

THE UNIVERSITY OF CHICAGO

Consolidated Financial Statements and
Supplemental University Information

June 30, 1998 and 1997

(With Independent Auditors' Report Thereon)

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THE UNIVERSITY OF CHICAGO

Consolidated Statements of Activities

Years ended June 30, 1998 and 1997

(in thousands of dollars)

	1998			1997
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets:				
Operating:				
Revenues:				
Tuition and fees – gross	\$ 253,005	–	253,005	239,771
Less:				
Undergraduate student aid	(32,554)	–	(32,554)	(29,622)
Graduate student aid	(70,484)	–	(70,484)	(71,654)
Tuition and fees – net	149,967	–	149,967	138,495
Government grants and contracts	167,430	–	167,430	160,347
Private gifts, grants, and contracts	79,740	496	80,236	67,365
Endowment payout	71,583	3,306	74,889	68,829
Earnings on other investments	12,808	33,963	46,771	25,250
Patient care	121,633	583,051	704,684	707,005
Auxiliaries	115,827	–	115,827	111,103
Other income	70,030	78,668	148,698	98,528
Total operating revenues	789,018	699,484	1,488,502	1,376,922
Expenses:				
Compensation:				
Academic salaries	232,808	–	232,808	219,688
Staff salaries	181,121	304,138	485,259	430,556
Benefits	80,423	61,487	141,910	133,953
Total compensation	494,352	365,625	859,977	784,197
Other operating expenses:				
Utilities, alterations, and repairs	22,713	8,509	31,222	32,028
Depreciation	39,769	40,447	80,216	73,574
Interest	14,879	16,285	31,164	27,256
Supplies and services	196,099	266,150	462,249	400,632
Insurance	7,566	6,852	14,418	20,758
Total other operating expenses	281,026	338,243	619,269	554,248
Total operating expenses	775,378	703,868	1,479,246	1,338,445
Excess (deficiency) of operating revenues over expenses	\$ 13,640	(4,384)	9,256	38,477

THE UNIVERSITY OF CHICAGO

Consolidated Statements of Activities, Continued

(in thousands of dollars)

	1998			1997
	University	Hospitals	Consolidated	Consolidated
Changes in unrestricted net assets: (continued from page 1)				
Nonoperating:				
Private gifts and grants for buildings and equipment	\$ 6,653	—	6,653	3,472
Endowment payout	96	—	96	132
Investment gains	262,784	17,583	280,367	333,761
Other	14,104	(19,008)	(4,904)	22,908
Change in unrestricted net assets from nonoperating activities	283,637	(1,425)	282,212	360,273
Increase (decrease) in unrestricted net assets	297,277	(5,809)	291,468	398,750
Changes in temporarily restricted net assets:				
Private gifts	13,173	2,188	15,361	14,298
Endowment payout	57	—	57	—
Investment gains	2,122	—	2,122	2,273
Other	(14,737)	(1,018)	(15,755)	(49,240)
Increase (decrease) in temporarily restricted net assets	615	1,170	1,785	(32,669)
Changes in permanently restricted net assets:				
Private gifts	33,191	2,311	35,502	39,415
Endowment payout	1,025	—	1,025	921
Investment gains	13,870	—	13,870	11,305
Other	(528)	—	(528)	21,031
Increase in permanently restricted net assets	47,558	2,311	49,869	72,672
Increase (decrease) in net assets	345,450	(2,328)	343,122	438,753
Net assets at beginning of year	2,507,008	428,534	2,935,542	2,496,789
Net assets at end of year	\$ 2,852,458	426,206	3,278,664	2,935,542

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Consolidated Balance Sheets

June 30, 1998 and 1997

(in thousands of dollars)

