

THE UNIVERSITY OF CHICAGO

Consolidated Financial Statements and
Supplemental University Information

June 30, 2002 and 2001

(With Independent Auditors' Report Thereon)

THE UNIVERSITY OF CHICAGO

Consolidated Statements of Activities

Years ended June 30, 2002 and 2001

(In thousands of dollars)

	2002		2001	
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets:				
Operating:				
Revenue:				
Tuition and fees – gross	\$ 340,936	—	340,936	316,692
Less:				
Undergraduate student aid	(35,286)	—	(35,286)	(35,234)
Graduate student aid	(103,100)	—	(103,100)	(95,741)
Tuition and fees – net	202,550	—	202,550	185,717
Government grants and contracts	240,371	—	240,371	203,218
Private gifts, grants, and contracts	97,001	413	97,414	83,573
Endowment payout	146,726	6,098	152,824	121,650
Earnings on other investments	13,209	10,287	23,496	24,452
Patient care	136,419	606,278	742,697	648,821
Auxiliaries	142,318	—	142,318	133,920
Other income	109,573	37,950	147,523	121,578
Total operating revenue	1,088,167	661,026	1,749,193	1,522,929
Expenses:				
Compensation:				
Academic salaries	282,499	—	282,499	270,428
Staff salaries	248,630	252,958	501,588	465,655
Benefits	110,552	47,306	157,858	150,603
Total compensation	641,681	300,264	941,945	886,686
Other operating expenses:				
Utilities, alterations, and repairs	28,613	19,347	47,960	46,637
Depreciation	54,876	39,795	94,671	89,770
Interest	23,517	13,923	37,440	37,818
Supplies and services	272,315	195,315	467,630	428,453
Insurance	8,235	5,989	14,224	13,597
Total other operating expenses	387,556	274,369	661,925	616,275
Total operating expenses	1,029,237	574,633	1,603,870	1,502,961
Excess of operating revenue over expenses	58,930	86,393	145,323	19,968
Loss from operation and sale of discontinued hospital	—	60,530	60,530	6,327
Excess of operating revenue over expenses and loss from discontinued hospital	58,930	25,863	84,793	13,641

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Consolidated Statements of Activities

Years ended June 30, 2002 and 2001

(In thousands of dollars)

		2002		2001	
		University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets:					
Nonoperating:					
Endowment payout	\$	—	—	—	66
Investment losses		(316,085)	(42,659)	(358,744)	(464,451)
Change in method of accounting for pension plan assets		(25,614)	—	(25,614)	—
Change in method of accounting for Baptist Theological Union net assets		—	—	—	50,766
Other, net		(25,792)	(11,715)	(37,507)	(14,627)
Change in unrestricted net assets from nonoperating activities		(367,491)	(54,374)	(421,865)	(428,246)
Decrease in unrestricted net assets		(308,561)	(28,511)	(337,072)	(414,605)
Changes in temporarily restricted net assets:					
Private gifts		55,118	5,471	60,589	61,972
Endowment payout		144	—	144	176
Investment losses		(520)	—	(520)	(1,912)
Other, net		(37,760)	(6,058)	(43,818)	(32,318)
Increase (decrease) in temporarily restricted net assets		16,982	(587)	16,395	27,918
Changes in permanently restricted net assets:					
Private gifts		50,098	277	50,375	42,899
Endowment payout		1,608	—	1,608	1,075
Investment losses		(4,615)	—	(4,615)	(3,100)
Change in method of accounting for Baptist Theological Union net assets		—	—	—	1,509
Other, net		2,307	—	2,307	11,253
Increase in permanently restricted net assets		49,398	277	49,675	53,636
Decrease in net assets		(242,181)	(28,821)	(271,002)	(333,051)
Net assets at beginning of year		4,057,545	378,405	4,435,950	4,769,001
Net assets at end of year	\$	3,815,364	349,584	4,164,948	4,435,950

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Consolidated Balance Sheets

June 30, 2002 and 2001

(In thousands of dollars)

Assets	2002			2001
	University	Hospitals	Consolidated	Consolidated
Cash and cash equivalents	\$ —	43,237	43,237	38,512
Notes and accounts receivable	218,096	123,709	341,805	275,295
Collateral held for securities loaned	476,342	—	476,342	566,591
Inventories	10,016	3,909	13,925	13,034
Prepaid expenses and other assets	85,489	29,283	114,772	227,260
Pledges receivable	141,023	22,337	163,360	135,087
Investments	3,605,852	387,428	3,993,280	4,125,182
Land, buildings, equipment, and books	829,204	332,271	1,161,475	1,045,641
Total assets	\$ 5,366,022	942,174	6,308,196	6,426,602
Liabilities and Net Assets				
Liabilities:				
Accounts payable and accrued expenses	\$ 152,820	222,330	375,150	365,002
Deferred revenue	68,771	—	68,771	59,085
Payable under securities loan agreements	476,342	—	476,342	566,591
Assets held in custody for others	24,831	—	24,831	26,171
Self-insurance liability	102,712	5,979	108,691	93,723
Notes and bonds payable	686,644	364,281	1,050,925	842,070
Refundable U.S. Government student loan funds	38,538	—	38,538	38,010
Total liabilities	1,550,658	592,590	2,143,248	1,990,652
Net assets:				
Unrestricted	2,828,170	318,382	3,146,552	3,483,624
Temporarily restricted	276,957	26,050	303,007	286,612
Permanently restricted	710,237	5,152	715,389	665,714
Total net assets	3,815,364	349,584	4,164,948	4,435,950
Total liabilities and net assets	\$ 5,366,022	942,174	6,308,196	6,426,602

