

THE VIRGINIA COMMONWEALTH UNIVERSITY  
HEALTH SYSTEM AUTHORITY

Financial Statements and Other Financial Information

Years ended June 30, 2005 and 2004 with Report of Independent Auditors

# The Virginia Commonwealth University Health System Authority

## Financial Statements and Other Financial Information

Years ended June 30, 2005 and 2004

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# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis

Years ended June 30, 2005 and 2004

This discussion and analysis is intended to be an introduction to the financial statements and notes that follow this section and should be read in conjunction with the financial statements and footnotes.

### **FINANCIAL STATEMENT OVERVIEW**

The financial statements herein are comprised of the balance sheets, the statements of revenues, expenses, and changes in net assets, the statements of cash flows, and the accompanying notes for the proprietary (enterprise) fund of the Virginia Commonwealth University Health System Authority (the Authority).

In addition, the Authority is the trustee, or fiduciary, for its employees' pension plans. The Authority's pension plan activities are reported in separate balance sheets and statements of changes in net assets on pages 7 and 8. We exclude these activities from the Authority's other financial statements because the Authority cannot use these assets to finance its operations. The Authority is responsible for ensuring that the assets reported in these funds are used for their intended purposes.

The Authority is an enterprise fund of Virginia Commonwealth University, a component unit of the Commonwealth of Virginia. Virginia Commonwealth University incorporates the Authority's statements for the years ended June 30, 2005 and 2004 into their financial statements for the years ended June 30, 2005 and 2004. The Authority's financial statements include University Health Services, Inc. (UHS) and MCV Associated Physicians (MCVP). Virginia Premier Health Plan, Inc. (Virginia Premier) is a wholly owned subsidiary of UHS.

*June 30, 2005 compared to June 30, 2004*

### **FINANCIAL HIGHLIGHTS**

- The Authority's net assets increased by \$60.5 million, or 14.6%, over the prior years, as a result of this year's activity.
- Patient service revenues comprise the majority of the Authority revenues. Net patient revenues increased \$88.1 million, or 13.7% from prior year due to an increase in volume of selected hospital services and improvement of revenue processes. In addition, the premium revenue of Virginia Premier increased by \$46.0 million or 20.0% from prior year. This was due to Virginia Premier's continued growth in enrollment. As a result of this expansion, Virginia Premier has 12,420 new members, an increase of 17% over prior year.

# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis (continued)

- During the year, the Authority's expenses increased by \$113.3 million from prior year. Approximately \$50.0 million of this increase is the result of increased personnel costs associated with service expansion and market conditions. Virginia Premier's continued network expansion resulted in a \$20.8 million increase in medical claims expense.
- The Authority showed income from operations for the year ended June 30, 2005 of \$64.2 million, a significant improvement over operating income of \$43.8 million for the year ended June 30, 2004. This improvement is primarily due to revenue processes enhancements as well as Virginia Premier's expansion.
- The major capital expenditures for the Authority in 2005 are related to the beginning construction of a critical care hospital, purchase of radiology and cardiology equipment, and infrastructure investments such as elevator and fire alarm system replacements, new air conditioning and heating systems and generator replacements.
- The Authority made \$15.6 million of unrestricted gifts to MCV Foundation in support of the academic and research mission of the University.
- The Authority provides service to the majority of indigent patients in the region and approximately 30% of the Commonwealth's indigent health care. The Authority operates Virginia Coordinated Care, a program that provides health care to the indigent population utilizing cost saving managed care principles.

### **THE AUTHORITY**

As indicated in Table 1 below, the Authority's total assets exceeded total liabilities by \$474.1 million. Of these net assets, over 46.0% (\$218.3 million) are related to capital assets, \$18.8 million are restricted funds, and the remaining \$237.0 million are unrestricted funds which can be used for on-going operations of the Authority.

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

**Table 1**  
**Virginia Commonwealth University Health System Authority**  
**Condensed Net Assets**  
*(In thousands)*

	<b>June 30</b>	
	<b>2005</b>	<b>2004</b>
Current and other assets	<b>\$ 481,066</b>	\$ 407,122
Capital assets	<b>299,372</b>	276,728
Total assets	<b>780,438</b>	683,850
Long-term liabilities outstanding	<b>112,067</b>	102,090
Other liabilities	<b>194,317</b>	168,171
Total liabilities	<b>306,384</b>	270,261
Net assets:		
Invested in capital assets, net of related debt	<b>218,288</b>	199,650
Restricted:		
Expendable	<b>599</b>	601
Nonexpendable	<b>18,150</b>	17,307
Unrestricted	<b>237,017</b>	196,031
Total net assets	<b>\$ 474,054</b>	\$ 413,589

The total net assets have increased \$60.5 million.

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

**Table 2**  
**Virginia Commonwealth University Health System Authority**  
**Condensed Statement of Revenues, Expenses and Changes in Net Assets**  
*(In thousands)*

	Year ended June 30	
	2005	2004
<b>Revenues:</b>		
Net patient service revenue	\$ 729,973	\$ 641,856
Premiums earned	276,216	230,192
Other revenues	26,611	27,156
Total revenues	<b>1,032,800</b>	899,204
<b>Expenses:</b>		
Salaries, wages and employee benefits	446,477	396,770
Depreciation and amortization expense	33,780	28,310
Other operating expense	488,380	430,300
Total expenses	<b>968,637</b>	855,380
Operating income	64,163	43,824
Net non-operating expenses	(6,524)	(6,975)
Income before transfers and beneficial interest in trusts	57,639	36,849
Transfers from VCU and change in beneficial interest in trusts	2,826	1,764
Increase in net assets	60,465	38,613
Beginning net assets	413,589	374,976
Ending net assets	<b>\$ 474,054</b>	\$ 413,589

# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis (continued)

As a result of this year's activities, the Authority's total revenues increased by 14.9% (\$133.6 million) over the prior year. This significant increase in revenues resulted from the expansion of Virginia Premier, changes in pricing for the Hospital and MCVP, and the mix of hospital and physician services. The total costs of all services showed a growth of slightly less, 13.2% (\$113.3 million). Personnel costs are the largest single cost of the system, comprising 46.0% of the total costs. An increase in personnel related costs of \$49.7 million, or 12.5%, from prior year reflects both the salary adjustments required to meet market demands and the required staff levels to meet both quality and volume initiatives. The growth of non-personnel expenses resulted from an increase of \$20.8 million in medical claims expenses from Virginia Premier's network expansion.

### CAPITAL ASSET AND DEBT ADMINISTRATION

#### Capital Assets

At June 30, 2005, the Authority's capital assets had increased by \$22.6 million, or 8.2% over last year.

**Table 3**  
**Virginia Commonwealth University Health System Authority**  
**Capital Assets**  
*(In thousands)*

	June 30	
	2005	2004
Land and improvements	\$ 1,716	\$ 2,683
Buildings and fixed equipment	310,903	295,260
Moveable equipment	270,725	253,750
Construction in progress	24,935	4,462
	<b>608,279</b>	556,155
Accumulated depreciation	<b>(308,907)</b>	(279,427)
Total	<b>\$ 299,372</b>	\$ 276,728

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

**Table 4**  
**Virginia Commonwealth University Health System Authority**  
**Schedule of Additions and Retirements**  
*(In thousands)*

	<b>Year ended June 30</b>	
	<b>2005</b>	<b>2004</b>
Capital assets, beginning of year	<b>\$ 276,728</b>	\$ 248,643
Additions, net of transfers	<b>58,825</b>	56,446
Disposals, net of transfers	<b>(2,648)</b>	(1,371)
Depreciation	<b>(33,533)</b>	(26,990)
Capital assets, end of year	<b>\$ 299,372</b>	<b>\$ 276,728</b>



The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

Major projects capitalized include (in millions):

	<b>Year ended June 30</b>	
	<b>2005</b>	<b>2004</b>
Construction in progress of Critical Care Hospital	\$ 9.8	\$ –
Performance Improvement Program for building heating and cooling/utility systems for the hospital and clinic buildings	4.8	5.3
Emergency generator replacement	4.7	–
Information system projects in process	4.3	–
Final year spending on multi-year replacement of clinical information system	–	14.6
Radiology and cardiology equipment	8.2	–
Major renovation projects	13.6	22.5
Major purchase and replacement of equipment	13.4	14.0
	<b>\$ 58.8</b>	<b>\$ 56.4</b>

# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis (continued)

The Authority has a five-year capital plan which includes a budget of \$75.0 million of expenditures in fiscal year 2006. A major initiative that began in the spring of 2005 is the construction of a critical care hospital that will house intensive care units, operating suites, and other services.

### Debt

At year-end, the Authority had \$81.1 million in bonds, construction debt and capital leases as shown in Table 5. The first principal payment for the General Revenue Bond Series 1998 was paid on July 1, 2004. The Authority's Bond Series 1998 is insured by MBIA and carries the highest rating by national rating agencies, Moody's and Standard & Poor's. More detailed information about the Authority's long-term liabilities is presented in Note 4 to the financial statements.

**Table 5**  
**Virginia Commonwealth University Health System Authority**  
**Debt**  
*(In thousands)*

	<b>June 30</b>	
	<b>2005</b>	<b>2004</b>
General Revenue Bonds Series 1998	<b>\$ 63,085</b>	\$ 65,080
Construction debt	<b>2,317</b>	2,649
Capital leases	<b>15,681</b>	9,349
Total	<b>\$ 81,083</b>	\$ 77,078

*June 30, 2004 compared to June 30, 2003*

### FINANCIAL HIGHLIGHTS

- The Authority's net assets increased by \$38.6 million, or 10%, over the prior years, as a result of this year's activity.

# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis (continued)

- Patient service revenues comprise the majority of the Authority revenues. Net patient revenues increased \$33.5 million, or 6% from prior year due to an increase in volume of selected hospital services and improvement of revenue processes. In addition, the premium revenue of Virginia Premier increased by \$33.0 million or 17% from prior year. This was due to Virginia Premier's continued growth in enrollment. As a result of this expansion, Virginia Premier has 12,420 new members, an increase of 17% over prior year.
- During the year, the Authority's expenses increased by \$56.2 million from prior year. The majority of this increase is the result of the medical claims expense increase of \$24.9 million which resulted from Virginia Premier's network expansion.
- The Authority showed income from operations for the year ended June 30, 2004 of \$43.8 million, a significant improvement over income of \$26.9 million for the year ended June 30, 2003. This improvement is primarily due to both improvement of revenue processes as well as Virginia Premier's expansion.
- The major capital expenditures for the Authority in 2004 related to the clinical information and joint registration systems, the creation of a Heart Center, and investments in energy performance equipment and systems.
- The Authority made an \$11 million unrestricted gift to MCV Foundation in support of the academic and research mission of the University.
- The Authority successfully implemented a replacement clinical information system and installed a common registration system for the Hospital and MCVP. There was no adverse effect on either ongoing operations or the revenue stream during the conversion process.
- The Authority provides service to the majority of indigent patients in the region and approximately 30% of the Commonwealth's indigent health care. The Authority operates Virginia Coordinated Care, a program that provides health care to the indigent population utilizing cost saving managed care principles.
- The Authority continues to restructure many of its support and administrative services to keep expenditures below the inflationary level, continue a high quality level of care, produce a modest margin and support its capital expansion program.

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

**THE AUTHORITY**

As indicated in Table 1 below, the Authority's total assets exceeded total liabilities by \$413.6 million. Of these net assets, over 48% (\$199.7 million) are related to capital assets, \$17.9 million are restricted funds, and the remaining \$196.0 million are unrestricted funds which can be used for on-going operations of the Authority.

**Table 1**  
**Virginia Commonwealth University Health System Authority**  
**Condensed Net Assets**  
*(In thousands)*

	<b>June 30</b>	
	<b>2004</b>	<b>2003</b>
Current and other assets	<b>\$ 407,122</b>	\$ 323,621
Capital assets	<b>276,728</b>	248,643
Total assets	<b>683,850</b>	572,264
Long-term liabilities outstanding	<b>102,090</b>	101,411
Other liabilities	<b>168,171</b>	95,877
Total liabilities	<b>270,261</b>	197,288
Net assets:		
Invested in capital assets, net of related debt	<b>199,650</b>	173,313
Restricted:		
Expendable	<b>601</b>	602
Nonexpendable	<b>17,307</b>	15,660
Unrestricted	<b>196,031</b>	185,401
Total net assets	<b>\$ 413,589</b>	\$ 374,976

The total net assets have increased \$38.6 million.

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

**Table 2**  
**Virginia Commonwealth University Health System Authority**  
**Condensed Statement of Revenues, Expenses and Changes in Net Assets**  
*(In thousands)*

	Year ended June 30	
	2004	2003
<b>Revenues:</b>		
Net patient service revenue	\$ 641,856	\$ 608,317
Premiums earned	230,192	197,237
Other revenues	27,156	20,552
Total revenues	<u>899,204</u>	<u>826,106</u>
<b>Expenses:</b>		
Salaries, wages and employee benefits	396,770	363,817
Depreciation and amortization expense	28,310	24,953
Other operating expense	430,300	410,437
Total expenses	<u>855,380</u>	<u>799,207</u>
Operating income	43,824	26,899
Net non-operating expenses	<u>(6,975)</u>	<u>(7,724)</u>
Income before transfers and beneficial interest in trusts	36,849	19,175
Transfers from VCU and change in beneficial interest in trusts	1,764	(769)
Increase in net assets	38,613	18,406
Beginning net assets	<u>374,976</u>	<u>356,570</u>
Ending net assets	<u>\$ 413,589</u>	<u>\$ 374,976</u>

# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis (continued)

The Authority's total revenues increased by 9% (\$73.1 million). This significant increase in revenues resulted from the expansion of Virginia Premier, changes in pricing for the Hospital and MCVP, and the mix of hospital services. The total costs of all services showed a growth of slightly less, 7% (\$56.1 million). Personnel costs are the largest single cost of the system, comprising 46.4% of the total costs. An increase in personnel related costs of \$33.0 million, or 9%, from prior year reflects both the salary adjustments required to meet market demands and the continued expansion of Virginia Premier. Non-personnel expenses remained relatively stable, with the exception of medical claims expenses, which increased with the expansion of Virginia Premier's network.

### CAPITAL ASSET AND DEBT ADMINISTRATION

#### Capital Assets

At June 30, 2004, the Authority's capital assets had increased by \$28.1 million, or 11% over last year.

**Table 3**  
**Virginia Commonwealth University Health System Authority**  
**Capital Assets**  
*(In thousands)*

	June 30	
	2004	2003
Land and improvements	\$ 2,683	\$ 2,683
Buildings and fixed equipment	295,260	265,751
Moveable equipment	253,750	196,653
Construction in progress	4,462	35,993
	<u>556,155</u>	<u>501,080</u>
Accumulated depreciation	(279,427)	(252,437)
Total	<u>\$ 276,728</u>	<u>\$ 248,643</u>

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

**Table 4**  
**Virginia Commonwealth University Health System Authority**  
**Schedule of Additions and Retirements**  
*(In thousands)*

	Year ended June 30	
	2004	2003
Capital assets, beginning of year	\$ 248,643	\$ 247,338
Additions, net of transfers	56,446	40,363
Disposals	(1,371)	(16,365)
Depreciation, net of disposals	(26,990)	(22,693)
Capital assets, end of year	<u>\$ 276,728</u>	<u>\$ 248,643</u>

The Virginia Commonwealth University Health System Authority

Management's Discussion and Analysis (continued)

Major projects capitalized include (in millions):

	<b>Year ended June 30</b>	
	<b>2004</b>	<b>2003</b>
Final year spending on the multi-year project replacing the Authority's clinical information system	<b>\$ 14.6</b>	\$ 21.2
Performance Improvement Program for building heating and cooling /utility systems for the hospital buildings	<b>5.3</b>	–
Creation of the Heart Center	<b>6.5</b>	–
Replacement of the Pediatric Intensive Care Unit	<b>2.0</b>	–
Replacement of the nurse call system	<b>2.8</b>	–
Renovation of the Children's Pavilion	<b>1.2</b>	–
Major renovation projects	<b>10.0</b>	2.9
Major purchase and replacement of equipment	<b>14.0</b>	16.3
	<b>\$ 56.4</b>	\$ 40.4



# The Virginia Commonwealth University Health System Authority

## Management's Discussion and Analysis (continued)

The Authority has a three-year capital plan which includes a budget of \$63.2 million of expenditures in fiscal year 2005. A major initiative that will begin in the coming year is the construction of a bed tower that will house replacement intensive care units and other services.

### Debt

At year-end, the Authority had \$77.1 million in bonds, construction debt and capital leases as shown in Table 5. The final principal payment for the Revenue Refunding Bond Series 1994D was paid on July 1, 2003 and the first principal payment for the General Revenue Bonds Series 1998 is due on July 1, 2004. The Authority's Bond Series 1998 is insured by MBIA. More detailed information about the Health System's long-term liabilities is presented in Note 4 to the financial statements.

**Table 5**  
**Virginia Commonwealth University Health System Authority**  
**Debt**  
*(In thousands)*

	June 30	
	2004	2003
General Revenue Bonds Series 1998	\$ 65,080	\$ 65,080
Revenue Refunding Bonds Series 1994D	–	6,015
Construction debt	2,649	3,008
Capital leases	9,349	1,227
Total	<u>\$ 77,078</u>	<u>\$ 75,330</u>

### CONTACTING THE AUTHORITY'S FINANCIAL MANAGEMENT

This financial report is designed to provide the reader with a general overview of the Authority's finances. If you have questions about this report or need additional financial information, contact the office of the Chief Financial Officer at PO Box 980510, Richmond, Virginia 23298.



## Report of Independent Auditors

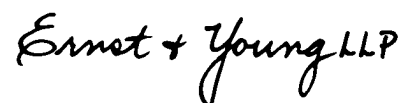
The Board of Directors  
The Virginia Commonwealth University Health System Authority

We have audited the accompanying financial statements of the business-type activities and the aggregate remaining fund information of The Virginia Commonwealth University Health System Authority (the Authority) as of June 30, 2005 and 2004, and for the years then ended, which collectively comprise the Authority's basic financial statements, as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. We were not engaged to perform an audit of the Authority's internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate remaining fund information of The Virginia Commonwealth University Health System Authority as of June 30, 2005 and 2004, and the respective changes in financial position and cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States.

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



August 30, 2005

The Virginia Commonwealth University Health System Authority

Balance Sheets – Enterprise Funds

	<b>June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 113,844,437	\$ 59,232,115
Patient accounts receivable, less allowance for doubtful accounts of \$95,197,000 and \$71,045,000 in 2005 and 2004, respectively	90,114,442	82,088,798
Non-patient accounts receivable	5,263,874	8,675,455
Inventories and prepaid expenses	13,265,214	10,025,808
Short-term investments	32,416,846	18,786,613
Current portion of assets whose use is limited	34,488,308	30,580,816
Total current assets	<u>289,393,121</u>	<u>209,389,605</u>
Assets whose use is limited, less current portion	112,892,901	136,433,832
Capital assets, less accumulated depreciation of \$308,907,034 in 2005 and \$279,427,701 in 2004	299,371,898	276,727,625
Other assets:		
Deferred financing and bond issuance costs, less accumulated amortization of \$928,601 and \$879,277 in 2005 and 2004, respectively	918,646	937,170
Long-term investments	70,430,484	53,010,283
Notes receivable from affiliates	716,173	792,518
Investments in joint ventures	2,289,756	2,133,951
Goodwill, less accumulated amortization of \$2,821,121 in 2005 and 2004	4,424,899	4,424,899
Total other assets	<u>78,779,958</u>	<u>61,298,821</u>
Total assets	<u><u>\$ 780,437,878</u></u>	<u><u>\$ 683,849,883</u></u>

