

University of Illinois

**Annual Financial Report
Health Services Facilities System**

**Year Ended June 30, 2008
with Comparative Totals for 2007**

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TABLE OF CONTENTS

	<u>Page</u>
Letter of Transmittal	2
Independent Auditor's Report	3
Financial Statements:	
Statement of Net Assets	4
Statement of Revenues, Expenses, and Changes in Net Assets	5
Statement of Cash Flows	6
Notes to Financial Statements	8

From the Vice President/Chief Financial Officer, Comptroller

UNIVERSITY OF ILLINOIS
Urbana-Champaign • Chicago • Springfield

Office of Vice President/Chief Financial Officer, Comptroller
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506 South Wright Street
Urbana, IL 61801

December 30, 2008

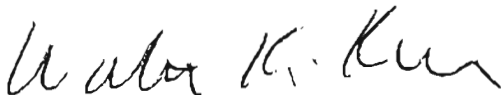
Holders of University of Illinois
Health Services Facilities System Revenue Bonds
and
The Board of Trustees
University of Illinois

I am pleased to transmit the Annual Financial Report of the University of Illinois Health Services Facilities System for the fiscal year ended June 30, 2008. This report supplements the financial statements of the University of Illinois presented in the Annual Financial Report.

The 2008 financial statements and accompanying notes appearing on pages 4 through 21 have been audited by Clifton Gunderson LLP, Independent Certified Public Accountants, as special assistants to the Auditor General of the State of Illinois, whose report on the financial statements appears on page 3.

Clifton Gunderson LLP will also prepare a report for the year ended June 30, 2008, containing special data requested by the Auditor General and another report covering their audit of the compliance of the University with applicable state and federal laws and regulations for the year ended June 30, 2008. These reports, which include some data related to the Health Services Facilities System, are not contained herein and are primarily for the use of the Auditor General and state and federal agencies.

Respectfully submitted,



Walter K. Knorr,
Vice President/Chief Financial Officer,
Comptroller

Independent Auditor's Report



The Honorable William G. Holland
Auditor General
State of Illinois
and
The Board of Trustees
University of Illinois

As Special Assistant Auditors for the Auditor General, we have audited the accompanying Statement of Net Assets of the University of Illinois Health Services Facilities System (System) as of June 30, 2008, and the related Statements of Revenues, Expenses and Changes in Net Assets and Cash Flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the System's 2007 financial statements and, in our report dated February 8, 2008 we expressed an unqualified opinion on these 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe our audit provides a reasonable basis for our opinion.

The accompanying financial statements were prepared for the purpose of complying with the requirements of the indenture for the System's Series 1997B, 2007, and 2008 Revenue Bonds, as described in Note 1, and are not intended to be a complete presentation of the University of Illinois' assets, liabilities, revenues and expenses.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the System as of June 30, 2008, and the respective changes in its net assets and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In connection with our audit, nothing came to our attention that caused us to believe that the System failed to comply with the terms, covenants, provisions or conditions of the Resolution of the Board of Trustees of the University of Illinois which provided for the issuance of the University of Illinois Health Services Facilities System Revenue Bonds, Series 1997B, 2007, and 2008 insofar as they relate to accounting matters. However, our audit was not directed primarily toward obtaining knowledge of such noncompliance.

In accordance with *Government Auditing Standards*, we have also issued a report dated December 30, 2008 on our consideration of the System'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.

This report is intended solely for the information and use of the Auditor General of the State of Illinois, the General Assembly, the Legislative Audit Commission, the Governor, the Comptroller, the Board of Trustees and the management of the University of Illinois, and the bondholders and is not intended to be and should not be used by anyone other than these specified parties.

Clifton Gunderson LLP

Peoria, Illinois
December 30, 2008

Statement of Net Assets as of June 30, 2008 with Comparative Totals for 2007

	2008	2007
Assets:		
Current assets		
Cash and cash equivalents	\$ 88,330,730	\$ 58,727,039
Restricted cash and investments, required for current liabilities	41,586,219	655,192
Patient receivables, less allowance for uncollectible accounts of \$230,454,904	65,553,154	73,038,604
Other receivables	10,093,471	11,494,823
Inventories	4,769,643	5,049,067
Prepaid expenses and other deposits	7,424,016	6,714,989
Total current assets	217,757,233	155,679,714
Noncurrent assets		
Restricted cash and Investments, less amount required for current liabilities of \$41,586,219	2,285,542	2,349,630
Capital assets, net	161,506,660	170,684,960
Prepaid expenses	398,324	598,671
Total noncurrent assets	164,190,526	173,633,261
Total assets	\$ 381,947,759	\$ 329,312,975
Liabilities:		
Current liabilities		
Accounts payable	\$ 16,340,391	\$ 17,581,803
Accrued payroll	13,941,835	10,664,331
Accrued interest payable	95,111	655,192
Estimated third party settlements	46,140,904	35,255,464
Current maturities of long term liabilities	46,839,672	7,085,235
Current portion of compensated absences	1,332,648	1,184,723
Total current liabilities	124,690,561	72,426,748
Noncurrent liabilities		
Long term debt, net of current maturities	71,528,626	73,679,209
Accrued compensated absences, net of current portion	21,948,602	20,472,163
Total noncurrent liabilities	93,477,228	94,151,372
Total liabilities	218,167,789	166,578,120
Net Assets:		
Invested in capital assets, net of related debt	90,433,055	95,661,032
Restricted -		
Expendable for capital projects	2,274,499	2,333,290
Expendable for debt service	11,043	16,340
Unrestricted	71,061,373	64,724,193
Total net assets	163,779,970	162,734,855
Total liabilities and net assets	\$ 381,947,759	\$ 329,312,975

See accompanying notes to financial statements.

