JCAHO HISTORY

1917: The ACS develops the Minimum Standard for Hospitals. Requirements fill one page.

1918 : The ACS begins on-site inspections of hospitals. Only 89 of 692 hospitals surveyed meet the requirements of the Minimum Standard. Arthur W. Allen (right), chairman of the American College of Surgeons board of regents, deftly negotiated the start-up of the Joint Commission on Accreditation of Hospitals.

1952: The ACS officially transfers its Hospital Standardization Program to JCAH, which begins offering accreditation to hospitals in January 1953.

1953: JCAH publishes Standards for Hospital Accreditation.

1965: Congress passes the Social Security Amendments of 1965 with a provision that hospitals accredited by JCAH are "deemed" to be in compliance with most of the Medicare Conditions of Participation for Hospitals and, thus, able to participate in the Medicare and Medicaid programs.

1971: The Accreditation Council for Long Term Care is established.

1972: The Social Security Act is amended to require that the Secretary of the U.S. Department of Health and Human Services (DHHS) validate JCAH findings. The law also requires the Secretary to include an evaluation of JCAH's accreditation process in the annual DHHS report to Congress.
The first issue of Perspectives on Accreditation is published.

1986: Quality Healthcare Resources® (QHR®), Inc., is formed as a not-for-profit consulting subsidiary of JCAH.

1987: The organization name changes to the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) to reflect an expanded scope of activities. The Agenda for Change is launched with a set of initiatives designed to place the primary emphasis of the accreditation process on actual organization performance.

THE JOINT COMMISSION ON ACCREDITATION OF HEALTHCARE ORGANIZATIONS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2002 AND 2001

1. NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of the Organization—The Joint Commission on Accreditation of Healthcare Organizations ("Joint Commission") is a not-for-profit organization that seeks to continuously improve the safety and quality of care provided to the public through the provision of health care accreditation and related services that support performance improvement in health care organizations. Accreditation survey fees are the most significant source of the Joint Commission's total revenues. i.e. from Hospitals!!

Principles of Consolidation—The consolidated financial statements include the accounts of the Joint Commission and its wholly owned subsidiary, Joint Commission Resources ("JCR"). JCR is a not-for-profit organization that was established for the purpose of independently assisting health care organizations in improving the quality of their services through the provision of technical assistance, educational programs and publications. An additional subsidiary, JCAHO Surveyor and QHR Consultant Corporation, administers an employment program for the Joint Commission. All intercompany transactions and balances have been eliminated in the consolidated financial statements.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported and disclosed in these financial statements. Actual results could differ from those estimates.

Cash Equivalents—For purposes of reporting, all investments with an original maturity of three months or less are considered cash equivalents.

Deloitte & Touche

The Joint Commission on Accreditation of Healthcare Organizations

Consolidated Financial Statements for the Years Ended December 31, 2002 and 2001 and Independent Auditors' Report

THE JOINT COMMISSION ON ACCREDITATION OF HEALTHCARE ORGANIZATIONS

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Deloitte & Touche

INDEPENDENT AUDITORS' REPORT

To the Board of Commissioners of
The Joint Commission on Accreditation of
Healthcare Organizations:

We have audited the accompanying consolidated balance sheet of The Joint Commission on Accreditation of Healthcare Organizations (an Illinois not-for-profit corporation) and Subsidiaries (the "Joint Commission) as of December 31, 2002, and the related consolidated statements of operations and changes in net assets and of cash flows for the year then ended. These financial statements are the responsibility of the Joint Commission's management. Our responsibility is to express an opinion on these financial statements based on our audit. The consolidated financial statements of the Joint Commission for the year ended December 31, 2001 were audited by other auditors who have ceased operations. Those auditors expressed an unqualified opinion on those financial statements in their report dated March 22, 2002.

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 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 audit provides a reasonable basis for our opinion.

In our opinion, such 2002 consolidated financial statements present fairly, in all material respects, the financial position of The Joint Commission on Accreditation of Healthcare Organizations and Subsidiaries as of December 31, 2002, and the results of their operations and their cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Deloitte & Touche LLP

April 1, 2003
(April 15, 2003 as to the third paragraph of Note 2)

THE JOINT COMMISSION ON ACCREDITATION OF HEALTHCARE ORGANIZATIONS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS
DECEMBER 31, 2002 AND 2001