Assets	1998			1997
	University	Hospitals	Consolidated	Consolidated
Cash and cash equivalents	\$ 93,939	24,951	118,890	137,849
Notes and accounts receivable	166,980	73,913	240,893	215,882
Inventories	9,157	6,205	15,362	15,068
Prepaid expenses and other assets	68,627	80,775	149,402	129,580
Pledges receivable	36,207	2,510	38,717	39,775
Investments, at market	2,635,261	372,115	3,007,376	2,628,525
Land, buildings, equipment, and books	498,347	377,675	876,022	846,421
Total assets	\$ 3,508,518	938,144	4,446,662	4,013,100
Liabilities and Net Assets				
Liabilities:				
Accounts payable and accrued expenses	101,112	234,250	335,362	293,791
Deferred revenue	59,445	—	59,445	49,595
Assets held in custody for others	48,462	—	48,462	48,003
Self-insurance liability	97,020	14,941	111,961	103,679
Notes and bonds payable	313,972	262,747	576,719	547,110
Refundable U.S. government student loans	36,049	—	36,049	35,380
Total liabilities	656,060	511,938	1,167,998	1,077,558
Net assets:				
Unrestricted	2,294,310	415,260	2,709,570	2,418,102
Temporarily restricted	66,916	5,934	72,850	71,065
Permanently restricted	491,232	5,012	496,244	446,375
Total net assets	2,852,458	426,206	3,278,664	2,935,542
Total liabilities and net assets	\$ 3,508,518	938,144	4,446,662	4,013,100

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Consolidated Statements of Cash Flows

Years ended June 30, 1998 and 1997

(in thousands of dollars)

	1998		1997	
	University	Hospitals	Consolidated	Consolidated
Cash flows from operating activities:				
Increase (decrease) in net assets	\$ 345,450	(2,328)	343,122	438,753
Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities:				
Depreciation	39,769	40,447	80,216	73,574
Net gain on investments	(278,776)	(17,583)	(296,359)	(347,339)
Private gifts and grants restricted for long-term investment	(53,017)	(4,499)	(57,516)	(57,185)
Other nonoperating (additions) deductions – net	(17)	20,026	20,009	4,248
Pension income	(7,729)	–	(7,729)	(5,093)
Changes in assets and liabilities:				
Notes and accounts receivable	1,896	373	2,269	(5,139)
Prepaid expenses and other assets	(7,958)	(4,429)	(12,387)	(27,462)
Accounts payable and other liabilities	20,248	32,301	52,549	82,869
Self-insurance liability	7,286	996	8,282	(5,670)
Total adjustments	(278,298)	67,632	(210,666)	(287,197)
Net cash provided by operating activities	67,152	65,304	132,456	151,556
Cash flows from investing activities:				
Purchase of investments	(584,761)	(72,206)	(656,967)	(281,995)
Proceeds from sale of investments	507,136	67,339	574,475	230,417
Acquisition of land, buildings, equipment, and books	(73,506)	(37,954)	(111,460)	(170,797)
Disposal of land, buildings, equipment, and books	1,195	448	1,643	6,518
Loans disbursed	(42,421)	–	(42,421)	(27,803)
Principal collected on loans	15,141	–	15,141	4,112
Net cash used in investing activities	(177,216)	(42,373)	(219,589)	(239,548)
Cash flows from financing activities:				
Proceeds from issuance of notes and bonds payable	45,361	–	45,361	38,895
Principal payments on notes and bonds payable	(12,824)	(2,928)	(15,752)	(4,278)
Proceeds from private gifts and grants restricted for long-term investment	56,180	2,394	58,574	66,687
Other nonoperating additions (deductions) – net	17	(20,026)	(20,009)	(4,248)
Net cash provided by (used in) financing activities	88,734	(20,560)	68,174	97,056
Increase (decrease) in cash and cash equivalents	(21,330)	2,371	(18,959)	9,064
Cash and cash equivalents at:				
Beginning of year	115,269	22,580	137,849	128,785
End of year	\$ 93,939	24,951	118,890	137,849
Supplemental disclosure of cash flow information – cash paid for interest	\$ 15,721	16,285	32,006	27,288

See accompanying notes to consolidated financial statements.

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

June 30, 1998 and 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. 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 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, 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)

- 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 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 operating revenue for fiscal years 1998 and 1997 consists of the following:

	1998			
	University	Hospitals	Total	1997
Private gifts:				
Unrestricted as to use	\$ 11,986	496	12,482	14,405
Temporarily restricted gifts whose restrictions were met during the fiscal year and reported as unrestricted revenue	30,431	–	30,431	18,002
Private grants and contract	37,323	–	37,323	34,958
Total	\$ 79,740	496	80,236	67,365

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 sheets. Included in deferred revenue at June 30, 1998 and 1997 is \$35,842 and \$28,171, 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.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

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.

