University of Illinois

Annual Financial Report
Health Services Facilities System

Year Ended June 30, 2004 with Comparative Totals for 2003

THE BOARD OF TRUSTEES

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From the Vice President for Administration, Comptroller

UNIVERSITY OF ILLINOIS

Chicago ● Springfield ● Urbana-Champaign

Office of Vice President for Administration, Comptroller
349 Henry Administration Building
506 South Wright Street
Urbana, IL 61801

October 15, 2004

Holders of University of Illinois
Health Services Facilities System Revenue Bonds
and
The Board of Trustees
University of Illinois

I am pleased to transmit the Annual Financial Report of the University of Illinois Health Services Facilities System for the fiscal year ended June 30, 2004. This report supplements the financial statements of the University of Illinois presented in the Annual Financial Report.

The 2004 financial statements and accompanying notes appearing on pages 4 through 16 have been audited by Clifton Gunderson LLP, Independent Certified Public Accountants, as special assistants to the Auditor General of the State of Illinois, whose report on the financial statements and applicable notes appears on page 3.

Clifton Gunderson LLP will also prepare a report for the year ended June 30, 2004, containing special data requested by the Auditor General and another report covering their audit of the compliance of the University with applicable state and federal laws and regulations for the year ended June 30, 2004. These reports, which include some data related to the Health Services Facilities System, are not contained herein and are primarily for the use of the Auditor General and state and federal agencies.

Respectfully submitted,

Stephen K. Rugg
Vice President for
Administration,
Comptroller

Independent Auditor's Report

Clifton Gunderson LLP
Certified Public Accountants & Consultants

The Honorable William G. Holland
Auditor General
State of Illinois
and
The Board of Trustees
University of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying statement of net assets of the University of Illinois (University) Health Services Facilities System (System) as of June 30, 2004, and the related statements of revenues, expenses and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the System's 2003 financial statements and, in our report dated September 16, 2003 we expressed an unqualified opinion on those financial statements.

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

The accompanying financial statements were prepared for the purpose of complying with the requirements of the indenture for the System's Series 1997A and 1997B Revenue Bonds, as described in Note 1, and are not intended to be a complete presentation of the University's assets, liabilities, revenues and expenses.

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

In connection with our audit, nothing came to our attention that caused us to believe that the System failed to comply with the terms, covenants, provisions or conditions of the Resolution of the Board of Trustees of the University of Illinois which provided for the issuance of the University of Illinois Health Services Facilities System Revenue Bonds, Series 1997A and 1997B, insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2004, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

This report is intended solely for the information and use of the Auditor General of the State of Illinois, the General Assembly, the Legislative Audit Commission, the Governor, the Board of Trustees and management of the University of Illinois, and the bondholders and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Peoria, Illinois
October 15, 2004

Statement of Net Assets as of June 30, 2004
with Comparative Totals for 2003

	2004	2003
Current assets:		
Claim on cash and on pooled investments	$ 23,263,144	$ 25,064,962
Restricted cash, required for current liabilities	652,273	663,321
Patient receivables, less allowance for doubtful accounts of $180,767,606	65,401,034	61,827,589
Other receivables	5,756,457	5,143,424
Inventories	4,771,182	5,208,887
Prepaid expenses and other deposits	9,244,952	1,039,239
Total current assets	109,089,042	98,947,422
Noncurrent assets:		
Restricted cash and investments,less amount required for current liabilities of $652,273	1,246,820	3,766,857
Capital assets	176,424,080	173,110,782
Prepaid expenses	698,419	731,679
Total noncurrent assets	178,369,319	177,609,318
Total assets	$ 287,458,361	$ 276,556,740
Current liabilities:		
Accounts payable	$ 14,032,852	$ 13,136,578
Accrued expenses	6,853,496	13,546,034
Accrued interest payable	652,273	663,321
Estimated third party settlements	15,131,310	11,476,080
Current maturities of long term liabilities	5,268,123	2,725,320
Current portion of compensated absences	781,776	1,000,000
Total current liabilities	42,719,830	42,547,333
Noncurrent liabilities:		
Long term debt, net of current maturities	79,354,735	71,856,112
Accrued compensated absences, net of current portion	19,704,613	20,736,741
Total noncurrent liabilities	99,059,348	92,592,853
Total liabilities	141,779,178	135,140,186
Net Assets:		
Invested in capital assets, net of related debt	99,645,226	98,822,443
Restricted -		
Expendable for capital projects	1,220,378	3,738,524
Expendable for debt service	26,442	28,332
Unrestricted	44,787,137	38,827,255
Total net assets	145,679,183	141,416,554
Total liabilities and net assets	$ 287,458,361	$ 276,556,740

See accompanying notes to financial statements.

Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended June 30, 2004 with Comparative Totals for 2003

	2004	2003
Operating revenues:		
Net patient service revenues	$ 326,502,545	303,192,233
Payments on behalf of the System - hospital and other medical activities	180,343,869	64,189,739
Fee for services - state appropriation	47,868,867	47,911,047
Other revenues	10,088,211	8,585,568
Total operating revenues	564,803,492	423,878,587
Operating expenses:		
Salaries and wages	191,600,422	177,865,775
Fringe benefits	173,739,515	55,954,633
Supplies and general expenses	145,859,946	130,770,251
Provision for bad debts	25,362,374	22,842,318
Administrative services	11,750,824	14,055,065
Depreciation and amortization	14,047,990	14,477,656
Total operating expenses	562,361,071	415,965,698
Operating income	2,442,421	7,912,889
Nonoperating revenue		
Payments on behalf of the System - supplies and annual expenses	5,021,020	4,092,463
Contributions	-	427,787
Total nonoperating revenue	5,021,020	4,520,250
Income before other nonoperating revenues	7,463,441	12,433,139
Other nonoperating revenue (expenses)		
Interest payments on capital debt	(3,145,537)	(3,290,910)
Investment income	320,341	453,921
Loss on disposal of plant assets	(375,616)	(1,411,171)
Net other nonoperating expense	(3,200,812)	(4,248,160)
Increase in net assets	4,262,629	8,184,979
Net assets beginning of the year	141,416,554	133,231,575
Net assets end of the year	$ 145,679,183	$ 141,416,554

See accompanying notes to financial statements.

Statement of Cash Flows
Year Ended June 30, 2004 with Comparative Totals for 2003

	2004	2003
Cash flows from operating activities:		
Patient services	$ 297,566,726	$ 273,826,675
Premiums	66,382,478	64,189,739
Payments to suppliers	(144,525,966)	(130,193,001)
Paments for administrative services	(11,750,824)	(14,055,065)
Payments to employees	(198,292,961)	(176,172,738)
Payments for benefits	(61,028,477)	(55,346,866)
Fee for services - state appropriations	47,554,342	47,188,098
Other receipts	12,402,667	14,688,807
Net cash provided by operating activities	8,307,985	24,125,649
Cash flows from noncapital financing activities:		
Payments on behalf of the system	5,021,020	4,092,463
Contributions	-	427,787
Net cash flows provided by noncapital financing activities	5,021,020	4,520,250
Cash flows from capital and related financing activities:		
Purchases of capital assets	(11,113,461)	(14,939,676)
Principal paid on capital debt and leases	(3,690,729)	(2,733,910)
Interest paid on capital debt and leases	(3,126,908)	(3,276,693)
Net cash used in capital and related financing activities	(17,931,098)	(20,950,279)
Cash flows from investing activities:		
Interest on investments	269,190	315,624
Net cash provided by investing activities	269,190	315,624
Net increase (decrease) in cash and cash equivalents	(4,332,903)	8,011,244
Cash and cash equivalents at beginning of year	29,495,140	21,483,896
Cash and cash equivalents at end of year	$ 25,162,237	29,495,140

Statement of Cash Flows
Year Ended June 30, 2004 with Comparative Totals for 2003 (continued)

	2004	2003
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	2,442,421	$ 7,912,889
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	14,047,990	14,477,656
Bad debt expense	25,362,374	22,842,318
Changes in assets and liabilities		
Patient receivables	(28,935,819)	(29,365,558)
Other receivables	(561,883)	1,030,633
Inventories	437,705	43,820
Prepaid expenses	(1,093,417)	(382,165)
Accounts payable and accrued expenses	(5,796,264)	2,226,467
Estimated third party settlements	3,655,230	4,731,822
Compensated absences	(1,250,352)	607,767
Net cash provided by operating activities	$ 8,307,985	$ 24,125,649

Supplemental disclosure of cash flow information:

During the year ended June 30, 2004, the System acquired property, plant and equipment transferred from the University of $445,619 and other obligations of $5,906,453

During the year ended June 30, 2004, the System transferred property, plant, and equipment of $308,113 to other State and University sources.

