UNIVERSITY OF VIRGINIA MEDICAL CENTER

CHARLOTTESVILLE, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2002

APA
Auditor of
Public Accounts
COMMONWEALTH OF VIRGINIA

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

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 22, 2002

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 the statement of cash flows of the **University of Virginia Medical Center**, a division of the University of Virginia, as of and for the year ended June 30, 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 financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center as of June 30, 2002 and 2001, and the changes in its financial position and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As described in Note 1 to the financial statements, the Medical Center has implemented a new financial reporting model as required by the provisions of Governmental Accounting Standards Board Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and Statement 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities* as of June 30, 2002. The financial statements as of June 30, 2001 and for the year then ended were restated in accordance with these standards.

The Management's Discussion and Analysis presented on pages four through eleven 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 INTERNAL CONTROLS AND COMPLIANCE

Our report on internal controls and compliance and recommendations for improvements in internal controls and instances of noncompliance with 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, 2002.

AUDITOR OF PUBLIC ACCOUNTS

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MANAGEMENT’S DISCUSSION AND ANALYSIS

<u>UNIVERSITY OF VIRGINIA MEDICAL CENTER</u>

<u>MANAGEMENT'S DISCUSSION AND ANALYSIS</u>

<u>AS OF JUNE 30, 2002</u>

The following discussion is intended to facilitate the understanding and assessment of significant changes and trends related to the Medical Center's results of operations and financial condition. This discussion and analysis should be read in conjunction with the financial statements and notes thereto.

THE ANNUAL REPORT

The annual report consists of a series of financial statements prepared in accordance with newly established rules by the Governmental Accounting Standards Board (GASB) Statement 34, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments;* GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis of Public Colleges and Universities* and with the Financial Accounting Standards Board requirements for Health Care Organizations. These financial statements differ in both the form and the accounting principles utilized from prior financial statements. In prior years, statements focused on the accountability of funds while the new statements focus on the financial condition of the Medical Center and the results of operations and cash flows of the Medical Center. The fiscal year 2001 information presented for comparison purposes has been restated to be consistent with the new required rules.

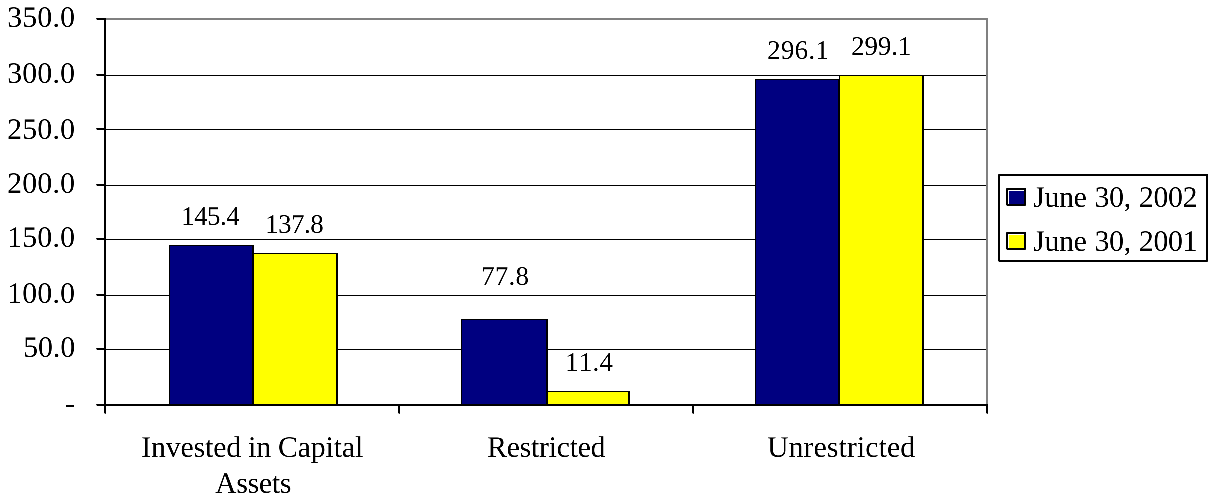
<u>Statements of Net Assets</u>

The Statement of Net Assets includes all assets (property that we own and what we are owed by others) and liabilities (what we owe to others). It is prepared under the accrual basis of accounting; whereby, revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service to the Medical Center, regardless of when cash is exchanged.

The Medical Center's net assets (the difference between assets and liabilities) is one indicator of financial health. Over time, increases or decreases in assets is one indicator of the improvement or erosion of the financial health when considered with non-financial facts such as admissions and outpatient visits and the condition of the facilities.

During the year the Medical Center's financial position improved. The net assets, which are the total assets less total liabilities, increased $70.9 million over the previous year. This increase resulted primarily from additions to the endowment funds of $66.1 million. The largest component of the increase was the proceeds of $51.3 million from the estate of Ward Buchanan.

Net Assets (in millions)



Statement of Net Assets (in millions)

	As of June 30, 2002	As of June 30, 2001
Current Assets	$ 142.5	$ 147.9
Capital Assets	234.0	230.9
Other Non-Current Assets	294.3	223.8
Total Assets	670.8	602.6
Current Liabilities	67.6	65.6
Non-current Liabilities	84.0	88.7
Total Liabilities	151.6	154.3
Net Assets:		
Invested in capital assets, net of related debt	145.3	137.8
Restricted for:		
Nonexpendable	53.1	.2
Expendable	24.7	11.2
Unrestricted	296.1	299.1
Total Net Assets	$ 519.2	$ 448.3

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total net assets as presented in the Statement of Net Assets are based on activity as presented in the Statement 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 and expenses incurred and any other revenues, expenses, gains, and losses.