Statement of Revenues, Expenses, and Changes in Net Assets
Year Ended June 30, 2008 with Comparative Totals for 2007

	2008	2007
Operating revenues:		
Net patient service revenues (net of provision for bad debts \$26,006,320)	\$ 418,522,755	\$ 385,656,404
Payments on behalf of the System - hospital and other medical activities	95,749,615	83,886,527
Fee for services - state appropriation	45,522,641	46,207,093
Other revenues	18,679,536	18,161,024
Total operating revenues	578,474,547	533,911,048
Operating expenses:		
Salaries and wages	260,712,706	241,830,669
Fringe benefits	88,278,114	75,567,845
Supplies and general expenses	191,194,614	180,110,425
Administrative services	10,825,000	9,600,000
Depreciation and amortization	21,257,827	20,065,748
Total operating expenses	572,268,261	527,174,687
Operating income	6,206,286	6,736,361
Nonoperating revenues (expenses):		
Net increase (decrease) in fair value of investments	(4,873,636)	510,143
Interest on capital asset related debt	(2,659,474)	(3,993,332)
Investment income	2,298,747	1,841,483
Loss on disposal of plant assets	(6,328)	(1,248,505)
Other nonoperating revenue (expense)	79,520	(721,333)
Net nonoperating expense	(5,161,171)	(3,611,544)
Increase in net assets	1,045,115	3,124,817
Net assets, beginning of the year	162,734,855	159,610,038
Net assets, end of the year	\$ 163,779,970	\$ 162,734,855

See accompanying notes to financial statements.

Statement of Cash Flows Year Ended June 30, 2008 with Comparative Totals for 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Patient services	\$ 426,008,205	\$ 382,081,800
Payments on behalf of the system	95,749,615	83,886,527
Payments to suppliers	(192,156,602)	(179,922,549)
Payments for administrative services	(10,825,000)	(9,600,000)
Payments to employees	(255,844,141)	(240,953,516)
Payments for benefits	(88,244,812)	(74,533,043)
Fee for services - state appropriations	45,522,641	46,207,093
Other receipts	31,318,232	26,022,808
Net cash provided by operating activities	<u>51,528,138</u>	<u>33,189,120</u>
Cash flows from noncapital financing activities:		
Proceeds on issuance of debt refunding bonds	41,415,000	
Payments on issuance of debt refunding bonds	(2,101,672)	
Payments on bond issuance costs	(443,111)	
Other receipts (payments)	(313,591)	238,082
Net cash provided by noncapital financing activities	<u>38,556,626</u>	<u>238,082</u>
Cash flows from capital and related financing activities:		
Purchases of capital assets	(7,569,779)	(10,177,111)
Principal paid on capital debt and leases	(6,343,864)	(6,422,280)
Interest paid on capital debt and leases	(3,085,392)	(3,979,426)
Net cash used by capital and related financing activities	<u>(16,999,035)</u>	<u>(20,578,817)</u>
Cash flows from investing activities:		
Interest on investments	2,258,537	1,569,850
Pooled cash allocated (to) from University to cover unrealized (losses) gains	(4,873,636)	510,143
Net cash (used) provided by investing activities	<u>(2,615,099)</u>	<u>2,079,993</u>
Net increase in cash and cash equivalents	<u>70,470,630</u>	<u>14,928,378</u>
Cash and cash equivalents, beginning of year	<u>61,731,861</u>	<u>46,803,483</u>
Cash and cash equivalents, end of year	<u>\$ 132,202,491</u>	<u>\$ 61,731,861</u>

**Statement of Cash Flows Year Ended June 30, 2008 with
Comparative Totals for 2007 (continued)**

	2008	2007
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	6,206,286	6,736,361
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization expense	21,257,827	20,065,748
Provision for uncollectible accounts	26,006,320	20,393,229
Changes in assets and liabilities:		
Patient receivables	(18,520,870)	(23,967,834)
Other receivables	1,441,561	175,965
Inventories	279,424	330,079
Prepaid expenses	311,695	51,755
Accounts payable and accrued expenses	2,036,092	734,952
Estimated third party settlements	10,885,440	7,634,064
Compensated absences	1,624,363	1,034,801
Net cash provided by operating activities	\$ 51,528,138	\$ 33,189,120
Noncash Investing, capital, and financing activities:		
Capital assets transferred from the University and other sources	\$ 707,483	\$ 99,299
Capital assets acquired through capital leases	3,770,548	176,099
Capital assets transferred to other State and University sources	(6,328)	(1,248,505)
Other obligations transferred from the University	729,679	2,843,969
Capital leases cancelled		883
Proceeds from HSFS Series 2007 bonds deposited to escrow	40,675,000	
Refunding of HSFS Series 1997A bonds paid from escrow	(40,675,000)	

See accompanying notes to financial statements

Notes to Financial Statements

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organizational Background and Basis of Presentation

The University of Illinois Health Services Facilities System (System) is comprised of the University of Illinois Hospital (Hospital) and associated clinical facilities providing patient care at, but not limited to, the University of Illinois at Chicago Medical Center. The System is a tertiary care facility located primarily in Chicago, Illinois offering a full range of clinical services. Management of the System is the responsibility of the University of Illinois (University).

The System was established by a Bond Resolution (Resolution) of the Board of Trustees (Board) of the University of Illinois adopted on January 22, 1997. These financial statements have been prepared to satisfy the requirements of the 1997B, 2007, and 2008 bond indentures. The financial balances and activities of the System, included in these financial statements, are included in the University's financial statements. The financial statements of the System are prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The System is not a separate legal entity and therefore has not presented management's discussion and analysis.

The System's resources are classified into net asset categories and reported in the Statement of Net Assets. These categories are defined as (a) Invested in capital assets, net of related debt - capital assets net of accumulated depreciation and outstanding debt balances (b) Restricted nonexpendable - assets restricted by externally imposed stipulations (c) Restricted expendable - assets subject to externally imposed restrictions that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time and (d) Unrestricted - assets not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board of Trustees.

