UNIVERSITY OF VIRGINIA

MEDICAL CENTER

CHARLOTTESVILLE, VIRGINIA

REPORT ON AUDIT

FOR THE YEARS ENDED

JUNE 30, 2003 AND 2002

Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

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Commonwealth of Virginia

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

November 10, 2003

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Kevin G. Miller
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 Statement of Net Assets, Statement of Revenues, Expenses and Changes in Net Assets, and Statement of Cash Flows of the University of Virginia Medical Center, a division of the University of Virginia, as of and for the years ended June 30, 2003 and 2002, which collectively comprise the Medical Center's basic financial statements. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these basic financial statements based on our audit.

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

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center as of June 30, 2003 and 2002, and the respective changes in financial position and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis presented on pages 3 through 9 is not a required part of the basic financial statements, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

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

Our report on internal controls and compliance and recommendations for improvements in internal controls and instances of noncompliance with state laws and regulations 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, 2003.

AUDITOR OF PUBLIC ACCOUNTS

JHS/kva
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MANAGEMENT'S DISCUSSION AND ANALYSIS

The following discussion and analysis provides an overview of the financial position and activities of the University of Virginia Medical Center (Medical Center) for the year ended June 30, 2003, with comparative information for the year ended June 30, 2002. 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 534-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

The Medical Center's operating results for fiscal year 2003 compare favorably to fiscal year 2002. Increased demand for patient services and increased reimbursement rates resulted in an increase in operating revenues of $44.5 million (7.6 percent) while management's ability to control cost resulted in a modest increase in operating expense of $21.7 million (3.6 percent). The favorable operating results contributed to the increase in liquidity on the Statement of Net Assets. Cash, as a percent of current assets, increased from 14.4 percent to 41.4 percent. Overall cash and investments increased by $112.3 million.

	2003*	2002*
Operating revenues	$633.4	$588.9
Operating income (loss)	$ 11.1	$(11.7)
Nonoperating income and other	29.0	82.6
Increase in net assets	$ 40.1	$ 70.9
Cash and investments	$420.0	$310.3
Other assets	363.1	360.5
Liabilities	223.9	151.6
Net assets	$559.2	$519.2

* in millions

Financial Statements

The Medical Center's financial report includes three financial statements: Statement of Net Assets, Statement of Revenues, Expenses, and Changes in Net Assets, and 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 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 Statement of Net Assets.

Statement of Net Assets
As of June 30, 2003 and 2002

	2003	2002
ASSETS		
Current assets	$182.1	$142.5
Capital assets	251.2	234.0
Other noncurrent assets	349.8	294.3
Total assets	783.1	670.8
LIABILITIES		
Current liabilities	100.8	67.6
Noncurrent liabilities	123.1	84.0
Total liabilities	223.9	151.6
NET ASSETS		
Invested in capital assets, Net of related debt	155.7	145.3
Restricted for:		
Nonexpendable	53.1	53.1
Expendable	11.7	24.7
Unrestricted	338.7	296.1
Total net assets	$559.2	$519.2

* in millions

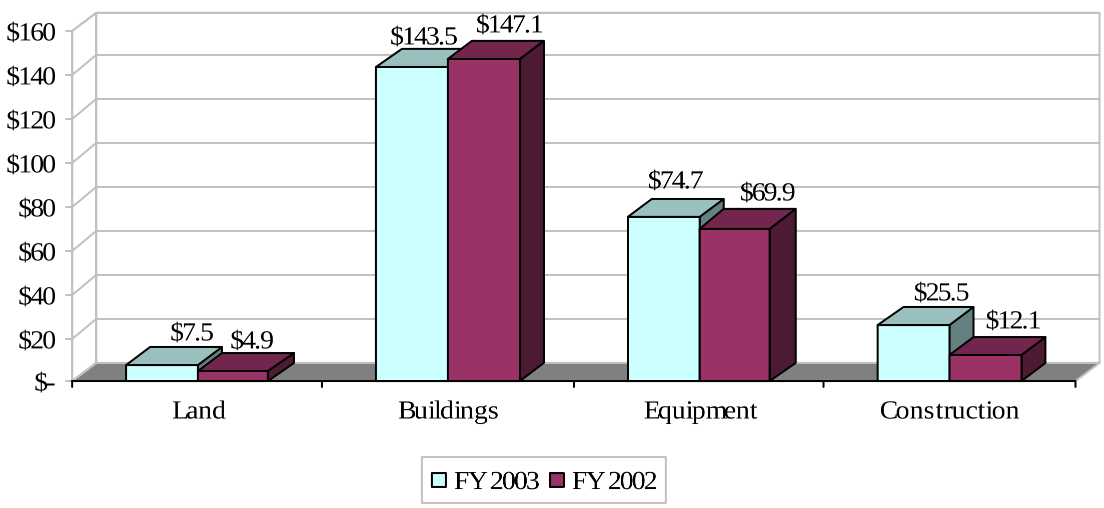
During fiscal year 2003, the Medical Center's financial position improved. The net assets increased by $40 million as a result of the Medical Center's positive operating performance. The increase in current assets results from a $54.9 million increase in operating cash. A portion of this increase in cash can be attributed to a decline in receivables due from patients, third-party payers, and others of $17.3 million. Average days revenue in net patient accounts receivable, a common healthcare industry measure of receivable levels, is down to 49.8 days at June 30, 2003 from 54.5 days at June 30, 2002. Capital assets have increased by $17.2 million as a result of significant investment in building and equipment. The following are the major capital additions made in the past two fiscal years.

