UNIVERSITY OF VIRGINIA

MEDICAL CENTER

CHARLOTTESVILLE, VIRGINIA

REPORT ON AUDIT

FOR THE YEAR ENDED

JUNE 30, 2004

APA
Auditor of Public Accounts
COMMONWEALTH OF VIRGINIA

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MANAGEMENT'S DISCUSSION AND ANALYSIS
(Unaudited)

The following discussion and analysis provides an overview of the financial position and activities of the University of Virginia's Medical Center (Medical Center) for the year ended June 30, 2004, with comparative information for the year ended June 30, 2003. 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 provides overall leadership and management of the Medical Center. The Medical Center is an integrated network of primary and specialty care services ranging from wellness programs and routine checkups to the most technologically advanced care. The hub of the Medical Center is a 574-bed hospital with a state-designated Level 1 trauma center located on the Charlottesville campus. In addition, primary and specialty care is provided at clinic locations throughout central Virginia communities.

Financial Highlights

	2004	2003
Operating results:		
Operating revenues	$713.4	$664.6
Operating income	$ 42.4	$ 42.3
Nonoperating income (loss) and other	3.5	(2.2)
Increase in net assets	$ 45.9	$ 40.1
Financial position:		
Cash and investments	$430.2	$420.0
Other assets	429.5	363.1
Liabilities	254.6	223.9
Net assets	$605.1	$559.2

(in millions)

The Medical Center's operating results for fiscal year 2004 compare favorably to fiscal year 2003. Increased demand for patient services and higher charge rates resulted in an increase in operating revenues of $48.8 million (7.3 percent). Operating costs also increased $48.8 million (7.8 percent). The increases in both operating revenue and operating expenses resulted in an increase in operating income of approximately $50,000 in fiscal year 2004. Nonoperating income increased $5.7 million in fiscal year 2004, thus yielding an 8.2 percent increase in net assets as shown in the Statement of Net Assets.

Financial Statements

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

Analysis of Public Colleges and Universities; and 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, 2004 and 2003

	2004	2003
Current assets	$218.0	$182.1
Capital assets	295.2	251.2
Other noncurrent assets	346.5	349.8
Total assets	859.7	783.1
Current liabilities	120.1	100.9
Noncurrent liabilities	134.5	123.0
Total liabilities	254.6	223.9
Net assets:		
Invested in capital assets, Net of related debt	170.0	155.7
Restricted for:		
Nonexpendable	53.1	53.1
Expendable	16.9	11.7
Unrestricted	365.1	338.7
Total net assets	$605.1	$559.2

(in millions)

During fiscal year 2004, the Medical Center's financial position improved. Net assets increased by $45.9 million as a result of the Medical Center's positive operating performance. The increase in current assets resulted from a $15.2 million increase in operating cash and a $15 million increase in accounts receivable. Average days revenue in net patient accounts receivable, a common healthcare industry measure of receivable levels, increased slightly to 51.8 days at June 30, 2004 from 49.8 days at June 30, 2003. Days in accounts receivable compare very favorably to the 55.7 days in accounts receivable for academic medical centers similar to the University of Virginia Medical Center. Capital assets increased by $44 million as a result of significant investment in building and equipment. The largest component of this increase was $21.6 million for construction on an expansion to the medical center and $13.7 million for the purchase of a new clinical office building. Shown next are the major capital additions made in the past two fiscal years.

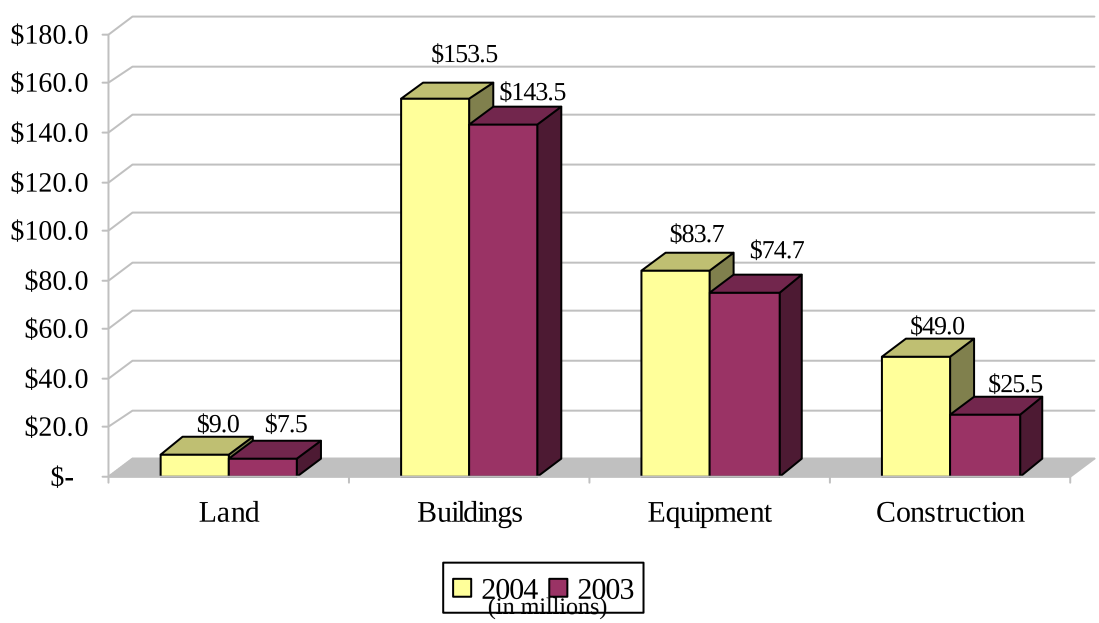
Major Capital Additions

	2004	2003
University hospital expansion	$21.6	$ 4.2
Medical office building at Fontaine Research Park	13.7	-
Radiology and imaging systems	9.9	7.0
Information systems and related hardware	8.9	11.0
Clinic renovations	3.4	4.0
Jefferson Park Avenue building renovation	2.5	8.3
Cafeteria renovations	2.5	-
Other health system renovations	2.2	-
Mobile operating rooms and equipment	1.3	-
Patient monitoring system	1.2	-
Helicopter	-	3.6
Bed replacement	-	2.5
ICU renovation and related bed replacement	-	0.6
Total	$67.2	$41.2