	<b>June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Note payable	\$ 25,000,000	\$ 25,000,000
Current portion of long-term debt and capital leases	6,398,838	4,969,600
Current portion of estimated losses on malpractice claims	1,500,000	1,000,000
Estimated medical claims payable (reported and unreported)	30,246,321	27,546,796
Trade accounts payable	30,389,116	24,701,153
Settlements due to third parties	36,934,733	35,144,083
Clinical earnings contribution	2,688,191	900,400
Accrued workers compensation claims	11,241,457	6,170,630
Accrued salaries, wages and professional fees	32,757,514	28,275,634
Accrued leave	9,420,103	9,078,380
Accrued interest payable	1,589,470	1,632,363
Due to affiliate	469,590	-
Other accrued liabilities	5,681,321	3,751,572
Total current liabilities	<u>194,316,654</u>	<u>168,170,611</u>
Other liabilities:		
Long-term debt and capital leases, less current portion	74,684,567	72,108,336
Accrued leave	6,579,118	6,046,857
Estimated losses on malpractice claims	30,202,199	23,907,942
Other	601,670	27,000
Total liabilities	<u>306,384,208</u>	<u>270,260,746</u>
Net assets:		
Invested in capital assets, net of related debt	218,288,493	199,649,689
Restricted:		
Expendable	598,745	601,047
Nonexpendable	18,149,556	17,306,738
Unrestricted	237,016,876	196,031,663
Total net assets	<u>474,053,670</u>	<u>413,589,137</u>
Total liabilities and net assets	<u>\$ 780,437,878</u>	<u>\$ 683,849,883</u>

*See accompanying notes.*

The Virginia Commonwealth University Health System Authority

Statements of Revenues, Expenses and Changes in Net Assets –  
Enterprise Funds

	Year ended June 30	
	2005	2004
<b>Operating revenues:</b>		
Net patient service revenue	\$ 729,972,568	\$ 641,855,810
Other contract revenue	11,835,242	10,955,412
Medical consultation income	1,693,835	1,586,885
Premiums earned	276,216,363	230,191,283
Other operating revenue	13,081,697	14,613,798
	<u>1,032,799,705</u>	<u>899,203,188</u>
<b>Operating expenses:</b>		
Salaries and wages	362,795,011	325,121,221
Employee benefits	83,681,885	71,649,210
Purchased services	58,090,682	52,962,341
Medical claims expense	215,902,593	195,136,839
Clinical earnings contribution to VCU	4,059,437	3,563,481
Other distributions to VCU	2,897,134	149,828
Supplies	143,299,455	136,269,915
Other expenses	59,671,550	38,326,137
Provision for depreciation and amortization	33,780,386	28,310,111
Interest expense	4,458,512	3,890,090
	<u>968,636,645</u>	<u>855,379,173</u>
Operating income	64,163,060	43,824,015
<b>Nonoperating revenues and expenses:</b>		
Investment income	8,985,957	3,578,756
Other nonoperating income	125,892	32,147
(Loss) gain on investments in joint ventures	(2,866)	221,710
Donations and gifts	(15,633,213)	(10,807,677)
Total nonoperating revenues and expenses	<u>(6,524,230)</u>	<u>(6,975,064)</u>
Income before transfers and beneficial interest in trusts	57,638,830	36,848,951
Contributions for purchases of capital assets	1,980,696	118,346
Increase in beneficial interest in trusts	845,007	1,645,877
Increase in net assets	<u>60,464,533</u>	<u>38,613,174</u>
Net assets at beginning of year	413,589,137	374,975,963
Net assets at end of year	<u>\$ 474,053,670</u>	<u>\$ 413,589,137</u>

*See accompanying notes.*

The Virginia Commonwealth University Health System Authority

Statements of Cash Flows – Enterprise Funds

	<b>Year ended June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Cash flows from operating activities:</b>		
Cash received from patients and third-party payors and premiums	<b>\$ 1,013,483,014</b>	\$ 922,560,448
Other operating cash receipts	<b>16,493,278</b>	13,420,348
Cash paid to employees	<b>(425,209,441)</b>	(413,052,152)
Cash paid to suppliers	<b>(467,791,382)</b>	(389,516,071)
Net cash provided by operating activities	<b>136,975,469</b>	133,412,573
<b>Cash flows from capital and related financing activities:</b>		
Acquisition and construction of capital assets, net	<b>(56,406,135)</b>	(56,345,571)
Donations and gifts	<b>(15,633,213)</b>	(10,807,677)
Principal payments on long-term debt and capital lease obligations	<b>(6,835,295)</b>	(8,518,289)
Proceeds from note payable	–	25,000,000
Contributions for purchases for capital assets	<b>1,980,696</b>	118,346
Interest expense	<b>(4,458,512)</b>	(3,890,090)
Decrease in accrued interest payable	<b>(42,893)</b>	(133,834)
Net cash used in capital and related financing activities	<b>(81,395,352)</b>	(54,577,115)
<b>Cash flows from investing activities:</b>		
Change in cash and cash equivalents	<b>(30,654,996)</b>	2,969,055
Purchases of investments	<b>(114,496,515)</b>	(184,479,607)
Sales of investments	<b>133,734,516</b>	110,918,281
Change in beneficial interest in perpetual trusts	<b>845,007</b>	1,645,877
Investment income	<b>8,985,957</b>	3,578,756
Decrease (increase) in investments in joint ventures	<b>(158,671)</b>	4,614,164
Change in notes receivable	<b>76,345</b>	10,304
Nonoperating income	<b>125,892</b>	32,147
Other	<b>574,670</b>	–
Net cash used in investing activities	<b>(967,795)</b>	(60,711,023)
Net increase in cash and cash equivalents	<b>54,612,322</b>	18,124,435
Cash and cash equivalents at beginning of year	<b>59,232,115</b>	41,107,680
Cash and cash equivalents at end of year	<b>\$ 113,844,437</b>	\$ 59,232,115
<b>Supplemental information:</b>		
Assets acquired through capital lease obligations	<b>\$ 10,840,764</b>	\$ 10,265,774

(continued)

The Virginia Commonwealth University Health System Authority

Statements of Cash Flows – Enterprise Funds (continued)

	<b>Year ended June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	<b>\$ 64,163,060</b>	\$ 43,824,015
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	<b>33,780,386</b>	28,310,111
Interest expense	<b>4,458,512</b>	3,890,090
Changes in operating assets and liabilities:		
Patient accounts receivable	<b>(8,025,644)</b>	(2,501,490)
Due to/from third-party payors	<b>1,790,650</b>	40,472,558
Non-patient accounts receivable	<b>3,411,581</b>	(1,247,950)
Inventories and prepaid expenses	<b>(3,239,406)</b>	(815,477)
Accrued salaries, wages, and professional fees	<b>4,481,880</b>	6,421,595
Accrued leave	<b>873,984</b>	909,601
Accrued workers compensation claims	<b>5,070,827</b>	(76,836)
Trade accounts payable	<b>16,528,727</b>	12,415,075
Clinical earnings contribution	<b>1,787,791</b>	37,651
Estimated losses on malpractice claims	<b>6,794,257</b>	(3,529,359)
Estimated medical claims payable	<b>2,699,525</b>	4,688,207
Other accrued liabilities	<b>1,929,749</b>	852,313
Due to affiliate	<b>469,590</b>	(237,531)
Net cash provided by operating activities	<b><u>\$ 136,975,469</u></b>	<b><u>\$ 133,412,573</u></b>

*See accompanying notes.*



The Virginia Commonwealth University Health System Authority

Balance Sheets – Pension Trust Funds

	<b>June 30</b>	
	<b>2005</b>	<b>2004</b>
<b>Assets</b>		
Assets whose use is limited	<u><b>\$ 64,479,484</b></u>	<u>\$ 53,307,876</u>
<b>Net assets</b>		
Reserve for employees' pension benefits	<u><b>\$ 64,479,484</b></u>	<u>\$ 53,307,876</u>

*See accompanying notes.*

The Virginia Commonwealth University Health System Authority

Statements of Changes in Net Assets – Pension Trust Funds

	<b>Year ended June 30</b>	
	<b>2005</b>	<b>2004</b>
Beginning net assets	\$ 53,307,876	\$ 37,767,947
Pension contributions	10,521,541	11,679,997
Investment gain	3,582,941	5,821,405
Pension benefit payments	(2,932,874)	(1,961,473)
Ending net assets	<u>\$ 64,479,484</u>	<u>\$ 53,307,876</u>

*See accompanying notes.*

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements

June 30, 2005 and 2004

### 1. Summary of Significant Accounting Policies

#### Reporting Entity

The Virginia Commonwealth University Health System Authority (the Authority) is a public corporate body and political subdivision of the Commonwealth of Virginia created and established by an Act of the General Assembly of the Commonwealth of Virginia during 1996. The Authority is a tax-exempt, not-for-profit organization under the provisions of Internal Revenue Code Section 115. Effective July 1, 2000, in conjunction with legislation enacted by the Commonwealth of Virginia, the Authority's board structure changed. Concurrent with the legislation and certain changes to MCV Associated Physicians' (MCVAP) board structure, MCVAP began operating as a blended component unit of the Authority.

The Authority's principal activity is the operation of the Medical College of Virginia Hospitals (the Hospitals), University Health Services, Inc. and Subsidiaries (UHS) and MCVAP. The Hospitals, a division of the Authority, is an approximately 900-bed teaching hospital which provides inpatient and outpatient services primarily to patients in the Commonwealth of Virginia. MCVAP, formed in 1991 as a nonstock, not-for-profit charitable educational organization, functions as the group practice plan for those physicians and health care professionals who have faculty appointments in Virginia Commonwealth University (VCU) School of Medicine. Separate financial statements for MCVAP may be obtained from MCVAP's corporate office. The Hospitals, UHS, and MCVAP are included in the enterprise funds of the Authority.

UHS, a blended component unit of the Authority, is a not-for-profit, non-stock, tax-exempt corporation which was incorporated on January 26, 1995 to support the educational, scientific, and charitable purpose and activities of the University and, in particular, the activities of the Medical College of Virginia (MCV/VCU) and the Hospitals. These activities include, but are not limited to, activities undertaken pursuant to Section 23-50.16B of the Code of Virginia. UHS is a blended component unit of the Authority due to the significance of the operational and financial relationship between the two entities. Virginia Premier Health Plan, Inc. (VA Premier) is a wholly-owned subsidiary of UHS Managed Care, Inc. which in turn is a wholly-owned subsidiary of UHS. VA Premier is a for-profit Medicaid health maintenance organization (HMO) whose primary purpose is to provide quality health care within a managed care framework.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

#### **Principles of Presentation**

The accounts of the Authority are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, net assets, revenues and expenses, as appropriate.

The enterprise funds, which include the accounts of the Hospitals, UHS and MCVAP, are used to account for the Authority's ongoing activities. Significant intercompany accounts and transactions have been eliminated in combination of these funds.

