



Consolidated Financial Statements, Additional Information, and Independent Auditors' Report

**YEARS ENDED JUNE 30,
2006 AND 2005**



Preparing people to lead extraordinary lives

INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Loyola University of Chicago
Chicago, Illinois

We have audited the accompanying consolidated statements of financial position of Loyola University of Chicago ("LUC") as of June 30, 2006 and 2005, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of LUC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of LUC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of LUC as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, LUC changed its method of accounting for conditional asset retirement obligations in 2006.

Deloitte & Touche LLP

October 2, 2006

LOYOLA UNIVERSITY OF CHICAGO
CONSOLIDATED STATEMENTS OF FINANCIAL POSITION
YEARS ENDED JUNE 30, 2006 AND 2005
(\$000s)

	University Academic	LUHS	Eliminating Entries	2006 Consolidated Total	2005 Consolidated Total
ASSETS					
CASH AND CASH EQUIVALENTS	\$ 143,681	\$ 34,538	\$ -	\$ 178,219	\$ 171,725
INTERFUND BALANCES	8,788		(8,788)		
RECEIVABLES	47,498	124,231		171,729	182,358
OTHER ASSETS	32,270	66,433		98,703	80,155
INVESTMENTS	320,535	237,258		557,793	502,834
ASSETS HELD IN TRUST BY OTHERS	11,096			11,096	40,713
INTEREST HELD IN PERPETUAL TRUST	8,464			8,464	7,755
LAND, BUILDINGS AND EQUIPMENT - NET	422,735	325,762		748,497	681,557
TOTAL ASSETS	<u>\$ 995,067</u>	<u>\$ 788,222</u>	<u>\$ (8,788)</u>	<u>\$ 1,774,501</u>	<u>\$ 1,667,097</u>
LIABILITIES AND NET ASSETS					
ACCOUNTS PAYABLE AND ACCRUED EXPENSES	\$ 82,563	\$ 71,160	\$ -	\$ 153,723	\$ 149,049
DEFERRED INCOME	21,644			21,644	20,034
UNEXPENDED GRANTS	17,483			17,483	19,016
REFUNDABLE ADVANCES - LOANS	16,860			16,860	16,573
INDEBTEDNESS	269,198	290,829		560,027	568,120
SELF-INSURANCE	7,835	123,020		130,855	127,384
INTERFUND BALANCES		8,788	(8,788)		
OTHER LIABILITIES	9,165	24,919		34,084	31,520
TOTAL LIABILITIES	<u>424,748</u>	<u>518,716</u>	<u>(8,788)</u>	<u>934,676</u>	<u>931,696</u>
NET ASSETS:					
Unrestricted	323,251	258,748		581,999	502,497
Temporarily restricted	156,529	4,373		160,902	140,262
Permanently restricted	90,539	6,385		96,924	92,642
TOTAL NET ASSETS	<u>570,319</u>	<u>269,506</u>	<u>-</u>	<u>839,825</u>	<u>735,401</u>
TOTAL LIABILITIES AND NET ASSETS	<u>\$ 995,067</u>	<u>\$ 788,222</u>	<u>\$ (8,788)</u>	<u>\$ 1,774,501</u>	<u>\$ 1,667,097</u>

See notes to consolidated financial statements

LOYOLA UNIVERSITY OF CHICAGO
CONSOLIDATED STATEMENTS OF ACTIVITIES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2006 AND 2005
(\$000s)

	University Academic	LUHS	Eliminating Entries	2006 Consolidated Total	2005 Consolidated Total
OPERATING REVENUES:					
Tuition and fees, net of scholarships \$79,686 (2006) and \$69,290 (2005)	\$ 214,762	\$ -	\$ -	\$ 214,762	\$ 189,405
Grants and contracts for sponsored projects	52,921	3,768	(1,362)	55,327	57,005
Academic support	49,797		(21,323)	28,474	27,231
Gifts	7,034	2,172		9,206	6,274
Interest income	5,677			5,677	2,503
Investment income designated for operations	1,444	12,821		14,265	16,611
Other	18,184	38,968		57,152	50,041
Auxiliary services	32,275			32,275	26,785
Net patient service revenues		659,973		659,973	652,497
Research and education net assets for operations	1,741			1,741	2,940
Net assets released from restrictions	13,635	2,295		15,930	13,637
Total operating revenues	397,470	719,997	(22,685)	1,094,782	1,044,929
OPERATING EXPENSES:					
Salary	170,147	283,241		453,388	434,411
Benefits	40,127	62,910		103,037	94,733
Non-salary operating expenses	93,998	262,357	(22,202)	334,153	334,611
Insurance	2,318	42,696		45,014	45,244
Depreciation and amortization	24,613	31,142		55,755	50,920
Interest	12,125	14,078		26,203	25,665
Utilities	7,634	12,120		19,754	16,596
Hurricane Katrina student relief support	3,450			3,450	
Total operating expenses	354,412	708,544	(22,202)	1,040,754	1,002,180
RESULTS OF OPERATIONS	43,058	11,453	(483)	54,028	42,749
NON-OPERATING ACTIVITIES:					
Investment income (loss) net of amounts designated for operations	10,425	(843)		9,582	6,735
Other	8,056	(483)	483	8,056	5,200
Change in pension liability	25,301	(9,944)		15,357	
Cumulative effect of asset retirement obligation	(7,198)	(328)		(7,526)	
Transfer of net assets	1,746			1,746	3,052
Research and education net assets for operations	(1,741)			(1,741)	(2,940)
Total non-operating activities	36,589	(11,598)	483	25,474	12,047
Increase (decrease) in unrestricted net assets	79,647	(145)		79,502	54,796
CHANGES IN TEMPORARILY RESTRICTED NET ASSETS:					
Gifts	13,649	2,003		15,652	12,437
Investment income	24,066	1,514		25,580	17,217
Change in annuity value	(257)			(257)	16
Other	(2,371)			(2,371)	44
Transfer of net assets	(2,034)			(2,034)	(2,985)
Net assets released from restrictions	(13,635)	(2,295)		(15,930)	(13,637)
Increase in temporarily restricted net assets	19,418	1,222		20,640	13,092
CHANGES IN PERMANENTLY RESTRICTED NET ASSETS:					
Gifts	4,345	98		4,443	3,889
Change in value of perpetual trust	831			831	(103)
Other	(1,280)			(1,280)	
Transfer of net assets	288			288	(67)
Increase in permanently restricted net assets	4,184	98		4,282	3,719
Increase in net assets	103,249	1,175		104,424	71,607
Net assets at beginning of year	467,070	268,331		735,401	663,794
Net assets at end of year	<u>\$ 570,319</u>	<u>\$ 269,506</u>	<u>\$ -</u>	<u>\$ 839,825</u>	<u>\$ 735,401</u>

See notes to consolidated financial statements

LOYOLA UNIVERSITY OF CHICAGO
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2006 AND 2005
(\$000s)