(in millions)

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

Net Capital Assets



(in millions)

The largest component of the increase in current liabilities was a $12.8 million increase in the amount owed to the Medicare and Medicaid programs because of overpayment made by these two programs for outpatient services. Of the net change in long-term liabilities of $11.6 million, $13.0 million is attributable to the debt incurred to fund the purchase of a clinical office building and reduced by payments of other long-term debt.

Statement of Revenues, Expenses and Changes in Net Assets

Changes in total net assets, shown in the Statement of Net Assets, is based on activity as presented in the Statement of Revenues, Expenses, and Changes in Net Assets. The purpose of this statement is to present the Medical Center's operating and nonoperating revenues recognized and 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, 2004 and 2003 is as follows:

Statements of Revenues, Expenses, and Changes in Net Assets
For the Years Ended June 30, 2004 and 2003

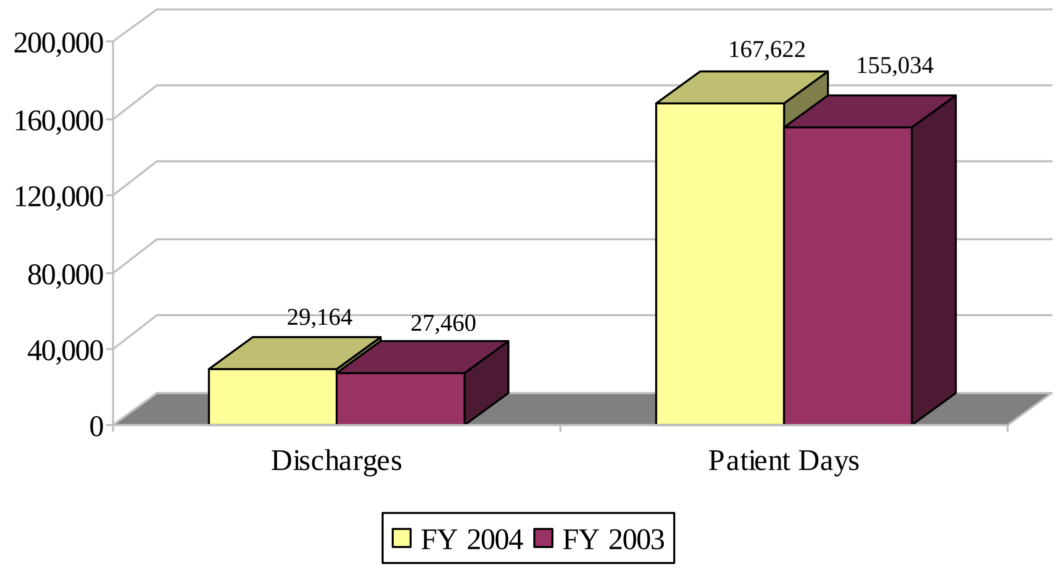
	2004	2003
Net patient service revenue	$686.6	$638.1
University allocations	11.4	12.3
Other	15.4	14.2
Total operating revenue	713.4	664.6
Salaries and benefits	305.7	277.9
Other operating expenses	365.3	344.4
Total operating expenses	671.0	622.3
Operating income	42.4	42.3
Non operating revenue (expense)	3.5	(2.3)
Increase in net assets	45.9	40.0
Net assets - beginning of year	559.2	519.2
Net assets - end of year	$605.1	$559.2

(in millions)

Operating Revenue

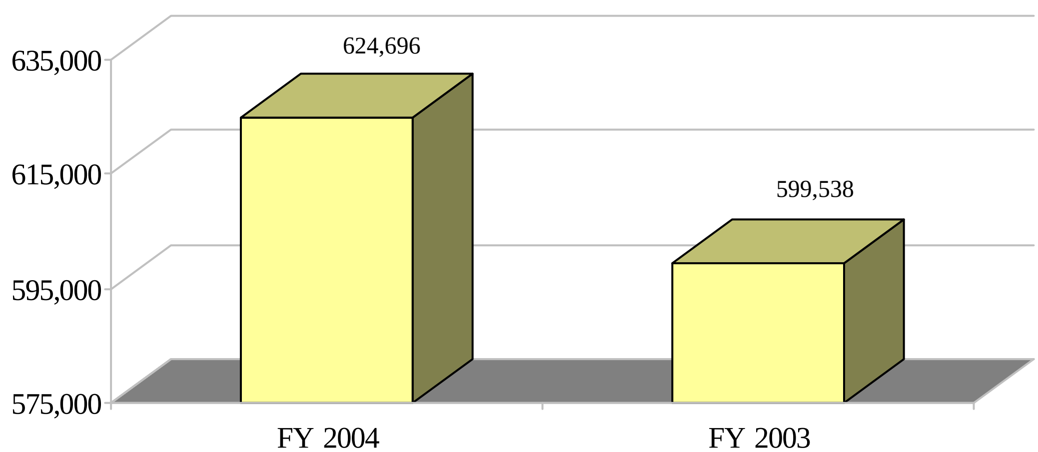
Total operating revenue for fiscal year 2004 was 7.3 percent above the prior year and resulted from both volume and rate increases. As shown by the following graph, both discharges and patients days were up over the prior year.

