UNIVERSITY OF VIRGINIA MEDICAL CENTER

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2007

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, 2007, found that the financial statements are presented fairly, in all material respects.

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

MANAGEMENT'S DISCUSSION AND ANALYSIS
(unaudited)

The following discussion and analysis provides an overview of the financial position and activities of the University of Virginia's Medical Center (Medical Center) for the year ended June 30, 2007, with comparative information for the year ended June 30, 2006. 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 provide overall leadership and management of the Medical Center. The Medical Center is an integrated network of primary and specialty care services ranging from wellness programs and routine checkups to the most technologically advanced care. The hub of the Medical Center is a 574-bed hospital with a state designated Level 1 trauma center located on the Charlottesville campus. In addition, primary and specialty care is provided at clinic locations throughout central Virginia communities.

Financial Highlights

Operating Results

	2007	2006
Operating revenues	$ 920.3	$ 857.0
Operating income	$ 48.9	$ 42.8
Net non-operating revenue	55.6	21.1
Capital appropriations	25.0	-
Transfers to the University	(25.0)	-
Increase in net assets	$ 104.5	$ 63.9
Cash and investments	$ 758.3	$ 623.2
Other assets	514.3	477.4
Liabilities	(435.7)	(368.2)
Net assets	$ 836.9	$ 732.4

*in millions

The Medical Center's financial results for fiscal year 2007 compare favorably to fiscal year 2006. Operating income increased by $6.1 million and net non-operating revenue increased by $34.5 million. As a result, the increase in net assets was $40.6 million greater in 2007 as compared to 2006. Increased demand for both inpatient and outpatient services, and increased charge rates resulted in an increase in operating revenues of $63.3 million (7.4 %) while operating costs increased by $57.3 million (7.0 %). Non-operating revenues of $55.6 million exceed last year's amount by 163.5%. The result of these changes was an increase of $104.5 million to net assets.

Financial Statements

The Medical Center's financial report includes three financial statements: the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows. These financial statements are prepared in accordance with the Governmental Accounting Standards Board (GASB) Statement 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments*; GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis of Public Colleges and Universities* and with the Financial Accounting Standards Board requirements for 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.

Statements of Net Assets
As of June 30, 2007 and 2006

			Increase/(Decrease)	
	2007	2006	Amount	Percent
Assets:				
Current assets	$ 383.3	$ 331.8	$ 51.5	15.5%
Capital assets	389.2	351.7	37.5	10.7%
Other non-current assets	500.1	417.2	82.9	19.9%
Total assets	1,272.6	1,100.7	171.9	15.6%
Liabilities:				
Current liabilities	265.3	212.1	53.2	25.1%
Non-current liabilities	170.4	156.1	14.3	9.1%
Total liabilities	435.7	368.2	67.5	18.3%
Net assets				
Invested in capital assets, net of related debt	228.9	210.2	18.7	8.9%
Restricted for				
Nonexpendable	53.1	53.1	-	-
Expendable	73.6	34.3	39.3	114.3%
Unrestricted	481.4	434.8	46.4	10.7%
Total net assets	$ 837.0	$ 732.4	$ 104.4	14.3%