	University Academic	LUHS	2006 Consolidated Total	2005 Consolidated Total
CASH FLOWS FROM OPERATING ACTIVITIES				
Increase in net assets	\$ 103,249	\$ 1,175	\$ 104,424	\$ 71,607
ADJUSTMENTS TO RECONCILE CHANGE IN NET ASSETS TO NET CASH FROM OPERATING ACTIVITIES:				
Add/Deduct Non-Cash Transactions:				
Depreciation and amortization	24,613	31,142	55,755	50,920
Cumulative effect of asset retirement obligation	7,198	328	7,526	
Provision for retirement costs	1,717	10,556	12,273	10,452
Minimum pension liability	(25,301)	9,944	(15,357)	
Change in unrealized gain on investments	2,326	(7,883)	(5,557)	(206)
Other	(1,232)		(1,232)	(1,511)
	<u>9,321</u>	<u>44,087</u>	<u>53,408</u>	<u>59,655</u>
Changes in assets and liabilities:				
Receivables	4,186	4,883	9,069	(4,797)
Other assets	(821)	(10,336)	(11,157)	(3,345)
Accounts payable and accrued expenses	993	3,491	4,484	6,429
Deferred income and unexpended grants	77		77	1,563
Self-insurance	25	3,446	3,471	12,991
Interest held in perpetual trust	(709)		(709)	26
Refundable advances - loans	287		287	(61)
Other liabilities	7,977	(16,315)	(8,338)	954
Interfund balances	(223)	223		
Total change in assets and liabilities	<u>11,792</u>	<u>(14,608)</u>	<u>(2,816)</u>	<u>13,760</u>
Net cash from operating activities	<u>124,362</u>	<u>30,654</u>	<u>155,016</u>	<u>145,022</u>
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from sale of investments	170,385	129,693	300,078	153,702
Purchase of investments	(216,411)	(139,279)	(355,690)	(221,420)
Proceeds on disposal of property	1,232		1,232	262
Purchase of property	(89,966)	(28,311)	(118,277)	(108,579)
Student loans issued	(32,068)		(32,068)	(2,496)
Student loans sold and collected	34,795		34,795	4,424
Net cash from investing activities	<u>(132,033)</u>	<u>(37,897)</u>	<u>(169,930)</u>	<u>(174,107)</u>
CASH FLOWS FROM FINANCING ACTIVITIES				
Proceeds of bond issue				71,800
Retirement of debt	(2,854)	(5,355)	(8,209)	(8,436)
Deposit of bond proceeds with trustee				(54,642)
Withdrawal of trusteed bond funds for construction	29,617		29,617	36,384
Net cash from financing activities	<u>26,763</u>	<u>(5,355)</u>	<u>21,408</u>	<u>45,106</u>
NET CHANGE IN CASH AND CASH EQUIVALENTS	19,092	(12,598)	6,494	16,021
CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR	<u>124,589</u>	<u>47,136</u>	<u>171,725</u>	<u>155,704</u>
CASH AND CASH EQUIVALENTS AT END OF YEAR	<u>\$ 143,681</u>	<u>\$ 34,538</u>	<u>\$ 178,219</u>	<u>\$ 171,725</u>

See notes to consolidated financial statements

LOYOLA UNIVERSITY OF CHICAGO

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

YEARS ENDED JUNE 30, 2006 AND 2005

(1) Overview of Loyola University of Chicago

Loyola University of Chicago (LUC) is a private, coeducational, not-for-profit institution of higher education, research and health care founded in 1870 by the Society of Jesus (Jesuits). The University patron saint and namesake is St. Ignatius Loyola (1491-1556), the founder of the Society of Jesus, which today is the largest religious order in the Roman Catholic Church. The LUC consolidated financial statements are comprised of Higher Education, Loyola Management Company (LMC), Mundelein College (Mundelein) (collectively, University Academic), and Loyola University Health System (LUHS) (see Note 4). University Academic operates on four campuses providing educational services to approximately fourteen thousand students primarily in undergraduate, graduate, and professional degree programs. LUC performs research, training, and other services under grants and contracts with government agencies and other sponsoring organizations. Mundelein and LMC exist to provide limited services for the benefit of LUC. LUHS is a wholly-owned subsidiary corporation of Loyola University of Chicago with an integrated health care delivery system providing a full continuum of health care services and competencies in primary care and tertiary care medicine.

(2) Tax Status

LUC, Mundelein, and LUHS are exempt from income taxes under section 501(c)(3) of the U.S. Internal Revenue Code (IRC), except with regard to unrelated business income, which is taxed at corporate income tax rates. LMC is exempt from income taxes under section 501(c)(2) of the IRC. Loyola University of Chicago Insurance Company Ltd. (LUCIC), a wholly-owned subsidiary of LUHS, is a for-profit Cayman Islands insurance company.

(3) Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements are prepared in conformity with accounting principles generally accepted in the United States of America (GAAP). These principles require management to make estimates and judgments affecting the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses in the reporting period. Actual results could differ from these estimates. In 2006, LUHS recorded \$4.5 million relating to recoveries of prior years receivables from a bankrupt HMO as reductions in the provisions for bad debts (\$3.4 million) and interest expense (\$1.1 million). Significant inter-company balances and transactions have been eliminated. These transactions are reflected in the eliminating entries column of the consolidated financial statements. Net assets, revenues, and investment income or loss are classified based on the existence or absence of donor-imposed restrictions, as follows:

Permanently Restricted - Net assets subject to donor-imposed restrictions requiring that the assets be retained permanently and invested. Restrictions permit the use of some or all of the income earned on the invested assets for specific purposes.

Temporarily Restricted - Net assets with donor-imposed restrictions expiring with the passage of time, the occurrence of an event, or the fulfillment of certain conditions. When donor-imposed restrictions are met, temporarily restricted net assets are reclassified as unrestricted net assets and reported in the consolidated statements of activities and changes in net assets as net assets released from restrictions.

Unrestricted - Net assets not subject to donor-imposed stipulations.

Operations

Revenues received and expenses incurred in conducting the programs and services are presented in the consolidated financial statements as operating activities. Non-operating results include investment income or loss, change in pension liability, gains or losses on the sale or disposal of property, non-recurring items and net change to the research and education assets.

Contributions, including unconditional promises to give (pledges), are recognized as revenue in the period received and reported at present value. The gifts are reported as either temporarily or permanently restricted if they are received with donor stipulations limiting their use. The expiration or fulfillment of donor-imposed restrictions on contributions is recognized in the period in which the restriction expires or the restrictions are fulfilled and are shown as net assets released from restrictions in operating revenue.

Certain unrestricted net assets are designated by management for specific purposes or uses under various internal agreements.

Tuition and fee revenue is reported in the fiscal year in which the educational program is predominantly conducted. Grant and contract revenue is recognized when the expenses are incurred. Academic support and auxiliary service revenues are recognized when earned as unrestricted net assets.

Cash and Cash Equivalents

Cash and cash equivalents are liquid investments having original maturities of three months or less, excluding certain instruments held in the endowment pending reinvestment or which are on deposit with a trustee.

Assets Held in Trust by Others

Assets held in trust are bond-trustee held assets to be used for future capital expenditures.

Investments

Investments are recorded at fair market value. The value of investments in publicly-traded fixed income and equity securities is based on quoted market prices. Certain fixed income securities may be valued based on dealer-supplied valuations. The value of investments not having a readily determined market value is based on estimates of fair value provided by external investment managers and is reviewed by management. Investment income is recorded on the accrual basis and purchases and sales of investment securities are recorded on a trade-date basis.

Derivative Financial Instruments

University Academic uses derivative financial instruments, primarily futures and options, in the management of its endowment portfolio to invest liquid cash, increase or decrease capital market exposures and to hedge the risk of a decline in value of certain equity securities. University Academic and LUHS use derivative financial instruments to offset interest rate risk or to otherwise modify the characteristics of their debt portfolio. All such financial instruments are marked to market and recorded at fair value.

Interest Held in Perpetual Trust

LUC is the beneficiary of funds held in trust. LUC does not control or have possession of these funds, but receives income from the trust in support of University Academic's Stritch School of Medicine (SSOM). Funds are recognized at the estimated fair value of future cash flows, which is estimated to equal the fair market value of the assets.

Land, Buildings and Equipment

Land, buildings and equipment are recorded at cost. Depreciation is calculated on a straight-line method using the following useful lives: building shell, 40-50 years; building improvements, 10-25 years; and equipment, 4-20 years. LUC uses the component method of capitalization.