Inpatient Volume



In addition to the increase in inpatient services there was also substantial growth in outpatient visits over the prior year, including emergency room visits.

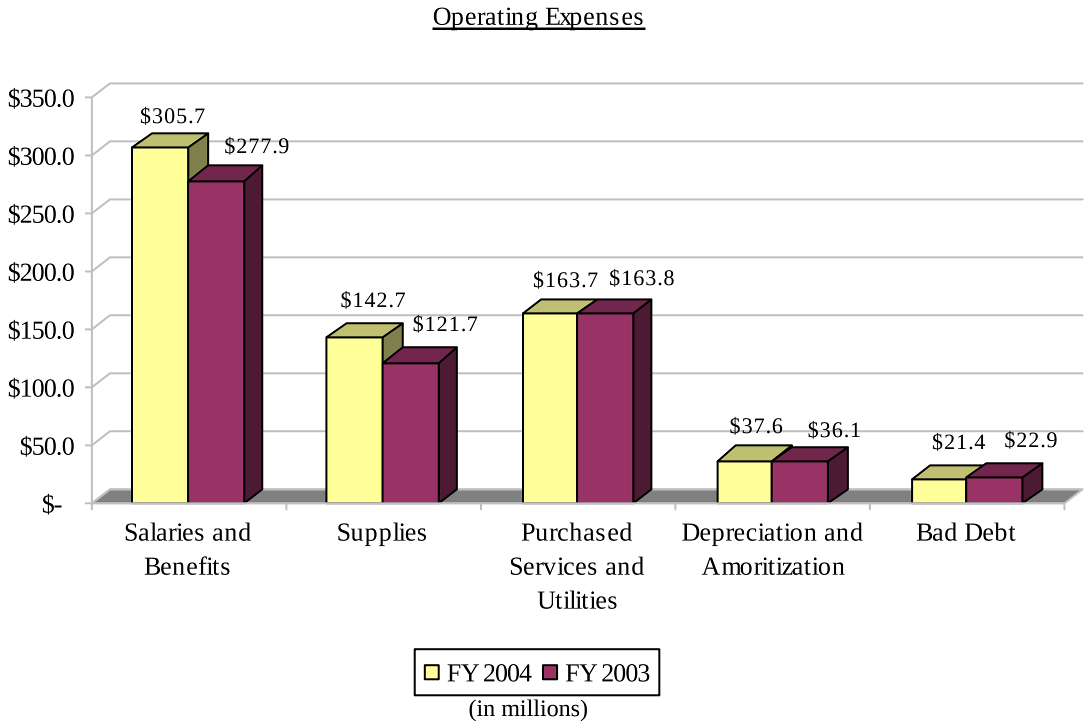
Outpatient Volume



Contributing to the increase in patient revenue were charge rate increases of nine percent in July 2003 and 1.25 percent increase in January 2004.

Operating Expenses

Primarily as a result of growth in patient volumes, operating expenses increased by 7.8 percent over the prior year.



There are two noteworthy issues regarding operating expenses:

- Compensation cost increased by $27.8 million. Contributing to this growth in personnel cost was an increase of 283 full-time equivalent employees (FTE's) from June 30, 2003 to June 30, 2004, and an average salary increase of 3.5 percent. The increase in FTE's was caused primarily by the increase in patient volumes.

- Supply expenses, which consist primarily of pharmaceuticals and medical supplies, increased 17.3 percent because of increased patient volumes and inflation. One of the largest components of increase was cost associated with the increased use of implantable devices for cardiology patients.

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, 2004 and 2003 is as follows:

Cash Flows

	2004	2003
Cash flows from operating activities	$ 79.0	$110.5
Cash flows from noncapital financing activities	(3.9)	4.8
Cash flows from capital and related financing activities	(78.4)	(19.8)
Cash flows from investing activities	22.9	(61.9)
Net increase in cash and cash equivalents	19.6	33.6
Cash and cash equivalents - beginning of year	81.2	47.6
Cash and cash equivalents - end of year	$100.8	$ 81.2

(in millions)

The cash generated from operating activities declined by $31.5 million from fiscal year 2003 to 2004 primarily as a result of the increase in operating costs which were driven by increased volume and by supply costs inflation. Cash flow from noncapital financing activities declined because of a $4.4 million payment to reduce a liability due to the University. Cash outflows for capital and related financing activities increased as a result of increased disbursements for property, plant and equipment. The increase in cash from investing activities is accounted for by the reduction in construction funds that are invested with the State Treasurer. In fiscal year 2003, $38 million was invested in that fund. During fiscal year 2004, $21.6 million was withdrawn to finance construction on the hospital expansion.

Economic Factors affecting the Future

During fiscal year 2003, the Medical Center began a major expansion of its University Hospital facility that will cost $63 million. This project was undertaken to expand and improve facilities for Heart, Perioperative, and Interventional Radiology services. Included in the project are an addition of five operating rooms and complete reconstruction of 19 existing operating rooms, expansion and reconstruction of Heart Center diagnostic, interventional, and clinic facilities, relocation and expansion of Interventional Radiology, and the reorganization and modernization of hospital based clinical laboratory functions. To ensure that the new facilities will have the capability to provide the most advanced care for patients well into the future, management has committed to a plan for making a major investment in the latest technology for the services located in the newly constructed spaces. By investing in this project, management is ensuring that the Medical Center facilities will be adequate to satisfy current and future demand for services.