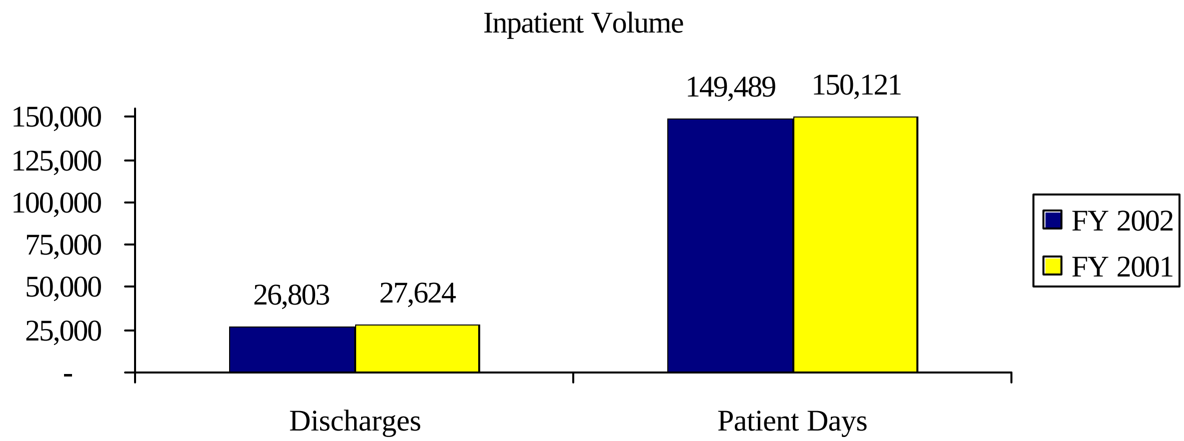
Statement of Revenues, Expenses, and Changes in Net Assets (in millions)

	Year Ended June 30, 2002	Year Ended June 30, 2001
Net Patient Service Revenue	$ 568.4	$ 516.3
Other Revenue	20.5	23.3
Total Operating Revenue	588.9	539.6
Salaries and Benefits	285.6	246.8
Other Operating Expenses	315.0	296.4
Total Operating Expenses	600.6	543.2
Operating Income (Loss)	(11.7)	(3.6)
Nonoperating Revenue	17.2	29.1
Additions to endowments	66.1	(0.3)
Transfers to the University of Virginia	(0.7)	(0.1)
Increase in Net Assets	70.9	25.1
Net assets - beginning of year	448.3	423.2
Net assets - end of year	$ 519.2	$ 448.3

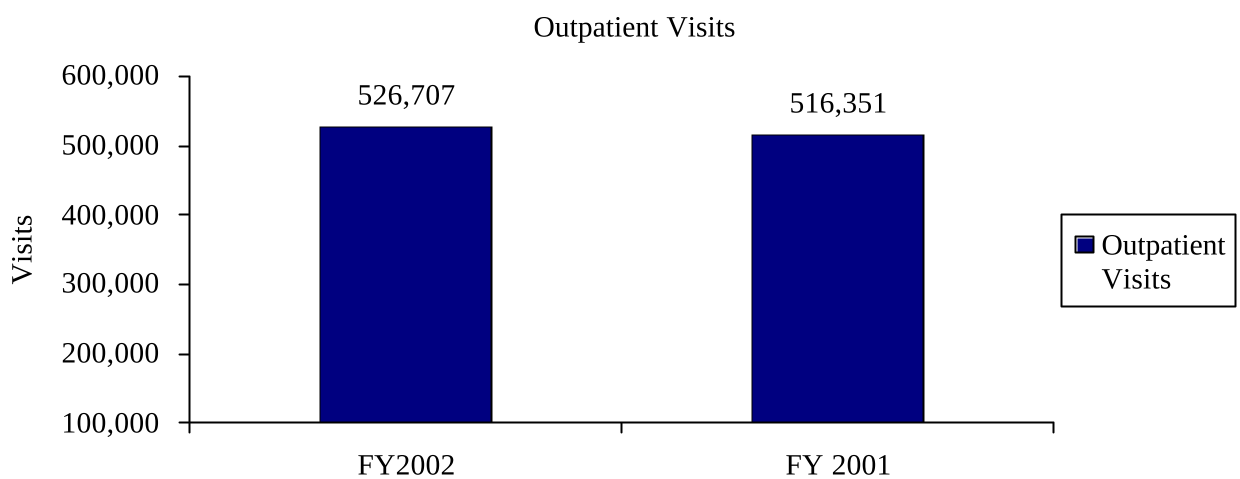
The Medical Center's financial position, as a whole, improved during the fiscal year ending June 30, 2002, as net assets increased $70.9 million or 15.8 percent.

Operating Revenue

Total operating revenue for fiscal year 2002 was 9.1 percent above prior year. The Medical Center realized this increase despite a decline in patient discharges of 821 (3.0 percent). Factors that contributed to the increase in operating revenue were an increase to patient charges of 15 percent, growth in the number of outpatients treated, and an increase in the acuity of inpatients.