During the year ended June 30, 2004, the System increased other deposits by $7,112,296 which were acquired through other obligations sources.

See accompanying notes to financial statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organizational Background and Basis of Presentation

The University of Illinois Health Services Facilities System (System) is comprised of the University of Illinois Hospital (Hospital) and associated clinical facilities providing patient care at, but not limited to, the University of Illinois at Chicago Medical Center. The System is a tertiary care facility located primarily in Chicago, Illinois offering a full range of clinical services. Management of the System is the responsibility of the University of Illinois (University).

The System was established by a Bond Resolution (Resolution) of the Board of Trustees (Board) of the University of Illinois adopted on January 22, 1997. These financial statements have been prepared to satisfy the requirements of the 1997A and 1997B bond indentures. The financial balances and activities of the System, included in these financial statements, are included in the University's financial statements. The financial statements of the System are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The System is not a separate legal entity and therefore has not presented management's discussion and analysis.

The System's resources are classified into net asset categories and reported in the Statement of Net Assets. These categories are defined as (a) Invested in capital assets, net of related debt - capital assets net of accumulated depreciation and outstanding debt balances (b) Restricted nonexpendable - assets restricted by externally imposed stipulations (c) Restricted expendable - assets subject to externally imposed restrictions that can be fulfilled by actions of the entity pursuant to those stipulations or that expire by the passage of time and (d) Unrestricted - assets not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board of Trustees.

The financial statements include prior year comparative information, which has been derived from the System's 2003 financial statements. Such information does not include all of the information required to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2003.

Certain items in the June 30, 2003 financial statements have been reclassified to correspond to the June 30, 2004 presentation.

Significant Accounting Policies

The System prepared its financial statements as a Business Type Activity, as defined by GASB Statement No. 35, using the economic resources measurement focus and the accrual basis of accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

The Statement of Revenues, Expenses, and Changes in Net Assets classifies the Facility's fiscal year activity as operating and nonoperating. Operating revenues generally result from exchange transactions such as payments received for providing goods and services.

Certain revenue sources that the System relies on for operations, including investment income, are defined by GASB Statement No. 35 as nonoperating. In addition, transactions related to capital and financing activities are components of nonoperating revenues.

A portion of the University's appropriations made from the State of Illinois General Revenue Fund for the benefit of the System are recognized as operating revenues to the extent expended, limited to available appropriations.

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Approximately 89 % of the Hospital's net patient service revenues were derived from Medicare, Medicaid, Blue Cross and managed care programs for the year ended June 30, 2004.

The System has agreements with various Health Maintenance Organizations (HMO's) to provide medical services to subscribing participants. Under these agreements, the System receives monthly capitation payments based on the number of each HMO's participants, regardless of services actually performed by the System. In addition, the HMO's make fee-for-service payments to the System for certain covered services based upon discounted fee schedules.

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2004 was as follows:

Medicare	25%
Medicaid	29
Blue Cross	1
Other third-party payors	42
Patients	3
	100%

In accordance with GASB No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the System reported payments made by the State on behalf of the System for contributions to State group insurance and retirement programs for System employees, and payments made by the University on behalf of the System for operations, maintenance and utility costs. During fiscal year 2004, SURS received supplemental funding from the State of Illinois. The System's calculated share of that funding is $109,383,231. These costs are reflected in revenues as payments on behalf of the System and as expenses in the appropriate expense category as follows:

Salaries and wages	$ 8,941,000
Fringe benefits	171,402,869
Supplies and general expenses	5,021,020
TOTAL	$ 185,364,889

The System first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

Accrued compensated absences for System personnel are charged to operations based on earned but unused vacation and sick leave days including the System's share of Social Security and Medicare taxes. The estimated outstanding liability at June 30, 2004 was $20,486,389. Of that liability, it is estimated that at June 30, 2004 , $4,485,532 of the accrued compensated absences liability will be paid out of State of Illinois General Revenue Fund appropriations to the System in years subsequent to June 30, 2004, rather than from current resources available at June 30, 2004.

