



**Financial Statements**  
**June 30, 2005**

**UNIVERSITY OF ARKANSAS**  
**FOR MEDICAL SCIENCES**

University of Arkansas for Medical Sciences

Financial Statements

Years ended June 30, 2005 and 2004

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# University of Arkansas for Medical Sciences

## Management's Discussion and Analysis (Unaudited)

This discussion and analysis provides an overview of the financial position and changes in net assets of the University of Arkansas for Medical Sciences (UAMS) for the fiscal years ended June 30, 2005, 2004 and 2003. UAMS is a state-assisted academic health center composed of:

- The Colleges of Medicine, Pharmacy, Nursing, Health Related Professions, Public Health and Graduate School with a combined full-time equivalent enrollment of 2,062 and faculty numbering 1,232;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 265 adult beds in use at June 30, 2005;
- Regional programs including Tele-education, Rural Hospital Program and seven Area Health Education Centers (AHEC) located throughout the state;
- The Arkansas Cancer Research Center;
- Jones Eye Institute;
- Donald W. Reynolds Center on Aging;
- Multiple Myeloma Institute;
- Arkansas Biosciences Institute; and
- Jackson T. Stephens Spine and Neurosciences Institute.

The UAMS financial statements were prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). The financial statement presentation required by GASB Statement No. 35 provides a comprehensive, entity-wide perspective of UAMS' assets, liabilities, net assets, revenue, expenses, changes in net assets and cash flows. This discussion has been prepared by management and should be read in conjunction with the financial statements and notes following this section.

# University of Arkansas for Medical Sciences

## Management's Discussion and Analysis (Unaudited) (continued)

### **OVERVIEW OF THE FINANCIAL STATEMENTS**

This financial report consists of three basic sets of financial statements: the Statements of Net Assets, the Statements of Revenue, Expenses and Changes in Net Assets, and the Statements of Cash Flows. These statements provide information about UAMS as a whole.

The Statements of Net Assets present the financial position of UAMS and include all assets and liabilities. The difference between total assets and total liabilities is net assets, and is an indicator of the current financial condition of UAMS. When revenue and other support exceed expenses, the result is an increase in net assets. When the reverse occurs, there is a decrease in net assets. Over time, increases or decreases in an institution's net assets are one, but not the only, indicator of whether its financial health is improving or diminishing.

The Statements of Revenue, Expenses and Changes in Net Assets reflect the results of UAMS' operations. The purpose of these statements is to present the revenue earned and expenses incurred by UAMS, both operating and nonoperating, and any other changes in net assets of UAMS.

The Statements of Cash Flows provide relevant information about the cash receipts and cash payments of UAMS. The Statements of Cash Flows also help users assess UAMS' ability to generate future net cash flows, its ability to meet its obligations as they come due, and its needs for external financing.

This discussion and analysis of UAMS' financial statements provides an overview of its financial activities for the fiscal year ended June 30, 2005, with comparative information for the fiscal years ended June 30, 2004 and 2003.

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Management's Discussion and Analysis (Unaudited) (continued)

**FINANCIAL HIGHLIGHTS**

UAMS' financial position remained strong at June 30, 2005, with assets of \$795,193,000 and liabilities of \$299,879,000. Net assets, which represent the residual interest in UAMS' assets after liabilities are deducted, were \$495,314,000 at June 30, 2005. Changes in net assets represent the activities of UAMS, which result from revenue, expenses, gains and losses, and are summarized for the years ended June 30, 2005, 2004 and 2003 as follows:

|                             | <b>Year ended June 30</b> |             |             |
|-----------------------------|---------------------------|-------------|-------------|
|                             | <b>2005</b>               | <b>2004</b> | <b>2003</b> |
|                             | <i>(in thousands)</i>     |             |             |
| Operating revenue           | \$ 763,828                | \$ 712,956  | \$ 629,151  |
| Operating expenses          | (776,700)                 | (724,168)   | (655,768)   |
| Nonoperating revenue        | 53,155                    | 46,743      | 48,130      |
| Other changes in net assets | 7,512                     | 11,438      | 32,821      |
| Increase in net assets      | \$ 47,795                 | \$ 46,969   | \$ 54,334   |

***Statements of Net Assets***

The Statements of Net Assets present the financial position of UAMS at the end of the fiscal year and include all assets, liabilities, and net assets of UAMS. The change in net assets is one, but not the only, indicator of whether the overall financial condition has improved or diminished during the year. Assets and liabilities are generally measured using current values, except for capital assets, which are stated at historical cost, or fair value at the date of donation, less an allowance for depreciation and amortization.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, reflects the equity in property, plant and equipment owned by UAMS. The next category is restricted net assets, which is divided into two subcategories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditures by UAMS, but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets, which are available for any lawful purpose of UAMS.

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Management's Discussion and Analysis (Unaudited) (continued)

From the data presented, readers of the Statements of Net Assets are able to determine the assets available to continue the operations of UAMS. They are also able to determine how much UAMS owes vendors, investors and lending institutions. Finally, the Statements of Net Assets provide a picture of the net assets (assets minus liabilities) and their availability for expenditure by UAMS.

A summarization of UAMS' assets, liabilities and net assets is as follows:

Statements of Net Assets  
(in thousands)

|   | <b>2005</b>       | <b>June 30<br/>2004</b> | <b>2003</b>       |
|---|-------------------|-------------------------|-------------------|
| <b>Assets</b>                                   |                   |                         |                   |
| Current assets                                  | \$ 218,011        | \$ 208,790              | \$ 130,392        |
| Noncurrent assets:                              |                   |                         |                   |
| Investments                                     | 213,480           | 88,442                  | 112,472           |
| Capital assets, net                             | 346,444           | 338,831                 | 326,579           |
| Other   | 17,258            | 16,041                  | 15,632            |
| <b>Total Assets</b>                             | <b>\$ 795,193</b> | <b>\$ 652,104</b>       | <b>\$ 585,075</b> |
| <b>Liabilities</b>                              |                   |                         |                   |
| Current liabilities                             | \$ 83,844         | \$ 94,789               | \$ 70,209         |
| Noncurrent liabilities                          | 216,035           | 109,796                 | 114,316           |
| <b>Total Liabilities</b>                        | <b>299,879</b>    | <b>204,585</b>          | <b>184,525</b>    |
| <b>Net Assets</b>                               |                   |                         |                   |
| Invested in capital assets, net of related debt | 234,791           | 235,691                 | 228,607           |
| Restricted:                                     |                   |                         |                   |
| Expendable                                      | 38,264            | 30,115                  | 26,894            |
| Nonexpendable                                   | 29,004            | 27,940                  | 24,392            |
| Unrestricted                                    | 193,255           | 153,773                 | 120,657           |
| <b>Total Net Assets</b>                         | <b>495,314</b>    | <b>447,519</b>          | <b>400,550</b>    |
| <b>Total Liabilities and Net Assets</b>         | <b>\$ 795,193</b> | <b>\$ 652,104</b>       | <b>\$ 585,075</b> |

UAMS' financial health reflects the continued growth in volume of patient care service, increases in grants funding, and efforts at improving reimbursement from payor sources. Current assets consist primarily of cash and cash equivalents, accounts receivable (net), inventories, prepaid expenses and notes and student loans receivable (net). Noncurrent

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### Management's Discussion and Analysis (Unaudited) (continued)

assets include investments, notes and student loans receivable (net), capital assets (net) and other noncurrent assets. Current liabilities consist primarily of accounts payable and accrued liabilities, deferred revenue, estimated third-party payor settlements (Medicare and Medicaid) and the current portion of compensated absences payable and the current portion of bonds, notes and capital leases payable. Noncurrent liabilities include primarily compensated absences payable, net of current portion, and bonds, notes and capital leases payable, net of current portion. Net assets represent the residual interest in UAMS' assets after liabilities are deducted.

A review of UAMS' Statements of Net Assets shows that UAMS continues to build upon its strong financial foundation.

UAMS' total assets increased by \$143,089,000 for fiscal year 2005. A review of the Statements of Net Assets reveals that the increase was primarily due to an increase of \$9,221,000 in current assets and \$7,613,000 in capital assets (net), plus an increase in investments of \$125,038,000.

The increase in current assets was primarily due to an increase in cash and cash equivalents of \$54,887,000, offset by a decrease in accounts receivable of \$42,179,000 related to the Enhanced Medicaid program, with the balance of the change being decreases in a number of other accounts receivable. The Enhanced Medicaid program accounted for \$44,314,000 of the increase in cash and cash equivalents. For additional information about the Enhanced Medicaid program, see the Economic Outlook section of this Management's Discussion and Analysis. The balance of the increase in cash and cash equivalents was generated from operating activities. The increase in capital assets was primarily due to an increase in buildings, fixtures, and equipment. More detailed information about UAMS' capital assets is presented in Note 7 to the financial statements. Construction funds related to the major building projects discussed in the Economic Outlook section of this Management's Discussion and Analysis and in Note 5 to the financial statements provided \$108,181,000 of the increase in investments. Additionally, \$9,824,000 of the increase related to investments purchased with operating cash. The balance of the increase is related to reinvested income and capital appreciation.

Total liabilities increased by \$95,294,000 for fiscal year 2005. Liabilities related to the Enhanced Medicaid program discussed above, which were included in accounts payable and accrued liabilities in fiscal year 2004, decreased by \$20,468,000. Bonds, notes and capital leases payable increased by \$104,324,000, primarily from the new bond issues (see Note 10). In addition, estimated third-party payor settlements (Medicare and Medicaid) increased by \$558,000, trade accounts payable increased by \$3,259,000, and compensated absences increased by \$2,405,000.

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### Management's Discussion and Analysis (Unaudited) (continued)

UAMS' total assets increased by \$67,029,000 for fiscal year 2004. A review of the Statements of Net Assets reveals that the increase was primarily due to an increase of \$78,398,000 in current assets and \$12,252,000 in capital assets (net), offset by a decrease in investments of \$24,030,000. The increase in current assets was primarily due to accounts receivable at June 30, 2004 for Enhanced Medicaid revenue of \$46,277,000 and by an increase in cash and cash equivalents of \$27,686,000. A payment of \$43,773,000 was received from the Enhanced Medicaid program in July 2004, with the balance of \$2,504,000 expected to be received in the second quarter of fiscal year 2005. The increase in cash and cash equivalents was from net proceeds from sales and maturities of investments of \$25,000,000, with the balance being an increase in cash generated from noncapital financing activities. The increase in capital assets was primarily due to an increase in buildings, fixtures, and equipment. More detailed information about UAMS' capital assets is presented in Note 7 to the financial statements.

Total liabilities increased by \$20,060,000 for fiscal year 2004. Liabilities related to the Enhanced Medicaid program discussed above, which were included in accounts payable and accrued liabilities, were \$20,468,000, of which \$18,627,000 was paid in July 2004. In addition, estimated third-party payor settlements (Medicare and Medicaid) increased by \$2,843,000 and compensated absences increased by \$884,000. Bonds, notes and capital leases payable decreased by \$4,852,000, primarily from scheduled debt payments offsetting the increases in liabilities noted above.