ASSETS	2002	2001
CURRENT ASSETS:		
Cash and cash equivalents	$ 14,681,577	$ 7,490,179
Short-term marketable securities (Notes 1 and 4)	14,936,329	12,773,212
Accounts receivable—net of allowance for doubtful accounts of $540,000 and $872,000 in 2002 and 2001, respectively	8,617,401	12,788,371
Publications inventory—net	1,067,808	1,409,315
Prepaid expenses	1,214,908	1,378,706
Total current assets	40,518,023	35,839,783
PROPERTY AND EQUIPMENT:		
Land	4,204,400	4,204,400
Building	26,556,534	26,502,166
Office systems, furniture and equipment	32,201,149	30,600,061
Total property and equipment	62,962,083	61,306,627
Less accumulated depreciation and amortization	(32,270,519)	(29,134,984)
Total property and equipment—net	30,691,564	32,171,643
MARKETABLE SECURITIES (Notes 1 and 4)	45,672,339	47,003,879
PREPAID PENSION COST (Note 5)		1,148,953
UNAMORTIZED DEBT ISSUANCE COSTS	817,243	898,958
TOTAL ASSETS	$117,699,169	$117,063,216

LIABILITIES AND NET ASSETS	2002	2001
CURRENT LIABILITIES:		
Accounts payable	$ 5,273,032	$ 6,779,225
Accrued expenses:		
Compensation and benefits	5,990,251	5,217,333
Other expenses	956,172	1,047,156
Deferred revenue:		
Survey and other fees	548,027	837,521
Subscriptions and other	2,985,300	2,735,626
Current maturity of note payable (Note 2)	980,000	905,000
Total current liabilities	16,732,782	17,521,861
NONCURRENT LIABILITIES:		
Note payable—less current maturity (Note 2)	30,025,000	31,005,000
Accrued pension and supplemental retirement plan cost (Note 5)	10,842,566	4,056,645
Fair value of hedge—interest rate swap (Note 2)	3,934,036	2,373,414
Other noncurrent liabilities	997,028	1,101,520
Total noncurrent liabilities	45,798,630	38,536,579
Total liabilities	62,531,412	56,058,440
UNRESTRICTED NET ASSETS	55,167,757	61,004,776
TOTAL LIABILITIES AND NET ASSETS	$117,699,169	$117,063,216

THE JOINT COMMISSION ON ACCREDITATION OF HEALTHCARE ORGANIZATIONS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS YEARS ENDED DECEMBER 31, 2002 AND 2001

	2002	2001
REVENUE:		
Survey fees	$ 80,568,799	$ 87,356,873
Publications and subscriptions	11,688,604	12,117,512
Educational programs	5,752,105	4,080,673
Technical assistance	5,518,034	7,199,854
Performance measurement activities	3,679,192	4,103,024
Subscription readiness services	2,690,669	2,221,035
Investment (loss) income (Notes 1 and 4)	(5,335,790)	1,863,054
Other	6,243,873	3,267,732
Total revenue	110,805,486	122,209,757
EXPENSES:		
Salaries and benefits	65,792,343	59,020,613
Travel costs	14,791,896	13,424,493
Publishing and printing	4,762,456	3,972,801
Occupancy	3,172,549	4,122,554
Fees and services	6,440,522	12,443,149
Depreciation and amortization	4,235,259	5,002,923
General and administrative	8,909,746	9,260,508
Total expenses	108,104,771	107,247,041
EXCESS OF REVENUE OVER EXPENSES	2,700,715	14,962,716
OTHER CHANGES IN UNRESTRICTED NET ASSETS:		
Unrealized investment loss (Notes 1 and 4)	(562,642)	(3,730,562)
Cumulative effect of change in accounting for interest rate swap		(1,453,526)
Increase in fair value of hedge—interest rate swap (Note 2)	(1,560,622)	(919,888)
Minimum pension liability adjustment (Note 5)	(6,414,470)	
CHANGE IN UNRESTRICTED NET ASSETS	(5,837,019)	8,858,740
NET ASSETS—Beginning of year	61,004,776	52,146,036
NET ASSETS—End of year	$ 55,167,757	$ 61,004,776

See notes to consolidated financial statements.

THE JOINT COMMISSION ON ACCREDITATION OF HEALTHCARE ORGANIZATIONS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2002 AND 2001

