# Notes to consolidated financial statements *Columnar amounts in millions*

## 1. Nature of operations

The American Medical Association (AMA) is a national professional association of physicians with approximately 250,000 members. The AMA serves the medical community and the public through standard setting and implementation in the areas of science, medical education, clinical research and patient care, ethics, representation and advocacy, policy development and image/identity building. The AMA's business operations include publishing and multimedia development, database licensing, book and catalog products, insurance and other services for physician practices. Membership dues are approximately 20 percent of revenues while non-dues revenues account for 80 percent of total revenue.

The AMA classifies all association and business operations results as revenues and expenses in the consolidated statements of activities, except non-operating and non-recurring items. Non-operating and non-recurring items include net realized and unrealized gains and losses on marketable securities, gains on real estate holdings and other non-recurring expenses or income.

## 2. Significant accounting policies

### Consolidation policy

The accompanying consolidated financial statements include the accounts of the AMA and its subsidiaries (collectively referred to herein as the AMA), except for the AMA's wholly owned reinsurance subsidiary, American Medical Assurance Company (AMACO). AMACO, which ceased writing new business and went into voluntary run-off in 1986, is included in the financial statements on the basis of the equity method of accounting. All significant intercompany transactions have been eliminated.

### Use of estimates

Preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect reported amounts of assets, liabilities, revenue and expenses as reflected in the financial statements. Actual results could differ from estimates.

### Cash equivalents

Cash equivalents consist of highly liquid investments with original maturities of three months or less.

### Inventories

Inventories, consisting primarily of book and catalog products, paper and supplies, are valued at the lower of cost or market.

### Property and equipment

Property and equipment are carried at cost, less accumulated depreciation and amortization. Depreciation is computed using the straightline method over the estimated useful lives of the assets. Equipment and software are depreciated or amortized over three to 10 years. Leasehold improvements are depreciated over the remaining lease term.

### Other assets

Other assets consist of investments maintained in separate accounts designated for various nonqualified benefit plans. These funds are not available for operations.

### Membership dues

Membership dues are deferred and recognized as revenue in equal monthly amounts during the applicable membership year, which ends on December 31. Dues from lifetime memberships are recognized as revenue over the approximate life of the member. Prepaid dues are included as deferred revenue in the consolidated statements of financial position.

### Subscriptions

Subscriptions to periodicals are recognized as revenue ratably over the terms of the subscriptions. Advertising revenue and direct publication costs are recognized in the period the related periodical is issued. Other publication costs are included in expense as incurred.

### Income taxes

The AMA is an exempt organization as defined by Section 501(c)(6) of the Internal Revenue Code and is subject to income taxes only on income determined to be unrelated business taxable income. The AMA's subsidiaries are taxable entities and are subject to income taxes.

### Reclassifications

Certain reclassifications have been made in the 2002 financial statements to conform to the classifications used in 2003.

## 3. Investments in marketable securities

Marketable securities are carried at market value. The aggregate carrying value (based on quoted market prices) of investments in marketable securities, exclusive of cash equivalents, at December 31 is summarized as follows:

| | 2003 | 2002 |
|---|---|---|
| Equity securities | | |
| Common stocks | **$ 77.2** | $ 52.2 |
| Debt securities | | |
| Corporate bonds | **7.9** | 6.8 |
| Fixed income mutual funds | **94.9** | 72.3 |
| | **$180.0** | $ 131.3 |

Interest and dividends are included in investment income as operating revenue while realized and unrealized gains and losses are included as a component of non-operating and non-recurring items.

Investment income consists of:

| | 2003 | 2002 |
|---|---|---|
| Marketable securities dividend and interest income net of management fees | **$ 3.9** | $ 4.4 |
| Interest income on cash and cash equivalents | **0.6** | 1.2 |
| Real estate and limited partnership income | **0.9** | 0.6 |
| | **$ 5.4** | $ 6.2 |

Non-operating results include:

| | 2003 | 2002 |
|---|---|---|
| Realized gains (losses) on marketable securities | **$ 1.0** | $ (5.7) |
| Unrealized gains (losses) on marketable securities | **19.8** | (7.2) |
| | **$ 20.8** | $ (12.9) |

## 4. Investments in real estate

Investments in real estate (rental properties) at December 31, 2003 and 2002 consist of land in Chicago, Illinois. At December 31, 2003, the AMA's one remaining rental property has a remaining lease term of 20 years with five renewal options of 10 years each and is carried at cost.

