

THE UNIVERSITY OF CHICAGO

Consolidated Financial Statements and Supplemental
University Information

June 30, 1997

(With Independent Auditors' Report Thereon)

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THE UNIVERSITY OF CHICAGO

Consolidated Statement of Activities

Year ended June 30, 1997
with comparative totals for 1996

(in thousands of dollars)

	1997		1996	
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets:				
Operating:				
Revenues:				
Tuition and fees – gross	\$ 239,771	–	239,771	226,763
Less:				
Undergraduate student aid	(28,734)	–	(28,734)	(27,024)
Graduate student aid	(72,542)	–	(72,542)	(69,593)
Tuition and fees – net	138,495	–	138,495	130,146
Government grants and contracts	160,347	–	160,347	156,819
Private gifts, grants, and contracts	67,365	–	67,365	71,071
Endowment payout	65,756	3,073	68,829	63,228
Earnings on other investments	13,536	11,714	25,250	28,499
Patient care	128,670	578,335	707,005	671,471
Auxiliaries	111,103	–	111,103	115,108
Other income	62,711	36,265	98,976	62,478
Total operating revenues	747,983	629,387	1,377,370	1,298,820
Expenses:				
Compensation:				
Academic salaries	219,688	–	219,688	209,806
Staff salaries	169,107	261,449	430,556	401,750
Benefits	79,049	54,904	133,953	126,143
Total compensation	467,844	316,353	784,197	737,699
Other operating expenses:				
Utilities, alterations, and repairs	23,291	8,737	32,028	31,326
Depreciation	39,183	34,391	73,574	67,266
Interest expense	13,715	13,541	27,256	23,640
Supplies and services	179,599	221,033	400,632	350,354
Insurance	11,795	9,411	21,206	28,407
Total other operating expenses	267,583	287,113	554,696	500,993
Total operating expenses	735,427	603,466	1,338,893	1,238,692
Excess of operating revenues over expenses	\$ 12,556	25,921	38,477	60,128

THE UNIVERSITY OF CHICAGO

Consolidated Statement of Activities, Continued

(in thousands of dollars)

	1997		1996	
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets: (continued from page 1)				
Nonoperating:				
Gifts and grants for buildings and equipment	\$ 3,410	62	3,472	7,754
Endowment payout	132	-	132	58
Investment gains	286,937	46,824	333,761	193,676
Net proceeds from sale of Encyclopedia Britannica	-	-	-	76,781
Other	32,955	(10,047)	22,908	16,630
Change in unrestricted net assets from nonoperating activities	323,434	36,839	360,273	294,899
Increase in unrestricted net assets	335,990	62,760	398,750	355,027
Changes in temporarily restricted net assets:				
Private gifts	11,081	3,217	14,298	25,811
Investment gains	2,273	-	2,273	2,701
Other	(48,087)	(1,153)	(49,240)	(25,958)
Increase (decrease) in temporarily restricted net assets	(34,733)	2,064	(32,669)	2,554
Changes in permanently restricted net assets:				
Gifts and grants	39,415	-	39,415	21,102
Endowment payout	921	-	921	907
Investment gains	11,305	-	11,305	5,730
Other	21,031	-	21,031	1,870
Increase in permanently restricted net assets	72,672	-	72,672	29,609
Increase in net assets	373,929	64,824	438,753	387,190
Net assets at beginning of year	2,133,079	363,710	2,496,789	2,109,599
Net assets at end of year	\$ 2,507,008	428,534	2,935,542	2,496,789

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Consolidated Balance Sheet

June 30, 1997
with comparative totals for 1996

(in thousands of dollars)

