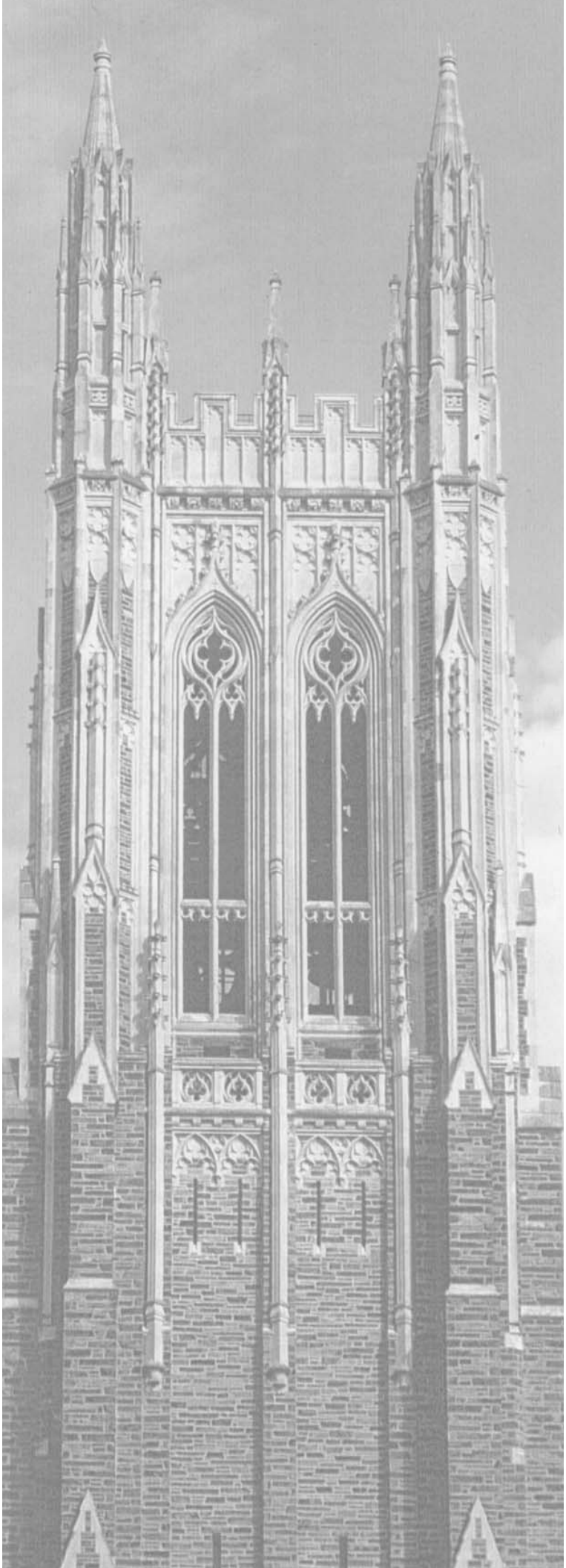
duke university

FINANCIAL REPORT
2001-2002



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Duke University Financial Services Contacts

Michael J. Mandl
Vice President for Financial Services

Joseph E. Schwartz
Director, Financial Accounting and GAAP Reporting

Letter From The

Executive Vice President

Duke had another good fiscal year in 2001-2002. As a whole, the university's programs finished the year with additions to reserves, due to sustained efforts by the schools and colleges to contain costs and increase revenues. These reserves will fund capital projects and cushion future budget issues.

Despite a weak economy and lackluster investment markets, university net assets for the year ended June 30, 2002, remained essentially flat at $4.3 billion. After five years of total returns averaging 21.4 percent, the total return on Duke's long-term investment portfolio was negative for the second year in a row, at (3.8) percent. Strong charitable support and prudent fiscal policies offset this loss. We continue to monitor our resource management in light of the uncertain economic outlook, and allocate our funds judiciously.

The university's financial strength and flexibility are reflected in its credit ratings. Moody's attached a positive outlook to our Aa1 bond rating. Only a few universities enjoy higher ratings, and each has a level of endowment per student several times that of Duke.

The Duke University Health System once again posted a modest operating surplus despite challenging market conditions and the downturn in the economy.

Duke's relatively rapid ascent as a leading research university is all the more remarkable given its modest resource base. Nevertheless, preserving Duke's academic quality will require substantial investments in teaching, research, and infrastructure. The university's strategic investment plan includes significant support for each of these areas. Our revised debt policy and capital budget process will buttress these initiatives.

I close this report by expressing yet again my deep appreciation to the countless people who have contributed to Duke's current strength and excellent prospects.

Tallman Trask III
EXECUTIVE VICE PRESIDENT

Independent Auditors' Report

The Board of Trustees of Duke University:

We have audited the accompanying consolidated balance sheet of Duke University as of June 30, 2002, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of Duke University's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit. The prior year summarized comparative information has been derived from Duke University's 2001 financial statements and in our report dated September 14, 2001 we expressed an unqualified opinion on those financial statements.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Duke University as of June 30, 2002, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the basic financial statements of Duke University taken as a whole. The supplementary information included in Schedules 1, 2, and 3 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

Greensboro, North Carolina
September 6, 2002

Consolidated Balance Sheet

DUKE UNIVERSITY
June 30, 2002
(with summarized financial information for June 30, 2001)
(000's omitted)

	2002	2001
Assets:		
Cash and cash equivalents	$ 232,804	$ 148,158
Cash held as collateral under securities lending transactions	363,725	502,408
Patient receivables, net	219,211	235,116
Other receivables, net	143,156	115,735
Prepaid expenses, deferred charges and inventories	103,261	100,401
Contributions receivable, net	211,838	168,362
Student loans receivable, net	41,245	42,592
Investments	3,693,705	3,899,506
Deposits with bond trustees	68,046	27,745
Land, buildings, and equipment, net	1,358,996	1,244,401
Interests in perpetual trusts held by others	553,339	634,563
Goodwill, net	122,272	126,959
Total assets	$ 7,111,598	$ 7,245,946
Liabilities:		
Accounts payable	$ 253,406	$ 231,160
Accrued payroll and employee withholdings	121,405	110,104
Deferred revenues and deposits	55,785	43,964
Liability under securities lending transactions	363,725	502,408
Notes and bonds payable	859,533	745,976
Annuity and other split-interest obligations	43,380	54,610
Accrued postretirement/postemployment and other benefit obligations	254,332	227,381
Other liabilities	40,878	40,339
Total liabilities	1,992,444	1,955,942
Net Assets:		
Unrestricted	3,675,487	3,824,563
Temporarily restricted	124,487	135,035
Permanently restricted	1,319,180	1,330,406
Total net assets	5,119,154	5,290,004
Total liabilities and net assets	$ 7,111,598	$ 7,245,946

See accompanying notes to consolidated financial statements.

Consolidated Statement of Activities

DUKE UNIVERSITY
Year ended June 30, 2002
(with summarized financial information for the year ended June 30, 2001)
(000's omitted)

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	2002 Total	2001 Total
Operating revenues and support:					
Tuition and fees	$ 304,825	$ …	$ …	$ 304,825	$ 288,128
Less student aid	(88,798)	…	…	(88,798)	(77,525)
	216,027	…	…	216,027	210,603
Grants, contracts and similar agreements:					
Government sources	319,097	…	…	319,097	264,924
The Private Diagnostic Clinic, PLLC	71,173	…	…	71,173	58,097
Other	151,369	…	…	151,369	149,390
Total grants, contracts and similar agreements	541,639	…	…	541,639	472,411
Contributions	115,550	…	…	115,550	113,259
Investment return designated for current operations:					
The Duke Endowment	15,868	…	…	15,868	18,501
Endowment spending	86,881	…	…	86,881	79,619
Other investment income	82,999	…	…	82,999	117,410
Auxiliary enterprises	128,588	…	…	128,588	134,718
Patient service revenue	1,102,343	…	…	1,102,343	1,027,582
Other	209,936	…	…	209,936	221,410
Net assets released from restrictions	83,587	(83,587)	…	…	…
Total operating revenues and support	2,583,418	(83,587)	…	2,499,831	2,395,513
Operating expenses:					
Salaries and wages	1,103,419	…	…	1,103,419	967,755
Employee benefits	217,037	…	…	217,037	193,641
Net postretirement/postemployment benefit costs	19,424	…	…	19,424	20,925
Materials and supplies	354,085	…	…	354,085	335,147
Professional services	117,992	…	…	117,992	127,832
Student aid	16,854	…	…	16,854	14,702
Other operating expenses	411,770	…	…	411,770	440,797
Interest on indebtedness	30,557	…	…	30,557	38,622
Depreciation and amortization	151,079	…	…	151,079	149,592
Asset impairment (recovery) write-down	(5,507)	…	…	(5,507)	53,600
Total operating expenses	2,416,710	…	…	2,416,710	2,342,613
Excess/(deficit) of operating revenues and support over/(under) operating expenses	166,708	(83,587)	…	83,121	52,900
Nonoperating activities:					
Contributions	…	76,233	63,195	139,428	96,972
Investment return in excess of (less than) amounts designated for current operations	(313,544)	(9,816)	6,220	(317,140)	(373,511)
Loss on disposals of property and equipment	(471)	…	…	(471)	(3,927)
(Loss) gain on perpetual trusts held by others and other nonoperating items	(607)	6,622	(80,641)	(74,626)	153,464
Change in net assets from nonoperating activities	(314,622)	73,039	(11,226)	(252,809)	(127,002)
Discontinued operations:					
Loss from discontinued operations	(808)	…	…	(808)	…
(Loss) gain on disposal of discontinued operations	(354)	…	…	(354)	4,129
Decrease in net assets	(149,076)	(10,548)	(11,226)	(170,850)	(69,973)
Net assets at beginning of year	3,824,563	135,035	1,330,406	5,290,004	5,359,977
Net assets at end of year	$ 3,675,487	$ 124,487	$ 1,319,180	$ 5,119,154	$ 5,290,004

See accompanying notes to consolidated financial statements.