The Statement of Cash Flows details the change in the cash and cash equivalents balance for the fiscal year. Cash and all liquid investments with original maturities of ninety days or less are defined as cash and cash equivalents.

Inventories of pharmaceutical and other supplies are stated at the lower of cost or market, determined using the first-in, first-out method.

The System provides allowances for uncollectible accounts receivable based upon management's best estimate of uncollectible accounts, considering type, age, collection history, and any other factors as considered appropriate.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenditures during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for doubtful accounts and contractual adjustments.

The System has cash and certain investments which are pooled with other University funds for the purpose of securing a greater return on investment and providing an equitable distribution of investment return. Pooled investments, which consist principally of U. S. Government and government agency securities and time deposits, are stated at fair market value, as determined by quoted market prices. Income is distributed based upon average quarterly balances invested in the pool. It is not feasible to separately categorize the System's claim on cash and on pooled investments by level of risk assumed. Claim on cash and pooled investments are classified as cash and cash equivalents.

In accordance with GASB Statement 20, *Accounting and Financial Reporting for Proprietary Funds and Other Government Entities That Use Proprietary Fund Accounting*, the System follows all applicable GASB pronouncements. In addition, the System applies all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The System has elected not to apply FASB pronouncements issued after November 30, 1989.

NOTE 2 - DEPOSITS AND INVESTMENTS

Illinois Statutes and Board Policy authorize the University to invest in obligations of the U.S. Treasury, agencies and instrumentalities (U.S. Government securities); bank and savings and loan time deposits; corporate bonds, stock and commercial paper; repurchase agreements; and mutual funds. These investments are stated at fair value, as determined by quoted market prices. Investment income and the change in fair value of investments is recognized in the fund which owned such investments. Illinois Statutes require a third party custodian to perfect the University's security interest under repurchase agreements. The University follows industry standards and requires that securities underlying repurchase agreements must have a fair value of at least 102% of the cost of the repurchase agreement. At June 30, 2004, the University had repurchase agreements of $68,618,000. The fair value of securities underlying these repurchase agreements was $71,041,000 at June 30, 2004.

Nearly all of the University's investments are managed by external professional investment managers. Many of these investments are made through commingled investment vehicles such as common trust funds and mutual funds. A number of the investment managers utilize derivatives in the execution of their investment strategies. In general, managers utilize derivatives to reduce or eliminate undesirable risks, to increase portfolio liquidity and flexibility or to increase investment return within the level of risk defined in the manager's investment guidelines. Examples of authorized derivative transactions would be the hedging of foreign currency exposure through the use of currency forwards, owning mortgage securities with embedded prepayment options or utilizing treasury futures to change the duration of a fixed income portfolio. The University did not engage in any other significant derivative transactions during 2004.

The University, by the authorization of the Board, increases its investment income by lending the University's securities, through its custodian, to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. Government securities and irrevocable bank letters of credit in an amount not less than 102% of the fair value of the securities loaned. Any collateral securities cannot be pledged or sold by the University unless the borrower defaults. The University receives interest and dividends during the loan period as well as a fee from the custodian. At June 30, 2004, the University has no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University. As of June 30, 2004, approximately $175,257,000 of the investments reported on the University's Statement of Net Assets were on loan, secured by collateral with a fair value of approximately $178,646,000.

At June 30, 2004, the carrying amount and bank balance of the System's deposits with financial institutions was $1,220,378. All deposits are fully insured by the Federal Depository Insurance Corporation or collateralized with securities held by the System's agent in the System's name.

The System's share of University investments are comprised of mutual funds and money market investments which are not classifiable by custodial credit risk category.

NOTE 3 - CAPITAL ASSETS

Capital assets are recorded at cost. Depreciation of buildings and equipment and software is calculated on a straight line basis over the estimated useful lives (three to fifty years) of the respective assets. The buildings are located on land primarily owned by the University and for which there is no charge to the System other than for maintenance.