	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:		
Change in net assets	$ (5,837,019)	$ 8,858,740
Adjustment to reconcile change in net assets to net cash flows from operating activities:		
Cumulative effect of change in accounting for interest rate swap		1,453,526
Unrealized investment loss	562,642	3,730,562
Change in fair value of hedge—interest rate swap	1,560,622	919,888
Minimum pension liability adjustment	6,414,470	
Depreciation and amortization	4,235,259	5,002,923
Loss on the sale of equipment	22,432	200,143
Changes in assets and liabilities:		
Accounts receivable	4,170,970	(2,202,047)
Accounts payable and accrued expenses	(824,259)	(1,990,177)
Deferred revenue	(39,820)	237,187
(Prepaid) accrued pension and supplemental plan cost	1,520,404	(1,148,953)
Other assets and liabilities	400,813	(751,854)
Net cash flows from operating activities	12,186,514	14,309,938
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of marketable securities	(18,565,686)	(9,839,649)
Sales of marketable securities	17,171,467	
Additions to property and equipment	(2,709,071)	(2,602,223)
Proceeds from sale of property and equipment	13,174	
Net cash flows from investing activities	(4,090,116)	(12,441,872)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments of note payable	(905,000)	(835,000)
NET INCREASE IN CASH AND CASH EQUIVALENTS	7,191,398	1,033,066
CASH AND CASH EQUIVALENTS—Beginning of year	7,490,179	6,457,113
CASH AND CASH EQUIVALENTS—End of year	$ 14,681,577	$ 7,490,179
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:		
Cash paid during the year for interest	$ 1,187,112	$ 1,227,106

See notes to consolidated financial statements.

THE JOINT COMMISSION ON ACCREDITATION OF HEALTHCARE ORGANIZATIONS AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS YEARS ENDED DECEMBER 31, 2002 AND 2001

1. NATURE OF ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of the Organization—The Joint Commission on Accreditation of Healthcare Organizations ("Joint Commission") is a not-for-profit organization that seeks to continuously improve the safety and quality of care provided to the public through the provision of health care accreditation and related services that support performance improvement in health care organizations. Accreditation survey fees are the most significant source of the Joint Commission's total revenues.

Principles of Consolidation—The consolidated financial statements include the accounts of the Joint Commission and its wholly owned subsidiary, Joint Commission Resources ("JCR"). JCR is a not-for-profit organization that was established for the purpose of independently assisting health care organizations in improving the quality of their services through the provision of technical assistance, educational programs and publications. An additional subsidiary, JCAHO Surveyor and QHR Consultant Corporation, administers an employment program for the Joint Commission. All intercompany transactions and balances have been eliminated in the consolidated financial statements.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported and disclosed in these financial statements. Actual results could differ from those estimates.

Cash Equivalents—For purposes of reporting, all investments with an original maturity of three months or less are considered cash equivalents.

Marketable Securities—Investments in equity securities with readily determinable fair values and all investments in debt securities are measured at fair value in the balance sheet. Interest and dividend income and realized gains (losses) on sales of investments are reported as investment income (loss), while unrealized gains (losses) and other-than-temporary declines in the fair value of investments are reported as unrealized investment gains (losses) in the consolidated statements of operations and changes in net assets.

Publications Inventory—Publications offered for sale or used in educational programs are stated at the lower of cost (first-in, first-out) or market net of an allowance for excess and obsolete inventory.

Property and Equipment—Property and equipment are stated at cost and are depreciated over their estimated useful lives using the straight-line method, as follows:

Building	40 years
Office systems, furniture and equipment	3-15 years

Betterments, improvements and repairs that extend the useful life of an asset are capitalized. Routine repairs and maintenance are expensed as incurred.

System Development Costs—The Joint Commission capitalizes certain costs of business systems developed or obtained for internal use, consistent with the provisions of Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Such system development costs, which include external direct costs of materials and services and payroll costs for employees directly associated with system development projects, are amortized over a three- or five-year period using the straight-line method.

Debt Issuance Costs—Financing and other costs incurred in connection with the issuance of long-term debt are amortized over the life of the debt using the effective interest method.

Derivative Instruments and Hedging Activities—Effective January 1, 2001, the Joint Commission adopted Statement of Financial Accounting Standards ("SFAS") No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. The derivative financial instrument used by the Joint Commission is an interest rate swap, in which a counterparty agrees to make variable payments based on a market interest rate (index rate). The fair value of the hedge is included in non-current liabilities in the accompanying consolidated balance sheets. The Joint Commission entered into the interest rate swap to hedge its exposure to fluctuations of the variable rate interest payments relating to the Joint Commission's outstanding variable rate debt. Management has determined that the interest rate swap is highly effective, and under SFAS No. 133, reports the effective portion of the hedge as a change in unrestricted net assets in the accompanying consolidated statements of operations and changes in net assets.

Revenue—Revenue from accreditation (survey fees), technical assistance, educational programs, and subscription readiness services is recognized when the related services are provided. Revenue from the sale of publications and periodicals is recognized when the related goods have been delivered and risk of loss has passed to the customer, persuasive evidence of an arrangement exists, the sales price is determinable, and collection of the related receivable is reasonably assured. Advance collections and deposits are recorded as deferred revenue in the accompanying balance sheets.

