

STATE OF ILLINOIS
SIU PHYSICIANS & SURGEONS, INC.

FINANCIAL AUDIT

For the year ended June 30, 2004
(with comparative totals for 2003)

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



Kerber, Eck & Braeckel LLP

STATE OF ILLINOIS
SIU Physicians & Surgeons, Inc.

FINANCIAL AUDIT

June 30, 2004

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State of Illinois
SIU Physicians & Surgeons, Inc.

AGENCY OFFICIALS

June 30, 2004

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, 2004

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.



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 SIU, as of and for the year ended June 30, 2004, 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 2003 financial statements and, in our report dated September 12, 2003, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and 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, 2004, 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.

The management's discussion and analysis on pages 7 through 15 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 3, 2004, 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.

Kulow, Eck & Brauchel LLP

Springfield, Illinois
September 3, 2004

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MANAGEMENT'S DISCUSSION AND ANALYSIS

Fiscal year ended June 30, 2004

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, 2004. 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 principles 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. And 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, 2004

Net assets for SIU P&S are divided into two major categories, invested in capital assets, 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. The second category, unrestricted net assets, represents balances from operational activities that have not been restricted by parties external to SIU P&S and are available for use.

Net Asset Summary		June 30, <u>2004</u>	June 30, <u>2003</u>	<u>Net Change</u>
Assets				
	Current Assets	\$21,071,416	\$16,748,650	\$4,322,766
	Capital Assets, net	<u>366,432</u>	<u>354,605</u>	<u>11,827</u>
Total Assets		21,437,848	17,103,255	4,334,593
Liabilities				
	Current Liabilities	5,146,868	4,359,513	787,355
	Long-term Debt	<u>250,000</u>	<u>-</u>	<u>250,000</u>
Total Liabilities		5,396,868	4,359,513	1,037,355
Net Assets				
	Invested in capital assets, net of debt	366,432	354,605	11,827
	Unrestricted	<u>15,674,548</u>	<u>12,389,137</u>	<u>3,285,411</u>
Total Net Assets		<u>\$16,040,980</u>	<u>\$12,743,742</u>	<u>\$3,297,238</u>

Current assets are largely comprised of realizable accounts receivables from patients (\$ 11,434,988). As of June 30, 2004, the gross accounts receivable balance was \$ 27,416,670. This is up from last year by 11% due to three main factors. First, charges have increased this last fiscal year by \$ 34 million which is a 30% increase. This is primarily related to the recruitment of new physicians, particularly in OB/GYN and Cardio-Thoracic Surgery where community providers have joined the School of Medicine and SIU P&S as full-time faculty. Secondly, until a new provider has been credentialed and issued provider numbers by the various third party

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

payers, i.e., Medicare, Medicaid, and managed care companies, the charges they submit are held in accounts receivable until the charges are able to be submitted for payment. This process may take anywhere from 2-6 months depending upon the third party payer. Lastly, we annually review the Charge Master and increase many of our fees.

As in prior years, Medicaid remains a delinquent payer and a significant portion of the total accounts receivable balance is attributed to this payer. There was a significant payment made by Medicaid in June 2004, but even after this payment, we estimate that they were still 2 months in arrears from their normal billing-payment cycle. Medicaid has continued to make payments in FY05 but these have not been sufficient to significantly reduce the lag time.

The overall accounts receivable, excluding Medicaid, increased 24% from the prior fiscal year with a corresponding increase of non-Medicaid charges of 31%. A measure of the collection effort efficiency is a computation known as the Days Charges Outstanding. This calculation is made by dividing the outstanding accounts receivable by the average daily charges. The Days Charges Outstanding for FY03 and FY04 were 72 days and 64 days respectively.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

Comparative gross accounts receivable by payer are as follows:

<u>Gross Accounts Receivable</u>				
<u>by Payer Class</u>				
As of	June 30, <u>2004</u>		June 30, <u>2003</u>	
Guarantor	\$6,374,852	23.04%	\$5,117,035	20.64%
Medicare	4,094,488	14.79%	3,004,256	12.12%
Medicaid	6,852,482	24.76%	8,026,720	32.38%
Indemnity	1,834,845	6.63%	2,024,049	8.17%
PPO Plans	3,887,226	14.04%	3,172,002	12.80%
HMO Plans	3,726,513	13.46%	2,956,569	11.93%
Workers Compensation	908,644	3.28%	485,540	1.96%
Unidentified remittances	<u>(262,380)</u>		<u>(109,428)</u>	
Total Accounts Receivable, Prior to Uncollectibles	<u>\$27,416,670</u>		<u>\$24,676,743</u>	
Net Change	<u>\$2,739,927</u>	11%		

Overall, the accounts receivable percentages by payer class remained relatively constant with the exception of Medicaid in FY04, where there was a noticeable reduction in the Medicaid percentage. The State of Illinois made a large cash payment prior to the end of the fiscal year. In years prior, the large catch up was made at the beginning of the fiscal year. As stated earlier, the State of Illinois continues to make payments in FY05 at levels that have positively impacted the payment lag time. At the end of FY04, the accounts receivable for Medicaid represented about 3.5 months of average charges and, as of the end of the first quarter of FY05, this average has been maintained.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

The change in Current Liabilities is primarily due to increased accounts payable and accrued liabilities, unpaid employee compensation and the current portion of long term debt. These year-end accruals are for the most part paid during the first quarter of the subsequent fiscal year. The regular monthly payroll plus the quarterly bonuses due the clinical faculty at June 30, 2004 were greater this year due to an overall rise in salary expenses for the year (discussed in the Statement of Revenues, Expenses and Changes in Net Assets). The unreimbursed amount due the University increased from FY03 to FY04 due to additional expenses, also discussed subsequently.

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 limited to investment activities.

<u>Revenue, Expenses and Changes in Net Assets</u>			
For the year ended	<u>June 30, 2004</u>	<u>June 30, 2003</u>	<u>Net Change</u>
Operating Revenues			
Net patient service revenues	\$57,106,931	\$47,443,432	\$9,663,499
Other operating revenue	<u>495,765</u>	<u>722,572</u>	<u>(226,807)</u>
Total Operating Revenues	<u>57,602,696</u>	<u>48,166,004</u>	<u>9,436,692</u>
Operating Expenses	<u>54,486,098</u>	<u>49,526,760</u>	<u>4,959,338</u>
Operating Income (Loss)	3,116,598	(1,360,756)	4,477,354
Non-Operating Revenue	<u>180,640</u>	<u>247,183</u>	<u>(66,543)</u>
Increase (Decrease) in Net Assets	3,297,238	(1,113,573)	4,410,811
Net Assets Beginning of Year	<u>12,743,742</u>	<u>13,857,315</u>	<u>(1,113,573)</u>
Net Assets End of Year	<u>\$16,040,980</u>	<u>\$12,743,742</u>	<u>\$3,297,238</u>

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

Net patient service revenues reflect estimated collectible charges for professional services. As discussed previously, there was a 30% increase in gross charges booked in FY04 largely due to several acquisitions of community provider practices into SIU P&S. The new providers had similar patient mixes and, as a result, the payer base shows only small changes in the charge mix percentages by payer. 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 continues to increase, though not as significantly as in prior years. A majority of this activity is on a discounted fee-for-service basis. However, a minimal amount of capitated arrangements are involved. The shift to managed care comes from the commercial or indemnity market as reported in the table below. Indemnity insurance charges have declined as a result of the increased level of managed care penetration. Comparative charges by payer class are:

<u>Total Charges by Payer Class</u>				
For the year ended	June 30, 2004		June 30, 2003	
Guarantor	\$15,452,497	10.51%	\$11,959,439	10.58%
Medicare	41,188,706	28.02%	31,975,477	28.29%
Medicaid	22,815,177	15.52%	18,091,593	16.01%
Indemnity	11,476,993	7.81%	10,211,454	9.04%
PPO Plans	30,985,078	21.08%	22,259,375	19.70%
HMO Plans	22,295,195	15.16%	16,556,252	14.65%
Workers Compensation	<u>2,808,620</u>	1.90%	<u>1,965,100</u>	1.74%
Total Charges	<u>\$147,022,266</u>		<u>\$113,018,690</u>	
Net Change	<u>\$ 34,003,576</u>	30%		

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

Additionally, as revenues increase, so do expenditures used to generate new revenues. The three components of operating expenses are direct SIU P&S overhead, university overhead and physician compensation (i.e. salaries expense). Other than the increase in employee salaries payable and related payroll taxes, there was a marked increase in SIU P&S direct overhead expenses associated with the faculty recruitments that occurred. Increases such as clinic supplies, rent and general administrative expenses were experienced. Amounts due the University for overhead expenses remained relatively constant between the two fiscal years as the new recruitments moved into existing space. University overhead comprises 39% of the operating expenses. 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. Salaries and payroll taxes comprise 38% of operating expenses and are primarily to compensate physician health care providers for services provided via patient care activities. These physicians are also faculty of the University and are compensated separately by the University for academic responsibilities.

Salaries and associated payroll tax expenses increased over 12% (\$ 2,230,267) from FY03 to FY04 from three factors. First, the number of physicians increased. Second, the health care providers were more clinically productive. And third, the medical specialty composition of the faculty changed. There was an overall increase in the number of clinicians in the procedural vs. cognitive specialties. Compensation levels for unit of work produced for proceduralists tend to be higher, increasing physician compensation.

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 used by the operating activities of SIU P&S. The second reflects cash flows from capital financing activities. Third, cash flows from investing activities, and finally, a reconciliation of net cash from operating activities to operating income (loss) as reflected on the Statement of Revenues, Expenses and Changes in Net Assets.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

<u>Cash Flows</u>			
For the year ended	June 30,	June 30,	
	<u>2004</u>	<u>2003</u>	<u>Net Change</u>
Cash Provided (Used) by:			
Operating activities	\$(982,404)	\$(117,046)	\$(865,358)
Non-capital financing activities	(1,663)	(4,542)	2,879
Capital financing activities	(108,130)	(124,415)	16,285
Investing activities	<u>588,313</u>	<u>251,725</u>	<u>336,588</u>
Net Change in Cash	(503,884)	5,722	(509,606)
Cash, Beginning of Year	<u>562,744</u>	<u>557,022</u>	<u>5,722</u>
Cash, End of Year	<u>\$ 58,860</u>	<u>\$ 562,744</u>	<u>\$(503,884)</u>

The year-end cash balance has decreased from FY03 to FY04 by \$ 504,000. The majority of the cash decrease was used to fund miscellaneous receivables. Cash has been maintained even with pressures of revenues and expenses as discussed above. Cash collections on professional fees increased by \$ 7.3 million from FY03 to FY04. 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, 2004 ,agency account balance was \$ 8.9 million, a \$ 3 million increase from year-end FY03.

Significant Long-Term Debt Activity

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. The loan agreement calls for retiring the debt on a predetermined schedule over multiple years. The note has been classified as current and long-term based on the maturity dates in the note. Incremental clinical revenues from the newly acquired group practice will be used to service both portions of the debt.

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 and services for women and children.

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MANAGEMENT'S DISCUSSION AND ANALYSIS - CONTINUED

Fiscal year ended June 30, 2004

Management continues to review expenses and operating processes in an effort to control costs and improve operating efficiencies. Efforts are currently underway to identify and commit to an electronic medical record. Vendor demonstrations have been completed and site visits to vendor installation clinics are currently underway. Though no specific system implementation date has been set, it is envisioned that implementation of an EMR would begin in the next eighteen (18) months.