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO
Consolidated Statements of Cash Flows
Years ended June 30, 2002 and 2001
(In thousands of dollars)

	2002			2001
	University	Hospitals	Consolidated	Consolidated
Cash flows from operating activities:				
Decrease in net assets from continuing operations:	\$ (242,181)	(3,864)	(246,045)	(325,791)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:				
Depreciation	54,876	39,795	94,671	89,770
Net loss on investments	321,220	24,205	345,425	483,708
Private gifts and grants restricted for long-term investment	(105,216)	(5,385)	(110,601)	(103,748)
Other nonoperating changes	59,493	14,816	74,309	42,097
Pension income	(427)	—	(427)	(14,262)
Change in method of accounting for pension plan assets	25,614	—	25,614	—
Change in method of accounting for Baptist Theological Union net assets	—	—	—	(52,275)
Changes in assets and liabilities:				
Notes and accounts receivable	(4,327)	(62,188)	(66,515)	45,510
Prepaid expenses and other assets	11,071	18,568	29,639	4,171
Accounts payable and other liabilities	35,015	32,724	67,739	(21,856)
Self-insurance liability	15,474	(506)	14,968	(11,779)
Total adjustments	412,793	62,029	474,822	461,336
Net cash provided by operating activities of continuing operations	170,612	58,165	228,777	135,545
Decrease in net assets from discontinued operations:	—	(24,957)	(24,957)	(7,260)
Loss on disposal of discontinued hospital	—	26,051	26,051	—
Change in assets and liabilities of discontinued hospital	—	(56,242)	(56,242)	8,696
Net cash from operating activities of discontinued hospital	—	(55,148)	(55,148)	1,436
Net cash provided by operating activities	170,612	3,017	173,629	136,981
Cash flows from investing activities:				
Purchase of investments	(484,262)	(316,798)	(801,060)	(825,651)
Proceeds from sale of investments	336,093	251,185	587,278	791,253
Acquisition of land, buildings, equipment, and books	(184,990)	(40,930)	(225,920)	(192,200)
Disposal of land, buildings, equipment, and books	2,986	—	2,986	8,202
Increase in investment assets held for other:	—	—	—	19,591
Loans disbursed	(52,183)	—	(52,183)	(53,860)
Principal collected on loans	52,188	—	52,188	45,796
Proceeds from sale of discontinued operations:	—	55,390	55,390	360
Net cash used in investing activities	(330,168)	(51,153)	(381,321)	(206,509)
Cash flows from financing activities:				
Proceeds from issuance of notes and bonds payable	294,595	89,050	383,645	87,409
Principal payments on notes and bonds payable	(160,967)	(13,896)	(174,863)	(52,972)
Proceeds from private gifts and grants restricted for long-term investment	77,026	5,302	82,328	80,953
Other nonoperating changes	(59,493)	(19,200)	(78,693)	(38,482)
Net cash provided by financing activities	151,161	61,256	212,417	76,908
Increase (decrease) in cash and cash equivalents	(8,395)	13,120	4,725	7,380
Cash and cash equivalents at:				
Beginning of year	8,395	30,117	38,512	31,132
End of year	\$ —	43,237	43,237	38,512
Supplemental disclosure of cash flow information – cash paid for interest	\$ 21,561	11,000	32,561	37,429

See accompanying notes to consolidated financial statements.

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Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

(1) Summary of Significant Accounting Policies

Description of Business

The University of Chicago (the University) is a private, nondenominational, coeducational institution of higher learning and research. The University provides education and training services, primarily for students enrolled in undergraduate, graduate, and professional degree programs, and performs research, training, and other services under grants, contracts, and other agreements with sponsoring organizations, including both government agencies and private enterprises. Certain members of the University's faculty also provide professional medical services to patients at The University of Chicago Hospitals (the Hospitals) and other health care facilities located in the area.

Significant accounting policies followed by the University and the Hospitals are set forth below. Accounting policies specific to the Hospitals are discussed in note 2.

Basis of Presentation

The consolidated financial statements of the University have been prepared on the accrual basis and include the accounts of the University and the Hospitals. The organization of the Hospitals and agreements between the University and the Hospitals are discussed in note 2.

The University maintains its accounts in accordance with the principles of fund accounting. Under this method of accounting, resources for various purposes are classified into funds that are in accordance with activities or objectives specified by donors. Separate accounts are maintained for each fund.

For reporting purposes, however, the University follows the reporting requirements of Statement of Financial Accounting Standards No. 117, *Financial Statements of Not-for-Profit Organizations* (SFAS No. 117). SFAS No. 117 requires that resources be classified for reporting purposes based on the existence or absence of donor-imposed restrictions. This is accomplished by classification of fund balances into three classes of net assets – unrestricted, temporarily restricted, and permanently restricted. Descriptions of the three net asset categories and the types of transactions affecting each category follow:

- Unrestricted – net assets that are not subject to donor-imposed restrictions. Items that affect this net asset category principally consist of fees for service and related expenses associated with the core activities of the University – instruction, conduct of sponsored research, and provision of health care services. In addition to these exchange transactions, changes in this category of net assets include realized and unrealized gains and losses on endowment funds and certain types of philanthropic support. Such philanthropic support includes unrestricted gifts, including those designated by the Board to function as endowment and restricted gifts whose donor-imposed restrictions were met during the fiscal year, as well as restricted gifts and grants for buildings and equipment that have been amortized over the useful life of the assets acquired or constructed.