The basic financial statements include prior year comparative information, which has been derived from the System's 2007 financial statements. Such information does not include all of the information required 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 System's financial statements for the year ended June 30, 2007.

Significant Accounting Policies

The System prepared its financial statements as a Business Type Activity, as defined by GASB Statement No. 35, using the economic resources measurement focus and the accrual basis of accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

The Statement of Revenues, Expenses, and Changes in Net Assets classifies the System's fiscal year activity as operating and nonoperating. Operating revenues generally result from exchange transactions such as payments received for providing goods and services. The majority of the System's expenses are exchange transactions which GASB defines as operating expenses for financial statement presentation.

Certain revenue sources that the System relies on for operations including investment income are defined by GASB Statement No. 35 as nonoperating. In addition, transactions related to capital and financing activities are components of net nonoperating revenues.

Appropriations made from the State of Illinois General Revenue Fund for the benefit of the System are recognized as operating revenues to the extent expended, limited to available appropriations.

Net patient service revenue is reported at the estimated net realizable amounts due from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Approximately 96% of the Hospital's net patient service revenues were derived from Medicare, Medicaid, Blue Cross and managed care programs for the year ended June 30, 2008.

Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2008 net patient revenue increased \$5,753,397 due to removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, reviews, and investigations.

The System provides care without charge or at amounts at less than its established rates to patients who meet the criteria of its charity care policy. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. The System's Charity Care Policy was revised in 2007 making it more available to individuals requiring assistance. Consideration for eligibility of charity care is based on the application of the policy and includes patient qualification criteria, financial resource criteria and service criteria. The System does not include the unreimbursed cost of providing care to Medicaid and Medicare patients as charity care.

The net cost of charity care provided in 2008 was approximately \$10,598,000, an increase of 92% over the prior year. The net cost of charity care is determined by the total charity care cost less any patient related revenue due to the sliding scale payments or other patient specific resources. Most of the patient specific resources came from the Center for Medicare & Medicaid Services 1011 program reimbursement.

The System has agreements with various Health Maintenance Organizations (HMO's) to provide medical services to subscribing participants. Under these agreements, the System receives monthly capitation payments based on the number of each HMO's participants, regardless of services actually performed by the System. In addition, the HMO's make fee-for-service payments to the System for certain covered services based upon discounted fee schedules.

The System grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2008 was as follows:

Medicare	18 %
Medicaid	14
Other payors	68
	<u>100 %</u>

The System provides allowances for uncollectible accounts receivable based upon management's best estimate of uncollectible accounts, considering type, age, collection history, and any other factors as considered appropriate.

In accordance with GASB No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the System reported payments made by the State on behalf of the System for contributions to State group insurance and retirement programs for System employees, and payments made by the University on behalf of the System for operations, and maintenance, utility, and insurance costs. These expenditures represent the cost of providing medical services, regardless of where the funding originates. The expenditures are factored into the State's cost-based inpatient reimbursement methodologies and considered to be a part of an exchange transaction. Therefore, these costs are reflected in operating revenues as payments on behalf of the System and as operating expenses in the appropriate expense category as follows:

Salaries and wages	\$ 6,087,000
Fringe benefits	83,843,559
Supplies and general expenses	5,819,056
Total	<u>\$ 95,749,615</u>

The System first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

Accrued compensated absences for System personnel are charged to operations based on earned but unused vacation and sick leave days including the System's share of Social Security and Medicare taxes. The estimated outstanding liability at June 30, 2008 was \$23,281,250. Of that liability, it is estimated that at June 30, 2008, \$173,591 of the accrued compensated absences liability will be paid out of State of Illinois General Revenue Fund appropriations to the System in years subsequent to June 30, 2008, rather than from current resources available at June 30, 2008.

The Statement of Cash Flows details the change in the cash and cash equivalents balance for the fiscal year. Cash and all liquid investments with original maturities of ninety days or less are defined as cash and cash equivalents.

Inventories of pharmaceutical and other supplies are stated at the lower of cost or market, determined using the first-in, first-out method.

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 the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. A material estimate that is particularly susceptible to significant change in the near term relates to the determination of the allowance for doubtful accounts, contractual adjustments, and the estimated third party payor settlements.

In accordance with GASB Statement 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System follows all applicable GASB pronouncements. In addition, the System follows all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The System has elected not to apply FASB pronouncements issued after November 30, 1989.

NOTE 2 - CASH AND CASH EQUIVALENTS

The System has cash and certain investments which are pooled with other University funds for the purpose of securing a greater return on investment and providing an equitable distribution of investment return. Pooled investments, which consist principally of allowable investments as presented in Note 3 below, are stated at fair market value, as determined by quoted market prices. Income is distributed based upon average quarterly balances invested in the pool.

NOTE 3 - INVESTMENTS

Illinois Statutes govern the investment policies of the University. Allowable investments under these policies include:

- Obligations of the U.S. Treasury, other federal agencies, and instrumentalities
- Interest-bearing savings accounts and time deposits of any bank as defined by the Illinois Banking Act
- Corporate bonds and stocks
- Commercial paper
- Repurchase agreements
- Mutual funds

Additionally, the University has investments in real estate and farm properties that are carried at cost, or when donated, at the fair value at the date of donation. All other investments are carried at their fair value, as determined by quoted market prices when available, and otherwise by generally accepted valuation principles. Investment income and the change in fair value of investments are recognized in the fund which owned such investments.

The Board develops University policy on investments and delegates the execution of those policies to its administrative agents. The University follows the State of Illinois Uniform Management of Institutional Funds Act when investing its endowment and operating funds. The State of Illinois Public Funds Investment Act provides the context and framework for plant fund investments.

Illinois Statutes require a third party custodian to perfect the University's security interest under repurchase agreements. The University follows industry standards and requires that securities underlying repurchase agreements must have a fair value of at least 102% of the cost of the repurchase agreement. At June 30, 2008, the System had no repurchase agreements.