Accounting Pronouncements

On July 1, 2005, LUC and LUHS adopted Financial Interpretation No. 47, (FIN 47) *Accounting for Conditional Asset Retirement Obligations*. FIN 47 clarifies the term “conditional asset retirement obligation” as used in Statement of Financial Accounting Standards (SFAS) No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and/or method of settlement.

Effective July 1, 2005, LUC and LUHS have determined they have legal obligations to perform certain asset retirement activities associated with constructed facilities and equipment. The obligations were recognized in 2006 as a change in accounting principle that requires the recognition of asset retirement obligations with a cumulative effect adjustment of \$7.2 million and \$328 thousand for LUC and LUHS, respectively, reflected in the consolidated statements of activities and changes in net assets and as a component of liabilities on the consolidated statements of financial position.

Reclassification

Certain reclassifications have been made to the 2005 balances to conform to the 2006 presentation.

(4) Loyola University Health System

Organization

LUHS is a regional integrated health care delivery system providing a full continuum of health care services and competencies in primary care and tertiary care medicine. LUHS provides services to patients in various settings, including a tertiary care hospital, home care and hospice services, outpatient service facilities, immediate care facilities and primary care practice sites.

LUC is the sole corporate member of LUHS, and LUHS is the sole corporate member of Loyola University Medical Center (LUMC) and LUCIC. LUMC is an Illinois not-for-profit corporation exempt from federal income taxes as an organization described in Section 501(c)(3) of the IRC.

Basis of Presentation

LUHS maintains its accounts and prepares stand-alone audited financial statements in conformity with accounting principles generally accepted in the United States of America or recommended in the Audit and Accounting Guide (Health Care Organizations) published by the American Institute of Certified Public Accountants.

Agreements with LUC

Affiliation and Operating Agreement - LUC and LUMC are participants in an Affiliation and Operating Agreement which provides for financial, operating, and shared services relationships between the organizations. Under this agreement LUMC makes payments to LUC for the following: reimbursements received by LUMC for direct medical education; a portion of the salaries and benefits of the Stritch School of Medicine (SSOM) faculty who provide health management services to LUMC; general support to University Academic; and capital support to SSOM. These amounts totaled \$32.8 million for 2006 and \$33.2 million for 2005.

Shared Services - Certain service departments in LUC and LUMC provide services to both entities. Examples of such shared services include portions of Information Services, Human Resources, Development, and Housekeeping. The

Affiliation and Operating Agreement defines allocation methodologies to be used to allocate costs for these services. These methodologies were consistently applied in 2006 and 2005.

Facilities Leases - In October 1995 LUC and LUMC entered into ten-year lease agreements to lease certain facilities space from each other and to pay prevailing competitive rates for use of the facilities. The lease terms have been extended on an annual basis. LUMC's rental of LUC facilities exceeds LUC's rental of LUMC facilities, and LUC agreed to forgive the annual rent differential. As required by the Affiliation and Operating Agreement, the amount forgiven under these leases was \$1.8 million in 2006 and 2005. These lease amounts are not reflected in the consolidated statements of activities and changes in net assets.

1997 Debt Refinancing Agreement - As part of the 1995 transfer of health care operations to LUMC, LUC and LUMC entered into certain Affiliate Guaranties related to LUC's then-outstanding bonds. In 1997, LUC and LUHS refinanced substantially all of LUC's and LUHS's debt in order to release LUMC from the restrictions of the Affiliate Guaranties and to separate LUC's credit from LUHS's credit. LUC, LUMC and LUHS entered into the 1997 Debt Refinancing Agreement which provides that LUMC and LUHS will pay LUC for any costs and expenses associated with refunding or defeasing LUC debt affected by the refinancing, including any ongoing increases in debt service resulting from the transaction or receive credit to the extent the variable interest rates produce effectively lower debt service. Because much of the refinanced debt originally paid variable rates of interest, the amounts payable between LUC and LUMC prior to 2003 have varied each year. As of June 30, 2003 LUMC and LUC agreed to discontinue payments under the debt service provisions, but other provisions of the agreement remain in place.

Net Patient Service Revenues

LUMC has agreements with third-party payers that provide for payments to LUMC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, per diem payments, discounted charges and reimbursed costs. Net patient service revenues are reported at the estimated net realizable amounts from patients, third-party payers, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payers. 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. In 2006, \$5.1 million of favorable Medicare prior year settlements were recorded. LUMC grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payer agreements.

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Laws and regulations governing Medicare and Medicaid programs are complex and subject to interpretation. Compliance with these laws and regulations, specifically those relating to the Medicare and Medicaid programs, can be subject to review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity continues with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenues from patient services. Management believes that LUMC is in substantial compliance with current laws and regulations.

In 2005, LUHS received \$20.1 million of Hospital Access Improvement payments from the Illinois Medicaid program. The payments are included in net patient services revenues. LUHS paid a related hospital assessment of \$12.3 million in 2005, which is included in non-salary operating expenses. The amount of such special payments from the Illinois Medicaid program, if any, which will be made to hospitals in the future, is uncertain.

It is an inherent part of LUMC's mission to provide necessary medical care free of charge, or at a discount, to individuals without insurance or other means of paying for such care. As the amounts determined to qualify as charity care are not pursued for collection, they are not reported as patient service revenues. LUMC also incurs losses related to the unreimbursed costs of providing services to Medicaid patients. The charges foregone associated with the provision of charity care and unreimbursed cost of Medicaid patients for fiscal years 2006 and 2005 are as follows:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Charges foregone for charity purposes	\$ <u>20,923</u>	\$ <u>18,627</u>
Excess cost over reimbursement for Medicaid patients:		
Excess cost before Hospital Access Improvement payments	\$33,721	\$ 26,606
Hospital Access Improvement payments – net	<u> -</u>	<u>(7,780)</u>
Excess cost over reimbursement for Medicaid patients	\$ <u>33,721</u>	\$ <u>18,826</u>

(5) Investments

University Academic

Investment policy for endowment assets is the responsibility of the Investment Committee of the Board of Trustees. All endowment assets are managed by outside investment managers and held in custody by third-party financial institutions.

The fair value of investments at June 30, 2006 and 2005 was:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Marketable equity investments	\$185,587	\$145,311
Private equity investments	38,869	39,603
Absolute return/hedge funds	21,786	20,398
Fixed income investments	61,327	59,357
Real estate	1,560	3,017
Cash pending investment	<u>11,406</u>	<u>9,149</u>
Total investments	\$ <u>320,535</u>	\$ <u>276,835</u>

Fair values of financial instruments approximate their carrying values in the consolidated financial statements except for indebtedness for which fair value information is provided in Note 8. The endowment portfolio is obligated to make future capital contributions in the maximum amount of \$12.1 million in private equity investments over the next four to six years.

Derivative Financial Instruments

University Academic uses derivative financial instruments, primarily futures and options, in the management of its endowment portfolio to invest liquid cash, increase or decrease capital market exposures and to hedge the risk of a decline in value of certain equity securities. Such financial instruments are classified as trading activity, not as hedges, and are marked to market and recorded at fair market value by recognizing gains and losses.

In 2006, the endowment investment portfolio used futures for the express purpose of maintaining the endowment asset allocation as close as possible to the policy allocation. Futures are used to maintain a fully invested position and to increase (with long positions) or decrease (with short positions) the portion of the portfolio allocated to stocks, bonds and cash. Futures are not used for tactical investment decisions or to speculate on the future direction of markets. Realized gains and losses from derivative instruments are included in investment income. Futures positions are fully collateralized and do not create leverage in the endowment portfolio.

