NOTES TO FINANCIAL STATEMENTS

As of June 30, 2002

Summary of Significant Accounting Policies

Organization and Purpose

The University of Virginia is an agency of the Commonwealth of Virginia and is governed by the University's Board of Visitors. 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 general-purpose financial statements of the Commonwealth. The University consists of three divisions. The Academic Division and University of Virginia's College at Wise generate and disseminate knowledge in the humanities, arts, scientific, and professional disciplines through instruction, research, and public service. The Medical Center Division provides routine and ancillary patient services through a full-service hospital and clinics.

Reporting Entity

The financial statements and the accompanying notes of the University include all funds and organizations for which the Board of Visitors has oversight responsibility. There are currently nineteen affiliated foundations created and operated in support of the interests of the University. Affiliated foundations are not-for-profit corporations controlled by separate boards of directors and are not included in the basic financial statements of the University.

Condensed financial statements for the following foundations, whose boards include officers of the University, are disclosed in Note 6:

University of Virginia Health Services Foundation, an educational, scientific, and charitable organization established to assist the University in providing hospital and medical care services, medical education programs, medical research, and programs of public charity at the University.

University of Virginia Foundation and Subsidiaries, which includes the University of Virginia Real Estate Foundation, established to promote, support, and aid the University in matters pertaining to real estate, as well as to use and administer gifts, grants, and bequests for the benefit of the University.

Reporting Basis

The accompanying financial statements are presented in accordance with generally accepted accounting principles applicable to governmental colleges and universities as promulgated by the Governmental Accounting Standards Board (GASB) and, for pronouncements issued prior to November 30, 1989, the Financial Accounting Standards Board (FASB). It is the University's policy not to follow FASB standards issued after that date.

In accordance with GASB Statement No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities,* as amended by GASB Statement Nos. 37 and 38, the University has elected to report as an entity engaged in business-type activities. Entities engaged in business-type activities are financed in whole or in part by fees charged to external parties for goods and services.

GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

Invested in capital assets, net of related debt: Capital assets, net of accumulated depreciation and long-term debt attributable to the acquisition, construction, or improvement of these assets.

Restricted: Net assets, either expendable or non-expendable, subject to donor-imposed restrictions stipulating how the resources may be used. Expendable net assets are those that can be satisfied by actions of the University. Non-expendable net assets, consisting of endowments, must be maintained in perpetuity.

Unrestricted: Net assets are those net assets that are not properly classified either as capital assets, net of related debt or restricted net assets. Unrestricted net assets may be designated for specific purposes by management or may otherwise be limited by contractual agreements with outside parties.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University's policy is first to apply the expense toward restricted resources, and then toward unrestricted. Restricted funds remain classified as such until restrictions have been satisfied.

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when incurred and measurable, regardless of when the related cash flows take place. Non-exchange transactions, in which the University receives value without directly giving equal value in exchange, include grants, state appropriations, and private donations. On an accrual basis, revenues from these transactions are recognized in the fiscal year in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection. The University does not capitalize works of art or historical treasures that are held for exhibition, education, research, or public service. These collections are neither disposed of for financial gain nor encumbered in any means. Accordingly, such collections are not recognized or capitalized for financial statement purposes.

Cash and Cash Equivalents

In addition to cash on deposit with private bank accounts, petty cash, and undeposited receipts, this classification includes cash on deposit with fiscal agents and short-term investments with the State Treasurer's Cash and Investment Pool (a governmental external investment pool). All other short-term investments are reported as investments.

Inventories

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

Investments

Investments in corporate stocks and marketable bonds are recorded at market value. Certain less marketable investments, principally real estate and private equity investments, are generally carried at estimated values as determined by management. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. Mortgages held for investment by the endowment fund are recorded at book value representing principal amounts due.