Endowment payout for fiscal years 1998 and 1997 consists of the following:

	1998			1997
	University	Hospitals	Total	
Interest, dividends, and rents	\$ 65,406	2,965	68,371	58,249
Realized investment gains used to support the endowment payout formula	7,355	341	7,696	11,633
Total	\$ 72,761	3,306	76,067	69,882

Unrestricted operating endowment payout revenue for fiscal years 1998 and 1997 consists of the following:

	1998			1997
	University	Hospitals	Total	
Unrestricted payout	\$ 18,455	–	18,455	17,333
Temporarily restricted payout whose restrictions were met during the fiscal year and reported as unrestricted revenue	53,128	3,306	56,434	51,496
Total	\$ 71,583	3,306	74,889	68,829

Operations

Operating results in the consolidated statements 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.

As discussed in note 2, the Hospitals provides certain operating support to the University Biological Sciences Division. Such support is included in other operating income by the University to the extent expended for non-capital purposes during the period, and amounted to \$20,954 in fiscal 1998 and \$9,167 in fiscal 1997.

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.

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Notes to Consolidated Financial Statements

(in thousands of dollars)

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

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 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 1997 amounts have been reclassified to conform to the 1998 presentation.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(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 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) Audit and Accounting Guide *Health Care Organizations*. The principles of the Audit and Accounting Guide *Health Care Organizations* 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 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 changes in net assets in the consolidated financial statements, several reclassifications have been made as follows: (1) \$56,422 provision for uncollectible Hospitals' patient accounts receivable has been reclassified as a reduction of sales and services of Hospitals revenue; and (2) \$12,914 endowment gains have been reclassified as a nonoperating change in unrestricted net assets.

The Hospitals have made certain commitments to support the enhancement and expansion of several programs within the University Biological Sciences Division. Under Hospitals accounting, these commitments have been recognized as a reduction in unrestricted net assets in the period in which the commitment is made. For purposes of presentation of the Hospitals' financial position and changes in net assets in the consolidated financial statements, these commitments are recognized as a reduction in unrestricted net assets when qualifying expenditures are made, at which time the program support is transferred to the University. At June 30, 1998 and 1997, the Hospitals' recognized commitments exceeded the amounts transferred to the University by \$28,822 and \$33,050, respectively. These unpaid commitments are not reflected in the accompanying consolidated balance sheets.

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

A reconciliation between the Hospitals' changes in unrestricted net assets reported in the stand-alone financial statements of the Hospitals and those included in the University consolidated statements of activities for the fiscal years ended June 30, 1998 and 1997 is presented below:

	1998	1997
Increase (decrease) in unrestricted net assets – as reported in the Hospitals' combined statements of changes in net assets	\$ (1,581)	77,537
Cumulative effect of adopting a new accounting standard for valuing investments previously adopted by the University	–	(17,713)
Hospitals' commitment to the University Biological Sciences Division for program enhancement and expansion:		
Recognized	15,000	15,000
Transferred	(18,741)	(10,937)
Other reconciling items	(487)	(1,127)
Increase (decrease) in unrestricted net assets – as reported in the University consolidated statements of activities	\$ (5,809)	62,760

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.

(3) Investments

Fair values of investments at June 30, 1998 and 1997 are shown below:

	1998				1997
	University and Hospitals Endowment	All others		Total	
	University	Hospitals			
Cash equivalents	\$ 36,103	9,148	13,858	59,109	123,110
Stocks	1,706,720	85,423	186,478	1,978,621	1,685,669
Bonds	354,683	95,066	62,160	511,909	453,453
Real estate	264,783	17,509	–	282,292	206,022
Assets held by trustee (primarily cash equivalents and bonds)	9,098	157,625	6,846	173,569	160,045
Other	–	1,876	–	1,876	226
Total	\$ 2,371,387	366,647	269,342	3,007,376	2,628,525

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

Changes in the market value of endowment investments were as follows for the fiscal years ended June 30, 1998 and 1997:

	1998			1997
	University	Hospitals	Consolidated	Consolidated
Investment return:				
Endowment yield (interest, dividends, and rents)	\$ 65,406	2,965	68,371	58,249
Realized gains on investments	286,392	13,255	299,647	69,390
Unrealized gains (losses) on investments	(15,493)	(979)	(16,472)	244,768
Total investment return	336,305	15,241	351,546	372,407
Endowment payout	(72,761)	(3,306)	(76,067)	(69,882)
Net investment return reinvested	263,544	11,935	275,479	302,525
Other changes in endowment investments:				
Gifts received in cash	36,139	799	36,938	39,741
Transfers from operating cash to create funds functioning as endowment	11,764	—	11,764	15,223
Other changes	11,406	756	12,162	(719)
Total other changes in endowment investments	59,309	1,555	60,864	54,245
Net change in endowment investments	322,853	13,490	336,343	356,770
Endowment investments at beginning of year	1,945,761	89,283	2,035,044	1,678,274
Endowment investments at end of year	\$ 2,268,614	102,773	2,371,387	2,035,044

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THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

(4) Notes and Accounts Receivable

Components of notes and accounts receivable at June 30, 1998 and 1997 are shown below:

	1998		1997	
	University	Hospitals	University	Hospitals
Patients	\$ 68,358	134,568	64,486	132,455
Students:				
Loans	92,077	—	64,833	—
Tuition	2,493	—	1,272	—
U.S. government	11,122	—	14,775	—
All other	40,322	—	37,730	—
Subtotal	214,372	134,568	183,096	132,455
Less allowance for doubtful accounts (primarily patient receivables)	(47,392)	(60,655)	(41,500)	(58,169)
Total	\$ 166,980	73,913	141,596	74,286

(5) Land, Buildings, Equipment, and Books

Components of land, buildings, equipment, and books at June 30, 1998 and 1997 are shown below:

	1998		1997	
	University	Hospitals	University	Hospitals
Land	\$ 25,585	18,770	25,606	18,381
Buildings	619,549	427,861	582,735	401,459
Equipment	197,660	224,585	184,624	221,421
Books	115,061	—	107,202	—
Subtotal	957,855	671,216	900,167	641,261
Less accumulated depreciation	(459,508)	(293,541)	(434,362)	(260,645)
Total	\$ 498,347	377,675	465,805	380,616

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, 1998 and 1997 are shown below:

	Maturity	Interest rate	1998	1997
University:				
Fixed rate:				
Illinois Educational Facilities Authority (IEFA):				
Series 1985	2026	5.7%	\$ 85,000	85,000
Series 1985 – student loan	2000	7.5%	1,195	1,370
Series 1993	2014	4.5%-5.9%	5,440	5,640
Series 1993B	2025	5.5%-5.7%	36,975	36,975
Series 1993C	2008	3.9%-5.0%	16,400	17,475
Unamortized discount			(2,386)	(2,491)
U.S. Government housing bonds	2003	3.0%-3.6%	579	758
Mortgage notes	2003	7.6%-8.5%	5,850	279
Total fixed rate			149,053	145,006
Variable rate:				
Illinois Health Facilities Authority (IHFA) – Series 1985	2016	3.8%	62,300	62,300
Illinois Student Assistance Commission	1998	5.4%	50,872	23,846
IEFA – Series 1985 NORC	2007	3.8%	497	558
IEFA – Pooled Financing Program	2011	3.7%	5,250	3,725
Taxable commercial paper	1998	5.8%	46,000	46,000
Total variable rate			164,919	136,429
Total University			313,972	281,435
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			(2,054)	(2,137)
Other	2001	6.5%-8.5%	11,911	14,459
Total fixed rate			207,052	209,517
Variable rate:				
IHFA:				
Series 1985D	1998	4.2%-5.7%	295	758
Series 1994C	2026	2.8%-4.2%	55,400	55,400
Total variable rate			55,695	56,158
Total Hospitals			262,747	265,675
Total notes and bonds payable			\$ 576,719	547,110

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Notes to Consolidated Financial Statements

(in thousands of dollars)

As of June 30, 1998, the total principal amount of indebtedness considered to be extinguished under in-substance defeasance transactions and, therefore, excluded from notes and bonds payable was \$11,340 for the University.

Principal payments required for outstanding fixed rate University notes and bonds in each of the five years ending June 30, 1999 through 2003 are approximately \$1,900, \$2,017, \$2,164, \$2,166, and \$2,169, respectively.