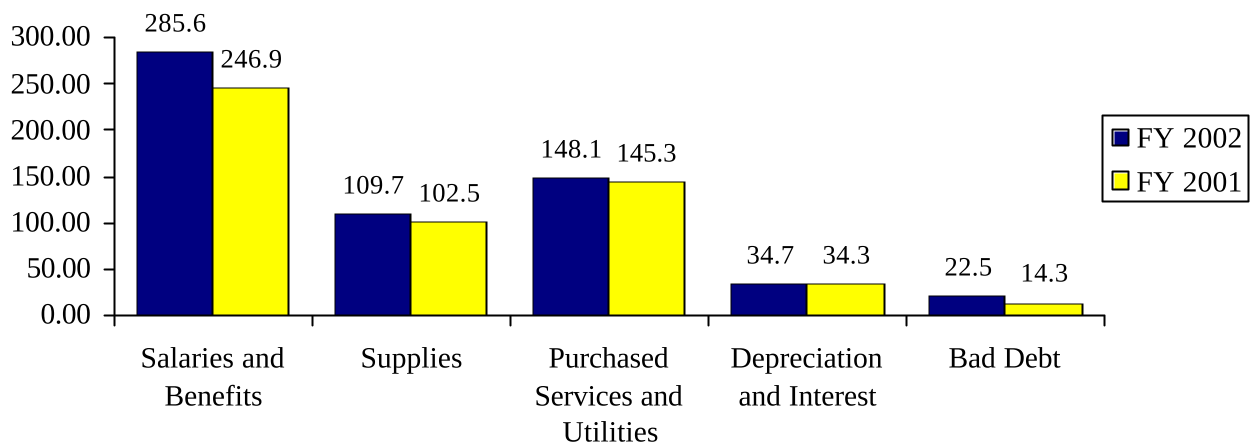
Outpatient volume such as same day patients and outpatient visits were above the prior year.



Operating Expenses

Total operating expenses for fiscal year 2002 were 10.6 percent over prior year.

Operating Expenses (in millions)



The areas of greatest increase were salaries and benefits, supplies, and bad debts.

- The increase in salaries and benefits was the result of the increase in full time equivalent employees (FTEs). Additional employees were hired to support new programs and open more beds. Hospital and clinic FTEs were as follows:

Full Time Equivalent Employees

	At June 30, 2002	At June 30, 2001	Increase
Hospital	4,849	4,597	252
Clinic	466	381	85
Total	5,315	4,978	337

- The increased supply expense was a result of increases in the cost of drugs and medical supplies.

- The increase in bad debt expense can be attributed to the rate increase and the increase in the unemployment rate.

As a result of these factors the Medical Center's operating loss increased from $3.7 million in fiscal year 2001 to $11.7 million.

Non-operating Revenue (Expenses)

Included in the non-operating expenses is an expense of $4.9 million from the sale of Blue Ridge Health Alliance, Inc.

Included in Other Revenue and Transfers is an increase of $66.1 million to permanent endowment. The largest component of this increase was $51.3 million proceeds from the estate of Ward Buchanan.

Statement of Cash Flows

Another important factor to consider when evaluating financial standing is the Medical Center's ability to meet financial obligations. This is usually measured by the Statement of Cash Flows. It presents information related to cash inflows and outflows summarized by operating, capital, financing, and investing activities.

Statement of Cash Flows (in millions)

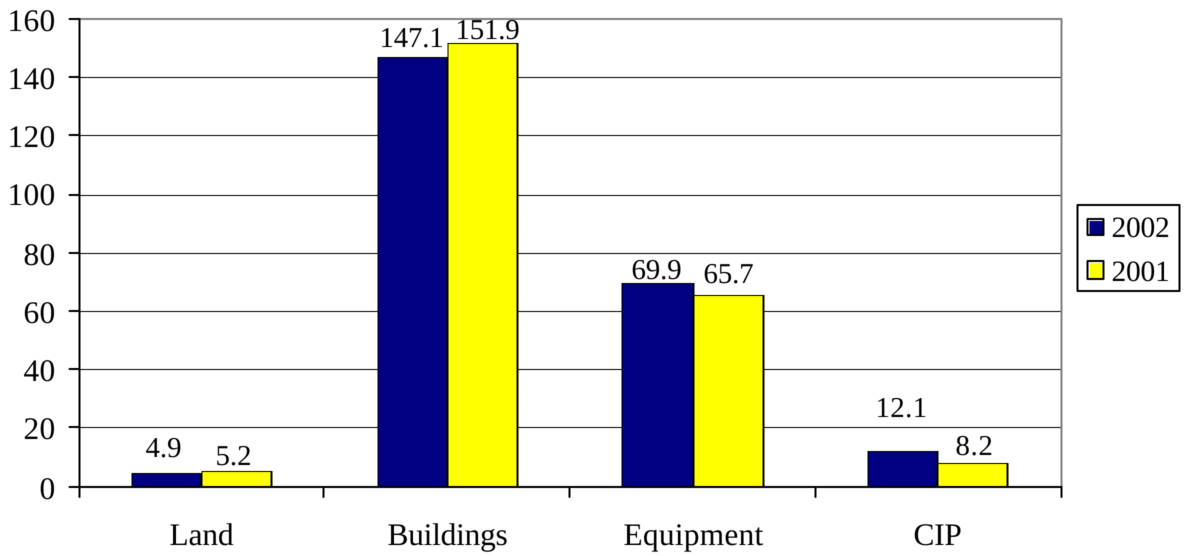
	Year Ended June 30, 2002	Year Ended June 30, 2001
Cash flows from operating activities	$ 12.3	$ 13.5
Cash flows from noncapital financing activities	86.1	26.0
Cash flows from capital and related financing activities	(43.5)	(54.0)
Cash flows from investing activities	(67.4)	(12.2)
Net decrease in cash and cash equivalents	(12.5)	(26.7)
Balances - beginning of the year	38.6	65.3
Balances - end of the year	$ 26.1	$ 38.6

The most significant transaction affecting cash flow is the non-capital financing activity from the increase in the endowments previously described. The subsequent investment of those funds is reflected above in the cash flows from investing activities. Included in cash flows from capital and related financing activities is the purchase of capital assets of $37.7 million.