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 struggle to reduce or even maintain a timely payment cycle for Medicaid recipients. Though the percentage of Medicaid recipients serviced to the total of all our patients served has remained steady, the overall number of patients and volume of services has increased. We currently estimate that the State is two months in arrears from their normal payment cycle and unless the economic outlook for the State improves, that could deteriorate in the current fiscal year.

The second area of concern is the level of reimbursement rates from Medicare. Currently, CMS is proposing a 1.5% increase overall in 2005. However, even though this is a positive change, it will fall short of providing additional revenues to SIU P&S to cover its incremental expense increases for staff salaries, space, clinic supplies and other expenses. The issue is further compounded by the fact that many of our managed care contract reimbursement levels are tied to a percentage of the then current Medicare reimbursement rates. With over 60% of our charges from Medicare or managed care patients, this minimal increase could impact SIU P&S's overall financial performance.

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STATEMENT OF NET ASSETS

June 30, 2004
(with comparative totals for 2003)

ASSETS	<u>2004</u>	<u>2003</u>
Current assets		
Cash (Note C2)	\$ 58,860	\$ 562,744
Deposits with SIU (Note I)	8,898,692	5,880,110
Accounts receivable (Note D)		
Patients, net of allowances and uncollectibles of \$ 15,981,682 and \$ 14,370,947	11,434,988	10,305,796
Other receivables	678,876	-
Total current assets	21,071,416	16,748,650
Noncurrent assets		
Capital assets, net (Note E)	366,432	354,605
Total assets	21,437,848	17,103,255
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities - SIU (Note I)	1,802,963	1,220,476
Accounts payable - other	340,391	421,705
Employee salaries payable	2,320,052	2,249,727
Retirement contributions payable	197,093	172,342
Withholding taxes payable	286,708	243,472
Employer taxes payable	53,912	50,048
Retirement loan payable	2,128	1,743
Current portion long-term debt (Note F)	143,621	-
Total current liabilities	5,146,868	4,359,513
Noncurrent liabilities		
Long-term debt, less current portion (Note F)	250,000	-
Total liabilities	5,396,868	4,359,513
NET ASSETS		
Invested in capital assets, net of related debt	366,432	354,605
Net assets, unrestricted	15,674,548	12,389,137
Total net assets	\$ 16,040,980	\$ 12,743,742

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, 2004
(with comparative totals for the year ended June 30, 2003)

	<u>2004</u>	<u>2003</u>
Operating revenues		
Net patient service revenue	\$ 57,106,931	\$ 47,443,432
Other operating revenues	495,765	722,572
	<u>57,602,696</u>	<u>48,166,004</u>
Operating expenses		
Salaries	19,698,321	17,542,611
Payroll taxes	929,549	854,992
General and administrative	290,335	74,481
Insurance	1,204,936	318,800
Professional services	741,934	665,706
Medical transcription	453,092	501,795
Software license fees	632,884	758,477
Clinical supplies	1,147,544	872,667
Equipment	40,948	98,817
Depreciation	96,303	81,408
Pharmaceutical	2,157,372	1,602,611
University overhead	21,183,565	21,272,534
Academic development	5,909,315	4,881,861
	<u>54,486,098</u>	<u>49,526,760</u>
Operating income (loss)	3,116,598	(1,360,756)
Nonoperating revenues (expenses)		
Interest expense	(12,389)	-
Interest income (Note C1)	194,692	251,725
Contributions/donations	(1,663)	(4,542)
	<u>180,640</u>	<u>247,183</u>
Net nonoperating revenues	180,640	247,183
Increase (decrease) in net assets	3,297,238	(1,113,573)
Net assets, beginning of year	<u>12,743,742</u>	<u>13,857,315</u>
Net assets, end of year	<u>\$ 16,040,980</u>	<u>\$ 12,743,742</u>

The accompanying notes are an integral part of this statement.