Fixed Assets and Depreciation

Fixed assets are stated at cost at date of acquisition or fair market value at date of donation in the case of gifts. In the case of buildings, the University capitalizes fixed assets that have a value or cost in excess of $50,000 at the date of acquisition and an expected useful life of one or more years. Both the Academic and Medical Center Divisions capitalize moveable equipment at a value or cost of $2,000 or greater and an expected useful life of one or more years. Maintenance or renovation expenditures of $50,000 or more are capitalized only to the extent that such expenditures prolong the life of the asset or otherwise enhance its capacity to render service.

Depreciation of buildings, of improvements other than buildings, and of infrastructure is provided on a straight-line basis over estimated useful lives ranging from ten to fifty years.

Depreciation of equipment and capitalized software is provided on a straight-line basis over estimated useful lives ranging from three to twenty years.

Depreciation of library books is calculated on a straight-line basis over ten years.

Fixed assets financed with debt proceeds are reported when expenditures are incurred. Projects that have not been completed as of the date of the statement of net assets are classified as Construction in Process. Construction period interest cost in excess of earnings associated with the debt proceeds is capitalized as a component of the fixed asset.

Fixed assets, such as roads, parking lots, sidewalks, and other non-building structures and improvements are capitalized as infrastructure and depreciated accordingly.

In accordance with AICPA Statement of Position 98-1, the University capitalizes computer software developed or obtained for internal use. Capitalization begins at the application development stage, which consists of the design, coding, installation, and testing of the software and interfaces.

Deferred Revenue

Deferred revenue represents revenues collected but not earned as of June 30. This is primarily composed of revenue for student tuition accrued in advance of the semester.

Deposits Held in Custody for Others

The University allows its affiliated foundations to participate in the University's endowment, such that the University invests funds on behalf of the foundations. As such, these funds are liabilities of the University to the foundations, and are reported on the Statement of Net Assets in deposits held in custody for others. At June 30, 2002, these liabilities amounted to $92.7 million of the $133.7 million total of deposits held in custody for others.

Accrued Compensated Absences

The amount of leave earned but not taken by non-faculty salaried employees is recorded as a liability on the statement of net assets. The amount reflects, as of June 30, 2002, all unused vacation leave, sabbatical leave, and the amount payable upon termination under the Commonwealth of Virginia's sick leave payout policy. The applicable share of employer-related taxes payable on the eventual termination payments is also included.

Revenue Recognition

Revenues, as reflected on the Statement of Revenues, Expenses, and Changes in Net Assets, include all exchange and non-exchange transactions earned and in which all eligibility requirements (resource provider conditions) have been satisfied, if measurable and probable of collection.

Student tuition and student auxiliary fees are presented net of scholarships and fellowships applied to student accounts.

Certain auxiliary operations provide goods and services to internal customers. These auxiliary operations include activities such as central stores, the print shop, and other auxiliaries with interdepartmental activities. The net effect of these internal transactions has been eliminated in the Statement of Revenues, Expenses, and Changes in Net Assets to avoid inflating revenues and expenses.

Medical Center Sales and Services

A significant portion of the Medical Center services is rendered to patients covered by Medicare, Medicaid, or Trigon Blue Cross Blue Shield of Virginia. The Medical Center has entered into contractual agreements with these third parties to accept payment for services in amounts less than scheduled charges. In accordance with these agreements, the difference between the contractual payments due and the Medical Center scheduled billing rates results in contractual adjustments. Contractual adjustments are recorded as deductions from Medical Center revenues in the period in which the related services are rendered.

Certain annual settlements of amounts due for Medical Center 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 basic financial statements. Since the determination of settlements 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 as an adjustment to Medical Center revenues.

Operating Activities

The University's policy for defining operating activities is based primarily on an activity's character as an exchange event. Exchange events generally involve payments or receipts for providing or receiving goods and services. With the exception of interest expense, all expense transactions are classified as operating, while some revenue transactions (i.e., state appropriations, gifts, and investment income) are classified as non-operating in accordance with GASB Statement No. 35.