Nearly all of the University's investments are managed by external professional investment managers, who have full discretion to manage their portfolios subject to investment policy and manager guidelines established by the University, and in the case of mutual funds and other commingled vehicles, in accordance with the applicable prospectus. The following details the carrying value of the System's restricted cash and investments as of June 30, 2008:

U.S. Treasury Security	\$ 40,875,000
Mutual Funds - Money Market	690,001
Consolidated Investment Pool	2,306,760
Total Restricted Cash and Investments	<u>\$ 43,871,761</u>

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University employs multiple investment managers, of which each has specific maturity assignments related to the operating funds. The funds are structured with different layers of liquidity. Funds expected to be used within one year are invested in money market instruments. Core operating funds are invested in longer maturity investments. Core operating funds investment manager's performance benchmarks are Lehman Brothers 1-3 year Government Credit Bond Index and the Lehman Brothers Intermediate Aggregate Bond Index. The University's manager guidelines provide that the average weighted duration of the portfolio, including option positions, not vary from that of their respective performance benchmarks by more than +/-20 percent. At June 30, 2008, the University's operating funds pool portfolio had an effective duration of 1.6 years. At June 30, 2008, all of the System's restricted cash and investments had maturities less than one year.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's policy requires that operating funds be invested in fixed income securities and money market instruments. Fixed income securities shall be rated investment grade or better by one or more nationally recognized statistical rating organizations. Securities not covered by the investment grade standard are allowed if, in the manager's judgment, those instruments are of comparable credit quality. Securities which fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager's discretion. It is expected that the average credit quality of the operating funds will not fall below Standard & Poor's AA- or equivalent. At June 30, 2008, all of the System's restricted cash and investments carried a AAA quality rating.

Custodial Credit Risk: Custodial credit risk is the risk that in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Exposure to custodial credit risk relates to investment securities that are held by someone other than the University and are not registered in the University's name. The University investment policy does not limit the value of investments that may be held by an outside party. At June 30, 2008, the University's investments and deposits had no custodial credit risk exposure.

Concentration of Credit Risk: Concentration of credit risk is the risk of loss attributed to the magnitude of the University's investment in a single issuer. The University's policy provides that the total operating funds portfolio will be broadly diversified across securities in a manner that is consistent with fiduciary standards of diversification. This diversification is achieved by employing multiple investment managers and imposing maximum position limits for each manager. The University's manager guidelines for operating investments provide that non-U.S. government obligations (other national governments) may not exceed 10% per issuer and private mortgage-backed and asset-backed securities may not exceed 10% per issuer (unless collateral is credit independent of the issuer and the security's credit enhancement is generated internally, in which case the limit is 25% per issuer). Obligations with other issuers, other than the U.S. government, U.S. agencies, or U.S. government sponsored corporations and agencies, may not exceed 5%. As of June 30, 2008, not more than 5% of the University's total investments were invested in securities of any one issuer, excluding securities issued or guaranteed by the U.S. government, mutual funds, and external investment pools or other pooled investments.

Foreign Currency Risk: Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The University's operating fund investments generally are not exposed to foreign currency risk.

Securities Lending: To enhance the return on investment, the Board of Trustees of the University has authorized participation in a securities lending program. Through its custodian bank, the University loans securities to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. Government securities and irrevocable bank letters of credit in an amount not less than 102% of the fair value of the securities loaned. Any collateral securities cannot be pledged or sold by the University unless the borrower defaults. The University receives interest and dividends during the loan period as well as a fee from the custodian. At June 30, 2008, the University has no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University. As of June 30, 2008, approximately \$129,527,000 of the investments reported on the University's Statement of Net Assets were on loan, secured by collateral with a fair value of approximately \$132,774,000. The System does not participate in security lending transactions.

NOTE 4 - CAPITAL ASSETS

Capital assets are carried at the System's cost or fair value at the date of a gift. University policy requires the System to capitalize all land and collection purchases, equipment at \$5,000, buildings and improvements at \$100,000, and infrastructure at \$1,000,000. Depreciation of buildings and equipment and software is calculated on a straight line basis over the estimated useful lives (three to fifty years) of the respective assets. The buildings are located on land primarily owned by the University and for which there is no charge to the System other than for maintenance.

Capital asset activity for the year ended June 30, 2008 is summarized as follows:

	Capital Assets				
	Beginning Balance	Additions	Retirements	Transfers	Ending Balance
Nondepreciable capital assets:					
Land	\$ 770,917	\$ -	\$ -	\$ -	\$ 770,917
Construction in process	2,606,591	1,324,443	-	(2,658,307)	1,272,727
Total nondepreciable capital assets	3,377,508	1,324,443	-	(2,658,307)	2,043,644
Depreciable capital assets:					
Buildings	175,889,563	-	-	2,812,697	178,702,260
Leasehold Improvements	2,366,301	-	-	(154,390)	2,211,911
Equipment	137,898,477	9,217,421	(441,938)	-	146,473,960
Software	18,154,765	1,505,945	-	-	19,660,700
Total depreciable capital assets	334,109,096	10,723,366	(441,938)	2,658,307	347,048,831
Less: accumulated depreciation					
Buildings	62,598,480	4,651,748	-	-	67,246,228
Leasehold improvements	490,605	262,922	-	-	753,527
Equipment	94,715,831	13,551,877	(435,610)	-	107,832,098
Software	8,998,728	2,753,234	-	-	11,751,962
Total accumulated depreciation	166,801,644	21,219,781	(435,610)	-	187,585,815
Total net depreciable capital assets	167,307,452	(10,496,415)	(6,328)	2,658,307	159,463,016
Total capital assets	\$ 170,884,960	\$ (9,171,972)	\$ (6,328)	\$ -	\$ 161,506,660

NOTE 5 - LONG TERM OBLIGATIONS

During fiscal year 1997, Health Services Facilities System Bonds Series 1997A and 1997B (Series 1997A and 1997B Bonds) were issued for \$47,210,000 and \$25,000,000, respectively. Series 1997A Bonds were current interest fixed rate bonds with semiannual payments. Series 1997 B Bonds are variable rate bonds which bear interest at a rate determined weekly and paid monthly.