To enhance the capacity and quality of its outpatient services, the Medical Center is making substantial investments in a number of outpatient service areas. Currently, construction is nearing completion for a new clinical office building located at the Fontaine Research Park. The clinics currently operating in the new clinical office building are the following: Ears, Nose, and Throat, Endocrine, Diabetes Education and Management, and Pituitary. Once construction is complete, the Medical Center expects Digestive Health Center, Adult Neurology, Pediatric Neurology and Epilepsy to move to the third floor of the building. On July 1, 2004 the Medical Center purchased an outpatient surgical facility from the University of Virginia Health Services Foundation which was operated as Virginia Ambulatory Surgical Center Inc. In November 2004, the Medical Center plans to purchase the dialysis facilities owned and operated by Lynchburg Nephrology Dialysis Inc., of Lynchburg Virginia. This acquisition will approximately double current dialysis capability.

A portion of the Medical Center's revenue is derived from the disproportionate share (DSH) payments received from the Department of Medical Assistance Services (DMAS). In May 2003, the Office of the Inspector General (OIG) of the U.S. Department of Health and Human Services released an audit report of the results of its review of this program. While finding that the Medical Center had calculated DSH in accordance with the state plan, the report concludes that the Medical Center overstated its uncompensated care costs as allowed by the Omnibus Budget Reconciliation Act of 1993. If the OIG recommendations are implemented, the U.S. Department of Health and Human Services will recoup funds from DMAS for overstated payments from 1997 to present. The impact of such recoupment, if any, on the Medical Center cannot be determined at this time; however, management has reduced net patient revenue by $21.1 million, the amount it believes to be the potential exposure related to this matter.

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2004
With Comparative Amounts as of June 30, 2003

	2004	2003
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 90,550,428	$ 75,372,699
Patient accounts receivable, Net of estimated uncollectible of $87,438,607 at June 30, 2004	105,727,319	90,712,405
Due from the University	4,178,723	2,181,912
Inventories and prepaid expenses	17,569,896	13,803,826
Notes receivable	24,154	22,059
Total current assets	218,050,520	182,092,901
Noncurrent assets:		
Cash and cash equivalents - restricted (Note 2)	5,998,184	5,606,486
Due from the University - noncurrent	112,297	224,595
Investments in pooled endowment funds (Note 2)	101,604,904	93,955,309
Goodwill (Note 3)	895,064	1,472,492
Investments (Note 2)	6,435,032	6,298,209
Investments in affiliated companies (Note 4)	5,135,530	3,164,699
Land (Note 5)	6,971,931	5,318,010
Construction-in-progress (Note 5)	48,981,126	25,494,996
Depreciable land improvements, buildings, and equipment, less accumulated depreciation of $332,253,645 at June 30, 2004 (Note 5)	239,240,838	220,423,660
Deferred bond discount and issue costs, net of amortization of $103,847 at June 30, 2004	647,579	316,971
Assets whose use is limited (Note 6)		
Cash and cash equivalents (Note 2)	4,248,821	234,801
Investments (Note 2)	221,380,109	238,538,775
Total noncurrent assets	641,651,415	601,049,003
Total assets	859,701,935	783,141,904
LIABILITIES		
Current liabilities:		
Accounts payable and accrued expenses (Note 7)	87,624,731	86,140,604
Due to third-party payors	18,314,066	5,543,457
Current installments of long-term debt (Note 8)	9,542,003	7,452,172
Grants payable - current portion	4,575,662	1,666,667
Bond premium - current amortization	109,847	109,847
Total current liabilities	120,166,309	100,912,747
Long-term liabilities:		
Long-term debt (Note 8)	126,866,758	117,190,045
Grants payable - noncurrent portion	5,000,000	3,333,333
Bond premium, Net of amortization	869,750	979,597
Noncontrolling interest in subsidiary	1,733,206	1,486,722
Total long-term liabilities	134,469,714	122,989,697
Total liabilities	254,636,023	223,902,444

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF NET ASSETS
As of June 30, 2004
With Comparative Amounts as of June 30, 2003

	2004	2003
NET ASSETS		
Invested in capital assets, Net of related deb	170,007,634	155,677,087
Restricted for:		
Nonexpendable	53,099,193	53,099,192
Expendable	16,914,436	11,703,166
Unrestricted	365,044,648	338,760,015
Total net assets	$605,065,911	$559,239,460

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF REVENUES AND EXPENSES AND CHANGES IN NET ASSETS
For the year ended June 30, 2004
With Comparative Amounts as of June 30, 2003

	2004	2003
Operating revenue:		
Net patient service revenue (Note 11)	$686,577,573	$638,105,053
University allocations (Note 12)	11,436,436	12,270,335
Other	15,397,773	14,227,250
Total operating revenue	713,411,782	664,602,638
Operating expenses:		
Salaries and wages	245,944,583	224,086,345
Fringe benefits	59,759,769	53,765,624
Supplies	142,671,941	121,703,466
Purchased services and other expenses	151,450,198	152,307,523
Utilities	12,203,069	11,514,979
Provision for depreciation and amortization	37,655,652	36,063,660
Provision for bad debts	21,376,370	22,859,711
Total operating expenses	671,061,583	622,301,308
Operating income	42,350,199	42,301,330
Nonoperating revenue/(expenses):		
Gifts	536,202	384,739
Investment income	10,009,986	7,910,307
Net increase in the fair value of investments	3,897,117	6,107,297
Net gain from investments in affiliated companies (Note 4	2,264,481	1,362,735
Noncontrolling interest in subsidiary income	(1,078,371)	(254,061)
Interest expense	(4,338,040)	(4,455,058)
Loss on disposal of fixed assets	(1,213,409)	(962,141)
Gain sharing with the School of Medicine (Note 13)	(6,601,714)	(11,981,737)
Other	-	(362,389)
Net nonoperating revenues/(expenses)	3,476,252	(2,250,308)
Increase in net assets	45,826,451	40,051,022
Net assets - beginning of year	559,239,460	519,188,438
Net assets - end of year	$605,065,911	$559,239,460