Restatement of Beginning Net Assets

As a result of the implementation of GASB Statement No. 35, the following adjustments have been made to reflect the cumulative effect of this accounting change (in millions):

Fund balances reported at June 30, 2001	$3,975
Adjustments:	
Accumulated depreciation on capital assets at June 30, 2001, not previously recorded	(868)
Infrastructure assets not previously recorded	109
Federal loan program contributions previously recorded as fund balance in loan funds, now recorded as liabilities	(13)
Restatement of sponsored programs receivables	(12)
Restatement of library assets	(3)
Other	1
Beginning net assets at July 1, 2001, as adjusted	$3,189

NOTE 1: ENDOWMENT

The major portion of the University's endowment is maintained in a single investment pool named the University Pooled Endowment Fund. The University has adopted and met an investment objective of top-quartile performance, measured by a peer group of thirty-five other endowment funds, over rolling three-year periods. The annual return for the Pooled Endowment Fund was -0.1 percent. This percentage has been computed using realized and unrealized gains and losses and investment income. The rate of inflation plus the average level of spending from endowment income was 5.7 percent.

Virginia statutes prescribe that the Board of Visitors may prudently appropriate for expenditure, for the uses and purposes for which an endowment fund is established, the net realized and unrealized appreciation in the fair value of the assets of an endowment fund over the historic dollar value of the aggregate fund. The University's policy is to retain the endowment realized and unrealized appreciation with the endowment after the spending rule distributions. Exceptions to the retention policy require executive management approval within prescribed annual limits and Board of Visitors approval for amounts in excess of prescribed annual limits. At June 30, 2002, the Pooled Endowment Fund includes restricted non-expendable net assets of $282 million, restricted expendable net assets of $902 million, unrestricted net assets of $502 million, and life income funds of $33 million.

The Pooled Endowment Fund is pooled using a market value basis, with each individual fund subscribing to or disposing of units (permanent shares) on the basis of the market value per unit at the beginning of the calendar month within which the transaction takes place. A summary of endowment and similar funds at market value follows:

ENDOWMENT AND SIMILAR FUNDS AS OF JUNE 30, 2002 (in thousands)

	POOLED ENDOWMENT ASSETS*	SEPARATELY INVESTED ASSETS	TOTAL
Mutual and Money Market Funds	$ 548,410	$ 3,308	$ 551,718
U.S. Government Securities	243,460	496	243,956
Corporate and Municipal Bonds	5,030	451	5,481
Corporate Notes	-	-	-
Common and Preferred Stock	411,489	4,848	416,337
Advances to Foundations (Note 3d)	8,612	30,723	39,335
Real Estate and Other Tangible Property	-	330	330
Mortgages	3,297	-	3,297
Private Placement Investments	540,612	-	540,612
Total Assets	$1,760,910	$ 40,156	$1,801,066
*Includes $32.5 million of trust assets			
Investment Income	$ 22,122	$ 6,934	$ 29,056
Realized Net Gain	51,506	1,967	53,473
Unrealized Net Gain/(Loss)	(82,970)	(347)	(83,317)

POOLED ENDOWMENT FUNDS

Number of Permanent Shares	707,928
Number of Participating Shares	697,340
Market Value Per Share	$ 2,445.67
Earnings Per Share	$ 33.77
Distribution Per Share—Class A	$ 95.36
Distribution Per Share—Class B	$ 134.33

NOTE 2: INVESTMENT RISK

The relative risk associated with the University's financial assets is detailed below.

Cash: All cash of the University is maintained in accounts that are collateralized in accordance with the Virginia Security for Public Deposits Act, Section 2.1-359, et seq., of the Code of Virginia.

Investments: The investment policy goals, objectives, and guidelines are established by the Finance Committee of the Board. The University's cash equivalents and investments are categorized by levels of credit risk as described below:

Category 1—Insured or registered securities or securities held by the University of Virginia or its agent in the University's name.