Consolidated Statement of Cash Flows

DUKE UNIVERSITY
Years ended June 30, 2002
(with summarized financial information for the year ended June 30, 2001)
(000's omitted)

	2002	2001
Cash flows from operating activities:		
Decrease in net assets	$ (170,850)	$ (69,973)
Adjustments to reconcile decrease in net assets to net cash provided by operating activities:		
Depreciation and amortization	151,079	149,592
Asset impairment (recovery) write-down	(5,507)	53,600
Loss on disposals of land, buildings, and equipment	471	644
Contributions of property	(8,311)	(1,503)
Contributions restricted for long-term investment and capital projects	(139,428)	(96,972)
Permanently restricted investment return	(6,220)	(6,439)
Permanently restricted gain on perpetual trusts held by others and other nonoperating items	80,641	(66,401)
Net realized and unrealized losses on investments	250,413	293,751
(Increase) decrease in:		
Patient receivables, net	15,905	(7,616)
Other receivables, net	(27,223)	16,689
Prepaid expenses, deferred charges and inventories	(2,979)	(41,892)
Contributions receivable, net	(43,476)	(22,015)
Interests in perpetual trusts held by others	81,224	(66,405)
Increase (decrease) in:		
Accounts payable	25,392	14,117
Accrued payroll and employee withholdings	11,301	14,396
Deferred revenues and deposits	11,821	(21,216)
Annuity and other split-interest obligations	(11,230)	(10,696)
Accrued postretirement/postemployment and other benefit obligations	26,951	20,544
Other liabilities	539	(76,886)
Net cash provided by operating activities	240,513	75,319
Cash flows from investing activities:		
Purchases of investments	(4,704,345)	(8,186,913)
Proceeds from sales and maturities of investments	4,659,733	8,074,264
Change in collateral deposits under securities lending transactions, net	138,683	502,408
Change in obligation to return collateral under securities lending transactions, net	(138,683)	(502,408)
Purchases of land, buildings, and equipment	(264,096)	(187,600)
Proceeds from disposals of land, buildings, and equipment	11,464	5,152
Sale of equity investment in joint venture	2,163	…
Disbursements for loans to students	(5,484)	(6,269)
Repayments of loans by students	6,831	5,442
(Increase) decrease in deposits with bond trustees	(40,301)	11,048
Net cash used in investing activities	(334,035)	(284,876)
Cash flows from financing activities:		
Contributions restricted for long-term investment and capital projects	139,428	96,972
Permanently restricted investment return	6,220	6,439
Permanently restricted gain on perpetual trusts held by others and other nonoperating items	(80,641)	66,401
Payments of notes and bonds payable	(105,272)	(9,553)
Proceeds from borrowings	218,433	22,654
Net cash provided by financing activities	178,168	182,913
Net increase (decrease) in cash and cash equivalents	84,646	(26,644)
Cash and cash equivalents at beginning of year	148,158	174,802
Cash and cash equivalents at end of year	$ 232,804	$ 148,158
Supplemental disclosure of cash flow information:		
Cash paid for interest (net of amounts capitalized)	$ 30,762	$ 38,409

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

OVERVIEW OF DUKE UNIVERSITY

Duke University (Duke) is a private, coeducational, not-for-profit institution of higher education, and research located primarily in Durham, North Carolina. Duke is governed by a Board of Trustees with thirty-seven members, consisting of the President of Duke and thirty-six members drawn from private, public, and community interests. Duke's educational programs include undergraduate and graduate programs in Arts and Sciences and Engineering and professional schools in Business, Medicine, Law, Divinity, Environment, and Nursing. The Duke University Medical Center, consisting of the School of Medicine, the School of Nursing, programs in Allied Health, and, through contract, the Private Diagnostic Clinic, PLLC, is an integral part of Duke. The School of Medicine receives extensive support from extramural grants and contracts.

Duke University Health System, Inc. (DUHS) is a North Carolina nonprofit corporation organized and controlled by Duke, operating health care facilities including Duke University Hospital, Durham Regional Hospital, Raleigh Community Hospital, and related health care clinics. (See Note 2).

The Private Diagnostic Clinic, PLLC (PDC) is a professional limited liability company consisting of physicians practicing primarily within DUHS facilities and contiguous PDC clinics. The purpose of the company is to provide a structure separate from Duke in which the members of the physician faculty of the Duke University School of Medicine may engage in the private practice of medicine while serving as members of the faculty of Duke conducting clinical teaching and medical research. Under a year-to-year contract between the PDC and Duke, the PDC: (1) reimburses Duke for the cost of employees, goods, and services furnished by Duke to the PDC; (2) pays a portion of its gross professional fee collections to Duke which are used to support academic programs in the clinical departments of the Duke University School of Medicine; and (3) pays a portion of its gross professional fee collections to Duke which are used for renovation, renewal, and replacement of capital assets within the Duke University Medical Center. These payments (excluding reimbursement amounts described in (1) above) are compensation for the use of space, facilities and equipment within the Medical Center, and for the goodwill derived from the association with Duke, and they totaled $71,604 and $58,501 (including $16,318 and $13,379 paid to DUHS and auxiliary enterprises) for the fiscal years ended June 30, 2002 and 2001, respectively.

Duke receives substantial support from The Duke Endowment, one of the nation's largest private foundations, in the forms of operating income and discretionary grants. Established in 1924 by James Buchanan Duke, The Duke Endowment is a charitable trust created to promote philanthropic purposes by making grants for educational, health care, child care, and religious purposes within North and South Carolina. The trust assets are held and controlled by a group of independent trustees, and Duke has no equity interest in the principal of the trust. The fair value of the assets of the trust at June 30, 2002 approximated $2.5 billion. Duke is the principal beneficiary of The Duke Endowment.

While Duke and The Duke Endowment have a common heritage, each having been founded through the generosity of James Buchanan Duke, they are two separate entities, each with its own purposes and each with its own officers, trustees, and investment management. The Duke Endowment is required by its indenture to distribute to Duke a certain amount of income from the Original Corpus, Corpus Item VIII and Corpus Item XI, subject to a limited right to withhold by The Duke Endowment's trustees, which right has never been exercised. At June 30, 2002 and 2001, the portion of The Duke Endowment from which Duke derives unrestricted income had a fair value of $472,804 and $545,118, respectively, and is recognized as an asset in Duke's consolidated balance sheet. The Duke Endowment's indenture provides for additional trustee discretion with respect to the disbursement of Endowment income to beneficiaries other than Duke and to Duke out of accounts other than the Original Corpus, Corpus Item VIII and Corpus Item XI. For the fiscal years ended June 30, 2002 and 2001, Duke received total distributions from The Duke Endowment of $32,185 and $37,197, respectively, which are included in investment return designated for current operations and contributions in the accompanying consolidated statement of activities.

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. BASIS OF PRESENTATION

The consolidated financial statements include all educational and research programs of Duke (The University) and all divisions of DUHS. The consolidated financial statements have, in all material respects, been prepared on the accrual basis. The preparation of consolidated 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 consolidated financial statements and revenues and expenses during the reporting period. Actual results could differ from those estimates.

B. NET ASSETS

Net assets and revenues, expenses, gains and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of Duke are classified and reported as follows:

Permanently restricted - Net assets subject to donor-imposed stipulations that they be maintained permanently by Duke. Generally, the donors of these assets permit Duke to use all or part of the income earned on related investments for general or specific purposes.

Temporarily restricted - Net assets subject to donor-imposed stipulations that may or will be met either by actions of Duke and/or the passage of time.

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

Revenues from sources other than contributions and investment returns are reported as increases in unrestricted net assets. Contributions are reported as increases in the appropriate category of net assets, except that contributions which impose restrictions that are met in the same fiscal year they are received are included in unrestricted revenues. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments are reported as increases or decreases in

unrestricted net assets unless their use is restricted by explicit donor stipulations. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from temporarily restricted net assets to unrestricted net assets. Temporary restrictions on gifts to acquire long-lived assets are considered met in the period in which the assets are acquired or placed in service.