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

UNIVERSITY OF VIRGINIA MEDICAL CENTER
STATEMENT OF CASH FLOWS
As of June 30, 2004
With Comparative Amounts as of June 30, 2003

	2004	2003
Cash flows from operating activities:		
Receipts from patients and third-parties	$ 670,877,319	$ 634,213,917
Receipts from other revenue	32,065,758	17,618,556
Payments to employees	(302,304,428)	(281,586,243)
Payments to suppliers	(309,441,092)	(248,213,152)
Payment for utilities	(12,203,069)	(11,510,232)
Net cash provided by operating activities	78,994,488	110,522,846
Cash flows from noncapital financing activities:		
Transfer (to) from the University	(4,400,000)	4,400,000
Gifts	536,202	384,739
Net cash provided (used) by noncapital financing activities	(3,863,798)	4,784,739
Cash flows from capital and related financing activities:		
Purchase of capital assets	(81,827,229)	(52,933,876)
Principal paid on capital debt	(7,967,001)	(5,550,000)
Interest paid on capital debt	(4,314,801)	(4,428,167)
Proceeds from issuance of note payable	-	4,379,310
Proceeds from incurring loan from the University	15,265,678	38,039,046
Proceeds from sale of capital assets	382,351	720,269
Net cash used by capital and related financing activities	(78,461,002)	(19,773,418)
Cash flows from investing activities:		
Interest on investments	8,955,852	10,218,833
Purchase of investments	(129,170,182)	(199,289,331)
Proceeds from sale of investments	143,493,681	126,995,860
Other	898,804	-
Transfer to affliliate	(32,509)	(211,200)
Payment from affiliate	-	331,719
Investment in affiliate	(400,000)	-
Owner distribution to afflilate member	(831,887)	-
Net cash from investing activities	22,913,759	(61,954,119)
Net increase in cash and cash equivalents	19,583,447	33,580,048
Cash and cash equivalents - beginning of the year	81,213,986	47,633,938
Cash and cash equivalents - end of the year	$ 100,797,433	$ 81,213,986
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 42,350,199	$ 42,301,330
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	37,655,652	36,063,660
Change in assets and liabilities:		
Accounts receivables	(12,803,303)	23,289,739
Inventories and prepaid expenses	(3,766,070)	(2,144,353)
Accounts payable and accrued expenses	15,558,010	11,012,470
Net cash provided by operating activity	$ 78,994,488	$ 110,522,846

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 (Medical Center) is a division of the University of Virginia (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 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 University 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 College and Universities.*

C. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

D. Subsidiary and Affiliated Companies

The consolidated financial statements include the accounts of controlled subsidiary companies where ownership is greater than 50 percent. Investments in affiliates in which the Medical Center has a substantial interest (approximately 20 to 50 percent) or for which the Medical Center exercises significant influence, but not control, over policy decisions are accounted for by the equity method.

E. Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Net patient service revenue also includes funds from the Commonwealth of Virginia's Department of Medical Assistance Services for disproportionate share and indirect medical education payments and funds from third-party payors for estimated retroactive adjustments under reimbursement agreements. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

F. Indigent Care

The Medical Center accepts all patients regardless of their ability to pay. A patient is classified as indigent by reference to established Commonwealth policies. The criteria for identifying indigent patients are based on asset and income guidelines that are updated annually in accordance with the federal poverty income guidelines as provided by the federal Office of Management and Budget. Because the Medical Center does not pursue collection of amounts determined to qualify as indigent care, they are not reported as revenue.

G. Receivables From Third Parties and Contractual Adjustments

A significant portion of the Medical Center's services is rendered to patients covered by Medicare, Medicaid, or other third-party payors. The Medical Center entered into contractual agreements with these third parties to accept payment for services in amounts less than scheduled charges.

Certain annual settlements of amounts due for patient services covered by third parties are determined through cost reports that are subject to audit and retroactive adjustment by the third parties. Provisions for possible adjustments of cost reports have been estimated and reflected in the accompanying financial statements. Since the determination of cost reimbursement settlements of amounts earned in prior years has been based on reasonable estimation, the difference in any year between the originally estimated amount and the final determination is reported in the year of determination.

H. Cash, Cash Equivalents, and Investments

Cash and cash equivalents include cash and all highly liquid investments with maturity of three months or less when purchased.

Donated investments are reported at the fair market value at the date of receipt. The major portion of the investments of the Medical Center's endowment funds is pooled under the University of Virginia Growth and Income Fund, the general endowment pool for the

University. Annually, endowment earnings on the consolidated endowment pool are distributed to the participating funds based on the participating share of each fund in the pool.

Investments are carried at fair value as determined by quoted market prices. Unrealized appreciation or depreciation of investments is included in the current period net earnings. All investment income, including changes in the fair value of investments (unrealized gains and losses), is reported as 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. Accrued Leave

The amount of leave earned, but not taken by salaried employees is recorded as a liability on the Statement of Net Assets. The amount reflects, as of June 30, 2004, all earned leave not taken and the amount payable under the catastrophic leave pay-out policy upon termination, which is the lesser of 25 percent of sick leave not taken or $5,000 per employee with five or more years of service. The liability is based on the probability that an employee with less than five years of service will eventually become vested and have a right to receive payment for sick leave benefits. The applicable share of employer-related taxes payable on the eventual termination payments is also included

M. Reclassifications

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

2. CREDIT RISK UNDERLYING CASH, CASH EQUIVALENTS AND INVESTMENTS

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 is in accounts of the University of Virginia or with the Treasurer of Virginia.