The pension trust funds are used to account for assets held in trust by Fidelity Investments, The Variable Annuity Life Insurance Company (Valic), and Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA/CREF) for the benefit of the employees of the Authority. The pension plan is sponsored by the Authority and governed by the Board of Directors of the Authority; therefore, the pension plan is included as a blended component unit of the Authority.

The financial statements of the pension trust funds are prepared using the accrual basis of accounting. Employer contributions to the plan are recognized when due. Benefits are recognized when due and payable in accordance with the terms of the plan.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Principles of Presentation (continued)

Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments* (Statement 34) established standards for external financial reporting for all state and local governmental entities, which includes a statement of net assets, a statement of activities and changes in net assets and a statement of cash flows. It requires the classification of net assets into three components – invested in capital assets, net of related debt; restricted; and unrestricted. These classifications are defined as follows:

- Invested in capital assets, net of related debt – This component of net assets consists of capital assets, including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. If there are significant unspent related debt proceeds at year-end, the portion of the debt attributable to the unspent proceeds are not included in the calculation of invested in capital assets, net of related debt. Rather, that portion of the debt is included in the same net assets component as the unspent proceeds.
- Restricted net assets – This component of net assets consists of constraints placed on net asset use through external constraints imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or constraints imposed by law through constitutional provisions or enabling legislation. Restricted net assets are either expendable or nonexpendable. Nonexpendable net assets are those that are required to be retained in perpetuity.
- Unrestricted net assets – This component of net assets consist of net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt”.

The accounting policies and practices of the Authority conform to accounting principles generally accepted in the United States applicable to a proprietary fund of a government unit.

#### Proprietary Fund Accounting

The Authority utilizes the proprietary fund method of accounting whereby revenues and expenses are recognized on the accrual basis.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Proprietary Fund Accounting (continued)**

Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Authority has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB) that do not contradict or conflict with GASB pronouncements, including those issued after November 30, 1989.

#### **Operating Revenues and Expenses**

The Authority's statement of revenues, expenses and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services – the Authority's principal activity. Nonexchange revenues, including investment income and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide health care services. Donations and gifts are reported as nonoperating expenses.

#### **Cash Equivalents**

The Authority considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

#### **Uncompensated Care**

The Authority provides care to patients who meet certain criteria under its indigent care policy at full established rates and at amounts less than its established rates. Because the Authority does not pursue collection of these charges determined to qualify as uncompensated care from the patients, the charges are not reported as revenue. The costs of providing these services are included in the Authority's operating expenses. Uncompensated care, which represents the difference between charges of the services provided and the costs of those respective services, approximated \$149,904,000 and \$145,810,000 for the years ended June 30, 2005 and 2004, respectively.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, and includes estimated retroactive adjustments due to future audits, reviews and investigations.

Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations.

A summary of the payment arrangements with major third-party payors is as follows:

*Anthem.* Inpatient acute care services rendered to Anthem subscribers are paid at rates per discharge (DRGs) or discounted rates. Outpatient services rendered to Anthem subscribers are reimbursed at discounted rates or applicable fee schedule. The rates are not subject to retroactive adjustment.

*Medicare.* Inpatient acute care services and defined capital costs rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Inpatient nonacute services, certain outpatient services and education related to Medicare beneficiaries are paid based on prospectively determined rates and a discounted cost reimbursement methodology. The Authority is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the Authority and audits thereof by the Medicare fiscal intermediary. The Authority's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2001.

*Medicaid.* Inpatient acute care services rendered to Medicaid program beneficiaries are paid at a per diem rate and APDRG (rates per discharge). Outpatient services rendered to Medicaid program beneficiaries are reimbursed on prospectively determined rates and a cost reimbursement methodology. In addition to inpatient and outpatient services provided to Medicaid program beneficiaries, Medicaid reimburses the Authority its costs related to services provided to indigent patients up to an amount which results in total Medicaid and indigent reimbursement to the Authority of \$217 million and \$207 million in 2005 and 2004, respectively. The Authority's Medicaid cost reports have been audited by the Medicaid program representative through June 30, 2001.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Net Patient Service Revenue (continued)**

In accordance with the third-party payor agreements, the difference between payment for services and the Authority's standard billing rates results in contractual adjustments. Contractual adjustments are recorded as deductions from patient service revenue in the period in which the related services are rendered. The annual settlements of reimbursement for patients services covered by third parties are determined through cost reports for Medicare (for outpatient and educational costs) and Medicaid. The settlements are subject to audit and retroactive adjustment by these third parties.

Provisions for possible adjustments of cost reports have been estimated and reflected in the accompanying financial statements as considered appropriate. 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 net patient service revenue. Net patient service revenue was increased by approximately \$5,800,000 in 2005 and decreased by approximately \$6,070,000 in 2004 as a result of such settlements.

#### **Premiums Earned**

VA Premier has contracts with the Virginia Department of Medical Assistance Services (DMAS) wherein VA Premier provides health care services to the Aid for Families with Dependent Children (AFDC), the Children's Medical Services Insurance Plan (CMSIP) and Aged, Blind and Disabled (ABD) residents of Virginia on a prepaid basis through a health maintenance organization (HMO). VA Premier recognizes premiums received from DMAS for members in the period to which health care coverage relates. All of VA Premier's premiums were earned from contracts with DMAS.

#### **Clinical Earnings Contribution**

Clinical earnings contribution represent amounts MCVAP has agreed to contribute to the VCU School of Medicine in support of its academic and educational goals.

#### **Uncollectible Accounts**

The Authority records a provision for uncollectible accounts during the period in which collection is considered doubtful.



# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Investments

Investments in open-end mutual funds, debt securities, and equity securities that have readily determinable fair values are carried at fair value. The fair values of marketable equity securities, bonds and other investments are based on quoted market prices.

#### Capital Assets

Capital assets are stated at cost or, if donated, at fair market value at the date of donation. The Authority capitalizes expenditures for equipment when the unit acquisition cost is \$5,000 or greater and the estimated useful life is two years or more.

Depreciation on capital assets, including capital leases and excluding land and construction in progress, is computed over the estimated useful lives of the assets based on the straight-line method. The general range of estimated useful lives is 10 to 40 years for buildings and fixtures and 5 to 20 years for equipment. Expenditures for construction in progress are capitalized as incurred.

#### Inventories

Inventories are carried at the lower of cost (determined on the first-in, first-out method) or market.

#### Deferred Financing and Bond Issuance Costs

The Authority deferred all financing expenses incurred in connection with the issuance of long-term debt. Such expenses are being amortized over the term of the related indebtedness using a method comparable to the effective interest method.

#### Accrued Leave

The Authority records a liability for all paid time off and related FICA taxes expected to be paid. The portion of the balance expected to be paid beyond a year has been classified as long-term.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **1. Summary of Significant Accounting Policies (continued)**

#### **Assets Whose Use is Limited**

Resources restricted for debt service under a bond indenture agreement, unrestricted resources appropriated or designated by the Board of Directors for capital acquisition and for the future funding of MCVAP malpractice insurance, resources restricted under malpractice trust agreement, resources restricted by insurance regulations of the Commonwealth of Virginia, and resources restricted under the pension plan agreement are reported as assets whose use is limited and are carried at fair value.

Restricted resources limited by donors to a specific period or purpose are reported as assets whose use is limited. These assets consist principally of beneficial interests in perpetual trust funds established by split interest agreements. Split interest agreements are trust agreements established by donors under which the Authority receives benefits that are shared with other beneficiaries. The trust agreements established by donors provide for a third party to hold the trust assets. These trusts do not permit donors to revoke their charitable contributions. Trust assets of \$18,151,000 and \$17,306,000 are restricted by donors for the Authority in perpetuity and are included in assets whose use is limited at June 30, 2005 and 2004, respectively, at fair value, which approximates the present value of the future cash receipts from the trust assets.

#### **Investment Income**

Investment income, including net realized and unrealized gains or losses on investment transactions of general funds, are recorded as nonoperating revenue, and investment transactions of restricted funds are recorded as restricted net asset transactions in the restricted funds. The income earned on restricted funds is restricted primarily for indigent care. Gains and losses from the sale of securities are recorded using specific identification.

#### **Estimated Medical Claims Payable**

VA Premier provides for the liability arising from services rendered to HMO members but unpaid at year-end based upon the experience of VA Premier and cost-per-member trends. Although considerable variability is inherent in such estimates, management believes it has recorded its best estimate. Any required revisions to these estimates are reflected in operations of the period in which such revisions are determined.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

#### Accrued Workers' Compensation Claims

The Authority is self insured for workers' compensation and provides for the liability based on the ultimate cost of known claims and claims incurred but not yet reported. The liability includes assumptions and factors related to the frequency and severity of claims, claims development history and claims settlement practices.

#### Reinsurance

VA Premier purchases reinsurance coverage. Reinsurance premiums and benefits paid or provided are accounted for on a basis consistent with the accounting for the original policies issued and the terms of the reinsurance contract. VA Premier is contingently liable for reinsurance losses to the extent that the reinsurance company cannot meet its obligations.

#### Income Taxes

The provision for income taxes of UHS's wholly-owned, taxable subsidiaries is determined using the asset and liability method based on tax laws as currently enacted.

#### Intangibles

In accordance with Statement of Financial Accounting Standards (SFAS) No. 142, *Goodwill and Other Intangible Assets*, goodwill arising from the acquisition of VA Premier is no longer amortized, but is reviewed annually for impairment.

#### Restricted Funds

Restricted funds are those whose use by the Authority has been limited by donors to a specific time period or purpose. Restricted funds primarily relate to the Authority's beneficial interest in two trust agreements, the income of which accrues to the Authority for use in providing indigent and other patient care. Gifts of cash and other assets are reported at fair value at the date of the gift.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **2. Cash, Cash Equivalents, Current and Long-Term Investments and Assets Whose Use is Limited**

Cash and cash equivalents represent deposits with maturities of less than three months when purchased. The recorded balance of such deposits at June 30, 2005 and 2004 totaled \$113,844,437 and \$59,232,115, respectively, and the bank balance totaled \$126,924,506 and \$71,510,761, respectively, which is covered by federal depository insurance or collateralized in accordance with the Virginia Security for Public Deposits Act. Differences between the bank balance and recorded balance are the result of reconciling items at June 30, 2005 and 2004, such as deposits in transit and outstanding checks.