*in millions

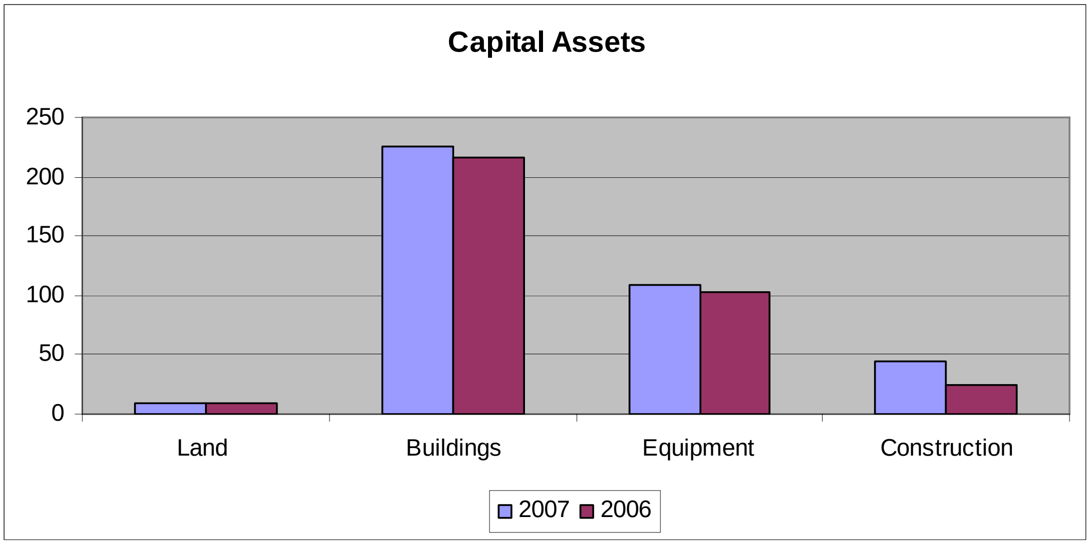
During fiscal year 2007, the Medical Center's financial position improved. Net assets increased by $104.5 million as a result of the Medical Center's positive operating performance. The increase of $51.5 million in current assets includes a $43.5 million increase in current cash resulting from both operating performance and improved collection of accounts receivable. The other significant increase relates to a $9 million increase in securities lending transactions executed by the State Treasurer's Office. These amounts are offset by a security lending obligation increase in the current liabilities. Several large items account for the $120.4 million increase in non-current assets. The Commonwealth of Virginia appropriated $25 million for the construction of a Cancer Center of which $20.5 million remains unspent and is shown in non-current assets. Two gifts totaling $20 million were received for the construction of a cancer center and a children's medical center. Although $20 million is shown as a non-current asset, $15 million is reported as a liability in accordance with GASB Statement 33 *Accounting and Financial Reporting for Nonexchange Transactions*. The largest item contributing to the increase in non-current assets was an increase of $37.5 million in the value of capital assets, net of depreciation. Shown below are the major capital additions made in the past two fiscal years.

Major Capital Additions

	2007	2006
University Hospital Expansion	$ 6.0	$ 24.6
UVA Outpatient Surgery Center	-	7.4
Radiology and imaging systems	10.5	6.5
Information systems and related hardware	7.4	6.4
Other health system renovations	25.7	6.4
Primary Care Building Renovation	0.9	3.4
Core Lab Building and Equipment	1.7	0.9
Kirtley Property	8.1	-
Emily Couric Clinical Cancer Center	3.3	-
Total	$ 63.6	$ 55.6

*in millions

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



*millions

The largest component of the increase in current liabilities resulted from the Medical Center's agreement to pay the School of Medicine $25 million for its "Fund for the Future". There was also a $9 million increase to obligations under security lending transaction as discussed above. The net increase to non-current liabilities of $14.3 million resulted primarily from an $11.5 million increase in grant payments due to the School of Medicine.

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, 2007 and 2006 is as follows:

Statements of Revenues, Expenses, and Changes in Net Assets
For the years ended June 30, 2007 and 2006

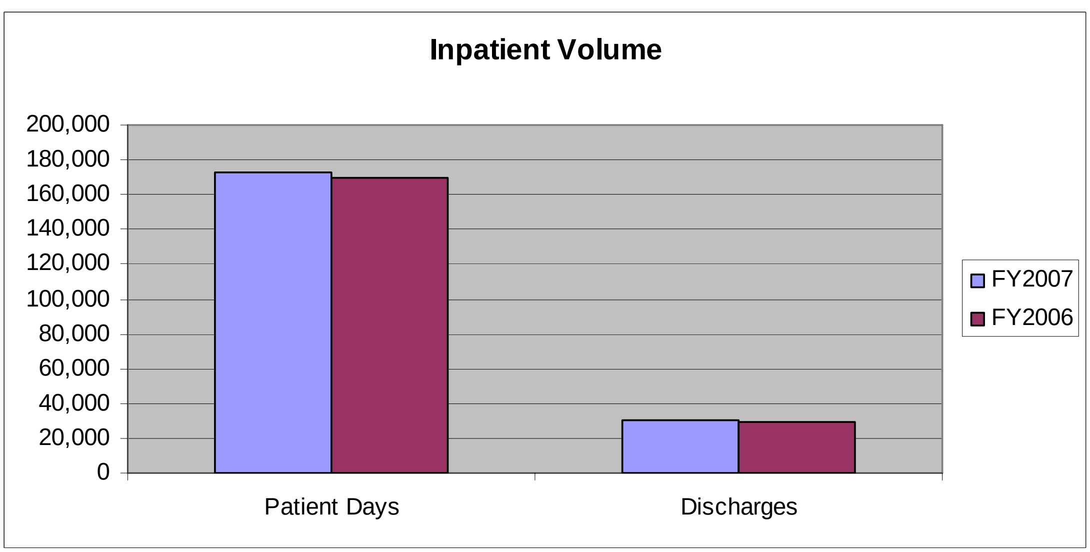
			Increase/(Decrease)	
	2007	2006	Amount	Percent
Net patient service revenue	$ 882.4	$ 819.5	$ 62.9	7.7%
University allocations	15.5	16.0	(0.5)	(3.6%)
Other	22.4	21.5	0.9	4.5%
Total operating revenue	920.3	857.0	63.3	7.4%
Salaries and benefits	376.8	352.2	24.6	7.0%