Assets	1997			1996
	University	Hospitals	Consolidated	Consolidated
Cash and cash equivalents	\$ 115,269	22,580	137,849	128,785
Notes and accounts receivable	141,596	74,286	215,882	187,052
Inventories	9,086	5,982	15,068	16,155
Prepaid expenses and other assets	53,011	76,569	129,580	95,937
Pledges receivable	39,370	405	39,775	49,278
Investments, at market	2,278,860	349,665	2,628,525	2,229,608
Land, buildings, equipment, and books – net	465,805	380,616	846,421	755,716
Total assets	\$ 3,102,997	910,103	4,013,100	3,462,531
Liabilities and Net Assets				
Liabilities:				
Accounts payable and accrued expenses	91,842	201,949	293,791	226,148
Deferred revenue	49,595	–	49,595	40,738
Assets held in custody for others	48,003	–	48,003	42,271
Self-insurance liability	89,734	13,945	103,679	109,349
Notes and bonds payable	281,435	265,675	547,110	512,493
Refundable U.S. government student loans	35,380	–	35,380	34,743
Total liabilities	595,989	481,569	1,077,558	965,742
Net assets:				
Unrestricted	1,997,033	421,069	2,418,102	2,019,352
Temporarily restricted	66,301	4,764	71,065	103,734
Permanently restricted	443,674	2,701	446,375	373,703
Total net assets	2,507,008	428,534	2,935,542	2,496,789
Total liabilities and net assets	\$ 3,102,997	910,103	4,013,100	3,462,531

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Consolidated Statement of Cash Flows

Year ended June 30, 1997
with comparative totals for 1996

(in thousands of dollars)

	1997			1996
	University	Hospitals	Consolidated	Consolidated
Cash flows from operating activities:				
Increase in net assets	\$ 373,929	64,824	438,753	387,190
Adjustments to reconcile increase in net assets to net cash provided by operating activities:				
Depreciation	39,183	34,391	73,574	67,266
Net gain on investments	(300,515)	(46,824)	(347,339)	(202,107)
Private gifts and grants restricted for long-term investment	(53,906)	(3,279)	(57,185)	(54,667)
Other nonoperating additions – net	(6,952)	(11,197)	(18,149)	(83,154)
Pension income	(5,093)	–	(5,093)	(2,108)
Changes in assets and liabilities:				
Notes and accounts receivable	(3,257)	(1,882)	(5,139)	18,740
Prepaid expenses and other assets	3,029	(30,491)	(27,462)	(8,459)
Accounts payable and other liabilities	34,265	48,604	82,869	19,632
Self-insurance liability	(5,047)	(623)	(5,670)	7,759
Total adjustments	(298,293)	(11,301)	(309,594)	(237,098)
Net cash provided by operating activities	75,636	53,523	129,159	150,092
Cash flows from investing activities:				
Purchase of investments	(252,337)	(29,658)	(281,995)	(839,818)
Proceeds from sale of investments	165,013	65,404	230,417	722,424
Acquisition of land, buildings, equipment, and books	(62,083)	(108,714)	(170,797)	(152,565)
Disposal of land, buildings, equipment, and books	2,934	3,584	6,518	8,022
Loans disbursed	(27,803)	–	(27,803)	(5,020)
Principal collected on loans	4,112	–	4,112	3,960
Net cash used in investing activities	(170,164)	(69,384)	(239,548)	(262,997)
Cash flows from financing activities:				
Proceeds from issuance of notes and bonds payable	26,395	12,500	38,895	2,373
Principal payments on notes and bonds payable	(2,331)	(1,947)	(4,278)	(4,439)
Proceeds from private gifts and grants restricted for long-term investment	63,349	3,338	66,687	59,952
Other nonoperating additions – net	6,952	11,197	18,149	83,154
Net cash provided by financing activities	94,365	25,088	119,453	141,040
Increase (decrease) in cash and cash equivalents	(163)	9,227	9,064	28,135
Cash and cash equivalents at:				
Beginning of year	115,432	13,353	128,785	100,650
End of year	\$ 115,269	22,580	137,849	128,785
Supplemental disclosure of cash flow information – cash paid for interest	\$ 13,747	13,541	27,288	23,806

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 1997

(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 (Hospitals) and other health care facilities located in the area.

Significant accounting policies followed by the University are set forth below. Accounting policies followed by 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. Following is a comparison of fund balances to the three net asset categories as of June 30, 1997.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

Fund balances	Net asset classifications			Total
	Unrestricted	Temporarily restricted	Permanently restricted	
University:				
Current unrestricted and unexpended plant	\$ 167,118	6,563	–	173,681
Current restricted:				
Restricted gifts	89,363	25,812	–	115,175
Pledges	–	17,120	22,251	39,371
Student loans	–	–	9,002	9,002
Endowment	1,567,551	6,147	380,159	1,953,857
Annuity and life income	–	10,659	32,262	42,921
Net investment in physical properties	173,001	–	–	173,001
Subtotal	1,997,033	66,301	443,674	2,507,008
Hospitals:				
Unrestricted	390,281	–	–	390,281
Restricted	–	4,764	–	4,764
Endowment (restricted and unrestricted)	30,788	–	2,701	33,489
Subtotal	421,069	4,764	2,701	428,534
Total	\$ 2,418,102	71,065	446,375	2,935,542