Contributions, including unconditional promises to give, are recognized as revenues in the period received. Contributions received for capital projects or permanent or term endowment funds and contributions under split-interest agreements or perpetual trusts are reported as nonoperating revenues. All other contributions are reported as operating revenues. Conditional promises to give are not recognized until the conditions on which they depend are substantially met. Contributions of assets other than cash are recorded at their estimated fair value at the date of gift. Contributions to be received after one year are discounted at a risk-free rate. Amortization of the discount is recorded as additional contribution revenue and used in accordance with donor-imposed restrictions, if any, on the contributions. Allowance is made for uncollectible contributions based upon management's judgment and analysis of the creditworthiness of the donors, past collection experience and other relevant factors.

Unrestricted net assets are those which are not subject to donor-imposed restrictions. Certain net assets classified as unrestricted are designated for specific purposes or uses under various internal operating and administrative arrangements of Duke.

Temporarily restricted net assets consist of the following at June 30:

	2002	2001
Contributions for instruction, research, divisional support and physical plant	$ 93,733	$ 106,369
Annuity and other split-interest agreements	30,754	28,666
	$ 124,487	$ 135,035

Permanently restricted net assets consist of the following at June 30:

	2002	2001
Permanent endowment funds for instruction, research and student aid	$ 635,927	$ 583,092
Contributions receivable for permanent endowment funds, net	113,190	96,823
Interests in perpetual trusts held by others	553,339	634,563
Student loan funds	16,724	15,928
	$ 1,319,180	$ 1,330,406

C. CASH AND CASH EQUIVALENTS

Short-term investments with maturities at dates of purchase of three months or less are classified as cash equivalents, except that any such investments purchased with funds on deposit with bond trustees or with funds held in trusts or by external endowment investment managers are classified with the deposits and investments, respectively. Cash equivalents include short-term U.S. Treasury securities and other short-term, highly liquid investments and are carried at fair value.

Cash and cash equivalents consist of the following at June 30:

	2002	2001
Cash in banks	$ 54,370	$ 34,543
Short-term investments	178,434	113,615
Total	$ 232,804	$ 148,158

D. SECURITIES LENDING TRANSACTIONS

Under FASB Statement No. 140 "Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities," Duke is required to recognize cash received as collateral for assets transferred to brokers in security lending transactions along with the obligation to return the cash. At June 30, 2002 and 2001, Duke held $363,725 and $502,408 of cash as collateral deposits. The collateral is included as both an asset and a liability in Duke's financial statements. The securities on loan had an estimated fair value of $410,970 and $491,723, respectively.

E. INVESTMENTS

Duke Management Company (DUMAC), a separate nonprofit support corporation organized and controlled by Duke, is responsible solely for managing Duke's investment assets. Investments are generally recorded at fair value. In the case of certain less marketable investments, principally real estate and private equity investments, value is established based on either external events which substantiate a change in value or a reasonable methodology that exists to capture and quantify changes in value. Otherwise, such investments are carried at cost. In some instances, those changes in value may require use of estimates.

Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market for the investments existed.

Duke's investments include various types of investment securities and investment vehicles. Investment securities are exposed to several risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in Duke's consolidated financial statements and schedules.

Duke utilizes three investment pools to invest its funds. Participation in or withdrawal from the Long Term and Intermediate Term Pools is based on the fair value per unit at various specified dates during the year. The Long Term Pool invests in a diversified portfolio of debt, equity, and other investments. The Intermediate Term Pool invests principally in fixed income securities rated as investment grade or higher. Both the Long Term Pool and Intermediate Term Pool are included in investments in the consolidated balance sheets.

The Institutional Reinvestment Account (IRA) contains both current and other short-term funds of Duke and its departments. The IRA can invest in the Long Term Pool of Duke, subject to certain restrictions. All remaining assets are invested in a Short Term Account which invests principally in fixed income securities and maintains a weighted average quality rating of AA or better as measured by Moody's and Standard and Poor's rating agencies and an average portfolio duration of one year or less. These funds are classified as investments or cash equivalents in the consolidated balance sheet, depending on maturity duration at the date of purchase.

Duke utilizes the total return concept (income yield and appreciation) in the management of its endowment. Duke has implemented a spending policy designed to stabilize annual spending levels and preserve the real value of the endowment over time. In accordance with Duke's policy, a predetermined endowment spending rate consistent with Duke's total return objective has been established.

Should endowment yields prove to be insufficient to support this policy, the balance is provided from capital gains. Should endowment yields exceed the amounts necessary to maintain this objective, the balance is reinvested in the endowment (in the form of increased fair value). The endowment spending rate for both years ended June 30, 2002 and 2001 was 5.5%, calculated as a percentage of the average of the unit market value for the previous three calendar year ends.

Investment return included in operating revenues consists of income and realized gains and losses on investments of working capital and nonpooled endowment funds and the annual distribution of income and realized gains for pooled endowment funds approved by the Board of Trustees. Any excess of income and realized gains earned over the distributed amount for pooled endowment funds, unrealized gains and losses on endowment funds, and income on investments held under split-interest agreements are reported as nonoperating revenues.

F. DEPOSITS WITH BOND TRUSTEES

Deposits with bond trustees consist of debt service reserve funds and the unexpended proceeds of certain bonds payable and commercial paper notes. These funds are invested in short-term, highly liquid securities and will be used for construction of certain facilities or payment of debt service.

G. LAND, BUILDINGS, AND EQUIPMENT

Land, buildings, and equipment are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. Depreciation is calculated on the straight-line basis over the estimated useful lives of the respective assets except for land, art collections, and construction in progress, which are not depreciated. Interest on borrowings to finance facilities is capitalized during construction, net of any investment income earned through the temporary investment of project borrowings. Total interest expense of $3,517 was capitalized in 2002 and none was capitalized in 2001.

Land, buildings, and equipment, net, is summarized as follows at June 30:

	2002	2001
Land and land improvements	$ 104,982	$ 98,994
Buildings and utilities	1,390,117	1,323,427
Equipment, furniture and vessels	827,074	789,061
Library and art collections	201,764	187,437
Construction in progress	219,635	111,795
	2,743,572	2,510,714
Less accumulated depreciation	(1,384,576)	(1,266,313)
	$ 1,358,996	$ 1,244,401

H. INTERESTS IN PERPETUAL TRUSTS HELD BY OTHERS

Interests in perpetual trusts held by others are assets held and administered by outside trustees from which Duke derives income or residual interest. Interests in perpetual trusts held by others, which includes The Duke Endowment, are reported as permanently restricted net assets at their fair value of $553,339 and $634,563 at June 30, 2002 and 2001, respectively. This approximates the present value of future income flows from these trusts adjusted for fair value appreciation and depreciation. Duke's interests in perpetual trusts held by others generated $18,654 and $21,366 of income distributions for the years ended June 30, 2002 and 2001, respectively (including $15,868 and $18,501 from The Duke Endowment). Income distributions from these trusts are recorded as investment return designated for current operations and contributions when received.

I. GOODWILL

Goodwill represents excess of cost over fair value related to DUHS's business acquisitions and affiliations with other regional health care providers. The assets and liabilities of acquired entities were adjusted to estimated fair values as of the acquisition dates. The amounts recorded as excess of cost over fair value of net assets acquired (goodwill) represent amounts paid that exceed estimated fair values assigned to the assets and liabilities of each acquired business. Such amounts are being amortized on a straight-line basis over periods ranging from twenty to thirty years. Duke assesses the recoverability of the excess of cost over the assigned value of net assets acquired by determining whether the amortization of the balance over its remaining life can be recovered through undiscounted future operating cash flows of the acquired operations. Accumulated amortization for the years ended June 30, 2002 and 2001 was $17,572 and $12,885, respectively.

J. SPLIT-INTEREST AGREEMENTS

Duke's split-interest agreements with donors consist primarily of irrevocable charitable remainder trusts for which Duke serves as trustee. Assets held in these trusts are included in investments. Contribution revenues are recognized at the date the trusts are established. Annuity and other split-interest obligations are adjusted annually at the end of each fiscal year.

K. SPONSORED RESEARCH

Research grants and contracts normally provide for the recovery of direct and facilities and administrative costs, subject to adjustment based upon review by the granting agencies. Duke recognizes revenue associated with direct costs as the related costs are incurred. The recovery of facilities and administrative costs is recorded at predetermined rates negotiated with the federal government through the fiscal year ended June 30, 2003. Facilities and administrative cost recovery revenues for the academic and support divisions of Duke were $101,885 and $88,061 in fiscal years 2002 and 2001, respectively.

L. AUXILIARY ENTERPRISES

Auxiliary enterprises, including residence halls, food services, retail stores, and the Duke University Telecommunications Center, furnish services to students, faculty, and staff. Fee charges are directly related to the costs of services rendered.

M. INCOME TAXES

Duke is exempt from federal income taxes on related income under Section 501(c)(3) of the Internal Revenue Code. Accordingly, no provision for income taxes is made in the consolidated financial statements.

