The Virginia Commonwealth University Health System Authority

Financial Statements

Years ended June 30, 2006 and 2005 with Report of Independent Auditors

The Virginia Commonwealth University Health System Authority

Financial Statements

Years ended June 30, 2006 and 2005

Contents

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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, 2006 and 2005, 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 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, 2006 and 2005, 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 3 through 17 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.

Ernst & Young LLP

August 31, 2006

0607-0754347-RIC

Our discussion and analysis of Virginia Commonwealth University Health System Authority's (VCUHSA) financial performance provides an overview of VCUHSA's financial activities for the fiscal years ended June 30, 2006 and 2005. Please read it in conjunction with the financial statements and footnotes which begin on page 18.

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 23 and 24. 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, 2006 and 2005 into their financial statements for the years ended June 30, 2006 and 2005. 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 Managed Care, Inc., which is a wholly owned subsidiary of UHS.

June 30, 2006 compared to June 30, 2005

FINANCIAL HIGHLIGHTS

- The Authority's net assets increased by $60.1 million, or 12.7%, over the prior years, as a result of this year's activity.

- Patient service revenues comprise the majority of the Authority revenues. Net patient service revenues increased $42.4 million, or 5.8% 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 $39.5 million or 14.3% from prior year. This was due to Virginia Premier's continued growth in enrollment. As a result of this expansion, Virginia Premier has 144,125 new member months, an increase of 13.4% over prior year.

- During the year, the Authority's expenses increased by $99.8 million from prior year. Approximately $30.4 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 $37.1 million increase in medical claims expense.

- The Authority showed income from operations for the year ended June 30, 2006 of $43.8 million, a $20.4 million decrease from operating income of $64.2 million for the year ended June 30, 2005.

- The major capital expenditures for the Authority in 2006 are related to the ongoing construction of a Critical Care Hospital, purchase of radiology, cardiology and radiation oncology equipment, investments in information systems infrastructure, business systems and equipment, and facility renovations.

- The Authority made $2.6 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 $534.2 million. Of these net assets, over 36.9% ($197.0 million) are related to capital assets, $19.6 million are restricted funds, and the remaining $317.7 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)

	June 30	
	2006	**2005**
Current and other assets	**$ 605,419**	$ 481,066
Capital assets	**325,661**	299,372
Total assets	**931,080**	780,438
Long-term liabilities outstanding	**205,982**	112,067
Other liabilities	**190,912**	194,317
Total liabilities	**396,894**	306,384
Net assets:		
Invested in capital assets, net of related debt	**196,950**	219,207
Restricted:		
Expendable	**596**	599
Nonexpendable	**18,937**	18,150
Unrestricted	**317,703**	236,098
Total net assets	**$ 534,186**	$ 474,054

The total net assets have increased $60.1 million.

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

	Year ended June 30	
	2006	**2005**
Revenues:		
Net patient service revenue	**$ 774,601**	$ 729,973
Premiums earned	**315,686**	276,216
Other revenues	**24,140**	26,611
Total revenues	**1,114,427**	1,032,800
Expenses:		
Salaries, wages and employee benefits	**476,889**	446,477
Depreciation and amortization expense	**36,262**	33,780
Other operating expense	**557,470**	488,380
Total expenses	**1,070,621**	968,637
Operating income	**43,806**	64,163
Net nonoperating revenue (expenses)	**16,875**	(6,524)
Income before transfers and beneficial interest in trusts	**60,681**	57,639
Transfers (to) from VCU and change in beneficial interest in trusts	**(549)**	2,826
Increase in net assets	**60,132**	60,465
Beginning net assets	**474,054**	413,589
Ending net assets	**$ 534,186**	$ 474,054

As a result of this year's activities, the Authority's total revenues increased by 7.7% ($79.4 million) over the prior year. This 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 10.3% ($99.8 million). Personnel costs are the largest single cost of the system, comprising 44.6% of the total costs. An increase in personnel related costs of $30.4 million, or 6.8%, 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 $37.1 million in medical claims expenses from Virginia Premier's network expansion and a $20.8 million increase in supplies.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2006, the Authority's capital assets had increased by $26.3 million, or 8.8% over last year.