Descriptions of the three net asset categories and the types of transactions affecting each category follow:

- Unrestricted Net Assets – net assets that are not subject to donor-imposed restrictions including the carrying value of all physical properties (land, building, equipment, and books). 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 certain types of philanthropic support – namely, unrestricted gifts, including those designated by the Board to function as endowment, as well as restricted gifts whose donor-imposed restrictions are for current or developing programs projects and were met during the fiscal year – and realized and unrealized gains and losses on endowment funds.
- Temporarily Restricted Net Assets – net assets subject to donor-imposed restrictions that may or 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 restrictions have not been met (primarily gifts awaiting designation by the donor), annuity and life income gifts and 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 are reported as reclassifications between the net asset classes, and included in other.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

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- Permanently Restricted Net Assets – 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.

Gifts

Gifts, including unconditional pledges, are recognized as revenue 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 present value of the expected future cash flows; discounts are amortized to gift revenue consistent with donor restrictions. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Private gifts, grants, and contracts revenue for fiscal years 1997 and 1996 consists of the following:

	1997	1996
Private gifts:		
Unrestricted as to use	\$ 14,405	10,051
Temporarily restricted gifts whose restrictions were met during the fiscal year and reported as unrestricted revenue	18,002	28,249
Private grants and contracts	34,958	32,771
Total	\$ 67,365	71,071

Grants and Contracts

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 sheet. Included in deferred revenue at June 30, 1997 and 1996 is \$28,171 and \$22,607, respectively, of grant and contract receipts which have not been expended.

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 realized and unrealized capital gains. If income received is in excess of the objective, the balance is reinvested in the endowment.

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Notes to Consolidated Financial Statements

(in thousands of dollars)

Endowment payout for fiscal years 1997 and 1996 consists of the following:

	1997			1996
	University	Hospitals	Total	
Interest, dividends, and rents	\$ 55,702	2,547	58,249	52,725
Realized investment gains used to support the endowment payout formula	11,107	526	11,633	11,468
Total	\$ 66,809	3,073	69,882	64,193

Unrestricted operating endowment payout revenue for fiscal years 1997 and 1996 consists of the following:

	1997			1996
	University	Hospitals	Total	
Unrestricted payout	\$ 17,333	–	17,333	14,555
Temporarily restricted payout whose restrictions were met during the fiscal year and reported as unrestricted revenue	48,423	3,073	51,496	48,673
Total	\$ 65,756	3,073	68,829	63,228

Operations

Operating results in the consolidated statement of activities reflect all transactions increasing or decreasing unrestricted net assets except those items of a capital nature, that is, associated with long-term investment or physical plant.

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 and annuity and life income 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 are valued at the lower of cost or net realizable value.

Investments

The University's 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. The fair value of significant direct real estate investments is determined from periodic valuations prepared by independent appraisers.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

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

Physical Properties

Physical properties 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 revenues are 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 of the University 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 revenues and expenses during the period. Actual results may differ from those estimates.

Reclassifications

Certain 1996 comparative totals have been reclassified to conform to the 1997 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 include Louis A. Weiss Memorial Hospital, a community hospital in Chicago, Illinois and QV, Inc., an affiliated not-for-profit health care corporation. The University elects the Hospitals' Board of Trustees. Accordingly, the Hospitals' financial information is included as a separate column in the consolidated financial statements.

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 (AICPA) *Health Care Audit Guide*. The principles of the *Health Care Audit Guide* differ in several significant respects from accounting and reporting principles followed by the University as follows: (1) provision for uncollectible patient accounts receivable is reflected as a reduction of revenue under University

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

accounting, but is recognized as an expense under Hospitals accounting; and (2) investment gains on endowment funds are classified as a nonoperating change in unrestricted net assets for University reporting, but are classified as operating revenue for Hospitals reporting.

For purposes of presentation of the Hospitals' financial position and results of operations in the consolidated financial statements, several reclassifications have been made as follows: (1) \$ _____ provision for uncollectible Hospitals' patient accounts receivable have been reclassified as a reduction of sales and services of Hospitals revenue; and (2) \$ _____ endowment gains have been reclassified as a nonoperating change in unrestricted net assets.