Other operating expenses	494.7	462.0	32.6	7.1%
Total operating expenses	871.5	814.2	57.3	7.0%
Operating income	48.9	42.8	6.1	14.1%
Non-operating revenue	55.6	21.1	34.5	163.5%
Income before other revenue and transfers	104.5	63.9	40.6	63.4%
Transfers to UVA	(25.0)	-	(25.0)	>100%
Capital appropriation	25.0	-	25.0	>100%
Increase in net assets	104.5	63.9	40.6	63.4%
Net assets-beginning of year	732.5	668.6	63.9	9.6%
Net assets-end of year	$ 837.0	$ 732.5	$104.5	14.3%

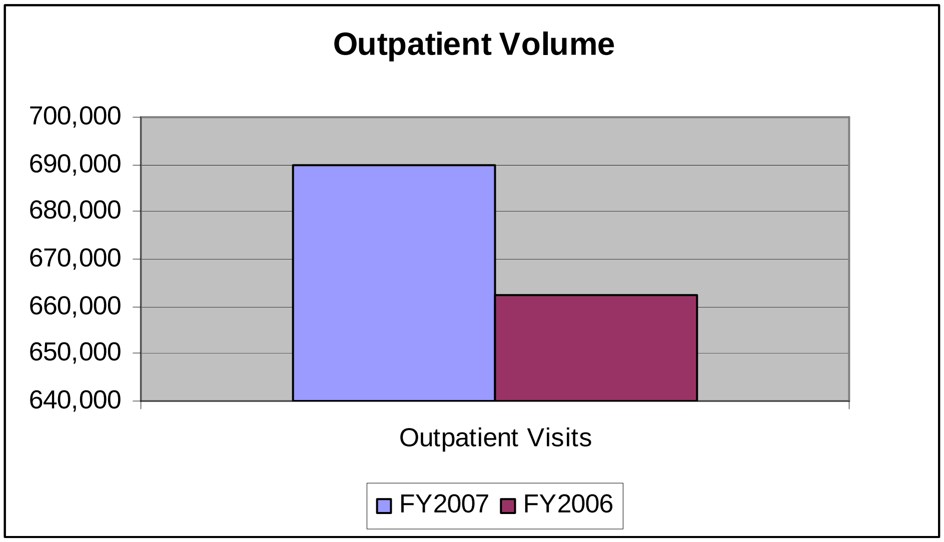
*millions

Operating Revenue

Total operating revenue for the fiscal year 2007 was 7.4% above the prior year. This increase resulted from patient volume increases and a rate increase. As shown by the graph below, both inpatient discharges and inpatient days were up slightly from the prior year. Although discharges increased 2.3% over the prior year, patient days increased by 1.7% as a result of a slight decrease in the average length of stay (ALOS) from 5.79 days last year to 5.69 days. Inpatient services, which experienced the most significant increases in admissions over the prior year, include orthopedics, pediatrics, psychiatry and family practice. Admissions to the thoracic cardiovascular surgery service have declined from last year.



