

**UNIVERSITY OF VIRGINIA MEDICAL CENTER
CHARLOTTESVILLE, VIRGINIA**

**REPORT ON AUDIT
FOR THE YEARS ENDED
JUNE 30, 2001 AND 2000**



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UNIVERSITY OFFICIALS

October 15, 2001

The Honorable James S. Gilmore, III
Governor of Virginia

The Honorable Vincent F. Callahan, Jr.
Chairman, Joint Legislative Audit
and Review Commission

The Board of Visitors
University of Virginia

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the balance sheets of the **University of Virginia Medical Center**, a division of the University of Virginia, as of June 30, 2001 and 2000, and the related statements of revenues and expenses, changes in fund balances, and cash flows for the years then ended. 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 audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center as June 30, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

AUDITOR OF PUBLIC ACCOUNTS

JHS:kva
kva:141

INDEPENDENT AUDITOR'S REPORT ON COMPLIANCE AND ON INTERNAL
CONTROL OVER FINANCIAL REPORTING

Our report on internal controls and compliance and recommendations for improvements in internal controls relative to the Medical Center's operations are included in our report on the total operations of the University of Virginia for the year ended June 30, 2001.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
BALANCE SHEETS
As of June 30, 2001 and 2000

	2001	2000
A S S E T S		
General funds:		
Current assets:		
Cash and cash equivalents (Note 3)	\$ 34,793,168	\$ 61,871,319
Accounts receivable, net of estimated uncollectibles of \$69,387,854 at June 30, 2001 and \$57,813,399 at June 30, 2000	81,683,287	60,844,461
Due from third-party payors	17,063,646	11,781,091
Inventories and prepaid expenses	11,096,962	9,638,118
Notes receivable (Note 7)	3,032,069	20,436
Total current assets	147,669,132	144,155,425
Other assets:		
Property, plant and equipment, less accumulated depreciation of \$301,829,065 at June 30, 2001 and \$293,587,784 at June 30, 2000 (Note 6)	230,927,712	219,184,011
Deferred bond discount and issue costs, net of amortization of \$3,939,914 at June 30, 2001 and \$3,851,904 at June 30, 2000	516,467	604,477
Advance to the University (Note 5)	2,898,911	2,697,071
Goodwill (Note 8)	2,944,017	2,550,948
Investments (Note 3)	5,823,161	5,494,100
Investments in affiliated companies (Note 7)	4,772,485	7,115,281
Total other assets	247,882,753	237,645,888
Assets whose use is limited (Note 4):		
Cash and cash equivalents (Note 3)	18,424,544	5,590,466
Investments (Note 3)	159,086,457	150,111,825
Total assets whose use is limited	177,511,001	155,702,291
Total assets	\$ 573,062,886	\$ 537,503,604
Restricted funds:		
Specific purpose funds:		
Cash and cash equivalents (Note 3)	\$ 3,787,872	\$ 3,394,522
Advance to the University (Note 5)	2,240,067	2,328,060
Total assets	\$ 6,027,939	\$ 5,722,582
Plant replacement and expansion funds:		
Cash and cash equivalents (Note 3)	\$ -	\$ 13,012
Total assets	\$ -	\$ 13,012
Endowment funds:		
Investments in pooled endowment funds (Note 3)	\$ 23,537,413	\$ 23,877,369

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
BALANCE SHEETS
As of June 30, 2001 and 2000

	2001	2000
LIABILITIES AND FUND BALANCES		
General funds:		
Current liabilities:		
Current installments of long-term debt (Note 14)	\$ 4,385,000	\$ 4,170,000
Accounts payable and accrued expenses	42,875,296	32,766,122
Retainage payable	-	114,427
Total current liabilities	47,260,296	37,050,549
Long-term liabilities:		
Long-term debt (Note 14)	87,430,000	91,815,000
Bond Premium net of amortization of \$219,995 at June 30, 2001 and \$110,148 at June 30, 2000	1,309,138	1,418,986
Accrued leave	18,290,881	13,536,002
Total long-term liabilities	107,030,019	106,769,988
Total liabilities	154,290,315	143,820,537
Fund balances	418,772,571	393,683,067
Total liabilities and fund balances	\$ 573,062,886	\$ 537,503,604
Restricted funds:		
Specific purpose funds:		
Fund balances	\$ 6,027,939	\$ 5,722,582
Plant replacement and expansion funds:		
Fund balances	\$ -	\$ 13,012
Endowment funds:		
Fund balances	\$ 23,537,413	\$ 23,877,369