In fiscal 1996 and 1997, the Hospitals made commitments of \$15.0 million to The University Biological Sciences Division for enhancement and expansion of several programs within the Division. Under Hospitals accounting, these commitments of have been recognized as expense. For purposes of presentation of The Hospitals' financial position and results of operations in the consolidated financial statements, the fiscal 1996 and 1997 commitments of \$15.0 million have been excluded from the Hospitals' results of operations.

A reconciliation between the Hospitals' results of operations reported in the stand-alone financial statements of the Hospitals and those included in the University consolidated statement of activities for the fiscal years ended June 30, 1997 and 1996 is presented below:

	1997	1996
Revenues in excess of expenses – as reported in the Hospitals' combined statement of revenues and expenses	\$ 13,228	21,015
Reclassification of gains on endowment activity from operating to nonoperating results	(2,307)	(2,804)
Hospitals' commitment to the University Biological Sciences Division for program enhancement and expansion	15,000	15,000
Excess of operating revenues over expenses – as reported in the University consolidated statement of activities	\$ 25,921	33,211

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.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(3) Investments

Fair values of investments at June 30, 1997 and 1996, are shown below:

	1997				1996
	University and Hospitals Endowment	All others		Total	
		University	Hospitals		
Cash equivalents	\$ 105,788	9,062	8,260	123,110	82,766
Stocks	1,445,255	71,067	169,347	1,685,669	1,304,469
Bonds	286,669	92,072	74,712	453,453	491,684
Real estate	188,541	17,481	—	206,022	170,114
Assets held by trustee (primarily cash equivalents and bonds)	8,791	143,191	8,063	160,045	180,263
Other	—	226	—	226	312
Total	\$ 2,035,044	333,099	260,382	2,628,525	2,229,608

Changes in the market value of endowment investments were as follows for the fiscal years ended June 30, 1997 and 1996:

	1997			1996
	University	Hospitals	Consolidated	Consolidated
Investment return:				
Endowment yield (interest, dividends, and rents)	\$ 55,702	2,547	58,249	52,725
Realized gains on investments	66,285	3,105	69,390	84,317
Unrealized gains on investments	233,982	10,786	244,768	118,415
Total investment return	355,969	16,438	372,407	255,457
Endowment payout	(66,809)	(3,073)	(69,882)	(64,193)
Net investment return reinvested	289,160	13,365	302,525	191,264
Other changes in endowment investments:				
Gifts received in cash	39,741	—	39,741	21,159
Transfers from operating cash to create funds functioning as endowment	15,223	—	15,223	84,120
Other changes	(1,403)	684	(719)	5,364
Total other changes in endowment investments	53,561	684	54,245	110,643
Net change in endowment investments	342,721	14,049	356,770	301,907
Endowment investments at beginning of year	1,603,040	75,234	1,678,274	1,376,367
Endowment investments at end of year	\$ 1,945,761	89,283	2,035,044	1,678,274

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Notes to Consolidated Financial Statements

(in thousands of dollars)

(4) Notes and Accounts Receivable

Components of notes and accounts receivable at June 30, 1997 and 1996, are shown below:

	1997		1996	
	University	Hospitals	University	Hospitals
Patients	\$ 64,486	132,455	65,166	140,630
Students:				
Loans	64,833	—	40,675	—
Tuition	1,272	—	3,058	—
U.S. government	14,775	—	16,349	—
All other	37,730	—	33,227	—
Subtotal	183,096	132,455	158,475	140,630
Less allowance for doubtful accounts (primarily patient receivables)	(41,500)	(58,169)	(43,827)	(68,226)
Total	\$ 141,596	74,286	114,648	72,404

(5) Land, Buildings, Equipment, and Books

Components of land, buildings, equipment, and books at June 30, 1997 and 1996, are shown below:

	1997		1996	
	University	Hospitals	University	Hospitals
Land	\$ 25,606	18,381	25,615	14,816
Buildings	582,735	401,459	551,738	345,634
Equipment	184,624	221,421	175,650	174,665
Books	107,202	—	99,351	—
Subtotal	900,167	641,261	852,354	535,115
Less accumulated depreciation	(434,362)	(260,645)	(406,515)	(225,238)
Total	\$ 465,805	380,616	445,839	309,877