N. PRIOR YEAR SUMMARIZED FINANCIAL INFORMATION

The financial statements include certain prior-year summarized comparative information which does not include sufficient detail to constitute a presentation in conformity with accounting principles generally accepted in the United States of America. Accordingly, such information should be read in conjunction with Duke's financial statements for the year ended June 30, 2001 from which the summarized information was derived.

O. RECLASSIFICATIONS

Certain June 30, 2001 amounts have been reclassified to conform with changes in classifications adopted in fiscal year 2002.

2. DUKE UNIVERSITY HEALTH SYSTEM, INC.

The financial position and results of operations of DUHS are consolidated into the financial results of Duke for corporate financial reporting under accounting principles generally followed by colleges and universities. All significant intercompany balances and transactions have been eliminated in consolidation. DUHS consists of:

- Duke University Hospital - a tertiary care teaching hospital licensed for 1,019 beds, leased from Duke, operated by DUHS and recognized nationally and internationally for excellence in patient care, medical education, and clinical research.

- Durham Regional Hospital – a full-service community hospital licensed for 391 acute care beds, leased by DUHS from Durham County for twenty years effective July 1, 1998.

- Raleigh Community Hospital – a community hospital licensed for 205 acute care beds, owned and operated by DUHS.

- Associated Health Services, Inc. (AHS) – an outpatient surgery facility licensed for eight operating rooms, doing business as the James E. Davis Ambulatory Surgical Center. Under the terms of DUHS' lease of Durham Regional Hospital, DUHS nominates and appoints a majority of the Board of Directors of AHS.

- Duke University Affiliated Physicians, Inc. (DUAP) – fourteen primary care physician practices, including one urgent care center, and two pediatric practices. Effective May 31, 2002, DUAP sold its interest in its sole OB/GYN practice (See Note 9).

- Duke Health Community Care, Inc. (DHCC) – consisting of:
  - ⇛ Duke Community Infusion Services, a full-range home infusion therapy program that provides administration of intravenous medications in the patient's home.
  - ⇛ Duke Community Hospice Services, providing hospice services in homes, long term care facilities and a six bed inpatient facility.
  - ⇛ Duke Community Bereavement Services, offering a full range of bereavement services, including critical incident debriefings, to persons of all ages who have suffered a loss due to death.
  - ⇛ Duke Community Home Health Services, providing nursing, wound care, rehabilitation and home health aide services in patients' homes.
  - ⇛ Equity investment in Duke and St. Joseph Home Care, LLC (DSJHC), a 50/50 joint venture with St. Joseph of the Pines to operate a home health and hospice service. On June 30, 2002, DSJHC sold substantially all of its assets to an unrelated third party, resulting in a $5,507 recovery of previously recognized asset impairment (See Note 10).

- Duke PRMO, LLC (PRMO) – a limited liability company established to manage the billing and accounts receivable activity of DUHS and the PDC.

- Duke Medical Strategies, Inc. (DMS) – a for-profit subsidiary of Duke that consisted solely of WellPath Community Health Plan, LLC (WellPath), a regional health care management and benefits company, operated by DMS. Accordingly, DUHS included results of operations from DMS and its subsidiaries in its combined financial statements. On October 2, 2000, the entire interest in WellPath was sold (See Note 9).

- Durham Casualty Company, Ltd. (DCC) – a wholly owned subsidiary of DUHS, insuring a portion of the medical malpractice risks of DUHS clinical providers and the PDC. Previously domiciled in Barbados, DCC relocated to Bermuda effective December 2001. Concurrent with the relocation, DCC changed its fiscal year to coincide with that of DUHS.

- Health System Medical Strategies, Inc. (HSMS) – a for-profit subsidiary of DUHS consisting of:
  - ⇛ Equity investment in Galloway Ridge Associates, LLC (GRA), which was established to develop a continuing care retirement community. GRA sold substantially all of its assets as of October 31, 2001 to a third party independent of DUHS. This third party will develop, construct, and own the facility. HSMS will continue to participate in the project through various contracts which provide fee revenue to HSMS.
  - ⇛ Duke Health Direct LLC, established to develop a provider network for employers with self-funded employee health care benefit programs.

DUHS records patient service revenue net of contractual adjustments and discounts and allowances. Third party contractual revenue adjustments under governmental reimbursement programs, including Medicare and Medicaid, are accrued on an estimated basis in the period the related services are rendered. The estimated amounts are adjusted to actual during the year that final settlement is determined by the fiscal intermediary for each program. DUHS receivables are reported net of allowances for contractual adjustments and uncollectible accounts of $120,752 and $188,263 at June 30, 2002 and 2001, respectively.

DUHS presents certain income items such as investment income and unrestricted gifts as non-operating income in their combined statement of operations. These items are reclassified as operating income to conform to financial statement presentation generally followed by colleges and universities.

The amounts reported by DUHS in their Combined Statements of Operations are reconciled to the amounts included in Duke's Consolidated Statement of Activities as follows:

	2002	2001
Total operating revenue per DUHS's Combined Statement of Operations	$ 1,278,331	$ 1,197,546
Reclassification of investment returns, contributions, and other items reported as non-operating items in DUHS's Combined Statement of Operations	18,370	32,922
DUHS operating revenues and support included in Duke's Consolidated Statement of Activities	$ 1,296,701	$ 1,230,468
Total operating expenses per DUHS's Combined Statement of Operations	$ 1,262,781	$ 1,192,025
Other adjustments	(104)	891
Asset impairment write-down (recovery)	(5,507)	53,600
DUHS operating expenses included in Duke's Consolidated Statement of Activities	$ 1,257,170	$ 1,246,516
Non-operating income per DUHS's Combined Statement of Operations	$ 21,328	$ 26,670
Reclassification of investment returns, contributions, and other items reported as non-operating items in DUHS's Combined Statement of Operations	(18,370)	(32,922)
Reclassification of net unrealized gains and losses on investments, changes in restricted net assets, and other items not included in income from continuing operations in DUHS's Combined Statement of Operations	(71,026)	(65,986)
DUHS nonoperating activities included in Duke's Consolidated Statement of Activities	$ (68,068)	$ (72,238)

3. CONTRIBUTIONS RECEIVABLE

Contributions receivable, net, are summarized as follows at June 30:

	2002	2001
Unconditional promises expected to be collected in:		
Less than one year	$ 76,498	$ 106,293
Between one year and five years	181,196	128,647
More than five years	4,944	11,925
	262,638	246,865
Less unamortized discount at 7.5%	(16,988)	(16,809)
Less allowance for uncollectible amounts	(33,812)	(61,694)
Total	$ 211,838	$ 168,362

At June 30, 2002 and 2001, Duke had also received bequest intentions and certain other conditional promises to give of approximately $43,811 and $43,521, respectively. These intentions and conditional promises to give are not recognized as assets and, if they are received, they will generally be restricted for specific purposes stipulated by the donors, primarily endowments for faculty support, scholarships or general operating support of a particular department or division of Duke.

4. INVESTMENTS

The fair value of investments consists of the following at June 30, 2002 and 2001:

	Long Term Pool	Intermediate Term Pool	Non-Pooled Assets	Short Term Account	2002 Total	2001 Total
Short-term investments	$ 30,892	$ 248	$ 14,765	$ …	$ 45,905	$ 91,990
U.S. government securities	231,619	7,342	11,100	40,393	290,454	323,368
Real estate	185,449	…	4,704	…	190,153	188,758
Domestic bonds and long-term notes	148,410	5,313	29,903	251,517	435,143	415,495
Domestic stocks	488,584	…	57,481	…	546,065	725,319
International stocks	479,383	…	8,134	…	487,517	445,343
International bonds and long-term notes	32,135	999	5	19,317	52,456	51,001
Private equity	412,310	…	10,009	…	422,319	518,023
Absolute return strategies	478,801	…	7,779	…	486,580	469,182
Inflation hedges	248,271	…	…	…	248,271	296,994
Other investments	470,795	…	18,047	…	488,842	374,033
Totals	$ 3,206,649	$ 13,902	$ 161,927	$ 311,227	$ 3,693,705	$ 3,899,506

Duke's investment activity for the year ended June 30 is as follows:

	2002	2001
Net realized (loss) gain from sales of investments	$ (53,679)	$ 666,078
Decrease in unrealized appreciation	(196,734)	(959,829)
Total net loss	(250,413)	(293,751)
Investment income	103,733	120,394
Total loss	(146,680)	(173,357)
Included in the consolidated statement of activities as:		
Investment return designated for current operations:		
Endowment spending	(86,881)	(79,619)
Investment income	(82,999)	(117,410)
Auxiliary enterprises	(580)	(3,125)
Investment return in deficit of amounts designated for current operations	$ (317,140)	$ (373,511)

The total return for the Long Term Pool (in which 95.5% and 96.2% of Duke's endowment was invested at June 30, 2002 and 2001, respectively) for the years ended June 30, 2002 and 2001 was (3.8)% and (4.6)%, net of external management fees but before internal costs. The total return for Duke's endowment, as such, is not calculated. Duke's traditionally defined endowment and similar funds consist of the following at June 30:

	2002	2001
Permanent endowment funds	$ 1,460,409	$ 1,530,554
Funds functioning as endowment	913,730	966,257
Charitable remainder funds	66,739	79,713
Total	$ 2,440,878	$ 2,576,524

Investment management fees totaled $17,988 and $18,370 in fiscal years 2002 and 2001, respectively. In 2002, $7,360 was internal and $10,628 was external and in 2001, $6,876 was internal and $11,494 was external.