Capital Asset and Debt Administration

At June 30, 2002, the Medical Center had $234 million invested in capital assets, net of accumulated depreciation of $310 million. Depreciation charges totaled $33.6 million for the current fiscal year compared to $32.9 million last year. Details of these assets for the two years are shown below:

Net Capital Assets (in millions)



Major Capital Additions Completed (in millions)

	2002	2001
Information Systems and Related Hardware	$ 1.9	$ 7.1
West Clinics Renovations	2.1	0.8
University Hospital Expansion	2.3	1.1
ICU Renovation and Related Bed Replacement	3.0	-
Patient Monitoring System	5.5	4.2
Radiology Systems	6.1	1.7
Purchase Building-Jefferson Park Ave.	-	7.2
Child Care Center	-	2.4
University Hospital Renovations	-	3.1
Total	$ 20.9	$ 27.6

Economic Factors That Will Affect the Future

During fiscal year 2003, the Medical Center plans to begin a major expansion of its University Hospital facility. A bond issue will finance this expansion, which is expected to cost in the range of $50 million to $60 million. The expansion project, expected to be completed in 2005, will increase the number of operating rooms and related support services available. By increasing its capacity for surgical admissions, the Medical Center will be able to increase its census and increase its net revenue.

A portion of the Medical Center's revenue is derived from the disproportionate share hospital payments (DSH) received from Virginia's Department of Medical Assistance Services (DMAS). On

August 2, 2002, the Office of Inspector General of the Federal Department of Health and Human Services released a draft audit report of the results of its review of this 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. At this time, the ultimate resolution of this issue is unknown but we believe that there is a reasonable likelihood that the Medical Center will have to reimburse DMAS for some portion of disallowed payments. We have recognized our potential liability from the audit report on this issue by increasing our contractual allowances by $6 million.

As a result of the sale of Blue Ridge Health Alliance (BRHA), the Medical Center negotiated a new contract with Coventry Health Care's affiliate, Southern Health Services Inc. The term of the contract is five years and became effective September 1, 2002. The terms of this contract are more favorable than those of the contract terminated with BRHA. These more favorable rates will improve the Medical Center's profitability as an estimate that 6.6 percent of the Medical Center's patients will be covered by this contract.

The Medical Center and Trigon Insurance Company signed a seven-year provider agreement. This agreement which went into effect September 1, 2002, contains an annual inflation adjustment factor that is indexed above a nationally recognized healthcare inflation rate. In fiscal year 2002, 18.9 percent of the Medical Center's patients were covered by Trigon. We have projected that the new agreement will provide an operating margin consistent with Board of Visitor guidelines.

FINANCIAL STATEMENTS

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2002 and 2001

	2002	2001
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 20,481,315	$ 34,793,168
Accounts receivable, net of estimated uncollectibles of $74,356,835 at June 30, 2002 and $69,387,854 at June 30, 2001	94,204,023	81,683,287
Due from third-party payors	13,815,309	17,063,646
Due from University of Virginia	2,311,958	212,777
Inventories and prepaid expenses	11,659,473	11,096,962
Notes receivable	22,185	3,032,069
Total current assets	142,494,263	147,881,909
Noncurrent assets:		
Cash and cash equivalents restricted (Note 2)	5,593,033	3,787,872
Due from University of Virginia - noncurrent	336,891	449,189
Advance to University of Virginia (Note 3)	-	4,477,011
Investments in pooled endowment funds (Note 2)	89,636,261	23,537,413
Goodwill (Note 5)	2,073,255	2,944,017
Investments (Note 2)	6,108,048	5,823,161
Investments in affiliated companies (Note 4)	1,639,324	4,772,485
Property, plant and equipment, less accumulated depreciation of $310,106,455 at June 30, 2002 and $301,829,066 at June 30, 2001 (Note 6)	233,979,486	230,927,712
Deferred bond discount and issue costs, net of amortization of at June 30, 2002 $4,027,924 and $3,939,914 at June 30, 2001	428,456	516,467
Assets held by trustees (Note 7)		
Cash and cash equivalents (Note 2)	21,559,590	18,424,544
Investments (Note 2)	166,955,746	159,086,457
Total noncurrent assets	528,310,090	454,746,328
Total assets	670,804,353	602,628,237

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2002 and 2001

	2002	2001
LIABILITIES		
Current liabilities:		
Current installments of long-term debt (Note 8)	$ 4,575,000	$ 4,385,000
Accounts payable and accrued expenses	62,986,623	61,166,178
Total current liabilities	67,561,623	65,551,178
Noncurrent liabilities:		
Long-term debt (Note 8)	82,855,000	87,430,000
Bond premium, net of amortization of $329,842 at June 30, 2002 and $219,995 at June 30, 2001	1,199,292	1,309,138
Total noncurrent liabilities	84,054,292	88,739,138
Total liabilities	151,615,915	154,290,316
NET ASSETS		
Invested in capital assets, net of related debt	145,350,194	137,803,574
Restricted for		
Nonexpendable endowment principal	53,099,192	233,450
Expendable gifts and endowment income	24,681,998	11,189,858
Unrestricted	296,057,054	299,111,039
Total net assets	$ 519,188,438	$ 448,337,921