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Management's Discussion and Analysis (Unaudited) (continued)

*Statements of Revenue, Expenses and Changes in Net Assets*

Changes in net assets, as presented in the Statements of Net Assets, are based on the activity presented in the Statements of Revenue, Expenses and Changes in Net Assets. A summary of UAMS' revenue, expenses and changes in net assets is as follows:

**Statements of Revenue, Expenses and Changes in Net Assets**  
(in thousands)

|   | Year ended June 30 |            |            |
|---|--------------------|------------|------------|
|   | 2005               | 2004       | 2003       |
| <b>Operating Revenue</b>                                |                    |            |            |
| Student tuition and fees, net of scholarship allowances | \$ 13,146          | \$ 12,191  | \$ 10,230  |
| Net patient services                                    | 583,680            | 535,148    | 486,166    |
| Sponsored programs                                      | 133,490            | 135,401    | 107,017    |
| Other   | 33,512             | 30,216     | 25,738     |
| Total Operating Revenue                                 | <b>763,828</b>     | 712,956    | 629,151    |
| <b>Operating Expenses</b>                               |                    |            |            |
| Compensation and benefits                               | 518,599            | 481,893    | 440,174    |
| Supplies and other services                             | 233,823            | 219,404    | 195,386    |
| Scholarships and fellowships                            | 192                | 196        | 464        |
| Depreciation and amortization                           | 24,086             | 22,675     | 19,744     |
| Total Operating Expenses                                | <b>776,700</b>     | 724,168    | 655,768    |
| <b>Operating Loss</b>                                   | <b>(12,872)</b>    | (11,212)   | (26,617)   |
| <b>Nonoperating Revenue (Expenses)</b>                  |                    |            |            |
| State appropriations, net                               | 41,458             | 36,961     | 39,266     |
| Gifts   | 7,182              | 6,610      | 5,778      |
| Investment gain, net of expense                         | 10,311             | 6,023      | 6,540      |
| Other   | (5,796)            | (2,851)    | (3,454)    |
| Total Nonoperating Revenue (Expenses)                   | <b>53,155</b>      | 46,743     | 48,130     |
| <b>Income Before Other Changes in Net Assets</b>        | <b>40,283</b>      | 35,531     | 21,513     |
| <b>Other Changes in Net Assets</b>                      |                    |            |            |
| Capital gifts   | 7,512              | 4,070      | 7,330      |
| Capital appropriations                                  | -                  | 7,368      | 25,491     |
| Total Other Changes in Net Assets                       | <b>7,512</b>       | 11,438     | 32,821     |
| <b>Increase in Net Assets</b>                           | <b>47,795</b>      | 46,969     | 54,334     |
| Net Assets - beginning of year                          | 447,519            | 400,550    | 346,216    |
| <b>Net Assets - end of year</b>                         | <b>\$ 495,314</b>  | \$ 447,519 | \$ 400,550 |

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### Management's Discussion and Analysis (Unaudited) (continued)

The Statement of Revenue, Expenses and Changes in Net Assets reflects an increase of \$47,795,000 in net assets for fiscal year 2005. Highlights of the information presented in this statement show how the following affected operating revenue during fiscal year 2005:

The growth in student tuition and fees, net of scholarship allowances, reflects an increase in students in all of the colleges, except the Graduate School, and small tuition increases. Net patient services revenue increased by \$48,532,000. The increase in net patient services revenue is primarily due to increased volume in both inpatient and outpatient services with the major growth being in Oncology services. Sponsored Programs, which include federal grants and contracts, state and local grants and contracts, and nongovernmental grants and contracts, increased by \$5,489,000, after adjusting for the \$7,400,000 discussed below, with modest growth in all three categories. During 2004, management determined that approximately \$7,400,000 of federal grants revenue related to prior years had not been recognized. Therefore, this revenue is recognized in federal grants and contracts in the accompanying 2004 financial statements. Other revenue includes auxiliary enterprises, which grew by \$2,055,000, primarily from cafeteria, and parking revenue, and other miscellaneous revenue sources, which account for the balance of the increase.

The following factors affected operating expenses during fiscal year 2005:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2005, increasing by \$36,706,000. Compensation and benefits expense related to patient care increased by \$14,598,000 due to necessary staffing to support increased patient volumes and salary adjustments due to the nursing and medical technologist shortages in the market area served by UAMS. Also, compensation and benefits expense increased by \$3,120,000 in sponsored programs due to new grants and contracts in fiscal year 2005, as discussed above in the revenue section. The balance of the increase in compensation and benefits was the result of normal salary increases and increased medical premiums. The increase in patient volume also contributed to increased supplies and other services expense of \$13,904,000, primarily related to Oncology and Radiology.

The Statement of Revenue, Expenses and Changes in Net Assets reflects an increase of \$46,969,000 in net assets for fiscal year 2004. Highlights of the information presented in this statement show how the following affected operating revenue during fiscal year 2004:

## University of Arkansas for Medical Sciences

### Management's Discussion and Analysis (Unaudited) (continued)

The growth in student tuition and fees, net of scholarship allowances, reflects an increase in students in all of the colleges, except the College of Medicine, and small tuition increases. Net patient services revenue increased by \$48,982,000. The Enhanced Medicaid program discussed above in the review of UAMS' *Statements of Net Assets* and below in the *Economic Outlook* section accounted for \$25,810,000 of the increase. The College of Medicine Pediatrics department recorded nonrecurring revenue of \$6,174,000 from a cost settlement. The balance of the increase in net patient services revenue is primarily due to increased volume in both inpatient and outpatient services. Sponsored Programs include federal grants and contracts, which increased by \$21,042,000, primarily from NIH awards, and other grants and contracts which increased by \$7,342,000, primarily from the new Antenatal and Neonatal Guidelines, Education and Learning System (ANGELS) program. ANGELS is a cooperative program between UAMS, the Arkansas State Department of Human Services and the Arkansas Medical Society to improve regional prenatal care for high-risk pregnancies. During 2004, management determined that approximately \$7,400,000 of federal grants revenue related to prior years had not been recognized. Therefore, this revenue is recognized in federal grants and contracts in the accompanying 2004 financial statements. Other revenue includes auxiliary enterprises, which grew by \$1,435,000, primarily from cafeteria, bookstore and parking revenue, and other miscellaneous revenue sources, which account for the balance of the increase.

The following factors affected operating expenses during fiscal year 2004:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2004, increasing by \$41,719,000. Compensation and benefits expense related to patient care increased by \$20,968,000 due to necessary staffing to support increased patient volumes and salary adjustments due to the nursing and medical technologist shortages in the market area served by UAMS. Also, compensation and benefits expense increased by \$11,977,000 in sponsored programs due to new grants and contracts in fiscal year 2004, as discussed above in the revenue section. The balance of the increase in compensation and benefits was the result of normal salary increases. The increase in patient volume also contributed to increased supplies and other services expense of \$6,065,000. The increased number of students in all of the colleges, except the College of Medicine, contributed to a \$6,368,000 increase in supplies and other services. Additionally, sponsored program supplies and other services expense increased by \$7,713,000, primarily due to subcontract awards and facilities and administrative expense.

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Management's Discussion and Analysis (Unaudited) (continued)

State appropriations are reported in the Statements of Revenue, Expenses and Changes in Net Assets as Nonoperating Revenue, net of the Medicaid match payments required under various contracts between UAMS and the Arkansas Department of Human Services.

Net state appropriations revenue for the years ended June 30, 2005, 2004 and 2003, is as follows (*in thousands*):

|                                    | <b>2005</b>      | <b>2004</b> | <b>2003</b> |
|------------------------------------|------------------|-------------|-------------|
| Gross state appropriations revenue | <b>\$ 83,324</b> | \$ 81,061   | \$ 79,167   |
| Less Medicaid match payments       | <b>41,866</b>    | 44,100      | 39,901      |
| Net state appropriations revenue   | <b>\$ 41,458</b> | \$ 36,961   | \$ 39,266   |

***Results of Operations***

In fiscal year 2005, UAMS experienced an increase of 10.7% in net assets. The major driver of the net asset growth was a 9.1% growth in net patient services revenue while holding the increase in operating expenses to a 7.2% growth. Additionally, capital gifts continue to be an important component of UAMS' growth, totaling \$7,512,000 in fiscal year 2005.

Although the overall financial position improved in 2005, there were some occurrences that adversely affected the financial position.

Gross state appropriations continue to decrease as a percent of UAMS' funding, accounting for approximately 10.0% and 10.2% of UAMS revenue for fiscal 2005 and 2004, respectively.

Compensation and employee benefits increased by 7.6%, which reflects the additional staffing needed to support the growth in patient volume, as well as a 24.1% increase in medical insurance expense. This increase was driven by both increased staffing and medical insurance rate increases of 12% on July 1, 2004 and 10% on November 1, 2004.

In fiscal year 2004, UAMS experienced an increase in net assets and its overall financial position improved compared to the previous fiscal year. Billings by the Hospital and the Faculty Group Practice (FGP) increased in 2004, and collections of patient receivables improved in the past year because of enhanced collection procedures and accounting

University of Arkansas for Medical Sciences

Management's Discussion and Analysis (Unaudited) (continued)

processes. Receipt of Enhanced Medicaid revenue accounted for \$25,810,000 of revenue in fiscal year 2004. Gross state appropriations accounted for approximately 10.2% and 11.2% of UAMS revenue for fiscal 2004 and 2003, respectively.

Although the overall financial position improved in 2004, there were some occurrences that adversely affected the financial position. These include a 9.5% increase in compensation and employee benefits which reflects the additional staffing needed to support the 6.1% growth in patient volume, additional staffing supporting the increased grants and contracts volume, and salary enhancements necessary to remain competitive in the market.

**Statements of Cash Flows**

The Statements of Cash Flows present information related to cash flows of UAMS. The statements present cash flows by category: operating activities, noncapital financing activities, capital and related financing activities and investing activities. The net cash and cash equivalents provided to, or used by UAMS, are presented by category.

**Statements of Cash Flows**  
(in thousands)

|   | Year ended June 30 |                  |                  |
|---|--------------------|------------------|------------------|
|   | 2005               | 2004             | 2003             |
| <b>Cash and cash equivalents provided by (used in):</b> |                    |                  |                  |
| Operating activities                                    | \$ 42,960          | \$ (13,137)      | \$ 7,248         |
| Noncapital financing activities                         | 52,050             | 42,061           | 40,692           |
| Capital and related financing activities                | 74,604             | (29,474)         | (32,043)         |
| Investing activities                                    | (114,727)          | 28,236           | (5,936)          |
| Net increase in cash and cash equivalents               | 54,887             | 27,686           | 9,961            |
| Cash and cash equivalents – beginning of year           | 58,495             | 30,809           | 20,848           |
| <b>Cash and cash equivalents – end of year</b>          | <b>\$ 113,382</b>  | <b>\$ 58,495</b> | <b>\$ 30,809</b> |

University of Arkansas for Medical Sciences

Management's Discussion and Analysis (Unaudited) (continued)

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

*Capital Assets*

At June 30, 2005, UAMS had \$346,444,000 invested in capital assets, net of accumulated depreciation and amortization of \$221,218,000. Depreciation and amortization charges totaled \$24,086,000 for the fiscal year ended June 30, 2005.

UAMS' capital additions totaled \$32,476,000 in fiscal year 2005. Capital additions primarily comprised replacement, renovation and new construction of academic, research and hospital facilities, as well as investments in equipment. Major capital additions in fiscal year 2005 and the sources that funded their acquisition included:

| <b>Project</b>  | <b>Amount of Additions</b> | <b>Funding Source</b>           |
|---|----------------------------|---------------------------------|
|   | <i>(in thousands)</i>      |                                 |
| Jones Eye Institute – Walker Tower Addition                                       | \$ 3,363                   | Pat & Willard Walker Foundation |
| Jackson T. Stephens Spine & Neurosciences Bldg. – Fred W. Smith Conference Center | 3,408                      | Reynolds Foundation and UAMS    |
| New Patient Bed Tower, Residence Hall & Parking Deck                              | 1,711                      | 2004 Bond Issuance              |

The Pat & Willard Walker Tower addition to the Harvey & Bernice Jones Eye Institute is scheduled to be completed in fiscal year 2006. The Fred W. Smith Conference Center that was constructed on the twelfth floor of the Jackson T. Stephens Spine and Neurosciences Institute was opened earlier in fiscal year 2005.