Major Capital Additions (in millions)

	2003 *	2002 *
Bed replacement	$ 2.5	$ -
Helicopter	3.6	-
Renovate Jefferson Park Avenue Building purchased in 2001	8.3	-
Radiology systems	7.0	6.1
Information systems and related hardware	11.0	1.9
West Clinic renovations	4.0	2.1
ICU renovation and related bed replacement	0.6	3.0
University hospital expansion	4.2	2.3
Patient monitoring system	-	5.5
Total	$41.2	$20.9

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

Net Capital Assets (in millions)



Noncurrent assets are greater than last year primarily because $30.2 million of cash borrowed in 2003 to fund the hospital expansion remains in the construction fund at year-end. The largest component of the increase in current liabilities was a $12 million increase in the amount owed to the School of Medicine in accordance with the Memorandum of Understanding (MOU) with the School. Of the total change in long-term liabilities of $39.0 million, $37.1 million is attributable to the debt incurred to fund the hospital expansion and other renovations.

Statements 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 as presented 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 recognized, expenses incurred and any other revenues, expenses, gains, and losses. A summarized comparison of revenues, expenses and other changes in net assets for the years ended June 30, 2003 and 2002 is as follows:

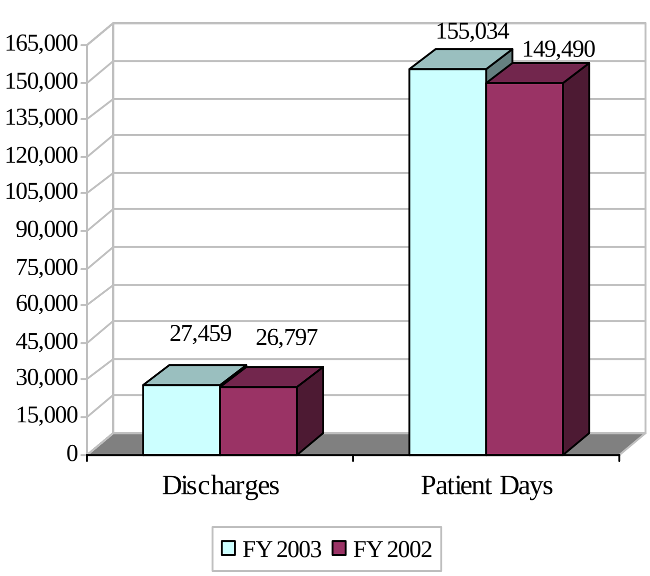
Statements of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2003 and 2002 (in millions)

	2003	2002
Net patient service revenue	$606.9	$568.4
Other revenue	26.5	20.5
Total operating revenue	633.4	588.9
Salaries and benefits	277.9	285.6
Other operating expenses	344.4	315.0
Total operating expenses	622.3	600.6
Operating income (loss)	11.1	(11.7)
Nonoperating revenue	28.9	17.2
Additions to endowments	-	66.1
Transfers to the University of Virginia	-	(.7)
Increase in net assets	40.0	70.9
Net assets - beginning of year	519.2	448.3
Net assets - end of year	$559.2	$519.2

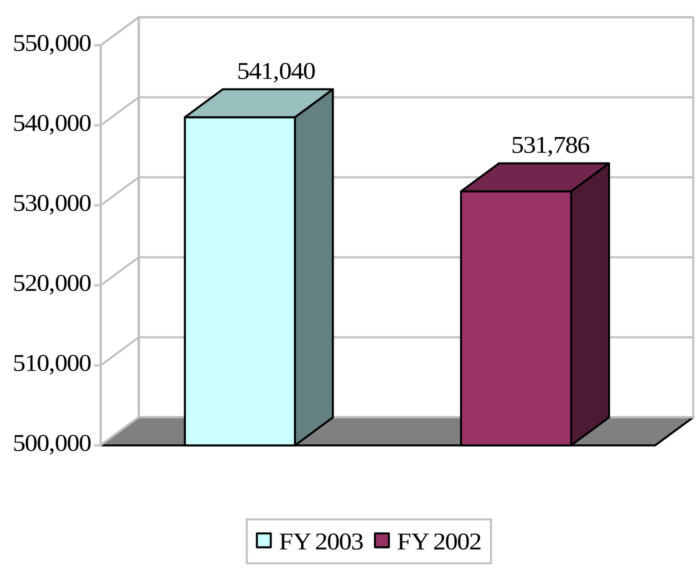
Operating Revenue

Total operating revenue for fiscal year 2003 was 7.6 percent above the prior year. This increase resulted from both volume and rate increases. As shown by the following graph, both discharges and patient days were up over the prior year. In addition to the increase in inpatient services, there was also modest growth in outpatient visits over the prior year. Other factors causing an increase in revenue were a six percent increase in the Medicaid payment rate and a five percent increase in patient charge rates.