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

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UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF REVENUES, AND EXPENSES, AND CHANGES IN NET ASSETS
For the Years Ended June 30, 2002 and 2001

	2002	2001
Operating revenue:		
Net patient service revenue (Note 9)	$ 568,371,705	$ 516,288,720
University allocations (Note 10)	9,033,098	10,056,847
Other	11,454,468	13,243,649
Total revenue	588,859,271	539,589,216
Operating expenses:		
Salaries and wages	231,120,180	200,839,963
Fringe benefits	54,433,402	46,025,703
Supplies	109,670,157	102,483,726
Purchased services and other expenses	137,097,408	134,785,892
Utilities	11,019,906	10,476,669
Provision for depreciation and amortization	34,722,054	34,313,603
Provision for bad debts	22,521,144	14,314,012
Total operating expenses	600,584,251	543,239,568
Income (loss) from operations	(11,724,980)	(3,650,352)
Nonoperating revenue (expenses):		
Disproportionate share hospital payment from Commonwealth (Note 9)	21,195,436	21,802,779
Gifts	440,169	203,971
Investment income	11,937,279	12,208,203
Net increase in the fair value of investments	17,262	4,860,259
Net loss from investments in affiliated companies (Note 4)	(6,706,509)	(2,342,796)
Interest expense	(4,613,866)	(4,801,814)
Loss on disposal of fixed assets	(214,913)	(2,548,403)
Loss on sale of affiliated company	(4,844,858)	-
Loss on settlement (Note 18)	(50,000)	(250,000)
Net nonoperating revenues (expenses)	17,160,000	29,132,199
Income before other revenues, expenses, and transfers	5,435,020	25,481,847
Additions to permanent endowments	66,098,848	(339,956)
Transfers to University of Virginia	(683,351)	(100,000)
Increase in net assets	70,850,517	25,041,891
Net Assets		
Net assets - beginning of year	448,337,921	423,296,030
Net assets - end of year	$ 519,188,438	$ 448,337,921

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

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UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF CASH FLOWS
For the Years Ended June 30, 2002 and 2001

	2002	2001
Cash flows from operating activities:		
Receipts from patients and third-parties	$ 535,901,361	$ 485,606,571
Receipts from other revenue	14,345,367	15,531,845
Payments to employees	(279,659,170)	(239,246,200)
Payments to suppliers	(247,236,533)	(236,012,136)
Payment for utilities	(11,040,924)	(10,476,669)
Payment for goodwill	-	(1,870,284)
Net cash provided by operating activities	12,310,101	13,533,127
Cash flows from noncapital financing activities:		
Disportionate share hospital payment	21,195,436	21,802,780
Transfer to University of Virginia	(683,351)	(100,000)
Settlement	(50,000)	(250,000)
Gifts	440,170	203,970
Increase in endowment	65,214,464	4,294,890
Net cash provided by noncapital financing activities	86,116,719	25,951,640
Cash flows from capital and related financing activities:		
Purchase of capital assets	(37,741,516)	(45,265,822)
Principal paid on capital debt	(4,385,000)	(4,170,000)
Interest paid on capital debt	(4,613,866)	(4,801,814)
Proceeds from sale of capital assets	3,267,579	259,904
Net cash used by capital and related financing activities	(43,472,803)	(53,977,732)
Cash flows from investing activities:		
Interest on investments	11,937,279	12,208,203
Purchase of investments	(201,923,646)	(123,279,486)
Proceeds from sale of investments	125,437,224	101,707,083
Loan to affiliate	3,016,512	(3,016,512)
Repayment of loan made to University of Virginia	2,490,128	175,864
Sale of Blue Ridge Health Alliance and other affiliate transactions	(8,418,206)	-
Net cash from investing activities	(67,460,709)	(12,204,848)
Net decrease in cash and cash equivalents	(12,506,692)	(26,697,813)
Cash and cash equivalents - July 1	38,581,040	65,278,853
Cash and cash equivalents - June 30	$ 26,074,348	$ 38,581,040
Reconciliation of operating income (loss) to net cash provided (used) by operating activities		
Operating income (loss)	$ (11,724,980)	$ (3,650,352)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:		
Depreciation and amortization	34,722,054	34,313,603
Accounts receivables	(9,279,027)	(26,406,213)
Inventories and prepaids	(562,511)	(1,458,844)
Goodwill		(1,870,284)
Accounts payable and accrued expenses	(845,435)	12,605,217
Net cash provided by operating activities	$ 12,310,101	$ 13,533,127

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

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NOTES TO FINANCIAL STATEMENTS

UNIVERSITY OF VIRGINIA MEDICAL CENTER

NOTES TO FINANCIAL STATEMENTS

AS OF JUNE 30, 2002 and 2001

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 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 health care services.

The financial statements have been prepared in accordance with GASB Statement 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements and Management's Discussion and Analysis of Public College and Universities*. These new statements will be effective for the Commonwealth and all of its component units for the fiscal year ending June 30, 2002. The financial statements as of June 30, 2001 and for the year then ended were restated in accordance with these standards.

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. 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 of 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.

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 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. 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.

J. 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.

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.*

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 three 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 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.