Construction-in-progress at June 30, 2005, included the Walker Tower addition along with various renovation and maintenance projects. More detailed information about UAMS' capital assets is presented in Note 7 to the financial statements.

# University of Arkansas for Medical Sciences

## Management's Discussion and Analysis (Unaudited) (continued)

### ***Debt Administration***

At June 30, 2005, UAMS had \$227,151,000 in outstanding obligations (for additional information, see the Economic Outlook section of this Management Discussion and Analysis), as shown in the following table:

| <b>Obligation</b>                | <b>Amount<br/>Outstanding<br/>(in thousands)</b> |
|----------------------------------|--|
| Bonds payable                    | \$ 180,187                                       |
| Notes payable                    | 8,438  |
| Obligations under capital leases | 9,768  |
| Compensated absences             | 28,758   |
|                                  | <u>\$ 227,151</u>                                |

Moody's Investment Service raised the rating of the University of Arkansas System from A1 to Aa3 in August 2004. UAMS, as one of the colleges in the University of Arkansas System, will benefit from this rating increase. More detailed information about short-term and long-term liabilities is presented in Notes 9, 10 and 11 to the financial statements.

### **ECONOMIC OUTLOOK**

UAMS' financial position continued to strengthen in fiscal year 2005 as evidenced by an approximate \$47,795,000 increase in Net Assets. One of UAMS' greatest financial strengths is the diverse stream of revenue which funds its operations, including tuition, patient services revenue, state appropriations, investment income, and philanthropic support from individuals, foundations, and corporations. UAMS continues to aggressively seek funding from all possible sources consistent with its fourfold mission to teach, to heal, to search, and to serve.

In fiscal year 2005, UAMS embarked on a series of expansion projects designed to support its four missions. This series of projects will include a \$168,000,000 building project to replace the 50-year-old hospital bed units, build a new dormitory, and add 40 new inpatient psychiatric bed units. UAMS refinanced \$58,265,000 of outstanding 1998 facility bonds and issued \$95,915,000 in new bonds in fiscal year 2005 with plans to issue \$100,000,000 more in fiscal year 2007. The new bonds will be secured by a pledge of patient service revenue. The new facility will house 350 to 375 bed units and additional bassinets, operating rooms, additional cardiac cath labs, radiology, and other

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### Management's Discussion and Analysis (Unaudited) (continued)

ancillary areas. UAMS will shell an additional two floors, which may hold another 120 beds. A psychiatry wing, The UAMS Psychiatry Institute, will house 40 psychiatric inpatient beds, psychiatry clinics, offices, and research areas. UAMS will build a power plant capable of maximum power generation which can meet all the power needs of the west side of the UAMS campus during peak operating periods and reduce operating costs. The new bonds are expected to be fixed 30-year indentures. In addition to the facility bonds, UAMS issued \$10,070,000 in parking facility bonds to add to UAMS' parking capacity. Parking system revenues are pledged for debt service.

While UAMS' hospital and clinics are well situated to maintain a strong financial position in the near term, ongoing constraints on revenue are expected to continue because of the continual tightening of reimbursement and fiscal pressures on employers and federal and state governments. Management believes that much of the pressure can be offset by growth in patient volume. An independent strategic planning consultant projected a 27% growth over ten years for inpatient volume and a 39% growth over ten years for outpatient volume. In the two years following the study, inpatient volume grew by 4.7% and outpatient volume grew by 14.1%.

Additionally, management recognizes the absolute necessity of cost control. Management has identified expense reduction targets for the upcoming year and is actively developing strategies for future years. All departments have reduced base budgets by 1% for efficiencies they are tasked to find. The hospital supply budget has been reduced by 4%. These reductions will help cover the costs of the extra debt service. UAMS has begun significant investments in information technology in order to generate necessary productivity gains, more closely manage clinical practice and outcomes, continue to increase patient safety, and to remain compliant with an ever-growing regulatory burden.

In addition to increases in patient volume, UAMS continues to enhance other funding sources. Two examples are the Enhanced Medicaid Program and the Tobacco Settlement Funds. Both programs are described below.

In the fourth quarter of fiscal year 2004, UAMS successfully completed the requirements to participate in the Enhanced Medicaid Program. The first payment under this program was received in July 2004 and covered the period October 2002 through May 2004. The net proceeds to UAMS from this payment were approximately \$25,810,000. Fiscal year 2005 net proceeds from this program were approximately \$25,265,000. UAMS expects modest growth in net proceeds in subsequent years. The additional expense to participate in the Enhanced Medicaid Program is minimal.

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### Management's Discussion and Analysis (Unaudited) (continued)

Initiated Act Number 1 of 2000, the Tobacco Settlement Proceeds Act, was passed by popular vote on November 7, 2000. During fiscal 2005 and 2004, UAMS received \$9,968,000 and \$9,478,000, respectively, in operating funds from the Tobacco Settlement Funds for the College of Public Health, the Donald W. Reynolds Center on Aging and the Department of Geriatrics, Delta Area Health Education Center, and the Arkansas Biosciences Institute. In addition to the operating funds, the Arkansas Development Finance Authority issued Tobacco Settlement Revenue Bonds. Proceeds from the sale of these bonds were used to provide funds for two capital projects on the UAMS Campus that were completed in fiscal 2004:

- The Arkansas Biosciences Institute (ABSI) building to house the University of Arkansas for Medical Sciences Biosciences Institute. The ABSI supports focused programs in the areas of agricultural research with medical implications, bioengineering, tobacco-related research, nutritional and other research focused on cancer prevention or treatment and additional research approved by the ABSI Board.
- The College of Public Health building to house the University of Arkansas for Medical Sciences College of Public Health. The mission of the college is to improve health and promote the well-being of individuals, families and communities in Arkansas through education, research and service.

UAMS has experienced solid financial growth with a three-year average annual growth in Net Assets of 14.4%. Because of the strength and commitment of the faculty, staff, and students, UAMS has positioned itself well to respond to future opportunities and challenges.

#### **REQUESTS FOR INFORMATION**

This financial report is designed to provide a general overview of UAMS' finances. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Vice Chancellor for Finance & Chief Financial Officer, 4301 West Markham, #632, Little Rock, Arkansas 72205.

## Report of Independent Auditors

The Board of Trustees  
University of Arkansas System

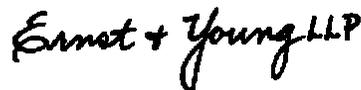
We have audited the accompanying statements of net assets, revenue, expenses and changes in net assets and cash flows of the University of Arkansas for Medical Sciences (UAMS) as of and for the years ended June 30, 2005 and 2004, as listed in the table of contents. These financial statements are the responsibility of UAMS' 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 and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. We were not engaged to perform an audit of UAMS' internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of UAMS' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Arkansas for Medical Sciences as of June 30, 2005 and 2004, and its changes in net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 7, 2005, on our consideration of UAMS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

Management's Discussion and Analysis on pages 1 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



October 7, 2005

# University of Arkansas for Medical Sciences

## Statements of Net Assets (in thousands)

|  | June 30    |            |
|--|------------|------------|
|  | 2005       | 2004       |
| <b>ASSETS</b>  |            |            |
| Current Assets:  |            |            |
| Cash and cash equivalents (Note 4)   | \$ 113,382 | \$ 58,495  |
| Patient accounts receivable, net (Note 2)  | 78,795     | 119,486    |
| Nonpatient accounts receivable, net  | 15,248     | 21,354     |
| Inventories  | 7,618      | 7,133      |
| Notes and student loans receivable, net (Notes 6 and 17)                             | 2,479      | 2,179      |
| Prepaid expenses   | 489        | 143        |
| Total Current Assets   | 218,011    | 208,790    |
| Noncurrent Assets:   |            |            |
| Investments (Note 5)   | 213,480    | 88,442     |
| Notes and student loans receivable, net (Notes 6 and 17)                             | 13,849     | 14,020     |
| Capital assets, net (Notes 7, 10 and 11)   | 346,444    | 338,831    |
| Other noncurrent assets  | 3,409      | 2,021      |
| Total Noncurrent Assets  | 577,182    | 443,314    |
| Total Assets   | \$ 795,193 | \$ 652,104 |
| <b>LIABILITIES</b>   |            |            |
| Current Liabilities:   |            |            |
| Accounts payable and accrued liabilities (Note 8)                                    | \$ 55,172  | \$ 67,684  |
| Deferred revenue   | 2,163      | 1,672      |
| Funds held in trust for others   | 442        | 413        |
| Estimated third-party payor settlements (Note 2)                                     | 14,829     | 14,271     |
| Compensated absences payable, current portion (Note 10)                              | 1,545      | 1,348      |
| Bonds, notes and capital leases payable, current portion<br>(Notes 9, 10 and 11)     | 9,693      | 9,401      |
| Total Current Liabilities  | 83,844     | 94,789     |
| Noncurrent Liabilities:  |            |            |
| Deposits   | 122        | 123        |
| Compensated absences payable, net of current portion (Note 10)                       | 27,213     | 25,005     |
| Bonds, notes and capital leases payable, net of current portion<br>(Notes 10 and 11) | 188,700    | 84,668     |
| Total Noncurrent Liabilities   | 216,035    | 109,796    |
| Total Liabilities  | 299,879    | 204,585    |
| Commitments and Contingencies (Notes 11, 14, 15 and 18)                              |            |            |
| <b>NET ASSETS</b>  |            |            |
| Invested in capital assets, net of related debt                                      | 234,791    | 235,691    |
| Restricted (Note 12):  |            |            |
| Expendable   | 38,264     | 30,115     |
| Nonexpendable  | 29,004     | 27,940     |
| Unrestricted (Note 13)   | 193,255    | 153,773    |
| Total Net Assets   | 495,314    | 447,519    |
| Total Liabilities and Net Assets   | \$ 795,193 | \$ 652,104 |

*See accompanying notes.*

University of Arkansas for Medical Sciences

Statements of Revenue, Expenses and Changes in Net Assets  
(in thousands)

|  | Year ended June 30 |                   |
|--|--------------------|-------------------|
|  | 2005               | 2004              |
| REVENUE  |                    |                   |
| Operating Revenue:   |                    |                   |
| Student tuition and fees (net of scholarship allowances<br>of \$2,116 in 2005 and \$2,134 in 2004) | \$ 13,146          | \$ 12,191         |
| Net patient services (Notes 2 and 10)  | 583,680            | 535,148           |
| Sponsored programs:  |                    |                   |
| Federal grants and contracts   | 82,796             | 87,573            |
| State and local grants and contracts   | 14,503             | 13,745            |
| Nongovernmental grants and contracts   | 36,191             | 34,083            |
| Sales and services of educational departments  | 20,762             | 19,076            |
| Auxiliary enterprises:   |                    |                   |
| Housing and food service   | 3,113              | 1,974             |
| Bookstore  | 785                | 836               |
| Other auxiliary enterprises  | 2,985              | 2,018             |
| Other operating revenue  | 5,867              | 6,312             |
| Total Operating Revenue  | <u>763,828</u>     | <u>712,956</u>    |
| EXPENSES   |                    |                   |
| Operating Expenses (Note 19):  |                    |                   |
| Compensation and benefits  | 518,599            | 481,893           |
| Supplies and other services  | 233,823            | 219,404           |
| Scholarships and fellowships   | 192                | 196               |
| Depreciation and amortization (Note 7)   | 24,086             | 22,675            |
| Total Operating Expenses   | <u>776,700</u>     | <u>724,168</u>    |
| Operating Loss   | (12,872)           | (11,212)          |
| NONOPERATING REVENUE (EXPENSES)  |                    |                   |
| State appropriations, net (Note 3)   | 41,458             | 36,961            |
| Gifts  | 7,182              | 6,610             |
| Investment gain, net of investment expense (Note 5)  | 10,311             | 6,023             |
| Interest on capital  | (4,964)            | (2,802)           |
| Loss on disposal of capital assets   | (832)              | (49)              |
| Total Nonoperating Revenue (Expenses)  | <u>53,155</u>      | <u>46,743</u>     |
| Income Before Other Changes in Net Assets  | 40,283             | 35,531            |
| OTHER CHANGES IN NET ASSETS  |                    |                   |
| Capital gifts  | 7,512              | 4,070             |
| Capital appropriations   | -                  | 7,368             |
| Total Other Changes in Net Assets  | <u>7,512</u>       | <u>11,438</u>     |
| Increase in Net Assets   | 47,795             | 46,969            |
| Net Assets – beginning of year   | 447,519            | 400,550           |
| Net Assets – end of year   | <u>\$ 495,314</u>  | <u>\$ 447,519</u> |

See accompanying notes.