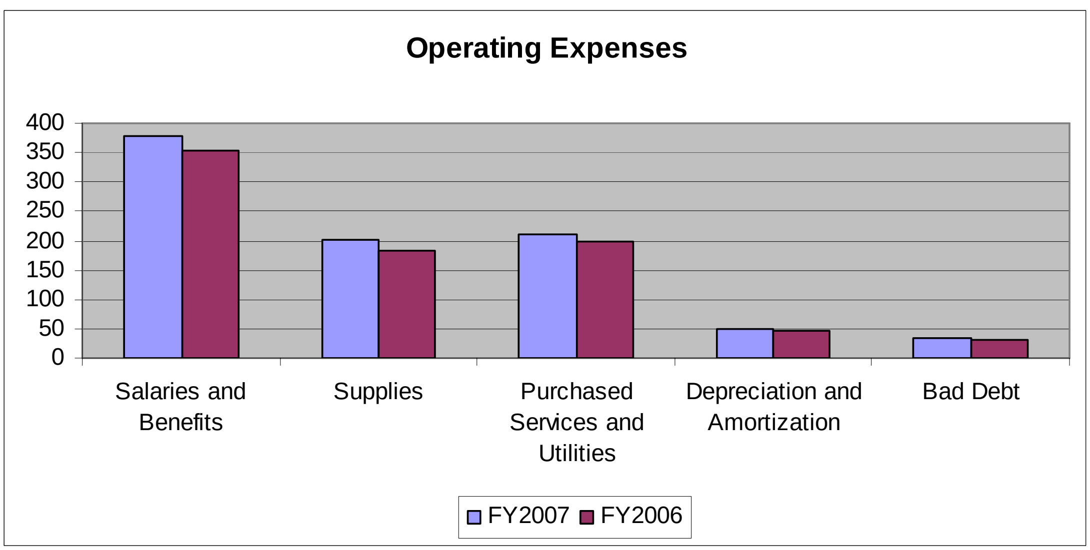
There was also a 4.2% growth in outpatient visits over the prior year, including Emergency Department visits.



Operating Expenses

As a result of growth in patient volumes and inflation, operating expenses increased by 7.0% over the prior year. The following items contributed to this growth:

- Compensation cost increased by 7.0%, which results from salary increases and the increase in full time equivalent employees (FTEs). FTEs increased from 5,767 in fiscal year 2006 to 5,904 in fiscal year 2007.
- Supply expense experienced a 10.1% cost increase. This was the result of volume increases 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, 2007 and 2006 is as follows:

Statements of Cash Flows
For the years ended June 30, 2007 and 2006

	2007	2006	Increase/(Decrease) Amount	Increase/(Decrease) Percent
Cash flows from operating activities	$ 102.8	$ 116.3	$ (13.5)	(11.6)%
Cash flows from non-capital financing activities	17.6	(2.5)	20.1	>100%
Cash flows from capital and related financing activities	(49.4)	(49.6)	0.2	0.4%
Cash flows from investing activities	52.2	(2.9)	55.1	>100%
Net Increase in cash and cash equivalents	123.2	61.3	61.9	100.9%
Cash and cash equivalents - beginning of the year	210.5	149.2	61.3	41.1%
Cash and cash equivalents - end of the year	$ 333.7	$ 210.5	$ 123.2	58.5%

*in millions

The cash generated from operating activities decreased by 13.5% from 2006 to 2007 primarily as a result of increased cash paid to employees and suppliers. Increases in salaries and an increase in full time equivalent employees increased cash paid to employees while increases in supply costs based on inflation and increases in service volume caused the increase in payments to suppliers. The increase of $20 million from non-capital financing activities results primarily from two gifts totaling $20 million discussed above. Cash required for capital and related financing remained steady as a result of borrowing $21.1 million less cash for construction than was borrowed the previous fiscal year; and spending $6.7 million more was spent for capital assets than the previous fiscal year. This was offset a capital appropriation from the Commonwealth of $25 million for the Cancer Center as discussed above. Cash provided from investing activities increased $55.1 million primarily as a result of $40.8 million of assets whose use is limited being converted to cash from investments since last fiscal year. Another $14.1 million of cash was provided by investment income.

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 with construction starting in the 2008 fiscal year. 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 and the remainder of the cost will be financed by 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 and will be completed in 2010.

The Medical Center is also planning to construct a Long Term Acute Care hospital at the North Ridge 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 $14.5 million and will be completed in 2009.

