

STATE OF ILLINOIS
SIU PHYSICIANS & SURGEONS, INC.

FINANCIAL AUDIT

For the year ended June 30, 2005
(with comparative totals for 2004)

Performed as Special Assistant Auditors
for the Auditor General, State of Illinois

STATE OF ILLINOIS
SIU PHYSICIANS & SURGEONS, INC.

FINANCIAL AUDIT

June 30, 2005

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* NOTE: THIS REPORT HAS BEEN ISSUED UNDER SEPARATE COVER.

State of Illinois
SIU Physicians & Surgeons, Inc.

AGENCY OFFICIALS

June 30, 2005

Mr. David J. Tkach

Chief Executive Officer

Mr. Peter R. Cadwell

Chief Financial Officer

Ms. M. Elizabeth Collier

Executive Director, Financial Affairs

Agency offices are located at:

800 North Rutledge Street
Springfield, Illinois 62794

State of Illinois
SIU Physicians & Surgeons, Inc.

FINANCIAL STATEMENT REPORT SUMMARY

June 30, 2005

The audit of the accompanying basic financial statements of SIU Physicians & Surgeons, Inc. was performed by Kerber, Eck & Braeckel LLP.

Based on their audit, the auditors expressed an unqualified opinion on SIU Physicians & Surgeons, Inc.'s basic financial statements.



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Management Consultants

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Independent Auditors' Report

Honorable William G. Holland,
Auditor General, State of Illinois
and
Board of Directors,
SIU Physicians & Surgeons, Inc.

As Special Assistant Auditors for the Auditor General, we have audited the accompanying basic financial statements of SIU Physicians & Surgeons, Inc. ("SIU P&S"), a component unit of Southern Illinois University, as of and for the year ended June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of SIU P&S's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year summarized comparative information has been derived from SIU P&S's 2004 financial statements, and in our report dated September 3, 2004, we expressed an unqualified opinion on those financial statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SIU Physicians & Surgeons, Inc. as of June 30, 2005, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 5, 2005, on our consideration of SIU P&S's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 7 through 14 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Kerben, Eck & Braetzel LLP

Springfield, Illinois
October 5, 2005

State of Illinois
SIU Physicians & Surgeons, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2005

Introduction

The discussion and analysis of the financial statements of SIU Physicians & Surgeons, Inc., ("SIU P&S") provide an overview of the financial activities for the year ended June 30, 2005. Management has prepared the financial statements and the related footnote disclosures along with the discussion and analysis.

SIU P&S is reported as a component unit of Southern Illinois University ("the University"). As such, its financial information is also included in the financial activities of the University. Therefore SIU P&S must comply with generally accepted accounting practices that are applicable to the University, including those pronouncements promulgated by the Governmental Accounting Standards Board ("GASB").

History and Background

SIU P&S, incorporated in 1997 as a 501(c)(3) tax-exempt organization, is the faculty practice plan for Southern Illinois University School of Medicine ("School of Medicine"). SIU P&S operates as a multi-specialty physician group which both aids in the training of medical students and residents and provides clinical services. The School of Medicine bills and collects the fees for the professional services performed by the physicians. The revenues received by SIU P&S are used to compensate its physician members, to support research and educational activities of the School of Medicine, and to pay for clinical operating costs.

Basic Financial Statements

The annual report consists of three basic financial statements: the Statement of Net Assets; the Statement of Revenues, Expenses and Changes in Net Assets; and the Statement of Cash Flows. These statements provide information on SIU P&S as a whole and present a long-term view of its finances. These statements include all assets and liabilities using the accrual basis of accounting. That is, revenues and assets are recognized when services are provided; expenses and liabilities are recognized when goods or services are received, regardless of when cash is received or paid. Each of these statements will be discussed.

Statement of Net Assets

The Statement of Net Assets reports what is owned (assets) and what is owed (liabilities) by SIU P&S. The net asset amount, the difference between what is owned and owed, is one way to measure the financial position of SIU P&S. Over time, the increase or decrease in net assets may indicate if that financial position is improving or not.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Statement of Net Assets - Continued

Net assets for SIU P&S are divided into three major categories: invested in Capital Assets, Unrestricted-Academic Development and Unrestricted. The first category, invested in capital assets, represents SIU P&S equity in property, plant and equipment, and is net of related debt and accumulated depreciation. The second category, Unrestricted-Academic Development, represents balances internally designated to be used in support of academic development activities of the clinical departments. The third category, Unrestricted, represents balances from operational activities that have not been restricted by parties external to SIU P&S and are available for general use.