On July 19, 2007 the University issued \$40,875,000 Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2007. Proceeds from the bonds funded the redemption of the Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 1997A and paid costs incidental to the issuance of the bonds. This resulted in savings of \$6,858,800 over the life of the issue at present value of approximately \$6,062,800. The difference between the reacquisition

price and net carrying amount of the old debt, loss on refunding was \$2,664,300. This loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

On June 26, 2008 the University issued \$41,215,000 Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2008. Proceeds from the bonds will fund the redemption of the Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2007 on July 28, 2008 and pay costs incidental to the issuance of the bonds. The difference between the reacquisition price and net carrying amount of the old debt, loss on refunding will be \$3,134,000. This loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Costs associated with the issuance of the bonds have been recorded as prepaid expense and are being amortized over the life of the bonds. Amortization was \$38,045 for the year ended June 30, 2008.

Long term obligations activity for the year ended June 30, 2008 was as follows:

Long Term Obligations							
Series	Yield on Outstanding Debt	Maturity Dates	Beginning Balance	Additons	Deductions	Ending Balance	Current Portion
Bonds Payable							
1997A	5.3% - 5.875%	2008-2027	\$ 40,675,000		\$ 40,675,000		
1997B	Variable	2008-2027	20,800,000		700,000	20,100,000	700,000
2007	Variable	2008-2027		40,875,000		40,875,000	40,875,000
2008	Variable	2008-2027		41,215,000		41,215,000	
			61,475,000	82,090,000	41,375,000	102,190,000	41,575,000
Unamortized Deferred Loss on Refunding			-	132,926	2,664,304	(2,531,378)	(138,705)
Unamortized Debt Discount			(563,869)	563,869			
Total Bonds Payable			60,911,131	82,786,795	44,039,304	99,658,622	41,436,295
Other Obligations			16,907,816	4,500,227	4,228,116	17,179,927	4,157,382
Internal Financing Payable			2,945,497		1,415,748	1,529,749	1,245,995
Total long term debt			80,764,444	87,287,022	49,683,168	118,368,298	46,839,672
Compensated Absences			21,656,886	3,206,059	1,581,695	23,281,250	1,332,648
Total Long Term Obligations			\$ 102,421,330	\$ 90,493,081	\$ 51,264,863	\$ 141,649,548	\$ 48,172,320

The bonds do not constitute obligations of the State of Illinois. Bond principal and interest payments are funded from revenues pledged from (a) Net system revenues, principally consisting of all charges, income and revenues received from the continued use and operation of the System, excluding depreciation charges and transfers, (b) Medical Service Plan (MSP) revenues net of bad debt expense, and (c) College of Medicine tuition revenue. These revenues for the year ended June 30, 2008 are as follows:

System net revenues	\$ 25,921,325
Adjusted MSP revenues	153,201,908
College of Medicine student tuition	35,931,568
Total	\$215,054,801

The resolution authorizing the University of Illinois Health Services Facilities System Revenue Bonds provides for the establishment of separate funds as follows: Revenue Fund, Project Fund, Repair and Replacement Reserve, Equipment Reserve, Bond and Interest Sinking Fund, and Development Reserve. All income and revenues received from the continued use and operation of the System, as provided for by the Bond Resolution, are to be deposited in the Revenue Fund and used to pay necessary operation and maintenance expenses of the System. The Bond Resolution also requires transfers to funds as follows:

Project Fund - at the discretion of the University Comptroller, amounts not needed to complete construction and renovation projects specified in the Bond Resolution are required to be transferred either to the Repair and Replacement Reserve or to the Bond and Interest Sinking Fund.

Repair and Replacement Reserve - an amount calculated as specified in the Bond Resolution to provide for the cost of unusual maintenance and repairs.

Equipment Reserve - an amount approved by the Board for the acquisition of movable equipment to be installed in the facilities constituting the System. The reserve may not exceed 20% of the book value of the movable equipment of the System.

Bond and Interest Sinking Fund - amounts transferred into the Bond and Interest Sinking Fund sufficient to pay principal and interest as it becomes due on the outstanding bonds.

Development Reserve - an amount approved by the Board for System development. No transfers were authorized by the Board during the year ended June 30, 2008, and there were no balances in the reserve at June 30, 2008.

The System made all required transfers for the year ended June 30, 2008.

After fulfillment of the provisions described above, the surplus, if any, remaining in the Revenue Fund may be used at the Board's option (a) to redeem bonds of the System which are subject to early redemption, (b) to improve or add facilities to the System, or (c) for any other lawful purpose.

Assets restricted by bond resolution were held for the following purposes at June 30, 2008:

Restricted Assets:	
Cash and cash equivalents	\$ 43,825,607
Investments	<u>46,154</u>
Total	<u>\$ 43,871,761</u>
Purpose:	
Bond refunding	\$ 41,491,108
Repair and replacement reserve	<u>2,274,499</u>
Bond and interest sinking fund	<u>106,154</u>
Total assets limited as to use	<u>43,871,761</u>
Less amounts required for current liabilities	<u>(41,586,219)</u>
Total	<u>\$ 2,285,542</u>

Health Services Facilities System Variable Rate Debt and Interest Rate Swap Agreement

On April 2, 2007 the University entered into a variable-to-fixed interest rate swap agreement with Lehman Brothers Commercial Bank. The purpose of this interest rate swap was to hedge variable rate demand Health Services Facility System revenue refunding bonds issued in July 2007. The notional amount of the interest rate swap was \$40,875,000 and equal to the par amount of the bonds. The University makes monthly payments to the counterparty equal to 3.534% times the notional amount and receives monthly payments from the counterparty equal to 68% of one-month LIBOR, commencing October 1, 2007. In the third and fourth quarters of Fiscal Year 2008 there was an unfavorable increase in the basis between the interest paid on the Series 2007 bonds and the variable payment received from the swap counterparty. This was primarily due to reduced demand for the bonds due to the financial troubles encountered by the bond insurer Ambac.