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENTS OF REVENUES AND EXPENSES - GENERAL FUNDS
For the Years Ended June 30, 2001 and 2000

	2001	2000
Net patient service revenue (Note 2)	\$ 538,091,500	\$ 476,215,177
Other revenue:		
University allocations (Note 10)	10,056,847	8,299,938
Other (including \$304,529 in 2001 and \$206,744 in 2000 from specific purpose funds)	13,548,179	9,472,647
Total other revenue	23,605,026	17,772,585
Total revenue	561,696,526	493,987,762
Expenses:		
Salaries and wages	200,839,963	168,373,911
Fringe benefits	46,025,703	39,849,141
Purchased services	133,850,422	117,671,163
Supplies	102,483,727	89,625,445
Other expenses	11,412,139	8,804,197
Provision for depreciation	32,858,225	30,407,581
Amortization	1,455,378	384,102
Interest expense	4,801,814	4,878,263
Provision for bad debts	14,314,012	12,035,906
Total expenses	548,041,383	472,029,709
Income from operations	13,655,143	21,958,053
Nonoperating gains (losses):		
Investment income from trustee held funds	11,038,455	9,444,626
Net (decrease) increase in the fair value of investments	4,860,259	(1,753,608)
Net loss from investments in affiliated companies (Note 7)	(2,342,796)	(1,457,810)
Endowment and interest income	663,834	510,647
Loss on disposal of fixed assets	(2,548,403)	(812,121)
Loss on settlement (Note 19)	(250,000)	(3,000,000)
Nonoperating gains, net	11,421,349	2,931,734
Revenue and gains in excess of expenses and losses	\$ 25,076,492	\$ 24,889,787

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENTS OF CHANGES IN FUND BALANCES
For the Years Ended June 30, 2001 and 2000

	2001	2000
General funds:		
Balances at beginning of year	\$ 393,683,067	\$ 368,793,280
Revenue and gains in excess of expenses and losses	25,076,492	24,889,787
Transferred from plant replacement and expansion funds	13,012	-
Balances at end of year	<u>\$ 418,772,571</u>	<u>\$ 393,683,067</u>
Restricted funds:		
Specific purpose funds:		
Balances at beginning of year	\$ 5,722,582	\$ 5,512,831
Private gifts, grants and contracts	203,971	275,732
Endowment income	205,371	157,979
Interest income	300,544	285,604
Transferred to:		
Other revenue	(304,529)	(206,743)
The University	(100,000)	(302,821)
Balances at end of year	<u>\$ 6,027,939</u>	<u>\$ 5,722,582</u>
Plant replacement and expansion funds:		
Balances at beginning of year	\$ 13,012	\$ 11,982
Transferred to general funds	(13,012)	1,030
Balances at end of year	<u>\$ -</u>	<u>\$ 13,012</u>
Endowment funds:		
Balances at beginning of year (Note 3)	\$ 23,877,369	\$ 16,159,877
Net increase (decrease) in fair value of investments	(339,956)	7,717,492
Balances at end of year	<u>\$ 23,537,413</u>	<u>\$ 23,877,369</u>

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

STATEMENTS OF CASH FLOWS - GENERAL FUNDS
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS
For the Years Ended June 30, 2001 and 2000