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(In thousands of dollars)

- Temporarily Restricted – net assets subject to donor-imposed restrictions that will be met either by actions of the University or the passage of time. Items that affect this net asset category are gifts for which donor-imposed restrictions have not been met, gifts and grants for buildings and equipment, annuity and life income gifts, pledges for which the ultimate purpose of the proceeds is not permanently restricted, and endowments where the principal may be expended upon the passage of a stated period of time (term endowments). Expirations of restrictions on temporarily restricted net assets, including amortization of restricted gifts and grants for buildings and equipment, are reported as reclassifications between the net asset classes and included in other.
- Permanently Restricted – net assets subject to donor-imposed restrictions to be maintained permanently by the University. Items that affect this net asset category include gifts and pledges wherein donors stipulate that the corpus be held in perpetuity (primarily gifts for endowment and providing loans to students) and only the income be made available for program operations, and annuity and life income gifts for which the ultimate purpose of the proceeds is permanently restricted.

Operations

Operating results in the consolidated statements of activities reflect all transactions increasing or decreasing unrestricted net assets except those items associated with long-term investment and other infrequent gains and losses.

As discussed in note 2, the Hospitals provides certain operating support to the University's Biological Sciences Division. Such support is included in other operating income by the University to the extent expended for noncapital purposes during the period, and amounted to \$18,908 in fiscal 2002 and \$21,969 in fiscal 2001.

Gifts, Grants, and Contracts

Gifts, including unconditional pledges, are recognized in the appropriate category of net assets in the period received. Contributions of assets other than cash are recorded at their estimated fair value at date of gift. Pledges receivable are stated at the estimated net present value, net of an allowance for uncollectible amounts. Conditional promises to give are not recognized until the conditions on which they depend are substantially met.

Revenue from government and private grant and contract agreements is recognized as it is earned through expenditure in accordance with the agreement. Any funding received in advance of expenditure is recorded as deferred revenue on the consolidated balance sheets. Included in deferred revenue at June 30, 2002 and 2001 are \$35,827 and \$33,002, respectively, of private grant and contract receipts which have not been expended.

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(In thousands of dollars)

Private gifts, grants, and contracts operating revenue for fiscal years 2002 and 2001 consists of the following:

		2002		2001
	University	Hospitals	Total	Total
Private gifts:				
Unrestricted as to use	\$ 27,225	413	27,638	14,077
Temporarily restricted gifts whose restrictions were met during the fiscal year and reported as unrestricted revenue	24,341	—	24,341	24,717
Private grants and contracts	45,435	—	45,435	44,779
Total	<u>\$ 97,001</u>	<u>413</u>	<u>97,414</u>	<u>83,573</u>

Endowment Payout

The University utilizes the total return concept in allocating endowment income. In accordance with the University's total return objective, 5% of a twelve quarter moving average of the market value of endowment investments is available each year for expenditure in the form of endowment payout. Change from the prior fiscal year's endowment payout is limited to a reduction of 4% with no limit on increases.

If endowment income received is not sufficient to support the total return objective, the balance is provided from capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

Endowment payout for fiscal years 2002 and 2001 consists of the following:

		2002		2001
	University	Total	Total	Total
Interest, dividends, and rents	\$ 64,659	2,545	67,204	76,321
Realized investment gains used to support the endowment payout formula	83,819	3,553	87,372	46,646
Total	<u>\$ 148,478</u>	<u>6,098</u>	<u>154,576</u>	<u>122,967</u>

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(In thousands of dollars)

Unrestricted operating endowment payout revenue for fiscal years 2002 and 2001 consists of the following:

		2002		2001
	University	Hospitals	Total	Total
Unrestricted payout	\$ 42,938	—	42,938	34,631
Temporarily restricted payout whose restrictions were met during the fiscal year and reported as unrestricted revenue	103,788	6,098	109,886	87,019
Total	\$ 146,726	6,098	152,824	121,650

Patient Care

Net patient service revenue reflects the estimated net realizable amounts due from third-party payors for services rendered. A majority of patient care revenue is derived from contractual agreements with Medicare, Medicaid, Blue Cross/Blue Shield, managed care, and certain other programs. Payments under these agreements and programs are based on specific amounts per case or contracted prices.

Cash Equivalents

Cash equivalents include U.S. Treasury notes, commercial paper, and corporate notes with original maturities of three months or less, except that such instruments purchased with endowment assets or funds on deposit with bond trustees are classified as investments.

Inventories

Inventories are comprised principally of goods and supplies held by the University Press and Hospitals and are valued at the lower of cost or net realizable value.

Investments

Investments are recorded in the consolidated financial statements at fair value. The value of investments in index funds and publicly-traded fixed income and equity securities is based upon quoted market prices and exchange rates, if applicable.

Fair values for certain private equity, real estate, and natural resource investments held through limited partnerships or commingled funds are estimated by the respective investment managers if market values are not readily ascertainable. These valuations necessarily involve estimates, assumptions, and methods which are reviewed by the University's Investment Office.