Inpatient Volume



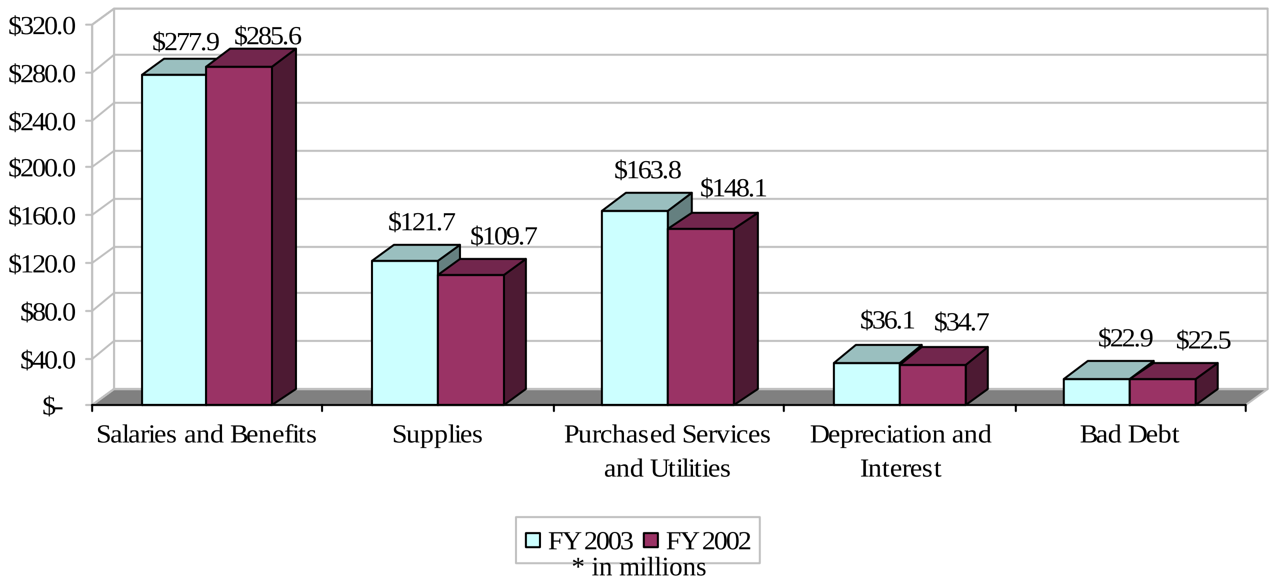
Outpatient Visits



Operating Expenses

In spite of inflation and growth in patient volumes, operating expenses increased by a modest 3.6 percent over the prior year.

Operating Expenses*



* in millions

There are several noteworthy issues regarding operating expenses:

- Compensation costs decreased by $7.7 million. These costs were held in check by a decline in the number of full time equivalent employees (FTEs) on the Medical Center's payroll. On average, the Medical Center was able to operate with 264 fewer employees in 2003.

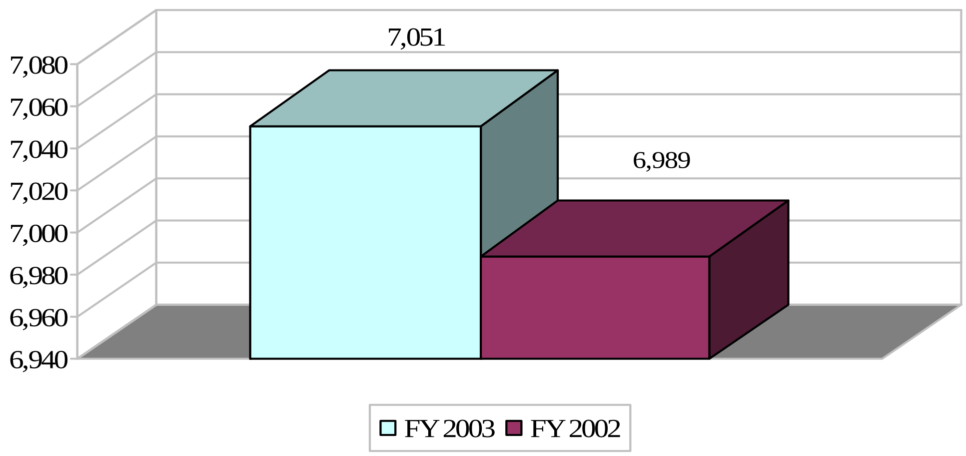
	FY 2003	FY 2002	Change
Hospital FTEs	4,545	4,849	(304)
Clinic FTEs	506	466	40
Total	5,051	5,315	(264)

- Supplies expense increased 11 percent because of increased patient volumes and pharmaceutical inflation of approximately 15 percent. One of the largest components of increase was cost associated with the increased use of cardiology devices.

- Factors contributing to the increase in purchased services included a $3.2 million increase in the amount of faculty and other services provided by the University of Virginia School of Medicine to assist the Medical Center in its mission of providing healthcare and medical education. This amount is shown as a purchased service expense and is exactly offset by an increase in other revenue. Another significant factor results from a new program under which the Medical Center awarded grants to the School of Medicine of $5 million to fund the cost of differentiating clinical projects. The remainder of the cost in purchased services is attributable to increases in the cost of services for contractual services provided by the School of Medicine to the Medical Center.

- The cost per discharge, as adjusted for outpatient volume and case mix index (CMI), increased less than one percent due to the control of cost during the year. CMI measures the intensity of resources required.

Cost per CMI and Outpatient-Adjusted Discharge



Nonoperating Revenues and Expenses

Two noteworthy items are included in nonoperating revenues and expenses:

- The disproportionate share hospital (DSH) payment from the Commonwealth increased by $11.6 million. This payment is made to the Medical Center by the state's Department of Medical Assistance Services (DMAS) in recognition of indigent care provided.

- Under the terms of its MOU with the University of Virginia's School of Medicine, the Medical Center will provide additional support to the programs of the Medical School. This amount of support is based on the Medical Center's results of operation in excess of its minimum requirements as specified by the Board of Visitors. During fiscal year 2003, the Medical Center incurred $12 million of program support under the MOU.

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, 2003 and 2002 is as follows:

Cash Flows*

	2003	2002
Cash flows from operating activities	$ 79.3	$ 12.3
Cash flows from noncapital financing activities	36.0	86.1
Cash flows from capital and related financing activities	(19.8)	(43.5)
Cash flows from investing activities	(61.9)	(45.9)
Net increase in cash and cash equivalents	33.6	9.0
Balance - beginning of the year	47.6	38.6
Balance - end of the year	$ 81.2	$ 47.6

* in millions

Economic Factors that will affect the Future

During fiscal year 2003, the Medical Center began a major expansion of its University Hospital facility. The expansion project will increase the number of operating rooms and related support services available. The addition is scheduled for completion in July 2004 and the remainder of the renovations should be completed by March 2006. By increasing its capacity for surgical admissions, the Medical Center will be able to increase its census and net revenue.

A portion of the Medical Center's revenue is derived from the DSH payments received from DMAS. In May 2003, the Office of the Inspector General of the Federal Department of Health and Human Services released an audit report of the results of its review of the DSH program. The purpose of this review was to determine if DMAS was handling DSH payments in accordance with the Omnibus Budget Reconciliation Act of 1993. The impact of such recoupment, if any, on the Medical Center cannot be determined at this time; however, management reduced net patient revenue by $6 million in fiscal year 2002; the amount that it believed to be the potential exposure related to this matter.