University of Arkansas for Medical Sciences

Statements of Cash Flows  
(in thousands)

|   | Year ended June 30 |                 |
|---|--------------------|-----------------|
|   | 2005               | 2004            |
| <b>CASH FLOWS FROM OPERATING ACTIVITIES</b>   |                    |                 |
| Tuition and fees (net of scholarships)  | \$ 13,742          | \$ 13,720       |
| Patient and insurance payments  | 633,304            | 480,290         |
| Research grants and contracts   | 138,521            | 134,149         |
| Collection of loans and interest  | 2,055              | 3,087           |
| Auxiliary enterprise revenue:   |                    |                 |
| Housing and food service  | 3,090              | 1,981           |
| Bookstore   | 785                | 836             |
| Other auxiliary enterprises   | 2,972              | 1,990           |
| Other receipts  | 23,821             | 24,705          |
| Payments to suppliers   | (251,006)          | (184,634)       |
| Payments to employees   | (425,253)          | (393,480)       |
| Payments of employee benefits   | (88,311)           | (84,033)        |
| Loans issued to students  | (2,397)            | (3,723)         |
| Scholarships and fellowships  | (192)              | (196)           |
| Other payments  | (8,171)            | (7,829)         |
| Net cash and cash equivalents provided by (used in)<br>operating activities                     | <b>42,960</b>      | <b>(13,137)</b> |
| <b>CASH FLOWS FROM NONCAPITAL FINANCING<br/>ACTIVITIES</b>                                      |                    |                 |
| State appropriations  | 44,218             | 34,946          |
| Gifts and grants  | 7,182              | 6,610           |
| Loan proceeds   | 450                | 15,000          |
| Other agency funds (net)  | 29                 | 221             |
| Repayments of loans   | 171                | (14,716)        |
| Net cash and cash equivalents provided by noncapital<br>financing activities                    | <b>52,050</b>      | <b>42,061</b>   |
| <b>CASH FLOWS FROM CAPITAL AND RELATED<br/>FINANCING ACTIVITIES</b>                             |                    |                 |
| Proceeds from issuance of debt  | 164,916            | —               |
| Proceeds from sale of capital assets  | 62                 | 57              |
| Purchases of capital assets   | (21,736)           | (20,475)        |
| Principal paid on capital debt and leases   | (63,877)           | (6,313)         |
| Interest and paying agent fees paid on debt and capital leases                                  | (4,761)            | (2,743)         |
| Net cash and cash equivalents provided by (used by)<br>capital and related financing activities | <b>74,604</b>      | <b>(29,474)</b> |

University of Arkansas for Medical Sciences

Statements of Cash Flows (continued)

(in thousands)

|  | Year ended June 30 |                    |
|--|--------------------|--------------------|
|  | 2005               | 2004               |
| <b>CASH FLOWS FROM INVESTING ACTIVITIES</b>  |                    |                    |
| Proceeds from sales and maturities of investments  | \$ 65,188          | \$ 35,000          |
| Interest on investments (net of fees)  | 2,382              | 3,236              |
| Purchase of investments  | <b>(182,297)</b>   | (10,000)           |
| Net cash and cash equivalents (used in) provided by investing activities   | <b>(114,727)</b>   | 28,236             |
| Net increase in cash and cash equivalents  | <b>54,887</b>      | 27,686             |
| Cash and cash equivalents – beginning of year  | <b>58,495</b>      | 30,809             |
| Cash and cash equivalents – end of year  | <b>\$ 113,382</b>  | <b>\$ 58,495</b>   |
| Operating loss   | <b>\$ (12,872)</b> | \$ (11,212)        |
| Adjustments to reconcile net operating loss to net cash and cash equivalents provided by (used in) operating activities: |                    |                    |
| Depreciation and amortization  | <b>24,086</b>      | 22,675             |
| Changes in assets and liabilities:   |                    |                    |
| Patient and nonpatient accounts receivable, net  | <b>43,977</b>      | (49,637)           |
| Inventories  | <b>(485)</b>       | 214                |
| Other assets   | <b>(646)</b>       | 132                |
| Accounts payable and accrued liabilities   | <b>(14,553)</b>    | 20,998             |
| Deferred revenue   | <b>491</b>         | (18)               |
| Deposits   | <b>(1)</b>         | (16)               |
| Compensated absences payable   | <b>2,405</b>       | 884                |
| Other liabilities  | <b>558</b>         | 2,843              |
| Net cash and cash equivalents provided by (used in) operating activities   | <b>\$ 42,960</b>   | <b>\$ (13,137)</b> |
| Noncash transactions:  |                    |                    |
| Fixed assets acquired by capital gift  | <b>\$ 7,512</b>    | \$ 4,070           |
| Fixed asset acquisition paid for by State of Arkansas  | <b>\$ –</b>        | \$ 5,106           |
| Fixed assets acquired by incurring capital lease obligations   | <b>\$ 3,284</b>    | \$ 6,949           |

See accompanying notes.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements

June 30, 2005

### 1. Summary of Significant Accounting Policies

The University of Arkansas for Medical Sciences (UAMS) is one of thirteen campuses operating within the University of Arkansas System, organized under various laws of the State of Arkansas and governed by the University of Arkansas' ten-member Board of Trustees.

***Basis of Presentation*** – UAMS accounts for its activities through the use of an enterprise fund. Enterprise funds are used to account for activities similar to those found in the private sector, where the determination of a change in financial position is necessary or useful for sound financial administration. The accounting records of UAMS are organized on the basis of funds as prescribed by accounting principles generally accepted in the United States (GAAP) applicable to governmental colleges and universities as established by the Governmental Accounting Standards Board (GASB).

UAMS has adopted GASB Statement No. 20 (GASB 20), *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*. GASB 20 requires enterprise funds to adhere to all applicable GASB pronouncements as well as those statements and interpretations of the Financial Accounting Standards Board (FASB), Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure, issued on or before November 30, 1989, which do not conflict with or contradict GASB pronouncements. UAMS has elected not to adopt any FASB statements and interpretations issued after November 30, 1989, unless implementation is required by a GASB pronouncement.

UAMS is a state-assisted academic health center composed of:

- The Colleges of Medicine, Pharmacy, Nursing, Health Related Professions, Public Health and Graduate School with a combined full-time equivalent enrollment of 2,062 and faculty numbering 1,232;
- The University Hospital of Arkansas, a tertiary care referral center with 265 adult beds in use at June 30, 2005;
- Regional programs including Tele-education, Rural Hospital Program and seven Area Health Education Centers (AHEC) located throughout the state;
- The Arkansas Cancer Research Center;
- Jones Eye Institute;
- Donald W. Reynolds Center on Aging;
- Multiple Myeloma Institute;
- Arkansas Biosciences Institute; and
- Jackson T. Stephens Spine and Neurosciences Institute.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

The Little Rock campus includes approximately 3,600,000 square feet of office, clinical research, educational, workshop and general-purpose space, excluding space utilized at Arkansas Children's Hospital and leased space in the community.

**Accrual Accounting** – The financial statements are prepared on the accrual basis of accounting. Revenue is recorded when earned and expenses are recorded when incurred.

**Cash and Cash Equivalents** – Cash and cash equivalents include short-term, highly liquid investments that are readily convertible to cash and have a maturity at acquisition of three months or less.

**Investments** – Investments and funds held in trust by others are reported at fair value as established by major securities markets. All investment income, including changes in the fair value of investments, is reported as nonoperating revenue.

The University of Arkansas System Board of Trustees and the University of Arkansas Foundation Board of Trustees are the sponsors of an external investment pool (the Pool) and are responsible for the operation and oversight of the Pool. The Pool is not SEC-registered, and participation is voluntary. Participation in or withdrawal from the cash segment of the Pool is based on the daily market value of the units within the Pool. Participation in or withdrawal from the investment segment of the Pool is based on the market value per unit at the beginning of the calendar quarter in which the transaction takes place. Income from the Pool is allocated to the participants in the Pool based on the market value per unit from the previous day. The Pool issues a publicly available financial report, which may be obtained by writing or calling the University of Arkansas System, 2404 North University Avenue, Little Rock, Arkansas 72207-3608, (501) 686-2500.

**Nonpatient Accounts Receivable** – Nonpatient accounts receivable represents primarily amounts due from other organizations and the State of Arkansas.

**Patient Accounts Receivable** – Patient accounts receivable is shown net of contractual adjustments and an allowance for doubtful accounts. Credit balances representing refunds due are reported as accounts payable.

**Loan Funds** – Loan funds, included in cash and cash equivalents in the statements of net assets, consist of resources made available for financial loans to students of UAMS. These resources include federal funds, funds from other external sources and UAMS funds.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

**Inventories** – Inventories, consisting primarily of medical supplies and drugs, are carried at the lower of cost or market on either the first-in, first-out (FIFO) basis or average cost basis.

**Capital Assets** – Capital assets are stated at cost at the date of acquisition or fair value at the date of donation. Interest on borrowings to finance facilities is capitalized during construction, net of any investment income earned through the temporary investment of project borrowings. UAMS has established a capitalization threshold of \$2,500 for its capital assets. Depreciation and amortization are calculated using the straight-line method over the lesser of the estimated useful lives as established by the American Hospital Association (AHA) or the lease term as follows:

|                        |  |
|------------------------|--|
| Buildings and fixtures | 15 to 40 years                                   |
| Equipment              | 3 to 15 years                                    |
| Leased assets          | Dependent on lease term; generally 3 to 10 years |
| Other                  | 3 to 15 years                                    |

Amortization of amounts under capital lease is included in depreciation and amortization expense.

**Compensated Absences** – Vested or accumulated vacation leave of UAMS employees is recorded as an expense and liability as the benefits are earned. Amounts recorded include salary expense as well as salary-related payments (e.g., FICA taxes, retirement). No liability is recorded for nonvested accumulated rights to receive sick pay benefits. The current portion of compensated absences is determined using the average balance paid in the prior two-year period.

**Operating Versus Nonoperating Revenue** – For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services and education are reported as operating revenue and expenses. Operating revenue consists of tuition and fees, patient services revenue, operating grants and contracts, educational department sales and services, as well as various auxiliary services. Nonoperating revenue consists of revenue that results from nonexchange transactions or investment-related activities including state appropriations (net of appropriations used for Medicaid match), nonoperating gifts, grants and bequests, capital contributions, loss on disposal of capital assets, investment income and additions to endowments.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**1. Summary of Significant Accounting Policies (continued)**

***Net Patient Services Revenue*** – Net patient services revenue is reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered. Retroactive adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted as final settlements are determined.