The use of futures contracts on equity and bond markets during 2006 and 2005 generated \$2.2 million and \$1.5 million in gains, respectively. As of June 30, 2006 and 2005, the endowment portfolio held futures contracts with a notional value of \$14.4 million and \$33.4 million, respectively. The net impact of the futures held at June 30, 2006 is to reduce the cash position in the endowment portfolio by 4.7% (\$14.4 million), while increasing equity assets by 4.7% (\$14.4 million).

At June 30, 2006, five option positions were held in the portfolio with a fair market value of (\$165) thousand, offsetting underlying stock positions of \$2.9 million. At June 30, 2005, five option positions were held in the portfolio with a market value of (\$278) thousand, offsetting underlying stock positions of \$1.3 million. Realized gains on exercised or expired options were \$594 thousand in 2006 and \$227 thousand in 2005.

The endowment portfolio may invest in commingled funds that employ derivative-based strategies as part of a diversified investment strategy.

Investment Return

Investment return, net of management fees, for the years ended June 30, 2006 and 2005 was:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Interest and dividend income (net of fees)	\$ 4,526	\$ 5,858
Net realized gains	33,735	19,527
Net unrealized gains	<u>(2,326)</u>	<u>727</u>
Total net return on investment	\$ <u>35,935</u>	\$ <u>26,112</u>

Interest income on cash and cash equivalents of \$5.7 million in 2006 and \$2.5 million in 2005 is not included in the investment return. The endowment's total investment return (net of management fees) for the years ended June 30, 2006 and 2005 was 13.7% and 10.6%, respectively.

Endowment

The following table provides a summary of the change in the fair market value of the endowment investment portfolio for the years ended June 30, 2006 and 2005:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Beginning of year endowment value	\$ 259,118	\$ 228,130
Gifts and transfers:		
Contributions (excluding pledges)	6,406	3,250
Transfers	<u>11,890</u>	<u>7,924</u>
Total gifts and transfers	18,296	11,174
Investment income:		
Interest and dividend income (net of fees)	4,120	5,320
Net realized gains	33,806	19,151
Net unrealized gains	<u>(2,249)</u>	<u>469</u>
Total investment income	35,677	24,940
Income distributed for operating purposes:		
Scholarships	(2,100)	(1,393)
Endowed chairs	(2,093)	(1,447)
Research	(882)	(795)
Other	<u>(2,352)</u>	<u>(1,491)</u>
Total income distributed for operating purposes	<u>(7,427)</u>	<u>(5,126)</u>
End of year endowment value	\$ <u>305,664</u>	\$ <u>259,118</u>

Endowment net assets at June 30 are classified as follows:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Unrestricted	\$ 110,152	\$ 86,971
Temporarily restricted	115,006	95,334
Permanently restricted	<u>80,506</u>	<u>76,813</u>
Total endowment net assets	\$ <u>305,664</u>	\$ <u>259,118</u>

Endowment Spending

University Academic uses a total return linked endowment spending policy. Endowment spending can consist of interest, dividends or accumulated capital gains when necessary. The primary benefit of a total return linked spending policy is to separate the spending decision from short-term investment results. Therefore, long-term investment strategy can be established independently of short-term income and spending needs. The current endowment spending rate is capped at 5.0%. At present, the spending is less than 5.0% in an effort to grow endowment funds at a higher rate. The spending rate applied to eligible endowment funds was 4.0% in 2006 and 2005. The effective spending rate was less than 3% for 2006 and 2005.

LUHS

Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the consolidated statements of financial position. The real estate investment is valued at cost and represents land not used in current operations. Investment income or loss (including realized gains and losses on investments, interest and dividends) is included in the results from operations in the consolidated statements of activities and changes in net assets, unless the income or loss is restricted by donor or by law. Unrealized gains and losses on investments, unless considered impaired, are excluded from results of operations and are recorded as non-operating activity in the consolidated statements of activities and changes in net assets.

As of June 30, 2006 and 2005, the aggregate amounts of unrealized losses reflected in investments were \$6.8 million and \$2.3 million on investments with a fair value of \$140.1 million and \$58.5 million, respectively. Management believes that these individual investments, which have not had an impairment recorded, have not met the criteria for recording an other-than-temporary impairment.

Gains and losses are calculated using the average cost method. LUHS recognized losses on impaired investments of \$14 thousand and \$907 thousand for the years ended June 30, 2006 and 2005, respectively, related to investments whose market value was significantly less than cost for an extended period of time. LUHS recorded an unrealized loss on investments of \$5.4 million and an unrealized gain of \$1.7 million in 2006 and 2005, respectively.

Investments include \$95.8 million and \$94.4 million at June 30, 2006 and 2005, respectively, held by LUCIC for the payment of general and professional liability claims.

The fair value of investments at June 30, 2006 and 2005 was:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Marketable equity investments	\$ 92,117	\$ 76,113
Fixed income investments	136,329	142,411
Real estate	<u>8,812</u>	<u>7,475</u>
Total investments	<u>\$237,258</u>	<u>\$225,999</u>

Investment return for the years ended June 30, 2006 and 2005 was:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Interest and dividend income	\$ 9,848	\$ 7,576
Net realized gains	8,905	11,814
Net unrealized gains	<u>(5,420)</u>	<u>1,699</u>
Total investment income	<u>\$ 13,333</u>	<u>\$ 21,089</u>

(6) Notes and Accounts Receivable

Notes and accounts receivable at June 30, 2006 and 2005 consisted of:

(in thousands of dollars)

	2006			2005
	University Academic	LUHS	Total	
Student loan notes (less allowance for doubtful accounts of \$1,683 (2006) and \$2,279 (2005))	\$17,898	\$ -	\$ 17,898	\$ 19,079
Contributions (less discount of \$6,159 (2006) and \$3,092 (2005) and allowance for doubtful accounts of \$1,198 (2006) and \$1,378 (2005))	10,220	982	11,202	14,016
Health care (less allowance for doubtful accounts of \$18,135 (2006) and \$25,712 (2005))		123,249	123,249	129,081
Student receivables (less allowance for doubtful accounts of \$7,603 (2006) and \$9,790 (2005))	8,941		8,941	6,185
Grant receivables (less allowance for doubtful accounts of \$506 (2006) and \$825 (2005))	3,075		3,075	7,510
Other (less allowance for doubtful accounts of \$937 (2006) and \$728 (2005))	<u>7,364</u>		<u>7,364</u>	<u>6,487</u>
Total notes and accounts receivable	<u>\$47,498</u>	<u>\$124,231</u>	<u>\$171,729</u>	<u>\$182,358</u>

Contributions receivable at June 30, 2006 and 2005 are due in the following periods:

(in thousands of dollars)

	2006			2005
	University Academic	LUHS	Total	
In one year or less	\$ 558	\$ 340	\$ 898	\$ 4,396
Between one year and five years	9,283	650	9,933	12,543
More than five years	7,678	50	7,728	1,547
Discount \$6,159 (2006) and \$3,092 (2005) and allowance for doubtful accounts of \$1,198 (2006) and \$1,378 (2005)	(7,299)	(58)	(7,357)	(4,470)
Total contributions receivable	<u>\$ 10,220</u>	<u>\$ 982</u>	<u>\$ 11,202</u>	<u>\$ 14,016</u>

(7) Land, Buildings and Equipment

Components of land, buildings, equipment, and library books at June 30, 2006 and 2005 were:

(in thousands of dollars)

	2006			2005
	University Academic	LUHS	Total	
Land	\$ 56,460	\$ 7,678	\$ 64,138	\$ 53,488
Buildings	489,648	368,005	857,653	807,300
Equipment	47,741	171,780	219,521	201,970
Library books and art	20,383		20,383	20,348
Construction in progress	68,398	17,555	85,953	55,616
Other real estate	<u>37,880</u>		<u>37,880</u>	<u>34,449</u>
Total	720,510	565,018	1,285,528	1,173,171
Accumulated depreciation	(297,775)	(239,256)	(537,031)	(491,614)
Land, buildings, and equipment – net	<u>\$ 422,735</u>	<u>\$ 325,762</u>	<u>\$ 748,497</u>	<u>\$ 681,557</u>