## 5. Investments in subsidiary and affiliates

### Preference Solutions, LLC

In August 2000, AMA and Acxiom Corporation entered into an agreement to form a joint venture, Preference Solutions, in the database licensing business, built around privacy safeguards for physician information. The AMA contributed $5 million in 2000 in exchange for a fifty-percent ownership interest. The investment in and operating results are included in the financial statements on the basis of the equity method of accounting.

The AMA's share of operating losses totaled $0.8 million and $1.6 million for 2003 and 2002, respectively. These results are included as a component of revenue. Preference Solutions was dissolved in June 2003 and $0.7 million was distributed to the AMA.

### Medem, Inc.

In November 1999, AMA and six other unaffiliated medical societies entered an agreement to form Medem Inc., a medical information website. The AMA contributed $1 million in total during 1999 and 2000, $0.5 million in 2002 and an additional $0.2 million in 2003. At December 31, 2003 and 2002, the investment is carried at zero.

### American Medical Assurance Company (AMACO)

AMACO, a wholly owned subsidiary of the AMA, is in the process of winding down its medical professional liability reinsurance business. AMACO ceased writing new and renewal business in 1986 and is paying claims on contracts entered into prior to 1987. AMACO declared and paid a $0.6 million and a $0.8 million dividend to the AMA in 2003 and 2002, respectively. The AMA's investment in AMACO was $8.9 million and $9.1 million at December 31, 2003 and 2002, respectively.

The operating profit totaled $0.4 million and $0.5 million for 2003 and 2002, respectively. The operating results of AMACO consist primarily of investment income, net of taxes. Its financial position at December 31 is summarized as follows:

| | 2003 | 2002 |
|---|---|---|
| Investments, principally bonds at amortized cost (market value of $11.0 million and $11.6 million) | **$ 10.7** | $ 11.0 |
| Capital and surplus | **$ 8.9** | $ 9.1 |

## 6. Property and equipment

Property and equipment at December 31 consists of:

| | 2003 | 2002 |
|---|---|---|
| Leasehold improvements | **$ 22.5** | $ 22.2 |
| Furniture and office equipment | **24.1** | 23.9 |
| Data processing equipment and software | **112.4** | 110.3 |
| | **159.0** | 156.4 |
| Accumulated depreciation and amortization | **(132.9)** | (124.7) |
| | **$ 26.1** | $ 31.7 |

## 7. Retirement pension plans

The AMA has a defined benefit pension plan covering eligible salaried and hourly employees. The plan is designed to pay a monthly retirement benefit that, together with Social Security benefits, provides retirement income based on employees' earnings, age and years of service.

The AMA funds this plan in accordance with minimum funding requirements as defined by statute, plus any additional amounts as the AMA may determine to be necessary to meet plan obligations. The cash contributions to the plan were $13.2 million and $25.1 million in 2003 and 2002, respectively.

The assets of the plan are maintained in a separate trust and invested in various stocks, mutual funds, bonds and cash equivalents.

In 2002, the AMA amended the pension plan to freeze pension benefits as of December 31, 2002. After that date, no individual shall become a participant in the plan and no further benefits shall accrue under the plan. Individuals not vested as of that date will be credited for future years of service for vesting purposes only. As a result, the AMA recorded a curtailment loss of $0.5 million in the consolidated statement of activities for the year ended December 31, 2002.

The provisions of Statement of Financial Accounting Standards (SFAS) No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, require the AMA to recognize settlement charges based on the actual employees receiving lump sum benefits in 2003. In 2003, the AMA recorded settlement charges of $1.8 million as a component of pension expense.

The fair value of plan assets, projected benefit obligation and funded status at December 31 are as follows:

| | 2003 | 2002 |
|---|---|---|
| Fair value of plan assets | **$ 95.3** | $ 74.5 |
| Projected benefit obligation | **93.0** | 81.9 |
| Funded status | **$ 2.3** | $ (7.4) |

The fair value of plan assets is the market value of the plan investments. The projected benefit obligation is the actuarial present value of all benefits attributed by the pension benefit formula to employee service rendered prior to the valuation date. The projected benefit obligation is measured using assumptions as to future compensation levels, turnover and mortality rates. The funded status is the difference between the fair value of plan assets and the projected benefit obligation at valuation date.