During fiscal year 2003, the Medical Center further evaluated its exposure on this issue and believes that its risk is greater than originally estimated. To adequately record what it believes is the extent of its potential liability on this issue, the Medical Center booked an additional reduction of $5.1 million to patient revenue for fiscal year 2003.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENTS OF NET ASSETS
As of June 30, 2003 and 2002

	2003	2002
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 75,372,699	$ 20,481,315
Accounts receivable, net of estimated uncollectibles of $75,614,721 at June 30, 2003 and $74,356,835 at June 30, 2002	90,712,405	94,204,023
Due from third-party payors	-	13,815,309
Due from the University	2,181,912	2,311,958
Inventories and prepaid expenses	13,803,826	11,659,473
Notes receivable	22,059	22,185
Total current assets	182,092,901	142,494,263
Noncurrent assets:		
Cash and cash equivalents restricted (Note 2)	5,606,486	5,593,033
Due from the University of Virginia - noncurrent	224,595	336,891
Investments in pooled endowment funds (Note 2)	93,955,309	89,636,261
Goodwill (Note 4)	1,472,492	2,073,255
Investments (Note 2)	6,298,209	6,108,048
Investments in affiliated companies (Note 3)	3,164,699	1,639,324
Property, plant and equipment, less accumulated depreciation of $319,445,121 at June 30, 2003 and $310,106,455 at June 30, 2002 (Note 5)	251,236,666	233,979,486
Deferred bond discount and issue costs, net of amortization of $0 at June 30, 2003 and $1,102,056 at June 30, 2002	316,971	428,456
Assets whose use is limited (Note 6):		
Cash and cash equivalents (Note 2)	234,801	21,559,590
Investments (Note 2)	238,538,775	166,955,746
Total noncurrent assets	601,049,003	528,310,090
Total assets	783,141,904	670,804,353
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	86,140,604	62,986,623
Due to third-party payors	5,543,457	-
Current installments of long-term debt (Note 8)	9,118,839	4,575,000
Total current liabilities	100,802,900	67,561,623

	2003	2002
Long-term liabilities:		
Long-term debt (Note 8)	$ 120,523,378	$ 82,855,000
Bond premium, net of amortization of $439,689 at June 30, 2003 and $329,842 at June 30, 2002	1,089,444	1,199,292
Noncontrolling interest in subsidiary	1,486,722	-
Total long-term liabilities	123,099,544	84,054,292
Total liabilities	223,902,444	151,615,915
NET ASSETS		
Invested in capital assets, net of related debt	155,677,087	145,350,194
Restricted for:		
Nonexpendable	53,099,192	53,099,192
Expendable	11,703,166	24,681,998
Unrestricted	338,760,015	296,057,054
Total net assets	$ 559,239,460	$ 519,188,438

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
For the Years Ended June 30, 2003 and 2002

	2003	2002
Operating revenue:		
Net patient service revenue (Note 11)	$606,896,883	$568,371,705
University allocations (Note 12)	12,270,335	9,033,098
Other	14,227,250	11,454,468
Total operating revenue	633,394,468	588,859,271
Operating expenses:		
Salaries and wages	224,086,345	231,120,180
Fringe benefits	53,765,624	54,433,402
Supplies	121,703,466	109,670,157
Purchased services and other expenses	152,307,523	137,097,408
Utilities	11,514,979	11,019,906
Provision for depreciation and amortization	36,063,660	34,722,054
Provision for bad debts	22,859,711	22,521,144
Total operating expenses	622,301,308	600,584,251
Income (loss) from operations	11,093,160	(11,724,980)
Nonoperating revenue (expenses):		
Disproportionate share hospital payment from the Commonwealth	31,208,170	21,195,436
Gifts	384,739	440,169
Investment income	7,910,307	11,937,279
Net increase in the fair value of investments	6,107,297	17,262
Net gain (loss) from investments in affiliated companies (Note 3)	1,362,735	(6,706,509)
Noncontrolling interest in subsidiary income	(254,061)	-
Interest expense	(4,455,058)	(4,613,866)
Loss on disposal of fixed assets	(962,141)	(214,913)
Loss on sale of affiliated company	-	(4,844,858)
Loss on settlement	-	(50,000)
Gain sharing with the School of Medicine (Note 13)	(11,981,737)	-
Other	(362,389)	-
Net nonoperating revenues (expenses)	28,957,862	17,160,000
Income before other revenues, expenses, gains or losses	40,051,022	5,435,020

	2003	2002
Additions to endowments	-	66,098,848
Transfers to the University	-	(683,351)
Increase in net assets	40,051,022	70,850,517
Net assets - beginning of year	519,188,438	448,337,921
Net assets - end of year	$ 559,239,460	$ 519,188,438

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF CASH FLOWS
For the Years Ended June 30, 2003 and 2002

	2003	2002
Cash flows from operating activities:		
Receipts from patients and third-parties	$ 603,005,747	$ 535,901,361
Receipts from other revenue	17,618,556	14,345,367
Payments to employees	(281,586,243)	(279,659,170)
Payments to suppliers	(248,213,152)	(247,236,533)
Payment for utilities	(11,510,232)	(11,040,924)
Net cash provided by operating activities	79,314,676	12,310,101
Cash flows from noncapital financing activities:		
Disportionate share hospital payment	31,208,170	21,195,436
Transfer from (to) the University	4,400,000	(683,351)
Settlement payment	-	(50,000)
Gifts	384,739	440,170
Increase in endowment	-	65,214,464
Net cash provided by noncapital financing activities	35,992,909	86,116,719
Cash flows from capital and related financing activities:		
Purchase of capital assets	(52,933,876)	(37,741,516)
Principal paid on capital debt	(5,550,000)	(4,385,000)
Interest paid on capital debt	(4,428,167)	(4,613,866)
Proceeds from issuance of note payable	4,379,310	-
Proceeds from issuance of bonds payable	38,039,046	-
Proceeds from sale of capital assets	720,269	3,267,579
Net cash used by capital and related financing activities	(19,773,418)	(43,472,803)
Cash flows from investing activities:		
Interest on investments	10,218,833	11,937,279
Purchase of investments	(199,289,331)	(180,364,056)
Proceeds from sale of investments	126,995,860	125,437,224
Transfer to afflilïate	(211,200)	-
Payment from affiliate	331,719	-
Loan to affiliate	-	3,016,512
Repayment of loan made to the University	-	2,490,128
Sale of Blue Ridge Health Alliance and other affiliate transactions	-	(8,418,206)
Net cash from investing activities	(61,954,119)	(45,901,119)