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

	June 30	
	2006	**2005**
Land and improvements	**$ 1,592**	$ 1,716
Buildings and fixed equipment	**320,480**	310,903
Moveable equipment	**297,062**	270,725
Construction in progress	**49,684**	24,935
	668,818	608,279
Accumulated depreciation	**(343,157)**	(308,907)
Total	**$ 325,661**	$ 299,372

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

	Year ended June 30	
	2006	**2005**
Capital assets, beginning of year	**$ 299,372**	$ 276,728
Additions, net of transfers	**63,241**	58,825
Disposals, net of accumulated depreciation	**(739)**	(2,648)
Depreciation, net of disposals	**(36,213)**	(33,533)
Capital assets, end of year	**$ 325,661**	$ 299,372

Major projects capitalized include (in millions):

	Year ended June 30	
	2006	**2005**
Construction in progress of Critical Care Hospital	**$ 24.9**	$ 9.8
Performance Improvement Program for building heating and cooling/utility systems for the hospital and clinic buildings	**–**	4.8
Emergency generator replacement	**–**	4.7
Investments in information systems infrastructure, business systems, and equipment	**13.3**	–
Information system projects in process	**–**	4.3
Radiology, cardiology and radiation oncology equipment	**7.4**	8.2
Major renovation projects	**10.8**	13.6
Major purchase and replacement of equipment	**6.8**	13.4
	$ 63.2	$ 58.8

The Authority has a five-year capital plan which includes a budget of $91.6 million of expenditures in fiscal year 2007. 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 $175.2 million in bonds, construction debt and capital leases as shown in Table 5. The Authority's Bond Series 1998 is insured by MBIA. In December 2005, the Hospital issued an additional $100,000,000 of General Revenue Bonds. These bonds were issued as auction rate securities in three series and initially will bear interest rates at auction rates established for seven-day auction periods. Ambac Assurance Corporation insures the Bond Series 2005. The Hospital entered into a forward interest rate swap that will expire on December 15, 2015. More detailed information about the Hospital's long-term liabilities is discussed in Note 4 to the financial statements and the swap is discussed in Note 5 to the financial statements.

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

	June 30	
	2006	**2005**
General Revenue Bonds Series 2005	**$ 100,000**	$ –
General Revenue Bonds Series 1998	**61,005**	63,085
Construction debt	**2,163**	2,317
Capital leases	**12,041**	15,681
Total	**$ 175,209**	$ 81,083

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 service 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 member months, an increase of 17% over prior year.

- 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 46.2% ($219.2 million) are related to capital assets, $18.8 million are restricted funds, and the remaining $236.1 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)

	June 30	
	2005	**2004**
Current and other assets	**$ 481,066**	$ 407,122
Capital assets	**299,372**	276,728
Total assets	**780,438**	683,850
Long-term liabilities outstanding	**112,067**	102,090
Other liabilities	**194,317**	168,171
Total liabilities	**306,384**	270,261
Net assets:		
Invested in capital assets, net of related debt	**219,207**	200,587
Restricted:		
Expendable	**599**	601
Nonexpendable	**18,150**	17,307
Unrestricted	**236,098**	195,094
Total net assets	**$ 474,054**	$ 413,589

The total net assets have increased $60.5 million.

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**
Revenues:		
Net patient service revenue	**$ 729,973**	$ 641,856
Premiums earned	**276,216**	230,192
Other revenues	**26,611**	27,156
Total revenues	**1,032,800**	899,204
Expenses:		
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	**968,637**	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	**$ 474,054**	$ 413,589

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
	608,279	556,155
Accumulated depreciation	**(308,907)**	(279,427)
Total	**$ 299,372**	$ 276,728

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

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

Major projects capitalized include (in millions):

	Year ended June 30 2005	2004
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
	$ 58.8	$ 56.4

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)

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

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.

The Virginia Commonwealth University Health System Authority

Balance Sheets – Enterprise Funds

	June 30	
	2006	**2005**
Assets		
Current assets:		
Cash and cash equivalents	**$ 103,893,112**	$ 113,844,437
Patient accounts receivable, less allowance for doubtful accounts of $70,013,000 and $95,197,000 in 2006 and 2005, respectively	**95,091,013**	90,114,442
Non-patient accounts receivable	**5,707,669**	5,263,874
Inventories and prepaid expenses	**12,607,707**	13,265,214
Short-term investments	**111,569,244**	32,416,846
Current portion of assets whose use is limited	**10,439,765**	34,488,308
Total current assets	**339,308,510**	289,393,121
Assets whose use is limited, less current portion	**201,463,055**	112,892,901
Capital assets:		
Land and improvements	**1,592,425**	1,716,025
Depreciable capital assts, less accumulated depreciation of $343,157,452 in 2006 and $308,907,034 in 2005	**324,068,722**	297,655,873
	325,661,147	299,371,898
Other assets:		
Deferred financing and bond issuance costs, less accumulated amortization of $394,598 and $345,273 in 2006 and 2005, respectively	**4,031,672**	918,646
Long-term investments	**47,775,701**	70,430,484
Notes receivable from affiliates	**716,173**	716,173
Other	**7,699,229**	2,289,756
Goodwill, less accumulated amortization of $2,821,121 in 2006 and 2005	**4,424,899**	4,424,899
Total other assets	**64,647,674**	78,779,958
Total assets	**$ 931,080,386**	$ 780,437,878

