQUENT EVENTS

OIG Indigent Care Investigation

On August 13, 2002, the U.S. Department of Health and Human Services, Office of the Inspector General (OIG), issued a draft 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 alleges that the Medical Center overstated its UCC. As this report is addressed to the Department of Medical Assistance Services, the impact on the Medical Center cannot be determined at this time; however, management has reduced net patient revenue by $6 million, the amount that it believes to be the potential exposure related to this matter.

UNIVERSITY ADMINISTRATION 2001–2002

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Internal Audit

Barbara J. Deily, Director of Audits

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About the Cover:
The view of the northeast wing of the Rotunda is by Dean Dass, a professor in the University's McIntire Department of Art. A member of the studio art faculty since 1985, Professor Dass teaches drawing and printmaking. His work has appeared in numerous solo and group shows in this country and abroad, and his prints and paintings can be found in such collections as the Brooklyn Museum of Art, the National Collection of Poland in Krakow, and the Alvar Aalto Museum in Finland. A graduate of the University of Northern Iowa, he holds an MFA degree from the Tyler School of Art at Temple University in Philadelphia.

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