Deposits, including checking accounts and certificate of deposits, are placed with banks and savings and loan institutions and are protected by federal depository insurance or collateral held under the provisions of the Virginia Security for Public Deposits Act (the Act), Section 2.1-539 et. seq. Under the Act, banks holding public deposits in excess of the amounts insured by the FDIC Bank Insurance Fund must pledge collateral in the amount of 50% of excess deposits to a collateral pool in the name of the State Treasury Board.

Savings and loan institutions are required to collateralize 100% of deposits in excess of FDIC Savings Association Insurance Fund limits. The State Treasury Board can assess additional collateral from participating financial institutions to cover collateral shortfalls in the event of default and is responsible for monitoring compliance with the collateralization and reporting requirements of the Act and for notifying local governments of compliance by banks and savings and loans.

The Authority adopted the provisions of GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, an amendment of GASB Statement No. 3, effective July 1, 2004. This Statement specifies certain disclosures regarding common deposit and investment risks related to credit risk, concentration of credit risk, interest rate risk, and foreign currency risk, as well as deposit and investment policies related to the risks identified.

In accordance with Resolutions adopted by its Board of Directors, the Authority can invest assets held with trustees in the following instruments: obligations of federal agencies or those guaranteed by the United States of America, savings accounts, certificates of deposit, time deposits, and obligations of the Commonwealth of Virginia.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**2. Cash, Cash Equivalents, Current and Long-Term Investments and Assets Whose Use is Limited (continued)**

In accordance with MCVAP's Statement of Spending and Investment Policy, adopted by its Board of Directors, MCVAP can invest assets within specified target levels of investment and returns in the following instruments: U.S. Large Cap Stock, U.S. Mid Cap Stocks, international stocks, fixed income and cash.

The cost and fair value of current and long-term investments as of June 30 are as follows:

	2005		2004	
	Cost	Fair Value	Cost	Fair Value
Commercial paper	\$ 14,412,189	\$ 14,534,501	\$ 22,350	\$ 22,350
Money market instruments	571,314	571,314	3,388,576	3,388,576
Mutual funds	15,047,724	15,542,628	4,758,849	4,765,589
Equity securities	5,477,005	5,892,865	10,756,507	11,305,749
U.S. government and agency obligations	54,493,382	54,329,387	35,052,536	34,642,230
Corporate obligations	11,809,901	11,822,972	17,403,097	17,381,830
Interest receivable	153,663	153,663	290,572	290,572
<b>Total</b>	<b>\$ 101,965,178</b>	<b>\$ 102,847,330</b>	<b>\$ 71,672,487</b>	<b>\$ 71,796,896</b>

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**2. Cash, Cash Equivalents, Current and Long-Term Investments and Assets Whose Use is Limited (continued)**

Assets whose use is limited are summarized as follows at June 30:

	2005		2004	
	Cost	Fair Value	Cost	Fair Value
<b>Enterprise Funds:</b>				
Externally restricted by insurance regulations:				
U.S. government and agency obligations	\$ 598,745	\$ 598,745	\$ 601,047	\$ 601,047
Externally restricted under bond indenture:				
Cash and cash equivalents	3,670,406	3,670,406	3,627,363	3,627,363
Internally restricted by the board for capital acquisition:				
Cash and cash equivalents	23,759,107	23,785,123	54,839,805	54,839,805
Commercial paper	15,518,121	15,649,819	28,744,288	28,637,156
U.S. government and agency obligations	39,226,438	39,373,487	6,180,490	6,092,676
Corporate obligations and other	10,930,574	10,991,571	29,135,593	29,036,969
Interest receivable	—	—	493,394	493,394
	<b>89,434,240</b>	<b>89,800,000</b>	119,393,570	119,100,000
Externally restricted by donor:				
Commercial paper	21,961	21,961	22,350	22,350
Beneficial interest in trust	15,922,778	18,129,195	17,284,188	17,284,188
	<b>15,944,739</b>	<b>18,151,156</b>	17,306,538	17,306,538
Internally restricted under medical malpractice trust (MCVAP):				
Cash and cash equivalents	7,028,363	7,028,363	500,000	500,000
Marketable equity securities	—	—	8,587,549	9,479,709
U.S. government obligations	6,102,484	6,137,552	—	—
Corporate obligations	15,599,275	15,090,865	—	—
	<b>28,730,122</b>	<b>28,256,780</b>	9,087,549	9,979,709
Externally restricted under non-risk transfer insurance contract (MCVAP):				
Cash and cash equivalents	—	—	3,773,396	3,773,396
Government and agency securities	—	—	5,572,912	5,556,406
	—	—	9,346,308	9,329,802
Externally restricted under medical malpractice trust (MCV Hospitals):				
Cash and cash equivalents	4,671,865	4,671,865	7,070,189	7,070,189
Agency mortgage backed	2,235,215	2,232,257	—	—
	<b>6,907,080</b>	<b>6,904,122</b>	7,070,189	7,070,189
	<b>\$ 145,285,332</b>	<b>\$ 147,381,209</b>	\$ 166,432,564	\$ 167,014,648
<b>Pension Trust Funds:</b>				
Externally restricted under pension plan agreement:				
Mutual funds	\$ N/A	\$ 64,479,484	\$ N/A	\$ 53,307,876
	<b>\$ —</b>	<b>\$ 64,479,484</b>	<b>\$ —</b>	<b>\$ 53,307,876</b>

N/A – Not available.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**2. Cash, Cash Equivalents, Current and Long-Term Investments and Assets Whose Use is Limited (continued)**

As of June 30, 2005, the Authority's investments (including assets whose use is limited) mature as follows:

	Fair Value	Investment Maturities (In Years)			
		Less than 1	1-5	6-10	More than 10
Cash and cash equivalents	\$ 39,155,757	\$ 39,155,757	\$ -	\$ -	\$ -
Money market	571,314	571,314	-	-	-
Mutual funds	15,542,628	N/A	N/A	N/A	N/A
Marketable equity securities	5,892,865	N/A	N/A	N/A	N/A
U.S. treasury notes	58,750,643	29,136,894	19,050,857	2,597,569	7,965,323
Commercial paper	30,206,281	30,206,281	-	-	-
Asset backed securities	10,398,335	-	6,770,110	2,793,414	834,811
Agency backed mortgages	44,090,502	19,323,008	6,039,063	5,756,135	12,972,296
Corporate notes	18,428,609	1,804,185	10,904,810	5,128,177	591,437
Corporate bonds	8,364,365	1,848,685	2,273,174	2,120,379	2,122,127
Foreign bonds/notes	544,382	-	-	488,594	55,788
Interest receivable	153,663	153,663	-	-	-
Beneficial interest in perpetual trust	18,129,195	-	-	-	18,129,195
	<u>\$ 250,228,539</u>	<u>\$ 122,199,787</u>	<u>\$ 45,038,014</u>	<u>\$ 18,884,268</u>	<u>\$ 42,670,977</u>

*N/A – Investment maturity not applicable to type of investments noted.*

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**3. Capital Assets**

Capital assets, and changes thereto, as of and for the year ended June 30, 2005, consisted of the following:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Transfers and Disposals</b>	<b>Ending Balance</b>
Land and improvements	\$ 2,683,248	\$ —	\$ (967,223)	\$ 1,716,025
Buildings and fixed equipment	295,260,184	15,642,567	—	310,902,751
Moveable equipment	253,750,153	22,709,879	(5,734,412)	270,725,620
Construction in progress	4,461,741	29,807,548	(9,334,753)	24,934,536
	<u>556,155,326</u>	<u>68,159,994</u>	<u>(16,036,388)</u>	<u>608,278,932</u>
Less accumulated depreciation	(279,427,701)	(33,532,943)	4,053,610	(308,907,034)
	<u>\$ 276,727,625</u>	<u>\$ 34,627,051</u>	<u>\$ (11,982,778)</u>	<u>\$ 299,371,898</u>



The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**3. Capital Assets (continued)**

Property and equipment, and changes thereto, as of and for the year ended June 30, 2004, consisted of the following:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Transfers and Disposals</b>	<b>Ending Balance</b>
Land and improvements	\$ 2,683,248	\$ -	\$ -	\$ 2,683,248
Buildings and fixed equipment	265,750,994	29,509,190	-	295,260,184
Moveable equipment	196,652,875	58,467,867	(1,370,589)	253,750,153
Construction in progress	35,993,041	32,057,179	(63,588,479)	4,461,741
	<u>501,080,158</u>	<u>120,034,236</u>	<u>(64,959,068)</u>	<u>556,155,326</u>
Less accumulated depreciation	(252,437,318)	(28,260,787)	1,270,404	(279,427,701)
	<u>\$ 248,642,840</u>	<u>\$ 91,773,449</u>	<u>\$ (63,688,664)</u>	<u>\$ 276,727,625</u>

**4. Long-Term Debt**

Long-term debt of the Hospitals and changes thereto, as of and for the year ended June 30, 2005, is summarized below:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Amounts Due Within One Year</b>
Series 1998 Bonds	\$ 65,080,000	\$ -	\$ (1,995,000)	\$ 63,085,000	\$ 2,080,000
Construction debt	2,648,784	61,651	(392,928)	2,317,507	155,000
Capital leases	9,349,152	10,840,764	(4,509,018)	15,680,898	4,163,838
	<u>\$ 77,077,936</u>	<u>\$ 10,902,415</u>	<u>\$ (6,896,946)</u>	<u>\$ 81,083,405</u>	<u>\$ 6,398,838</u>

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**4. Long-Term Debt (continued)**

Long-term debt of the Hospitals and changes thereto, as of and for the year ended June 30, 2004, is summarized below:

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>	<b>Amounts Due Within One Year</b>
Series 1998 Bonds	\$ 65,080,000	\$ —	\$ —	\$ 65,080,000	\$ 1,995,000
Series 1994D Bonds	6,015,000	—	(6,015,000)	—	—
Construction debt	3,007,876	—	(359,092)	2,648,784	388,784
Capital leases	1,227,575	10,265,774	(2,144,197)	9,349,152	2,585,816
Total long-term debt	<u>\$ 75,330,451</u>	<u>\$ 10,265,774</u>	<u>\$ (8,518,289)</u>	<u>\$ 77,077,936</u>	<u>\$ 4,969,600</u>

The Hospitals General Revenue Bonds, Series 1998, are secured by revenues of the Authority and are due in various installments from July 1, 2005 through July 1, 2023. Interest rates range from 4.40% to 5.25%, payable semiannually in January and July.