FINANCIAL STATEMENTS

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2007
With Comparative Amounts as of June 30, 2006

A S S E T S	2007	2006
Current assets:		
Cash and cash equivalents (Note 2)	$ 222,324,882	$ 178,835,424
Cash and cash equivalents - securities lending	11,844,107	24,895,527
Short term investments - securities lending	46,660,683	24,636,981
Accounts receivable, net of estimated uncollectibles of $222,192,464 at June 30, 2007	76,627,319	79,339,057
Due from University of Virginia	4,658,610	4,573,840
Inventories and prepaid expenses	21,174,990	19,473,170
Notes receivable (Note 4)	12,587	13,131
Total current assets	383,303,178	331,767,130
Noncurrent assets:		
Cash and cash equivalents - restricted (Note 2)	48,547,796	9,283,699
Due from the University of Virginia - non current (Note 5)	419,164	185,309
Investments in pooled endowment funds (Note 2)	149,651,352	124,044,694
Goodwill (Note 3)	13,743,847	14,185,686
Investments (Note 2)	6,910,638	6,751,479
Investments in affiliated companies (Note 4)	7,901,433	7,354,670
Land (Note 5)	8,190,246	8,190,246
Contruction in Progress (Note 5)	44,786,145	23,851,624
Depreciable land improvements, buildings, and equipment, less accumulated depreciation of $433,762,132 at June 30, 2007 (Note 5)	336,261,130	319,692,383
Deferred bond discount and issue costs, net of amortization of $203,368 at June 30, 2007	548,058	581,232
Assets whose use is limited:		
Cash and cash equivalents (Note 2)	62,873,756	22,421,228
Investments (Note 2)	209,491,963	232,344,744
Total noncurrent assets	889,325,528	768,886,994
Total assets	1,272,628,706	1,100,654,124

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2007
With Comparative Amounts as of June 30, 2006

	2007	2006
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	$ 106,314,193	$ 92,308,913
Deferred revenue	18,758,120	3,788,290
Obligations under security lending (Note 2)	58,504,790	49,532,508
Due to third-party payors	65,034,807	49,956,124
Current installments of long-term debt (Note 8)	11,940,304	8,265,292
Grants payable - current portion	4,631,471	8,106,874
Bond premium - current amortization	109,847	111,954
Total current liabilities	265,293,532	212,069,955
Long-term liabilities:		
Long-term debt (Note 8)	160,571,555	149,380,915
Grants payable - noncurrent portion	8,073,334	4,333,334
Bond premium, net of amortization	540,208	647,948
Noncontrolling interest in subsidiary	1,200,770	1,755,940
Total long-term liabilities	170,385,867	156,118,137
Total liabilities	435,679,399	368,188,092
NET ASSETS		
Invested in capital assets, net of related debt	228,897,132	210,214,172
Restricted for		
Nonexpendable	53,099,192	53,099,192
Expendable	73,602,078	34,337,981
Unrestricted	481,350,905	434,814,687
Total net assets	$ 836,949,307	$ 732,466,032

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENTS OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS
As of June 30, 2007
With Comparative Amounts as of June 30, 2006

	2007	2006
Operating revenue:		
Net patient service revenue (Note 9)	$ 882,400,985	$ 819,501,040
University allocations (Note 10)	15,473,585	16,036,687
Other	22,438,098	21,479,825
Total operating revenue	920,312,668	857,017,552
Operating expenses:		
Salaries and wages	301,798,710	282,904,809
Fringe benefits	74,988,737	69,279,721
Supplies	202,305,914	183,721,915
Purchased services and other expenses	197,822,838	185,561,337
Utilities	13,425,698	14,485,006
Provision for depreciation and amortization	48,267,336	45,962,412
Provision for bad debts	32,842,637	32,285,536
Total operating expenses	871,451,870	814,200,736
Income from operations	48,860,798	42,816,816
Nonoperating revenue (expenses):		
Gifts	5,820,588	771,447
Investment income	39,341,599	20,374,317
Net increase in the fair value of investments	17,740,628	7,388,831
Net loss from investments in affiliated companies (Note 4)	1,058,547	1,196,837
Noncontrolling interest in subsidiary income	(1,955,793)	(2,019,894)
Interest expense	(5,953,921)	(4,712,274)
Loss on disposal of fixed assets	(429,171)	(1,892,656)
Net nonoperating revenues	55,622,477	21,106,608
Income before other revenues, expenses, gains or losses	104,483,275	63,923,424
Capital appropriation	25,000,000	-
Transfers to the University of Virginia (Note 19)	(25,000,000)	-
Increase in net assets	104,483,275	63,923,424
Net assets - beginning of year	732,466,032	668,542,608
Net assets - end of year	$ 836,949,307	$ 732,466,032