	2001	2000
Cash flows from operating activities:		
Income from operations	\$ 13,655,143	\$ 21,958,053
Loss on settlement	(250,000)	(3,000,000)
Reconciliation of income from operations to net cash provided by operating activities:		
Provision for depreciation	32,858,225	30,407,581
Amortization of bond issue costs and goodwill	1,455,378	384,102
Interest payments for capital and related financing activities	4,801,814	4,878,263
Increase in goodwill	(1,870,284)	(1,787,188)
Increase in net accounts receivable	(20,838,826)	(7,375,188)
Increase in amounts due from third-party payors	(5,282,556)	(771,559)
(Increase) Decrease in inventories and prepaid expenses	(1,458,844)	88,917
(Increase) Decrease in notes receivable	(3,011,633)	7,121,484
Increase in accounts payable and accrued expenses	10,109,175	287,807
Increase in accrued leave	4,754,880	1,117,667
Net cash provided by operating activities	34,922,472	53,309,939
Cash flows from capital and related financing activities:		
Payment of principal and interest on long-term debt	(8,971,814)	(8,712,663)
Net change in cash, cash equivalents, investments and accrued interest of trustee held funds and unrestricted investments	(17,277,513)	(14,710,116)
Proceeds from issuance and incurrence of long-term debt	-	4,480,000
Acquisition and construction of capital assets	(47,410,234)	(34,626,292)
Increase (Decrease) in retainage payable	(114,427)	78,679
Proceeds from sale of equipment	259,904	262,225
Transferred from restricted funds	13,012	-
Net cash used for capital and related financing activities	(73,501,072)	(53,228,166)
Cash flows from investing activities:		
Increase in advance to the University	(201,840)	(282,242)
Investment income from trustee held funds	11,038,455	9,444,626
Loss from investments in affiliated companies	(2,342,796)	(1,457,810)
Endowment and interest income	663,834	510,647
(Increase) Decrease in investment in affiliated companies	2,342,796	(5,723,422)
Net cash provided by investing activities	11,500,449	2,491,799
Net increase (decrease) in cash and cash equivalents	(27,078,151)	2,573,571
Cash and cash equivalents at the beginning of the year	61,871,319	59,297,748
Cash and cash equivalents at the end of the year	\$ 34,793,168	\$ 61,871,319

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2001 and 2000

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Organization and Mission

The University of Virginia Medical Center (the Medical Center) is a division of the University of Virginia (the University). 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 health care service. Only those activities directly associated with the furtherance of this mission are considered to be operating activities. Other activities that result in gains or losses unrelated to the Medical Center's primary mission are considered to be nonoperating.

A separate report is prepared for the Commonwealth of Virginia (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 of Virginia is a component unit of the Commonwealth of Virginia and is included in the general-purpose 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 health care services.

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. Accounting Standards

Pursuant to Governmental Accounting Standards Board Statement No. 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 the Financial Accounting Standards Board, including those issued after November 30, 1989.

E. Fund Accounting

To ensure observance of limitations and restrictions placed on the use of resources, the accounts of the Medical Center are maintained in accordance with the principles of fund accounting.

General funds are used to reflect resources of the Medical Center that are not restricted by a donor or grantor. Assets whose use is limited in substance under terms of debt indentures, trust agreements, fiduciary responsibilities, or Board restrictions are reported in the general funds section as “Assets whose use is limited.”

Resources restricted as to use by a donor or a grantor are segregated in restricted funds and are classified under the following categories:

Specific Purpose Funds account for funds received from donors and other third parties for specific operating purposes. Restricted funds are reported as general funds revenue when expended.

Plant Replacement and Expansion Funds account for funds received from donors and other third parties for additions to property, plant, and equipment. When expended, these funds are recorded as transfers to the general funds.

Endowment Funds account for funds received from donors and other third parties for specific purposes where the principal must be invested and remain intact and only the income is available for spending. Income of endowment funds is recorded as nonoperating gains, if unrestricted, and specific purpose fund additions, if restricted.

F. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, and includes funds from the General Fund of the Commonwealth of Virginia and estimated retroactive adjustments under reimbursement agreements with third-party payors. 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.

G. 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.

H. 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 Blue Cross. The Medical Center has 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.

I. Investments

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.

In accordance with Governmental Accounting Standards Board Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*, 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.

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

J. Inventories

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

K. 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 \$1,000 or more and having a useful life of two years or greater in accordance with the Medicare Reimbursement Manual. Prior to fiscal year 2001, the capitalization threshold was \$500 or more and having a useful life of two years or greater.

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.