***Charity Care*** – UAMS provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UAMS does not pursue collection of amounts determined to qualify as charity care, these amounts are accounted for as a reduction of patient services revenue at the time the services are rendered.

***Grants and Contracts*** – UAMS has been awarded grants and contracts for operations for which the monies have not been received or expended. These awards have not been reflected in the financial statements but represent commitments of sponsors to provide funds for specific research and training projects.

Federal research grants and contracts normally provide for the recovery of direct and indirect costs, subject to adjustment based upon review by the granting agencies. UAMS recognizes revenue associated with direct costs as the related costs are incurred. The recovery of indirect costs is recorded at predetermined rates negotiated with the federal government that are effective from July 1, 2002 through June 30, 2005. The recovery of indirect costs will be recorded at a previously negotiated provisional rate after July 1, 2005, until such time as a new rate can be negotiated.

During fiscal 2004, management determined that approximately \$7,400,000 of federal grants revenue related to prior years had not been recognized. Therefore, this revenue was recognized in federal grants and contracts in the fiscal 2004 financial statements. There was no revenue recognition issue to report in fiscal year 2005.

***Student Financial Aid*** – Revenue and expenditures for student financial aid are recognized as such in the period earned. Tuition and fees are shown net of applicable scholarship allowances.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 1. Summary of Significant Accounting Policies (continued)

**Endowment Income** – Endowment funds are subject to the restrictions of gift instruments requiring that the principal be invested in perpetuity and only the income be utilized. Term endowment funds are similar to endowment funds except that, upon the passage of a stated period of time or the occurrence of a particular event, all or part of the principal may be expended. While quasi-endowment funds have been established by the Board of Trustees for the same purposes as endowment funds, any portion of quasi-endowment funds may be expended. As such, the expired portion of term endowments and all quasi-endowments are reflected as unrestricted net assets in the statements of net assets. UAMS employs a total-return policy in determining the amount of investment income to be spent.

**Income Taxes** – UAMS is part of the University of Arkansas System and, as such, is exempt from federal income taxes except for tax on unrelated business income. Management of UAMS is not aware of any significant unrelated business income. Accordingly, no provision for income taxes is made in the accompanying financial statements.

**Use of Restricted Resources** – When both restricted and unrestricted resources are available for use, it is UAMS' policy to use restricted resources first, then unrestricted resources as they are needed.

**Net Assets** – Net assets restricted by outside sources are distinguished from unrestricted funds allocated for specific purposes by action of the Board of Trustees. Externally restricted funds may only be utilized in accordance with the purposes established by the donor or grantor; whereas, unrestricted funds may be used by UAMS in achieving any of its institutional purposes.

**Use of Estimates** – The preparation of financial statements in conformity with GAAP and governmental accounting standards requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

**Reclassifications** – Certain reclassifications have been made to the 2004 financial statements to conform to the 2005 presentation.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**2. Net Patient Services Revenue and Charity Care**

The University Hospital of Arkansas (the Hospital) is a division of UAMS, and the Faculty Group Practice (FGP) is the collective body of the full-time faculty involved in professional practice at UAMS. FGP is an integral component of UAMS, functioning as an unincorporated division of the College of Medicine. As such, it is subject to the policies and regulations of the College of Medicine, UAMS and the Board of Trustees of the University of Arkansas System. Patient care operations are included in the accompanying financial statements under accounting principles generally followed by governmental colleges and universities. Patient accounts receivable at June 30, 2005 and 2004, are recorded net of an allowance for doubtful accounts of \$803,054,000 and \$733,183,000, respectively.

Net patient services revenue for the years ended June 30, 2005 and 2004, is as follows (*in thousands*):

|  | <u>2005</u>       | <u>2004</u>       |
|--|-------------------|-------------------|
| Gross patient revenue                        | \$ 1,180,647      | \$ 1,091,848      |
| Less patient services contractual allowances | 520,594           | 479,779           |
| Less provision for bad debts                 | 76,373            | 76,921            |
| Net patient services revenue                 | <u>\$ 583,680</u> | <u>\$ 535,148</u> |

UAMS provided approximately \$53,000,000 and \$37,300,000 in charity care, based on established rates, during the years ended June 30, 2005 and 2004, respectively. Because UAMS does not pursue collection of amounts determined to qualify as charity care, they are not included in gross patient revenue above. Net patient services revenue for the years ended June 30, 2005 and 2004, includes approximately \$46,383,000 and \$19,800,000, respectively, from the Medicaid program representing payments relating to Upper Payment Limit and Disproportionate Share reimbursements. These payments are available to State Operated Teaching Hospitals under Medicaid regulations. Net patient services revenue for the years ended June 30, 2005 and 2004, includes approximately \$25,265,000 and \$25,810,000, respectively, of net revenue from the Enhanced Medicaid program.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **2. Net Patient Services Revenue and Charity Care (continued)**

The Hospital, FGP, and AHECs have agreements with governmental and other third-party payors that provide for reimbursement at amounts different from their established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with significant third-party payors follows:

#### Hospital:

- Medicare – Inpatient acute care services rendered to program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Some transplantation services are paid based upon a cost reimbursement methodology. Outpatient services are paid based on a prospective payment system where services are classified into groups called Ambulatory Payment Classifications or APCs. Services in each APC are similar clinically and in terms of the resources they require. The Hospital is paid for cost-reimbursable items at a tentative rate with final settlement determined after submission of an annual cost report by the Hospital and audit by the Medicare fiscal intermediary. As of June 30, 2005, the Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2003.
- Medicaid – Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed based upon a cost reimbursement methodology. The Hospital is paid at a tentative rate with final settlement determined after submission of an annual cost report by the Hospital and audits by the Medicaid fiscal intermediary. The Hospital is required to pay the federal match for the difference in reimbursement between the Tax Equity and Fiscal Responsibility Act (TEFRA) inpatient rate and full cost. For outpatient services, the Hospital is required to pay the federal match for the difference reimbursed between the outpatient prospective rates and full cost. As of June 30, 2005, the Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2003.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **2. Net Patient Services Revenue and Charity Care (continued)**

FGP and AHECs:

- Services rendered to both Medicare and Medicaid program beneficiaries are reimbursed on prospectively determined rates per unit of service.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net adjustments to estimated settlements resulted in a decrease to net patient services revenue of \$1,397,000 and \$681,000 for the years ended June 30, 2005 and 2004, respectively. Management believes that UAMS is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

The Hospital, FGP, and AHECs have agreements with certain commercial insurance carriers and preferred provider organizations, which include prospectively determined rates per discharge, discounts from established charges and prospectively determined per diem rates.

### **3. Net State Appropriations Revenue**

State appropriations are reported in the Statements of Revenue, Expenses and Changes in Net Assets as Nonoperating Revenue, net of the Medicaid match payments required under various contracts between UAMS and the Arkansas Department of Human Services.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**3. Net State Appropriations Revenue (continued)**

Net state appropriations revenue for the years ended June 30, 2005 and 2004, is as follows (*in thousands*):

|                                    | <u>2005</u>      | <u>2004</u>      |
|------------------------------------|------------------|------------------|
| Gross state appropriations revenue | \$ 83,324        | \$ 81,061        |
| Less Medicaid match payments       | 41,866           | 44,100           |
| Net state appropriations revenue   | <u>\$ 41,458</u> | <u>\$ 36,961</u> |

**4. Cash and Cash Equivalents**

All cash deposits of UAMS are carried at cost. The carrying amount of deposits is separately displayed in the statements of net assets as cash and cash equivalents. The carrying amount differs from the bank balance shown below due to timing differences of clearing outstanding checks and deposits.

UAMS' deposits at June 30, 2005 and 2004, are categorized below to give an indication of the level of risk assumed by UAMS at each year-end. Category 1 includes deposits that are insured or collateralized with securities held by UAMS or by its agent in UAMS' name. Category 2 includes uninsured deposits collateralized with securities held by the pledging financial institution's trust department or agent in UAMS' name. Category 3 includes uncollateralized deposits or deposits collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in UAMS' name. Amounts are shown in thousands.

|                       | Carrying<br>Amount | Bank<br>Balance | Category |      |      |
|-----------------------|--------------------|-----------------|----------|------|------|
|                       |                    |                 | 1        | 2    | 3    |
| Cash at June 30, 2005 | \$ 6,254           | \$ 4,104        | \$ 4,104 | \$ - | \$ - |
| Cash at June 30, 2004 | \$ 5,077           | \$ 3,366        | \$ 3,366 | \$ - | \$ - |

At June 30, 2005 and 2004, Category 1 is composed of \$330,000 and \$308,000, respectively, of insured deposits and \$3,774,000 and \$3,058,000, respectively, of securities that are held in joint custody by the Federal Reserve Bank.

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Notes to Financial Statements (continued)

**4. Cash and Cash Equivalents (continued)**

The following schedule reconciles the reported amount of deposits to the statements of net assets under GASB Statement No. 3 (GASB 3), *Deposits with Financial Institutions, Investments (Including Repurchase Agreements) and Reverse Repurchase Agreements (in thousands)*:

|   | <b>June 30</b>    |             |
|---|-------------------|-------------|
|   | <b>2005</b>       | <b>2004</b> |
|   | <hr/>             | <hr/>       |
| Reported amount of deposits under GASB 3                              | \$ 6,254          | \$ 5,077    |
| Cash equivalents disclosed as investments under GASB 3                | <b>107,128</b>    | 53,418      |
|   | <hr/>             | <hr/>       |
| Cash and cash equivalents as reported in the statements of net assets | <b>\$ 113,382</b> | \$ 58,495   |
|   | <hr/> <hr/>       | <hr/> <hr/> |

**5. Investments**

The investments of UAMS are governed by the University of Arkansas System’s Investment Policy (the Policy). The Policy permits investment in varying amounts of managed external investment pools; United States Treasury and Agency issues, including mortgage-backed securities; state and local municipality bonds; banker’s acceptances; corporate stocks and bonds; mutual funds and short-term money funds.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

The following table lists the invested assets of UAMS at June 30, 2005 (*in thousands*):

*Statement of Invested Assets*

| <u>Investment Type</u>      | <u>Fair Value</u> |
|-----------------------------|-------------------|
| <b>Short Term</b>           | <b>\$ 482</b>     |
| Certificate of Deposits     | 482               |
| <b>Equity</b>               | <b>79</b>         |
| U.S.                        | 79                |
| <b>Commingled Funds</b>     | <b>82,382</b>     |
| U.S. Equity                 | 2,223             |
| U.S. Fixed Income           | 897               |
| Short Term Common Fund      | 77,884            |
| Money Market Funds          | 1,378             |
| <b>Other Investments</b>    | <b>237,665</b>    |
| Guaranteed Investment Trust | 107,353           |
| External Investment Pool    | 130,312           |
| <b>Cash</b>                 | <b>6,254</b>      |
| <b>Total</b>                | <b>\$ 326,862</b> |