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STATEMENT OF CASH FLOWS

For the year ended June 30, 2004
(with comparative totals for the year ended June 30, 2003)

	<u>2004</u>	<u>2003</u>
Cash flows from operating activities		
Cash receipts from patient services	\$ 52,280,282	\$ 47,265,381
Payments to employees	(20,485,310)	(18,006,299)
Payments for goods and services	(6,750,359)	(4,765,878)
Payments to University	(23,803,861)	(22,975,701)
Payments to Foundation	(2,718,921)	(2,357,121)
Other cash receipts	495,765	722,572
Net cash used by operating activities	(982,404)	(117,046)
Cash flows from noncapital financing activities		
Contributions/donations paid	(1,663)	(4,542)
Proceeds from long-term debt	393,621	-
Net cash provided (used) by noncapital financing activities	391,958	(4,542)
Cash flows from capital financing activities		
Purchase of capital assets	(108,130)	(124,415)
Net cash used by capital financing activities	(108,130)	(124,415)
Cash flows from investing activities		
Interest income	194,692	251,725
Net cash provided by investing activities	194,692	251,725
Net increase (decrease) in cash	(503,884)	5,722
Cash at beginning of year	562,744	557,022
Cash at end of year	\$ 58,860	\$ 562,744

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STATEMENT OF CASH FLOWS - CONTINUED

For the year ended June 30, 2004
(with comparative totals for the year ended June 30, 2003)

	<u>2004</u>	<u>2003</u>
Reconciliation of operating income (loss) to net cash used by operating activities		
Operating income (loss)	\$ 3,116,598	\$ (1,360,756)
Adjustments to reconcile operating income (loss) to net cash used by operating activities		
Depreciation expense	96,303	81,408
Changes in assets and liabilities		
Deposits with SIU	(3,018,582)	(1,049,922)
Receivables (net)	(1,808,068)	871,871
Accounts payable and other liabilities	<u>631,345</u>	<u>1,340,353</u>
Net cash used by operating activities	<u>\$ (982,404)</u>	<u>\$ (117,046)</u>

The accompanying notes are an integral part of this statement.

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NOTES TO BASIC FINANCIAL STATEMENTS

June 30, 2004

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 SIU School of Medicine ("School of Medicine").

Due to the significance of the financial relationship with SIU ("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.

State of Illinois
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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

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, 2004:

Government programs	
Medicare	28%
Medicaid	16
Commercial insurance	44
Self-pay and other	<u>12</u>
	<u>100%</u>

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

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."

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.

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

NOTE A - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES - Continued

8. *Financial Information*

The financial statements include prior-year summarized comparative information. 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 organization's financial statements for the year ended June 30, 2003, from which the summarized information was derived.

9. *Adoption of New Government Accounting Standard (GASB Statement No. 42)*

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, is effective for periods beginning after December 15, 2004. However, SIU P&S has elected to early implement the standard. There is no impact on the financial statements because SIU P&S has no capital assets that are impaired as of June 30, 2004.

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.

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 \$ 194,692.

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

NOTE C - CASH AND INVESTMENTS - Continued

2. *Cash*

At June 30, 2004, the carrying amount of SIU P&S's deposits with financial institutions was \$ 58,860 and the bank balance was \$ 606,328.

The bank balance is categorized as follows:

Amount insured by the FDIC	\$ 100,000
Uninsured	<u>506,328</u>
	<u>\$ 606,328</u>

NOTE D - PATIENTS' ACCOUNTS RECEIVABLE

Following is a summary of patients' accounts receivable at June 30, 2004, by type of payor:

Government programs	
Medicare	\$ 4,094,488
Medicaid	6,852,482
Commercial insurance	9,448,584
Self-pay and other	<u>7,021,116</u>
	27,416,670
Less:	
Allowance for assignment losses	13,347,354
Allowance for doubtful accounts	<u>2,634,328</u>
	<u>15,981,682</u>
Net patients' accounts receivable	<u>\$ 11,434,988</u>