L. Deferred Bond Issue Costs

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

M. Assets Whose Use Is Limited

Assets whose use is limited include assets held by trustees under indenture agreements.

N. Accrued Leave

Salaried employees' attendance and leave regulations make provision for the granting of a specified number of days of leave each year. The amounts recorded on the balance sheet reflect 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 years or more of service. The liability is based on the probability that an employee with less than five years of service will eventually become vested and have a right to receive payment for sick leave benefits. The liability also includes related FICA taxes.

O. Disproportionate Share and Indirect Medical Education Payments

The Medical Center's appropriations from the General Fund of the Commonwealth for indigent care and medical education costs have been replaced by disproportionate share and indirect medical education payments paid by the Department of Medical Assistance Services. These payments are recorded as net patient service revenue in the Medical Center's General Fund in the year received.

P. Cash and Cash Equivalents

Cash and cash equivalents include cash and all highly liquid investments with maturity of three months or less when purchased. For the statement of cash flows, cash and cash equivalents whose use is limited are not subject to the immediate use by the Medical Center and, therefore, are not included in the beginning or ending balance of cash and cash equivalents.

Q. Reclassifications

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

2. NET PATIENT SERVICE REVENUE

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

	<u>Fiscal Year 2001</u>	<u>Fiscal Year 2000</u>
Gross patient service revenue:		
Inpatient:		
Routine services	\$131,946,636	\$124,344,591
Ancillary services	296,517,012	280,131,012
Outpatient:		
Ancillary services	243,195,814	196,437,128
Clinics	<u>8,836,048</u>	<u>4,865,269</u>
Total gross patient service revenue	680,495,510	605,778,000
Allowances for indigent care and contractual adjustments	<u>(142,404,010)</u>	<u>(129,562,823)</u>
Net patient service revenue	<u>\$538,091,500</u>	<u>\$476,215,777</u>

The Medical Center received \$40,614,933 and \$36,464,703 in fiscal years 2001 and 2000, respectively, for disproportionate share and indirect medical education payments from the Department of Medical Assistance Services for patients that are indigent. These payments are included in net patient service revenue as an adjustment of allowances for indigent care and contractual adjustments.

Amounts written off for indigent care net of the disproportionate share and indirect medical education payments were \$16,086,242 and \$23,179,756 in 2001 and 2000, respectively.

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

A. Cash and cash equivalents

All Medical Center cash is fully collateralized in accordance with the Virginia Security for Public Deposits Act (Section 2.1-359, et seq. of the Code of Virginia). All cash, except for \$1,682,622 at June 30, 2001, and \$800,298 at June 30, 2000, is in accounts of the University of Virginia or with the Treasurer of Virginia. The bank balance of the excluded cash was \$5,230 at June 30, 2001 and \$201,013 at June 30, 2000.

Each fund's equity in pooled University or state funds is reported as "Cash and cash equivalents" on the accompanying balance sheet and is not categorized as to credit risk, except for \$18,424,544 and \$5,590,466 at June 30, 2001 and 2000, respectively, of assets whose use is limited. These assets consist of repurchase agreements considered to be Category 1 as defined below.

B. Investments

The resolutions authorizing Series 1993A, 1998B, and 1999A Bonds require that the Medical Center establish and maintain various funds to be held by the Treasurer of Virginia. The resolutions mandate funding requirements at the time of the bonds' sale and during and after the construction period. These funds are invested and held by the Treasurer of Virginia.

Investments are categorized by levels of credit risk in accordance with Governmental Accounting Standards Board Statement No. 3, as described below:

Category 1 - Insured or registered securities or securities held by the Medical Center or its agent in the Medical Center's name.

Category 2 - Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Medical Center's name.

Category 3 - Uninsured and unregistered, with securities held by the counterparty, or its trust department or agent, but not in the Medical Center's name.