Principal payments required in each of the five years ending June 30, 1999 through 2003 for the Hospitals' notes and bonds are approximately \$13,342, \$4,907, \$4,995, \$4,772, and \$4,420, respectively.

On July 1, 1998, the University issued \$215,510 in revenue bonds through the Illinois Educational Facilities Authority (IEFA) consisting of \$125,000 (IEFA Series 1998A) fixed rate revenue bonds and \$90,510 (IEFA Series 1998B) adjustable rate revenue bonds. The IEFA Series 1998A fixed rate bonds were issued at an average interest rate of 5.1% to finance the renovation and construction of certain educational facilities. The IEFA Series 1998B adjustable rate bonds were issued with an initial fixed rate of 4.4% through 2004 and an adjustable rate thereafter to advance refund the \$85,000 IEFA Series 1985 bonds.

In August 1998, the Hospitals issued \$119,500 in revenue bonds through the Illinois Health Facilities Authority (IHFA Series 1998) to advance refund the IHFA Series 1994A and 1994B bonds. In connection with the issuance of the IHFA Series 1998 bonds, the Hospitals entered into an interest rate exchange agreement which effectively fixes the interest rate on the IHFA Series 1998 bonds at 4.5%.

(7) Collateral for Notes and Bonds Payable

Notes and bonds payable are secured by certain physical properties with a carrying value of \$11,233 and securities with a market value of \$1,564. In addition, at June 30, 1998, the University had approximately \$19,995 of assets held by trustees for debt service.

The Hospitals Series 1985D revenue bonds are secured by certain physical properties purchased with the proceeds. The Hospitals Series 1993 and Series 1994 revenue bonds are guaranteed by a municipal bond insurance policy and secured by patient accounts receivable.

(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, 1998, investment securities with an aggregate market value of \$337,475 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, 1998 and 1997 is shown below:

	1998		1997	
	University	Hospitals	University	Hospitals
Unconditional promises (net of discount of \$5,396 in 1998 and \$6,908 in 1997) expected to be collected in:				
Less than one year	\$ 16,731	569	17,945	145
One year to five years	23,118	1,941	25,856	260
More than five years	249	—	29	—
	40,098	2,510	43,830	405
Less allowance for uncollectible pledges	(3,891)	—	(4,460)	—
Total	\$ 36,207	2,510	39,370	405

(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, 1998 and 1997, was \$4,000 per claim and \$19,000 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 \$22,000 higher than the amount recorded in the consolidated financial statements at June 30, 1998. 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 \$2,000 per claim and \$4,000 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 \$1,925 higher.

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

	1998		1997	
	University	Hospitals	University	Hospitals
Medical malpractice	\$ 90,676	9,254	83,043	8,900
Workers' compensation	3,200	5,687	3,200	5,045
Other	3,144	—	3,491	—
Total	\$ 97,020	14,941	89,734	13,945

(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 1998 and 1997 is shown below:

	1998	1997
Defined contribution plans:		
Academic	\$ 15,151	13,495
Nonacademic	2,185	1,473
Defined benefit plan – nonacademic	(7,729)	(5,093)
Total	\$ 9,607	9,875

Under the defined contribution plan for academic staff, the University and plan participants make annual contributions that accrue to the benefit of the plan participant at retirement.

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 1998 and 1997 includes the components shown below:

	1998	1997
Service cost – benefits earned during the period	\$ 8,250	7,498
Interest cost on projected benefit obligations	12,666	12,722
Actual return on plan assets	(89,014)	(31,199)
Net amortization and deferral	60,369	5,886
Net pension income	\$ (7,729)	(5,093)

The discount rates used in determining net pension income were 8.3% in 1998 and 7.8% in 1997.

The funded status of the defined benefit pension plan for nonacademic personnel at March 31, 1998 and 1997, and amounts recognized in the University's consolidated balance sheets at June 30, 1998 and 1997, are shown below:

	1998	1997
Actuarial present value of benefit obligations as of March 31:		
Vested	\$ 157,961	133,788
Nonvested	2,560	1,726
Accumulated benefit obligation	160,521	135,514
Effect of projected future salary increases	26,686	23,640
Projected benefit obligation	187,207	159,154
Plan assets at fair value	355,977	281,072
Plan assets in excess of projected benefit obligation	168,770	121,918
Unrecognized gain	(126,115)	(84,024)
Unrecognized prior service cost	10,147	11,394
Unrecognized transition asset recognized over 13 years	(8,428)	(12,644)
Prepaid pension expense recognized in the consolidated balance sheets	\$ 44,374	36,644

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.