5. NOTES AND BONDS PAYABLE

Notes and bonds payable at June 30 consist of the following:

	2002	2001
Duke University Health System Revenue Bonds:		
Series 1985 B – payable in annual sinking fund installments of $8,700 from 2011 through 2015, with interest at a variable rate not to exceed 20% (actual interest rate at June 30, 2002 was 1.20%)	$ 43,500	$ 43,500
Series 1985 C – payable in sinking fund installments of $5,600 in 2011; $5,700 in 2012, 2013, and 2014; and $5,785 in 2015, with interest at a variable rate not to exceed 20% (actual interest rate at June 30, 2002 was 1.20%)	28,485	28,485
Series 1985 D – payable in sinking fund installments of $1,100 in 2011 and 2012; $1,200 in 2013 and 2014; and $1,330 in 2015, with interest at a variable rate not to exceed 20% (actual interest rate at June 30, 2002 was 1.20%)	5,930	5,930
Series 1993 A – payable in sinking fund installments ranging from $5,160 to $6,330 from 2019 to 2023, with interest at a variable rate (actual interest rate at June 30, 2002 was 1.20%) (See Note 6)	28,650	28,650
Series 1996 C – payable in sinking fund installments ranging from $2,248 to $11,055 through 2026, with fixed interest rates varying from 4.63% to 5.6% (average interest rate at June 30, 2002 was 4.72%)	108,719	112,149
Series 1998 A – payable in sinking fund installments ranging from $280 to $13,675 through 2028, with fixed interest rates varying from 4.1% to 5.0% (average interest rate at June 30, 2002 was 4.79%)	82,450	82,725
Series 1998 B – payable in sinking fund installments ranging from $855 to $19,690 through 2028, with fixed interest rates varying from 4.0% to 5.13% (average interest rate at June 30, 2002 was 4.83%)	187,775	191,780
Duke University Health System Taxable Bonds:		
Series 1996 A – payable in annual installments ranging from $1,220 to $1,935 through 2007, with fixed interest rates varying from 6.05% to 6.38% (average interest rate at June 30, 2002 was 6.17%)	8,655	10,635

	2002	2001
Duke University Revenue Bonds:		
Series 1987 A – payable in sinking fund installments of $6,000 in 2015 and 2016, and $6,900 in 2017, with interest at a variable rate not to exceed 20% (actual interest rate at June 30, 2002 was 1.00%)	18,900	18,900
Series 1988 A – payable in one principal installment of $260 in 2004 (cumulative interest in the amount of $593 due with principal installment)	260	260
Series 1991 B – payable in annual sinking fund installments of $8,000 from 2017 to 2021, with interest at a variable rate (actual interest rate at June 30, 2002 was 1.00%)	40,000	40,000
Series 1992 A – payable in sinking fund installments of $7,000 from 2023 to 2026, and $7,240 in 2027, with interest at a variable rate (actual interest rate at June 30, 2002 was 1.00%)	35,240	35,240
Series 1996 B – payable in sinking fund installments ranging from $990 to $1,890 through 2017, with fixed interest at rates varying from 4.25% to 5.0% (average interest rate at June 30, 2002 was 4.79%)	20,695	21,645
Series 2001 A – payable in sinking fund installments of $32,310 in 2026, $35,000 in 2039 and 2040, and $76,030 in 2041, with fixed interest rates of 5.13% and 5.25% (average interest rate at June 30, 2002 was 5.16%)	178,340	---
Series 1991 C – repaid in 2002	---	32,425
Notes Payable:		
Taxable commercial paper note and tax-exempt bond anticipation program, $300,000 authorized:		
Taxable issue, weighted average maturity and interest rate at June 30, 2002 of 9.7 days and 1.84%, respectively	50,000	72,000
Tax-exempt issue, weighted average maturity and interest rate at June 30, 2002 of 38 days and 1.36%, respectively	5,558	---
6.49% unsecured mortgage note, payable in monthly installments of $45, including interest, through 2005	1,277	1,719
Various notes and capital leases	27,694	26,413
Total notes and bonds payable	872,128	752,456
Less unamortized discount	(12,595)	(6,480)
Net notes and bonds payable	$ 859,533	$ 745,976

Aggregate maturities of notes and bonds payable (excluding commercial paper) for each of the five fiscal years subsequent to June 30, 2002 are as follows: $12,526 in 2003; $12,131 in 2004; $11,672 in 2005; $12,710 in 2006; and $11,598 in 2007.

Duke capitalizes and amortizes on a straight-line basis the original issue discount and issue costs related to applicable bond issues. At June 30, 2002 and 2001, unamortized bond issue costs of $4,945 and $3,243 are included in Duke's consolidated balance sheet, respectively, and unamortized original issue discount on related bonds of $12,595 and $6,480 is included in notes and bonds payable in Duke's consolidated balance sheet, respectively. Total amortization expense for issue costs and discount was $514 and $358 for the years ended June 30, 2002 and 2001, respectively.

Duke had $11,345 at June 30, 2002 and 2001 in a debt service reserve fund designated to meet scheduled principal and interest payments on the Series 1985B, 1985C and 1985D DUHS Revenue Bonds. These amounts are included in deposits with bond trustee in the accompanying consolidated balance sheet at June 30, 2002 and 2001.

In prior fiscal years DUHS defeased certain obligations by irrevocably placing assets with a trustee to pay principal and interest on the obligations as they become due. The outstanding balance of the defeased obligations was $11,040 and $13,800 at June 30, 2002 and 2001, respectively.

The DUHS revenue and taxable bonds are collateralized by the revenues and assets of DUHS.

Trust indentures underlying DUHS Revenue Bonds, DUHS Taxable Bonds, and the University Revenue Bonds contain certain covenants and restrictions, all of which have been complied with at June 30, 2002 and 2001.

6. DERIVATIVE AND OTHER FINANCIAL INSTRUMENTS

Duke has limited involvement with derivative financial instruments and does not use them for trading purposes. In the normal course of its business, DUHS entered into a long-term interest rate swap agreement having a notional amount of $28,650 which effectively fixed the interest rate on the Series 1993A variable rate bond issue at 5.09% through June 1, 2023 (See Note 5). DUHS receives amounts based on Tax-Exempt Note Rate (TENR) and makes payments at 5.09% and settles with the counterparty on a quarterly basis. TENR is the interest rate index used as a basis for repricing the Series 1993A variable rate bonds. DUHS selected the combination of a variable rate bond issue and a thirty-year interest rate swap agreement to obtain fixed rate financing at the lowest available cost at the time of the transaction. The fair value is the estimated amount the bank would receive or pay to terminate the swap agreement at the reporting date, taking into account current interest rates and the current creditworthiness of the swap counterparties. The fair value of the interest rate swap included in accounts payable was $1,949 and $478 at June 30, 2002 and 2001, respectively. DUHS is exposed to credit loss in the event of nonperformance by the counterparty to its long-term interest rate swap. DUHS obtained (and deposited, as required) $2,000 in cash and securities collateral to support the long-term interest rate swap.

On July 3, 2001, DUHS entered into a basis swap agreement, effective July 6, 2001, having an effective notional amount of $400,000. DUHS receives amounts based on 72.125% of one-month London Interbank Offered Rate (LIBOR) and makes payments at Bond Market Association Municipal Swap Index (BMA) and settles with the counterparty on a semi-annual basis. The basis swap carries a 20-year term. DUHS entered into the basis swap as a hedging technique to reduce the interest rate risk on variable rate indebtedness by utilizing the spread between the yield curves for taxable debt securities and tax-exempt municipal debt securities. The basis swap does not qualify for hedge accounting. The net settlement amount earned on the swap during the year ended June 30, 2002 of $462 is included in operating income. The fair value of the basis swap is the estimated amount DUHS would receive or pay to terminate the swap agreement at the reporting date, taking into account interest rates, the current creditworthiness of the swap counterparties and other variables. The fair value of the basis swap included as an unrealized loss in investment return and accounts payable was $15,610 at June 30, 2002. DUHS is exposed to risk of non-performance by the counterparty and interest rate risk driven by factors influencing the spread between the taxable and tax-exempt market interest rates. DUHS monitors the credit standing of its counterparties.