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	June 30	
	2006	**2005**
Liabilities and net assets		
Current liabilities:		
Note payable	**$ –**	$ 25,000,000
Current portion of long-term debt and capital leases	**5,724,387**	6,398,838
Current portion of estimated losses on malpractice claims	**3,200,000**	1,500,000
Estimated medical claims payable (reported and unreported)	**30,711,322**	30,246,321
Trade accounts payable	**31,633,879**	30,389,116
Settlements due to third parties	**55,943,286**	36,934,733
Clinical earnings contribution to VCU	**5,845,729**	2,688,191
Accrued workers compensation claims	**11,529,346**	11,241,457
Accrued salaries, wages and professional fees	**28,945,143**	32,757,514
Accrued leave	**10,728,583**	9,420,103
Accrued interest payable	**1,543,709**	1,589,470
Due to affiliate	**147,175**	469,590
Other accrued liabilities	**4,960,019**	5,681,321
Total current liabilities	**190,912,578**	194,316,654
Other liabilities:		
Long-term debt and capital leases, less current portion	**169,484,233**	74,684,567
Accrued leave	**6,953,817**	6,579,118
Estimated losses on malpractice claims	**28,942,282**	30,202,199
Other	**601,670**	601,670
Total liabilities	**396,894,580**	306,384,208
Net assets:		
Invested in capital assets, net of related debt	**196,949,584**	219,207,139
Restricted:		
Expendable	**596,073**	598,745
Nonexpendable	**18,937,324**	18,149,556
Unrestricted	**317,702,825**	236,098,230
Total net assets	**534,185,806**	474,053,670
Total liabilities and net assets	**$ 931,080,386**	$ 780,437,878

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	
	2006	**2005**
Operating revenues:		
Net patient service revenue	**$ 772,401,249**	$ 729,972,568
Other contract revenue	**13,244,249**	11,835,242
Medical consultation income	**1,773,227**	1,693,835
Premiums earned	**315,686,397**	276,216,363
Other operating revenue	**9,122,145**	13,081,697
	1,112,227,267	1,032,799,705
Operating expenses:		
Salaries and wages	**390,579,785**	362,795,011
Employee benefits	**86,309,172**	83,681,885
Purchased services	**70,835,854**	58,090,682
Medical claims expense	**253,021,147**	215,902,593
Clinical earnings contribution to VCU	**4,376,108**	4,059,437
Other distributions to VCU	**2,356,028**	2,897,134
Supplies	**164,052,754**	143,299,455
Other expenses	**56,393,488**	59,671,550
Provision for depreciation and amortization	**36,262,497**	33,780,386
Interest expense	**4,234,722**	4,458,512
	1,068,421,555	968,636,645
Operating income	**43,805,712**	64,163,060
Nonoperating revenues and expenses:		
Investment income	**16,924,726**	8,985,957
Other nonoperating income	**2,645,385**	125,892
Loss on investments in joint ventures	**(11,064)**	(2,866)
Donations and gifts	**(2,684,027)**	(15,633,213)
Total nonoperating revenues and expenses	**16,875,020**	(6,524,230)
Income before transfers and beneficial interest in trusts	**60,680,732**	57,638,830
Contributions for purchases of capital assets	**919,018**	1,980,696
Transfer to VCU	**(2,250,350)**	–
Increase in beneficial interest in trusts	**782,736**	845,007
Increase in net assets	**60,132,136**	60,464,533
Net assets at beginning of year	**474,053,670**	413,589,137
Net assets at end of year	**$ 534,185,806**	$ 474,053,670

See accompanying notes.