	2003	2002
Net increase in cash and cash equivalents	33,580,048	9,052,898
Balance - beginning of the year	47,633,938	38,581,040
Balance - end of the year	$ 81,213,986	$ 47,633,938

Reconciliation of operating income (loss) to net cash provided (used) by operating activities:		
Operating income (loss)	$ 11,093,160	$ (11,724,980)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation and amortization	36,063,660	34,722,054
Change in assets and liabilities:		
Accounts receivables	23,289,739	(9,279,027)
Inventories and prepaids	(2,144,353)	(562,511)
Accounts payable and accrued expenses	11,012,470	(845,435)
Net cash provided by operating activities	$ 79,314,676	$ 12,310,101

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

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 creation of an environment for professional preparation of individuals dedicated to healthcare service. Only those activities directly associated with the furtherance of this mission are considered to be operating activities. Other activities that result in gains or losses unrelated to the Medical Center's primary mission are considered to be nonoperating.

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

B. Basis of Accounting

The Medical Center has adopted the 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 Colleges and Universities*.

C. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, 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 percent to 50 percent) or for which the company exercises significant influence, but not control over policy decisions, are accounted for by the equity method.

E. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered 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.

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 Blue Cross. 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.

In accordance with GASB Statement 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. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as nonoperating revenue in the Statement of Revenues, Expenses, and Changes in Net Assets.

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

I. Inventories

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

J. Property, Plant, and Equipment

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

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

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

K. Deferred Bond Issue Costs

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

L. Assets Whose Use Is Limited

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

M. 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 Statement of Net Assets 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.

N. Appropriations and 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, but funded by the Commonwealth of Virginia. The payments for indirect medical education are recorded as net patient service revenue and the disproportionate share payments are recorded as nonoperating revenue in the financial statements.

O. 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

A. Cash and Cash Equivalents

All Medical Center cash is fully collateralized in accordance with the Virginia Security for Public Deposits Act (Section 2.2-4400, et seq. of the Code of Virginia). All cash except for $925,706 at June 30, 2003, and $1,127,979 at June 30, 2002, is in accounts of the University of Virginia or with the Treasurer of Virginia. The bank balance of the excluded cash was $10,727 at June 30, 2003, and $10,885 at June 30, 2002.

Each fund's equity in pooled University or state funds is reported as "Cash and cash equivalents" on the accompanying Statement of Net Assets and is not categorized as to credit risk, except for $234,801 and $21,559,590 at June 30, 2003 and 2002, respectively, of assets whose use is limited. These assets consist of repurchase agreements considered to be Category 1 as defined on the following page.

B. Investments

The resolutions authorizing Series 1993A, 1998B, 1999A, 2003A, and 2003B 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 GASB Statement 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 securities held by the counterparty's trust department or agent in the Medical Center's name.

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

	As of June 30, 2003			As of June 30, 2002		
	Category 1	Non-Categorized	Total	Category 1	Non-Categorized	Total
U.S. Gov't and U.S. Gov't Agency Securities:						
Guaranteed Investment Contracts	$ -	$ 30,172,083	$ 30,172,083	$ -	$ -	$ -
FNMA	75,926,017	-	75,926,017	70,541,553	-	70,541,553
FHLMC	53,809,406	-	53,809,406	56,590,051	-	56,590,051
FHLB	81,247,578	-	81,247,578	35,099,635	-	35,099,635
FFCB	3,112,500	-	3,112,500	10,264,063	-	10,264,063
Bank of New York - STIF		569,400	569,400	-	568,492	568,492
University of Virginia Growth & Income Fund	-	93,955,309	93,955,309	-	89,636,261	89,636,261
Total	$214,095,501	$124,696,792	$338,792,293	$172,495,302	$90,204,753	$262,700,055

3. AFFILIATED COMPANIES

University of Virginia Imaging, LLC

On March 26, 2002, the University of Virginia Medical Center entered into an agreement with Outpatient Imaging Affiliates, LLC (OIA) to establish the 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, Virginia area.

The Medical Center formerly operated an outpatient imaging department offering MRI, plain film radiography, fluoroscopy and ultrasound in office space at the Fontaine Research Park in Charlottesville, Virginia. Although available to all University physicians, the site principally serviced the orthopedic physicians located at Fontaine. UVI provides services to outpatients from the Medical Center's primary and secondary service areas. The existing operations at Fontaine, merged with this new outpatient diagnostic center, also located at Fontaine. Operations started on October 1, 2002.

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

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 healthcare delivery. This new model gives physicians an organizational structure that allows them the opportunity to practice independently in a virtual private practice environment with all the risks and gains associated with an independent model.

On November 14, 2000, the University of Virginia established 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 and 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 investment of $500,000 was made in July 2001, bringing the total equity contributions in Community Medicine to $1,250,000. During fiscal year 2003, the Medical Center made additional investments of $310,000, bringing the total investment to $1,560,000. Community Medicine has recorded losses of $712,340 and $823,912 for the fiscal years ending June 30, 2003 and 2002, respectively, bringing the net investment to $23,748.

Central Virginia Health Network, Inc.

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

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

University of Virginia / HealthSouth, LLC

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

Valiance Health, 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 engaging in the business of integrating and coordinating the delivery of healthcare services in central and western Virginia. The Medical Center contributed $100,000 in initial capital, which entitles it to a pro-rata distribution of any profits and losses of Valiance.