O. Appropriations, 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.

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. 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 $1,127,979 at June 30, 2002, and $1,682,622 at June 30, 2001, is in accounts of the University of Virginia or with the Treasurer of Virginia. The bank balance of the excluded cash was $10,885 at June 30, 2002 and $5,230 at June 30, 2001.

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 $21,559,590 and $18,424,544 at June 30, 2002 and 2001, 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.

AS OF JUNE 30, 2002

Description	Category 1	Non-Categorized	Total
U.S. Government and U.S. Government Agency Securities:			
U.S. Treasury Notes	$ -	$ -	$ -
FNMA	70,541,553	-	70,541,553

FHLMC	56,590,051	-	56,590,051
FHLB	35,099,635	-	35,099,635
FFCB	10,264,063	-	10,264,063
Bank of New York - STIF	-	568,492	568,492
University of Virginia Growth and Income Fund	-	89,636,261	$ 89,636,261
Total	$172,495,302	$90,204,753	$262,700,055

AS OF JUNE 30, 2001

Description	Category 1	Non-Categorized	Total
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	$164,333,013	$24,114,018	$188,447,031

3. 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 $5,712,805 to the University that 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.

4. AFFILIATED COMPANIES

Blue Ridge Health Alliance, Inc.

The Medical Center was a participant with the Health Services Foundation (HSF) in Blue Ridge Health Alliance, Inc. (Blue Ridge Health Alliance or the Corporation), a joint venture to develop and operate a managed health care organization in central and western Virginia and certain counties in West Virginia. Blue Ridge Health Alliance, a for-profit corporation, was formed in April 1994, to develop a regional network of physicians, hospitals, and other health care providers through which to deliver health benefits to insured and self-funded employers and other groups. QualChoice of Virginia

Health Plan, Inc. (QualChoice), was a wholly owned subsidiary of the Corporation formed to operate a health maintenance organization (HMO) serving employers and other groups in the Commonwealth of Virginia. QualChoice commenced operations on January 4, 1995.

Blue Ridge Health Alliance had authorized capital stock consisting of one million two (1,000,002) shares of common stock, par value $0.01 per share (the "Common Stock"). The authorized shares of common stock consist of 1,000,000 shares of Class A Voting Common Stock and two shares of Class B Voting Common Stock. In 1994, the Medical Center and the HSF each executed a Shareholders Subscription Agreement under which each agreed to contribute $4,550,000 as equity capital. Subsequently, the Medical Center and HSF each were issued one share of Class B Voting Common Stock and shares of Class A Voting Common Stock. Except for the original obligations of the founding shareholders under the Founding Shareholders Subscription Agreements, no shareholder had an obligation to make any loans, advances, or additional equity contributions whatsoever to the capital of the Corporation. The shareholders acknowledged and agreed that the Corporation was expected to retain its earnings in order to finance growth and that there was no expectation that the Corporation 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 HSF and the Medical Center for $5,000,000. HSF elected not to participate in this capital call in accordance with their rights prescribed in the Shareholders Agreement; accordingly, the Medical Center contributed the entire $5,000,000, 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 HSF and the Medical Center, HSF relinquished its share of Class B Voting Common Stock to the Medical Center. Corporate actions enumerated in the Amended Articles of Incorporation require approval of the holders of all of the shares of the Class B Voting Common Stock. Except for this special voting requirement, the shares of Class A and Class B Voting Common Stock have equal rights, privileges, and dividend distribution rights. On November 25, 1998, the Medical Center provided a loan to the corporation as evidenced by a promissory note in the amount of $6,678,595 due February 24, 1999, at 4.50 percent 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, HSF contributed an additional $12,181,232 and Martha Jefferson Hospital contributed an additional $22,881. Once these additional contributions had been made the Medical Center owned 48.08 percent of the class A stock, HSF owned 48.08 percent and Martha Jefferson Hospital owned 3.84 percent. In addition, the University transferred to HSF one share of class B common stock so that both HSF and the University each owned one of the two shares which have been authorized.

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

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 5-year provider contract with Blue Ridge's current majority owners, the University of Virginia Medical Center, and the University of Virginia Health Services Foundation.

Central Virginia Health Network, Inc.

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

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

In December 1986, the Medical Center became a member of the University HealthSystem Consortium (UHC). Founded in 1984, UHC is an alliance of the clinical enterprises of academic health centers. While focusing on the clinical mission, UHC is mindful of and supports the research and education missions. The mission of the University HealthSystem Consortium is to advance knowledge, foster collaboration, and promote change to help members compete in their respective 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 FY 2001, the Medical Center began recording the portion of the patronage dividends that were held by UHC as patronage equity.

As of June 30, 2002

Description	Central Virginia Health Network	HealthSouth	Valiance	UHC
Common Stock and Equity Contributions	$ 232,500	$ 2,230,000	$ 100,000	$ -
Share of Income/(Loss)	(23,139)	(1,437,035)	47,579	489,419
Net Investment	$ 209,361	$ 792,965	$ 147,579	$ 489,419

As of June 30, 2001

Description	Blue Ridge Health Alliance	Central Virginia Health Network	HealthSouth	Valiance	UHC
Common Stock and Equity Contributions	$ 36,139,402	$ 232,500	$2,230,000	$100,000	$ -
Share of Income/(Loss)	(32,338,162)	(18,844)	(1,996,361)	40,875	383,075
Net Investment	$ 3,801,240	$ 213,656	$ 233,639	$140,875	$383,075

Community Medicine, L.L.C.