The Virginia Commonwealth University Health System Authority

Statements of Cash Flows – Enterprise Funds

	Year ended June 30 2006	2005
Cash flows from operating activities:		
Cash received from patients and third-party payors and premiums	**$ 1,117,137,104**	$ 1,013,483,014
Other operating cash receipts	**8,678,350**	16,493,278
Cash paid to employees	**(478,730,260)**	(425,209,441)
Cash paid to suppliers	**(545,515,861)**	(467,791,382)
Net cash provided by operating activities	**101,569,333**	136,975,469
Cash flows from capital and related financing activities:		
Acquisition and construction of capital assets, net	**(65,664,772)**	(56,406,135)
Donations and gifts	**(2,684,027)**	(15,633,213)
Principal payments on long-term debt and capital lease obligations	**(6,473,128)**	(6,835,295)
Repayment of line of credit	**(25,000,000)**	–
Contributions for purchases for capital assets	**(1,331,332)**	1,980,696
Proceeds from bond issuance	**100,000,000**	–
Interest expense	**(4,234,722)**	(4,458,512)
Decrease in accrued interest payable	**(45,761)**	(42,893)
Change in other assets	**(2,903,768)**	–
Net cash used in capital and related financing activities	**(8,337,510)**	(81,395,352)
Cash flows from investing activities:		
Change in cash and cash equivalents, included in investments	**(48,620,778)**	(30,654,996)
Purchases of investments	**(191,153,293)**	(114,496,515)
Sales of investments	**118,754,845**	133,734,516
Change in beneficial interest in perpetual trusts	**782,736**	845,007
Investment income	**16,924,726**	8,985,957
Increase in other assets	**(2,516,769)**	(158,671)
Change in notes receivable	**–**	76,345
Nonoperating income	**2,645,385**	125,892
Other	**–**	574,670
Net cash used in investing activities	**(103,183,148)**	(967,795)
Net (decrease) increase in cash and cash equivalents	**(9,951,325)**	54,612,322
Cash and cash equivalents at beginning of year	**113,844,437**	59,232,115
Cash and cash equivalents at end of year	**$ 103,893,112**	$ 113,844,437
Supplemental information:		
Assets acquired through capital lease obligations	**$ 598,343**	$ 10,840,764

(continued)

The Virginia Commonwealth University Health System Authority

Statements of Cash Flows – Enterprise Funds (continued)

	Year ended June 30	
	2006	**2005**
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	**$ 43,805,712**	$ 64,163,060
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	**36,262,497**	33,780,386
Interest expense	**4,234,722**	4,458,512
Changes in operating assets and liabilities:		
Patient accounts receivable	**(4,976,571)**	(8,025,644)
Due to/from third-party payors	**19,008,553**	1,790,650
Non-patient accounts receivable	**(443,795)**	3,411,581
Inventories and prepaid expenses	**657,507**	(3,239,406)
Accrued salaries, wages, and professional fees	**(3,812,371)**	4,481,880
Accrued leave	**1,683,179**	873,984
Accrued workers compensation claims	**287,889**	5,070,827
Trade accounts payable	**1,843,106**	16,528,727
Clinical earnings contribution	**3,157,538**	1,787,791
Estimated losses on malpractice claims	**440,083**	6,794,257
Estimated medical claims payable	**465,001**	2,699,525
Other accrued liabilities	**(721,302)**	1,929,749
Due to affiliate	**(322,415)**	469,590
Net cash provided by operating activities	**$ 101,569,333**	$ 136,975,469

See accompanying notes.

The Virginia Commonwealth University Health System Authority

Balance Sheets – Pension Trust Funds

	June 30	
	2006	**2005**
Assets		
Assets whose use is limited	**$ 71,168,709**	$ 64,479,484
Net assets		
Reserve for employees' pension benefits	**$ 71,168,709**	$ 64,479,484

See accompanying notes.

The Virginia Commonwealth University Health System Authority

Statements of Changes in Net Assets – Pension Trust Funds

	Year ended June 30	
	2006	**2005**
Beginning net assets	**$ 64,479,484**	$ 53,307,876
Pension contributions	**10,116,734**	10,521,541
Investment gain	**5,366,954**	3,582,941
Pension benefit payments	**(3,766,061)**	(2,932,874)
Other	**(5,028,402)**	–
Ending net assets	**$ 71,168,709**	$ 64,479,484

See accompanying notes.

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.

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.

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.

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 represent amounts given to other non-profit organizations and 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 $150,504,000 and $149,904,000 for the years ended June 30, 2006 and 2005, respectively.

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.

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, 2002.

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 $234 million and $217 million in 2006 and 2005, respectively. The Authority's Medicaid cost reports have been audited by the Medicaid program representative through June 30, 2001.

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.

Settlements due to third parties include amounts that are currently under appeal with various federal and state agencies. 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, appeals and investigations.

Net patient service revenue decreased by approximately $12,300,000 in 2006 and increased by approximately $5,800,000 in 2005 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 to VCU

Clinical earnings contribution represent amounts MCVAP has agreed to contribute to the VCU School of Medicine in support of its academic and educational goals and is based on percentage of net patient service revenue, as defined.

1. Summary of Significant Accounting Policies (continued)

Allowance for Doubtful Accounts

The Authority records an allowance for doubtful accounts during the period in which collection is considered doubtful. Bad debt expense is included in net patient service revenue.

Investments

Investments in open-end mutual funds, debt securities, and equity securities are carried at fair value based on quoted market prices. Short-term investments include investments whose maturity is less than one year 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.