University HealthSystem Consortium

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. Its mission 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. In fiscal year 2001, the Medical Center began recording the portion of the patronage dividends that were held by UHC as patronage equity.

	As of June 30, 2003			As of June 30, 2002		
	Common Stock and Equity Contributions	Share of accumulated income/(loss)	Net Investment	Common Stock and Equity Contributions	Share of accumulated income/(loss)	Net Investment
UVI	$ 687,019	$ 1,016,246	$1,703,265	$ -	$ -	$ -
Community Medicine	1,560,000	(1,536,252)	23,748	1,250,000	(823,912)	426,088
CVHN	232,500	(31,279)	201,221	232,500	(23,139)	209,361
HealthSouth	2,230,000	136,338	2,366,338	2,230,000	(1,437,035)	792,965
Valiance	100,000	56,281	156,281	100,000	47,579	147,579
UHC	-	440,859	440,859	-	489,419	489,419

HealthCare Partners, Inc.

In May, 1995, HealthCare Partners, Inc., a nonstock, nonprofit 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 University of Virginia Health Services Foundation (HSF) 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.

4. GOODWILL

On May 12, 2000, the Medical Center acquired from Augusta Health Care, Inc. the kidney dialysis assets in a transaction accounted for as a purchase. Accordingly, $987,188 was recorded as goodwill for the purchase of the assets and is being amortized over five years. An additional $800,000 was recorded as goodwill for a non-competition agreement and is being amortized over its ten-year life.

On December 15, 2000, the Medical Center acquired from 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 asset and is being amortized over five years.

5. PROPERTY, PLANT, AND EQUIPMENT

A summary of the property, plant, and equipment accounts and the related accumulated depreciation as of June 30, 2003 and 2002, respectively, is presented as follows:

As of June 30, 2003

	Beginning Balance	Additions	Reductions	Ending Balance
Property, plant, and equipment:				
Land	$ 3,905,791	$ 1,412,219	$ -	$ 5,318,010
Land improvements	6,490,666	1,657,616	-	8,148,282
Building	313,861,460	10,145,381	1,178,619	322,828,222
Equipment - Fixed	16,594,227		39,595	16,554,632
Equipment - Moveable	191,164,954	29,456,782	28,284,091	192,337,645
Construction in progress	12,068,843	27,263,649	13,837,496	25,494,996
Total property, plant, and equipment	544,085,941	69,935,647	43,339,801	570,681,787
Accumulated depreciation:				
Land improvements	5,393,328	588,607	-	5,981,935
Building	166,768,165	12,961,700	436,440	179,293,424
Equipment - Fixed	13,342,542	1,050,611	155,222	14,237,931
Equipment - Moveable	124,602,420	20,650,259	25,320,849	119,931,831
Total accumulated depreciation	310,106,455	35,251,177	25,912,511	319,445,121
Property, plant, and equipment, Net	$233,979,486	$34,684,470	$17,427,290	$251,236,666

As of June 30, 2002

	Beginning Balance	Additions	Reductions	Ending Balance
Property, plant, and equipment:				
Land	$ 3,905,791	$ -	$ -	$ 3,905,791
Land improvements	6,402,601	88,065	-	6,490,666
Building	306,197,936	7,682,541	19,017	313,861,460
Equipment - Fixed	16,749,352	92,989	248,114	16,594,227
Equipment - Moveable	191,304,746	28,759,680	28,899,472	191,164,954
Construction in progress	8,196,352	3,872,491	-	12,068,843
Total property, plant, and equipment	532,756,778	40,495,766	29,166,603	544,085,941
Accumulated depreciation:				
Land improvements	5,115,300	278,029	-	5,393,328
Building	154,251,083	12,530,643	13,561	166,768,165
Equipment - Fixed	12,543,737	1,046,707	247,902	13,342,542
Equipment - Moveable	129,918,946	20,290,128	25,606,654	124,602,420
Total accumulated depreciation	301,829,066	34,145,507	25,868,117	310,106,455
Property, plant, and equipment, Net	$230,927,712	$ 6,350,259	$ 3,298,486	$233,979,486

6. ASSETS HELD BY TRUSTEES

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

The Series 1993A, 1998B, 1999A, 2003A, and 2003B Bond resolutions require that deposits be made in a specific order to various accounts and funds held by the Treasurer of Virginia as follows:

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

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

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

D. to the credit of the Reserve Fund, the amount necessary to fund the reserve account requirement, as defined by the bond resolution;

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

F. to the credit of any other fund or account created pursuant to an applicable series resolution.

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

Assets	2003	2002
Construction Fund	$ 231,666	$ 228,833
Construction Fund – Pooled *	569,258	563,196
Bond Sinking Fund – 1993A	-	1,469
Bond Sinking Fund – 1998B	228	498
Bond Sinking Fund – 1999A	2,907	7,588
Bond Sinking Fund – Pooled *	142	5,296
Depreciation reserve	207,797,293	187,708,456
Bond Sinking Fund – 2003B (Construction Fund)	30,172,082	-
Total assets	$238,773,576	$188,515,336

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

7. ACCOUNTS PAYABLE

As of June 30, 2003 and 2002, respectively, the components of accounts payable and accrued expenses consisted of the following:

	2003	2002
Vendor accounts payable	$20,400,068	$15,008,202
Other accounts payable	8,228,493	785,619
Accrued payroll	5,917,664	10,102,736
Accrued leave	19,535,747	19,203,894
Other accrued expenses	12,608,803	17,886,172
Due to University of Virginia	19,449,829	-
Total accounts payable and accrued expenses	$86,140,604	$62,986,623