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 $4,248,821 at June 30, 2004 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 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, as of June 30, 2004, 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 with securities held by the counterparty's trust department or agent in the Medical Center's name. None of the Medical Center's investments are categorized as category 2 investments.

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. None of the Medical Center's investments are categorized as category 3 investments.

Description	Category 1	Non-Categorized	Total
U.S. Government and U.S. Government			
Agency Securities:			
Guaranteed Investment Contracts	$ -	$ 12,202,097	$ 12,202,097
FNMA	58,687,152	-	58,687,152
FHLMC	59,026,562	-	59,026,562
FHLB	94,211,466	-	94,211,466
FFCB	3,112,500	-	3,112,500
Bank of New York - STIF	-	575,364	575,364
University of Virginia			
Growth and Income Fund	-	101,604,904	101,604,904
Total	$215,037,680	$114,382,365	$329,420,045

3. GOODWILL

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

In July 1994, the Medical Center and the University of Virginia Health Services Foundation (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. In December 2000, the Medical Center acquired from HSF its interest in the hyperbaric oxygen unit. Of the acquisition price, $1,166,615 was recorded as goodwill for the purchase of the assets and is being amortized over five years.

4. AFFILIATED COMPANIES

University of Virginia Imaging, LLC

On March 26, 2002, the Medical Center entered into an agreement with Outpatient Imaging Affiliates of Virginia, LLC (OIA) to establish University of Virginia Imaging, LLC (UVI). The limited liability corporation was formed to operate an outpatient diagnostic imaging center to help respond to the need for radiology services in the Charlottesville area.

The Medical Center currently operates an outpatient imaging department offering MRI, plain film radiography, fluoroscopy, and ultrasound in office space at the Fontaine Research Park. Although available to all Medical Center physicians, the site principally serves orthopedic physicians located at the Fontaine Office Park. UVI also provides services to outpatients from the Medical Center's primary and secondary service areas.

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

Community Medicine, LLC

On November 14, 2000, the University 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. This model gives physicians an organizational structure that allows them the opportunity to practice independently in a virtual private practice environment with all the risks and gains associated with an independent model. As an LLC, which is a wholly owned subsidiary of the University, Community Medicine is considered a disregarded entity for tax purposes and its financial activity is accounted for under the consolidation method.

Community Medicine commenced operations on July 1, 2001 and as of July 1, 2003, the Medical Center's investment totaled $1,560,000. During fiscal year 2004, the Medical Center made an additional investment of $250,000, bringing the total investment to $1,810,000.

Central Virginia Health Network, Inc.

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

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

University of Virginia / HEALTHSOUTH, LLC

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

Valiance Health, LLC

In November 1997, the Medical Center became a participant with Rockingham Memorial Hospital and Augusta Health Care, Inc., in Valiance Health, LLC (Valiance), a joint venture integrating and coordinating the delivery of healthcare services in central and western Virginia. The Medical Center contributed $100,000 in initial capital, which entitles it to a pro-rata distribution of any profits and losses of Valiance. In October 2003, the Medical Center contributed an additional $400,000 in capital to Valiance, bringing the Medical Center's total investment to $500,000.

University HealthSystem Consortium (UHC)

In December 1986, the Medical Center became a member of the University HealthSystem Consortium (UHC). Founded in 1984, UHC is an alliance of the clinical enterprises of academic health centers. While focusing on the clinical mission, UHC is mindful of and supports the research and education missions. The mission of the University HealthSystem Consortium is to advance knowledge, foster collaboration, and promote change to help members compete in their respective healthcare markets. In keeping with this mission, UHC helps members pool resources, create economies of scale, improve clinical and operating efficiencies, and influence the direction and delivery of healthcare. Accordingly, UHC is organized and operated on a cooperative basis for the benefit of its member health systems as patrons.

UHC is a not-for-profit organization. It is incorporated as a nonstock corporation and designated as a nonexempt cooperative which is taxable under Subchapter T, section 1382-1388, of the Internal Revenue Code. As such, UHC's bylaws provide for distributions of patronage dividends to its patrons. This allocation is based on the value of business done with or for each patron by UHC. The Medical Center records the portion of the patronage dividends that were held by UHC as patronage equity.

As of June 30, 2004

	Common Stock and Equity Contributions	Share of accumulated income (loss)	Net Investment
UVA Imaging, LLC	$ 687,019	$ 5,329,729	$ 6,016,748
Community Medicine, LLC	1,810,000	(1,973,973)	(163,973)
Central Virginia Health Network, Inc.	232,500	(31,279)	201,221
HealthSouth, LLC	2,230,000	1,528,951	3,758,951
Valiance Health, LLC	500,000	61,874	561,874
University HealthSystem Consortium	-	613,484	613,484

HealthCare Partners, Inc.