<u>Net Asset Summary</u>				
	As of	June 30, <u>2005</u>	June 30, <u>2004</u>	<u>Net Change</u>
Assets				
	Current Assets	\$ 33,852,509	\$ 25,042,207	\$ 8,810,302
	Capital Assets, net	<u>593,226</u>	<u>366,432</u>	<u>226,794</u>
Total Assets		34,445,735	25,408,639	9,037,096
Liabilities				
	Current Liabilities	5,858,081	5,146,868	711,213
	Long-term Debt	<u>-</u>	<u>250,000</u>	<u>(250,000)</u>
Total Liabilities		5,858,081	5,396,868	461,213
Net Assets				
	Invested in capital assets, net of debt	593,226	366,432	226,794
	Designated (Note A6)	1,841,323	-	1,841,323
	Unrestricted	<u>26,153,105</u>	<u>19,645,339</u>	<u>6,507,766</u>
Total Net Assets		<u>\$ 28,587,654</u>	<u>\$ 20,011,771</u>	<u>\$ 8,575,883</u>

Current assets are largely comprised of realizable accounts receivables from patients (\$ 15,755,765). As of June 30, 2005, the gross accounts receivable balance was \$ 44,695,942 and the comparable amount from the prior fiscal year was \$ 27,416,670 an increase of \$ 17,279,272 or 63%. This increase is related to two main factors. First, charges have increased this last fiscal year by \$ 46 million which is a 31% increase, primarily related to the recruitment

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Statement of Net Assets - Continued

of new clinical faculty. Second, Medicaid remains a delinquent payer and a significant portion of the overall accounts receivable increase is attributable to this payer. The average monthly Medicaid charges were up by 38% due to the overall increase in charges and more community physicians limiting or refusing to accept Medicaid patients into their practices. The gross accounts receivable balance for Medicaid increased by \$ 12,228,855 or nearly a 178% increase between the two fiscal years. A normal payment cycle (billing to payment received) would be two (2) months for this payer but at June 30, 2005, the accounts receivable balance represented approximately 7.5 months with 5.5 months considered delinquent.

A measure of collection effort efficiency is a computation known as the Days Charges Outstanding. This calculation is made by dividing the gross outstanding accounts receivable by the average daily charges for the period. The Days Charges Outstanding for all combined payers excluding Medicaid was 58 days at June 30, 2005 and 61 days at June 30, 2004.

Comparative gross patients' accounts receivable by payer are as follows:

<u>Gross Patients' Accounts</u>					
<u>Receivable by Payer Class</u>					
As of	<u>June 30, 2005</u>		<u>June 30, 2004</u>		
Guarantor	\$ 8,282,349	18.48%	\$ 6,374,852	23.04%	
Medicare	6,015,619	13.42%	4,094,488	14.79%	
Medicaid	19,081,337	42.58%	6,852,482	24.76%	
Indemnity	2,811,241	6.27%	1,834,845	6.63%	
PPO Plans	4,325,021	9.65%	3,887,226	14.04%	
HMO Plans	3,647,956	8.14%	3,726,513	13.46%	
Workers Compensation	653,339	1.46%	908,644	3.28%	
Unidentified remittances	<u>(120,920)</u>		<u>(262,380)</u>		
Total Patients' Accounts Receivable, Prior to Uncollectibles	<u>\$ 44,695,942</u>		<u>\$ 27,416,670</u>		
Net Change	<u>\$ 17,279,272</u>	<u>63%</u>			

Overall, the gross accounts receivable increased by \$ 17,279,272 or 63% over the prior fiscal year. When you factor out the Medicaid balances from the totals, the overall increase was only 25% from the prior fiscal and, as previously stated, charges for the comparable period had increased over 31%.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Statement of Net Assets - Continued

In addition to the patient accounts receivable increase previously described, there were also significant changes in the cash and accounts receivable due from the Illinois Department of Healthcare and Family Services (IDHFS) balances from the prior fiscal year. The increase in cash was primarily due to an accounting change in how funds for academic development purposes were accounted for in FY05. Beginning in FY05, amounts for academic development activities were no longer transferred to School of Medicine and SIU Foundation accounts but rather retained by the corporation and used for the same purpose. The second increase was an increase in the accounts receivable due from the Illinois Department of Healthcare and Family Services. This new accounts receivable is generated by Southern Illinois University's participation in an IDHFS cost reimbursement program with the federal government.