The University does not engage directly in unhedged speculative investments, however, the Board of Trustees has authorized derivative investments to gain market exposure within asset class ranges, hedge non-dollar investments and currencies, and provide for defensive portfolio strategies. To

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June 30, 2002 and 2001

(In thousands of dollars)

minimize the risk of loss, hedge fund investments are diversified by strategy, external manager, and number of positions. In addition, the activities of all hedge fund managers are regularly reviewed by independent outside auditors and the University Investment Office. The risk of any derivative exposure is limited to the amount invested with each manager. Derivative investments are recorded at fair value and valuation gains and losses are included in the consolidated statements of activities.

Land, Building, Equipment, and Books

Land, buildings, equipment, and books are generally stated at cost, less accumulated depreciation. Depreciation is computed on the straight-line method over the estimated useful lives of the assets.

Split Interest Agreements

The University's split interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which the University serves as trustee. Assets held in these trusts are included in investments. Contribution revenue is recognized at the dates the trusts are established after recording liabilities for the present value of the estimated future payments to be made to the donors and/or other beneficiaries. The liabilities are adjusted during the term of the trusts for changes in the value of the assets, accretion of the discount, and other changes in the estimates of future benefits.

Use of Estimates

The preparation of financial statements in accordance with generally accepted accounting principles requires that management make a number of estimates and assumptions related to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities at the balance sheet date, and the reporting of revenue, expenses, gains, and losses during the period. Actual results may differ from those estimates.

Accounting Changes

Beginning in fiscal 2002, the University changed its method of accounting for recognizing gains and losses in the value of pension assets for its defined benefit pension plan. Previously, the University immediately recognized gains and losses on pension assets as they occurred. The University changed its method of accounting to systematically and gradually recognize gains and losses as they occur over subsequent periods. This change in method of accounting reduces the volatility of pension assets for significant changes in valuations. The cumulative effect of this change in method of accounting amounts to \$25,614 and is shown as a nonoperating reduction in unrestricted net assets.

In fiscal 2001, the University adopted Statement of Financial Accounting Standards (SFAS) No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust that Raises or Holds Contributions for Others*. SFAS No. 136 establishes standards for transactions in which a donor makes a contribution to a not-for-profit organization that agrees to use the assets or the return on those assets for the benefit of another organization specified by the donor. In this regard, the cumulative effect of this change in method of accounting was to transfer to the University \$52,275 of

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(In thousands of dollars)

net assets held by the Baptist Theological Union, a not-for-profit organization that distributes its earnings on endowment assets to the University's Divinity School, effective July 1, 2000.

Reclassifications

Certain 2001 amounts have been reclassified to conform to the 2002 presentation.

(2) The University of Chicago Hospitals

Organization

The University of Chicago Hospitals was incorporated and assumed the operations of the University hospitals and clinics on October 1, 1986. The University of Chicago Hospitals also includes QV, Inc., an affiliated not-for-profit health care corporation consisting of a home health agency and several clinics; and until June 2002, Louis A. Weiss Memorial Hospital (Weiss), a community hospital in Chicago, Illinois. The University elects the Hospitals' board of trustees. Accordingly, the Hospitals' financial information is included in the consolidated financial statements.

On June 6, 2002, Weiss sold substantially all of its assets at a loss. The loss on the sale (\$26,051) and the fiscal 2002 and 2001 operating losses associated with Weiss (\$34,479 and \$6,327, respectively) are shown as an operating change in unrestricted net assets in the consolidated statements of activities.

Agreements with the University

The relationship between the University and the Hospitals is defined in the Affiliation Agreement and the Operating Agreement, both dated October 1, 1986. The Affiliation Agreement specifies University and Hospitals responsibilities for the provision of patient care, teaching, and research at the hospitals and clinics. The Operating Agreement provides for the management and operation by the Hospitals of the University's hospital and clinic facilities. On June 30, 1987, the University and the Hospitals entered into a lease agreement. Under the agreement, the Hospitals acquired a 40-year leasehold interest in the University's health care facilities.

Basis of Presentation

The Hospitals maintains its accounts and prepares stand-alone financial statements in conformity with accounting and reporting principles of the American Institute of Certified Public Accountants *Audit and Accounting Guide Health Care Organizations*. For purposes of presentation of the Hospitals' financial position and changes in net assets in the consolidated financial statements, several reclassifications have been made as follows: (1) the provision for uncollectible Hospitals' patient accounts receivable of \$55,420 in fiscal year 2002 and \$65,029 in fiscal year 2001 has been reclassified as a reduction of patient care revenue and (2) realized investment gains (losses) of (\$33,897) in fiscal year 2002 and \$17,593 in fiscal year 2001 not used for operations have been reclassified as a nonoperating change in unrestricted net assets.

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(In thousands of dollars)

The Hospitals recognizes changes in accounting estimates for the collectibility of accounts receivable, including the effects of changes in billing systems and processes, as more experience is acquired. During 2002, adjustments to these estimates related to prior years increased operating revenue by \$36,300.

The Hospitals have made certain commitments to support the enhancement and expansion of several programs within the University's Biological Sciences Division. During fiscal 2002 and fiscal 2001, the Hospitals transferred \$15,000 to the University in support of these programs.