Investments as of June 30, 2001

<u>Description</u>	<u>Category 1</u>	<u>Non-Categorized</u>	<u>Total</u>
U.S. Government and U.S. Government Agency Securities:			
U.S. Treasury Notes	\$ 6,073,125	\$ -	\$ 6,073,125
FNMA	70,304,420	-	70,304,420
FHLMC	29,047,500	-	29,047,500
FHLB	53,812,656	-	53,812,656
FFCB	5,095,312	-	5,095,312
Bank of New York – STIF	-	576,605	576,605
University of Virginia Growth and Income Fund	-	23,537,413	23,537,413
Total	<u>\$164,333,013</u>	<u>\$24,114,018</u>	<u>\$188,447,031</u>

Investments as of June 30, 2000

<u>Description</u>	<u>Category 1</u>	<u>Non-Categorized</u>	<u>Total</u>
U.S. Government and U.S. Government Agency Securities:			
U.S. Treasury Notes	\$ 7,988,751	\$ -	\$ 7,988,751
FNMA	103,104,879	-	103,104,879
FHLMC	5,549,096	-	5,549,096
FHLB	33,486,328	-	33,486,328
FFCB	4,823,438	-	4,823,438
Bank of New York - STIF	-	653,433	653,433
University of Virginia Growth and Income Fund	-	23,877,369	23,877,369
Total	<u>\$154,952,492</u>	<u>\$24,530,802</u>	<u>\$179,483,294</u>

4. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited consists of assets held by trustees under indenture agreements.

The Series 1993A, 1998B, and 1999A 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, for each year;
- F. to the credit of any other fund or account created pursuant to an applicable Series Resolution.

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

<u>Assets</u>	<u>2001</u>	<u>2000</u>
Construction Fund	\$ 223,132	\$ 392,141
Construction Fund – Pooled *	563,196	561,230
Bond Sinking Fund - 1993A	2,055	14,916
Bond Sinking Fund – 1998B	741	1,272
Bond Sinking Fund – 1999A	633,482	527,738
Bond Sinking Fund – Pooled *	13,409	92,203
Depreciation Reserve	<u>176,074,986</u>	<u>154,130,001</u>
Total Assets	<u>\$177,511,001</u>	<u>\$155,719,501</u>

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

5. ADVANCE TO THE UNIVERSITY

During 1996, the Board of Visitors authorized the University to loan the University of Virginia Real Estate Foundation (UREF) up to \$7,000,000 to construct the Virginia Neurological Institute Building. The Medical Center advanced \$2,854,410 of General Funds and \$2,858,395 of Specific Purpose Funds to the University's Quasi Endowment Fund, which was loaned to UREF for the construction of the building. Advance amounts include interest earnings capitalized to the advances. This loan was refinanced by UREF and the advance returned to the Medical Center on July 25, 2001.

6. PROPERTY, PLANT, AND EQUIPMENT

A summary of the property, plant, and equipment accounts and the related accumulated depreciation consists of the following as of June 30:

<u>Accounts</u>	<u>2001</u>	<u>2000</u>
Land	\$ 3,905,791	\$ 2,549,578
Land improvements	6,402,601	7,154,331
Buildings	306,197,935	298,061,012
Fixed equipment	16,749,352	16,509,057
Moveable equipment	191,304,746	179,959,871
Construction in progress	<u>8,196,352</u>	<u>8,537,946</u>
Total	532,756,777	512,771,795
Accumulated depreciation	<u>(301,829,065)</u>	<u>(293,587,784)</u>
Property, plant and equipment, net	<u>\$230,927,712</u>	<u>\$219,184,011</u>

7. AFFILIATED COMPANIES

Blue Ridge Health Alliance, Inc.

The Medical Center is a participant with the Health Services Foundation (the Foundation) 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), is 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 has 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 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 has an obligation to make any loans, advances, or additional equity contributions whatsoever to the capital of the Corporation. The shareholders have acknowledged and agreed that the Corporation is expected to retain its earnings in order to finance growth and that there is no expectation that the Corporation will pay any cash dividends in the foreseeable future.