The change in Current Liabilities remained relatively stable from FY04 to FY05 with the exception of salaries payable. The regular monthly payroll plus the quarterly bonuses due the clinical faculty at June 30, 2005, were greater this year due to an overall rise in clinical productivity for the year (discussed in the Statement of Revenues, Expenses and Changes in Net Assets).

Statement of Revenues, Expenses and Changes in Net Assets

The change in total net assets as presented in the Statement of Net Assets is impacted by activity as reported in the Statement of Revenues, Expenses and Changes in Net Assets. This statement presents the operating, as well as the non-operating results of SIU P&S. Excess revenues over expenses result in increases in net assets; when expenses exceed revenues a decrease in net assets results.

The Statement is segregated by operating and non-operating activities. Operating revenues are those received for services provided in the normal course of business by SIU P&S. These primarily relate to patient care. Operating expenses are those expenses paid to acquire goods or services that are needed to provide patient care services. Non-operating revenues and expenses for SIU P&S are primarily limited to investment activities.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Statement of Revenues, Expenses and Changes in Net Assets - Continued

<u>Revenue, Expenses and Changes in Net Assets</u>			
For the year ended	<u>June 30, 2005</u>	<u>June 30, 2004</u>	<u>Net Change</u>
Operating Revenues			
Net patient service revenues	\$ 68,934,176	\$ 58,737,420	\$ 10,196,756
Other operating revenue	<u>838,616</u>	<u>495,765</u>	<u>342,851</u>
Total Operating Revenues	69,772,792	59,233,185	10,539,607
Operating Expenses	<u>61,388,239</u>	<u>54,486,098</u>	<u>6,902,141</u>
Operating Income	8,384,553	4,747,087	3,637,466
Net Non-Operating Revenue	<u>191,330</u>	<u>180,640</u>	<u>10,690</u>
Increase in Net Assets	8,575,883	4,927,727	3,648,156
Net Assets Beginning of Year	<u>20,011,771</u>	<u>15,084,044</u>	<u>4,927,727</u>
Net Assets End of Year	<u>\$ 28,587,654</u>	<u>\$ 20,011,771</u>	<u>\$ 8,575,883</u>

Net patient service revenues reflect estimated collectible charges for professional services. As discussed previously there was a 31% increase in gross charges booked in FY05 largely due to recruitment of new clinical faculty and secondly to annual fee increases made during the year. SIU P&S currently operates in a market with a moderate level of managed care penetration. In terms of overall charges, the payer mix of managed care showed a slight decrease in FY05. A majority of this activity is on a discounted fee-for-service basis. However, a minimal amount of capitated arrangements are involved. The most significant increase by Payer Class was in Medicare and this is directly attributable to the medical specialties recruited to SIU P&S during the current fiscal year. Comparative charges by payer class are:

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Statement of Revenues, Expenses and Changes in Net Assets - Continued

Total Patient Charges by				
Payer Class				
For the year ended	June 30,		June 30,	
	2005		2004	
Guarantor	\$ 16,874,416	8.76%	\$ 15,452,497	10.51%
Medicare	62,402,983	32.39%	41,188,706	28.02%
Medicaid	31,484,588	16.34%	22,815,177	15.52%
Indemnity	13,454,245	6.98%	11,476,993	7.81%
PPO Plans	39,685,676	20.59%	30,985,078	21.08%
HMO Plans	26,696,867	13.86%	22,295,195	15.16%
Workers Compensation	<u>2,075,336</u>	1.08%	<u>2,808,620</u>	1.90%
Total Charges	<u>\$192,674,112</u>		<u>\$147,022,266</u>	
Net Change	<u>\$ 45,651,846</u>	31%		