Investment strategies employed by DUMAC incorporate the use of various derivative financial instruments with off-balance-sheet risk. These include exchange contracts, equity futures, equity options, and swap agreements. Such financial instruments as of June 30, 2002 had a fair value of $(9,176) and a notional value of $65,000. There were no such derivative financial instruments as of June 30, 2001. DUMAC uses these instruments for a number of investment purposes, including hedging or altering exposure to certain asset classes and cost-effectively adding exposures as required to portions of the portfolio. Positions are expected to create gains or losses, that when combined with the applicable portion of the total investment portfolio, provides an expected result. The portfolio is exposed to certain counterparty credit risks associated with these instruments. DUMAC controls this counterparty credit risk by considering the credit rating, business risk, and reputation of any counterparty before entering into a transaction, monitoring for any change in the credit standing of its counterparty during the life of the transaction, and requiring collateral to the maximum extent possible under normal trading practices.

7. PENSION AND OTHER POSTRETIREMENT BENEFIT PLANS

Faculty and staff members of Duke are eligible to participate in a contributory defined contribution pension plan. For the years ended June 30, 2002 and 2001, Duke contributed $48,379 and $42,906, respectively, to this plan.

In addition, Duke has a noncontributory defined benefit pension plan for its other full-time employees. Pension income for this plan for the years ended June 30, 2002 and 2001 amounted to $4,262 and $19,663, respectively. The benefits for the defined benefit plan are based on years of service and the employee's compensation during the last ten years of employment.

Duke also sponsors an unfunded, defined benefit postretirement medical plan that covers all its full time employees who elect coverage and satisfy the plan's eligibility requirements when they retire. The plan is contributory with retiree contributions established as a percentage of the total cost for retiree health care and for the health care of their dependents. Duke pays all benefits on a current basis. Effective January 1, 2002, the plan benefits were changed to reduce Duke's percentage contribution to the total cost of plan benefits, subject to a "grandfather" schedule for existing retirees and employees. The effect of this change is included in the calculation of Duke's liability and cost for the plan. In June 2002, additional benefit changes were approved by the DUHS Board of Directors to be effective July 1, 2002. The changes, which affect DUHS employees only, include increasing eligibility requirements, effectively reducing the number of employees who will receive benefits. As the change was approved subsequent to the measurement date, the estimated curtailment gain of $7,633 will be reflected in fiscal year 2003. Periodic expense related to the Plan is expected to decrease in future years. As a healthcare provider, Duke utilizes an incremental cost approach to determine its liability for the postretirement medical plan. The total liability reflects estimated additional costs to provide healthcare benefits to retirees within DUHS plus the full cost to provide healthcare benefits to retirees at facilities other than DUHS facilities.

The following tables provide a reconciliation of the changes in the plans' benefit obligations and fair value of assets :

	Pension Benefits		Postretirement Benefits	
	2002	2001	2002	2001
Reconciliation of benefit obligation				
Obligation at July 1	$ 372,754	$ 337,702	$ 226,110	$ 196,010
Service cost	22,422	21,384	8,964	10,973
Interest cost	28,293	25,120	13,558	15,128
Plan amendments	...	15,050	(39,848)	...
Actuarial (gain) loss	12,075	(10,993)	(24,614)	9,318
Benefit payments	(10,255)	(14,009)	(4,348)	(5,319)
Change in measurement date	(12,304)	...	(3,872)	...
Administrative expenses (estimated)	(1,500)	(1,500)	...	...
Obligation at June 30	$ 411,485	$ 372,754	$ 175,950	$ 226,110
Reconciliation of fair value for plan assets				
Fair value of plan assets at July 1	$ 656,696	$ 703,702	...	...
Actual return on plan assets	(18,480)	(33,738)	...	...
Employer contributions	...	2,114	...	...
Participant contributions	68	105	...	...
Benefit payments	(10,255)	(14,009)	...	...
Administrative expenses	(1,002)	(1,478)	...	...
Fair value of plan assets at measurement date	$ 627,027	$ 656,696	...	...
Funded status				
Funded status at June 30	$ 215,542	$ 283,942	$ (175,950)	$ (226,110)
Unrecognized transition (asset)	(3,133)	(4,557)	...	...
Unrecognized prior-service cost	32,019	35,153	(33,853)	5,013
Unrecognized (gain) loss	(219,136)	(293,509)	(15,879)	12,607
Accrued benefit liability / net amount recognized	$ 25,292	$ 21,029	$ (225,682)	$ (208,490)

The following table provides the components of net periodic benefit cost for the plans for fiscal years 2002 and 2001:

	Pension Benefits		Postretirement Benefits	
	2002	2001	2002	2001
Service cost	$ 22,422	$ 21,384	$ 8,964	$ 10,973
Interest cost	28,293	25,120	13,558	15,128
Expected return on plan assets	(49,192)	(53,003)	...	...
Amortization of transition (asset)	(1,424)	(1,424)	...	...
Amortization of prior-service cost	3,134	3,134	(982)	617
Amortization of net loss	(7,391)	(14,773)	...	...
Employee contributions	(104)	(101)	...	...
Net periodic benefit cost (income)	$ (4,262)	$ (19,663)	$ 21,540	$ 26,718

The prior-service costs are amortized on a straight-line basis over the average remaining service period of active participants. Gains and losses in excess of 10% of the greater of the benefit obligation and the market-related value of assets are amortized over the average remaining service period of active participants.

The assumptions used in the measurement of Duke's benefit obligation are shown in the following table:

	Pension Benefits		Postretirement Benefits	
	2002	2001	2002	2001
Weighted average assumptions as of measurement date				
Discount rate	7.5%	7.5%	7.5%	7.5%
Expected return on plan assets	9.5%	9.5%	N/A	N/A
Rate of compensation increase	5.8%	5.8%	N/A	N/A

An 7.5% annual rate of increase in the per capita costs of covered health care benefits was assumed for plan participants until age 65, decreasing to an ultimate annual rate of increase of 5.0%. A 9.5% annual rate of increase in the per capita costs of covered health care benefits was assumed for plan participants age 65 and over, decreasing to an ultimate annual rate of increase of 5.0%.

Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

	1% Increase	1% Decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	$ 6,363	$ (4,716)
Effect on the health care component of the accumulated postretirement benefit obligation	$ 39,142	$ (30,265)

Duke currently provides postemployment medical and life insurance benefits to employees in receipt of long term disability income benefits. Total postemployment benefit cost of $2,960 and $288 is included as an expense in fiscal 2002 and 2001, respectively, and the June 30, 2002 and 2001 consolidated balance sheet includes a liability of $10,055 and $8,827, respectively, for accrued postemployment benefit cost.

The measurement date for the defined benefit plan and the postretirement and postemployment benefit plans was moved from the fiscal year end to March 31 to improve the internal budgeting process of Duke. The impact of this change on the consolidated financial statements is immaterial.

8. FAIR VALUE OF FINANCIAL INSTRUMENTS

The carrying amounts of cash and cash equivalents, patient receivables and other receivables approximate fair value because of the short maturity of these financial instruments. Contributions receivable and annuity and other split-interest obligations carrying amounts approximate fair value because these instruments are recorded at net present value. Investments, deposits with bond trustees, and interests in perpetual trusts held by others are reported at fair value as of the date of the consolidated financial statements. The carrying amount of student loans receivable under Duke loan programs approximates fair value.

The carrying amounts of accounts payable, accrued payrolls and employee withholdings and related accruals approximate fair value because of the short maturity of these financial instruments. The carrying amount of notes and bonds payable with variable interest rates approximates their fair value because the variable rates reflect current market rates for bonds with similar maturities and credit quality. The fair value of notes and bonds payable with fixed interest rates is based on rates assumed to be currently available for bond issues with similar terms and average maturities. The estimated fair value and carrying amount of these bonds payable at June 30, 2002 approximated $589,918 and $588,171, respectively. The estimated fair value and carrying amount of these bonds payable at June 30, 2001 approximated $447,263 and $451,619, respectively.

9. SEGMENT DISPOSAL

On May 31, 2000, DUHS executed a letter of intent between DUHS and an unrelated third party to sell the entire membership interest of WellPath Community Health Plan, LLC including all subsidiaries. DUHS had expected to incur a loss on the sale of $22,639. On October 2, 2000, DUHS completed the sale for $20,743 subject to post-closing adjustments. The sale transaction and the first settlement and reconciliation of the closing balance sheet resulted in an adjustment to the loss of $4,129 which is recorded as a gain on disposal of HMO for the year ended June 30, 2001. Final settlement and release of $1,500 in escrowed funds resulted in an adjustment to the loss of $1,530 which is recorded as a gain on disposal of HMO for the year ended June 30, 2002. The adjustments were largely due to favorable outcomes relative to original estimates of uncertainties that existed at June 30, 2000.

On May 31, 2002, DUHS entered into a settlement agreement with certain employed physicians in an OB/GYN practice. The agreement provides for a variety of payments to or on behalf of the physicians, for the sale of the practice fixed assets, and a limited non-compete covenant. From July 1, 2001 to November 28, 2001 (the measurement date), the practice incurred operating losses in the amount of $808. The total loss on disposal of the physician practice of $1,884 is comprised of operating losses of $1,391 from the measurement date to the sale date of May 31, 2002 and the net loss on the sale of the physician practice assets of $493.