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

Actuarial assumptions used for the years ended March 31, 1998 and 1997 are shown below:

	1998	1997
Discount rate	7.3%	8.3
Rate of increase in future compensation levels	3.6	4.0
Long-term rate of return on plan assets	8.5	8.0

In addition, Weiss Memorial Hospital maintains a separate defined benefit pension plan for certain of its employees. Assets of this plan approximated \$32,300 and \$27,300 at June 30, 1998 and 1997, and compared with the related projected benefit obligations of \$34,300 and \$27,200 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.

Periodic postretirement benefit cost for fiscal years 1998 and 1997 includes the following components:

	1998	1997
Service cost	\$ 746	766
Interest cost on accumulated postretirement benefit obligation	2,081	1,777
Actual return on plan assets	(1,669)	—
Net amortization and deferral	2,087	832
Total periodic postretirement benefit cost	\$ 3,245	3,375

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Consolidated Financial Statements

(in thousands of dollars)

The financial status of the postretirement benefit plan and amounts recognized in the University's consolidated balance sheets at June 30, 1998 and 1997 are shown below:

	1998	1997
Accumulated postretirement benefit obligation:		
Retirees	\$ 13,561	12,515
Fully eligible active employees	7,412	6,321
Active employees not yet eligible	9,082	7,054
Accumulated postretirement benefit obligation	30,055	25,890
Plan assets at fair value	10,721	-
Accumulated postretirement benefit obligation in excess of plan assets	19,334	25,890
Unrecognized prior service cost	2,124	2,317
Unrecognized prior period actuarial gain (loss)	45	(7,760)
Unrecognized transition obligation recognized over 20 years	(11,992)	(12,791)
Accrued postretirement benefit cost recognized in the consolidated balance sheets	\$ 9,511	7,656

Actuarial assumptions used in determining the accumulated postretirement benefit obligation as of June 30, 1998 and 1997 are shown below:

	1998	1997
Discount rate	7.3%	8.3
Health care cost trend rates:		
Through fiscal year 2001	7.5	7.5
Fiscal years 2001 through 2008	4.5	4.5
Fiscal year 2009 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, 1998 would increase by \$3,224, 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 \$567.

(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, 1998 and 1997 are shown below:

	1998	1997
University:		
Academic and research:		
Instruction	\$ 379,823	342,680
Research	110,484	105,440
Auxiliary enterprises	95,436	93,418
Library	13,404	13,167
Student services	23,009	16,927
Operation and maintenance of physical plant	58,009	61,860
Depreciation	37,191	37,323
Interest on notes and bonds	14,701	13,371
Total academic and research	732,057	684,186
Administration:		
Institutional support	38,218	46,795
Operation and maintenance of physical plant	2,346	2,242
Depreciation	2,578	1,860
Interest on notes and bonds	179	344
Total administration	43,321	51,241
Total University	775,378	735,427
Hospitals – hospital services	703,868	603,466
Total	\$ 1,479,246	1,338,893

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.

(Continued)

THE UNIVERSITY OF CHICAGO

Notes to Combined 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, 1998 and 1997 were \$58,444 and \$50,046, respectively. Unrestricted net assets at December 31, 1998 and 1997 were \$6,458 and \$4,927, 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, 1998 and 1997, BTU distributed \$3,428 and \$3,238 to the University's Divinity School, respectively. The market value of the BTU endowment at June 30, 1998 and 1997 was \$42,822 and \$37,854, 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 \$490,300 in fiscal year 1998 and \$524,285 in fiscal year 1997 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.

(15) 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 financial position of the University.