1. Summary of Significant Accounting Policies (continued)

Assets Whose Use is Limited

Resources restricted for debt service under bond indenture agreements, 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 $18,912,000 and $18,151,000 are restricted by donors for the Authority in perpetuity and are included in assets whose use is limited at June 30, 2006 and 2005, 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 or expenses, and investment transactions of restricted funds are recorded in restricted net assets. The income earned on nonexpendable 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.

1. Summary of Significant Accounting Policies (continued)

Accrued Workers' Compensation Claims

The Authority is self insured for workers' compensation and provides for the liability on an undiscounted basis 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.

Reclassifications

Certain prior year amounts have been reclassified to conform to the current year's presentation.

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, 2006 and 2005 totaled $103,893,112 and $113,844,437, respectively, and the bank balance totaled $105,515,959 and $126,924,506, 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, 2006 and 2005, 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 the Authority's Statement of Spending and Investment Policy, adopted by its Board of Directors, the Authority 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.

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

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

	Fair Value	
	2006	**2005**
Enterprise Funds:		
Assets whose use is limited:		
Externally restricted by insurance regulations	**$ 596,073**	$ 598,745
Externally restricted under bond indenture	**46,184,097**	3,670,406
Internally restricted by the board for capital acquisition	**108,834,615**	89,800,000
Externally restricted by donor	**18,937,324**	18,151,156
Internally restricted for medical malpractice (MCVAP)	**–**	28,256,780
Externally restricted under medical malpractice trust (MCVAP)	**30,026,533**	–
Externally restricted under medical malpractice trust (MCV Hospitals)	**7,324,178**	6,904,122
	$ 211,902,820	$ 147,381,209
Investments	**$ 159,344,945**	$ 102,847,330
Pension Trust Funds:		
Externally restricted under pension plan agreement	**$ 71,168,709**	$ 64,479,484

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

As of June 30, 2006, investments (including assets whose use is limited) mature as follows:

		Investment Maturities (In Years)			
	Fair Value	**Less than 1**	**1-5**	**6-10**	**More than 10**
Cash and cash equivalents	**$ 9,465,021**	**$ 9,465,021**	**$ –**	**$ –**	**$ –**
Money market	**13,921,248**	**13,921,248**	**–**	**–**	**–**
Mutual funds	**57,451,588**	**N/A**	**N/A**	**N/A**	**N/A**
Marketable equity securities	**21,365,151**	**N/A**	**N/A**	**N/A**	**N/A**
U.S. treasury notes	**30,508,077**	**16,070,036**	**5,027,505**	**3,013,673**	**6,396,863**
Commercial paper	**155,670,931**	**155,670,931**	**–**	**–**	**–**
Asset backed securities	**6,497,157**	**–**	**4,854,403**	**759,480**	**883,274**
Agency backed mortgages	**26,898,003**	**9,363,816**	**3,831,439**	**2,009,021**	**11,693,727**
Corporate notes	**20,093,429**	**6,257,467**	**9,015,398**	**3,924,186**	**896,378**
Corporate bonds	**9,816,409**	**1,808,077**	**3,692,712**	**1,513,296**	**2,802,324**
Interest receivable	**263,928**	**263,928**	**–**	**–**	**–**
Beneficial interest in perpetual trust	**18,911,931**	**–**	**–**	**–**	**18,911,931**
Other	**384,892**	**384,892**	**–**	**–**	**–**
	$ 371,247,765	**$ 213,205,416**	**$ 26,421,457**	**$ 11,219,656**	**$ 41,584,497**

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

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

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

		Investment Maturities (In Years)			
	Fair Value	**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
	$ 250,228,539	$ 122,199,787	$ 45,038,014	$ 18,884,268	$ 42,670,977

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

3. Capital Assets

Capital assets, and changes thereto, as of and for the year ended June 30, 2006, consisted of the following:

	Beginning Balance	Additions	Transfers and Disposals	Ending Balance
Land and improvements	$ 1,716,025	$ –	$ (123,600)	$ 1,592,425
Buildings and fixed equipment	310,972,032	10,324,203	(816,770)	320,479,465
Moveable equipment	270,656,339	28,167,758	(1,761,766)	297,062,331
Construction in progress	24,934,536	41,210,961	(16,461,119)	49,684,378
	608,278,932	79,702,922	(19,163,255)	668,818,599
Less accumulated depreciation	(308,907,034)	(36,213,173)	1,962,755	(343,157,452)
	$ 299,371,898	$ 43,489,749	$ (17,200,500)	$ 325,661,147