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, which is a wholly owned subsidiary of the University, Community Medicine is considered a disregarded entity for tax purposes. As a wholly owned subsidiary the financial activity of Community Medicine will be accounted for under the consolidation method.

An initial investment of $750,000 was made to Community Medicine in May 2001. Community Medicine commenced operations on July 1, 2001. An additional investment of $500,000 was made in July 2001, bringing the total equity contributions in Community Medicine to $1,250,000. Community Medicine has recorded losses of $823,912 through June 30, 2002, bringing the net investment to $426,088.

HealthCare Partners, Inc.

In May, 1995, HealthCare Partners, Inc. (HealthCare Partners), a non-stock, non-profit corporation, was established to support networking, external business relationships with neighboring hospitals and physicians groups, and expansion of primary care activities. The Medical Center and the Health Services Foundation are the primary contributors to the funding of the corporation. The corporation is governed by a board of directors composed of Health Sciences Center staff, community members, and University Board of Visitors appointees.

5. 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 amortized over five years, which concluded in September 2001.

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

On December 15, 2000, the Medical Center acquired from the University of Virginia Health Services Foundation (HSF) its interest in the Hyperbaric Oxygen Unit. In July 1994, the Medical Center and HSF entered into a Memorandum of Agreement for the purpose of joint purchase and operation of a Hyperbaric Oxygen Unit. The Memorandum provided that HSF would own 67 percent interest and the Medical Center would own 33 percent. Accordingly, $1,166,615 was recorded as goodwill for the purchase of the assets and is being amortized over five years.

6. PROPERTY, PLANT AND EQUIPMENT

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

	Beginning Balance	Additions	Reductions	Ending Balance
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
CIP	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
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

7. ASSETS HELD BY TRUSTEES

Assets held by trustees consists of assets whose use is limited 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:

Assets	2002	2001
Construction Fund	$ 228,833	$ 223,132
Construction Fund – Pooled *	563,196	563,196
Bond Sinking Fund - 1993A	1,469	2,055
Bond Sinking Fund – 1998B	498	741
Bond Sinking Fund – 1999A	7,588	633,482
Bond Sinking Fund – Pooled *	5,296	13,409
Depreciation Reserve	187,708,456	176,074,986
Total Assets	$188,515,336	$177,511,001

* 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.

8. LONG-TERM DEBT

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

(presented in thousands)

Future Debt Requirements:

Fiscal Year	Principal	Interest	Total
2003	$ 4,575,000	$ 4,434,765	$ 9,009,765
2004	4,780,000	4,229,175	9,009,175
2005	5,000,000	4,014,025	9,014,025
2006	5,240,000	3,767,773	9,007,773
2007	5,505,000	3,508,068	9,013,068
2008 – 2012	33,550,000	12,883,788	46,433,788
2013 – 2017	27,255,000	3,532,317	30,787,317
2018 – 2020	1,525,000	117,100	1,642,100
Total	$87,430,000	$36,487,011	$ 123,917,011

9. NET PATIENT SERVICE REVENUE

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

	2002	2001
Gross patient service revenue:		
Inpatient:		
Routine services	$ 149,344,112	$ 131,946,636
Ancillary services	344,400,282	296,517,012
Outpatient:		
Ancillary services	307,623,076	243,195,814
Clinics	17,693,816	8,836,048
Total gross patient service revenue	819,061,286	680,495,510
Allowances for indigent care and contractual adjustments	(250,689,581)	(164,206,790)
Net patient service revenue	$ 568,371,705	$ 516,288,720

The Medical Center received $40,614,933 and $40,614,933 in fiscal year 2002 and 2001, respectively, from the Department of Medical Assistance Services that were funded by the Commonwealth of Virginia. Of that, $21,195,436 and $21,802,779, respectively, was for disproportionate share for the care provided to indigent patients. These payments are recorded in nonoperating revenue. The remaining $19,419,497 and $18,812,153 in fiscal year 2002 and 2001, respectively, was for indirect medical education. These payments are included in net patient service revenue as an adjustment to allowances for indigent care and contractual adjustments.

Of the $21,195,436 and $21,802,780 in fiscal year 2002 and 2001, the Medical Center acted as a pass-through for the portion of these payments that were related to physician services provided to indigent patients. Those funds, $5,494,594 and $5,494,594, respectively, were transferred to the School of Medicine. These payments are included in purchased services expense.

Amounts written off for indigent care net of the disproportionate share and indirect medical education payments were $25,561,079 and $16,086,242 in 2002 and 2001, respectively.

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, 2002 and 2001 was $7,455,862 and $8,953,127, 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, 2002 and 2001 was $1,577,236 and $1,103,720, 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. COMMITMENTS

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

Year Ending June 30,	Operating Leases
2003	$ 4,178,333
2004	2,183,024
2005	1,659,774
2006	1,070,383
2007	890,501
2008 – 2012	1,072,533
2013 – 2017	823,200
2018 – 2022	823,200
2023 – 2027	823,200
2028 – 2032	823,200
2033 – 2037	823,200
2038 – 2042	823,200
2043 – 2047	823,200
2048 – 2052	329,280
Total	$17,146,228

The total rental expense for operating leases for the years ended June 30, 2002 and 2001, was $7,074,915 and $6,915,628, respectively.

The Medical Center was party to construction contracts and commitments for the years ended June 30, 2002 and 2001, totaling $25,009,533 and $10,243,606, respectively. Of these amounts, $11,357,128 and $8,781,813 were incurred as of June 30, 2002 and 2001, respectively.