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, 2007
With Comparative Amounts as of June 30, 2006

	2007	2006
Cash flows from operating activities:		
Receipts from patients and third-parties	$ 865,055,264	$ 827,614,562
Receipts from other revenue	19,621,804	20,138,787
Payments to employees	(384,523,915)	(364,501,498)
Payments to suppliers	(383,691,674)	(352,464,488)
Payment for utilities	(13,659,572)	(14,485,006)
Net cash provided by operating activities	102,801,907	116,302,357
Cash flows from non-capital financing activities:		
Payments on grants	(3,235,403)	(3,231,654)
Gifts	5,820,588	771,447
Unearned gift	15,000,000	-
Net cash used by non-capital financing activities	17,585,185	(2,460,207)
Cash flows from capital and related financing activities:		
Purchase of capital assets	(75,908,967)	(69,249,861)
Principal paid on capital debt	(9,781,126)	(13,045,231)
Interest paid on capital debt	(5,135,283)	(4,824,332)
Capital appropriation	25,000,000	-
Proceeds from incurring loan from the University	16,369,939	37,423,897
Proceeds from sale of capital assets	71,000	126,703
Net cash used by capital and related financing activities	(49,384,437)	(49,568,824)
Cash flows from investing activities:		
Interest on investments	30,283,409	16,197,151
Purchase of investments	(136,369,626)	(183,284,773)
Proceeds from sale of investments	160,255,408	166,322,954
Transfer to affiliate	(4,800)	(5,000)
Payment to affiliate	(1,960,961)	(2,125,814)
Net cash provided (used) by investing activities	52,203,430	(2,895,482)
Net increase in cash and cash equivalents	123,206,085	61,377,844
Cash and cash equivalents - beginning of the year	210,540,350	149,162,506
Cash and cash equivalents - end of the year	$ 333,746,435	$ 210,540,350

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF CASH FLOWS
As of June 30, 2007
With Comparative Amounts as of June 30, 2006

	2007	2006
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 48,860,798	$ 42,816,815
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	48,267,336	45,962,412
Change in assets and liabilities		
Accounts receivables	17,672,781	35,055,401
Inventories and prepaid expenses	(1,935,674)	(2,280,694)
Accounts payable and accrued expenses	(10,063,334)	(5,251,577)
Net cash provided by operating activities	$ 102,801,907	$ 116,302,357

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

NOTES TO FINANCIAL STATEMENTS

UNIVERSITY OF VIRGINIA MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2007

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, 2007, 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 2007.

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 are in FHLB, FHLMC, FNMA, and the University of Virginia Growth and Income Fund. These investments represent 14 percent, 18 percent, 21 percent, and 48 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 2007.

The following information is provided with respect to the risks associated with the Medical Center's cash, cash equivalents, and investments at June 30, 2007.

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 Number 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

	Fair Value	Credit Rating	Concentration Risk Percent
Cash equivalents:			
U.S. government securities:			
Short-term investment fund	$ 62,873,756	Aaa	
State non-arbitrage program Virginia College Building Authority- 1999A Pooled Bond Fund	482,649		
Federal Home Loan Bank	49,863,754	P-1	
Total cash equivalents	113,220,159		
Investments:			
U.S. government securities:			
Federal Home Loan Bank	37,119,921	Aaa	11%
Federal Home Loan Bank (Callable)	4,993,750	Aaa	2%
Federal Home Loan Mortgage Corporation	49,871,650	Aaa	16%
Federal Home Loan Mortgage Corporation (Callable)	4,992,850	Aaa	2%
Federal National Mortgage Association	59,815,700	Aaa	19%
Federal National Mortgage Association (Step Up)	4,923,450	Aaa	2%
University of Virginia Growth and Income Fund	149,651,352		48%
Total investments	311,368,673		
Total cash equivalents and investments	$ 424,588,832		

Interest Rate Risk – Maturities

	Less than one year	1 to 5 years	Total
U.S. government securities:			
Federal Home Loan Bank	$ 22,169,921	$ 14,950,000	$ 37,119,921
Federal Home Loan Bank (Callable)	4,993,750	-	4,993,750
Federal Home Loan Mortgage Corporation	29,955,050	19,916,600	49,871,650
Federal Home Loan Mortgage Corporation (Callable)	4,992,850		4,992,850
Federal National Mortgage Association	4,957,800	54,857,900	59,815,700
Federal National Mortgage Association (Step up)	4,923,450	-	4,923,450
University of Virginia Growth and Income Fund	149,651,352	-	149,651,352
Total investments	$ 221,644,173	$ 89,724,500	$ 311,368,673

Securities Lending Transactions

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).