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

5. PROPERTY, PLANT, AND EQUIPMENT

A summary of the property, plant and equipment accounts and the related accumulated depreciation as of June 30, 2004, is presented as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Property, plant, and equipment:				
Land	$ 5,318,010	$ 1,653,921	$ -	$ 6,971,931
Land improvements	8,148,282	156,464	-	8,304,746
Buildings	322,828,222	23,831,395	25,515	346,634,102
Equipment - Fixed	16,554,632	622,016	19,548	17,157,100
Equipment - Moveable	192,337,645	32,641,671	25,580,781	199,398,535
Construction-in-progress	25,494,996	41,191,837	17,705,707	48,981,126
Total property, plant, and equipment	570,681,787	100,097,304	43,331,551	627,447,540
Accumulated depreciation:				
Land improvements	5,981,935	283,686	-	6,265,621
Buildings	179,293,424	13,806,797	4,133	193,096,088
Equipment - Fixed	14,237,931	730,324	13,728	14,954,527
Equipment - Moveable	119,931,831	22,091,508	24,085,930	117,937,409
Total accumulated depreciation	319,445,121	36,912,315	24,103,791	332,253,645
Property, plant, and equipment, Net	$251,236,666	$ 63,184,989	$19,227,760	$295,193,895

6. ASSETS HELD BY TRUSTEES

Assets held by trustees consist of assets whose use is limited under indenture agreements. The Series 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; and

F. to the credit of any other fund or account created pursuant to an applicable Series Resolution.

Funds held by the Treasurer and restricted by bond agreements consist of the following as of June 30, 2004:

Assets:	
Construction Fund	$ 233,354
Construction Fund – Pooled *	575,315
Bond Sinking Fund – 1998B	226
Bond Sinking Fund – 1999A	2,883
Bond Sinking Fund – Pooled *	49
Depreciation Reserve	212,615,006
Bond Sinking Fund-2003B (Construction Fund)	12,202,097
Total assets	$225,628,930

* 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, 2004, the components of accounts payable and accrued expenses consist of the following:

Vendor accounts payable	$24,005,859
Other accounts payable	6,660,857
Accrued payroll	7,820,776
Accrued leave	20,794,476
Other accrued expenses	20,048,956
Due to the University	8,293,807
Total accounts payable and accrued expenses	$87,624,731

8. LONG-TERM DEBT (in thousands)

Description	Interest Rate %	Maturity	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Bonds payable:							
Series 1998B	3.5 - 5.00	2018	$ 5,540	$ -	$ 270	$ 5,270	$ 280
Series 1999A	4.5 - 5.25	2013	40,860	-	4,040	36,820	4,225
Series 1999A Pooled	4.5 - 6.00	2019	4,085	-	155	3,930	165
Series 2003A Pooled	4.7 - 6.00	2015	32,370	-	315	32,055	330
Series 2003B Pooled	4.7 - 6.00	2023	38,356	-	1,191	37,165	1,248
UVa pooled debt	4.7 - 6.00	2024	-	17,672	110	17,562	663
Total bonds payable			121,211	17,672	6,081	132,802	6,911
Notes payable:							
Helicopter	1.8 - 2.4	2006	2,951	-	1,000	1,951	975
UVA Imaging	5.8	2004	480	1,656	480	1,656	1,656
Total notes payable			3,431	1,656	1,480	3,607	2,631
Total long-term debt			$124,642	$19,328	$7,561	$136,409	$9,542

Future debt requirements:

Fiscal Year	Principal	Interest	Total
2005	$ 9,542,003	$ 6,472,039	$ 16,014,042
2006	8,215,942	6,135,217	14,351,159
2007	7,600,986	5,781,330	13,382,316
2008	7,965,546	5,409,346	13,374,892
2009	9,059,834	5,019,812	14,079,646
2010 - 2014	50,162,438	18,212,543	68,374,981
2015 - 2019	27,372,062	7,075,417	34,447,479
2020 - 2024	16,489,950	2,087,704	18,577,654
Total	$136,408,761	$56,193,408	$192,602,169

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 floors in that building. This project was undertaken to expand and improve facilities for Heart, Perioperative, and Interventional Radiology services. Included in the project are an addition of five operating rooms and the complete reconstruction of 19 existing operating rooms; expansion and reconstruction of Heart Center diagnostic, interventional, and clinic facilities; relocation and expansion of Interventional Radiology; and the reorganization and modernization of hospital based clinical laboratory functions. The addition was completed in July 2004 and the remainder of the renovations should be completed 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. Amounts previously borrowed in fiscal year 2003 will be repaid over a 20-year period that began June 1, 2004. The funds required to complete the remainder of the project will be borrowed from the University in the fall of 2005.

The second project increases and expands the facilities available for Cancer Services. Included in this project is the expansion and relocation of breast care services, construction of a new Infusion Center in the west wing of the Hospital West Complex, and the expansion of examination rooms and other support space. This renovation is scheduled for completion in June 2005. The cost of this project is expected to be $5 million and was borrowed from the University's Pooled Bond Program.

A third project was initiated during fiscal year 2004. The Clinical Office Building at Fontaine Research Park was purchased in April 2004. The Medical Center borrowed $17.6 million from the University's Pooled Bond Program to buy the building and complete its construction. The purpose of this building is to expand the outpatient clinic services for the Medical Center.

10. UNIVERSITY WORKING CAPITAL LOAN

In July 2002, the Medical Center secured a variable interest working capital loan of $3.9 million from the University with a four-year term and annual principal and interest payments to purchase a helicopter from Agusta Aerospace Corporation.

11. NET PATIENT SERVICE REVENUE

The Medical Center's patient service revenue is as follows for the year ended June 30, 2004:

Gross patient service revenue:	
Inpatient:	
Routine services	$ 172,109,590
Ancillary services	521,716,053
Outpatient:	
Ancillary services	419,983,818
Clinics	27,467,921
Total gross patient service revenue	1,141,277,382
Allowances for indigent care and contractual adjustments	(454,699,809)
Net patient service revenue	$ 686,577,573

The Medical Center received $65,198,888 in fiscal year 2004 from the Commonwealth of Virginia's Department of Medical Assistance Services. Of this amount, $34,171,616 was the payment of disproportionate share relating to the care provided to indigent patients. The remaining $31,027,272 was a payment to reimburse the Medical Center for indirect medical education. These payments are included in net patient service revenue as an adjustment to allowances for indigent care and contractual adjustments.