Additionally, as revenues increase, so do expenditures used to generate new revenues. Expenses increased 12% over the FY04 level. The three primary components of operating expenses are direct SIU P&S overhead, university overhead, and member compensation (i.e., salaries expense). Other than the increase in member salaries payable and related payroll taxes, there was an increase in SIU P&S direct overhead expenses associated with pharmaceutical and clinical supplies. These increases for the most part can be attributed to the increased levels of clinical productivity of the existing faculty as well as the new recruits. Amounts due the University for overhead expenses remained relatively constant between the two fiscal years with University overhead comprising 39% and 40% of the operating expenses in FY04 and FY05 respectively. These are costs that the School of Medicine incurs on behalf of SIU P&S for clinical operations. These operating costs are for support staff, supplies, rent, and ongoing malpractice costs for the entire faculty. SIU P&S reimburses the School of Medicine for these costs via an overhead charge. Member compensation (salaries expense plus payroll taxes) comprises 39% of operating expenses to pay member health care providers for services provided via patient care activities. These members are also faculty of the University and are compensated separately by the University for their academic responsibilities.

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SIU Physicians & Surgeons, Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Statement of Cash Flows

The Statement of Cash Flows provides relevant information about the cash receipts and cash payments during the year. It helps users assess the ability to generate future net cash flows, the ability to meet financial obligations as they come due, and the need for external financing.

For SIU P&S, the statement is divided into four parts. The first shows net cash provided (used) by the operating activities of SIU P&S. The second reflects cash flows from non-capital and capital financing activities. Third, cash flows from investing activities are presented. Finally, a reconciliation of net cash from operating activities to operating income as reflected on the Statement of Revenues, Expenses and Changes in Net Assets is presented.

<u>Cash Flows</u>	<u>For the year ended</u>	<u>June 30, 2005</u>	<u>June 30, 2004</u>	<u>Net Change</u>
Cash Provided (Used) by				
Operating activities		\$ 3,182,149	\$ (982,404)	\$ 4,164,553
Non-capital financing activities		(395,180)	391,958	(787,138)
Capital financing activities		(344,890)	(108,130)	(236,760)
Investing activities		<u>200,601</u>	<u>194,692</u>	<u>5,909</u>
Net Change in Cash		2,642,680	(503,884)	3,146,564
Cash, Beginning of Year		<u>58,860</u>	<u>562,744</u>	<u>(503,884)</u>
Cash, End of Year		<u>\$ 2,701,540</u>	<u>\$ 58,860</u>	<u>\$ 2,642,680</u>

The year-end cash balance has increased from FY04 to FY05 by \$ 2,642,680. The primary reason for this cash increase is due to SIU P&S, Inc. now holding and disbursing academic development funds that used to flow through the SIU Foundation. Academic development funds are used to further the School of Medicine's teaching, research and service missions. One factor mitigating cash flow concerns is the balance in the University agency account. The University collects and holds cash collections on behalf of SIU P&S until a distribution determination is made. The June 30, 2005 agency account balance was \$ 10.3 million, a \$ 1.4 million increase from year-end FY04.

During FY04, SIU P&S borrowed \$ 393,621 from Southern Illinois University School of Medicine to help finance the acquisition of a group practice located in Springfield, Illinois. This loan was paid in its entirety in FY05.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2005

Future Outlook

Overall, management remains optimistic about the short and long term viability and outlook of the health care sector of the economy and SIU P&S. There has been and continues to be a focused effort on expanding our clinical programs and faculty. Several examples include the Cancer Institute and the coordinated health programs with St. John's Hospital for women and children.

Management continues to review expenses and operating processes in an effort to control costs and improve operating efficiencies.

Management is aware of two potential issues that could have a negative impact on fiscal performance in the coming year. The State of Illinois continues to fall further behind in meeting its financial obligations. The State is currently averaging 7.5 months in payments due SIU P&S and this is an increase over the same period last year when the State was averaging 4 months.

The second area of concern is the level of reimbursement rates from Medicare. Under currently structured fee schedules, Medicare's overall payment levels to providers is expected to decrease by 4.5% effective January 2006. We have had these negative projections planned before and the government has implemented changes to the fee schedule and these decreases have been averted. However, we remain confident that Centers for Medicare and Medicaid Services will implement a fee schedule in the coming year which will result in a positive increase to our reimbursement levels from this payer source.