3. Capital Assets (continued)

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

	Beginning Balance	Additions	Transfers and Disposals	Ending Balance
Land and improvements	$ 2,683,248	$ –	$ (967,223)	$ 1,716,025
Buildings and fixed equipment	295,329,465	15,642,567	–	310,972,032
Moveable equipment	253,680,872	22,709,879	(5,734,412)	270,656,339
Construction in progress	4,461,741	29,807,548	(9,334,753)	24,934,536
	556,155,326	68,159,994	(16,036,388)	608,278,932
Less accumulated depreciation	(279,427,701)	(33,532,943)	4,053,610	(308,907,034)
	$ 276,727,625	$ 34,627,051	$ (11,982,778)	$ 299,371,898

4. Long-Term Debt

Long-term debt, and changes thereto, as of and for the year ended June 30, 2006 is summarized below:

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
Series 2005 Bonds	$ –	$100,000,000	$ –	$ 100,000,000	$ –
Series 1998 Bonds	63,085,000	–	(2,080,000)	61,005,000	2,175,000
Construction debt	2,317,507	–	(155,000)	2,162,507	172,679
Capital leases	15,680,898	598,343	(4,238,128)	12,041,113	3,376,708
Total long-term debt	$ 81,083,405	$100,598,343	$ (6,473,128)	$ 175,208,620	$ 5,724,387

4. Long-Term Debt (continued)

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

	Beginning Balance	Additions	Reductions	Ending Balance	Amounts Due Within One Year
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
Total long-term debt	$ 77,077,936	$10,902,415	$ (6,896,946)	$ 81,083,405	$ 6,398,838

In December 2005, the Hospitals issued $100 million of General Revenue Bonds, Series 2005 to fund a portion of the cost of constructing a new critical care hospital, refund existing indebtedness of the Hospitals and pay certain costs of issuance of the Series 2005 Bonds. The bonds were issued at face value with interest rates determined at auction at a 7-day interval, not to exceed 15% per annum (the rate averaged 3.1% for the year ended June 30, 2006). The bonds may be convertible to an auction period of a different length at the option of the VCUHS under certain conditions. The bonds are subject to mandatory sinking fund redemptions with principal amounts varying between $1,825,000 on July 1, 2010 and $9,650,000 at maturity on July 1, 2031.

In December 2005, University Health Services, Inc., and its subsidiaries, UHS at Stony Point, Inc. and UHS Managed Care, Inc. were removed as members of the Obligated Group under the Series 1998 and 2005 General Revenue Bonds.

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, 2024. 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%.

4. Long-Term Debt (continued)

A summary of future principal requirements of long-term debt as of June 30, 2006 follows:

	Series 2005 Bonds	Series 1998 Bonds	Construction Debt Due to the University	Capital Leases	Total
2007	$ –	$ 2,175,000	$ 172,679	$ 3,376,708	$ 5,724,387
2008	–	2,270,000	182,680	2,463,750	4,916,430
2009	–	2,385,000	193,954	2,409,586	4,988,540
2010	1,825,000	2,500,000	196,373	2,853,613	7,374,986
2011	1,875,000	2,625,000	206,377	707,732	5,414,109
2012 – 2016	10,500,000	15,215,000	1,210,444	229,724	27,155,168
2017 – 2021	12,450,000	19,540,000	–	–	31,990,000
2022 – 2026	25,500,000	14,295,000	–	–	39,795,000
2027 – 2031	47,850,000	–	–	–	47,850,000
Total	$ 100,000,000	$ 61,005,000	$ 2,162,507	$ 12,041,113	$ 175,208,620

A summary of future interest requirements of long-term debt as of June 30, 2006 follows:

	Series 2005 Bonds	Series 1998 Bonds	Construction Debt Due to the University	Total
2007	$ 3,274,000	$ 2,991,721	$ 104,708	$ 6,370,429
2008	3,274,000	2,878,221	95,532	6,247,753
2009	3,274,000	2,758,971	85,742	6,118,713
2010	3,214,250	2,633,971	77,984	5,926,205
2011	3,152,862	2,502,721	68,165	5,723,748
2012 – 2016	14,757,556	7,949,725	174,120	22,881,401
2017 – 2021	12,851,270	5,766,138	–	18,617,408
2022 – 2026	10,066,732	756,962	–	10,823,694
2027 – 2030	3,242,079	–	–	3,242,079
Total	$ 57,106,749	$ 28,238,430	$ 606,251	$ 85,951,430

4. Long-Term Debt (continued)

The Hospitals are required to make interest and principal payments to the interest and principal accounts included in the bond funds for the Series 2005 and Series 1998 Bonds. For the years ended June 30, 2006 and 2005, the Hospitals transferred approximately $3,717,000 and $3,669,000, respectively, to the bond service accounts.

The Series 2005 and 1998 bond agreements place restrictions on future borrowings and require certain minimum insurance coverage. The related agreements also contain certain covenants, including a requirement that charges to patients are 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 125 percent of maximum total annual debt service in each fiscal year.