The University engaged a third-party consultant to calculate the "mark to market" or "market value" of the swap transaction. On June 30, 2008, the mark to market value of the swap was \$(1,471,467). Since this is a negative number, it represents an approximation of the amount of money that the University would be required to pay the swap provider to terminate the swap. In accordance with governmental accounting standards, this amount is not required to be included in the accompanying financial statements.

The University has the option to terminate the swap early. The University or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. The University may terminate the swap if both credit ratings of the counterparty fall below BBB+ as issued by Standard & Poor's and Baa1 as issued by Moody's Investors Service. The counterparty credit rating by Standard & Poor's was A and by Moody's Investors Service was A2. If at the time of termination the swap has a negative fair value, the University would be liable to the counterparty for a payment equal to the swap's fair value.

The interest rate swap agreement with Lehman Brothers Commercial Bank will transfer to the Series 2008 bonds on July 28, 2008.

Debt Service Requirements

Future debt service requirements for the Series 1997B, 2007, and 2008 Bonds at June 30, 2008 are as follows:

	Principal	Interest
2009	41,575,000	\$ 2,036,701
2010	800,000	1,751,831
2011	800,000	1,739,027
2012	1,935,000	1,699,619
2013	2,890,000	1,624,466
2014-2018	16,215,000	6,739,763
2019-2023	19,520,000	4,098,691
2024-2028	18,455,000	1,020,358
Total Debt Service	\$ 102,190,000	\$ 20,710,456
Unamortized Loss on Refunding	(2,531,378)	
Total Bonds Payable	\$ 99,658,622	

The required debt service for the variable rate Series 1997B, 2007 and 2008, Bonds has been calculated using the current interest rate of 3.77%, 7.0%, and 1.6% respectively, over the remaining life of the bonds.

Using the actual rate in effect as of June 30, 2008 (7.0% for Series 2007 and 1.6% for Series 2008), debt service requirements of the variable-rate debt and net-swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net-swap payments will also vary.

Health Services Facilities System Revenue Bonds, Series 2007
Variable-Rate Debt Service Requirements
(in thousands)

	Variable Rate Certificates		Interest Rate Swaps, Net	Total
	Principal	Interest		
2009	40,875,000	448,499		41,323,499
TOTAL	\$ 40,875,000	\$ 448,499	\$ -	\$ 41,323,499

Health Services Facilities System Revenue Bonds, Series 2008
Variable-Rate Debt Service Requirements
(in thousands)

	Variable Rate Certificates		Interest Rate Swaps, Net	Total
	Principal	Interest		
2009	\$ -	\$ 815,297	\$ 658,789	\$ 1,274,088
2010	-	659,440	790,523	1,449,963
2011	-	658,440	790,523	1,449,963
2012	1,135,000	647,333	778,018	2,558,351
2013	2,090,000	618,987	742,011	3,450,998
2014-2018	11,415,000	2,566,640	3,077,123	17,058,763
2019-2023	13,620,000	1,560,080	1,870,339	17,050,419
2019-2027	12,955,000	388,133	465,288	13,808,422
TOTAL	\$ 41,215,000	\$ 7,715,350	\$ 9,170,594	\$ 58,100,944

NOTE 6 - LEASES AND OTHER OBLIGATIONS

As of June 30, 2008 the System had outstanding debt to the University of Illinois relating to certain building renovation projects completed during the past fiscal years. The agreement between the System and the University of Illinois requires annual payments including interest at a variable rate which was 4.50% at June 30, 2008. Aggregate annual maturities as of June 30, 2008 are as follows:

	Principal	Interest
2009	\$ 1,245,995	\$ 68,839
2010	283,754	12,769
Total	\$ 1,529,749	\$ 81,608

Other obligations consist of third party financing arrangements for equipment which have maturity dates from 2009 through 2015 and interest rates ranging from 2.87% to 4.25%. As of June 30, 2008, future minimum payments under other obligations are as follows:

	Principal	Interest
2009	\$ 4,157,382	\$ 595,192
2010	4,125,898	543,994
2011	4,013,863	333,917
2012	1,539,866	188,164
2013	1,524,049	129,088
2014-2015	1,818,868	79,394
Total minimum payments	\$ 17,179,926	\$ 1,869,749

The System leases various buildings and equipment under operating lease agreements, including leases renewed on an annual basis. Total rental expense under these agreements was \$693,615 for the year ended June 30, 2008. In future years, the System expects to incur annual rental expense in amounts similar to 2008. The future minimum lease payments under operating leases (excluding those leases renewed on an annual basis) are as follows:

2009	\$ 323,285
2010	148,088
2011	113,101
2012	117,049
2013	90,071
Total Minimum Lease Payments	\$ 791,592

NOTE 7 - PATIENT ACCOUNTS RECEIVABLE AND ACCOUNTS PAYABLE AND OTHER CURRENT LIABILITIES

Patient accounts receivable and accounts payable and other current liabilities, reported as current assets and liabilities, consisted of the following amounts:

Patient accounts receivable	
Patients and their insurance carriers	\$ 200,242,750
Medicare	53,945,914
Medicaid	41,819,384
Total	296,008,058
Less: allowance for uncollectible accounts	(230,454,904)
Total patient accounts receivable, net	\$ 65,553,154
Accounts payable and other current liabilities	
Payable to employees	\$ 13,941,835
Payable to suppliers and service providers	15,219,440
Payable to health plans and for workers' compensation claims	3,120,951
Estimated third party settlements	46,140,904
Total accounts payable and other current liabilities	\$ 76,423,130

Estimated third party settlements increased \$10,885,440 over FY 2007 primarily due to pending negotiations with Medicaid regarding the increase in payments received during FY 2008 and the proper application of these payments against current and past receivables.