THE UNIVERSITY OF CHICAGO

Statement of Activities Information – University

Years ended June 30, 1998 and 1997

(in thousands of dollars)

	1998	1997
Changes in unrestricted net assets:		
Operating:		
Revenues:		
Tuition and fees – gross	\$ 253,005	239,771
Less:		
Undergraduate student aid	(32,554)	(29,622)
Graduate student aid	(70,484)	(71,654)
Tuition and fees – net	149,967	138,495
Government grants and contracts	167,430	160,347
Private gifts, grants, and contracts	79,740	67,365
Endowment payout	71,583	65,756
Earnings on other investments	12,808	13,536
Patient care	121,633	128,670
Auxiliaries	115,827	111,103
Other income	70,030	62,263
Total operating revenues	789,018	747,535
Expenses:		
Compensation:		
Academic salaries	232,808	219,688
Staff salaries	181,121	169,107
Benefits	80,423	79,049
Total compensation	494,352	467,844
Other operating expenses:		
Utilities, alterations, and repairs	22,713	23,291
Depreciation	39,769	39,183
Interest	14,879	13,715
Supplies and services	196,099	179,599
Insurance	7,566	11,347
Total other operating expenses	281,026	267,135
Total operating expenses	775,378	734,979
Excess of operating revenues over expenses	\$ 13,640	12,556

THE UNIVERSITY OF CHICAGO

Statement of Activities Information – University

(in thousands of dollars)

	1998	1997
Changes in unrestricted net assets: (continued from page 22)		
Nonoperating:		
Gifts and grants for buildings and equipment	\$ 6,653	3,410
Endowment payout	96	132
Investment gains	262,784	286,937
Other	14,104	32,955
Change in unrestricted net assets from nonoperating activities	283,637	323,434
Increase in unrestricted net assets	297,277	335,990
Changes in temporarily restricted net assets:		
Private gifts	13,173	11,081
Endowment payout	57	–
Investment gains	2,122	2,273
Other	(14,737)	(48,087)
Increase (decrease) in temporarily restricted net assets	615	(34,733)
Changes in permanently restricted net assets:		
Private gifts	33,191	39,415
Endowment payout	1,025	921
Investment gains	13,870	11,305
Other	(528)	21,031
Increase in permanently restricted net assets	47,558	72,672
Increase in net assets	345,450	373,929
Net assets at beginning of year	2,507,008	2,133,079
Net assets at end of year	\$ 2,852,458	2,507,008

See accompanying independent auditors' report.

THE UNIVERSITY OF CHICAGO

Balance Sheet Information – University

June 30, 1998 and 1997

(in thousands of dollars)

Assets	1998	1997
Cash and cash equivalents	\$ 93,939	115,269
Notes and accounts receivable	166,980	141,596
Inventories	9,157	9,086
Prepaid expenses and other assets	68,627	53,011
Pledges receivable	36,207	39,370
Investments, at market	2,635,261	2,278,860
Land, buildings, equipment, and books	498,347	465,805
Total assets	\$ 3,508,518	3,102,997
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	101,112	91,842
Deferred revenue	59,445	49,595
Assets held in custody for others	48,462	48,003
Self-insurance liability	97,020	89,734
Notes and bonds payable	313,972	281,435
Refundable U.S. government student loans	36,049	35,380
Total liabilities	656,060	595,989
Net assets:		
Unrestricted	2,294,310	1,997,033
Temporarily restricted	66,916	66,301
Permanently restricted	491,232	443,674
Total net assets	2,852,458	2,507,008
Total liabilities and net assets	\$ 3,508,518	3,102,997

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, 1998 and 1997, 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, which statements reflect total assets constituting 21 percent and 23 percent and total increase in net assets constituting 1 percent and 15 percent of the related consolidated totals in 1998 and 1997, respectively. Those statements were audited by other auditors, whose reports have 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 reports of such auditors.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our 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, 1998 and 1997, and the change in its net assets and its cash flows for the years then ended in conformity with generally accepted accounting principles.

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.

In accordance with *Government Auditing Standards*, we have also issued a report dated September 30, 1998, on our consideration of the University's internal control over financial reporting and out tests of its compliance with laws and regulations.

KPMG LLP

September 30, 1998





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, 1998 and 1997, 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 audit. We did not audit the financial statements of The University of Chicago Hospitals, which statements reflect total assets constituting 21 percent and 23 percent and total increase in net assets constituting 1 percent and 15 percent of the related consolidated totals in 1998 and 1997, respectively. Those statements were audited by other auditors, whose reports have 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 reports of such auditors.

We conducted our audits 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 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, 1998 and 1997, and the change in its net assets and its cash flows for the years then ended in conformity with generally accepted accounting principles.

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

September 30, 1998