(3) Investments

Fair values of investments at June 30, 2002 and 2001 are shown below:

	2002				
	University and Hospitals Endowment	All others		Total	2001 Total
		University	Hospitals		
Cash equivalents	\$ 70,254	2,082	14,788	87,124	69,273
Domestic public equities	559,701	44,211	80,703	684,615	1,134,066
International public equities	525,972	14,979	549	541,500	891,052
Private equity	563,674	3,110	17,270	584,054	390,738
Real assets	244,800	8,329	21,464	274,593	206,688
Absolute return	503,032	2,775	—	505,807	332,852
High yield bonds	227,862	5,616	—	233,478	217,228
Fixed income	529,335	161,855	48,595	739,785	687,892
Funds held in trust (primarily cash equivalents and bonds)	15,318	251,269	75,737	342,324	195,393
Total	\$ 3,239,948	494,226	259,106	3,993,280	4,125,182

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June 30, 2002 and 2001

(In thousands of dollars)

Changes in the fair value of endowment investments were as follows for the fiscal years ended June 30, 2002 and 2001:

	2002			2001
	University	Hospitals	Consolidated	Consolidated
Investment return:				
Endowment yield (interest, dividends, and rents)	\$ 64,659	2,545	67,204	76,321
Realized gains (losses) on investments	(134,068)	(5,845)	(139,913)	304,966
Unrealized losses on investments	(97,395)	(4,298)	(101,693)	(708,282)
Total investment loss	(166,804)	(7,598)	(174,402)	(326,995)
Endowment payout	(148,478)	(6,098)	(154,576)	(122,967)
Net investment loss	(315,282)	(13,696)	(328,978)	(449,962)
Other changes in endowment investments:				
Gifts and pledge payments received in cash	40,786	476	41,262	45,415
Transfers to create funds functioning as endowment	26,084	—	26,084	14,260
Baptist Theological Union assets added to endowment	—	—	—	52,275
Other changes	9,826	25	9,851	2,852
Total other changes in endowment investments	76,696	501	77,197	114,802
Net change in endowment investments	(238,586)	(13,195)	(251,781)	(335,160)
Endowment investments at:				
Beginning of year	3,350,212	141,517	3,491,729	3,826,889
End of year	\$ 3,111,626	128,322	3,239,948	3,491,729

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Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

(4) Notes and Accounts Receivable

Components of notes and accounts receivable at June 30, 2002 and 2001 are shown below:

		2002		2001	
		University	Hospitals	University	Hospitals
Patients	\$	91,134	186,847	92,922	128,861
Students:					
Loans		124,804	—	123,456	—
Tuition and fees		3,502	—	3,090	—
U.S. Government		17,952	—	19,985	—
All other		57,888	—	48,955	—
Subtotal		295,280	186,847	288,408	128,861
Less allowance for doubtful accounts (primarily patient receivables)		(77,184)	(63,138)	(74,634)	(67,340)
Total	\$	<u>218,096</u>	<u>123,709</u>	<u>213,774</u>	<u>61,521</u>

(5) Land, Buildings, Equipment, and Books

Components of land, buildings, equipment, and books at June 30, 2002 and 2001 are shown below:

		2002		2001	
		University	Hospitals	University	Hospitals
Land	\$	27,922	21,905	26,325	25,389
Buildings		832,264	375,039	696,230	378,976
Equipment		254,468	213,864	233,487	217,975
Books		155,424	—	143,579	—
Construction in-progress		156,184	31,313	167,867	14,386
Subtotal		1,426,262	642,121	1,267,488	636,726
Less accumulated depreciation		(597,058)	(309,850)	(565,412)	(293,161)
Total	\$	<u>829,204</u>	<u>332,271</u>	<u>702,076</u>	<u>343,565</u>

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Notes to Consolidated Financial Statements
June 30, 2002 and 2001
(In thousands of dollars)

(6) Notes and Bonds Payable

Notes and bonds payable at June 30, 2002 and 2001 are shown below:

	<u>Fiscal year maturity</u>	<u>Interest rate</u>	<u>2002</u>	<u>2001</u>
University:				
Fixed rate:				
Illinois Educational Facilities Authority (IEFA):				
Series 1993	2014	5.3%-6.0%	\$ 4,490	4,740
Series 1993B	2025	5.5%-5.7%	36,975	36,975
Series 1993C	2008	4.6%-5.0%	10,700	12,200
Series 1998A	2039	5.0%-5.3%	125,000	125,000
Series 2001A	2042	5.3%	75,000	—
Illinois Health Facilities Authority (IHFA) – Series 1985				
	2021	5.5%	62,080	62,200
U.S. Government housing bonds	2003	3.5%-3.6%	24	169
Unamortized discount			(6,288)	(3,325)
Total fixed rate			<u>307,981</u>	<u>237,959</u>
Variable rate:				
Illinois Student Assistance Commission	2003	3.9%	81,974	80,207
IEFA:				
Series 1985 NORC	2007	1.3%	254	315
Pooled financing program	2011	1.4%	8,625	8,625
Series 1998B	2026	4.4%	90,510	90,510
Series 2000 commercial paper	—	—	—	100,000
Series 2001B-1	2037	2.7%	60,000	—
Series 2001B-2	2037	4.0%	40,000	—
Series 2001B-3	2037	2.1%	75,000	—
Bank line of credit (\$65,000 available)	2003	4.1%	22,300	35,400
Total variable rate			<u>378,663</u>	<u>315,057</u>
Total University			<u>686,644</u>	<u>553,016</u>
Hospitals:				
Fixed rate:				
IHFA:				
Series 1993A	2009	4.5%-5.5%	34,225	38,290
Series 1993B	2015	5.8%	41,000	41,000
Series 2001 Serial bond	2024	5.1%	36,725	—
Series 2001 Term bond	2032	5.0%	28,100	—
Series 2001 Term bond	2037	5.1%	24,065	—
Unamortized discount			(1,232)	(224)
Total fixed rate			<u>162,883</u>	<u>79,066</u>
Variable rate:				
IHFA:				
Series 1994C	2027	1.8%	55,400	55,400
Series 1998	2027	4.5%	116,900	117,800
IEFA pooled financing program	2029	1.5%	27,866	27,866
Bank and other notes	2003	—	1,232	8,922
Total variable rate			<u>201,398</u>	<u>209,988</u>
Total Hospitals			<u>364,281</u>	<u>289,054</u>
Total notes and bonds payable			<u>\$ 1,050,925</u>	<u>842,070</u>