Depreciation is calculated on a straight-line basis using the following useful lives: buildings and building improvements, 13 to 63 years; equipment, 3 to 20 years; and books, 10 years.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(6) Notes and Bonds Payable

Notes and bonds payable at June 30, 1997 and 1996, are shown below:

	Maturity	Interest rate	1997	1996
University:				
Fixed rate:				
Illinois Educational Facilities Authority (IEFA):				
Series 1985	2026	5.7%-6.2%	\$ 85,000	85,250
Series 1985 – student loan	2000	7.5%	1,370	1,730
Series 1993	2014	4.2%-5.9%	5,640	5,840
Series 1993B	2025	5.5%-5.7%	36,975	36,975
Series 1993C	2008	3.9%-5.0%	17,475	17,475
U.S. Government housing bonds	2003	3.0%-3.6%	758	1,057
Mortgage notes	2003	7.6%-8.0%	279	347
Unamortized discount			(2,491)	(2,595)
Total fixed rate			145,006	146,079
Variable rate:				
Illinois Health Facilities Authority (IHFA) – Series 1985				
	2016	3.6%	62,300	62,300
Illinois Student Assistance Commission				
	1997	5.3%	23,846	173
IEFA – Series 1985 NORC				
	2007	4.0%	558	619
IEFA – Series 1995				
	1997	3.9%	3,725	2,200
Taxable commercial paper				
	1997	5.6%	46,000	46,000
Total variable rate			136,429	111,292
Total University			281,435	257,371
Hospitals:				
Fixed rate:				
IHFA:				
Series 1993A	2008	4.5%-5.5%	48,470	48,470
Series 1993B	2014	5.8%	41,000	41,000
Series 1994A	2026	5.0%-6.1%	51,925	51,925
Series 1994B	2019	6.3%	55,800	55,800
Unamortized discount			(2,137)	(2,217)
Other	2001	6.5%-8.5%	14,459	3,481
Total fixed rate			209,517	198,459
Variable rate:				
IHFA:				
Series 1985D	1998	4.4%-6.7%	758	1,263
Series 1994C	2026	3.4%	55,400	55,400
Total variable rate			56,158	56,663
Total Hospitals			265,675	255,122
Total notes and bonds payable			\$ 547,110	512,493

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Notes to Consolidated Financial Statements

(in thousands of dollars)

As of June 30, 1997, the total principal amount of indebtedness considered to be extinguished under in-substance defeasance transactions and, therefore, excluded from notes and bonds payable was \$11,965 and \$78,600 for the University and Hospitals, respectively.

Principal payments required for outstanding University notes and bonds in each of the five years ending June 30, 1998 through 2002 are approximately \$1,560, \$1,768, \$1,874, \$2,010, and \$2,000, respectively.

Principal payments required in each of the five years ending June 30, 1998 through 2002 for the Hospitals' notes and bonds are approximately \$3,128, \$13,477, \$5,160, \$4,995, and \$4,778, respectively.

(7) Collateral for Notes and Bonds Payable

Notes and bonds payable are secured by certain physical properties with a carrying value of \$15.5 million and securities with a market value of \$1.6 million. In addition, at June 30, 1997, the University had approximately \$19.9 million of assets held by trustees for debt service.

The IEFA Series 1985 Student Loan Fund bonds are a limited recourse obligation of the University, payable solely from repayments of education loan notes made to students and parents or guardians of students attending the University. In addition, bond principal and interest payments are secured by a bank letter of credit and the education loan notes are insured against default under the terms of a private insurance agreement.

The Hospitals Series 1985-D revenue bonds are secured by certain physical properties purchased with the proceeds. The Hospitals Series 1993 and Series 1994 revenue bonds are secured by patient accounts receivable. In addition, payment of the principal and interest on the Series 1993 and Series 1994 revenue bonds is guaranteed by a municipal bond insurance policy.

(8) Securities Loaned

The University has an agreement with its investment custodian to lend University securities to brokers in exchange for a fee. The security lending agreement specifies that the custodian is responsible for the lending of securities and obtaining adequate collateral from the borrower. At June 30, 1997, investment securities with an aggregate market value of \$362.9 million were loaned to various brokers and are returnable on demand.