The activities during fiscal year 2005 affecting UAMS' investments are summarized below (*in thousands*):

|                         | <b>Total Return<br/>Pool</b> | <b>Short/<br/>Intermediate<br/>Pool</b> | <b>Other<br/>Investments</b> | <b>Total</b>      |
|-------------------------|------------------------------|---|------------------------------|-------------------|
| June 30, 2004           | \$ 34,451                    | \$ 49,098                               | \$ 58,311                    | \$ 141,860        |
| Income                  | 1,003                        | 2,005                                   | 3,081                        | 6,089             |
| Realized gains (losses) | 2,597                        | (4)                                     | (105)                        | 2,488             |
| Unrealized gains        | 280                          | 946                                     | 55                           | 1,281             |
| Expenses paid           | (195)                        | (131)                                   | (17)                         | (343)             |
| Transfers in            | 11,500                       | -                                       | 157,733                      | 169,233           |
| June 30, 2005           | <b>\$ 49,636</b>             | <b>\$ 51,914</b>                        | <b>\$ 219,058</b>            | <b>\$ 320,608</b> |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

The activities during fiscal year 2004 affecting UAMS' investments are summarized below (*in thousands*):

|                           | <b>Total Return<br/>Pool</b> | <b>Short/<br/>Intermediate<br/>Pool</b> | <b>Other<br/>Investments</b> | <b>Total</b>      |
|---------------------------|------------------------------|---|------------------------------|-------------------|
| June 30, 2003             | \$ 32,238                    | \$ 73,908                               | \$ 30,471                    | \$ 136,617        |
| Income                    | 870                          | 2,784                                   | 439                          | 4,093             |
| Realized gains (losses)   | 2,919                        | (773)                                   | (20)                         | 2,126             |
| Unrealized gains (losses) | 1,454                        | (1,673)                                 | 183                          | (36)              |
| Expenses paid             | (162)                        | (148)                                   | (3)                          | (313)             |
| Transfers in              | (2,868)                      | (25,000)                                | 27,241                       | (627)             |
| June 30, 2004             | <u>\$ 34,451</u>             | <u>\$ 49,098</u>                        | <u>\$ 58,311</u>             | <u>\$ 141,860</u> |

The following schedule reconciles the reported amount of investments and funds held in trust as disclosed for GASB 3 to the statements of net assets (*in thousands*):

|   | <b>June 30</b>    |             |
|---|-------------------|-------------|
|   | <b>2005</b>       | <b>2004</b> |
| Reported amount of investments and funds held in trust under GASB 3             | <b>\$ 320,608</b> | \$ 141,860  |
| Cash equivalents disclosed as investments under GASB 3                          | <b>(107,128)</b>  | (53,418)    |
| Investments and funds held in trust as reported in the statements of net assets | <b>\$ 213,480</b> | \$ 88,442   |

A substantial portion of the endowment investments is pooled, with participation in or withdrawal from the Pool based on the market value per unit at the beginning of the calendar quarter in which the transaction takes place.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

The following table summarizes the relationship between the pooled assets and their earnings (*in thousands, except unit amounts*):

|                                    | <b>June 30</b> |                |
|------------------------------------|----------------|----------------|
|                                    | <b>2005</b>    | <b>2004</b>    |
| Fair value at June 30              | \$ 25,585      | \$ 23,288      |
| Number of units in Pool at June 30 | 463,101        | 463,040        |
| Fair value per unit at June 30     | \$ 55.25       | \$ 50.29       |
| Realized gains for the year        | 1,567          | 2,031          |
| Income earned for the year         | 598            | 607            |
| Realized gains per unit            | \$ 3.38        | \$ 4.39        |
| Income earned per unit             | 1.29           | 1.31           |
| Total income per unit              | <u>\$ 4.67</u> | <u>\$ 5.70</u> |

The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Additionally, realized gains and losses on investments held in more than one fiscal year and sold in fiscal 2005 and 2004 were included as a change in the fair value of investments reported in fiscal 2005 and 2004, respectively.

Effective June 30, 2005, UAMS is required under GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, to provide investment risk disclosures for all invested funds. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The risks for UAMS' funds, including the external investment pools, guaranteed investment contracts (GICs), and the Common Fund, are shown separately below.

The following tables contain information on the risk disclosure for the Pool, which commingles (pools) the monies of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. The Pool was originally established in 1997 by the University of Arkansas and the University of Arkansas Foundation. During 1998, the Walton Arts Foundation joined the Pool, and during 2003, the Fayetteville Campus Foundation joined the Pool. The participants of the Pool have adopted investment guidelines and performance objectives for the accounts within the Pool. This information is provided in total for the pools, which includes the Total Return Pool, the Intermediate Pool, and the Cash Pool. UAMS owns 11.2% of the total of these pools.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

*EXTERNAL INVESTMENT POOL*

*Statement of Invested Assets (in thousands)*

| Investment Type                            | Fair Value          |
|--|---------------------|
| <b>Fixed Income</b>                        | <b>\$ 374,511</b>   |
| <b>U.S. Government</b>                     | <b>100,382</b>      |
| U.S. Government Treasuries, Notes, Bonds   | 55,103              |
| U.S. Government TIPS                       | 29,050              |
| U.S. Government Agency                     | 15,894              |
| Other U.S. Government                      | 335                 |
| <b>Mortgage Backed</b>                     | <b>59,055</b>       |
| Government Pass-Through                    | 49,710              |
| Corporate Pass-Through                     | 9,345               |
| <b>Collateralized Mortgage Obligations</b> | <b>37,238</b>       |
| Government CMOs                            | 9,575               |
| Corporate CMOs                             | 27,663              |
| <b>Corporate</b>                           | <b>161,443</b>      |
| Corporate Bonds                            | 100,728             |
| Corporate Asset Backed                     | 56,165              |
| Private Placements                         | 4,550               |
| <b>Municipals</b>                          | <b>3,528</b>        |
| <b>Yankee Bonds</b>                        | <b>530</b>          |
| <b>Developed Markets</b>                   | <b>4,600</b>        |
| Dev. Government/Sovereign                  | 1,491               |
| Dev. Corporate                             | 3,109               |
| <b>Emerging Markets</b>                    | <b>7,735</b>        |
| Emg. Government/Sovereign                  | 2,050               |
| Emg. Corporate                             | 5,685               |
| <b>Short Term</b>                          | <b>994</b>          |
| Repurchase Agreements                      | 994                 |
| <b>Equity</b>                              | <b>311,617</b>      |
| U.S.                                       | 304,019             |
| Non-U.S.                                   | 7,598               |
| <b>Alternative Investments</b>             | <b>51,937</b>       |
| Private Equity                             | 51,937              |
| <b>Real Estate</b>                         | <b>48,251</b>       |
| <b>Commingled Funds</b>                    | <b>402,940</b>      |
| U.S. Equity                                | 92,051              |
| Non-U.S. Equity                            | 137,877             |
| U.S. Fixed Income                          | 91,109              |
| Money Market Funds                         | 81,903              |
| <b>Other Investments</b>                   | <b>65</b>           |
| <b>Cash</b>                                | <b>(26,973)</b>     |
| <b>Total</b>                               | <b>\$ 1,163,342</b> |

\* Other Investments include GICS/GACS, and loans to participants

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

In accordance with the Policy, UAMS manages its exposure to credit risk by diversifying the portfolio. The policy prohibits purchase of securities rated less than BBB-. Securities downgraded below BBB should not represent more than 5% of the portfolio at cost or market. The average quality of the portfolio shall be no less than AA. Except for United States Treasury and Agency obligations, the portfolio shall contain no more than 5% exposure to any issuer. The following table presents the credit risk associated with the portfolio.

***Credit Risk – S&P Quality Ratings***

| <b>Investment Type and Fair Value (in thousands)</b> | <b>TSY</b>      | <b>AGY</b>       | <b>AAA</b>        | <b>AA</b>        | <b>A</b>         | <b>BBB</b>       | <b>BB</b>       | <b>NR</b>       |
|--|-----------------|------------------|-------------------|------------------|------------------|------------------|-----------------|-----------------|
| <b>Fixed Income</b>                                  | <b>\$ 8,817</b> | <b>\$ 51,829</b> | <b>\$ 193,953</b> | <b>\$ 14,776</b> | <b>\$ 52,898</b> | <b>\$ 42,452</b> | <b>\$ 4,780</b> | <b>\$ 5,006</b> |
| <b>U.S. Government</b>                               | <b>8,817</b>    | <b>6,020</b>     | <b>85,210</b>     | –                | –                | –                | –               | <b>335</b>      |
| U.S. Government Treas., Notes, Bonds                 | 3,929           | –                | 51,174            | –                | –                | –                | –               | –               |
| U.S. Government TIPS                                 | 4,888           | –                | 24,162            | –                | –                | –                | –               | –               |
| U.S. Government Agency                               | –               | 6,020            | 9,874             | –                | –                | –                | –               | –               |
| Other U.S. Government                                | –               | –                | –                 | –                | –                | –                | –               | 335             |
| <b>Mortgage Backed</b>                               | –               | <b>39,481</b>    | <b>17,826</b>     | <b>528</b>       | –                | –                | –               | <b>1,220</b>    |
| Government Pass-Through                              | –               | 39,481           | 10,229            | –                | –                | –                | –               | –               |
| Corporate Pass-Through                               | –               | –                | 7,597             | 528              | –                | –                | –               | 1,220           |
| <b>Collateralized Mortgage Obligations</b>           | –               | <b>6,328</b>     | <b>28,250</b>     | <b>228</b>       | <b>500</b>       | –                | –               | <b>1,932</b>    |
| Government CMOs                                      | –               | 6,328            | 3,019             | 228              | –                | –                | –               | –               |
| Corporate CMOs                                       | –               | –                | 25,231            | –                | 500              | –                | –               | 1,932           |
| <b>Corporate</b>                                     | –               | –                | <b>59,960</b>     | <b>11,902</b>    | <b>48,604</b>    | <b>34,678</b>    | <b>4,780</b>    | <b>1,519</b>    |
| Corporate Bonds                                      | –               | –                | 6,319             | 9,276            | 45,971           | 33,867           | 4,631           | 664             |
| Corporate Asset Backed                               | –               | –                | 53,192            | 139              | 2,003            | 380              | –               | 451             |
| Private Placements                                   | –               | –                | 449               | 2,487            | 630              | 431              | 149             | 404             |
| <b>Municipals</b>                                    | –               | –                | <b>2,255</b>      | <b>1,273</b>     | –                | –                | –               | –               |
| <b>Yankee Bonds</b>                                  | –               | –                | –                 | –                | <b>131</b>       | <b>399</b>       | –               | –               |
| <b>Developed Markets</b>                             | –               | –                | <b>452</b>        | <b>845</b>       | <b>2,531</b>     | <b>772</b>       | –               | –               |
| Dev. Government/ Sovereign                           | –               | –                | 452               | 487              | 552              | –                | –               | –               |
| Dev. Corporate                                       | –               | –                | –                 | 358              | 1,979            | 772              | –               | –               |
| <b>Emerging Markets</b>                              | –               | –                | –                 | –                | <b>1,132</b>     | <b>6,603</b>     | –               | –               |
| Emg. Government/ Sovereign                           | –               | –                | –                 | –                | –                | 2,050            | –               | –               |
| Emg. Corporate                                       | –               | –                | –                 | –                | 1,132            | 4,553            | –               | –               |
| <b>Short Term</b>                                    | –               | –                | –                 | –                | –                | –                | –               | <b>994</b>      |
| Repurchase Agreements                                | –               | –                | –                 | –                | –                | –                | –               | 994             |
| <b>Total</b>   | <b>\$ 8,817</b> | <b>\$ 51,829</b> | <b>\$ 193,953</b> | <b>\$ 14,776</b> | <b>\$ 52,898</b> | <b>\$ 42,452</b> | <b>\$ 4,780</b> | <b>\$ 6,000</b> |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