The provisions of SFAS No. 87, *Employers' Accounting for Pension Costs*, required the AMA to recognize a minimum pension liability equal to the amount by which the accumulated benefit obligation in the plan exceeds the fair value of plan assets and accrued pension liabilities. The adjustment reduces net assets accordingly. At December 31, 2002, the AMA's net assets were reduced by $17.1 million to reflect the additional minimum pension liability. That charge reflected a $19.3 million increase in minimum pension liability, offset by a $2.2 million tax benefit.

At December 31, 2003, the accumulated benefit obligation no longer exceeded the fair value of plan assets and accrued pension liabilities. As a result, the AMA was no longer required to recognize the minimum pension liability and reversed the 2002 charge of $19.3 million as well as the related tax benefit of $2.2 million, resulting in a $17.1 million increase in association equity.

Distributions to retirees from the plan trust totaled $8.1 million and $6.9 million in 2003 and 2002, respectively.

The AMA has recorded an asset totaling $24.8 million in 2003 and a liability totaling $7.3 million in 2002 for the actuarially determined pension obligation in its consolidated statements of financial position, at December 31, 2003 and 2002, respectively.

The weighted average assumptions used in determining the December 31 actuarial valuations are:

| | 2003 | 2002 |
|---|---|---|
| Discount rate | **6.0%** | 6.75% |
| Expected long-term return on plan assets | **8.0%** | 9.0% |
| Rate of compensation increase | **5.0%** | 5.0% |

The AMA recognizes pension expense in its consolidated statements of activities. The components of pension expense are:

| | 2003 | 2002 |
|---|---|---|
| Service cost | **$ —** | $ 6.1 |
| Interest cost | **5.4** | 6.6 |
| Expected return on plan assets | **(6.9)** | (6.5) |
| Lump sum settlement charges | **1.8** | — |
| Recognized actuarial loss | **—** | 0.2 |
| Pension expense | **$ 0.3** | $ 6.4 |

Actuarial assumptions used in determining pension expense were:

| | 2003 | 2002 |
|---|---|---|
| Discount rate | **6.75%** | 7.5% |
| Expected long-term return on plan assets | **8.0%** | 9.0% |
| Rate of compensation increase | **5.0%** | 5.0% |

The AMA also maintains a nonqualified, unfunded supplemental pension plan for certain long-term employees. Participation in the plan was closed in 1994. The AMA recognizes the liability in its consolidated statement of financial position. The liability totaled $1.2 million and $1.4 million at December 31, 2003 and 2002, respectively. The associated expense for this plan is not material.

## 8. Postretirement health care benefits

The AMA provides health care benefits to retired employees. Generally, qualified employees become eligible for these benefits if they retire in accordance with the provisions of the AMA pension plan and are participating in the AMA medical plan at the time of their retirement. The AMA shares the cost of the retiree health care payments with retirees, paying approximately 80 percent of the benefit payments. The AMA has the right to modify or terminate the postretirement benefit plan at any time.

The postretirement health care plan is unfunded. In accordance with SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, the AMA recognizes this liability in its consolidated statements of financial position. The actuarially determined accrued postretirement health care benefit obligation totaled $48.2 million and $30.3 million at December 31, 2003 and 2002, respectively. The amounts recognized at December 31 in the AMA's consolidated statements of financial position for the accrued postretirement health care benefit obligation are $37.2 million and $32 million in 2003 and 2002, respectively.

The discount rate used in determining the accumulated postretirement benefit obligation at December 31 was 6 percent and 6.75 percent in 2003 and 2002, respectively.

For measurement purposes, an 11 percent and a 12 percent annual rate of increase in the per capita cost of covered health care benefits for pre-Medicare and post-Medicare costs, respectively, was assumed for 2003. The rate is assumed to decrease gradually to 5 percent for both pre-Medicare and post-Medicare costs by 2010 and remain at that level thereafter.

Postretirement health care benefit expense was $6.8 million and $3.3 million for 2003 and 2002, respectively.