Capital asset activity for the year ended June 30, 2004 is summarized as follows:

Capital Assets for the System

	Beginning Balance	Additions	Retirements	Ending Balance
Nondepreciable Capital Assets:				
Land	$ 770,917			$ 770,917
Depreciable Capital Assets:				
Buildings	169,348,885	$ 2,249,431	-	171,598,316
Equipment and software	113,801,445	15,216,102	$ (137,505)	128,880,042
Subtotal	283,150,330	17,465,533	(137,505)	300,478,358
Less accumulated depreciation	110,810,465	14,014,730		124,825,195
Total net depreciable capital assets	172,339,865	3,450,803	(137,505)	175,653,163
Total Capital Assets	$ 173,110,782	$ 3,450,803	$ (137,505)	$ 176,424,080

NOTE 4 - LONG TERM OBLIGATIONS

During fiscal year 1997, Health Services Facilities System Bonds Series 1997A and 1997B (Series 1997A and 1997B Bonds) were issued for $47,210,000 and $25,000,000, respectively. Series 1997A Bonds are current interest fixed rate bonds with semiannual payments. Series 1997 B Bonds are variable rate bonds which bear interest at a rate determined weekly and paid monthly. The System capitalized all costs incurred to issue the bonds. The bond issuance costs are being amortized over the life of the bonds. Amortization was $ 33,260 for the year ended June 30, 2004.

At June 30, 2004 Health Services Facilities System long term obligations are as follows:

					Current Portion
				)	
				)	600,000
incipal Payable				)	
rtized Debt Discount				)	(29,677)
				9	
Other obligations	98,002		952,539		
Internal Financing Payable	7,146,009		1,213,190		
Total long term debt	74,581,433	13,732,154	3,690,729	84,622,858	5,268,123
Compensated Absences	21,736,741		1,250,352		
TOTAL	$ 96,318,174	$ 13,732,154	$ 4,941,081	$ 105,109,247	6,049,899

The bonds do not constitute obligations of the State of Illinois. Bond principal and interest payments are funded from revenues pledged from (a) Net system revenues, principally consisting of all charges, income and revenues received from the continued use and operation of the System, excluding depreciation charges and transfers, (b) Medical Service Plan (MSP) revenues net of bad debt expense, and (c) College of Medicine tuition revenue. These revenues for the year ended June 30, 2004 are as follows in thousands:

System net revenues	$ 14,066
Adjusted MSP revenues	114,967
College of Medicine	
student tuition	26,683
TOTAL	$ 155,716

The resolution authorizing the University of Illinois Health Services Facilities System Revenue Bonds provides for the establishment of separate funds as follows: Revenue Fund, Project Fund, Repair and Replacement Reserve, Equipment Reserve, Bond and Interest Sinking Fund, and Development Reserve. All income and revenues received from the continued use and operation of the System, as provided for by the Bond Resolution, are to be deposited in the Revenue Fund and used to pay necessary operation and maintenance expenses of the System. The Bond Resolution also requires transfers to funds as follows:

Project Fund - at the discretion of the University Comptroller, amounts not needed to complete construction and renovation projects specified in the Bond Resolution are required to be transferred either to the Repair and Replacement Reserve or to the Bond and Interest Sinking Fund.

Repair and Replacement Reserve - an amount calculated as specified in the Bond Resolution to provide for the cost of unusual maintenance and repairs.

Equipment Reserve - an amount approved by the Board for the acquisition of movable equipment to be installed in the facilities constituting the System. The reserve may not exceed 20% of the book value of the movable equipment of the System.

Bond and Interest Sinking Fund - amounts into the Bond and Interest Sinking Fund sufficient to pay principal and interest as it becomes due on the outstanding bonds.

After fulfillment of the provisions described above, the surplus, if any, remaining in the Revenue Fund may be used at the Board's option (a) to redeem bonds of the System which are subject to early redemption, (b) to improve or add facilities to the System, or (c) for any other lawful purpose.

Assets restricted by bond resolution were held for the following purposes at June 30, 2004:

Restricted Assets:	
Cash	$ 1,220,378
Investments	678,715
TOTAL	$ 1,899,093
Purpose:	
Repair and replacement reserve	$ 1,220,378
Bond and interest sinking fund	678,715
Total assets limited as to use	1,899,093
Less amounts required for current liabilities	(652,273)
TOTAL	$ 1,246,820

Debt Service Requirements

Future debt service requirements for the Series 1997A and 1997B Bonds are as follows:

	Principal	Interest
2005	$ 1,595,000	$ 2,725,350
2006	1,670,000	2,663,984
2007	1,755,000	2,601,091
2008	1,835,000	2,534,221
2009	1,925,000	2,461,618
2010-2014	11,170,000	11,039,453
2015-2019	14,385,000	8,378,552
2020-2024	18,530,000	4,875,647
2025-2029	13,630,000	772,953

The required debt service for the variable rate Series 1997B Bonds has been calculated using the current interest rate of 1.05 % over the life of the bonds.