Income Taxes—The Internal Revenue Service has determined that the Joint Commission is exempt from federal income taxation under Section 501(c)(3) of the Internal Revenue Code. The Joint Commission is subject to income taxes only on income determined to be unrelated business taxable income.

Reclassifications—Certain reclassifications have been made to the 2001 financial statements to conform to the 2002 presentation.

2. NOTE PAYABLE AND INTEREST RATE SWAP

In October 1988, the Joint Commission entered into a Financing Agreement (the "Agreement") with the City of Elmhurst, Illinois (the "City") to finance the acquisition of land and the construction and furnishing of a new office building, as well as costs the Joint Commission might incur in exiting existing long-term lease agreements and in moving its operations to the new facility. Pursuant to the Agreement, the City issued $37,000,000 of its tax-exempt Adjustable Demand Revenue Bonds and used the proceeds to purchase the Joint Commission's Adjustable Demand Note (the "Note"). The Joint Commission has occupied the office building since April 1990.

Under the terms of the Note, the Joint Commission is required to pay principal and interest in amounts sufficient to cover principal and interest on the bonds issued by the City. As security for the Note and to ensure the City's ability to meet the terms of its related bonds, the Joint Commission provided the City a direct pay letter of credit of $31,606,412, which is scheduled to expire January 2005. In so doing, the

Joint Commission agreed to pay the bank issuance fees as well as an annual fee of .50% on the unused portion of the letter of credit.

In April 2003, the letter of credit agreement was amended to make the Joint Commission and JCR jointly and severally liable for amounts due to the issuing bank. As security for the letter of credit, the Joint Commission has granted the issuing bank a first mortgage and security interest in virtually all of the Joint Commission's assets. Further, under terms of the amended letter of credit agreement, the Joint Commission and JCR have agreed to meet various covenants including maintenance of certain financial ratios and a minimum level of cash and investments. Management believes the Joint Commission is in compliance with such covenants, as amended, at December 31, 2002.

The Note matures on July 1, 2018. Note redemption commenced on July 1, 1994, and will continue pursuant to the terms of the Agreement through maturity. The Note is also subject to mandatory redemption upon the expiration of the letter of credit in January 2005. The annual maturities of the Note are as follows:

2003	$ 980,000
2004	1,065,000
2005	1,155,000
2006	1,250,000
2007	1,360,000
Thereafter	25,195,000
Total	$31,005,000

Interest on the Note is variable and subject to weekly adjustments that parallel fluctuations in the municipal bond market. The effective interest rate on the Note was 1.41% in 2002 and 2.66% in 2001. The interest rate for non-payment of principal or interest is prime plus 2%. Under certain conditions described in the Agreement, the Joint Commission may convert its interest rate on the Note to a fixed interest rate or a floating rate which changes less frequently than weekly.

The Joint Commission utilizes an interest rate swap agreement to reduce the risk associated with the weekly adjustment to the Note's interest rate. The interest rate swap agreement involves a declining notional amount that reflects two-thirds of the remaining principal balance of the Note. The following table summarizes the swap agreement terms in place during 2002 and 2001:

			Market Value as of	
Notional Amount (in millions)	Expiration	Fixed Rate	December 31 2002	December 31 2001
$21.8 to $21.3	2018	5.3 %	$ (3,934,036)	$ (2,373,414)

The Joint Commission makes payments to a counterparty at the stated fixed rate, and in return, receives payments based on the underlying 1988 Series City of Elmhurst bonds. Management continually monitors the credit rating of the counterparty, which is a large financial institution. Should nonperformance of the counterparty occur, interest costs would fluctuate with the weekly adjustable interest rate under the Note.

Interest expense on the Note, net of payments made and received under the interest rate swap agreement, totaled $1,152,016 in 2002 and $1,315,972 in 2001 and is included in occupancy expense in the consolidated statements of operations.

The estimated fair value of debt obligations, as determined by the Joint Commission's bond remarketing agents, approximates the carrying value at December 31, 2002 and 2001.

3. LEASES

The Joint Commission primarily leases office space, laptop computers, printers, and copiers. Lease terms generally range from 3 to 6 years and contain renewal or purchase options. There are no leases that contain restrictions on the Joint Commission's ability to incur additional debt or engage in further leasing activities.

Rent expense related to operating lease agreements was $1,960,585 in 2002 and $2,573,461 in 2001.