Of the payment received for disproportionate share relating to the care provided to indigent patients, $5,494,594 was transferred to physician researchers for related physician services and is included in the purchased services expense.

The amounts written off for indigent care, net of the disproportionate share and indirect medical education payments, were $14,186,762 for the year ended June 30, 2004.

12. UNIVERSITY ALLOCATIONS

The School of Medicine faculty assists the Medical Center in its mission of providing healthcare and medical education. A survey is conducted annually to determine the value of this effort. An allocation is made on the 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 year ended June 30, 2004 was $9,331,470.

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, Expenses, and Changes in Net Assets to reflect the difference between the direct charge to the Medical Center and the actual cost of these services. The amount of this allocation for the year ended June 30, 2004 was $2,104,966.

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

13. GAIN SHARING WITH THE SCHOOL OF MEDICINE

Beginning with fiscal year 2003, the Medical Center and the School of Medicine entered into a Memorandum of Understanding for gain sharing. The amount of gain sharing with the School of Medicine is a tiered arrangement based on the Medical Center's income in excess of minimum requirements established by the Board of Visitors. For fiscal year ending June 30, 2004, the scheduled payment to the School of Medicine was $6,601,714.

14. COMMITMENTS

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

Year Ending June 30,	Operating Leases
2005	$ 3,927,316
2006	2,089,620
2007	1,703,923
2008	787,100
2009	272,997
2010 - 2014	906,311
2015 - 2019	823,200
2020 - 2024	823,200
2025 - 2029	823,200
2030 - 2034	823,200
2035 - 2039	823,200
2040 - 2044	823,200
2045 - 2049	823,200
Total	$15,449,667

The total rental expense for operating leases for the year ended June 30, 2004, was $8,939,701.

The Medical Center was party to construction contracts and commitments for the year ended June 30, 2004 totaling $88,266,400 of which $55,895,406 was incurred as of June 30, 2004.

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

Year Ending June 30,	Maintenance Contracts
2005	$ 6,542,478
2006	2,484,854
2007	1,641,654
2008	1,006,593
2009	165,647
Total	$11,841,226

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.

On August 1, 2000, management of 63 outpatient clinics operated by HSF since July 1, 1994, 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 physicians' costs. 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 $12,960,265 for supervisory and administrative services; $15,216,596 for other services; and $1,634,370 for rental of space for the year ended June 30, 2004.

HSF paid the Medical Center $8,189,952 for clinic facility fees and other services and $44,015 for the rental of space for clinics for the year ended June 30, 2004.

16. 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 Division of Risk Management. Participation in this program provides the Medical Center with medical malpractice insurance on an occurrence basis with no aggregate limitation and with such limits of coverage equal to the statutory malpractice recovery limits as specified in Section 8.01-581.15 of the Code of Virginia. In the opinion of management, such coverage is adequate to provide for the ultimate liability, if any, which might result from the settlement of claims currently asserted against the Medical Center, as well as the potential liability for medical incidents of which the Medical Center has knowledge, but for which claims have not yet been asserted against the Medical Center. Accordingly, no provision is included in the financial statements for such potential liabilities.

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

The University sponsors a self-funded, comprehensive program of 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's 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.

17. 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 $8,893,812 for the year ended June 30, 2004. Contributions to the Optional Retirement Plans were calculated using base salaries of $120,949,089 for the year ended June 30, 2004. The contribution percentage amounted to eight percent for the year ended June 30, 2004.

18. POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Commonwealth participates in the VRS-administered statewide group life insurance program that provides post-employment life insurance benefits to eligible retired and terminated employees. The Medical Center also provides retiree life insurance to certain retirees.

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

19. OIG DISPROPORTIONATE SHARE PAYMENT REVIEW

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 October 12, 2004. If CMS implements OIG's recommendations, it will recoup funds from the Commonwealth of Virginia's Department of Medical Assistance Services for funds paid from 1997 to present. The impact of such recoupment, if any, on the Medical Center cannot be determined at this time; however, management had reduced net patient revenue by $17.6 million; the amount that it believed to be the potential exposure related to this matter as of June 30, 2003.

During fiscal year 2004, 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 $3.5 million to patient revenue for fiscal year 2004.

20. SUBSEQUENT EVENT

Virginia Ambulatory Surgery Center

The Medical Center purchased the Virginia Ambulatory Surgery Center on July 1, 2004 for $10.3 million.

Commonwealth of Virginia

Walter J. Kucharski, Auditor

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

October 20, 2004

The Honorable Mark R. Warner
Governor of Virginia

The Honorable Lacey E. Putney
Chairman, Joint Legislative Audit
and Review Commission

Board of Visitors
University of Virginia

INDEPENDENT AUDITOR'S REPORT ON FINANCIAL STATEMENTS

We have audited the accompanying basic financial statements of the University of Virginia Medical Center, a division of the University of Virginia, as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Virginia Medical Center as of June 30, 2004, and the changes in its net assets and its cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis presented on pages one through eight is not a required part of the basic financial statements, but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplemental information. However, we did not audit the information and express no opinion on it.

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

Our report on internal control over financial reporting and on compliance and other matters, including our 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, 2004.

AUDITOR OF PUBLIC ACCOUNTS

JHS/kva
kva:43