NOTE 5 - LEASES AND OTHER OBLIGATIONS

Other obligations consist of third party financing arrangements which have maturity dates from 2006 through 2011 and interest rates ranging from 2.82% to 3.89%. As of June 30, 2004, future minimum payments under other obligations are as follows:

2005	$ 2,601,417
2006	2,102,451
2007	2,087,739
2008	2,079,737
2009	1,620,360
2010-2014	3,049,641
Total minimum payments	13,541,345
Amount representing interest	(1,377,133)
NET PRESENT VALUE	$ 12,164,212

As of June 30, 2004 the System had outstanding debt to the University of Illinois relating to certain building renovation projects completed during the past fiscal year. The agreement between the System and the University of Illinois requires annual payments of $ 1,560,089 including interest at 4.50% through June 30, 2009. Aggregate annual maturities as of June 30, 2004 are as follows:

2005	$ 1,287,583
2006	1,345,524
2007	1,406,073
2008	1,458,236
2009	1,119,131
TOTAL	$ 6,616,547

The System leases various buildings and equipment under operating lease agreements, including leases renewed on an annual basis. Total rental expense under these agreements was approximately $191,300 for the year ended June 30, 2004. In future years, the System expects to incur annual rental expense in amounts similar to 2004. The future minimum lease payments under operating leases (excluding those leases renewed on an annual basis) are as follows:

2005	$ 138,168
2006	103,919
2007	103,858
2008	103,088
TOTAL MINIMUM LEASE PAYMENTS	$ 449,033

NOTE 6 - NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payments to the Hospital at established program rates or costs, as defined, for rendering services to program beneficiaries. The Hospital provides contractual allowances on a current basis for the differences between charges for services rendered and the expected payments under these programs. The patient revenues from third-party payor programs for fiscal year 2004 are as follows:

Gross revenue	
Medicaid	$ 271,389,506
Medicare	206,109,374
HMO / PPO	288,725,746
Commercial	35,086,735
Self-pay & other	28,671,247
Total gross revenue	829,982,608
Less: Contractual allowance	(503,480,063)
NET PATIENT REVENUE	$ 326,502,545

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

Medicare - Inpatient acute care services 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 skilled nursing services are paid at prospectively determined rates that are based on the patients' acuity. Other inpatient nonacute services, and defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. Substantially all outpatient services are subject to a prospective payment system. Under this system, payments to the Hospital are based on a predetermined package rate based on services provided to patients. The System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary. At June 30, 2004 all Medicare settlements for 2004, 2003, and 2002 are subject to audit and retroactive adjustment.

Medicaid - Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates-per-discharge. Outpatient services rendered to program beneficiaries are reimbursed at prospectively determined rates.

Blue Cross - Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed under a cost reimbursement methodology. The System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by Blue Cross. At June 30, 2004, the Blue Cross settlements for 2004 and 2003 are subject to audit and retroactive adjustment.

The System also has payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment under these agreements include prospectively determined rates-per-discharge, discounts from established charges, prospectively determined daily rates, and capitated per member per month rates.

NOTE 7 - RETIREMENT AND POSTEMPLOYMENT BENEFITS

Substantially all employees of the System participate in the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined-benefit pension plan. The University contributes to the plan with a special funding situation whereby the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. The University contributions include payments for System employees covered under the plan.

SURS was established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of the State universities, certain affiliated organizations, and certain other State educational and scientific agencies and for survivors, dependents, and other beneficiaries of such employees. SURS is considered a component unit of the State of Illinois' financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Section 5/15, Chapter 40, of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to SURS, 1901 Fox Drive, Champaign, IL 61820 or by calling 1-800-275-7877.

Eligible employees must participate upon initial employment. Employees are ineligible to participate if (a) employed after having attained age 68; (b) employed less than 50 percent of full-time; or (c) employed less than full-time and attending classes with an employer. Of those University employees ineligible to participate, the majority are students at the University.