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(9) Pledges

The present value of unconditional pledges receivable, net of an allowance for uncollectible amounts at June 30, 1997 and 1996, is shown below:

	1997		1996	
	University	Hospitals	University	Hospitals
Unconditional promises (net of discount of \$6,908 in 1997 and \$6,534 in 1996) expected to be collected in:				
Less than one year	\$ 17,945	145	22,466	121
One year to five years	25,856	260	31,660	343
More than five years	29	—	46	—
	43,830	405	54,172	464
Less allowance for uncollectible pledges	(4,460)	—	(5,358)	—
Total	\$ 39,370	405	48,814	464

At June 30, 1997, the University also has a \$10,610 conditional promise to give based on the University's ability to stimulate new and increased giving to the Graduate School of Business.

(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 years ended June 30, 1997 and 1996, was \$4 million per claim and \$19 million 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 \$21 million higher than the amount recorded in the consolidated financial statements at June 30, 1997. The interest rate assumed in determining the present value was 6%.

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

In addition, the Hospitals maintains a separate professional self-insurance program for certain of its employees at Weiss Memorial Hospital. This program is supplemented with commercial excess insurance above a self-insurance retention of \$2 million per claim and \$4 million in annual aggregate. The liability for this self-insurance program is actuarially determined on a present value basis. If the present value method was not used, the liability for these claims would be approximately \$.7 million higher.

The estimated liability for incurred malpractice, workers' compensation, and other claims (filed and unfiled) is presented below:

	1997		1996	
	University	Hospitals	University	Hospitals
Medical malpractice	\$ 83,043	8,900	90,267	9,300
Workers' compensation	3,200	5,045	3,200	5,268
Other	3,491	—	1,314	—
Total	\$ 89,734	13,945	94,781	14,568

(11) Pension Plans

Substantially all personnel of the University participate in either the contributory 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.

Pension cost (income) for fiscal years 1997 and 1996 is shown below:

	1997	1996
Defined contribution plans:		
Academic	\$ 13,495	12,664
Nonacademic	1,473	907
Defined benefit plan – nonacademic	(5,093)	(2,108)
Total	\$ 9,875	11,463

Under the defined contribution plan for academic staff, the University and plan participants make annual contributions to purchase individual annuities equivalent to retirement benefits earned.

Under the defined benefit plan for nonacademic personnel, benefits are based on years of service and the employee's compensation during the last five years of employment. The University and Hospitals make annual contributions to the defined benefit plan at a rate necessary to maintain the plan on an actuarially sound basis. Under the defined contribution plan for nonacademic personnel, the University and plan participants make contributions that accrue to the benefit of the employee at retirement.

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

The nonacademic defined benefit pension income for fiscal years 1997 and 1996 includes the components shown below:

	1997	1996
Service cost – benefits earned during the period	\$ 7,498	6,412
Interest cost on projected benefit obligations	12,722	12,121
Actual return on plan assets	(31,199)	(50,028)
Net amortization and deferral	5,886	29,387
Net pension income	\$ (5,093)	(2,108)

The funded status of the defined benefit pension plan for nonacademic personnel at March 31, 1997 and 1996, and amounts recognized in the University's balance sheet at June 30, 1997 and 1996, are shown below:

	1997	1996
Actuarial present value of benefit obligations as of March 31:		
Vested	\$ 133,788	133,089
Nonvested	1,726	1,813
Accumulated benefit obligation	135,514	134,902
Effect of projected future salary increases	23,640	34,735
Projected benefit obligation	159,154	169,637
Plan assets at fair value	281,072	261,120
Plan assets in excess of projected benefit obligation	121,918	91,483
Unrecognized gain	(84,024)	(55,635)
Unrecognized prior service cost	11,394	12,562
Unrecognized transition asset recognized over 13 years	(12,644)	(16,859)
Prepaid pension expense recognized in the consolidated balance sheet	\$ 36,644	31,551

Plan assets are managed through the Teachers Insurance and Annuity Association and College Retirement Equities Fund and consist primarily of equity securities and fixed income obligations.

Actuarial assumptions used as of March 31, 1997 and 1996, are shown below:

	1997	1996
Discount rate	7.8%	8.0
Rate of increase in future compensation levels	5.0	5.0
Long-term rate of return on plan assets	8.0	8.0

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

In addition, Weiss Memorial Hospital maintains a separate defined benefit pension plan for certain of its employees. Assets of this plan approximated \$27.3 million and \$23.3 million at June 30, 1997 and 1996, and compared with the related projected benefit obligations of \$27.2 million and \$26.2 million for those years, respectively.