Category 2—Uninsured and unregistered, with securities held by the counterparty's trust department or agent in the University of Virginia's name. None of the University's investments are classified as category 2 investments.

Category 3—Uninsured and unregistered, with securities held by the counterparty, or by its trust department or agent but not in the University of Virginia's name. None of the University's investments are classified as category 3 investments.

Security Lending: Under authorization of the board of the University of Virginia Investment Management Company, the University of Virginia, through its agent, Deutsche Bank AG New York, lends U.S. government and equity securities to various broker-dealers on a temporary basis for collateral. All security loan agreements are collateralized by readily marketable and liquid securities, loans, or other obligations secured by a lien or similar interest on an asset, thereof totaling at least 102 percent of the market value of the loaned securities. The University of Virginia retains the right to pledge or sell these securities held as collateral at its discretion. All security loans can be terminated on demand by either the University or the borrower, and the average term of the security loans as well as collateral held is less than one week. No securities were on loan as of June 30, 2002. Collateral held for securities lending transactions represents the University's allocated share of cash collateral received and reinvested and securities received for the State Treasury's securities lending program. Information related to the credit risk of these investments and the State Treasury's securities lending program is available on a statewide level in the Commonwealth of Virginia's *Comprehensive Annual Financial Report (CAFR)*.

CATEGORIZATION OF INVESTMENT RISK FOR ASSETS HELD AS OF JUNE 30, 2002 (in thousands)

	CATEGORY 1	NON-CATEGORIZED	FAIR VALUE	COST
U.S. Government Securities	$ 581,037	$ -	$ 581,037	$ 572,532
Corporate Bonds	33,256	-	33,256	32,987
Corporate Notes	-	-	-	-
Common and Preferred Stocks	416,337	-	416,337	318,140
Municipal Securities	225	-	225	25
Mutual and Money Market Funds	-	589,222	589,222	555,870
Real Estate and Other Tangible Property	-	39,665	39,665	39,665
Mortgages	-	32,818	32,818	33,091
Private Placement Investments	-	540,611	540,611	602,860
Other Intangible Property	-	2,374	2,374	2,374
Total	**$ 1,030,855**	**$ 1,204,690**	**$ 2,235,545**	**$ 2,157,544**

Derivative Financial Instruments: Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indexes. A derivative instrument generally has one or more underlying investment, requires little or no initial net investment, and requires or permits a net settlement. In addition, some traditional securities can have derivative-like characteristics. Examples of common derivatives include, but are not limited to, futures, forwards, options, or swap contracts. Although the contract or notional amount of the derivative is not recorded on the financial statements, all derivative instruments are recognized as either an asset or a liability depending on the rights or obligations of the contract measured at fair value.

The University has indirect exposure to various derivative financial instruments that are used in the normal course of business to enhance returns on investments and manage risk exposure to changes in value due to fluctuations in market conditions. These investments may involve, to varying degrees, elements of credit and market risk in excess of amounts recognized on the financial statements. Credit risk is the possibility that losses may occur from the failure of a counterparty to perform according to the terms of the agreement. The University minimizes the credit (or repayment) risk in its direct derivative instrument by entering into transactions with high-quality counterparties and a legally enforceable master netting agreement. The "net" mark to market exposure represents the netting of the positive and negative exposures with the same counterparty. Market risk arises due to adverse changes in market price, interest rate, and foreign exchange rate fluctuations that may result in a decrease in the market value of a financial investment and/or increases in its funding cost. The University manages market risk by establishing and monitoring limits as to the type and degree of risk that may be undertaken.