In conjunction with the transfer agreement associated with the formation of the Authority, the University transferred to the Authority a parking deck, and related construction debt. The Authority assumed responsibility for payments on the associated construction debt. Debt is payable to the University in installments beginning in 2003 through 2016. The interest rates range from 5.375% to 5.9%.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**4. Long-Term Debt (continued)**

A summary of future principal requirements of long-term debt as of June 30, 2005 follows:

	<b>Series 1998 Bonds</b>	<b>Construction Debt due to the University</b>	<b>Capital Leases</b>	<b>Total</b>
2006	\$ 2,080,000	\$ 155,000	\$ 4,163,838	\$ 6,398,838
2007	2,175,000	172,679	3,262,274	5,609,953
2008	2,270,000	182,680	2,345,506	4,798,186
2009	2,385,000	193,954	2,287,405	4,866,359
2010	2,500,000	196,373	2,727,365	5,423,738
2011 – 2015	14,490,000	1,149,261	894,510	16,533,771
2016 – 2020	18,580,000	267,560	–	18,847,560
2021 – 2025	18,605,000	–	–	18,605,000
<b>Total</b>	<b>\$ 63,085,000</b>	<b>\$ 2,317,507</b>	<b>\$ 15,680,898</b>	<b>\$ 81,083,405</b>

A summary of future interest requirements of long-term debt as of June 30, 2005 follows:

	<b>Series 1998 Bonds</b>	<b>Construction Debt due to the University</b>	<b>Total</b>
2006	\$ 3,087,421	\$ 113,039	\$ 3,200,460
2007	2,991,721	104,708	3,096,429
2008	2,878,221	95,532	2,973,753
2009	2,758,971	85,742	2,844,713
2010	2,633,971	77,984	2,711,955
2011 – 2015	11,088,643	231,583	11,320,226
2016 – 2020	6,767,563	10,702	6,778,265
2021 – 2025	1,489,581	–	1,489,581
<b>Total</b>	<b>\$ 33,696,092</b>	<b>\$ 719,290</b>	<b>\$ 34,415,382</b>

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**4. Long-Term Debt (continued)**

The Hospitals are required to make semi-annual interest payments to the interest accounts included in the bond funds for the Series 1994D and Series 1998 Bonds and annual principal payments to the bond service account included in the bond fund for the Series 1994D Bonds. For the years ended June 30, 2005 and 2004, the Hospitals transferred approximately \$3,669,000 and \$3,627,000, respectively, to the bond service accounts.

The Series 1998 bond agreements place restrictions on future borrowings and require certain minimum insurance coverage. Charges to patients are required to be maintained at a level which will produce income available for debt service, as defined by the bond resolutions, in each fiscal year equal to or greater than 110 percent of maximum total annual debt service in each fiscal year.

The fair value of the Authority's long-term debt (excluding capital leases), estimated based on the quoted market prices for the same or similar issues or discounted cash flow analyses, is as follows at June 30:

	<b>2005</b>		<b>2004</b>	
	<b>Carrying Value</b>	<b>Fair Value</b>	<b>Carrying Value</b>	<b>Fair Value</b>
Long-term obligations	<b>\$ 65,402,507</b>	<b>\$ 69,670,790</b>	\$ 67,728,784	\$ 69,095,646

For the years ended June 30, 2005 and 2004, the Authority paid approximately \$3,386,000 and \$4,024,000, respectively, for interest.

The Hospital has an unsecured \$25,000,000 line of credit with First Union National Bank which expires on June 27, 2006. The interest rate is LIBOR plus 0.75% (4.03% at June 30, 2005). At June 30, 2005 and 2004, \$25,000,000 was outstanding on this line of credit.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**5. Operating Leases**

Total payments under operating leases were approximately \$7,352,000 and \$8,132,000 in 2005 and 2004, respectively. Future minimum lease payments are as follows:

2006	\$ 3,799,477
2007	2,773,444
2008	1,790,100
2009	1,084,946
	<u>\$ 9,447,967</u>

**6. Commitments**

Estimated costs to complete construction in progress for capital assets at June 30, 2005 are approximately \$36.1 million related to the construction of a 300 unit bed tower.

**7. Contingencies**

**Professional Liability**

*MCV Hospitals*

Through June 30, 1990, the Hospitals were insured under a claims-made policy with respect to institutional and professional liability, each with liability limits of \$1 million per incident and an aggregate annual liability limit of \$3 million in each policy year. Either the PHICO Insurance Company or The Virginia Insurance Reciprocal provided insurance.

Effective July 1, 1990 and through June 30, 1998, the Hospitals were insured under a risk management plan with the Commonwealth of Virginia. This plan was also claims-made with institutional and professional liability limits of \$1 million per incident but no aggregate limit.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **7. Contingencies (continued)**

#### **Professional Liability (continued)**

##### *MCV Hospitals (continued)*

Effective July 1, 1998, the Hospitals became self-insured. Professional liability limits of \$1 million per incident and \$3 million in aggregate are self-insured. Excess insurance coverage up to \$10 million was provided by The Reciprocal of America (the Reciprocal), a multiprovider reciprocal insurance company until June 30, 2002. In connection with the self-administered plan effective July 1, 2002, an excess professional liability policy for the Hospitals was written by Columbia Casualty Group of the CNA Insurance Group. This policy covers losses in excess of the Reciprocal limits for an additional annual aggregate amount of \$5 million. Effective July 1, 2003, the Hospitals no longer maintain excess professional liability coverage.

There have been malpractice claims asserted against the Hospitals by various claimants. The claims are in various stages of processing and some may ultimately be brought to trial. There are also known incidents that have occurred through June 30, 2005 that may result in the assertion of additional claims. In addition, there may be other claims from unreported incidents arising from services provided to patients through June 30, 2005. At June 30, 2005, the Hospitals' management accrued professional liability losses to the extent they fall within the limits of the Hospitals' self-insurance program or exceed the limits of the excess insurance coverage. The liability for medical malpractice at June 30, 2005 and 2004 includes approximately \$6,920,000 and \$5,598,000, respectively, for claims and related legal expenses for reported and unreported incidents occurring since July 1, 1998. The liability (discounted at 5%) was actuarially determined combining industry data and the Hospitals' historical experience.

A revocable trust has been established and is funded for payment of malpractice claims and related expenses. At June 30, 2005 and 2004, the medical malpractice trust fund for the Hospitals includes approximately \$6,904,000 and \$7,070,000, respectively.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### 7. Contingencies (continued)

#### Professional Liability (continued)

##### *MCVAP*

Prior to fiscal year 2005, MCVAP's professional liability coverage was provided through a claims-made policy obtained from Universal Re-Insurance Company (URIC), a Bermuda insurance corporation. The policy provided coverage of \$1,650,000 per occurrence and \$8,000,000 annual aggregate. Premiums paid by MCVAP to URIC were recorded as expense by MCVAP and deposited in an irrevocable trust fund administered by SunTrust Bank. Under the terms of the agreement with URIC, no risk was transferred by MCVAP to URIC. As a result, the irrevocable trust, totaling \$9.3 million at June 30, 2004, was recorded as assets whose use is limited with an equal liability for estimated losses for malpractice claims (discounted at 5%) as of June 30, 2004. There were no premiums paid during 2005 and 2004 related to this arrangement.

In addition, MCVAP was self-insured for any claims in excess of its insurance coverage with URIC. The Board set aside funds to be used to fund estimated losses based on actuarially determined reserves. At June 30, 2004, assets whose use is limited included \$9,979,709 that was designated by the Board to fund malpractice claims. Also, estimated losses on malpractice claims (discounted at 5%) included \$9,979,709 at June 30, 2004, in addition to the amount recorded under the URIC agreement.

During fiscal year 2005, MCVAP terminated its contract with the Universal Re-Insurance Company and became self-insured for all malpractice claims. As such, the Board sets aside funds to be used to fund estimated losses based on actuarially determined reserves. At June 30, 2005, assets whose use is limited includes \$28,256,780 that has been designated by the Board to fund malpractice claims. Also, estimated losses on malpractice claims (discounted at 5%) was approximately \$24,782,000 at June 30, 2005.

Estimated claims liabilities are recorded based on factors such as actual claims history and the percentage of certainty that actual losses will not exceed the reserve recorded. During the fiscal year ended June 30, 2005 and 2004, respectively, the accrual for estimated claims was calculated based on an assumption of 90% certainty (90% confidence level) that the actual losses related to professional liability would not exceed the reserve recorded. During the year ended June 30, 2004, due to changes in malpractice estimates, management reduced the accrual for malpractice claims by approximately \$6,382,000, which resulted in a credit for malpractice expense in the statements of revenues, expenses and changes in net assets.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **7. Contingencies (continued)**

#### **Professional Liability (continued)**

##### *MCVAP (continued)*

There is uncertainty as to whether the actual malpractice reserves will conform to the assumptions inherent in the determination of the amounts recorded. Because of the uncertainties related to the recording of malpractice reserves, the ultimate settlement of the reserve estimates may vary from the estimated amounts included in the accompanying financial statements.

##### *VA Premier*

VA Premier maintains general and professional liability policies. The general liability policy in force is occurrence-based. The coverage under the professional liability policy is on a claims-made basis and must be renewed or replaced with the equivalent insurance if claims incurred during its terms, but asserted after its expiration, are to be insured. Coverage limits for the general liability policy are \$1 million per occurrence and \$3 million annual aggregate. The coverage limits for the professional liability policy are \$5 million per medical incident and \$5 million annual aggregate. Management does not believe the amount of liability for any claims incurred but unreported as of June 30, 2005 is significant.

#### **Other Contingencies**

During fiscal 1996, the Department of Health and Human Services (HHS) announced its intention to audit Medicare billings submitted by teaching physicians at all of the major teaching hospitals in the United States. During fiscal 1998, MCVAP received notification from the Department of Justice (DOJ) stating that it was the subject of investigations relating to CHAMPUS and Medicare billing practices. MCVAP has cooperated fully with this notification from the DOJ. Since the date of the notification, MCVAP has not received any further correspondence from HHS. At the present time, management does not have sufficient information to determine if MCVAP will have any liability related to these issues or what the potential liability, if any, might be.