(8) Indebtedness

Notes and bonds payable as of June 30, 2006 and 2005 are shown below:

(in thousands of dollars)	<u>Final Maturity</u>	<u>Interest Rate</u>	<u>2006</u>	<u>Interest Rate</u>	<u>2005</u>
University Academic					
Fixed rate:					
Illinois Finance Authority (IFA) (formerly Illinois Educational Facilities Authority (IEFA)):					
Series 1997A convertible bonds	2026	5.70%	\$ 27,635	5.70%	\$ 27,635
Series 1997C taxable bonds	2013	6.90-7.12%	40,215	6.88-7.12%	42,430
Series 2003A bonds	2027	5.00%	28,155	5.00%	28,155
Series 2003B bonds	2022	5.60%	37,520	5.60%	37,520
Series 2004A bonds	2026	5.00-5.25%	24,000	5.00-5.25%	24,000
Series 2003C direct obligation bonds	2019	4.80-5.30%	40,805	4.80-5.30%	40,805
Medium-term note	2018	7.52%	21,100	7.52%	21,100
Mortgage notes:					
6566-82 N. Sheridan Rd.	2010	9.00%	488	9.00%	586
6542-48 N. Sheridan Rd.	2016	9.50%	679	9.50%	724
845-847 N. State Street	2009	2.50%	750	2.50%	1,000
Capital Lease	2007	8.31%	64	8.31%	186
City of Chicago Loan	2013	0.00%	<u>813</u>	0.00%	<u>938</u>
Total fixed rate			<u>\$222,224</u>		<u>\$225,079</u>
Variable rate: *					
IFA Series 2004B bonds	2035	3.75%	\$ 34,800	3.00%	\$ 34,800
IEFA commercial paper pool	2014	3.51%	<u>12,174</u>	2.45%	<u>12,174</u>
Total variable rate			<u>\$ 46,974</u>		<u>\$ 46,974</u>
Total University Academic indebtedness			<u>\$269,198</u>		<u>\$272,053</u>

* Interest rates shown in the variable rate section of this chart represent the average outstanding interest rate at June 30.

During 2005, University Academic entered into an unsecured bank line of credit under which it may borrow up to \$20.0 million related to the University's graduate and professional student loan program. There were no borrowings under this line of credit as of June 30, 2005. In fiscal year 2006, \$28.2 million was issued to students and subsequently sold to a financial institution without recourse to the University. Borrowings under this line of credit bear interest at the commercial paper rate plus .40% (5.37% at June 30, 2006 and 3.80% at June 30, 2005). As of June 30, 2006 and 2005, there were no principal amounts outstanding under this line of credit.

(in thousands of dollars)	<u>Final Maturity</u>	<u>Interest Rate</u>	<u>2006</u>	<u>Interest Rate</u>	<u>2005</u>
LUHS					
Long-Term debt:					
Fixed rate:					
Illinois Health Facilities Authority (IHFA):					
Series 2001A bonds	2031	5.80-6.10%	\$ 90,376	5.80-6.10%	\$ 90,319
Series 1997A bonds	2024	5.00-6.00%	<u>117,663</u>	5.00-6.00%	<u>121,013</u>
Total fixed rate			<u>\$208,039</u>		<u>\$211,332</u>

(in thousands of dollars)	<u>Final</u> <u>Maturity</u>	<u>Interest</u> <u>Rate</u>	<u>2006</u>	<u>Interest</u> <u>Rate</u>	<u>2005</u>
LUHS (continued)					
Variable rate:					
Illinois Health Facilities Authority (IHFA):					
Series 1997B bonds	2024	3.95%	\$ 14,090	2.30%	\$ 14,635
Series 1997C bonds	2024	5.40%	<u>44,700</u>	3.30%	<u>46,100</u>
Total variable rate			<u>\$ 58,790</u>		<u>\$ 60,735</u>
Total long-term debt			<u>\$266,829</u>		<u>\$272,067</u>
Short-Term debt:					
Line of credit			<u>\$ 24,000</u>		<u>\$ 24,000</u>
Total short-term debt			<u>\$ 24,000</u>		<u>\$ 24,000</u>
Total LUHS indebtedness			<u>\$290,829</u>		<u>\$296,067</u>

LUHS maintains an unsecured bank line of credit of \$50.0 million at a LIBOR-based interest rate payable monthly (5.2% at June 30, 2006 and 3.6% at June 30, 2005). As of June 30, 2006 and 2005, \$24.0 million was outstanding on the line of credit. Interest paid on LUHS's line of credit was \$1.0 million and \$406 thousand for the years ended June 30, 2006 and 2005, respectively.

In 2006 University Academic recorded capitalized interest of \$1.18 million, and in 2006 LUHS recorded capitalized interest of \$343 thousand. Bond discounts, premiums, and costs incurred in connection with the issuance of bonds are deferred and amortized over the life of the related indebtedness.

Debt Covenants

Some debt agreements require LUC and LUHS to maintain sinking or reserve funds, and some require the maintenance of financial ratios or impose other restrictions. Both LUC and LUHS are in compliance with all debt covenants as of June 30, 2006.

Repayments and Classification

Total scheduled maturities for the next five fiscal years are:

(in thousands of dollars)	<u>Fiscal</u> <u>Year</u>	<u>University</u> <u>Academic</u>	<u>LUHS</u>	<u>Total</u>
	2007	\$ 5,486	\$ 7,670	\$ 13,156
	2008	5,751	8,225	13,976
	2009	15,586	8,665	24,251
	2010	7,784	9,135	16,919
	2011	6,577	9,660	16,237
	thereafter	<u>228,014</u>	<u>223,474</u>	<u>451,488</u>
		<u>\$269,198</u>	<u>\$266,829</u>	<u>\$536,027</u>

Disclosure of Fair Value of Long-term Debt

The fair value of the outstanding debt as of June 30, 2006 and 2005 was:

(in thousands of dollars)	<u>2006</u>		<u>2005</u>	
	<u>Fair</u> <u>Value</u>	<u>Carrying</u> <u>Value</u>	<u>Fair</u> <u>Value</u>	<u>Carrying</u> <u>Value</u>
University Academic	\$256,914	\$269,198	\$253,837	\$272,053
LUHS	270,517	266,829	270,498	272,067

The fair value of long-term debt is determined based on quoted market prices when available or discounted cash flows, using interest rates currently available on similar borrowings.

Interest

Interest paid for the years ended June 30, 2006 and 2005 was:

(in thousands of dollars)	<u>2006</u>			
	<u>University</u>	<u>LUHS</u>	<u>Total</u>	<u>2005</u>
Interest paid	\$14,448	\$14,313	\$28,761	\$25,184

Interest Rate Swaps

From time to time, LUC enters into interest rate swap agreements to modify the interest rate characteristics of its outstanding debt from floating to a fixed-rate or vice versa. These agreements involve the exchange of floating and fixed-rate interest payments over the life of the agreement without an exchange of the underlying principal amount. The differential to be paid or received is recognized as an adjustment to interest expense related to the debt. The related amount payable to or receivable from counterparties is included in other liabilities or assets.