The following table reconciles cash payments made by the AMA and plan participants for health care benefit payments.

| | 2003 | 2002 |
|---|---|---|
| AMA | **$ 1.5** | $ 1.1 |
| Plan participants | **0.4** | 0.3 |
| Total benefits paid | **$ 1.9** | $ 1.4 |

## 9. Income taxes

The provision for income taxes includes the following components:

| | 2003 | 2002 |
|---|---|---|
| Current | **$ 5.4** | $ 3.0 |
| Deferred | **1.1** | 2.8 |
| Adjustment of prior years' estimates | **(3.5)** | (0.1) |
| | **$ 3.0** | $ 5.7 |

The adjustment of prior years' estimates includes a $1.2 million reduction in tax reserves related to an outstanding claim with the IRS that was settled in 2003 and a $2.3 million reduction of prior years' deferred taxes. The AMA determines its provision for income taxes using the asset and liability method. Under this method, deferred tax assets and liabilities are recognized for the future tax effects of temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Future tax benefits of tax losses are also recognized as deferred tax assets.

Deferred tax liabilities recognized in the consolidated statements of financial position at December 31 consist of:

| | 2003 | 2002 |
|---|---|---|
| Real estate | **$ 3.9** | $ 3.8 |
| Benefit plans | **0.2** | (0.8) |
| Deferred revenue | **(0.6)** | (0.5) |
| Other | **(0.2)** | (0.1) |
| | **$ 3.3** | $ 2.4 |

Cash payments for income taxes were $5.2 million and $4.7 million in 2003 and 2002, respectively.

## 10. Functional expenses

| | 2003 | 2002 |
|---|---|---|
| Membership | **$ 8.5** | $ 6.1 |
| Business operations | | |
| Publications | **58.5** | 60.9 |
| Book and Products | **25.9** | 26.4 |
| Insurance Agency | **14.6** | 13.9 |
| Internet and Database Operations | **9.5** | 9.1 |
| Other business | **1.2** | 0.7 |
| | **109.7** | 111.0 |
| Investments | **0.3** | 0.3 |
| Core operations | | |
| Advocacy and Federation Relations | **21.6** | 19.7 |
| Communications and Core Identity | **6.9** | 6.9 |
| Professional Standards | **19.4** | 17.8 |
| | **47.9** | 44.4 |
| Governance | **11.0** | 10.4 |
| Administration and Operations | | |
| Information Technology | **21.6** | 24.3 |
| Corporate Services | **6.6** | 6.7 |
| General Counsel | **4.7** | 5.0 |
| Senior Executive Management | **4.7** | 4.4 |
| Finance | **4.6** | 4.4 |
| Human Resources | **3.6** | 3.6 |
| Planning | **1.0** | 1.4 |
| Other | **9.0** | 11.1 |
| | **55.8** | 60.9 |
| | **$233.2** | $ 233.1 |

## 11. Commitments and contingencies

Lease commitments
Rent expense under operating leases was $9.5 million and $9.3 million in 2003 and 2002, respectively. At December 31, 2003, minimum lease commitments under existing operating leases for office facilities are:

| | |
|---|---|
| 2004 | $ 9.7 |
| 2005 | 9.8 |
| 2006 | 9.9 |
| 2007 | 9.2 |
| 2008 | 8.2 |
| Later years | 57.9 |
| | $ 104.7 |

All leases have renewal options.

Contingencies
In the opinion of management, there are no pending legal actions for which the ultimate liability will have a material effect on the equity of the AMA.

# Independent auditors' report

The Board of Trustees
American Medical Association

We have audited the accompanying consolidated statements of financial position of the American Medical Association and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the Association'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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the American Medical Association and its subsidiaries at December 31, 2003 and 2002, and the changes in their equity and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP
Chicago, Illinois

*March 3, 2004*

**Written statement of certification**

The undersigned hereby certify that the information contained in the audited financial statements of the American Medical Association for the years ended December 31, 2003 and 2002 fairly present, in all material respects, the financial condition and the results of operations of the American Medical Association.

**Michael D. Maves, MD, MBA**
AMA executive vice president/CEO

**Denise M. Hagerty**
AMA chief financial officer

*March 3, 2004*