NOTE 8 - NET PATIENT SERVICE REVENUE

The Hospital has agreements with third-party payors that provide for payments to the Hospital at established program rates or costs, as defined, for rendering services to program beneficiaries. The Hospital provides contractual allowances on a current basis for the differences between charges for services rendered and the expected payments under these programs. The patient revenues from third-party payor programs less the contractual allowances and provision for uncollectible accounts for fiscal year 2008 are as follows:

Medicaid	\$ 453,650,791
Medicare	348,193,708
HMO / PPO	447,072,573
Commercial	34,722,025
Self-pay & other	49,603,637
Total gross revenue	1,333,242,734
Less:	
Contractual allowances	(888,713,659)
Provision for uncollectible accounts	(26,006,320)
Net Patient Revenue	\$ 418,522,755

A summary of the payment arrangements with major third-party payor follows:

Medicare - Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined rates that are based on the patients' acuity. Other inpatient nonacute services, and defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. Substantially all outpatient services are subject to a prospective payment system. Under this system, payments to the Hospital are based on a predetermined package rate based on services provided to patients. The System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by the Medicare fiscal intermediary. At June 30, 2008 all Medicare settlements for 2008, 2007, and 2006 are subject to audit and retroactive adjustment.

Medicaid - Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates-per-discharge. Outpatient services rendered to program beneficiaries are reimbursed at prospectively determined rates.

Blue Cross - Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed under a cost reimbursement methodology. The System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits thereof by Blue Cross. At June 30, 2008, the Blue Cross settlements for 2008 and 2007 are subject to audit and retroactive adjustment.

The System also has payment agreements with certain commercial insurance carriers, health maintenance organizations and preferred provider organizations. The basis for payment under these agreements include prospectively determined rates-per-discharge, discounts from established charges, prospectively determined daily rates, and capitated per member per month rates.

NOTE 9 - RETIREMENT AND POSTEMPLOYMENT BENEFITS

Substantially all employees of the System participate in the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined-benefit pension plan. The University contributes to the plan with a special funding situation whereby

the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. The University contributions include payments for System employees covered under the plan.

SURS was established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of the State universities, certain affiliated organizations, and certain other State educational and scientific agencies and for survivors, dependents, and other beneficiaries of such employees. SURS is considered a component unit of the State of Illinois' financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Section 5/15, Chapter 40, of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to SURS, 1901 Fox Drive, Champaign, IL 61820 or by calling 1-800-275-7877.

Eligible employees must participate upon initial employment. Employees are ineligible to participate if (a) employed after having attained age 68; (b) employed less than 50 percent of full-time; or (c) employed less than full-time and attending classes with an employer. Of those University employees ineligible to participate, the majority are students at the University.

Plan members are required to contribute 8.0% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 12.88% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The University's contributions to SURS for the years ended June 30, 2008, 2007 and 2006, were \$174,318,000, \$138,499,000, and \$101,570,000, respectively, equal to the required contributions for each year.

The State provides health, dental, vision, and life insurance benefits for retirees and their dependents in a program administered by the Department of Healthcare and Family Services along with the Department of Central Management Services. Substantially all State employees become eligible for post-employment benefits if they eventually become annuitants of one of the State sponsored pension plans. Health, dental, and vision benefits include basic benefits for annuitants and dependents under the State's self-insurance plan and insurance contracts currently in force. Annuitants may be required to contribute towards health, dental, and vision benefits with the amount based on factors such as date of retirement, years of credited service with the State, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed health care plan. Annuitants who retired prior to January 1, 1998, and who are vested in the State Employee's Retirement System do not contribute towards health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced five percent for each year of credited service with the State allowing those annuitants with twenty or more years of credited service to not have to contribute towards health, dental, and vision benefits. Annuitants also receive life insurance coverage equal to the annual salary of the last day of employment until age 60, at which time the benefit becomes \$5,000.

The State pays the System's portion of employer costs for the benefits provided. The total cost of the State's portion of health, dental, vision, and life insurance benefits of all members, including post-employment health, dental, vision, and life insurance benefits, is recognized as an expenditure by the State in the Illinois Comprehensive Annual Financial Report. The State finances the costs on a pay-as-you-go basis. The total costs incurred for health, dental, vision, and life insurance benefits are not separated by department or component unit for annuitants and their dependents nor active employees and their dependents.

A summary of post-employment benefit provisions, changes in benefit provisions, employee eligibility requirements including eligibility for vesting, and the authority under which benefit provisions are established are included as an integral part of the financial statements of the Department of Healthcare and Family Services. A copy of the financial statements of the Department of Healthcare and Family Services may be obtained by writing to the Department of Healthcare and Family Services, 201 South Grand Ave., Springfield, Illinois, 62763-3838.

NOTE 10 - RELATED PARTY TRANSACTIONS

The University charged the System for administrative and other services totaling \$10,825,000 in 2008, based upon the gross expenditures and debt service transfers of various operations of the System. These charges represent a portion of the estimated administrative and other service costs incurred by the University in support of the System. An additional \$11,906,056 was paid by the University on behalf of the System for salaries and utility costs for the year ended June 30, 2008, and are reported as Payments on behalf of the System.

Most health care services rendered by physicians at the University are charged, billed and collected through the Medical Service Plan (MSP). For ambulatory care services, there is a charge for both a professional and technical component. The System bills and collects on behalf of the MSP for the professional component of ambulatory care services. Based on the underlying agreements between the MSP and the University, the System remits funds collected to the MSP. Total MSP remittances from the System for the year ended June 30, 2008 relating to the billing and collection of physician fees and the delivery of ambulatory care were \$11,159,672.