The Medical Center contributed a total of \$15,000,000 to Blue Ridge Health Alliance during the period ended June 30, 1998. Also, on April 6, 1998, the Medical Center loaned \$3,800,000 to the Corporation due on July 6, 1998, and bearing interest at 6.25 percent per annum. In July 1998, the Board of Directors of the Corporation issued a capital call to the Foundation and the Medical Center for \$5,000,000. The Foundation 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 \$5,000,000, by converting the \$3,800,000 loan to capital and contributing \$1,200,000 in cash. This contribution increased the Medical Center's percentage ownership to 52.05 percent. By agreement between the Foundation and the Medical Center, the Foundation 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 per annum. 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 per annum. Effective September 15, 1999, Blue Ridge Health Alliance revised its Shareholders' Agreement to provide additional capital and to affect a transfer of shares among the shareholders. Under this agreement, the debt owed to the Medical Center was converted to capital, the Foundation 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, the Foundation owned 48.08 percent and Martha Jefferson Hospital owned 3.84 percent. In addition, the University transferred to the Foundation one share of Class B Common Stock, so that both the Foundation and the University each own one of the two shares, which have been authorized.

On May 30, 2001, the Medical Center loaned \$3,000,000 to the Corporation due on May 30, 2004, bearing an interest rate of 6.19 percent per annum.

The net investment in Blue Ridge Health Alliance is summarized below. Complete financial statements for Blue Ridge Health Alliance, Inc., can be obtained from the corporate office: Towncenter 1, 1000 Research Park Blvd., Charlottesville, Virginia 22911.

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. 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, Virginia 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 below. 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 health care 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

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 health care 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 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. For fiscal year 2001, the Medical Center started recording the portion of the patronage dividends that were held by UHC as patronage equity.

Net Investments in Affiliated Companies as of June 30, 2001

<u>Description</u>	<u>Blue Ridge Health Alliance</u>	<u>Central Virginia Health Network</u>	<u>HealthSouth</u>	<u>Valiance</u>	<u>UHC</u>
Common stock and equity contributions	\$36,139,402	\$232,500	\$2,230,000	\$100,000	\$ -
Share of income (loss)	<u>(32,338,162)</u>	<u>(18,844)</u>	<u>(1,996,361)</u>	<u>40,875</u>	<u>383,075</u>
Net investment	<u>\$ 3,801,240</u>	<u>\$213,656</u>	<u>\$ 233,639</u>	<u>\$140,875</u>	<u>\$383,075</u>

Net Investments in Affiliated Companies as of June 30, 2000

<u>Description</u>	<u>Blue Ridge Health Alliance</u>	<u>Central Virginia Health Network</u>	<u>HealthSouth</u>	<u>Valiance</u>
Common stock and equity contributions	\$ 36,139,402	\$232,500	\$2,230,000	\$100,000
Share of income (loss)	<u>(29,569,737)</u>	<u>(54,559)</u>	<u>(1,974,319)</u>	<u>11,995</u>
Net investment	<u>\$ 6,569,665</u>	<u>\$177,941</u>	<u>\$ 255,681</u>	<u>\$111,995</u>

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.

8. 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, \$1,800,000 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 Unit 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.

9. COMMITMENTS

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

Year Ending <u>June 30,</u>	Operating <u>Leases</u>
2002	\$ 3,437,136
2003	2,622,303
2004	1,035,882
2005	734,724
2006	342,844
Subsequent Years	<u>7,386,988</u>
Total	<u>\$15,559,877</u>

The total rental expense for operating leases for the years ended June 30, 2001 and 2000, was \$6,915,628 and \$5,862,312, respectively.

The Medical Center was party to construction contracts and commitments for the years ended June 30, 2001 and 2000, totaling \$10,243,606 and \$7,058,141, respectively. Of these amounts, \$8,781,813 and \$5,319,660 were incurred as of June 30, 2001 and 2000, respectively.

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

Year Ending <u>June 30,</u>	Maintenance <u>Contracts</u>
2002	\$7,891,090
2003	2,442,459
2004	2,233,773
2005	2,182,617
2006	160,289

10. UNIVERSITY ALLOCATIONS

The University of Virginia School of Medicine faculty assists the Medical Center in its mission of providing health care and medical education. A survey is conducted annually to determine the value of this effort. An allocation is made on the Medical Center's Statement of Revenues and Expenses to reflect the value of this effort as income. This allocation is offset in the operating expenses of the Medical Center by an equal amount in purchased services. The amount of this allocation for the years ended June 30, 2001 and 2000 was \$8,953,127 and \$7,492,248, respectively.