Summary of the University's outstanding derivatives at June 30, 2002 (in thousands):

	NOTIONAL	FAIR VALUE
Indirect Derivative Exposure		
Fair Value Hedge	$ 10,159	$ 9,130
Cash Flow Hedge	51,487	(2,185)
Foreign Currency Hedge	24,646	(3,668)
Not Used for Hedging	2,522	1,932
Total Indirect Derivative Exposure	$ 88,814	$ 5,209

NOTE 3: STATEMENT OF NET ASSET DETAILS

a. Accounts receivable

Accounts receivable include the following (in thousands):

Patient Care	$ 153,533
Estimated Amounts Due from Third-Party Payors	13,815
Grants and Contracts	20,712
Pledges	16,455
Related Foundation	5,824
Other	22,716
Less Allowance for Doubtful Accounts	(77,116)
Total	$ 155,939

b. Notes receivable

Notes receivable are reported net of the allowance for uncollectible student loans, which amounted to $2.8 million.

c. Pledges

The University recorded $33.9 million in pledges receivable, of which $3.8 million relates to plant construction. These are reported net of the allowance for uncollectible pledges, which amounts to $3.4 million.

d. Advances to foundations

The University advances funds to affiliated foundations to enable the foundations to acquire real property in areas near the University and to enhance foundation operations. Foundations are expected to make principal repayments as funds become available. The Board of Visitors has authorized up to $48 million for advances to the University of Virginia Real Estate Foundation. At June 30, 2002, advances to foundations totaled $39.3 million.

e. Capital assets

Capital assets activity for the year ended June 30, 2002, is summarized as follows (in thousands):

INVESTMENT IN PLANT-CAPITAL ASSETS (in thousands)

	Beginning Balance	Additions	Retirements	Ending Balance
Land	$ 31,934	$ 2,642	$ -	$ 34,576
Improvements Other Than Buildings	132,603	19,856	-	152,459
Infrastructure	145,390	4,332	-	149,722
Buildings	965,957	115,852	1,972	1,079,837
Equipment	484,699	58,010	40,145	502,564
Software Capitalization	14,366	11,053	-	25,419
Library Books	76,654	4,993	-	81,647
Construction in Process	135,374	116,670	140,557	111,487
	1,986,977	333,408	182,674	2,137,711
Less Accumulated Depreciation	(867,984)	(98,415)	(26,760)	(939,639)
Total	**$ 1,118,993**	**$ 234,993**	**$ 155,914**	**$ 1,198,072**

Construction in Process additions, in the above table, represent expenditures for new projects net of the amount of capital assets placed in service.

f. 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, $1.8 million was recorded as goodwill and is being amortized over five years.

On May 12, 2000, the Medical Center acquired from Augusta Health Care, Inc., the Kidney Dialysis 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.

NOTE 4: NON-CURRENT LIABILITIES

NON-CURRENT LIABILITY ACTIVITY AS OF JUNE 30, 2002, IS SUMMARIZED AS FOLLOWS (in thousands):

DESCRIPTION	INTEREST RATES	MATURITY	BEGINNING BALANCE	ADDITIONS	REDUCTIONS	ENDING BALANCE	CURRENT PORTION
Long-Term Debt:							
Revenue bonds							
Medical Center series 1993A	4.1% to 5.2%	2015	$ 32,960	$ -	$ 290	$ 32,670	$ 300
Medical Center series 1998B	3.5% to 5.0%	2018	6,050	-	250	5,800	260
Medical Center series 1999A	4.5% to 5.25%	2011	48,435	-	3,705	44,730	3,870
University of Virginia series 1995A	variable	2014	4,120	-	480	3,640	221
University of Virginia series 1998A	4.0% to 5.125%	2018–2024	70,050	-	1,950	68,100	2,025
University of Virginia series 1993B	4.25% to 5.375%	2013–2020	49,925	-	2,075	47,850	2,180
U.Va.'s College at Wise 1973B	5.6% to 5.875%	2011	260	-	20	240	20
Commonwealth of Virginia bonds	3.8% to 9.25%	2003–2021	50,988	4,670	4,619	51,039	4,693
Notes payable to VCBA	3.75% to 5.0%	2018	4,145	-	165	3,980	170
Notes payable to VCBA	4.5% to 6.0%	2020	31,635	-	1,015	30,620	1,065
Notes payable to VCBA	4.25% to 5.75%	2021	47,480	-	1,090	46,390	1,495
Higher Education Equipment Trust Fund leases payable	3.85% to 5.0%	2003	5,371	-	3,941	1,430	1,430
Other	various	2007	128	253	84	297	90
Total Long-Term Debt			**351,547**	**4,923**	**19,684**	**336,786**	**17,819**
Other non-current liabilities:							
Accrual for compensated absences			37,388	42,376	37,432	42,332	35,332
Perkins loan program			11,773	649	-	12,422	-
Bond premium			1,309	-	110	1,199	-
Other			19	-	1	18	-
Total Other Non-Current Liablities			**50,489**	**43,025**	**37,543**	**55,971**	**35,332**
Total Non-Current Liabilities			**$ 402,036**	**$ 47,948**	**$57,227**	**$392,757**	**$ 53,151**