Obligations under operating leases having initial terms in excess of one year at current rates are as follows:

2003	$1,909,313
2004	263,976
Total	$2,173,289

4. INVESTMENTS IN MARKETABLE SECURITIES

The following table summarizes the types of investments and total return on investments as of and for the year ended December 31:

	2002	2001
Type of investments:		
U.S. Government and government agency securities	$20,572,392	$14,796,677
Common stocks	22,570,572	9,458,791
Corporate bonds and demand notes	17,465,704	35,521,623
Total investments, at fair market value	$60,608,668	$59,777,091
Return on investments:		
Interest income and dividends	$ 918,475	$ 1,240,669
Realized (losses) gains on sales of investments	(6,254,265)	622,385
Unrealized market depreciation	(562,642)	(3,730,562)
Total return on investments	$ (5,898,432)	$ (1,867,508)
Reported as:		
Investment (loss) income	$ (5,335,790)	$ 1,863,054
Unrealized investment loss	(562,642)	(3,730,562)
Total return on investments	$ (5,898,432)	$ (1,867,508)

The investment losses realized in 2002 related primarily to a change of an investment manager and related liquidation of that manager's investment portfolio.

5. RETIREMENT PLANS

The Joint Commission has a noncontributory account-based defined benefit pension plan (the "Pension Plan") that covers substantially all of its employees. The Joint Commission's funding policy is to contribute to the Pension Plan an annual amount necessary to meet or exceed the minimum funding standards under the Employee Retirement Income Security Act.

The Joint Commission also sponsors nonqualified supplemental defined benefit retirement plans for certain key executives (the "Supplemental Plans"). Benefits under the Supplemental Plans are paid when incurred from the Joint Commission's unrestricted net assets.

The following table sets forth information on the funded status, amounts recognized in the consolidated financial statements, and assumptions related to the Joint Commission's Pension and Supplemental Plans for the years ended December 31, 2002 and 2001:

	2002	2001
Projected benefit obligation	$ 25,524,071	$21,729,706
Fair value of plan assets	12,069,577	13,323,093
Funded status	$ (13,454,494)	$ (8,406,613)
Prepaid (accrued) pension cost:		
Prepaid pension cost	$ -	$ 1,148,953
Accrued pension cost and supplemental retirement plan	$ (4,428,096)	$ (4,056,645)
Minimum pension liability adjustment	(6,414,470)	
Total accrued pension cost and supplemental retirement plan	$ (10,842,566)	$ (4,056,645)
Benefit cost	$ 2,870,403	$ 2,424,710
Employer contribution	1,350,000	4,206,352
Benefits paid	710,783	1,901,307
Assumptions:		
Discount rate	6.50 %	7.00 %
Expected return on plan assets	8.00	8.50
Rate of compensation increase	4.75 to 5.00	4.75 to 5.00

Marketable securities totaling $3,713,614 and $2,817,628 at December 31, 2002 and 2001, respectively, have been designated for the payment of benefits under the Supplemental Plans when due. These amounts are excluded from the fair value of plan assets in the table above.

The provisions of SFAS No. 87, *Employers Accounting for Pension Costs*, require the Joint Commission to recognize a minimum pension liability relating to certain unfunded pension and supplemental plan obligations and to reduce net assets accordingly. At December 31, 2002, the Joint Commission's net assets were reduced by $6,414,470 to reflect the minimum liability adjustments. Of this amount, $2,625,447 relates to prior periods.

The Joint Commission has a 401(k) Smart Saver Plan whereby employees contribute up to 15% of current earnings to the plan and the Joint Commission makes a matching contribution equal to 50% of the first 6% of annual salary contributed by the employee. The Joint Commission's obligations under this plan are limited to its contributions, which were $1,053,898 in 2002 and $967,575 in 2001.

6. FUNCTIONAL EXPENSES

The Joint Commission provides services and products, which promote patient safety and quality in the delivery of health care services. Expenses related to providing these services and products approximated 71% of total expenses in both 2002 and 2001.

7. COMMITMENTS AND CONTINGENCIES

The Joint Commission is subject to legal proceedings regarding a claim which is incidental to its normal business activities. In the opinion of management, the amount of ultimate liability, if any, with respect to this action will not materially affect the operations or net assets of the Joint Commission.

8. SUBSEQUENT EVENT

In March 2003, the Joint Commission entered into an agreement with a third party for the formation of a not-for-profit corporation to develop a new accreditation program to protect the safety and rights of participants in clinical trials and research programs. Under terms of the joint venture agreement, the Joint Commission will make an initial capital contribution of $275,000 in exchange for a 50% ownership interest in the assets and operations of the new entity. Additional capital contributions may be required in 2003 and future periods. The Joint Commission's investment in the new entity will be accounted for using the equity method, under which the Joint Commission will recognize in its statement of operations its proportionate share of the entity's income or loss.

* * * * * *