State of Illinois
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NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

NOTE E - CAPITAL ASSETS

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

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending Balance</u>
Equipment	\$ 545,982	\$ 135,826	\$ (27,696)	\$ 654,112
Office furniture	<u>13,777</u>	<u>-</u>	<u>-</u>	<u>13,777</u>
	<u>559,759</u>	<u>135,826</u>	<u>(27,696)</u>	<u>667,889</u>
Less accumulated depreciation for				
Equipment	194,329	94,335	-	288,664
Office furniture	<u>10,825</u>	<u>1,968</u>	<u>-</u>	<u>12,793</u>
	<u>205,154</u>	<u>96,303</u>	<u>-</u>	<u>301,457</u>
Capital assets, net	<u>\$ 354,605</u>	<u>\$ 39,523</u>	<u>\$ (27,696)</u>	<u>\$ 366,432</u>

NOTE F - NOTE PAYABLE

During 2004, SIU P&S borrowed \$ 393,621 from SIU School of Medicine to finance the acquisition of a medical practice in Springfield, Illinois. The note is due June 30, 2008, in periodic installments, such that the unpaid balance comprised of both principal and interest does not exceed the amounts listed below on the dates specified:

December 31, 2004	\$ 250,000
June 30, 2006	125,000
June 30, 2008	-

The current interest rate is 4%.

Current maturities for the four years ended June 30, 2008, are as follows:

June 30, 2005	\$ 143,621
June 30, 2006	125,000
June 30, 2007	-
June 30, 2008	125,000

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

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, 2004, \$ 1,168,100 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 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.

Capital Bank and Trust Company (the "Trustee") maintained an investment portfolio for the Plan contributions with the American Funds Group, until January 2004. The Plan is now sponsored through Morgan Stanley, who also acts as the trustee. Contributions are deposited into the participants' accounts, and they may direct the investments among a family of mutual funds selected by the Trustee. 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, 2004, was valued at \$ 13,295,918.

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 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 \$ 8,898,692 at June 30, 2004, are classified as deposits with SIU in the accompanying statement of net assets.

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

NOTE I - RELATED PARTY - Continued

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, 2004, the University earned \$ 21,183,565 for services provided to SIU P&S, of which \$ 1,527,087 is included in the amount due to SIU at June 30, 2004.

The University and 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, 2004, SIU P&S contributed to the University \$ 3,190,394 and the Foundation \$ 2,718,921 for such Academic Development services. At June 30, 2004, SIU P&S has a liability to the University for \$ 275,876, which is included in the amount due to SIU. At June 30, 2004, there was no liability due to the Foundation.

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.

NOTE K - LEASE COMMITMENTS

SIU P&S entered into a five-year operating lease for sonography equipment expiring December 31, 2004, and a five-year operating lease for surgical equipment expiring June 30, 2006. Rent expense for the equipment for the year ended June 30, 2004, was \$ 24,830. Future rental payments are due as follows:

<u>Year ending June 30</u>	<u>Amount</u>
2005	\$ 21,326
2006	17,822

State of Illinois
SIU Physicians & Surgeons, Inc.

NOTES TO BASIC FINANCIAL STATEMENTS - CONTINUED

June 30, 2004

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, 2004. 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.

Report on Compliance and Other Matters
and on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements Performed
in Accordance with *Government Auditing Standards*

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 basic financial statements of SIU Physicians & Surgeons, Inc. (“SIU P&S”), as of and for the year ended June 30, 2004, and have issued our report thereon dated September 3, 2004. 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether SIU P&S’s financial statements are free of material misstatement, we performed tests of compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered SIU P&S’s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not

necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the Auditor General, the General Assembly, the Legislative Audit Commission, the Governor, the Board of Directors, and the SIU P&S management and is not intended to be and should not be used by anyone other than these specified parties.

Kulow, Eick & Brauchel LLP

Springfield, Illinois
September 3, 2004