10. ASSET IMPAIRMENT

In connection with management's ongoing reviews of operations, continued operating losses and negative operating cash flows triggered impairment reviews of certain operating units of DUHS in 2001. As a result of these reviews, DUHS recorded a charge of $53,600 for the write-down of goodwill and other assets related to a hospital affiliation and certain other provider operations. The amount of the charge was based on the present value of cash flows of the underlying businesses. These write-offs comprise the total asset impairment write-down of $53,600 that is included in the consolidated statement of activities for the year ended June 30, 2001. During 2002, certain of these assets were disposed of by sale for amounts in excess of their previously adjusted book value, resulting in a gain of $5,507 in the current year.

11. FUNCTIONAL EXPENSES

Expenses are reported in the consolidated statement of activities in natural categories. Functional expenses for each of the years ended June 30, 2002 and 2001 were categorized as follows:

	2002	2001
Instruction and departmental research	$ 421,529	$ 410,861
Sponsored and separately budgeted research	364,925	313,174
Libraries	29,624	28,047
Student services	33,954	33,545
General administration	83,373	94,150
Student aid	19,824	16,594
Health care services	1,257,170	1,246,516
Auxiliary enterprises	117,364	112,439
Other	88,947	87,287
Total operating expenses	$ 2,416,710	$ 2,342,613

Functional expenses are shown in categories recommended by the National Association of College and University Business Officers. Duke's primary program services are instruction and departmental research, sponsored and separately budgeted research, and health care services. Expenses reported as libraries, student services, general administration, student aid, and auxiliary enterprises are incurred in support of these primary program services.

Plant operation and maintenance expense is allocated to program and supporting activities based upon periodic assessment of facilities usage. Total amounts allocated in fiscal years 2002 and 2001 are $56,822 and $55,525, respectively.

12. COMMITMENTS AND CONTINGENCIES

A. CONSTRUCTION AND PURCHASE COMMITMENTS

At June 30, 2002 and 2001, open contracts for the construction of physical properties amounted to $141,269 and $122,392, respectively, and outstanding purchase orders for normal operating supplies and equipment amounted to $66,033 and $31,066, respectively.

B. OPERATING LEASES

Duke leases various machinery, equipment and office space under operating leases expiring at various dates through December 2020. Total rental expense in fiscal years 2002 and 2001 for all operating leases was $29,261 and $30,364, respectively.

Future minimum lease payments under noncancelable operating leases as of June 30, 2002 are as follows:

Year	
2003	$ 26,425
2004	18,355
2005	13,479
2006	10,964
2007	9,582
Thereafter	67,477
Total minimum operating lease payments	**$146,282**

C. INVESTMENT COMMITMENTS

Duke is obligated under certain investment fund agreements to periodically advance additional funding up to specified levels. At June 30, 2002, Duke had future commitments of $623,340, which are likely to be called through 2007.

D. MEDICAL MALPRACTICE COVERAGE

Durham Casualty Company, Ltd. (see Note 2) insures a portion of the medical malpractice risks of Duke University Hospital, Raleigh Community Hospital, DUAP and the PDC. The assets, liabilities, and results of operations for the subsidiary have been reflected in the unrestricted net assets of DUHS. DCC has per incident and annual aggregate insurance limits. Effective January 1, 2002, DCC also insures a portion of the medical malpractice risks of Durham Regional Hospital.

E. DEBT GUARANTEE

At June 30, 2002, DUHS is a guarantor on tax-exempt Series A variable interest rate revenue bonds in the amount of $9,030 issued by the North Carolina Medical Care Commission as conduit for The United Methodist Retirement Homes, Inc.

F. SELF-INSURANCE

Duke is also self-insured for employee healthcare, long-term disability benefits, unemployment benefits, and workers compensation benefits. In the opinion of management, adequate provision has been made for related risks.

G. LITIGATION

Duke is involved in various legal actions occurring in the normal course of activities. While the final outcomes cannot be determined at this time, management is of the opinion that the resolution of these matters will not have a material effect on Duke's financial position.

13. SUBSEQUENT EVENT

In July, 2002, the North Carolina Facilities Finance Agency issued the Duke University Revenue Bonds Series 2002A in the principal amount of $121,000. The Series 2002A bonds (issued at a discount of $1,748) were issued to refund the $5,558 of tax-exempt commercial paper outstanding at June 30, 2002, and to finance the costs of constructing the Center for Interdisciplinary Engineering, Medicine and Applied Sciences and a parking structure and for renovations to the Kilgo Quadrangle Student Residences. The Series 2002A bonds were issued with an effective interest rate of 5.24%. The trust indenture contains certain ongoing covenants and restrictions.

Balance Sheet

THE UNIVERSITY (Supplementary Information)
June 30, 2002
(with summarized financial information at June 30, 2001)
(000's omitted)

	2002	2001
Assets:		
Cash and cash equivalents	$ 183,929	$ 99,737
Cash held as collateral under securities lending transactions	363,725	502,408
Other receivables, net	98,023	89,043
Prepaid expenses, deferred charges and inventories	41,816	36,045
Contributions receivable, net	208,840	163,371
Student loans receivable, net	41,245	42,592
Investments	3,081,672	3,251,601
Deposits with bond trustees	55,768	2,341
Land, buildings, and equipment, net	853,094	728,008
Interests in perpetual trusts held by others	553,339	634,563
Total assets	$ 5,481,451	$ 5,549,709
Liabilities:		
Accounts payable	$ 94,360	$ 81,313
Accrued payroll and employee withholdings	70,052	66,559
Deferred revenues and deposits	35,069	28,036
Liability under securities lending transactions	363,725	502,408
Notes and bonds payable	349,463	205,194
Annuity and other split-interest obligations	43,380	54,610
Accrued postretirement/postemployment and other benefit obligations	153,836	133,772
Other liabilities	40,878	40,339
Total liabilities	**1,150,763**	**1,112,231**
Net Assets:		
Unrestricted	2,897,459	2,978,043
Temporarily restricted	119,397	135,029
Permanently restricted	1,313,832	1,324,406
Total net assets	4,330,688	4,437,478
Total liabilities and net assets	$ 5,481,451	$ 5,549,709

The supplementary information in this schedule presents the balance sheet of Duke University exclusive of the financial position of Duke University Health System, Inc.

See accompanying Independent Auditors' Report

Statement of Activities

THE UNIVERSITY (Supplementary Information)
Year ended June 30, 2002
(with summarized financial information for the year ended June 30, 2001)
(000's omitted)

	Unrestricted Net Assets	Temporarily Restricted Net Assets	Permanently Restricted Net Assets	2002 Total	2001 Total
Operating revenues and support:					
Tuition and fees	$ 304,559	$ …	$ …	$ 304,559	$ 287,978
Less student aid	(88,798)	…	…	(88,798)	(77,525)
	215,761	…	…	215,761	210,453
Grants, contracts and similar agreements:					
Government sources	318,941	…	…	318,941	264,651
The Private Diagnostic Clinic, PLLC	55,286	…	…	55,286	45,122
Other	151,361	…	…	151,361	149,190
Total grants, contracts and similar agreements	525,588	…	…	525,588	458,963
Contributions	114,898	…	…	114,898	111,546
Investment return designated for current operations:					
The Duke Endowment	15,868	…	…	15,868	18,501
Endowment spending	82,594	…	…	82,594	76,252
Other investment income	59,851	…	…	59,851	89,258
Auxiliary enterprises	128,588	…	…	128,588	134,718
Other	59,982	…	…	59,982	65,354
Net assets released from restrictions	83,587	(83,587)	…	…	…
Total operating revenues and support	1,286,717	(83,587)	…	1,203,130	1,165,045
Operating expenses:					
Salaries and wages	590,560	…	…	590,560	530,488
Employee benefits	122,692	…	…	122,692	111,719
Net postretirement/postemployment benefit costs	12,537	…	…	12,537	12,222
Materials and supplies	107,713	…	…	107,713	99,940
Professional services	63,869	…	…	63,869	61,893
Student aid	16,854	…	…	16,854	14,702
Other operating expenses	142,190	…	…	142,190	160,297
Interest on indebtedness	6,394	…	…	6,394	10,398
Depreciation and amortization	96,731	…	…	96,731	94,438
Total operating expenses	1,159,540	…	…	1,159,540	1,096,097
Excess/(deficit) of operating revenues and support over/(under) operating expenses	127,177	(83,587)	…	43,590	68,948
Nonoperating activities:					
Contributions	…	71,462	63,082	134,544	96,885
Investment return in excess (deficit) of amounts designated for current operations	(242,223)	(10,309)	7,580	(244,952)	(305,984)
Loss on disposals of property and equipment	(117)	…	…	(117)	(414)
(Loss) gain on perpetual trusts held by others and other nonoperating items	218	6,802	(81,236)	(74,216)	154,749
Change in net assets from nonoperating activities	(242,122)	67,955	(10,574)	(184,741)	(54,764)
Transfer of net assets from DUHS	34,361	…	…	34,361	8,514
Increase (decrease) in net assets	(80,584)	(15,632)	(10,574)	(106,790)	22,698
Net assets at beginning of year	2,978,043	135,029	1,324,406	4,437,478	4,414,780
Net assets at end of year	$ 2,897,459	$ 119,397	$ 1,313,832	$ 4,330,688	$ 4,437,478

The supplementary information in this schedule presents the statement of activities of Duke University exclusive of the operations of Duke University Health System, Inc.