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

As of June 30, 2002 and 2001, the total principal amount of indebtedness considered to be legally extinguished and, therefore, excluded from notes and bonds payable was \$93,340 and \$94,170, respectively for the University, and \$106,160 and \$106,525, respectively for the Hospitals.

Principal payments required for University notes and bonds in each of the five years ending June 30, 2003 through 2007 are approximately \$2,061; \$2,487; \$2,162; \$2,187; and \$9,241, respectively.

Principal payments required in each of the five years ending June 30, 2003 through 2007 for the Hospitals' notes and bonds are approximately \$6,167; \$5,475; \$5,480; \$7,170; and \$7,280, respectively.

The carrying value of long-term debt does not differ materially from its estimated fair value as of June 30, 2002 and 2001, based on quoted market prices for the same or similar issues.

(7) Collateral for Notes and Bonds Payable

The University notes and bonds payable are secured by certain physical properties with a carrying value of approximately \$2,679 as of June 30, 2002. In addition, at June 30, 2002, the University had approximately \$8,661 of assets held by trustees for debt service.

Each of the Hospital's IHFA bond series is collateralized and subject to certain restrictions. The Hospitals Series 1993, 1994, and 1998 bonds are guaranteed by a municipal bond insurance policy.

Payment on the University and Hospitals IEFA Pooled Financing Program bonds is guaranteed by a bank letter of credit.

(8) Securities Loaned

The University has an agreement with its investment custodian to lend University securities to brokers in exchange for a fee. Among other provisions that limit the University's risk, the security lending agreement specifies that the custodian is responsible for the lending of securities and obtaining adequate collateral from the borrower. Collateral is limited to cash, government securities, and irrevocable letters of credit. At June 30, 2002 and 2001, investment securities with an aggregate market value of \$707,926 and \$698,640, respectively, were loaned to various brokers and are returnable on demand. In exchange, the University received cash collateral of \$476,342 and \$566,591 and noncash collateral of \$251,084, and \$153,042 at June 30, 2002 and 2001, respectively. In accordance with SFAS No. 140, the cash collateral is shown as both an asset and liability of the University.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

(9) Pledges

Pledges receivable at June 30, 2002 and 2001 are shown below:

	2002		2001	
	University	Hospitals	University	Hospitals
Unconditional promises expected to be collected in:				
Less than one year	\$ 45,846	6,777	36,877	4,344
One year to five years	115,395	17,960	96,928	17,121
More than five years	16,919	—	1,691	4,089
	178,160	24,737	135,496	25,554
Less unamortized discount and allowance for uncollectible pledges	(37,137)	(2,400)	(22,663)	(3,300)
Total	\$ 141,023	22,337	112,833	22,254

(10) Self-insurance Liability

The University maintains a self-insurance program for medical malpractice liability. This program is supplemented with commercial excess insurance above the University's self-insurance retention, which, for the year ended June 30, 2002, was \$8,000 per claim and \$18,000 in annual aggregate. The self insurance retention for the year ended June 30, 2001 was \$4,000 per claim and \$20,000 in annual aggregate. The Hospitals are included under this insurance program and are charged for their portion of self-insurance costs. The University and Hospitals also maintain a self-insurance program for workers' compensation and certain other liability claims.

Under the medical malpractice self-insurance program, the University makes annual contributions to a related trust fund at an actuarially determined rate that is intended to provide adequate funding of the self-insurance liability over a period of years. Actual settlements of medical malpractice claims may be more or less than the liability estimated by the University.

The medical malpractice self-insurance liability is the estimated present value of self-insured claims that will be settled in the future, and considers anticipated payout patterns as well as interest to be earned on available assets prior to payment. If the present value method was not used, the liability for medical malpractice self-insurance claims would be approximately \$26,000 higher than the amount recorded in the consolidated financial statements at June 30, 2002. The interest rate assumed in determining the present value was 7.6%.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

The estimated liability for incurred malpractice, workers' compensation, and other claims (filed and unfiled) as of June 30, 2002 and 2001 is presented below:

	2002		2001	
	University	Hospitals	University	Hospitals
Medical malpractice	\$ 97,792	—	81,651	—
Workers' compensation	3,100	5,979	3,100	6,485
Other	1,820	—	2,487	—
Total	<u>\$ 102,712</u>	<u>5,979</u>	<u>87,238</u>	<u>6,485</u>

(11) Pension Plans and Other Postretirement Benefits

Substantially all personnel of the University participate in either the defined contribution pension plan for academic staff or the defined benefit and contribution pension plans for nonacademic personnel. The majority of Hospitals employees participate in the University's pension plan for nonacademic employees.