Maturities and interest on notes and bonds payable for the next five years and in subsequent five-year periods are as follows:

	PRINCIPAL	INTEREST
2003	$ 17,819	$ 17,486
2004	16,257	16,629
2005	16,950	15,862
2006	17,399	15,030
2007	17,844	14,125
2008–2012	109,123	53,607
2013–2017	83,730	26,944
2018–2022	49,800	7,805
2023–2027	7,864	595
	$336,786	$168,083

NOTE 5: 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 would pay any cash dividends in the foreseeable future.

The Medical Center contributed a total of $15 million to Blue Ridge Health Alliance during the period ended June 30, 1998. Also, on April 6, 1998, the Medical Center loaned $3.8 million to the Corporation due on July 6, 1998, and bearing interest at 6.25 percent. In July 1998, the Board of Directors of the Corporation issued a capital call to HSF and the Medical Center for $5 million. 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 million, by converting the $3.8 million loan to capital and contributing $1.2 million 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. 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. Effective September 15, 1999, Blue Ridge Health Alliance revised its Shareholders Agreement to provide additional capital and to effect 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 million to the Corporation due on May 30, 2004, bearing an interest rate of 6.19 percent.

On August 31, 2001, Coventry Health Care, Inc., acquired Blue Ridge Health Alliance, Inc., and its HMO subsidiary, QualChoice of Virginia Health Plan, Inc. The transaction was accounted for as a purchase in which Coventry paid $12.5 million. The Medical Center recognized a loss on the sale of $4.8 million. As part of the definitive agreement, Coventry will enter into a five-year provider contract with Blue Ridge's current majority owners, the University of Virginia Medical Center and the University of Virginia Health Services Foundation.

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, VA 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 on the following page. Complete financial statements can be obtained from the managing member: HEALTHSOUTH Corporation, 7700 East Parham Road, Richmond, VA 23294.

Valiance Health, 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 healthcare services in Central and Western Virginia. The Medical Center contributed $100,000 in initial capital, which entitles it to a pro-rata distribution of any profits and losses of Valiance.

University HealthSystem Consortium (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 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 non-stock corporation and designated as a non-exempt cooperative that is taxable under Subchapter T (Section 1382–1388) of the Internal Revenue Code. As such, UHC's bylaws provide for distributions of patronage dividends to its patrons. This allocation is based on the value of business done with or for each patron by UHC. For fiscal year 2001, the Medical Center began recording the portion of the patronage dividends that were held by UHC as patronage equity.

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.

AFFILIATED COMPANIES AS OF JUNE 30, 2002 (in thousands)

	CENTRAL VIRGINIA HEALTH NETWORK	HEALTH SOUTH	VALIANCE	UHC
Common Stock and Equity Contributions	$ 232	$ 2,230	$ 100	$ -
Share of Income/(Loss)	(23)	(1,437)	48	489
Net Investment	$ 209	$ 793	$ 148	$ 489

Community Medicine, L.L.C.