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STATEMENT OF NET ASSETS

June 30, 2005
(With comparative totals for June 30, 2004)

	<u>2005</u>	<u>2004</u> (Restated)
ASSETS		
Current assets		
Cash	\$ 2,701,540	\$ 58,860
Deposits with SIU (Note I)	10,262,961	8,898,692
Accounts receivable (Note D)		
Patients, net of allowances and uncollectibles of		
\$ 28,940,177 for 2005 and \$ 15,981,682 for 2004	15,755,765	11,434,988
Estimated Illinois Department of Healthcare and Family Services	5,132,243	3,970,791
Other receivables	-	678,876
	<hr/>	<hr/>
Total current assets	33,852,509	25,042,207
Noncurrent assets		
Capital assets, net (Note E)	593,226	366,432
	<hr/>	<hr/>
Total assets	34,445,735	25,408,639
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities - SIU (Note I)	1,793,437	1,802,963
Accounts payable - other	635,479	340,391
Employee salaries payable	2,806,390	2,320,052
Retirement contributions payable	225,199	197,093
Withholding taxes payable	333,929	286,708
Employer taxes payable	59,869	53,912
Retirement loan payable	2,878	2,128
Garnishments payable	900	-
Current portion long-term debt (Note F)	-	143,621
	<hr/>	<hr/>
Total current liabilities	5,858,081	5,146,868
Noncurrent liabilities		
Long-term debt (Note F)	-	250,000
	<hr/>	<hr/>
Total liabilities	5,858,081	5,396,868
NET ASSETS		
Invested in capital assets, net of related debt	593,226	366,432
Net assets, unrestricted	27,994,428	19,645,339
	<hr/>	<hr/>
Total net assets	<u>\$ 28,587,654</u>	<u>\$ 20,011,771</u>

The accompanying notes are an integral part of this statement.

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STATEMENT OF REVENUES, EXPENSES AND
CHANGES IN NET ASSETS

For the year ended June 30, 2005
(With comparative totals for the year ended June 30, 2004)

	<u>2005</u>	<u>2004</u> (Restated)
Operating revenues		
Net patient service revenue	\$ 68,934,176	\$ 58,737,420
Other operating revenues	838,616	495,765
	69,772,792	59,233,185
Operating expenses		
Salaries	22,968,895	19,698,321
Payroll taxes	1,041,861	929,549
General and administrative	425,106	290,335
Insurance	572,657	1,204,936
Professional services	808,437	741,934
Medical transcription	574,486	453,092
Software license fees	631,311	632,884
Clinical supplies	1,262,801	1,147,544
Equipment	64,952	40,948
Depreciation	118,096	96,303
Pharmaceutical	2,571,490	2,157,372
University overhead (Note I)	24,664,328	21,183,565
Academic development (Note I)	5,683,819	5,909,315
	61,388,239	54,486,098
Total operating expenses		
	8,384,553	4,747,087
Operating income		
Nonoperating revenues (expenses)		
Interest expense	(7,712)	(12,389)
Interest income (Note C1)	200,601	194,692
Contributions/donations	(1,559)	(1,663)
	191,330	180,640
Net nonoperating revenues		
	8,575,883	4,927,727
Increase in net assets, as restated for 2004		
Net assets, beginning of year, as previously reported	16,040,980	12,743,742
Prior-period adjustment (Note M)	3,970,791	2,340,302
	20,011,771	15,084,044
Net assets, beginning of year as restated		
	20,011,771	15,084,044
Net assets, end of year	\$ 28,587,654	\$ 20,011,771

The accompanying notes are an integral part of this statement.

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STATEMENT OF CASH FLOWS

For the year ended June 30, 2005
(With comparative totals for the year ended June 30, 2004)