The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**8. Net Patient Service Revenue**

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

	<u>2005</u>	<u>2004</u>
Gross patient revenue:		
Inpatient:		
Routine services	\$ 179,593,338	\$ 160,437,477
Ancillary services	763,117,630	714,013,357
Outpatient:		
Emergency	54,082,918	51,928,467
Special medical	448,729,177	378,425,473
Total gross patient service revenue (Hospitals)	<u>1,445,523,063</u>	1,304,804,774
Provision for indigent care, contractual adjustments and bad debts	<u>(813,123,733)</u>	(759,952,218)
Net patient service revenue (Hospitals)	632,399,330	544,852,556
MCVAP's net patient service revenue	<u>97,573,238</u>	97,003,254
Net patient service revenue (Authority)	<u>\$ 729,972,568</u>	\$ 641,855,810

**9. Estimated Medical Claims Payable**

Claims expenses and liabilities arising from services rendered to VA Premier's HMO members are reported when it is probable that services have been provided and the amount of the claim can be reasonably estimated. The claims payable at June 30, 2005 and 2004 includes an estimate of claims that have been incurred but not reported. At June 30, 2005 and 2004, the amount of these liabilities were \$30,246,321 and \$27,546,796, respectively. This liability is VA Premier's best estimate based on available information.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**10. Related Parties**

**Virginia Commonwealth University**

Effective July 1, 1997, the Authority and the University, concurrently, entered into an affiliation agreement, which provides that each will support the mission of the other. The University will provide graduate medical education, clinical support, and administrative support to the Authority. The Authority will provide operation and maintenance support for certain buildings included in a five-year lease agreement and be the primary teaching hospital for the University.

The University leased the patient care facilities to the Authority under a ninety-nine year lease for the greater of the annual debt service on the facilities or \$1 per year. Additionally, the Authority leased space in other buildings from the University under a five-year lease with two renewal options, except the West Hospital which is not included in the renewal options.

Payments under the agreement with the University for the years ended June 30 were as follows:

	<u>2005</u>	<u>2004</u>
Payments by the University to the Authority:		
Operation and maintenance – Buildings (5 year lease)	<u>\$ 3,207,888</u>	<u>\$ 2,696,321</u>
Payments by the Authority to the University:		
Graduate education services	\$ 256,524	\$ 256,524
Non-physician clinical support	3,502,060	2,771,347
Administrative support	5,504,638	4,884,133
Rent on the short-term space	3,070,647	2,909,950
Principal and interest on parking deck debt	522,950	522,950
Use of steam plant	587,556	587,556
Total paid by the Authority to the University	<u>\$ 13,444,375</u>	<u>\$ 11,932,460</u>

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### **10. Related Parties (continued)**

#### **MCV Foundation**

The Hospitals gave an unrestricted gift of \$12.9 million and \$6.0 million to the Medical College of Virginia Foundation (MCV Foundation) for the years ended June 30, 2005 and 2004, respectively. These gifts were made in support of the educational and research mission of the Virginia Commonwealth University and its School of Medicine. For the years ended June 30, 2005 and 2004, \$2 million and \$0, respectively, was donated for similar purpose by Virginia Premier Health Plan to the MCV Foundation. In addition, for the years ended June 30, 2005 and 2004, MCV Physicians transferred \$0.7 million and \$4.8 million, respectively, to the MCV Foundation, which was also in support of the educational and research mission of the Virginia Commonwealth University and its School of Medicine. The MCV Foundation is a related party of VCUHS whose mission is to inspire and steward philanthropy throughout the MCV Campus of Virginia Commonwealth University.

#### **Intergovernmental Transfer**

The Authority participated in an intergovernmental transfer (IGT) with the Virginia Department of Medical Assistance (DMAS) in the amount of \$40,000,000 in June 2005 whereby the Authority transferred this amount to the Commonwealth of Virginia and received \$40,000,000 in supplemental payments from DMAS. These amounts are reflected as nonoperating activity in the accompanying statement of revenues, expenses and changes in net assets. The Commonwealth of Virginia intends to utilize the federal matching funds generated from this IGT for the Commonwealth's Medicaid budget.

### **11. Litigation**

The Hospitals have been named as defendant in a number of lawsuits regarding matters generally incidental to the business. The final outcome of any of these lawsuits cannot be determined at this time. However, management is of the opinion that any ultimate liability to which the Hospitals may be exposed will not have a material effect on the Authority's financial position or results of operations.

# The Virginia Commonwealth University Health System Authority

## Notes to Financial Statements (continued)

### 12. Contributions to Pension Plan

#### Hospitals

Prior to July 1, 1997, employees of the Hospital were employees of the Commonwealth of Virginia (the Commonwealth). These employees are eligible to participate in a defined benefit pension plan administered by the Virginia Retirement System (VRS). The VRS also administers life insurance and health-related plans for retired employees. Information relating to these plans is available at the statewide level only in the Commonwealth of Virginia's Comprehensive Annual Financial Report. The Commonwealth, not the Hospital, has overall responsibility for these plans. Total pension costs paid to the Commonwealth for the years ended June 30, 2005 and 2004 for these plans were approximately \$4,879,800 and \$4,645,000, respectively.

Effective July 1, 1997, the Hospital established the Medical College of Virginia Hospitals Authority Defined Contribution Plan (the Plan). Effective July 1, 2000, the Plan Sponsor and the Employer became a part of the Virginia Commonwealth University Health System Authority. The Plan was amended and restated effective January 1, 2002 and is now referred to as the VCUHS Retirement Plan. All employees, excluding Housestaff, working at least 20 hours a week in a benefit-eligible position are eligible to participate in the Plan. At June 30, 2005 and 2004, there were 4,017 and 3,772 participants, respectively, in the Plan. Per the Plan document as approved by the Hospital's Board of Directors, the Hospital contributes up to 10% of the participant's salary to the Plan not to exceed the lesser of (a) the amount in accordance with Code 415(d), or (b) one hundred percent (100%) of the Participant's Compensation for such limitation year. Total contributions to the Plan for the years ended June 30, 2005 and 2004 were approximately \$8,217,000 and \$8,831,000, respectively. The Hospital shall have the right at anytime, and without the consent of any party, to terminate the Plan in its entirety. Any changes to the provisions of the Plan, including the contribution requirements, must be approved in writing by the Hospital's Board of Directors.

The Authority has also established the Virginia Commonwealth University Health System Authority Health Care Providers Defined Contribution Plan (the HCP Plan). All persons hired as a health care provider on or after July 1, 1993 and prior to July 1, 1997 and working at least 35 hours of service per week are eligible to participate in the HCP Plan. At June 30, 2005 and 2004, there were 6 and 7 participants in the HCP Plan, respectively. All significant provisions of the HCP Plan, including the contribution requirements, are similar to the Plan. Total contributions to the HCP Plan for the years ended June 30, 2005 and 2004 were approximately \$30,400 and \$31,000, respectively.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**12. Contributions to Pension Plan (continued)**

**Hospitals (continued)**

The Plan and the HCP Plan use the accrual basis of accounting and the Plan assets, which consist of mutual funds, are carried at fair market value. The fair market values of the mutual funds are based on quoted market prices. Investments with investment managers at June 30 are as follows:

	<u>2005</u>	<u>2004</u>
Fidelity Investments	<b>\$ 30,747,110</b>	\$ 25,089,058
TIAA/CREF	<b>22,494,953</b>	18,827,947
VALIC	<b>11,237,421</b>	9,390,871
	<u><b>\$ 64,479,484</b></u>	<u>\$ 53,307,876</u>

**MCVAP**

MCVAP sponsors the MCVAP 401(a) Retirement Plan (the 401(a) Plan), a noncontributory, defined contribution plan which covers substantially all full-time clinical provider employees of MCVAP. Contributions to the 401(a) Plan by MCVAP, as determined annually at the discretion of the Board of Directors, were approximately \$5,288,000 and \$4,906,000 for the years ended June 30, 2005 and 2004, respectively.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**12. Contributions to Pension Plan (continued)**

**MCVAP (continued)**

MCVAP sponsors the VCUHS 401(a) Retirement Plan (the VCUHS 401(a) Plan), a defined contribution plan which covers all non-medical employees of MCVAP and the VCUHS 457(b) Retirement Plan (VCUHS 457(b) Plan), a salary reduction plan that represents employee contributions. These plans became effective on January 1, 2002 and replaced the MCVAP 403(b) plan for all non-medical staff. The 401(a) Plan contributions are a function of the employee's age plus years of service per the table below. MCVAP employees may contribute to the VCUHS 457(b) Salary Reduction Plan. Employees may also receive a 2% matching contribution in their VCUHS 401(a) Plan based on their 457(b) salary reduction contribution.

<u>Age + Years of Service</u>	<u>Employer Contribution (401(a) Plan)</u>
65+	10%
55 – 65	8
45 – 55	6
35 – 45	4
<35	2

Contributions to the VCUHS 401(a) Plan for the period ended June 30, 2005 and 2004 were approximately \$2,210,000 and \$3,160,000, respectively.

**VA Premier**

Effective August 1, 1999, VA Premier adopted a 401(k) plan sponsored by Prudential Mutual Fund Management, Inc. Employees may enter into the plan on the first day of the month coinciding with or following the date on which the employee begins employment. There is no minimum service or age requirement to be in the 401(k) plan. Employees may contribute 1% to 15% of their compensation. VA Premier will match 50% of the employees' contributions up to 4% of the employees' compensation. Matching will occur based on the bi-weekly pay periods. In addition, VA Premier contributes 3% of the employee's compensation after each bi-weekly payroll effective when the employee begins employment. Employees are fully vested after 4 years of service in which the employees have at least 1,000 hours of service each year. Contributions to the VA Premier 401(k) Plan in 2005 and 2004 were approximately \$463,000 and \$313,000, respectively.