The University believed it was imperative to offer health care 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 Community Medicine University of Virginia, L.L.C. (Community Medicine). Community Medicine was established as a limited liability corporation (L.L.C.) under the laws of the Commonwealth of Virginia to house physician practices. As an L.L.C., which is a wholly owned subsidiary of the University, Community Medicine is considered a disregarded entity for tax purposes. Because Community Medicine is a wholly owned subsidiary, its financial activity will be accounted for under the consolidation method.

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

NOTE 6: AFFILIATED FOUNDATIONS

The financial statements do not include the assets, liabilities, or net assets of the University of Virginia Health Services Foundation, the University of Virginia Foundation and Subsidiaries, nor any other foundation. These foundations are separately incorporated entities and the related financial statements are examined by other auditors. The University received gifts from these and other foundations amounting to approximately $34.8 million. The condensed summary below is based solely upon the reports of other auditors.

As a result of the issuance of GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, the University is conducting a review of all affiliated foundations to determine whether they qualify as component units. If it is determined that any entities qualify as component units, they will be reported with the University's financial statement for the year ending June 30, 2004.

AFFILIATED FOUNDATIONS CONDENSED BALANCE SHEET (in thousands)

	Health Services Foundation June 30, 2001	University of Virginia Foundation June 30, 2001
Assets		
Current assets due from the University	$ 5,115	$ -
Other current assets	53,464	4,254
Other assets	58,862	180,530
Total assets	**$ 117,441**	**$ 184,784**
Liabilities and net assets		
Current liabilities due to the University	$ 7,295	$ 8,212
Other current liabilities	30,517	7,523
Long-term debt due to the University	-	36,875
Other long-term debts	50,672	66,102
Obligations to the University under trust agreements	-	11,833
Net assets	28,957	54,239
Total liabilities and net assets	**$ 117,441**	**$ 184,784**

AFFILIATED FOUNDATIONS CONDENSED STATEMENT OF REVENUES AND EXPENDITURES (in thousands)

	Health Services Foundation June 30, 2001	University of Virginia Foundation June 30, 2001
Revenues		
Professional and technical services provided by the University	$ 19,900	$ 28,608
Rental income from the University	-	2,025
Other	143,823	-
Total revenues	**$ 163,723**	**$ 30,633**
Expenditures		
Office space and administrative services provided by the University	$ 790	$ -
Clinical operations provided by the University	1	-
Gifts to the University	7,546	-
Other	161,085	29,921
Total expenditures	**$ 169,422**	**$ 29,921**

NOTE 7: APPROPRIATIONS

The University receives state appropriations from the General Fund of the Commonwealth. The Appropriation Act specifies that such unexpended appropriations shall revert, as specifically provided by the General Assembly, at the end of the biennium. For years ending at the middle of a biennium, unexpended appropriations that have not been approved for reappropriation in the next year by the governor become part of the General Fund of the Commonwealth and are, therefore, no longer available to the University for disbursements.

The following is a summary of state appropriations received by the University and the University's College at Wise, including all supplemental appropriations and reversions (in thousands):

Original Legislative Appropriation per Chapter 814	$177,087
Adjustments:	
Match Funds for Deferred Compensation Program	589
Retirees' Health Insurance Credit	(670)
VRS Rate Reduction	(3,674)
Miscellaneous E&G	5,457
Budget Cuts	(7,184)
Reappropriation FY 2001	4,639
Miscellaneous Appropriation	(67)
Adjusted State Appropriation	$176,177

NOTE 9: RETIREMENT PLANS

Employees of the University 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 University, has overall responsibility for contributions to this plan.