The fair value of 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:

	2006		**2005**	
	Carrying Value	**Fair Value**	**Carrying Value**	**Fair Value**
Long-term obligations	**$163,167,507**	**$164,394,092**	$ 65,402,507	$ 69,670,790

Interest expense for the years ended June 30 is summarized as follows:

	2006	**2005**
Total interest incurred	**$ 5,869,646**	$ 4,458,512
Less interest capitalized as part of construction in progress	**1,634,924**	–
	$ 4,234,722	$ 4,458,512

Interest income from unexpended proceeds totaling approximately $1,070,000 was capitalized during 2006 as a reduction of construction in progress costs.

For the years ended June 30, 2006 and 2005, the Authority paid approximately $4,280,000 and $4,501,000, respectively, for interest (net of amounts capitalized).

4. Long-Term Debt (continued)

The Hospitals had an unsecured $25,000,000 line of credit with First Union National Bank which expired on June 27, 2006. The interest rate was LIBOR plus 0.75%. At June 30, 2005, $25,000,000 was outstanding on this line of credit.

5. Derivative Instrument

In December 2005, the Hospitals entered into an interest rate swap agreement in conjunction with the issuance of its Series 2005 tax-exempt bonds (see Note 4). The swap has a notional amount of $75 million, which declines over time to $67 million at the maturity date of December 15, 2015. The Hospital pays a fixed rate of 3.274% and the counterparty pays 67% of LIBOR. The payments are settled monthly at the first of the month. Financial Accounting Standards Board (FASB) Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, requires companies to recognize their derivative instruments as either assets or liabilities in the balance sheet at fair value. As of June 30, 2006, the fair market value of the swap is included with other non-current assets in the accompanying balance sheets – enterprise funds. Changes in the fair market value of the swap is reported on the accompanying statements of revenues, expenses and changes in net assets – enterprise funds as nonoperating revenue or expense. As the swap agreement is not designated as an effective cash flow hedge, any payments or receipts under the terms of the swap are also recorded as nonoperating revenue or expense. For the year ended June 30, 2006, the Hospitals recognized other nonoperating income related to the change in fair value of the swap of approximately $2.5 million.

6. Operating Leases

Total expense under operating leases was approximately $6,574,000 and $7,352,000 in 2006 and 2005, respectively. Future minimum lease payments for noncancelable operating leases are as follows:

2007	$ 4,382,782
2008	3,186,181
2009	1,967,527
2010	270,954
	$ 9,807,444

7. Commitments

Estimated costs to complete construction in progress for capital assets at June 30, 2006 are approximately $89 million related to the construction of a 300 unit bed tower, the implementation of the Lawson General Ledger system, and various other projects.

8. 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.

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.

8. Contingencies (continued)

Professional Liability (continued)

MCV Hospitals (continued)

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 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. The Hospitals' management accrues 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 for the Hospitals at June 30, 2006 and 2005 is approximately $6,669,000 and $6,920,000, respectively, for claims and related legal expenses for reported and unreported incidents. The liability (undiscounted in 2006, discounted at 1% in 2005) 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, 2006 and 2005, the medical malpractice trust fund for the Hospitals includes approximately $7,324,000 and $6,904,000, respectively.

MCVAP

MCVAP is 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, 2006 and 2005, assets whose use is limited includes $30,026,533 and $28,256,780, respectively, that will be used to fund malpractice claims. Also, estimated losses on malpractice claims was approximately $25,500,000 and $24,782,000 at June 30, 2006 and 2005, respectively.

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, 2006 and 2005, 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.

8. 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.

MCVAP management is of the opinion that its financial position would not be materially affected by the difference between the amount recorded and the ultimate cost related to unasserted claims, if any, at June 30, 2006.

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, 2006 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.

9. Net Patient Service Revenue

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

	2006	2005
Gross patient revenue:		
Inpatient:		
Routine services	**$ 192,181,328**	$ 179,593,338
Ancillary services	**861,937,658**	763,117,630
Outpatient:		
Emergency	**67,357,381**	54,082,918
Special medical	**510,720,335**	448,729,177
Total gross patient service revenue (Hospitals)	**1,632,196,702**	1,445,523,063
Provision for indigent care, contractual adjustments and bad debts	**(964,790,940)**	(813,123,733)
Net patient service revenue (Hospitals)	**667,405,762**	632,399,330
MCVAP's net patient service revenue	**107,195,487**	97,573,238
Net patient service revenue (Authority)	**$ 774,601,249**	$ 729,972,568

10. Estimated Medical Claims Payable

Medical 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, 2006 and 2005 includes an estimate of claims that have been incurred but not reported. At June 30, 2006 and 2005, the amount of these liabilities were $30,711,322 and $30,246,321, respectively. This liability is VA Premier's best estimate based on available information.