See accompanying Independent Auditors' Report

Statement of Cash Flows

THE UNIVERSITY (Supplementary Information)
Years ended June 30, 2002
(with summarized financial information for the year ended June 30, 2001)
(000's omitted)

	2002	2001
Cash flows from operating activities:		
Increase (decrease) in net assets	$ (106,790)	$ 22,698
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	96,731	94,438
Loss on disposals of land, buildings and equipment	117	414
Contributions of property	(8,311)	(1,503)
Contributions restricted for long-term investment and capital projects	(134,544)	(96,885)
Permanently restricted investment return	(7,580)	(6,439)
Permanently restricted gain on perpetual trusts held by others and other nonoperating items	81,236	(66,401)
Net realized and unrealized losses on investments	176,357	228,294
(Increase) decrease in:		
Other receivables, net	(8,980)	(955)
Prepaid expenses, deferred charges and inventories	(5,771)	(23,147)
Contributions receivable, net	(45,469)	(17,024)
Interests in perpetual trusts held by others	81,224	(66,405)
Increase (decrease) in:		
Accounts payable	13,047	9,037
Accrued payroll and employee withholdings	3,493	12,986
Deferred revenues and deposits	7,033	6,981
Annuity and other split-interest obligations	(11,230)	(10,696)
Accrued postretirement/postemployment and other benefit obligations	20,064	11,841
Other liabilities	539	(76,886)
Net cash provided by operating activities	151,166	20,348
Cash flows from investing activities:		
Purchases of investments	(3,924,158)	(6,828,379)
Proceeds from sales and maturities of investments	3,917,730	6,727,123
Change in collateral deposits under securities lending transactions, net	138,683	502,408
Change in obligation to return collateral under securities lending transactions, net	(138,683)	(502,408)
Purchases of land, buildings and equipment	(215,961)	(130,047)
Proceeds from disposals of land, buildings and equipment	2,495	3,816
Disbursements for loans to students	(5,484)	(6,269)
Repayments of loans by students	6,831	5,442
Increase in deposits with bond trustees	(53,427)	(537)
Net cash used in investing activities	(271,974)	(228,851)
Cash flows from financing activities:		
Contributions restricted for long-term investment and capital projects	134,544	96,885
Permanently restricted investment return	7,580	6,439
Permanently restricted gain on perpetual trusts held by others and other nonoperating items	(81,236)	66,401
Payments of notes and bonds payable	(74,321)	(1,240)
Proceeds from borrowings	218,433	22,654
Net cash provided by financing activities	205,000	191,139
Net increase (decrease) in cash and cash equivalents	84,192	(17,364)
Cash and cash equivalents at beginning of year	99,737	117,101
Cash and cash equivalents at end of year	$ 183,929	$ 99,737

The supplementary information in this schedule presents the statement of cash flows of Duke University exclusive of the operations of Duke University Health System, Inc.

See accompanying Independent Auditors' Report

The Growth of DUKE 1993–2002

(UNAUDITED)	2002	2001	2000
General Data (for the year ended June 30):			
Enrollment (Fall term, in full-time equivalents)			
Undergraduate Schools	5,916	5,990	6,202
Graduate and Professional Schools	5,588	5,273	4,969
Degrees Conferred:			
Undergraduate Schools	1,615	1,592	1,561
Graduate and Professional Schools	1,926	1,841	1,754
Annual Tuition:			
Per Full-time Undergraduate Student	$ 26,000	$ 24,890	$ 24,040
Per Full-time Graduate Student	$ 23,700	$ 22,800	$ 21,900
Tuition and Fees Revenue - Gross	$ 304,825	$ 288,128	$ 270,784
Faculty:			
Number (Regular rank)	2,290	2,243	2,159
Average Annual Compensation (1)	$ 118,829	$ 113,469	$ 108,100
Libraries:			
Number of Volumes (000's omitted):	5,208	5,150	4,974
Number of Manuscripts (000's omitted):	17,758	17,073	17,719
Salaries and Benefits (2):			
Amount (000's omitted)	$ 1,312,063	$ 1,192,799	$ 1,028,598
Benefits as a Percentage of Total Compensation (3)	17.5%	17.7%	18.1%
Endowment and Similar Funds (at June 30): (4)			
Original Endowment Value (000's omitted):			
Current Fiscal Year's Additions - Net	$ 71,747	$ 55,779	$ 85,486
Cumulative Additions to Date	$ 971,786	$ 900,039	$ 844,260
Market Value (000's omitted)	$ 2,440,878	$ 2,576,524	$ 2,754,261
Endowment Funds per Full-time Equivalent Student	$ 212,176	$ 228,760	$ 246,555
Long Term Pool/Endowment Total Rate of Return (5)	(3.8%)	(4.6%)	58.8%
Student Loans Outstanding (at June 30, 000's omitted):	$ 42,650	$ 43,324	$ 42,380
Plant (at June 30, 000's omitted):			
Long Term Debt	$ 859,533	$ 745,976	$ 732,875
Total Square feet of Buildings (6)(7)	12,587	12,253	12,364
Duke University Health System (7)			
Total Inpatient Days	336,006	333,481	342,0522
Average Adult Daily Census	921	914	935
Average Adult Percent Occupancy	78%	80%	76%
Adult Discharges	59,728	58,577	59,342
Average Adult Length of Stay (in Days)	5.6	5.7	5.8
Number of Surgical Operations Performed	55,384	53,472	52,604
Outpatient Visits	1,075,849	1,066,284	1,009,544

(1) Excludes School of Medicine
(2) Beginning in 2001, numbers reflect business acquisitions of DUHS
(3) Excludes value of vacation, holidays, and sick leave
(4) Excludes Endowment Funds Held in Trust by Others
(5) Net of external management fees
(6) Excluding parking garages
(7) Beginning in 1999, numbers reflect business acquisitions of DUHS

1999	1998	1997	1996	1995	1994	1993
6,125	6,109	6,114	6,104	5,975	6,100	6,033
4,789	4,838	4,884	4,832	4,749	4,737	4,583
1,568	1,653	1,520	1,556	1,490	1,665	1,427
1,717	1,770	1,731	1,695	1,603	1,658	1,550
$ 22,420	$ 21,550	$ 20,520	$ 19,500	$ 18,590	$ 16,720	$ 15,700
$ 20,790	$ 19,800	$ 18,000	$ 16,350	$ 14,550	$ 12,750	$ 11,400
$ 252,618	$ 238,431	$ 203,593	$ 187,746	$ 172,311	$ 159,312	$ 146,876
2,146	2,094	2,063	2,011	1,988	1,995	1,907
$ 104,301	$ 100,200	$ 95,384	$ 93,118	$ 89,288	$ 87,452	$ 83,927
4,865	4,765	4,645	4,534	4,416	4,338	4,239
14,429	13,688	13,051	12,440	11,175	10,911	10,152
$ 969,068	$ 905,654	$ 850,297	$ 812,349	$ 779,856	$ 755,551	$ 695,880
22.3%	22.1%	21.6%	21.1%	21.9%	22.0%	20.7%
$ 73,162	$ 67,850	$ 64,839	$ 56,396	$ 39,536	$ 31,640	$ 40,662
$ 758,774	$ 685,612	$ 617,762	$ 552,923	$ 496,527	$ 456,991	$ 425,351
$ 1,759,636	$ 1,432,703	$ 1,190,460	$ 1,008,872	$ 790,584	$ 699,002	$ 669,074
$ 161,227	$ 130,876	$ 108,243	$ 92,252	$ 73,721	$ 64,501	$ 63,025
23.1%	20.3%	17.7%	29.7%	15.5%	7.4%	14.2%
$ 41,672	$ 39,397	$ 37,325	$ 35,630	$ 34,030	$ 33,129	$ 31,822
$ 803,110	$ 481,975	$ 443,686	$ 315,505	$ 319,158	$ 323,958	$ 310,119
12,233	10,498	10,046	9,835	9,706	9,234	8,867
334,062	250,191	248,835	249,297	263,686	283,990	299,525
933	673	672	672	714	762	804
74%	78.9%	76.4%	75.7%	75.3%	77.6%	79.9%
55,768	37,400	35,564	34,421	35,184	35,424	36,332
6.0	6.6	6.9	7.2	7.4	7.8	8.1
49,790	27,190	26,290	24,118	23,764	23,171	23,104
1,349,556	866,953	764,711	695,967	699,187	621,739	548,682