Substantially all full-time faculty, certain administrative staff, and Health Care Professionals participate in Faculty Optional Retirement Plans. These are fixed-contribution plans in which the retirement benefits received are based upon the employer and employee contributions (all of which are paid by the University), and the interest and dividends. Individual contracts issued under the plans for full-time faculty and certain administrative staff provide for full and immediate vesting of both the University's and the participant's contributions. Health Care Professionals' employer contributions fully vest after one year of employment. Total pension costs under the plans were approximately $33.3 million. Contributions to the Optional Retirement Plans were calculated using base salaries of $337.6 million. The contribution percentage amounted to 9.9 percent.

NOTE 8: NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

OPERATING EXPENSES BY FUNCTIONAL CLASSIFICATION AS OF JUNE 30, 2002 (in thousands):

	COMPENSATION	SUPPLIES AND SERVICES	SCHOLARSHIPS	UTILITIES	DEPRECIATION	OTHER	TOTAL
Instruction	$ 213,120	$ 7,975	$ 3,781	$ 1,820	$ -	$ -	$ 226,696
Research	114,194	83,767	8,186	899	-	-	207,046
Public Service	8,645	7,689	262	186	-	-	16,782
Academic Support	62,714	29,168	551	548	-	-	92,981
Student Services	14,309	5,540	115	247	-	-	20,211
Institutional Support	52,729	3,188	24	2,300	-	-	58,241
Operation of Plant	4,718	14,287	7	37,301	-	-	56,313
Student Aid	531	2,584	21,114	-	-	-	24,229
Auxiliary	33,885	45,124	105	1,534	-	-	80,648
Depreciation	-	-	-	-	64,266	-	64,266
Patient Services	285,617	236,286	-	11,019	34,362	22,522	589,806
Other	6,497	(9,107)	11	373	-	-	(2,226)
TOTAL	**$ 796,959**	**$ 426,501**	**$ 34,156**	**$ 56,227**	**$ 98,628**	**$ 22,522**	**$ 1,434,993**

NOTE 10: POST-EMPLOYMENT BENEFITS OTHER THAN PENSION BENEFITS

The Commonwealth of Virginia participates in the VRS-administered statewide group life insurance program, which provides post-employment life insurance benefits to eligible retired and terminated employees. The Commonwealth also provides health care credits against the monthly health insurance premiums of its retirees who have at least fifteen years of state service and participate in the state health plan. Information related to these plans is available at the statewide level in the Commonwealth's *Comprehensive Annual Financial Report (CAFR).*

NOTE 11: SELF-INSURANCE

All University employees have an option to participate in the University's self-funded, comprehensive medical care benefits program. The cost of medical care is paid out of employee and employer contributions and is held in a separate bank account with a June 30, 2002, market value balance of $20 million. The estimated liability for outstanding claims was $7.7 million. The University has contracted with Southern Health Services, Inc., a third-party administrator, to provide administrative services for this healthcare benefits program.

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

The risk management insurance plans are administered by the 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 (includes medical malpractice), aviation and watercraft coverage, and automobile liability. 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 and vehicle physical damage insurance coverage.

NOTE 12: FUNDS HELD IN TRUST BY OTHERS

Assets of funds held by trustees for the benefit of the University are not reflected in the accompanying statement of net assets. The University has irrevocable rights to all or a portion of the income of these funds, but the assets of the funds are not under the management of the University. The market value of the funds held by trustees for the benefit of the University as of June 30, 2002, was $113 million, and income received totaled $6.5 million.

NOTE 13: COMMITMENTS

As of June 30, 2002, the University was a party to construction contracts totaling approximately $219 million, of which $142 million had been incurred. The University's commitments for equipment, leases, and services are as follows (in thousands):

YEAR ENDING JUNE 30		LEASE OBLIGATION
2003	$	6,987
2004		4,994
2005		2,113
2006		1,446
2007		1,207
2008–2012		1,358
2013–2017		1,083
2018–2022		875
2023–2027		823
2028–2032		823
2033–2037		823
2038–2042		823
2043–2047		823
2048–2052		332
	$	24,510

The total rental expense for all property and equipment was approximately $17.6 million.

NOTE 14: SUBSEQUENT EVENTS

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.