	<u>2005</u>	<u>2004</u> (Restated)
Cash flows from operating activities		
Cash receipts from patient services	\$ 62,766,555	\$ 52,280,282
Payments to employees	(23,441,485)	(20,485,310)
Payments for goods and services	(6,616,153)	(6,750,359)
Payments to University	(30,117,783)	(23,803,861)
Payments to Foundation	(247,601)	(2,718,921)
Other cash receipts	<u>838,616</u>	<u>495,765</u>
Net cash provided by (used in) operating activities	<u>3,182,149</u>	<u>(982,404)</u>
Cash flows from noncapital financing activities		
Proceeds of long-term debt	-	393,621
Payment on long-term debt	(393,621)	-
Contributions/donations paid	<u>(1,559)</u>	<u>(1,663)</u>
Net cash provided by (used in) noncapital financing activities	<u>(395,180)</u>	<u>391,958</u>
Cash flows from capital financing activities		
Purchase of capital assets	<u>(344,890)</u>	<u>(108,130)</u>
Net cash used in capital financing activities	<u>(344,890)</u>	<u>(108,130)</u>
Cash flows from investing activities		
Interest income	<u>200,601</u>	<u>194,692</u>
Net cash provided by investing activities	<u>200,601</u>	<u>194,692</u>
Net increase (decrease) in cash	2,642,680	(503,884)
Cash at beginning of year	<u>58,860</u>	<u>562,744</u>
Cash at end of year	<u><u>\$ 2,701,540</u></u>	<u><u>\$ 58,860</u></u>

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STATEMENT OF CASH FLOWS - CONTINUED

For the year ended June 30, 2005
(With comparative totals for the year ended June 30, 2004)

	<u>2005</u>	<u>2004</u> (Restated)
Reconciliation of operating income to net cash used by operating activities		
Operating income	\$ 8,384,553	\$ 4,747,087
Adjustments to reconcile operating income to net cash provided by (used in) operating activities		
Depreciation expense	118,096	96,303
Changes in assets and liabilities		
Deposits with SIU	(1,364,269)	(3,018,582)
Receivables (net)	(4,803,353)	(3,438,557)
Accounts payable and other liabilities	847,122	631,345
	<u>847,122</u>	<u>631,345</u>
Net cash provided by (used in) operating activities	<u>\$ 3,182,149</u>	<u>\$ (982,404)</u>

The accompanying notes are an integral part of this statement.

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of SIU Physicians & Surgeons, Inc. ("SIU P&S") have been prepared in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB). To facilitate the understanding of data included in the financial statements, summarized below are the more significant accounting policies.

1. Financial Reporting Entity

SIU P&S is organized exclusively for charitable, educational and scientific purposes and to benefit and support the teaching, research and service missions of Southern Illinois University School of Medicine ("School of Medicine").

Due to the significance of the financial relationship with Southern Illinois University ("University"), in accordance with Governmental Accounting Standards Board Statement No. 14, *The Financial Reporting Entity*, SIU P&S is included as a component unit of the University for financial reporting purposes. The financial activities included in these financial statements are reported in a separate column in the University's financial statements to emphasize that SIU P&S is an Illinois not-for-profit organization legally separate from the University.

These financial statements include all financial activities over which SIU P&S exercises direct responsibility.

2. Basis of Presentation

SIU P&S is a special-purpose government entity engaged only in business-type activities, which are financed in whole or in part by fees charged to external parties. Accordingly, the overall activity of SIU P&S is reported through the government-wide statement of net assets, statement of revenue, expenses and changes in net assets and statement of cash flows.

Operating revenues, such as charges for services, result from exchange transactions associated with the principal activity of SIU P&S. Exchange transactions are those in which each party receives and gives up essentially equal values. Non-operating revenues, such as investment earnings, result from non-exchange transactions or ancillary activities.

Operating expenses are those expenses paid to acquire goods or services that are needed to provide patient care services. Non-operating expenses are primarily limited to investment activities.

State of Illinois
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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

3. *Basis of Accounting*

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of when the related cash flow takes place.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, are generally followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. SIU P&S has the option of following subsequent private-sector guidance, subject to this same limitation. SIU P&S has elected not to follow subsequent private-sector guidance as it relates to its operations.

4. *Net Patient Service Revenue*

SIU P&S has agreements with certain third-party payors, including Medicare and Medicaid, that provide for payments at amounts different from established rates. Patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered.

The following is a breakdown of gross patient service revenues, by payor, for the year ended June 30, 2005:

Government programs	
Medicare	32%
Medicaid	16
Commercial insurance	42
Self-pay and other	<u>10</u>
	<u>100%</u>

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

5. *Capital Assets*

Capital assets are reported at cost. Contributed assets are reported at estimated fair value at the time received. Capital assets that exceed \$ 5,000 are capitalized and depreciated using the straight-line method. Estimated useful lives of capital assets are as follows:

Scientific/medical equipment	7 years
Office equipment	7 years
Office furniture	7 years
EDP equipment	5 years

6. *Net Assets*

In the accompanying financial statements, equity is displayed in three components as follows:

Invested in Capital Assets, Net of Related Debt - Consists of capital assets, net of accumulated depreciation, less the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets. There is currently no related debt associated with capital assets.