On June 22, 2005, University Academic entered into a forward-starting interest rate swap agreement which expires in 2023. Under the terms of the agreement LUC expects to issue tax-exempt variable rate bonds in April of 2007 and use the proceeds to call the \$27,635,000 outstanding 5.7% Series 1997A Bonds. Beginning with the issuance of the 2007 bonds, LUC will pay bondholders a variable rate based on the Bond Market Association Municipal Swap Index. LUC will receive a similar payment from the swap counterparty, and LUC will pay the counterparty a fixed rate of 3.905%. This transaction effectively reduces interest expense on approximately \$27 million of debt from 5.7% to 3.905% plus costs, generating a net present value savings of \$2.9 million. At its inception date of June 22, 2005, the swap instrument had a value of zero. At June 30, 2006 the swap instrument had a value of \$943 thousand. This agreement is considered a derivative financial instrument and has been reported at fair value as a component of other assets in the consolidated statements of financial position at June 30, 2006. The net change in the fair value of the agreement since inception has been reported as a component of other income in the non-operating activities section of the consolidated statements of activities and changes in net assets for the years ended June 30, 2006 and 2005.

LUHS entered into two interest rate swap agreements in March 2002 and one interest rate swap agreement in May 2003 to offset future fluctuations in interest rates related to LUHS's fixed and variable rate debt. The March 2002 fixed rate swap agreement has a rate of 3.46%, extends over a five-year period, and has a notional amount of \$50 million. This swap agreement was terminated on March 1, 2006. The March 2002 floating rate agreement has a rate equal to 73.75% of the one-month LIBOR, extends over a twenty-year period, and has a notional amount of \$100 million. The May 2003 floating rate agreement has a rate equal to 63.00% of the one-month LIBOR plus .705%, extends over a twenty-year period, and has a notional amount of \$125.0 million. The net amounts received under the interest rate swap agreements reduced interest expense by \$991 thousand in 2006 and by \$1.1 million in 2005.

The fair value of the swap agreements at June 30, 2006, an unrealized loss of \$1.1 million, is recorded as a component of other liabilities in the consolidated statements of financial position. The swap agreements do not qualify for hedge accounting. Accordingly, LUHS recorded the net mark-to-market fair value adjustment of the swaps of a gain of \$4.6 million and a loss of \$2.1 million for the years ended June 30, 2006 and 2005, respectively, as a component of the non-operating activities section of the consolidated statements of activities and changes in net assets.

(9) Self Insurance

University Academic

University Academic maintains risk retention programs for professional liability, certain general liability risks, and certain employee benefits.

Under a risk retention program designed to provide general and professional liability protection to LUC and patient liability protection to participating faculty, LUC has responsibility for pre-1995 exposure. The risk retention program is supplemented by commercial excess umbrella protection on an occurrence basis through 1986, and thereafter on a combined claims-made and occurrence basis.

The provision for risk retention is calculated using an independent actuarial basis and management judgment. The reserve for risk retention is the estimated value of claims and claims adjustment expense which will be settled in the future. Management considers the reserve adequate to cover LUC's loss exposure for all years.

LUHS

LUMC purchases claims-made insurance coverage from LUCIC for primary and patient general liability claims as well as excess liability claims. The accounts and results of operations of LUCIC are included in the accompanying consolidated financial statements. Estimated claims are discounted using a rate of 6.5% at June 30, 2006 and 2005. The amounts of the discounts were \$33.1 million in 2006 and \$34.6 million in 2005. Self-insurance liabilities are estimated at the actuarially determined expected level, plus an estimate of incurred but not reported claims.

Expenses related to general and professional liability were \$42.7 million and \$43.3 million for 2006 and 2005, respectively. This includes primary and patient general liability and medical malpractice liability insurance to Loyola University Physician Foundation (LUPF) and its physicians (see Note 14). LUPF expenses related to general liability and medical malpractice liability insurance were \$17.0 million and \$14.1 million for 2006 and 2005, respectively. Reinsurance recoveries receivable of \$8.3 million and \$15.8 million were recorded as other assets at June 30, 2006 and 2005, respectively.

(10) Retirement Plans

Substantially all personnel participate in either a defined contribution retirement plan or a defined benefit plan (LUERP). University Academic froze pension benefits in LUERP effective March 31, 2004 for all but a grandfathered group of "ameliorated" participants. This group is allowed to continue to earn additional Adjusted Benefit Credited Service accruals for a period of up to five years. Effective April 1, 2004, University Academic established a new defined contribution plan.

LUMC froze pension benefits in LUERP effective March 31, 2004 for all participants. All LUMC participants will continue to earn pension benefits after March 31, 2004 in a new defined benefit plan, the Loyola University Medical Center Employees' Retirement Plan (LUMC-ERP), which is substantially similar in design to LUERP and provides coverage effective April 1, 2004. The primary differences between LUMC-ERP and LUERP include removal of the unlimited lump sum optional form of payment, increase in the retirement age from 65 to Social Security Normal Retirement Age, and an increase in the hour requirement for participation and service accrual from 500 to 1,000.

LUMC expects to contribute a minimum of \$10.0 million to LUMC-ERP in 2007.

At June 30, 2003, University Academic recorded a minimum pension liability of \$35.2 million. The adjustment was shown as a non-operating charge in the consolidated statements of activities and changes in net assets, decreasing unrestricted net assets of University Academic by \$32.0 million. The adjustment is required by FAS 87, *Employer's Accounting for Pensions*, when the accumulated benefit obligation of the plan exceeds the fair value of the underlying assets. At June 30, 2006 the fair value of the plan assets exceeded the accumulated benefit obligation, resulting in an increase in unrestricted net assets of \$25.3 million for University Academic. Included in the consolidated statements of financial position at June 30, 2006 and 2005 is a prepaid pension asset of \$25.1 million and a pension liability of \$164 thousand, respectively.

At June 30, 2006, LUMC recorded a minimum pension liability of \$12.5 million. The adjustment was reflected as a non-operating charge in the consolidated statements of activities and changes in net assets, net of the recognition of an intangible asset included in other assets in the amount of \$2.6 million and in the accrued pension benefit. This accounting treatment is required when the accumulated benefit obligation of the plan exceeds the fair value of the underlying pension plan assets and the accrued pension liabilities.

For LUHS, the LUERP plan has a projected benefit obligation of \$144.6 million and \$143.7 million, an accumulated benefit obligation of \$144.6 million and \$139.5 million, and a fair value of plan assets of \$151.6 million and \$143.2 million as of March 31, 2006 and March 31, 2005, respectively. The LUMC-ERP plan has a projected benefit obligation of \$51.1 million and \$37.5 million, an accumulated benefit obligation of \$25.0 million and \$5.5 million, and a fair value of plan assets of \$14.6 million and \$7.6 million as of March 31, 2006 and 2005, respectively.

Retirement plan expenses included in the consolidated statements of activities and changes in net assets for the years ended June 30, 2006 and 2005 were:

(in thousands of dollars)

	<u>2006</u>			<u>2005</u>
	<u>University Academic</u>	<u>LUHS</u>	<u>Total</u>	
	\$13,124	\$13,925	\$27,049	\$24,488

Summary information for the defined benefit pension plans follows:

(in thousands of dollars)