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

Year Ending June 30,	Maintenance Contracts
2003	$ 4,167,276
2004	3,526,771
2005	2,736,272
2006	438,996
2007	22,264

12. 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 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 physicians themselves. On August 1, 2000, the Medical Center entered into employee lease agreements with the HSF for limited personnel who remained HSF employees but were performing Medical Center duties.

The Medical Center paid HSF $635,511 and $1,797,188 for costs associated with the operation of the outpatient clinics for years ended June 30, 2002 and 2001, respectively. Implementation of PBCs and reclassing of other services to the miscellaneous HSF agreement section were the primary reasons for decrease.

The Medical Center paid HSF $10,698,291 and $12,167,329 for the provision of supervisory and administrative services for the years ended June 30, 2002 and 2001, respectively.

The Medical Center paid HSF $10,022,536 and $9,776,816 for other services for the years ended June 30, 2002 and 2001, respectively.

The Medical Center paid HSF $1,608,581 and $1,608,193 for rental of space for the years ended June 30, 2002 and 2001, respectively. HSF paid the Medical Center $294,900 and $388,085 for rental of space for the clinics for the years ended June 30, 2002 and 2001, respectively.

HSF paid the Medical Center $4,277,577 and $4,453,490 for clinic facility fees and other services for the years ended June 30, 2002 and 2001, respectively.

13. 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 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, as amended effective August 1, 1999. 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.

The Medical Center is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; non-performance of duty; injuries to employees; and natural disasters. The University participates in risk management insurance plans maintained by the Commonwealth of Virginia and administered by the Department of Treasury, Division of Risk Management. Risk management insurance includes property, general liability, faithful performance of duty bond, automobile, and air and watercraft plans. Medical Center employees are covered for Faithful Performance of Duty in the amount of $500,000 for each loss. The University pays premiums to each of these Departments for its insurance coverage. Information relating to the Commonwealth's 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.

14. 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 Professional's employer contributions fully vest after one year of employment.

Total pension costs under the plans were $8,733,985 and $7,274,256 for the years ended June 30, 2002 and 2001, respectively. Contributions to the Optional Retirement Plans were calculated using base salaries of $107,054,751 and $88,848,544 for the years ended June 30, 2002 and 2001, respectively. The contribution percentage amounted to 8.2 percent and 8.2 percent for both years ended June 30, 2002 and June 30, 2001, respectively.

15. 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 through Cigna to certain retirees.

The state 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. Additionally, some employees receive health care 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.

16. 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.

17. SETTLEMENTS

During the year ended June 30, 2000, the 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 Justice Department, Medical Center, and HSF negotiated a tentative settlement of this issue. The settlement had several provisions, one of which was a payment to the Government of $3,000,000, made in October 2001. Internal controls have been implemented which will prevent a re-occurrence of the problems identified during the investigation.

18. SUBSEQUENT EVENTS

Community Medicine University of Virginia, LLC

The Medical Center contributed an additional $210,000 to Community Medicine in July 2002, bringing its total contributions to $1,460,000.

Max Trax Purchase

On July 1, 2002, the Medical Center acquired the Max and Trax Nightclub property from Word Merchants LTD for $1.2 million. This property, located at 120 11th Street S.W., consists of a 16,060 square foot building and .425 acres of land, strategically located near the Medical Center. Current plans call for the building to be razed and the lot to be used as a support area for construction related to the hospital expansion project.

University of Virginia Imaging, LLC

On March 26, 2002, the Medical Center entered into an agreement with OIA of Virginia, LLC to establish the University of Virginia Imaging, LLC. 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 University of Virginia Medical Center currently operates an outpatient imaging department offering MRI, plain film radiography, fluoroscopy, and ultrasound in office space at the Fontaine Research Park. Although available to all UVA physicians, the site principally services the orthopedic physicians located at Fontaine. The University of Virginia Imaging, LLC will provide services to outpatients from the Medical Center's primary and secondary service areas. The existing operations at Fontaine Research Park will merge with this new outpatient diagnostic center, also located at the Fontaine Research Park in Charlottesville, Virginia. Operations are to commence on October 1, 2002.

The Medical Center, which will own 80 percent of University of Virginia Imaging, LLC, will present its financial activity under the consolidation method.

OIG Indigent Care Investigation

On August 13, 2002, the U.S. Department of Health and Human Services, Office of the Inspector General (OIG) issued a draft report entitled, *Review of Medicaid Disproportionate Share Hospital Payments Made by Virginia's Department of Medical Assistance Services to the University of Virginia Medical Center for Fiscal Years Ending June 30, 1997 and June 30, 1998*. The objectives of the review were to determine if disproportionate share hospital (DSH) payments made to the Medical Center for fiscal years 1997 and 1998 (1) were calculated in accordance with the approved State plan and (2) did not exceed the uncompensated care costs (UCC) as mandated by the Omnibus Budget Reconciliation Act of 1993 (OBRA 1993).

While finding that the Medical Center had calculated DSH in accordance with the State plan, the report alleges that the Medical Center overstated its UCC. As this report is addressed to the Department of Medical Assistance Services, the impact on the Medical Center cannot be determined at this time; however, management has reduced net patient revenue by $6 million; the amount that it believes to be the potential exposure related to this matter.

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UVA 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 tied to the Fed Funds rate. The term of the loan is four years, with annual principal and interest payments. The loan will be used to finance the purchase of a new helicopter, to be delivered in December 2002, from Agusta Aerospace Corporation.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
Charlottesville, Virginia