Restricted - Consists of net assets that are legally restricted by outside parties or by law through constitutional provisions or enabling legislation. When both restricted and unrestricted resources are available for use, generally it is SIU P&S's policy to use restricted resources first, then unrestricted resources when they are needed. SIU P&S currently has no restricted net assets.

Unrestricted - Consists of net assets that do not meet the definition of "restricted" or "invested in capital assets, net of related debt." The Board of Directors has designated a portion of unrestricted assets totaling \$ 1,841,323 to use for academic development purposes.

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

7. *Use of Estimates*

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

8. *Financial Information*

The financial statements include certain prior-year summarized comparative information in total. Such information does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with the Corporation's financial statements for the year ended June 30, 2004, from which the summarized financial information was derived.

9. *Adoption of New Government Accounting Standard (GASB Statement No. 40)*

Effective July 1, 2004, SIU P&S adopted GASB Statement No. 40, *Deposit and Investment Risk Disclosures*. The objective of this statement is to update the custodial credit risk disclosure requirements and to establish more comprehensive disclosure requirements addressing other common risks of deposits and investments.

NOTE B - TAX STATUS

The U.S. Treasury Department issued a determination letter, dated June 9, 1997, indicating SIU P&S is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code.

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE C - CASH AND INVESTMENTS

1. Deposits with SIU

SIU P&S deposits most of its cash receipts in the University's pooled cash investment accounts. The University, acting as agent for SIU P&S, makes all distributions as directed. Pooled cash and investments, which consist principally of cash and certificates of deposit, are stated at cost which approximates fair value. SIU P&S's pooled cash and investments are not classified with investments since specific investment securities of the pooled fund maintained by the University are not purchased on behalf of, and/or separately allocated to, the participants of the fund. Interest on pooled cash and investments allocated from the University was \$ 200,601.

2. Custodial Credit Risk Related to Deposits

Custodial credit risk is the risk that, in the event of a bank failure, SIU P&S's deposits might not be recovered. SIU P&S does not have a deposit policy for custodial credit risk.

At June 30, 2005, \$ 2,922,351 of SIU P&S's bank balance of \$ 3,022,351 was uninsured and uncollateralized.

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE D - ACCOUNTS RECEIVABLE

Following is a summary of patients' accounts receivable at June 30, 2005, by type of payor:

Government programs				
Medicare			\$ 6,015,619	
Medicaid			19,081,337	
Commercial insurance			10,784,218	
Self-pay and other			<u>8,814,768</u>	
			44,695,942	
Less				
Allowance for assignment losses			25,657,614	
Allowance for doubtful accounts			<u>3,282,563</u>	
			<u>28,940,177</u>	
Net patients' accounts receivable			<u>\$ 15,755,765</u>	

SIU P&S has an agreement with the Illinois Department of Healthcare and Family Services. Under such agreement, SIU P&S receives additional reimbursement based upon a cost reimbursement methodology. SIU P&S is reimbursed at defined rates with additional reimbursement being received after submission of an annual cost settlement. Estimated settlements at June 30, 2005, were \$ 5,132,243.

NOTE E - CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, was as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending Balance</u>
Equipment	\$ 654,112	\$ 344,890	\$ -	\$ 999,002
Office furniture	<u>13,777</u>	<u>-</u>	<u>-</u>	<u>13,777</u>
	<u>667,889</u>	<u>344,890</u>	<u>-</u>	<u>1,012,779</u>
Less accumulated depreciation for				
Equipment	288,664	117,112	-	405,776
Office furniture	<u>12,793</u>	<u>984</u>	<u>-</u>	<u>13,777</u>
	<u>301,457</u>	<u>118,096</u>	<u>-</u>	<u>419,553</u>
Capital assets, net	<u>\$ 366,432</u>	<u>\$ 226,794</u>	<u>\$ -</u>	<u>\$ 593,226</u>

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE F - NOTE PAYABLE

During 2004, SIU P&S borrowed \$ 393,621 from the School of Medicine to finance the acquisition of a medical practice in Springfield, Illinois. The note was due June 30, 2008, and had an interest rate of 4%. During 2005, the debt was paid in full.