	<u>2006</u>			<u>2005</u>
	<u>University Academic</u>	<u>LUHS</u>	<u>Total</u>	
Change in projected benefit obligation				
Projected benefit obligation, beginning of year	\$ 85,968	\$ 181,229	\$ 267,197	\$ 247,711
Service cost	1,810	9,226	11,036	10,563
Interest cost	4,532	10,610	15,142	14,215
Benefits paid	(6,602)	(10,215)	(16,817)	(15,947)
Actuarial gain	(3,611)	4,845	1,234	10,655
Projected benefit obligation, end of year	\$ <u>82,097</u>	\$ <u>195,695</u>	\$ <u>277,792</u>	\$ <u>267,197</u>
Change in plan assets				
Fair value of plan assets, beginning of year	\$ 85,804	\$ 150,760	\$ 236,564	\$ 226,602
Actual return on plan assets	11,120	19,332	30,452	18,534
Company contributions		6,255	6,255	7,375
Benefits paid	(6,602)	(10,215)	(16,817)	(15,947)
Fair value of plan assets, end of year	\$ <u>90,322</u>	\$ <u>166,132</u>	\$ <u>256,454</u>	\$ <u>236,564</u>
Reconciliation of funded status				
Funded status	\$ 8,226	\$(29,563)	\$(21,337)	\$(30,633)
Unrecognized net actuarial gain	16,911	35,998	52,909	65,368
Unrecognized prior service cost		2,602	2,602	2,980
Minimum pension liability		(9,944)	(9,944)	(25,206)
Contribution		3,000	3,000	
Pension (liability) asset	\$ <u>25,137</u>	\$ <u>2,093</u>	\$ <u>27,230</u>	\$ <u>12,509</u>
Accumulated benefit obligation, end of year	\$ <u>82,097</u>	\$ <u>169,642</u>	\$ <u>251,739</u>	\$ <u>235,205</u>
Weighted average assumptions of benefit obligations				
Discount rate	6.09%	6.23%		5.50-6.00%
Lump sum distributions	5.34%	6.23%		4.75-6.00%
Rate of compensation increase	N/A	3.00%		2.50%
Components of net pension expense				
Service cost	\$ 1,810	\$ 9,226	\$ 11,036	\$ 10,563
Interest cost	4,533	10,610	15,143	14,215
Expected return on plan assets	(6,991)	(12,440)	(19,431)	(18,873)
Net amortization and deferral	553	2,496	3,049	2,220
Net periodic pension cost	(95)	9,892	9,797	8,125
Effect of plan curtailment				
Total pension expense (income)	\$ <u>(95)</u>	\$ <u>9,892</u>	\$ <u>9,797</u>	\$ <u>8,125</u>
Weighted average assumptions of net periodic pension expense				
Discount rate	5.50%	6.00%		5.50-6.00%
Lump sum distributions	4.75%	6.00%		4.75-6.00%

Expected long-term return on plan assets	8.50%	8.50%	8.50%
Rate of compensation increase	N/A	3.00%	2.50%

Defined benefit plan asset allocation at the March 31 measurement date was as follows:

	<u>2006</u>		<u>2005</u>	
	<u>University Academic</u>	<u>LUHS</u>	<u>University Academic</u>	<u>LUHS</u>
Cash and cash equivalents	1%	7%	1%	3%
Equity securities	47%	48%	48%	47%
Fixed income securities	31%	31%	30%	29%
Private investments	14%	13%	17%	17%
Real estate investments	<u>7%</u>	<u>1%</u>	<u>4%</u>	<u>4%</u>
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

LUERP assets are held in trust by an external trustee. The trust portfolio is managed in accordance with the policies established by the LUERP Retirement Allowance Committee. Management developed the estimate of the expected long-term rate of return on plan assets based upon this mix and the expected rates of return for the various investment strategies employed.

Expected future benefit payments for the years ended June 30 are as follows:

(in thousands of dollars)	<u>Fiscal Year</u>	<u>University Academic</u>	<u>LUHS</u>	<u>Total</u>
	2007	\$ 7,001	\$12,076	\$ 19,077
	2008	8,126	12,520	20,646
	2009	6,580	13,727	20,307
	2010	6,371	13,678	20,049
	2011	6,266	13,442	19,708
	2012-2016	30,632	81,651	112,283

LUMC employees who are covered by LUERP and/or LUMC-ERP are eligible to participate in the Loyola Retirement Matched Savings Plan. LUMC matches one-half of employees' voluntary contributions to a maximum of 2% of compensation. LUMC's expense for 2006 and 2005 was \$2.8 million and \$2.6 million, respectively. In addition, all employed physicians who work 1,000 or more hours are eligible to participate in a defined contribution plan. The plan provides for periodic contributions based on the salary of the employees. LUMC's expense under the provisions of the plan for 2006 and 2005 was \$1.3 million and \$1.2 million, respectively.

(11) Other Postretirement Benefits

University Academic has a defined benefit retiree health plan covering eligible employees upon their retirement. Health benefits are provided subject to various cost-sharing features and are not prefunded.

Effective January 1, 2001, LUMC no longer contributes to the cost of retiree health coverage for certain future retirees. LUMC contributes to the cost of health coverage for current retirees, active employees who were 60 years of age with ten years of service at December 31, 2000, and active employees with 25 years or more of service at December 31, 2000, regardless of age.

In 2005, LUHS adopted the guidance of FASB Staff Position No. 106-1, *Accounting for Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003*. This resulted in a reduction of prior service cost of \$385 thousand in 2005, which is included in the amortization.

Effective January 1, 2006, LUMC amended its plan to eliminate coverage of prescription drugs for participants age 65 and over. The impact of this amendment results in an \$8.9 million reduction in the accumulated benefit obligation which will be amortized as a reduction to the annual net periodic postretirement benefit cost.

Defined benefit retiree health plan costs included in the consolidated statements of activities and changes in net assets for the years ended June 30, 2006 and 2005 were:

(in thousands of dollars)

	2006			2005
	University Academic	LUHS	Total	
Change in benefit obligation				
Benefit obligation, beginning of year	\$ 28,999	\$ 11,571	\$ 40,570	\$ 41,470
Service cost	1,763	277	2,040	1,946
Interest cost	1,680	667	2,347	2,246
Participant contributions	1,234	588	1,822	1,799
Plan amendments		(8,927)	(8,927)	
Benefits paid	(2,435)	(1,005)	(3,440)	(4,305)
Actuarial gain (loss)	(2,097)	459	(1,638)	(2,586)
Benefit obligation, end of year	\$ <u>29,144</u>	\$ <u>3,630</u>	\$ <u>32,774</u>	\$ <u>40,570</u>
Change in plan assets				
Fair value of plan assets, beginning of year	\$ -	\$ -	\$ -	\$ -
Employer contributions	1,201	417	1,618	2,505
Participant contributions	1,234	588	1,822	1,799
Benefits paid	(2,435)	(1,005)	(3,440)	(4,304)
Fair value of plan assets, end of year	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>	\$ <u>-</u>
Reconciliation of funded status				
Funded status	\$ 29,144	\$ 3,630	\$ 32,774	\$ 40,570
Unrecognized actuarial gain (loss)	<u>1,510</u>	<u>5,443</u>	<u>6,953</u>	<u>(1,757)</u>
Accrued postretirement benefit obligation	\$ <u>30,654</u>	\$ <u>9,073</u>	\$ <u>39,727</u>	\$ <u>38,813</u>
Components of net period postretirement benefit cost				
Service cost	\$ 1,763	\$ 276	\$ 2,040	\$ 1,946
Interest cost	1,680	667	2,347	2,246
Unrecognized actuarial (loss) gain	(1,726)	(27)	(1,754)	(1,740)
Net period postretirement benefit cost	\$ <u>1,717</u>	\$ <u>916</u>	\$ <u>2,633</u>	\$ <u>2,452</u>
Discount rate	6.00%	6.23%	6.00%	6.10%
Assumed health care cost trend rates				
	2006	2007	2008	
HMO plans	6.00%	6.00%	6.00%	
Non-HMO plans	6.00%	6.00%	6.00%	

(in thousands of dollars)

	2006			2005
	University Academic	LUHS	Total	
Effect of a 1% change in the health care cost trend rates				
1% increase				
On year-end postretirement benefit obligations	\$ 2,186	\$ 318	\$ 2,504	\$ 2,142
On total of service and interest cost components	272	29	301	584
1% decrease				
On year-end postretirement benefit obligations	\$(2,027)	\$(293)	\$(2,320)	\$(1,877)
On total of service and interest cost components	(250)	(26)	(276)	(487)

The postretirement benefit measurement date was March 31, 2006.