| Years to Maturity<br>Investment Type (in thousands) | Investment Maturities (in years) |                  |                   |                  |                   |
|---|----------------------------------|------------------|-------------------|------------------|-------------------|
|   | Fair Value                       | Less than 1      | 1-5               | 6-10             | More than 10      |
| <b>Fixed Income</b>                                 | <b>\$ 374,511</b>                | <b>\$ 24,772</b> | <b>\$ 163,224</b> | <b>\$ 29,452</b> | <b>\$ 157,063</b> |
| <b>U.S. Government</b>                              | <b>100,382</b>                   | <b>9,987</b>     | <b>58,050</b>     | <b>13,780</b>    | <b>18,565</b>     |
| U.S. Government Treas., Notes, Bonds                | 55,103                           | 3,864            | 39,863            | 1,094            | 10,282            |
| U.S. Government TIPS                                | 29,050                           | —                | 9,415             | 11,563           | 8,072             |
| U.S. Government Agency                              | 15,894                           | 6,123            | 8,772             | 788              | 211               |
| Other U.S. Government                               | 335                              | —                | —                 | 335              | —                 |
| <b>Mortgage Backed</b>                              | <b>59,055</b>                    | <b>945</b>       | <b>2,162</b>      | <b>126</b>       | <b>55,822</b>     |
| Government Pass-Through                             | 49,710                           | 543              | 296               | —                | 48,871            |
| Corporate Pass-Through                              | 9,345                            | 402              | 1,866             | 126              | 6,951             |
| <b>Collateralized Mortgage Obligations</b>          | <b>37,238</b>                    | <b>—</b>         | <b>5,190</b>      | <b>2,002</b>     | <b>30,046</b>     |
| Government CMOs                                     | 9,575                            | —                | 1,988             | 2,002            | 5,585             |
| Corporate CMOs                                      | 27,663                           | —                | 3,202             | —                | 24,461            |
| <b>Corporate</b>                                    | <b>161,443</b>                   | <b>13,025</b>    | <b>91,169</b>     | <b>10,850</b>    | <b>46,399</b>     |
| Corporate Bonds                                     | 100,728                          | 11,897           | 47,056            | 9,833            | 31,942            |
| Corporate Asset Backed                              | 56,165                           | 1,024            | 40,930            | 976              | 13,235            |
| Private Placements                                  | 4,550                            | 104              | 3,183             | 41               | 1,222             |
| <b>Municipals</b>                                   | <b>3,528</b>                     | <b>—</b>         | <b>2,266</b>      | <b>1,262</b>     | <b>—</b>          |
| <b>Yankee Bonds</b>                                 | <b>530</b>                       | <b>—</b>         | <b>—</b>          | <b>183</b>       | <b>347</b>        |
| <b>Developed Markets</b>                            | <b>4,600</b>                     | <b>815</b>       | <b>2,223</b>      | <b>455</b>       | <b>1,107</b>      |
| Dev. Government/Sovereign                           | 1,491                            | —                | 834               | 205              | 452               |
| Dev. Corporate                                      | 3,109                            | 815              | 1,389             | 250              | 655               |
| <b>Emerging Markets</b>                             | <b>7,735</b>                     | <b>—</b>         | <b>2,164</b>      | <b>794</b>       | <b>4,777</b>      |
| Emg. Government/Sovereign                           | 2,050                            | —                | —                 | —                | 2,050             |
| Emg. Corporate                                      | 5,685                            | —                | 2,164             | 794              | 2,727             |
| <b>Short Term</b>                                   | <b>994</b>                       | <b>994</b>       | <b>—</b>          | <b>—</b>         | <b>—</b>          |
| Repurchase Agreements                               | 994                              | 994              | —                 | —                | —                 |
| <b>Total</b>  | <b>\$ 375,505</b>                | <b>\$ 25,766</b> | <b>\$ 163,224</b> | <b>\$ 29,452</b> | <b>\$ 157,063</b> |

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Notes to Financial Statements (continued)

**5. Investments (continued)**

In accordance with the Policy, UAMS manages its exposure to interest rate risk by diversifying the portfolio. The weighted average duration should range between 80% to 115% of the benchmark's (the Lehman Brothers Intermediate Government Credit LB Int. G/c Index) duration.

| <b>Investment Type (<i>in thousands</i>)</b> | <b>Fair Value</b> | <b>Effective Duration (Years)</b> |
|--|-------------------|-----------------------------------|
| <b>Fixed Income</b>                          | <b>\$ 374,511</b> | <b>3.31</b>                       |
| <b>U.S. Government</b>                       | <b>100,382</b>    | <b>4.79</b>                       |
| U.S. Government Treasuries, Notes, Bonds     | 55,103            | 3.67                              |
| U.S. Government TIPS                         | 29,050            | 8.73                              |
| U.S. Government Agency                       | 15,894            | 1.48                              |
| Other U.S. Government                        | 335               | 0.00                              |
| <b>Mortgage Backed</b>                       | <b>59,055</b>     | <b>2.82</b>                       |
| Government Pass-Through                      | 49,710            | 2.60                              |
| Corporate Pass-Through                       | 9,345             | 3.98                              |
| <b>Collateralized Mortgage Obligations</b>   | <b>37,238</b>     | <b>2.33</b>                       |
| Government CMOs                              | 9,575             | 2.01                              |
| Corporate CMOs                               | 27,663            | 2.43                              |
| <b>Corporate</b>                             | <b>161,443</b>    | <b>2.59</b>                       |
| Corporate Bonds                              | 100,728           | 3.05                              |
| Corporate Asset Backed                       | 56,165            | 1.74                              |
| Private Placements                           | 4,550             | 3.28                              |
| <b>Municipals</b>                            | <b>3,528</b>      | <b>1.68</b>                       |
| <b>Yankee Bonds</b>                          | <b>530</b>        | <b>9.27</b>                       |
| <b>Developed Markets</b>                     | <b>4,600</b>      | <b>5.57</b>                       |
| Dev. Government/Sovereign                    | 1,491             | 6.98                              |
| Dev. Corporate                               | 3,109             | 4.89                              |
| <b>Emerging Markets</b>                      | <b>7,735</b>      | <b>5.86</b>                       |
| Emg. Government/Sovereign                    | 2,050             | 12.38                             |
| Emg. Corporate                               | 5,685             | 3.51                              |
| <b>Short Term</b>                            | <b>994</b>        | <b>0.00</b>                       |
| Repurchase Agreements                        | 994               | 0.00                              |
| <b>Total</b>                                 | <b>\$ 375,505</b> | <b>3.31</b>                       |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

***GICS***

UAMS invested the construction funds from the 2004 bond issues in GICs. The GICs offer a guaranteed rate of return (2.77%) for a specific period of time with a guarantee of principal and interest earnings. The GICs provide full flexibility to withdraw funds as needed.

*Interest rate risk.* UAMS is not exposed to interest rate risk on the GICs.

*Credit risk.* If the ratings of the long-term, senior unsecured debt obligations of the Guarantor are, at any time while the guarantee is in effect with respect to these GICs, suspended, withdrawn or rated below AA- by S&P and Aa3 by Moody's, UAMS shall have the right to require collateralization or repayment of the entire balance. However, as the following table shows, the GICs are not rated:

| <b>Investment Type (in thousands)</b> | <b>Fair Value</b> | <b>Credit Risk</b> |              |                  |
|---------------------------------------|-------------------|--------------------|--------------|------------------|
|                                       |                   | <b>AAA/Aaa</b>     | <b>AA/Aa</b> | <b>Not Rated</b> |
| Guaranteed Investment Contract        | \$10,011          | \$ -               | \$ -         | \$10,011         |
| Guaranteed Investment Contract        | \$97,342          | \$ -               | \$ -         | \$97,342         |

***COMMON FUND***

UAMS invests daily operating funds in the Common Fund for Short Term Investments (Short Term Fund). The Short Term Fund is a bank common trust fund and as such is regulated by the United States Treasury Department Office of the Comptroller of the Currency.

*Interest rate risk.* The Short Term Fund invests in securities with maturities from one day to five and one-half years, but the portfolio is structured so that it will approximate the volatility of 3-month U.S. Treasury securities and not exceed the volatility of one-year U.S. Treasury securities.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

*Credit risk.* The Short Term Fund is restricted to investments in U.S. Treasury and government agency securities, high quality corporate securities, mortgage- and asset-backed securities, and commercial and bank paper. However, as the following table shows, the Short Term Fund is not rated:

| Investment Type <i>(in thousands)</i> | Fair Value | Credit Risk |       |           |
|---------------------------------------|------------|-------------|-------|-----------|
|                                       |            | AAA/Aaa     | AA/Aa | Not Rated |
| Bank Common Trust Fund                | \$77,884   | \$ -        | \$ -  | \$77,884  |

The following Arkansas Code sections outline the ability of UAMS to spend any net appreciation in endowment funds:

28-69-603 *Expenditure of endowment funds.* The governing board may expend so much of the endowment fund or an aggregation of the endowment fund as the governing body determines to be prudent under the standard established by Section 28-69-607 for the uses and purposes for which an endowment fund is established. This section does not limit the authority of the governing board to expend funds as permitted under other law, the terms of the applicable gift instrument, or the charter of the institution. Except as otherwise specified, this section applies to endowment funds established and instruments executed or in effect before or after the effective date of this subsection.

28-69-604 *Rule of construction.* A restriction upon the expenditure of an endowment fund may not be implied from a designation of a gift as an endowment, or from a direction or authorization in the applicable gift instrument to use only ‘income,’ ‘interest,’ ‘dividends,’ ‘net appreciation in the fair value of the assets of an endowment fund over the historic dollar value of the endowment,’ or ‘rents, issues or profits’ or ‘to preserve the principal intact’ or a direction which contains other words of similar import. The rule of construction under subsection (a) of this section applies to endowment funds and gift instruments executed or in effect before or after the effective date of this subsection. The provisions of 28-69-603(a) shall not apply to instruments if the instrument indicates by saying ‘I direct that the expenditure provisions of Arkansas Code 28-69-603(a) not apply to this gift’ or words of similar import reflecting a donor’s specific intent that 28-69-603(a) not apply to the gift.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

28-69-607 *Standard of conduct.* In the administration of the powers to expend endowment funds, to make and retain investments, and to delegate investment management of institutional funds, members of a governing board shall exercise ordinary business care and prudence under the facts and circumstances prevailing at the time of the action or decision. In so doing they shall consider long and short term needs of the institution in carrying out its educational, religious, charitable, or other eleemosynary purposes, its present and anticipated financial requirements, expected total return on its investments, price level trends, and general economic conditions, and the aggregate value of all endowment funds held by the institution.