NOTE G - CHARITY CARE

SIU P&S has a policy to provide charitable medical care to individuals unable to pay for such services. During the year ended June 30, 2005, \$ 1,765,692 was foregone for charitable medical care and supplies furnished.

NOTE H - RETIREMENT PLAN

SIU P&S employees may elect to participate in the SIU P&S Retirement Plan (the "Plan"), a defined contribution plan. Participants may contribute up to 25% (but not less than 10%) of taxable compensation through a one-time irrevocable election. If the participant makes no election, an assumption is made that 15% will be contributed each pay period.

Quorum Consulting Services (the "Trustee") maintains an investment portfolio for the Plan contributions with Smith Barney, Citigroup. Contributions are deposited into the participants' accounts, and they may direct the investments among a collection of mutual funds selected by the Plan Administrator. Investment earnings are allocated to the participants' accounts based on the investment return of the mutual fund(s). The combined participants' investment portfolio at June 30, 2005, was valued at \$ 16,880,414.

SIU P&S acts as the Plan Administrator, but does not own any Plan assets and has no responsibility for the Plan obligations.

NOTE I - RELATED PARTY

SIU P&S entered into a master contract with the Board of Trustees of SIU, which specifies the relationship between the two organizations in accordance with the Legislative Audit Commission's University Guidelines, as amended in 1997. The contract states, among other provisions, that the University shall employ members of SIU P&S as full-time faculty of the School of Medicine for the performance of duties related to its teaching, research and service

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE I - RELATED PARTY - Continued

missions and that SIU P&S shall provide separate and concurrent employment to members of SIU P&S for the performance of duties related to patient care and service to the community. The University, in return, supports SIU P&S by continuing operation of outpatient clinics, maintenance of records and accounting systems, billing and collection services, custody and handling of funds, procurement of goods and services and other related activities as agreed upon by both parties. Funds collected by the University and not yet remitted to SIU P&S, totaling \$ 10,262,961, are classified as deposits with SIU in the accompanying statement of net assets.

The University receives a portion of SIU P&S's professional income for providing support services in accordance with the master agreement. For the year ended June 30, 2005, the University earned \$ 24,664,328 for services provided to SIU P&S, of which \$ 1,793,437 is included in the amount due to SIU.

The University and SIU Foundation at Carbondale also receive from SIU P&S, after providing for support services, funds for Academic Development that are to be used for medical, educational, and research development for the School of Medicine. For the year ended June 30, 2005, SIU P&S contributed to the University \$ 5,436,218 and the Foundation \$ 247,601 for such Academic Development services. In September of 2005, the SIU P&S Board of Directors approved the Academic Development funds previously contributed to the SIU Foundation be retained and designated the funds to be used for the purposes stated previously.

NOTE J - PROFESSIONAL LIABILITY

All professional liability is assumed by the University and coverage is included as part of the University's overall self-insurance program.

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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2005

NOTE K - LEASE COMMITMENTS

SIU P&S entered into a five-year operating lease for surgical equipment expiring June 30, 2006. Rent expense for the equipment for the year ended June 30, 2005, was \$ 21,326. Future rental payments are due as follows:

<u>Year ending June 30</u>	<u>Amount</u>
2006	\$ 17,822

NOTE L - LINE OF CREDIT

SIU P&S has a \$ 3,000,000 line of credit with National City Bank of Michigan/Illinois, all of which was unused at June 30, 2005. Advances on the line of credit are payable on demand and carry an interest rate equal to the 30-day London Interbank Offered Rate. The line of credit is secured by a security interest in accounts receivable.

NOTE M - PRIOR-PERIOD ADJUSTMENT

The amount of net assets at the beginning of fiscal year 2005 has been adjusted to recognize an unrecorded accrual of additional Medicaid reimbursements based on an agreement with the Illinois Department of Healthcare and Family Services. The effect of the restatement was to increase net assets by \$ 3,970,791. Additionally, comparative totals for fiscal year 2004 have been restated to reflect the unrecorded accrual. The amount of net assets at the beginning of fiscal year 2004 has been increased by \$ 2,340,302 due to the effects of the restatement on prior years. The effect on the restatement for fiscal year 2004 was to increase change in net assets by \$ 1,630,489.