Likewise, the University provides the Medical Center various general and administrative support services. An analysis is prepared annually to determine the cost of providing these services. The same type of allocation as above is made to the Medical Center Statement of Revenues and Expenses 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 years ended June 30, 2001 and 2000 was \$1,103,720 and \$807,690, respectively.

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

11. UNIVERSITY OF VIRGINIA HEALTH SERVICES FOUNDATION

The University of Virginia Health Services Foundation (the Foundation), 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 of Virginia. For the period beginning July 1, 1994 and ending July 31, 2000, the Foundation assumed all costs associated with the operation of the outpatient clinics.

On August 1, 2000, management of 63 clinics, formerly managed by physicians, transferred to the Medical Center. At that time, the Medical Center filed for provider-based status with the federal government and became responsible for all costs associated with the operations of these Provider-Based Clinics (PBCs), except for the costs of the physicians themselves. On August 1, 2000, the Medical Center entered into leased employment agreements with the Foundation for limited personnel who remained Foundation employees, but were performing Medical Center duties.

The Medical Center paid the Foundation \$1,797,188 and \$9,807,726 for costs associated with the operation of the outpatient clinics for years ended June 30, 2001 and 2000, respectively. The implementation of PBCs and reclassification of other services to the miscellaneous HSF agreement section were the primary reasons for the decrease.

The Medical Center paid the Foundation \$12,167,329 and \$16,707,424 for the provision of supervisory and administrative services for the years ended June 30, 2001 and 2000, respectively. The decrease from the prior year is primarily due to the shift directly to the Medical Center of some of the former "Allotment B" expenses under the PBC model.

The Medical Center paid the Foundation \$9,776,816 and \$5,300,848 for other services for the years ended June 30, 2001 and 2000, respectively. Reclassifying other services to the miscellaneous HSF agreement section was the primary reason for the increase.

The Medical Center paid the Foundation \$1,608,193 and \$1,477,959 for rental of space for the years ended June 30, 2001 and 2000, respectively. The Foundation paid the Medical Center \$388,085 and \$744,727 for rental of space for the clinics for the years ended June 30, 2001 and 2000, respectively.

The Foundation paid the Medical Center \$4,453,490 for clinic facility fees and other services for the year ended June 30, 2001.

12. CONTINGENCIES - MEDICAL MALPRACTICE CLAIMS

The Medical Center is a participant in the Commonwealth of Virginia's self-insurance program administered by the Department of Treasury's Division of Risk Management. Participation in this program provides the Medical Center with insurance under an "occurrence" policy for institutional and professional liability with a liability limit of \$1,500,000 per occurrence and with no limit of aggregate annual liability for each policy year. The Commonwealth of Virginia has a \$1,550,000 limit on malpractice awards. 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.

This insurance also includes worker's compensation, property, general liability, and automobile plans. Information relating to the Commonwealth's self-insurance plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

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.

13. DEFEASANCE OF DEBT

In 1985, the Medical Center defeased Hospital Revenue Bonds, Series A and Series B, by placing the proceeds of Hospital Revenue Refunding Bonds, Series C and Variable Rate Demand Revenue Refunding Bonds, Series D, in an irrevocable trust to provide for all future debt service payments on the Series A and Series B Bonds. As of June 30, 2000, \$6,555,000 of the defeased bonds remained outstanding. They were redeemed on June 1, 2001.

14. LONG-TERM DEBT

<u>Series</u>	<u>Interest Rate</u>	<u>Maturity</u>	<u>As of June 30,</u>	
			<u>2001</u>	<u>2000</u>
1998B	3.50% - 5.00%	1998-2018	\$ 6,050,000	\$ 6,290,000
1993A	4.00% - 5.20%	1998-2015	32,960,000	33,230,000
1999A	4.50% - 5.25%	1999-2013	48,435,000	51,985,000
1999A Pooled	4.50% - 6.00%	2001-2019	<u>4,370,000</u>	<u>4,480,000</u>
Total indebtedness			<u>\$91,815,000</u>	<u>\$95,985,000</u>

Total indebtedness matures as follows:

<u>Year Ending June 30,</u>	
2002	\$ 4,385,000
2003	4,575,000
2004	4,780,000
2005	5,000,000
2006	5,240,000
Subsequent Years	<u>67,835,000</u>
Total	<u>\$91,815,000</u>

15. RETIREMENT PLANS

Employees of the Medical Center are employees of the Commonwealth. Substantially all full-time classified salaried employees participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). Information relating to this plan is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report (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 professionals' employer contributions fully vest after one year of employment.