11. Related Parties

Virginia Commonwealth University

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

The University leased the patient care facilities to the Hospital under a ninety-nine year lease for the greater of the annual debt service on the facilities or $1 per year. Additionally, the Hospital leased space in other buildings from the University under a five-year lease with two five-year renewal options. Leased space in the West Hospital is renewed on an annual basis.

In connection with the University's construction of a parking deck at 8th and Duval Streets on the Hospitals' campus, the Hospitals agreed to fund approximately $2,250,000 of the construction costs and to assume responsibility for 50% of the payments on the associated construction debt. The Hospitals' total commitment through 2026 is approximately $9,150,000. This transfer has been recorded as a transfer to the University in the accompanying statement of revenues, expenses and changes in net assets – enterprise funds for the year ended June 30, 2006.

Payments under the affiliation and lease agreements with the University for the years ended June 30 were as follows:

	2006	2005
Payments by the University to the Authority:		
Operation and maintenance – Buildings (5 year lease)	**$ 3,207,888**	$ 3,207,888
Payments by the Authority to the University:		
Graduate education services	**$ 256,524**	$ 256,524
Non-physician clinical support	**3,688,715**	3,502,060
Administrative support	**6,011,049**	5,504,638
Rent on the short-term space	**3,070,647**	3,070,647
Principal and interest on parking deck debt	**268,423**	522,950
Use of steam plant	**586,719**	587,556
Total paid by the Authority to the University	**$ 13,882,077**	$ 13,444,375

11. Related Parties (continued)

MCV Foundation

The Hospitals gave an unrestricted gift of $12.9 million to the Medical College of Virginia Foundation (MCV Foundation) during the year ended June 30, 2005. This gift was made in support of the educational and research mission of the Virginia Commonwealth University and its School of Medicine. No such gift was given by the Hospitals during the year ended June 30, 2006. For the years ended June 30, 2006 and 2005, $2 million was donated for a similar purpose by Virginia Premier Health Plan to the MCV Foundation. In addition, for the years ended June 30, 2006 and 2005, MCV Physicians transferred $0.6 million and $0.7 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. No such IGT occurred during 2006.

12. 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.

13. Contributions to Pension Plan

Hospitals

Prior to July 1, 1997, employees of the Hospitals 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 Hospitals, has overall responsibility for these plans. Total pension costs paid to the Commonwealth for the years ended June 30, 2006 and 2005 for these plans were approximately $4,745,000 and $4,879,800, respectively.

Effective July 1, 1997, the Hospitals 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, 2006 and 2005, there were 4,164 and 4,017 participants, respectively, in the Plan. Per the Plan document as approved by the Hospitals' Board of Directors, the Hospitals contribute 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, 2006 and 2005 were approximately $10,062,000 and $8,217,000, 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 Hospitals' 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, 2006 and 2005, there were 6 participants in the HCP Plan. 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, 2006 and 2005 were approximately $29,900 and $30,400, respectively.

13. 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:

	2006	**2005**
Fidelity Investments	**$ 37,815,903**	$ 30,747,110
TIAA/CREF	**26,243,571**	22,494,953
VALIC	**7,109,235**	11,237,421
	$ 71,168,709	$ 64,479,484

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 $6,211,000 and $5,288,000 for the years ended June 30, 2006 and 2005, respectively.

13. 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.

Age + Years of Service	Employer Contribution (401(a) Plan)
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, 2006 and 2005 were approximately $2,212,000 and $2,210,000, 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 2006 and 2005 were approximately $430,000 and $463,000, respectively.

14. 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:

	2006	2005
Medicaid	**11%**	12%
Commercial	**4**	6
Medicare	**17**	14
Anthem	**23**	21
Other	**45**	47
	100%	100%

Revenue from the Medicare and Medicaid/Indigent programs accounted for approximately 22% and 19%, respectively, of the Authority's net patient service revenue for the year ended June 30, 2006 (22% and 20%, respectively, for the year ended June 30, 2005). 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.

15. 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:

	June 30	
	2006	2005
Current	**$ 7,709,392**	$ 9,073,604
Deferred	**180,577**	280,689
	$ 7,889,969	$ 9,354,293

15. 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 on 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:

	June 30	
	2006	**2005**
Deferred tax liabilities:		
Property and equipment basis	**$ 107,040**	$ 169,170
Intangibles	**719,226**	476,520
Net deferred tax liability	**$ 826,266**	$ 645,690

Income tax payments made in the year ending June 30, 2006 and 2005 were approximately $7.8 million and $9.6 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.

16. 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 $(470,000) and $(483,000) are included in medical claims expense for the years ended June 30, 2006 and 2005, respectively.