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**13. Concentration of Credit Risk**

The Authority grants credit without collateral to its patients, most of whom are area residents insured under third-party payor agreements. The composition of net receivables from patients and third-party payors is as follows as of June 30:

	<u>2005</u>	<u>2004</u>
Medicaid	19%	28%
Commercial	9	9
Medicare	21	14
Anthem	31	30
Other	20	19
	<u>100%</u>	<u>100%</u>

Revenue from the Medicare and Medicaid/Indigent programs accounted for approximately 22% and 29%, respectively, of the Authority's net patient service revenue for the year ended June 30, 2005 (23% and 30%, respectively, for the year ended June 30, 2004). Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

**14. Federal Income Taxes**

VA Premier files a consolidated income tax return with UHS Managed Care, Inc. for U.S. tax purposes.

The income tax provision for VA Premier which is included in other expenses consisted of the following (in thousands):

	<b>June 30</b>	
	<u>2005</u>	<u>2004</u>
Current	\$ 9,074	\$ 3,271
Deferred	280	365
	<u>\$ 9,354</u>	<u>\$ 3,636</u>

The Virginia Commonwealth University Health System Authority

Notes to Financial Statements (continued)

**14. Federal Income Taxes (continued)**

There are differences between the provision for current income taxes and the amount determined by applying the federal statutory rate to income before income taxes which are attributed primarily to providing deferred income tax, state income taxes, and certain nondeductible expenses.

The components of the net deferred tax liability which is included in other current liabilities were as follows (in thousands):

	<b>June 30</b>	
	<b>2005</b>	<b>2004</b>
Deferred tax liabilities:		
Property and equipment basis	<b>\$(169)</b>	\$(234)
Intangibles	<b>(476)</b>	(131)
Net deferred tax liability	<b><u>\$(645)</u></b>	<b><u>\$(365)</u></b>

Income tax payments made in the year ending June 30, 2005 and 2004 were approximately \$9.6 million and \$2.5 million, respectively.

In March 2004, UHS and VA Premier requested a ruling from the Internal Revenue Service (IRS) to be treated as not-for-profit entities exempt from tax under Section 501(c)(3) of the Internal Revenue Code. Conversion to not-for-profit status may result in the payment of significant federal and state income taxes. No determination from the IRS has yet been received by UHS.

**15. Stop-Loss Coverage**

VA Premier has a stop-loss arrangement to limit its losses on individual claims. This contract provides stop-loss coverage for all VA Premier enrollee claims. This contract provides coverage for 100% of certain hospital claims in excess of \$100,000 subject to certain limitations and an annual limit of \$1,000,000 per enrollee and a lifetime limit of \$2,000,000 per enrollee. Stop-loss premiums net of reinsurance recoveries of approximately \$(483,000) and \$(352,000) are included in medical claims expense for the years ended June 30, 2005 and 2004, respectively.



# Other Financial Information

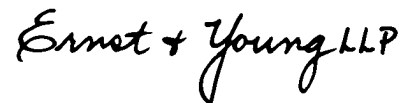


## Report of Independent Auditors on Other Financial Information

Board of Directors

The Virginia Commonwealth University Health System Authority

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise The Virginia Commonwealth University Health System Authority's basic financial statements. The accompanying financial statements as of and for the year ended June 30, 2005 as listed under "Other Financial Information" in the table of contents are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on them.



August 30, 2005

# Virginia Commonwealth University Health System Obligated Group

## Balance Sheet

June 30, 2005

	<b>Combined</b>	<b>Eliminations</b>	<b>MCV Hospitals</b>	<b>University Health Services, Inc.</b>
<b>Assets</b>				
Current assets:				
Cash and cash equivalents	\$ 89,758,107	\$ –	\$ 39,272,350	\$ 50,485,757
Patient accounts receivable and, less allowance for doubtful accounts of \$78,327,543	79,209,709	–	79,209,709	–
Non-patient accounts receivable	4,024,367	(2,000,000)	1,316,592	4,707,775
Due from affiliates	9,791,170	1,376,450	8,356,595	58,125
Inventories and prepaid expenses	12,675,403	–	12,377,415	297,988
Investments	14,534,501	–	14,534,501	–
Current portion of assets whose use is limited	33,488,308	–	33,488,308	–
<b>Total current assets</b>	<b>243,481,565</b>	<b>(623,550)</b>	<b>188,555,470</b>	<b>55,549,645</b>
Assets whose use is limited, less current portion	85,636,121	–	85,037,376	598,745
Capital assets:				
Land & improvements	1,670,525	–	670,525	1,000,000
Buildings and fixed equipment	310,308,168	–	293,308,845	16,999,323
Moveable equipment	264,577,652	–	259,801,100	4,776,552
Construction in progress	24,934,536	–	24,934,536	–
<b>Total capital assets</b>	<b>601,490,881</b>	<b>–</b>	<b>578,715,006</b>	<b>22,775,875</b>
Less allowance for depreciation	(304,059,610)	–	(297,432,585)	(6,627,025)
<b>Total capital assets, net</b>	<b>297,431,271</b>	<b>–</b>	<b>281,282,421</b>	<b>16,148,850</b>
Other assets:				
Deferred financing and bond issue costs, less accumulated amortization of \$928,601	918,646	–	918,646	–
Long-term investments	64,537,624	–	46,775,684	17,761,940
Goodwill, less accumulated amortization of \$2,821,121	4,424,899	–	–	4,424,899
Notes receivable	716,173	–	–	716,173
Investments in joint ventures	2,289,756	–	1,913,505	376,251
<b>Total other assets</b>	<b>72,887,098</b>	<b>–</b>	<b>49,607,835</b>	<b>23,279,263</b>
<b>Total assets</b>	<b>\$ 699,436,055</b>	<b>\$ (623,550)</b>	<b>\$ 604,483,102</b>	<b>\$ 95,576,503</b>

	<b>Combined</b>	<b>Eliminations</b>	<b>MCV Hospitals</b>	<b>University Health Services, Inc.</b>
<b>Liabilities and net assets</b>				
Current liabilities:				
Note payable	\$ 25,000,000	\$ –	\$ 25,000,000	\$ –
Current portion of long-term debt and capital leases payable	6,398,838	–	6,398,838	–
Current portion of estimated losses on malpractice claims	500,000	–	500,000	–
Due to affiliate	–	(550,000)	–	550,000
Other accrued liabilities	5,469,305	–	192,770	5,276,535
Trade accounts payable	29,336,888	(73,550)	23,624,472	5,785,966
Settlements due to third parties	36,934,733	–	36,934,733	–
Estimated medical claims payable (reported and unreported)	30,246,321	–	–	30,246,321
Accrued salaries, wages and professional fees	24,540,460	–	24,540,460	–
Accrued workers compensation claims	11,241,457	–	11,241,457	–
Accrued leave	8,041,144	–	8,041,144	–
Accrued interest payable	1,589,470	–	1,589,470	–
<b>Total current liabilities</b>	<b>179,298,616</b>	<b>(623,550)</b>	<b>138,063,344</b>	<b>41,858,822</b>
Other liabilities:				
Other	601,670	–	601,670	–
Long-term debt and capital leases, less current portion	74,684,567	–	74,684,567	–
Accrued leave	6,579,118	–	6,579,118	–
Estimated losses on malpractice claims	6,420,395	–	6,420,395	–
<b>Total liabilities</b>	<b>267,584,366</b>	<b>(623,550)</b>	<b>226,349,094</b>	<b>41,858,822</b>
Net assets:				
Invested in capital assets, net of related debt	216,347,865	–	200,199,016	16,148,849
Restricted net assets:				
Expendable	598,745	–	–	598,745
Nonexpendable	18,149,556	–	18,149,556	–
Unrestricted net assets	196,755,523	–	159,785,436	36,970,087
<b>Total net assets</b>	<b>431,851,689</b>	<b>–</b>	<b>378,134,008</b>	<b>53,717,681</b>
<b>Total liabilities and net assets</b>	<b>\$ 699,436,055</b>	<b>\$ (623,550)</b>	<b>\$ 604,483,102</b>	<b>\$ 95,576,503</b>

# Virginia Commonwealth University Health System Obligated Group

## Statement of Operations

Year ended June 30, 2005

	<b>Combined</b>	<b>Eliminations</b>	<b>MCV Hospitals</b>	<b>University Health Services, Inc.</b>
<b>Operating revenues:</b>				
Net patient service revenue	\$ 632,399,330	\$ (12,227,195)	\$ 644,626,525	\$ –
Other operating revenue	8,562,289	–	8,342,866	219,423
Premiums earned	276,216,363	–	–	276,216,363
	<u>917,177,982</u>	<u>(12,227,195)</u>	<u>652,969,391</u>	<u>276,435,786</u>
<b>Operating expenses:</b>				
Salaries and wages	254,038,751	–	244,991,927	9,046,824
Employee benefits	63,858,206	–	61,665,786	2,192,420
Medical claims expense	218,846,192	(12,227,195)	–	231,073,387
Purchased services	96,372,728	–	95,754,502	618,226
Supplies	137,075,132	–	135,651,971	1,423,161
Other expenses	43,202,487	–	25,658,077	17,544,410
Provision for depreciation and amortization	33,177,580	–	32,007,961	1,169,619
Interest expense	4,458,512	–	4,458,512	–
	<u>851,029,588</u>	<u>(12,227,195)</u>	<u>600,188,736</u>	<u>263,068,047</u>
Operating income	66,148,394	–	52,780,655	13,367,739
<b>Nonoperating revenues and expenses:</b>				
Investment income	6,738,509	–	5,373,837	1,364,672
Donations and gifts	(14,956,000)	–	(12,956,000)	(2,000,000)
Nonoperating income	125,892	–	125,892	–
Loss on equity in joint ventures	(2,866)	–	–	(2,866)
	<u>58,053,929</u>	<u>–</u>	<u>45,324,384</u>	<u>12,729,545</u>
Income before capital contributions, transfers and other	58,053,929	–	45,324,384	12,729,545
Increase in beneficial interest in trusts	845,007	–	845,007	–
Transfers from VCU	1,980,696	–	1,980,696	–
Contributed capital	(600,000)	–	(2,007,444)	1,407,444
Increase in net assets	60,279,632	–	46,142,643	14,136,989
Net assets beginning of year	371,572,057	–	331,991,365	39,580,692
Net assets end of year	<u>\$ 431,851,689</u>	<u>\$ –</u>	<u>\$ 378,134,008</u>	<u>\$ 53,717,681</u>