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, 2007

	Common stock and equity contribution	Share of accumulated income (loss)	Net investment
UVA Imaging, LLC	$ 687,019	$ 306,108	$ 993,127
Community Medicine, LLC	1,810,000	(3,239,064)	(1,429,064)
Central Virginia Health Network, Inc.	232,500	(41,026)	191,474
HealthSouth, LLC	1,830,000	4,475,576	6,305,576
Valiance, LLC	350,000	408,281	758,281
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, 2007, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 8,190,246	$ -	$ -	$ 8,190,246
Construction in progress	$ 23,851,624	$ 49,301,345	$ 28,366,824	$ 44,786,145
Depreciable capital assets				
Land improvements	$ 8,327,598	$ 200,186	$ -	$ 8,527,784
Buildings	439,568,937	26,790,190	492,453	465,866,674
Equipment-fixed	20,937,970	466,535	-	21,404,505
Equipment-movable	239,596,198	36,545,271	1,917,170	274,224,299
Total depreciable capital assets	708,430,703	64,002,182	2,409,623	770,023,262
Less accumulated depreciation				
Land improvements	6,636,579	187,971	-	6,824,550
Buildings	223,767,183	16,322,032	-	240,089,215
Equipment-fixed	15,813,324	648,138	-	16,461,462
Equipment-movable	142,521,234	29,680,961	1,815,290	170,386,905
Total accumulated depreciation	388,738,320	46,839,102	1,815,290	433,762,132
Depreciable land improvements, buildings and equipment, net	$ 319,692,383	$ 17,163,080	$ 594,333	$ 336,261,130

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, and 2006 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, 2007:

Construction Fund-Pooled*	$ 482,649
Bond Sinking Fund-1998B	1,054
Bond Sinking Fund-1999A	13,638
Depreciation Reserve	274,625,001
Bond Sinking Fund-2003B (Construction Fund)	1,085,854
Bond Sinking Fund-2006 (Construction Fund)	3,253,023
Total assets	$279,461,219

*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, 2007, the components of accounts payable and accrued expenses consist of the following:

Vendor accounts payable	$ 20,500,090
Accrued leave	24,777,570
Accrued allotments	16,994,760
Other accrued expenses	8,741,863
Other accounts payable	7,272,088
Due to the University	28,027,822
Total accounts payable and accrued expenses	$ 106,314,193

8. LONG-TERM DEBT

Description	Interest Rate	Maturity	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Bonds payable:							
Series 1998B	3.5-5.00	2018	$ 4,700	$ -	$ 305	$ 4,395	$ 315
Series 1999A	4.5-5.25	2013	28,160	-	4,660	23,500	4,565
Series 1999A Pooled	4.5-5.25	2019	765	-	180	585	185
Series 1999A Pooled Refinance	4.5-5.25	2020	2,935	-	10	2,925	10
Series 2003A Pooled	4.5-6.00	2015	31,380	-	360	31,020	705
Series 2003B Pooled	4.7-6.00	2023	34,610	-	1,361	33,249	1,425
UVA Pooled Debt	4.7-6.00	2024	16,205	-	727	15,478	727
Series 2006 Pooled	4.5-6.00	2027	36,864	-	-	36,864	1,151
Series 2007 Pooled	4.5-6.00	2014	-	14,118	1,491	12,627	1,563
Total bonds payable			155,619	14,118	9,094	160,643	10,646
Notes payable:							
UVA Imaging			2,027	2,496	655	3,868	1,054
Capital leases			-	8,000	-	8,000	240
Total long-term debt			$ 157,646	$ 24,614	$ 9,749	$ 172,511	$ 11,940