During 2008, various departments within the College of Medicine agreed to reimburse the System for a portion of the expenses related to the resident and fellowship training program. This reimbursement, which totaled approximately \$1,901,715 has been reflected in the financial statements as a reduction of the related expenses.

NOTE 11 - COMMITMENTS AND CONTINGENCIES

Contingencies

The University (including the System) is involved in regulatory audits arising in the normal course of business. On June 8, 2007, a notice was received from the Office of Inspector General on behalf of the Illinois Department of Healthcare and Family Services (HFS) indicating that the University received an overpayment of \$14.8 million on behalf of Medicaid patients, of which \$10 million and \$4.8 million related to the University's College of Pharmacy and the System, respectively. University management is in the process of contesting this overpayment and estimates the System's portion of the probable liability related to this overpayment is approximately \$3.3 million, which has been reflected in the System's financial position and results from operations as of June 30, 2008. During fiscal year 2008 the University submitted additional documentation and evidence of its positions. HFS conducted a re-audit and on June 18, 2008 issued a revised notice of audit findings reducing the overpayment from \$14.8 million to \$8.6 million, primarily effecting the College of Pharmacy's portion of the findings. The University continues to contest the findings and is pursuing its administrative options. It is estimated that the System's liability of \$3.3 million remains sufficient to cover the probable outcome of the audit.

Accrued Self-Insurance and Legal Actions

The University (including the System) is a defendant in a number of legal actions primarily related to medical malpractice. These legal actions have been considered in estimating the University's accrued self-insurance liability which covers hospital and clinical patient liability; hospital and medical professional liability; estimated general and contract liability; and workers' compensation liability. At June 30, 2008 the University's total accrued self-insurance liability, discounted at a rate of 5.5%, was \$177,168,675.

The University's accrued self-insurance includes \$124,287,496 at June 30, 2008, for the most probable and reasonably estimable ultimate cost of uninsured medical malpractice liabilities. Ultimate cost consists of amounts estimated by the University's risk management division and actuaries for asserted claims, unasserted claims arising from reported incidents, expected litigation expenses and amounts determined by actuaries using relevant industry data and Hospital specific data to cover projected losses for claims incurred but not yet reported. The System contributes to the University's self insurance reserve through annual assessments for claim exposure. Therefore, no liability related to medical malpractice claims is included in these financial statements but is reflected in the University's financial statements.

The University has contracted with several commercial carriers to provide varying levels and upper limits of excess indemnity coverage. These coverages have been considered in determining the required accrued self-insurance liability.

Amounts of accrued self-insurance liability related to the activities of the System are calculated based upon estimates made by the University's actuaries and the University's risk management division. For the year ended June 30, 2008, the System's calculated required contribution for its portion of the University's self-insurance liability was \$13,287,000. The University is responsible for the payment of claim judgements and settlements actually incurred, and therefore no accrued self-insurance liability has been recorded by the System. These amounts are reported as supplies and general expenses in the Statement of Revenues, Expenses, and Changes in Net Assets.

Because the amounts accrued by the University are estimates, the aggregate claims actually incurred could differ significantly from the accrued self-insurance liability at June 30, 2008. Changes in these estimates for claims related to the activities of the System will be charged by the University to the System and reflected by the System in the Statement of Revenues, Expenses, and Changes in Net Assets in the periods when additional information is available.

The total of amounts claimed under legal actions, including potential settlements and amounts relating to losses incurred but not reported, could exceed the amount of the self-insurance liability. In the opinion of the University's administrative officers, the University's self-insurance liability, including the System's portion, and limited excess indemnity insurance coverage from commercial carriers are adequate to cover the ultimate liability of these legal actions, in all material respects.

NOTE 12 – SUBSEQUENT EVENT

On July 28, 2008, the University refunded Variable Rate Demand Health Services Facilities System Revenue Refunding Bonds Series 2007 in the amount of \$40,875,000. The proceeds from Series 2008 bonds were used to retire the Series 2007 debt. Please refer to Note 5 for details regarding this debt refunding.

Lehman Brothers Commercial Bank is the counterparty for the variable-to-fixed interest rate swap agreement which was transferred to the Health Services Facilities System (HSFS) Series 2008 on July 28, 2008. Lehman Brothers Holdings, Inc. filed for Chapter 11 bankruptcy protection on September 15th, 2008. Lehman Brothers Commercial Bank is a subsidiary of Lehman Brothers Holdings, Inc. Lehman Brothers Commercial Bank did not file for bankruptcy. Lehman Brothers Commercial Bank was downgraded to B3 by Moody's on September 15, 2008 and to D by Standard & Poor's on September 16, 2008. This downgrade gave the University the option to terminate the HSFS Series 2008 interest swap agreement. The mark to market value of the swap on September 17, 2008 was (\$2,915,000). This is approximately the amount that the University would have to pay to terminate the interest rate swap.

The System has outstanding bonds that have variable interest rates. These interest rates are tied to various indexes which reset on a weekly basis. Subsequent to year-end, the interest rates on these variable rate bonds fluctuated upward due to volatile market conditions. After September 2008, these fluctuations in interest rates have trended downward to rates similar to those disclosed at June 30, 2008. The interest that was paid, after year-end and prior to issuance of this report, due to these fluctuations did not have a material impact on the overall financial position of the System.

On August 22, 2008, the University received a letter from the Office of Inspector General relating to the audit by the Illinois Department of Healthcare and Family Services mentioned in Note 11. The letter stated the overpayment owed by the University was reduced to approximately \$5 million dollars.

The System has pooled cash and certain investments with other University funds in the University's investment portfolio. During fiscal year 2008, financial markets as a whole have incurred declines in values. Subsequent to fiscal year end, the University's investment portfolio, has also incurred a decline in the values reported in the accompanying financial statements. However, because the values of individual investments fluctuate with market conditions, the amount of investment losses that the System will recognize in its future financial statements, if any, cannot be determined.

This information is an integral part of the accompanying financial statements.