Plan members are required to contribute 8.0% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 9.65% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The University's contributions to SURS for the years ended June 30, 2004, 2003 and 2002, were $755,398,000, $139,955,000, and $123,613,000, respectively, equal to the required contributions for each year. The 2004 contribution includes an annual calculated contribution of $158,153,000 and additional funding from the State of Illinois of $597,245,000.

In addition to providing pension benefits, the State provides certain health, dental and life insurance benefits to annuitants who are former State employees. This includes annuitants of the System. Substantially all State employees, including the employees of the System, may become eligible for postemployment benefits if they eventually become annuitants. Health and dental benefits include basic benefits for annuitants under the State's self-insurance plan and insurance contracts currently in force. Life insurance benefits for annuitants under age 60 are equal to their annual salary at the time of retirement; life insurance benefits for annuitants age 60 and older are limited to $5,000 per annuitant.

NOTE 8 - RELATED PARTY TRANSACTIONS

The University charged the System for administrative and other services totaling $11,750,824 in 2004, based upon the gross expenditures and debt service transfers of various operations of the System. These charges represent a portion of the estimated administrative and other service costs incurred by the University in support of the System. An additional $ 13,962,020 was paid by the University on behalf of the System for salaries, operation, maintenance and utility costs for the year ended June 30, 2004, and are reported as Payments on behalf of the System.

Most health care services rendered by physicians at the University are charged, billed and collected through the Medical Service Plan (MSP). For ambulatory care services, there is a charge for both a professional and technical component. The System bills and collects on behalf of the MSP for the professional component of ambulatory care services. Based on the underlying agreements between the MSP and the University, the System remits funds collected to the MSP. Total MSP remittances from the System for the year ended June 30, 2004 relating to the billing and collection of physician fees and the delivery of ambulatory care were $10,677,049 .

During 2004, various departments within the College of Medicine agreed to reimburse the System for a portion of the expenses related to the resident and fellowship training program. This reimbursement, which totaled approximately $1,423,000, has been reflected in the financial statements as a reduction of the related expenses.

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Commitments

At June 30, 2004, the System had commitments outstanding for the perpetual right and license to use any or all of the Cerner licensed software. The fixed technology fee commitment totals $15,080,000 payable in annual amounts of $2,000,000 to $2,860,000 through the year ending June 30, 2007.

Accrued Self-Insurance and Legal Actions

The University (including the System) is a defendant in a number of legal actions primarily related to medical malpractice. These legal actions have been considered in estimating the University's accrued self-insurance liability which covers hospital and clinical patient liability; hospital and medical professional liability; estimated general and contract liability; and workers' compensation liability. At June 30, 2004 the University's total accrued self-insurance liability, discounted at a rate of 6%, was $98,038,000.

The University's accrued self-insurance includes $63,106,000 at June 30, 2004, for the most probable and reasonably estimable ultimate cost of uninsured medical malpractice liabilities. Ultimate cost consists of amounts estimated by the University's risk management division and actuaries for asserted claims, unasserted claims arising from reported incidents, expected litigation expenses and amounts determined by actuaries using relevant industry data and Hospital specific data to cover projected losses for claims incurred but not yet reported.

The University has contracted with several commercial carriers to provide varying levels and upper limits of excess indemnity coverage. These coverages have been considered in determining the required accrued self-insurance liability.

Amounts of accrued self-insurance liability related to the activities of the System are calculated based upon estimates made by the University's actuaries and the University's Risk Management Division. For the year ended June 30, 2004, the System's calculated required contribution for its portion of the University's self-insurance liability was $8,545,528. The University is responsible for the payment of claim judgements and settlements actually incurred, and therefore no accrued self-insurance liability has been recorded by the System. These amounts are reported as supplies and general expenses in the Statement of Revenues, Expenses, and Changes in Net Assets.

Because the amounts accrued by the University are estimates, the aggregate claims actually incurred could differ significantly from the accrued self-insurance liability at June 30, 2004. Changes in these estimates for claims related to the activities of the System will be charged by the University to the System and reflected by the System in the Statement of Revenues, Expenses, and Changes in Net Assets in the periods when additional information is available.

The total of amounts claimed under legal actions, including potential settlements and amounts relating to losses incurred but not reported, could exceed the amount of the self-insurance liability. In the opinion of the University's administrative officers, the University's self-insurance liability, including the System's portion, and limited excess indemnity insurance coverage from commercial carriers are adequate to cover the ultimate liability of these legal actions, in all material respects.