*In thousands

Future Debt Requirements

Fiscal Year	Principal	Interest	Total
2008	$ 11,940,304	$ 7,931,555	$ 19,871,859
2009	14,777,155	7,411,322	22,188,477
2010	12,554,732	6,844,440	19,399,172
2011	12,487,796	6,249,024	18,736,820
2012	13,070,908	5,626,694	18,697,602
2013-2017	56,358,837	18,428,863	74,787,700
2018-2022	29,591,925	9,226,269	38,818,194
2023-2027	18,228,366	2,929,624	21,157,990
2028-2032	602,136	664,893	1,267,029
2033-2037	755,943	521,762	1,277,705
2038-2042	949,735	340,347	1,290,082
2042-2047	1,194,022	110,406	1,304,429
Total	$ 172,511,859	$ 66,285,199	$ 238,797,058

During the fiscal year ended June 30, 2007, the Commonwealth, on behalf of the University, issued bonds to the Medical Center for $14,118,838 for the equipment related to Hospital Expansion Project. The bonds repaid amounts previously borrowed from the University's Pooled Bond Program.

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 and the remainder of the renovations should be completed in 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.

10. NET PATIENT SERVICE REVENUE

The Medical Center's patient service revenue is as follows for the year ended June 30, 2007:

Gross patient service revenue:	
Inpatient	
Routine services	$ 275,398,784
Ancillary services	831,156,869
Outpatient	
Ancillary services	724,791,587
Clinics	37,088,255
Total gross patient service revenue	1,868,435,495
Allowances for indigent care and contractual adjustments	(986,034,510)
Net patient service revenue	$ 882,400,985

The Medical Center received $96,344,373 in fiscal year 2007 from the Commonwealth's Department of Medical Assistance Services. Of this amount, $39,562,283 was the payment of disproportionate share relating to the care provided to indigent patients. The remaining $56,782,090 was a payment to reimburse the Medical Center for indirect medical education. These payments are 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, $16,089,309 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 $25,550,630 for the year ended June 30, 2007.

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, 2007 was $13,231,502.

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, 2007 was $2,242,083.

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 2007, 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
2008	$ 7,085,420
2009	3,774,795
2010	3,548,090
2011	2,048,386
2012	757,681
2013-2017	2,010,592
2018-2022	823,200
2023-2027	823,200
2028-2032	823,200
2033-2037	823,200
2038-2042	823,200
2043-2047	823,200
2048-2050	423,920
Total	$ 24,588,084

The total rental expense for operating leases for the year ended June 30, 2006, was $7,513,669.

The Medical Center was party to construction contracts and commitments for the year ended June 30, 2007 totaling $135,353,946 of which $117,252,069 was incurred as of June 30, 2007.

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 $16,452,512 as expense payable to HSF for the provision of supervisory and administrative services, $18,276,538 for other services, and $1,599,501 for rental of space for the year ended June 30, 2007.

The Medical Center recorded income from HSF of $9,859,160 for clinic facility fees and other services, and $54,853 for the rental of space for clinics for the year ended June 30, 2007.

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 and 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 $12,361,203 for the year ended June 30, 2007. Contributions to the Optional Retirement Plans were calculated using base salaries of $179,399,353 for the year ended June 30, 2007. The contribution percentage amounted to seven percent for the year ended June 30, 2007.

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 & 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. It is still uncertain as to the amount, if any, that the Medical Center will be required to return.

DMAS has under consideration a proposal from the Medical Center to file suit asking that the decision of the DAB be reversed.

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

19. TRANSFER TO THE UNIVERSITY OF VIRGINIA

In fiscal year 2007, the Medical Center entered into an agreement to make an unrestricted contribution of $25 million to the School of Medicine. The contribution is for the creation of a quasi-endowment account, “Fund for the Future,” to function as an unrestricted account to meet various needs of the School of Medicine. It is anticipated that a significant amount of the needs of the School of Medicine would be clinical in nature. However, as an unrestricted quasi-endowment account the expenditures would be determined by the School of Medicine and utilized for any purpose deemed appropriate in support of the School of Medicine.

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 12, 2007

The Honorable Timothy M. Kaine
Governor of Virginia

The Honorable Thomas K. Norment, Jr.
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, 2007, as listed in the table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center as of June 30, 2007, 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 of Analysis presented on pages 1 through 8 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 12, 2007, on our consideration of the University of Virginia's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. 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

JHS:clj