8. LONG-TERM DEBT (in thousands)

As of June 30, 2003

Description	Interest Rate (%)	Maturity	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Bonds payable:							
Series 1993A	4.0-5.20	2015	$32,670	$ -	$32,670	$ -	$ -
Series 1998B	3.5-5.00	2018	5,800	-	260	5,540	270
Series 1999A	4.5-5.25	2013	44,730	-	3,870	40,860	4,040
Series 1999A - Pooled	4.5-6.00	2019	4,230	-	145	4,085	155
Series 2003A - Pooled	4.7-6.00	2015	-	32,670	300	32,370	315
Series 2003B - Pooled	4.7-6.00	2023	-	38,356	-	38,356	1,191
Total bonds payable			87,430	71,026	37,245	121,211	5,971
Notes payable:							
Helicopter	1.8-2.4	2006	-	3,926	975	2,951	1,000
UVI	5.8	2004	-	480	-	480	480
Total notes payable			-	4,406	975	3,431	1,480
Obligations under grant agreements		2007	-	5,000	-	5,000	1,667
Total long-term debt			$87,430	$80,432	$38,220	$129,642	$9,118

As of June 30, 2002

Description	Interest Rate (%)	Maturity	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Bonds payable:							
Series 1993A	4.0-5.20	2015	$ 32,960	$ -	$ 290	$32,670	$ 300
Series 1998B	3.5-5.00	2018	6,050	-	250	5,800	260
Series 1999A	4.5-5.25	2013	48,435	-	3,705	44,730	3,870
Series 1999A - Pooled	4.5-6.00	2019	4,370	-	140	4,230	145
Total bonds payable			$ 91,815	$ -	$ 4,385	$87,430	$4,575

Future Debt Requirements

Fiscal Year	Principal	Interest	Total
2004	$ 9,118,839	$ 5,909,568	$ 15,028,407
2005	8,889,210	5,637,847	14,527,057
2006	9,188,469	5,332,501	14,520,970
2007	6,873,875	5,011,586	11,885,461
2008	7,203,896	4,674,139	11,878,035
2009-2013	43,553,187	17,478,777	61,031,964
2014-2018	30,979,894	6,640,996	37,620,890
2019-2023	13,834,847	1,970,818	15,805,665
Total	$129,642,217	$52,656,232	$182,298,449

On June 1, 2003, the Medical Center paid and redeemed $32,670,000 of outstanding Series 1993A bonds. The funds used to redeem these bonds were 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 $63 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 floor 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; complete reconstruction of 19 existing operating rooms; expansion and reconstruction of the Heart Center's diagnostic, interventional, and clinic facilities; relocation and expansion of Interventional Radiology; and the reorganization and modernization of hospital-based clinical laboratory functions. The addition is scheduled for completion in July 2004 and the remainder of the renovations should be completed by March 2006. The cost of the project is being financed by a loan from the University's Pooled Bond Program through which the University has issued bonds and made cash available to various University entities to finance construction projects. The amount of the initial loan was $33.3 million and will be repaid over a 20-year period beginning June 1, 2004. The funds required to complete the remainder of the project will be borrowed from the University in the fall of 2003.

The second project increases and expands the facilities available for Cancer Services. Included in this project are the expansion and relocation of Breast Care Services, construction of a new Infusion Center in the west wing of the Multistory Building, and the expansion of examination rooms and other support space. This renovation is scheduled for completion in September 2004. The cost of this project is expected to be $5 million and was borrowed from the University's Pooled Bond Program.

10. UNIVERSITY WORKING CAPITAL LOAN

On July 10, 2002, the Medical Center secured a working capital loan from the University of Virginia. The amount of the loan is $3.9 million with a variable interest rate. The term of the loan is four years with annual principal and interest payments. The loan was used to finance the purchase of a new helicopter from Agusta Aerospace Corporation.

11. NET PATIENT SERVICE REVENUE

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

	2003	2002
Gross patient service revenue:		
Inpatient:		
Routine services	$ 152,080,139	$ 149,344,112
Ancillary services	418,401,973	344,400,282
Outpatient:		
Ancillary services	366,995,917	307,623,076
Clinics	25,353,691	17,693,816
Total gross patient service revenue	962,831,720	819,061,286
Allowances for indigent care and contractual adjustments	(355,934,837)	(250,689,581)
Net patient service revenue	$ 606,896,883	$ 568,371,705

The Medical Center received $50,608,933 and $40,614,933 in fiscal years 2003 and 2002, respectively, from the Department of Medical Assistance Services that was funded by the Commonwealth of Virginia. Of that, $31,208,170 and $21,195,436, respectively, was for the disproportionate share hospital payment (DSH) for the care provided to indigent patients. These payments are recorded in nonoperating revenue. The Medical Center acted as a pass-through for the portion of the DSH payments related to physician services provided to indigent patients. Those funds, $7,060,594 and $5,494,594, respectively, were transferred to the School of Medicine. These payments are included in purchased services expense.

The remaining $19,400,763 and $19,419,497 in fiscal years 2003 and 2002, respectively, were for indirect medical education. These payments are included in net patient service revenue as an adjustment to allowances for indigent care and contractual adjustments.

Amounts written off for indigent care, net of the disproportionate share and indirect medical education payments, were $18,631,596 and $25,561,079 in fiscal years 2003 and 2002, respectively.

12. UNIVERSITY ALLOCATIONS

The University of Virginia School of Medicine faculty assists the Medical Center in its mission of providing healthcare and medical education. A survey is conducted annually to determine the value of this effort. An allocation is made on the Medical Center's Statement of Revenues, Expenses, and Changes in Net Assets to reflect the value of this effort as income. This allocation is offset in the operating expenses of the Medical Center by an equal amount in purchased services. The amount of this allocation for the years ended June 30, 2003 and 2002 was $10,316,939 and $7,455,862, respectively.

Likewise, the University provides the Medical Center with various general and administrative support services. An analysis is prepared annually to determine the cost of providing these services. The same type of allocation as above is made to the Medical Center's Statement of Revenues 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, 2003 and 2002 was $1,953,396 and $1,577,236, 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.