(12) Postretirement Benefits

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 University has adopted the provisions of Statement of Financial Accounting Standards No. 106, *Employers' Accounting for Postretirement Benefits Other than Pensions* (SFAS No. 106), the provisions of which apply to the University's health care benefits for retired employees. SFAS No. 106 permits the initial accrued liability for these postretirement health care benefits (\$16 million) to be recognized in operations over a 20-year period.

Periodic postretirement benefit cost for fiscal years 1997 and 1996 includes the following components:

	1997	1996
Service cost	\$ 766	682
Interest cost on accumulated postretirement benefit obligation	1,777	1,571
Actual return on plan assets	32	(57)
Amortization of transition obligation	800	800
Total periodic postretirement benefit cost	\$ 3,375	2,996

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

The financial status of the postretirement benefit plan and amount recognized in the University's consolidated balance sheet at June 30, 1997 and 1996, are shown below:

	1997	1996
Accumulated postretirement benefit obligation:		
Retirees	\$ 12,515	10,402
Fully eligible active employees	6,321	6,054
Active employees not yet eligible	7,054	7,000
Total accumulated postretirement benefit obligation	25,890	23,456
Unrecognized prior service cost	2,317	2,510
Unrecognized prior period actuarial loss	(7,760)	(6,852)
Unrecognized transition obligation	(12,791)	(13,591)
Accrued postretirement benefit cost recognized in the consolidated balance sheet	\$ 7,656	5,523

Actuarial assumptions used in determining the accumulated postretirement benefit obligation as of June 30, 1997 and 1996, are shown below:

	1997	1996
Discount rate	7.8%	8.0
Health care cost trend rates:		
Through fiscal year 2000	7.5	7.5
Fiscal years 2001 through 2007	4.5	4.5
Fiscal year 2008 and later	3.5	3.5

If the health care cost trend rate assumptions were increased by 1%, the accumulated postretirement benefit obligation as of June 30, 1997 would increase by \$4.0 million, and the sum of the service and interest cost components of the periodic postretirement benefit cost for the fiscal year then ended would increase by \$.5 million.

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(13) Functional Classification of Expenses

Expenses by functional classification for the years ended June 30, 1997 and 1996, are shown below:

	1997	1996
University:		
Academic and research:		
Instruction and research	\$ 445,405	417,675
Auxiliary enterprises	104,963	107,269
Library and academic support	15,853	17,832
Student services	17,563	16,543
Operation and maintenance of physical plant	44,169	37,355
Depreciation	33,763	32,693
Interest on notes and bonds	11,075	11,134
Total academic and research	672,791	640,501
Administration:		
Institutional support	46,678	40,582
Operation and maintenance of physical plant	8,413	7,115
Depreciation	5,419	4,694
Interest on notes and bonds	2,126	2,128
Total administration	62,636	54,519
Total University	735,427	695,020
Hospitals – hospital services	603,466	543,672
Total	\$ 1,338,893	1,238,692

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

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(14) Affiliated Organizations

The University has an ongoing relationship with the National Opinion Research Center (NORC) and The Baptist Theological Union (BTU). Consolidation of these financially interrelated not-for-profit organizations is not required because the University does not have both control and an economic interest. A summary description of these organizations follows:

- NORC is 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 revenues for the years ended December 31, 1996 and 1995 were \$50,046 and \$46,041, respectively. Unrestricted net assets at December 31, 1996 and 1995 were \$4,927 and \$4,298, respectively.
- BTU is a not-for-profit organization that distributes its earnings on endowment assets to the University's Divinity School. No University faculty or officers are members of the BTU Board of Trustees. During the fiscal years ended June 30, 1997 and 1996, BTU distributed \$3,238 and \$3,344 to the University's Divinity School, respectively. The market value of the BTU endowment at June 30, 1997 and 1996 was \$37,854 and \$31,144, respectively.

In addition, the University operates the 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 \$524,285 in fiscal year 1997 and \$555,997 in fiscal year 1996 are not included in the consolidated statement 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 sheet.