Total pension costs under the plans were \$7,274,256 and \$5,218,543 for the years ended June 30, 2001 and 2000, respectively. Contributions to the optional retirement plans were calculated using base salaries of \$88,848,544 and \$63,211,085 for the years ended June 30, 2001 and 2000, respectively. The contribution percentage amounted to 8.2 percent and 8.3 percent for both years ended June 30, 2001 and 2000, respectively.

16. 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 Commonwealth also provides health care 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. Information related to these plans is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

17. SELF-INSURANCE

The University sponsors a self-funded, comprehensive program of medical care benefits. The program covers all employees of the University and the Medical Center. Fringe benefit expenses include estimates for claims that have been incurred, but not reported.

18. SURETY BOND

Medical Center employees are covered for Faithful Performance of Duty in the amount of \$500,000 for each loss under a self-insurance program administered by the Commonwealth of Virginia's Department of Treasury, Division of Risk Management. Detailed information relating to this policy is available at the statewide level in the Commonwealth's Comprehensive Annual Financial Report.

19. SETTLEMENTS

During the year ended June 30, 2000, the U. S. Department of Justice reviewed outpatient billings submitted to Government Payers by the University of Virginia Health Services Foundation (the Foundation) and the University of Virginia Medical Center. This review revealed a small number of billing errors. To avoid protracted legal and operational costs, the Justice Department, the Medical Center, and the Foundation negotiated a tentative settlement of this issue. The settlement will have several provisions, one of which will be a payment to the federal government of \$3,000,000. Internal controls have been implemented, which will prevent a reoccurrence of the problems identified during the investigation.

As of June 30, 2001, the final settlement had not been reached. It is anticipated that all aspects of the settlement will be agreed upon and payment rendered in the second quarter of fiscal year 2002. An additional \$250,000 was accrued in fiscal year 2001 while the payment aspect of the settlement was being finalized.

20. SUBSEQUENT EVENTS

Community Medicine University of Virginia, LLC

The University believed it was imperative to offer healthcare in the community that allowed the University primary care physician providers an alternative to the traditional model of health care 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 the Community Medicine University of Virginia, LLC (Community Medicine). Community Medicine was established as a limited liability corporation (LLC) under the laws of the Commonwealth of Virginia to house physician practices. 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 will be accounted for under the consolidation method.

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

Blue Ridge Health Alliance Sale

As previously disclosed in the “Affiliated Companies” footnote, the Medical Center is a participant with the Health Services Foundation (the Foundation) in Blue Ridge Health Alliance (the Corporation), Inc. 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., is a wholly-owned subsidiary of the Corporation.

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.

IDX Refund

The Medical Center and IDX Inc., one of the vendors contracted with to provide services and equipment related to the Integrated Health Information Management Systems (IHIMS) project, mutually agreed to rescind portions of the original agreement. The effect of these changes will result in IDX refunding an estimated \$3.5 million to the Medical Center. While no executed agreement was in place as of June 30, 2001, it is anticipated that all aspects of the refund will be agreed upon and payment rendered in the second quarter of FY 2002.

Pending GASB Statement

Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, issued June 1999, will be effective for the fiscal year ending June 30, 2002. This statement imposes new standards for financial reporting. The changes to the Medical Center's financial statements will be minimal since its activity is accounted for in an enterprise fund. However, Medical Center's management will be required to provide a management's discussion and analysis that gives readers an analysis of the Medical Center's overall financial position and results of operations including a comparison of current year results with the prior year. The Medical Center will be preparing for the required changes during fiscal year 2002.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
Charlottesville, Virginia

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