In addition to providing pension benefits, the University provides certain health care benefits for retired employees. All Medicare eligible tenured faculty who elect to participate in the University Faculty Retirement Incentive Program receive supplemental health insurance at no cost for themselves and their spouses. All other academic and nonacademic employees are entitled to supplemental health insurance coverage subject to deductibles, copayment provisions, and other limitations.

The postretirement benefit obligation, fair value of plan assets, and funded status along with the prepaid (accrued) benefit cost for these plans are shown below:

	Defined Benefit Pension Plan		Postretirement Health Care Benefits	
	2002	2001	2002	2001
Benefit obligation at March 31	\$ 248,882	241,775	56,206	45,033
Fair value of plan assets at March 31	313,178	330,110	17,756	17,807
Excess (deficiency) of plan assets over benefit obligation	<u>\$ 64,296</u>	<u>88,335</u>	<u>(38,450)</u>	<u>(27,226)</u>
Prepaid (accrued) benefit cost recognized in the consolidated balance sheets at June 30	<u>\$ 64,983</u>	<u>90,170</u>	<u>(17,673)</u>	<u>(18,876)</u>

Plan assets for the defined benefit pension plan are managed through the Teachers Insurance and Annuity Association and College Equities Fund and consist primarily of equity securities and fixed income obligations.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

The weighted average assumptions used in the accounting for the pension and postretirement plans are shown below as of March 31:

	Defined Benefit Pension Plan		Post retirement Health Care Benefits	
	2002	2001	2002	2001
Discount rate	7.5%	7.5%	7.5%	7.5%
Expected return on plan assets	8.5	8.5	6.0	6.0
Rate of compensation increase	4.0	4.5	—	—
Health care cost trend rates:				
Next two fiscal years	—	—	7.5-10.0	5.0
Next seven fiscal years	—	—	4.0-8.0	4.0-5.0
Thereafter	—	—	4.0	4.0

The net periodic benefit cost (income), employer contribution, participant contributions, and benefits paid for these plans are shown below for the fiscal years ended June 30:

	Defined Benefit Pension Plan		Post retirement Health Care Benefits	
	2002	2001	2002	2001
Benefit cost (income) included in the consolidated statements of activities	\$ (427)	(14,262)	3,564	3,463
Employer contributions	—	—	3,648	2,395
Plan participants' contributions	—	—	1,716	1,725
Benefits paid	21,400	20,229	5,374	4,120

Defined contribution pension plan costs included in the consolidated statements of activities amounted to \$21,372 in fiscal 2002 and \$20,317 in fiscal 2001.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

(12) Functional Classification of Expenses

Expenses by functional classification for the years ended June 30, 2002 and 2001 are shown below:

	<u>2002</u>	<u>2001</u>
University:		
Academic and research:		
Instruction	\$ 484,072	473,925
Research	160,939	131,078
Auxiliary enterprises	115,667	104,446
Library	16,346	15,299
Student services	29,584	25,662
Operation and maintenance of physical plant	68,353	67,330
Depreciation	50,036	47,315
Interest on notes and bonds	21,961	22,136
Total academic and research	<u>946,958</u>	<u>887,191</u>
Administration:		
Institutional support	72,757	60,381
Operation and maintenance of physical plant	3,126	2,260
Depreciation	4,840	3,275
Interest on notes and bonds	1,556	823
Total administration	<u>82,279</u>	<u>66,739</u>
Total University	1,029,237	953,930
Hospitals:		
Hospital services	574,633	549,031
Total	<u>\$ 1,603,870</u>	<u>1,502,961</u>

The University's primary program services are instruction and research. Expenses reported as auxiliary enterprises, library, and student services are incurred in support of these primary program activities.

(13) Affiliated Organizations

The University has an ongoing relationship with the National Opinion Research Center (NORC), a not-for-profit organization that conducts research in the public interest primarily for various federal agencies. The majority of NORC's board of trustees are faculty members or officers of the University. Program related revenue for the years ended December 31, 2001 and 2000 was \$45,539 and \$46,136, respectively. Unrestricted net assets at December 31, 2001 and 2000 were \$3,387 and \$5,195, respectively. In addition, the University has guaranteed \$8,000 of NORC's debt. Consolidation of this not-for-profit organization is not required because the University does not have both control and an economic interest.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 2002 and 2001

(In thousands of dollars)

The University operates Argonne National Laboratory under a contract with the U.S. Department of Energy, which provides for the payment of a fixed management allowance and an additional fee based on performance judged against established measures. The expenditures under this contract and the related reimbursements of \$507,695 in fiscal year 2002 and \$511,197 in fiscal year 2001 are not included in the consolidated statements of activities. Also, net assets relating to Argonne National Laboratory are owned by the United States government and, therefore, are not included in the consolidated balance sheets.

(14) Contingencies

Various lawsuits, claims, and other contingent liabilities arise in the ordinary course of the University's education, research, and health care activities. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material adverse effect on the consolidated financial position of the University.