(15) Contingencies

Various lawsuits, claims and other contingent liabilities arise in the ordinary course of the University's education, research, and health care activities. While the ultimate disposition of the aforementioned contingencies is not determinable at this time, management believes that any liability resulting therefrom will not materially affect the financial position of the University.

THE UNIVERSITY OF CHICAGO

Statement of Activities Information – University

Years ended June 30, 1997 and 1996

(in thousands of dollars)

	1997	1996
Changes in unrestricted net assets:		
Operating:		
Revenues:		
Tuition and fees – gross	\$ 239,771	226,763
Less:		
Undergraduate student aid	(28,734)	(27,024)
Graduate student aid	(72,542)	(69,593)
Tuition and fees – net	138,495	130,146
Government grants and contracts	160,347	156,819
Private gifts, grants, and contracts	67,365	68,102
Endowment payout	65,756	60,257
Earnings on other investments	13,536	12,253
Patient care	128,670	133,316
Auxiliaries	111,103	115,108
Other income	62,711	45,936
Total operating revenues	747,983	721,937
Expenses:		
Compensation:		
Academic salaries	219,688	209,806
Staff salaries	169,107	160,737
Benefits	79,049	75,530
Total compensation	467,844	446,073
Other operating expenses:		
Utilities, alterations, and repairs	23,291	23,743
Depreciation	39,183	37,387
Interest expense	13,715	13,262
Supplies and services	179,599	158,576
Insurance	11,795	15,979
Total other operating expenses	267,583	248,947
Total operating expenses	735,427	695,020
Excess (deficiency) of operating revenues over expenses	\$ 12,556	26,917

THE UNIVERSITY OF CHICAGO

Statement of Activities Information – University

(in thousands of dollars)

	1997	1996
Changes in unrestricted net assets: (continued from page 22)		
Nonoperating:		
Private gifts and grants for buildings and equipment	\$ 3,410	7,305
Endowment payout	132	58
Investment gains	286,937	180,289
Net proceeds from sale of Encyclopedia Britannica	–	76,781
Other	32,955	7,368
Change in unrestricted net assets from nonoperating activities	323,434	271,801
Increase in unrestricted net assets	335,990	298,718
Changes in temporarily restricted net assets:		
Private gifts	11,081	23,997
Investment gains	2,273	2,701
Other	(48,087)	(10,263)
Increase in temporarily restricted net assets	(34,733)	16,435
Changes in permanently restricted net assets:		
Private gifts	39,415	21,101
Endowment payout	921	907
Investment gains	11,305	5,730
Other	21,031	1,870
Increase in permanently restricted net assets	72,672	29,608
Increase in net assets	373,929	344,761
Net assets at beginning of year	2,133,079	1,788,318
Net assets at end of year	\$ 2,507,008	2,133,079

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Balance Sheet Information – University

June 30, 1997 and 1996

(in thousands of dollars)

Assets	1997	1996
Cash and cash equivalents	\$ 115,269	115,432
Notes and accounts receivable	141,596	114,648
Inventories	9,086	9,425
Prepaid expenses and other assets	53,011	50,607
Pledges receivable	39,370	48,814
Investments, at market	2,278,860	1,891,021
Land, buildings, equipment, and books – net	465,805	445,839
Total assets	\$ 3,102,997	2,675,786
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	91,842	72,803
Deferred revenue	49,595	40,738
Assets held in custody for others	48,003	42,271
Self-insurance liability	89,734	94,781
Notes and bonds payable	281,435	257,371
Refundable U.S. government student loans	35,380	34,743
Total liabilities	595,989	542,707
Net assets:		
Unrestricted	1,997,033	1,661,043
Temporarily restricted	66,301	101,034
Permanently restricted	443,674	371,002
Total net assets	2,507,008	2,133,079
Total liabilities and net assets	\$ 3,102,997	2,675,786

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 sheet of The University of Chicago as of June 30, 1997, and the related consolidated statements of activities and cash flows for the year 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 audit. We did not audit the financial statements of The University of Chicago Hospitals, which statements reflect total assets constituting 23 percent and total increase in net assets constituting 15 percent of the related consolidated totals. Those statements were audited by other auditors, whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for The University of Chicago Hospitals, is based solely on the report of such auditors.

We conducted our audit in accordance with generally accepted auditing standards. 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 and the report of the other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audit and the report 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, 1997, and the increase in its net assets and its cash flows for the year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the basic 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 financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

September 26, 1997