Estimated future benefit payments:

(in thousands of dollars)	<u>Fiscal Year</u>	<u>University Academic</u>	<u>LUHS</u>	<u>Total</u>
	2007	\$ 2,477	\$ 327	\$ 2,804
	2008	2,758	319	3,077
	2009	3,098	324	3,422
	2010	3,362	330	3,692
	2011	3,493	333	3,826
	2012-2016	19,593	1,519	21,112

Effective July 1, 2004, University Academic changed its plan for retiree health benefits. New retirees after 2006 will receive an account-based retiree medical subsidy. The subsidy will be an annual allocation of \$2.8 million (not indexed) towards an interest-bearing account. The allocations will be given for each year of active employment after age 50, up to a maximum of 15 years. Accounts will continue to earn interest during retirement and can be used by the retiree or spouse to pay qualified retiree medical expenses, including monthly premiums for coverage under University Academic's health plan. This new design was reflected in the June 30, 2004 year-end disclosures and development of 2005 expense.

(12) Functional Classification of Expenses

Expenses are reported in the consolidated statements of activities and changes in net assets in natural classifications. Expenses by functional classification for the years ended June 30, 2006 and 2005 were:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Instruction	\$ 91,980	\$ 85,123
Research and other sponsored programs	41,333	41,584
Academic support	49,388	46,884
Student services	23,129	21,208
Institutional support	55,322	50,674
Operations and maintenance	22,317	19,472
Depreciation	19,373	19,220
Patient care	708,544	695,979
Auxiliary services	<u>29,368</u>	<u>22,036</u>
Total operating expenses	<u>\$1,040,754</u>	<u>\$1,002,180</u>

(13) Restricted Net Assets

The program restrictions for temporarily and permanently restricted net assets at June 30, 2006 and 2005 were:

(in thousands of dollars)	<u>2006</u>			<u>2005</u>
	<u>University Academic</u>	<u>LUHS</u>	<u>Total</u>	
Temporarily Restricted				
Academic or program support and student financial aid	\$120,860	\$ -	\$120,860	\$100,553
Research	7,842		7,842	5,577
Student loans	2,998		2,998	2,950
Construction	1,175		1,175	5,067
Other	<u>23,654</u>	<u>4,373</u>	<u>28,027</u>	<u>26,115</u>
Total temporarily restricted net assets	<u>\$156,529</u>	<u>\$4,373</u>	<u>\$160,902</u>	<u>\$140,262</u>
Permanently Restricted				
Academic or program support and student financial aid	\$ 89,391	\$ -	\$ 89,391	\$ 85,207
Student loans	1,148		1,148	1,148
Other		<u>6,385</u>	<u>6,385</u>	<u>6,287</u>
Total permanently restricted net assets	<u>\$ 90,539</u>	<u>\$6,385</u>	<u>\$ 96,924</u>	<u>\$ 92,642</u>

(14) Related Party Transactions

LUPF is an incorporated tax-exempt medical faculty practice plan consisting of the faculty of University Academic's SSOM. The physician employees of LUPF perform their clinical services by contractual arrangement with LUC and LUMC. LUPF provides billing, collection, and distribution services of professional fees generated by SSOM physicians from their private practice of medicine at LUMC and other approved locations. LUC and LUMC received a percentage of fees collected, less certain expenses, for the funding of various SSOM activities and for the use of LUMC's practice-related facilities. Revenues to LUC and LUMC in the years ended June 30, 2006 and 2005 and amounts receivable on these dates were:

(in thousands of dollars)	<u>2006</u>			<u>2005</u>
	<u>University Academic</u>	<u>LUHS</u>	<u>Total</u>	
Revenues	\$27,999	\$17,044	\$45,043	\$43,410
Accounts receivable	2,444	3,542	5,986	7,254

LUMC is reimbursed for providing administrative personnel and certain overhead services to LUPF. The reimbursement was \$7.0 million and \$6.6 million for 2006 and 2005, respectively. Additionally, LUMC is reimbursed for services provided relating to LUCIC exposures. Amounts billed for 2006 and 2005, respectively, were \$512 thousand and \$488 thousand. As of June 30, 2006 and 2005, LUPF's liability to LUMC for all services was \$3.5 million and \$5.0 million, respectively.

LUPF is party to a common paymaster agreement with LUC. The following summarizes unaudited condensed financial information of LUPF as of and for the years ended June 30, 2006 and 2005:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Net assets	\$ 26,651	\$ 29,510
Operating revenues	155,704	156,295
Operating expenses	159,878	165,385

LUPF is neither consolidated nor accounted for under the equity method of accounting by LUC or LUHS in the consolidated financial statements because neither LUC nor LUHS exercise significant influence over the board of directors of LUPF.

RML Specialty Hospital

LUMC owns a 49.5% interest in RML Specialty Hospital (RML), a long-term acute care hospital located in Hinsdale, Illinois. LUMC's investment in RML of \$8.7 million and \$8.5 million as of June 30, 2006 and 2005, respectively, is recorded using the equity method. LUMC provides renal dialysis and reference laboratory services to RML. The revenue from these services was \$1.3 million and \$1.2 million for 2006 and 2005, respectively. In addition, LUHS has guaranteed 50% of certain outstanding debt of RML. As of June 30, 2006, LUHS's guarantee was \$2.2 million.

The following summarizes condensed financial information of RML as of and for the years ended May 31, 2006 and 2005:

(in thousands of dollars)	<u>2006</u>	<u>2005</u>
Net assets	\$16,856	\$16,310
Revenues	43,266	41,674
Expenses	37,664	36,157

Loyola Ambulatory Surgical Center

LUHS owns a 49% interest in Loyola Ambulatory Surgical Center (LASCO), a joint venture with HealthSouth. LUHS investment in LASCO was \$1.8 million and \$1.6 million as of June 30, 2006 and 2005, respectively, and is recorded using the equity method. The following summarizes unaudited condensed financial information of LASCO as of and for the years ended December 31, 2005 and 2004:

(in thousands of dollars)	<u>2005</u>	<u>2004</u>
Net assets	\$3,587	\$3,217
Revenues	5,396	5,052
Expenses	4,578	4,652

The investments in RML Specialty Hospital and Loyola Ambulatory Surgical Center are recorded in other assets. LUHS's equity interest in the earnings of RML and LASCO totaled \$2.8 million and \$477 thousand, respectively, in 2006 and \$2.8 million and \$264 thousand, respectively, in 2005, and are recorded in other revenues in the consolidated statements of activities and changes in net assets.

(15) Leases

LUHS has certain non-cancelable operating leases for specific property, plant, and equipment. Under the terms of these lease agreements, LUHS has a maximum obligation of \$3.9 million in the event the lease for the cogeneration plant is not renewed in January 2010 and the plant is not sold. The obligation may be reduced by excess proceeds from the sale of the plant.

Rent paid under operating leases was \$9.4 million in 2006 and \$7.4 million in 2005.

The future minimum lease commitments under these operating leases are as follows:

(in thousands of dollars)	
Fiscal year ending June 30	
2007	\$ 9,559
2008	8,451
2009	5,990
2010	5,060
2011	4,581
thereafter	<u>9,067</u>
Total	<u>\$42,708</u>

(16) Commitments and Contingencies

Various lawsuits, claims, and other contingent liabilities occasionally arise in the ordinary course of LUC's education, research, and patient care activities. In the opinion of management, all such matters have been adequately provided for, are without merit, or are of such kind that if disposed of unfavorably, would not have a material effect on LUC's financial position or results of operations.

(17) Financial Instruments with Off-Balance Sheet Risk

LUC has agreed to guarantee loans issued to its employees by the Loyola University Employees' Federal Credit Union to an aggregate maximum of \$750 thousand.

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