Schedule 1

THE UNIVERSITY OF CHICAGO
 Statements of Activities Information – University
 Years ended June 30, 2002 and 2001
 (In thousands of dollars)

	<u>2002</u>	<u>2001</u>
Changes in unrestricted net assets:		
Operating:		
Revenue:		
Tuition and fees – gross	\$ 340,936	316,692
Less:		
Undergraduate student aid	(35,286)	(35,234)
Graduate student aid	(103,100)	(95,741)
Tuition and fees – net	202,550	185,717
Government grants and contracts	240,371	203,218
Private gifts, grants, and contracts	97,001	83,156
Endowment payout	146,726	116,767
Earnings on other investments	13,209	15,615
Patient care	136,419	133,027
Auxiliaries	142,318	133,920
Other income	109,573	96,647
Total operating revenue	<u>1,088,167</u>	<u>968,067</u>
Expenses:		
Compensation:		
Academic salaries	282,499	270,428
Staff salaries	248,630	228,386
Benefits	110,552	102,012
Total compensation	<u>641,681</u>	<u>600,826</u>
Other operating expenses:		
Utilities, alterations, and repairs	28,613	27,987
Depreciation	54,876	50,590
Interest	23,517	22,959
Supplies and services	272,315	243,776
Insurance	8,235	7,792
Total other operating expenses	<u>387,556</u>	<u>353,104</u>
Total operating expenses	<u>1,029,237</u>	<u>953,930</u>
Excess of operating revenue over expenses	<u>58,930</u>	<u>14,137</u>

Schedule 1

THE UNIVERSITY OF CHICAGO
 Statements of Activities Information – University
 Years ended June 30, 2002 and 2001
 (In thousands of dollars)

	<u>2002</u>	<u>2001</u>
Changes in unrestricted net assets:		
Nonoperating:		
Endowment payout	\$ —	66
Investment losses	(316,085)	(417,973)
Change in method of accounting for pension plan assets	(25,614)	—
Change in method of accounting for Baptist Theological Union net assets	—	50,766
Other, net	(25,792)	(302)
Change in unrestricted net assets from nonoperating activities	(367,491)	(367,443)
Decrease in unrestricted net assets	(308,561)	(353,306)
Changes in temporarily restricted net assets:		
Private gifts	55,118	39,625
Endowment payout	144	176
Investment losses	(520)	(1,912)
Other, net	(37,760)	(29,750)
Increase in temporarily restricted net assets	16,982	8,139
Changes in permanently restricted net assets:		
Private gifts	50,098	42,845
Endowment payout	1,608	1,075
Investment losses	(4,615)	(3,100)
Change in method of accounting for Baptist Theological Union net assets	—	1,509
Other, net	2,307	11,253
Increase in permanently restricted net assets	49,398	53,582
Decrease in net assets	(242,181)	(291,585)
Net assets at beginning of year	4,057,545	4,349,130
Net assets at end of year	\$ <u>3,815,364</u>	<u>4,057,545</u>

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Balance Sheet Information – University

June 30, 2002 and 2001

(In thousands of dollars)

Assets	2002	2001
Cash and cash equivalents	\$ —	8,395
Notes and accounts receivable	218,096	213,774
Collateral held for securities loaned	476,342	566,591
Inventories	10,016	9,142
Prepaid expenses and other assets	85,489	122,621
Pledges receivable	141,023	112,833
Investments	3,605,852	3,778,903
Land, buildings, equipment, and books	829,204	702,076
Total assets	<u>\$ 5,366,022</u>	<u>5,514,335</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 152,820	126,679
Deferred revenue	68,771	59,085
Payable under securities loan agreements	476,342	566,591
Assets held in custody for others	24,831	26,171
Self-insurance liability	102,712	87,238
Notes and bonds payable	686,644	553,016
Refundable U.S. Government student loan funds	38,538	38,010
Total liabilities	<u>1,550,658</u>	<u>1,456,790</u>
Net assets:		
Unrestricted	2,828,170	3,136,731
Temporarily restricted	276,957	259,975
Permanently restricted	710,237	660,839
Total net assets	<u>3,815,364</u>	<u>4,057,545</u>
Total liabilities and net assets	<u>\$ 5,366,022</u>	<u>5,514,335</u>

See accompanying independent auditors' report.



303 East Wacker Drive
Chicago, IL 60601

Independent Auditors' Report

The Board of Trustees
The University of Chicago:

We have audited the accompanying consolidated balance sheets of The University of Chicago as of June 30, 2002 and 2001, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We did not audit the financial statements of The University of Chicago Hospitals (the Hospitals), which statements reflect total assets constituting 15% and 14% and total change in net assets constituting 11% and 12% of the related consolidated totals in 2002 and 2001, respectively. Our opinion, insofar as it relates to the amounts included for the Hospitals, is based solely on the reports of other auditors.

The financial statements of the Hospitals as of June 30, 2002 and for the year then ended were audited by other auditors whose report has been furnished to us. That report indicated that the financial statements of the Hospitals as of and for the year ended June 30, 2001 were audited by other auditors who have ceased operations and whose report, dated October 4, 2001, expressed an unqualified opinion on the 2001 financial statements before the restatement to retroactively adopt Statement of Financial Accounting Standards No. 144.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 audits and the reports of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the reports of the other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The University of Chicago as of June 30, 2002 and 2001, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in note 1 to the financial statements, the University changed its method of accounting for recognizing gains and losses in its defined benefit pension plan in fiscal year 2002.





Our audits were made for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The supplementary information included in schedules 1 and 2 is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

KPMG LLP

October 16, 2002