13. GAIN SHARING WITH SCHOOL OF MEDICINE

Beginning with the fiscal year ended June 30, 2003, the Medical Center and the University of Virginia School of Medicine entered into a Memorandum of Understanding pertaining to a gain sharing arrangement between both parties. The amount of the gain sharing with the School of Medicine is a tiered arrangement based upon the income of the Medical Center in excess of minimum requirements established by the Board of Visitors. For the fiscal year ended June 30, 2003, the scheduled payment to the School of Medicine is $11,981,737.

14. COMMITMENTS

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

Year Ending June 30,	Operating Leases
2004	$ 5,353,102
2005	2,311,814
2006	1,772,245
2007	1,365,218
2008	619,037
2009 - 2013	1,237,174
2014 - 2018	823,200
2019 - 2023	823,200
2024 - 2028	823,200
2029 - 2033	823,200
2034 - 2038	823,200
2039 - 2043	823,200
2044 - 2048	658,560
2049 - 2052	81,530
Total	$18,337,880

The total rental expense for operating leases for the years ended June 30, 2003 and 2002, was $5,570,885 and $7,074,915, respectively.

The Medical Center was party to construction contracts and commitments for the years ended June 30, 2003 and 2002, totaling $84,449,676 and $25,009,533, respectively. Of these amounts, $35,840,324 and $11,357,128 were incurred as of June 30, 2003 and 2002, respectively.

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

Year Ending June 30,	Maintenance Contracts
2004	$7,045,845
2005	4,750,577
2006	3,248,896
2007	1,061,935
2008	457,601
Total	$16,564,854

15. UNIVERSITY OF VIRGINIA HEALTH SERVICES FOUNDATION

The University of Virginia Health Services Foundation (HSF), a nonprofit educational, scientific, and charitable organization, began operating with the approval of the Board of Visitors as of June 30, 1980, to assist the University in providing hospital and medical care services, medical education programs, and programs of public charity at the University of Virginia. For the period beginning July 1, 1994 and ending July 31, 2000, HSF assumed all costs associated with the operation of the outpatient clinics.

On August 1, 2000, management of 63 clinics, formerly managed by the 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 except for the costs of physician services. On August 1, 2000, the Medical Center entered into leased employment agreements with HSF for limited personnel who remained HSF employees, but were performing Medical Center duties.

The Medical Center paid HSF $529,242 and $635,511 for costs associated with the operation of the outpatient clinics for the years ended June 30, 2003 and 2002, respectively.

The Medical Center paid HSF $15,774,788 and $10,698,291 for the provision of supervisory and administrative services for the years ended June 30, 2003 and 2002, respectively.

The Medical Center recorded $17,192,761 and $10,022,536 as expense payable to HSF for the provision of supervisory and administrative services for the years ended June 30, 2003 and 2002, respectively.

The Medical Center paid HSF $1,724,105 and $1,608,581 for rental of space for the years ended June 30, 2003 and 2002, respectively. HSF paid the Medical Center $223,461 and $294,900 for rental of space for the clinics for the years ended June 30, 2003 and 2002, respectively.

HSF paid the Medical Center $6,883,244 and $4,277,577 for clinic facility fees and other services for the years ended June 30, 2003 and 2002, respectively.

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 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 employer and employee contributions (all of which are paid by the Medical Center), 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 $8,880,214 and $8,733,985 for the years ended June 30, 2003 and 2002, respectively. Contributions to the Optional Retirement Plans were calculated using base salaries of $110,542,830 and $107,054,751 for the years ended June 30, 2003 and 2002, respectively. The contribution percentage amounted to 8.0 percent and 8.2 percent for the years ended June 30, 2003 and 2002, respectively.

17. POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

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

18. RISK MANAGEMENT AND SELF-INSURANCE

The Medical Center is a participant in the Commonwealth of Virginia's self-insurance program administered by the Department of Treasury's 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 § 8.01-581.15 of the Code of Virginia. In the opinion of management, such coverage is adequate to provide for the ultimate liability, if any, which might result from the settlement of claims currently asserted against the Medical Center, as well as the potential liability for medical incidents of which the Medical Center has knowledge, but for which claims have not yet been asserted against the Medical Center. Accordingly, no provision is included in the financial statements for such potential liabilities.

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

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

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

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

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

19. SETTLEMENTS

During the year ended June 30, 2000, the United States Department of Justice reviewed outpatient billings submitted to government payers by the University of Virginia Health Services Foundation (HSF) and the University of Virginia Medical Center. This review revealed a small number of billing errors. To avoid protracted legal and operational costs, the Department of Justice, the Medical Center, and HSF negotiated a settlement of this issue. The settlement had several provisions, one of which was a payment to the federal government of $3 million, made in October 2001. Internal controls have been implemented, which will prevent a reoccurrence of the problems identified during the investigation.

20. OIG INDIGENT CARE INVESTIGATION

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

While finding that the Medical Center had calculated DSH in accordance with the state plan, the report concludes that the Medical Center overstated its UCC. OIG can only make recommendations. The decision to accept or reject OIG's recommendations will be made by the Centers for Medicare and Medicaid Services (CMS) within the U.S. Department of Health and Human Services. CMS had not made a final determination as of November 10, 2003. If CMS implements OIG's recommendations, it will recoup funds from the Commonwealth of Virginia's Department of Medical Assistance Services. The impact of such recoupment, if any, on the Medical Center cannot be determined at this time; however, management previously reduced net patient revenue by $6 million; the amount that it believed to be the potential exposure related to this matter.

During fiscal year 2003, the Medical Center further evaluated its exposure on this issue and believes that its risk is greater than originally estimated. To adequately record what it believes is the extent of its potential liability on this issue, the Medical Center has booked an additional reduction of $5.1 million to patient revenue for fiscal year 2003.

21. SUBSEQUENT EVENT

Community Medicine University of Virginia, LLC

The Medical Center contributed an additional $250,000 to Community Medicine in July 2003, bringing its total contributions to $1,810,000.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
Charlottesville, Virginia

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