**6. Notes and Student Loans Receivable, Net**

The net unpaid balances of notes and student loans receivable on June 30, 2005 and 2004, net of allowances of \$2,524,000 and \$2,113,000, respectively, are as follows (*in thousands*):

|   | <b>June 30</b>   |             |
|---|------------------|-------------|
|   | <b>2005</b>      | <b>2004</b> |
| Perkins Loans                                       | \$ 2,464         | \$ 2,593    |
| Health Professional Loans                           | 4,488            | 4,429       |
| Institutional funds loans                           | 6,281            | 6,605       |
| University of Arkansas at Fayetteville              | 1,605            | 1,605       |
| University of Arkansas System note receivable       | 626              | 844         |
| Miscellaneous                                       | 864              | 123         |
| Total notes and student loans receivable, net       | <b>16,328</b>    | 16,199      |
| Less current portion                                | <b>(2,479)</b>   | (2,179)     |
| Notes and student loans receivable, noncurrent, net | <b>\$ 13,849</b> | \$ 14,020   |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**7. Capital Assets**

Balances as of June 30, 2004 and 2005, and changes in capital assets during fiscal 2005 were as follows (*in thousands*):

|   | June 30,<br>2004 | Additions | Transfers | Dispositions | June 30,<br>2005 |
|---|------------------|-----------|-----------|--------------|------------------|
| Nondepreciable:                                 |                  |           |           |              |                  |
| Land  | \$ 6,079         | \$ 17     | \$ -      | \$ -         | \$ 6,096         |
| Construction-in-progress                        | 235              | 12,295    | (103)     | -            | 12,427           |
| Depreciable:                                    |                  |           |           |              |                  |
| Buildings and fixtures                          | 405,364          | 2,743     | 103       | -            | 408,210          |
| Improvements other than buildings               | 2,453            | -         | -         | -            | 2,453            |
| Equipment                                       | 111,536          | 14,137    | 541       | (7,306)      | 118,908          |
| Leased property                                 | 14,473           | 3,284     | (541)     | (205)        | 17,011           |
| Other   | 2,557            | -         | -         | -            | 2,557            |
| Total capital assets                            | 542,697          | 32,476    | -         | (7,511)      | 567,662          |
| Less accumulated depreciation and amortization: |                  |           |           |              |                  |
| Buildings and fixtures                          | 116,471          | 11,270    | 33        | (17)         | 127,757          |
| Improvements other than buildings               | 1,979            | 91        | -         | -            | 2,070            |
| Equipment                                       | 79,369           | 9,523     | 332       | (6,548)      | 82,676           |
| Leased property                                 | 4,541            | 2,583     | (365)     | (169)        | 6,590            |
| Other   | 1,506            | 619       | -         | -            | 2,125            |
| Total accumulated depreciation and amortization | 203,866          | 24,086    | -         | (6,734)      | 221,218          |
| Capital assets, net                             | \$338,831        | \$ 8,390  | \$ -      | \$ (777)     | \$346,444        |

The buildings and fixtures above include \$1,987,000 and \$1,125,000 of net assets under capital leases at June 30, 2005 and 2004.

Capitalized interest of \$1,400,000, net of interest income of \$1,787,000, and \$0 was recognized during the years ended June 30, 2005 and 2004, respectively. \$1,292,000 was related to the borrowing for the Various Facility Construction Revenue Bonds, Series 2004B and \$108,000 was related to the borrowing for the Parking System Revenue Construction Bonds, Series 2004.

Library holdings are comprised of books and periodicals, including old and rare books, held by UAMS. The estimated value of the holdings at June 30, 2005 and 2004, was \$1,730,000 and \$1,780,000, respectively. UAMS has not reported library holdings in the accompanying statements of net assets.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**8. Accounts Payable and Accrued Liabilities**

Accounts payable and accrued liabilities consist of the following at year-end (*in thousands*):

|  | <b>June 30</b>   |                  |
|--|------------------|------------------|
|  | <b>2005</b>      | <b>2004</b>      |
| Trade payables                                 | \$ 9,609         | \$ 6,350         |
| Accrued wages                                  | 28,716           | 26,104           |
| Miscellaneous payables                         | 16,847           | 35,230           |
| Total accounts payable and accrued liabilities | <u>\$ 55,172</u> | <u>\$ 67,684</u> |

**9. Obligation Under Short-Term Borrowing**

UAMS had an unsecured \$10,000,000 revolving line of credit agreement with Bank of America, which expired October 15, 2004, for the purpose of supplementing short-term cash flow operating needs. At June 30, 2005, UAMS had no line of credit. Interest expense of \$0 and \$83,000 was recognized during the years ended June 30, 2005 and 2004, respectively, related to the borrowing. Interest is computed based on LIBOR + 70 basis points and ranged from 1.89% to 1.79%. Activity was as follows for fiscal years 2005 and 2004 (*in thousands*):

|                                 | <b>Balance at<br/>Beginning<br/>of Year</b> |   | <b>Additions</b> | <b>Reductions</b> | <b>Balance at<br/>End of<br/>Year</b> |   |
|---------------------------------|---|---|------------------|-------------------|---------------------------------------|---|
| Line of credit at June 30, 2005 | \$  | - | \$               | -                 | \$                                    | - |
| Line of credit at June 30, 2004 | \$  | - | \$ 15,000        | \$ 15,000         | \$                                    | - |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**10. Long-Term Obligations**

Changes in long-term obligations during fiscal year 2005 were as follows (*in thousands*):

|                      | <b>Beginning<br/>Balance</b> | <b>Additions</b> | <b>Reductions</b> | <b>Ending<br/>Balance</b> |
|----------------------|------------------------------|------------------|-------------------|---------------------------|
| Bonds payable        | \$ 71,060                    | \$168,442        | \$ 59,315         | \$ 180,187                |
| Notes payable        | 12,793                       | 642              | 4,997             | 8,438                     |
| Capital leases       | 10,216                       | 3,284            | 3,732             | 9,768                     |
| Total debt           | 94,069                       | 172,368          | 68,044            | 198,393                   |
| Compensated absences | 26,353                       | 2,405            | —                 | 28,758                    |
| Total obligations    | <u>\$ 120,422</u>            | <u>\$174,773</u> | <u>\$ 68,044</u>  | <u>\$ 227,151</u>         |

The current and long-term portions of the categories noted above were as follows at June 30, 2005 (*in thousands*):

|                      | <b>Current</b>   | <b>Long-Term</b>  | <b>Total</b>      |
|----------------------|------------------|-------------------|-------------------|
| Bonds payable        | \$ 4,045         | \$ 176,142        | \$ 180,187        |
| Notes payable        | 2,150            | 6,288             | 8,438             |
| Capital leases       | 3,498            | 6,270             | 9,768             |
| Total debt           | 9,693            | 188,700           | 198,393           |
| Compensated absences | 1,545            | 27,213            | 28,758            |
| Total obligations    | <u>\$ 11,238</u> | <u>\$ 215,913</u> | <u>\$ 227,151</u> |

UAMS has bonds outstanding for the Patient Bed Tower, Central Arkansas Radiation Therapy Institute (CARTI) Building, the Westmark Building, the Diagnostic Clinic, and the East Parking Deck. In addition, bonds have been issued for the following new construction projects: Patient Bed Tower, Residence Hall, Psychiatry Building and the power plant. The income from the revenue-producing facilities, along with a portion of tuition and fees, is pledged to meet the principal and interest payments of certain bonds. Separate accounting is not required for these facilities under the provisions of the debt instruments; accordingly, segment reporting is not required for financial reporting purposes. A summary of the principal amount of outstanding debt is as follows at June 30, 2005 and 2004 (*in thousands*):

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**10. Long-Term Obligations (continued)**

|   | June 30                      |   |
|---|------------------------------|---|
|   | 2005                         | 2004  |
| <b><i>Bonds Payable:</i></b>  |                              |   |
| Various Facility Revenue Construction Bonds, Series 2004B,<br>\$95,915,000 original amount, plus unamortized premium of<br>\$3,342,000 at June 30, 2005, due annually to 2034, various<br>fixed interest rates of 2.0% to 5.0% over the life of the issue,<br>collateralized by pledged revenue.  | <b>PAR</b><br><b>Premium</b> | <b>\$ 95,915</b><br><b>3,342</b>  |
| Various Facility Revenue Refunding Bonds, Series 2004A,<br>\$54,085,000 original amount plus unamortized premium of<br>\$4,586,000 at June 30, 2005, due annually to 2018, various<br>fixed interest rates of 4.0% to 5.0% collateralized by pledged<br>revenue.  | <b>PAR</b><br><b>Premium</b> | <b>54,085</b><br><b>4,586</b>   |
| Various Facility Revenue and Refunding Bonds, Series 1998,<br>\$73,695,000 original amount, due annually to 2019, variable<br>interest rates ranging from 1.07% to 1.81% and 0.78% to<br>1.25% during fiscal years 2005 and 2004, respectively,<br>collateralized by pledged revenue. This issue was refunded<br>into the Various Facility Revenue Refunding Series 2004A<br>in November 2004.  | <b>PAR</b>                   | –<br><b>58,265</b>  |
| Parking System Revenue Construction and Refunding Bonds,<br>Series 1998, \$14,260,000 original amount, due annually to<br>2013 with \$5,740,000 in term bonds due 2019, various<br>interest rates of 4.40% to 5.05% and 4.30% to 5.05% during<br>fiscal years 2005 and 2004, respectively, collateralized by a<br>pledge of gross revenue derived from all parking facilities<br>owned by UAMS. | <b>PAR</b>                   | <b>11,785</b><br><b>12,320</b>  |
| Parking System Revenue Construction Bonds, Series 2004,<br>\$10,070,000 original amount plus unamortized premium of<br>\$159,000 at June 30, 2005, due annually to 2035, various<br>fixed interest rates of 2.125% to 5.0% over the life of the<br>issue, collateralized by a pledge of gross revenue derived<br>from all parking facilities owned by UAMS.                                     | <b>PAR</b><br><b>Premium</b> | <b>10,070</b><br><b>159</b>   |
| Various Facility Revenue Bonds, Series 1995, \$2,045,000<br>original amount, various interest rates of 4.25% to 5.25%,<br>due annually to 2006 and collateralized by tuition and certain<br>Hospital revenue.   | <b>PAR</b>                   | <b>245</b><br><b>475</b>  |
| <b>Total Bonds Payable</b>  |                              | <hr style="border-top: 1px solid black;"/> <b>\$ 180,187</b> <b>\$ 71,060</b> |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**10. Long-Term Obligations (continued)**

|   | June 30         |                  |
|---|-----------------|------------------|
|   | 2005            | 2004             |
| <b>Notes Payable:</b>   |                 |                  |
| 2.50% note payable to the State of Arkansas under Act 908 of 1989, \$20,000,000 original amount, collateralized by certain tax revenue.   | \$ 6,988        | \$ 10,653        |
| Floating rate, Arkansas Development Finance Authority note, \$1,500,000 original amount, due monthly through 2012, collateralized by general operating revenue.                           | 763             | 846              |
| Project Mercury Note Payable – Refinanced, \$2,300,000 original amount, 4.35% rate, due monthly to July 2005, collateralized by general operating revenue.                                | 67              | 847              |
| Boiler House Expansion Note Payable – Refinanced on May 31, 2003, \$1,890,000 original amount, 4.35% rate, and due monthly to January 2005, collateralized by the value of the equipment. | –               | 447              |
| Miscellaneous Notes Payable   | 620             | –                |
| Total Notes Payable   | <u>\$ 8,438</u> | <u>\$ 12,793</u> |

Scheduled maturities of bonds and notes payable are as follows. Interest on variable rate debt is calculated based on the rate in effect at June 30, 2005 (*in thousands*):

|           | Bonds Payable     |                   |                   |                   | Notes Payable   |               |                 |
|-----------|-------------------|-------------------|-------------------|-------------------|-----------------|---------------|-----------------|
|           | Principal         | Interest          | Premium Amortized | Total             | Principal       | Interest      | Total           |
| 2006      | \$ 4,045          | \$ 8,263          | \$ (462)          | \$ 11,846         | \$ 680          | \$ 55         | \$ 735          |
| 2007      | 4,140             | 8,058             | (462)             | 11,736            | 135             | 47            | 182             |
| 2008      | 4,300             | 7,894             | (462)             | 11,732            | 139             | 38            | 177             |
| 2009      | 4,475             | 7,724             | (462)             | 11,737            | 128             | 30            | 158             |
| 2010      | 4,650             | 7,544             | (462)             | 11,732            | 118             | 22            | 140             |
| 2011-2015 | 26,790            | 34,160            | (2,310)           | 58,640            | 250             | 17            | 267             |
| 2016-2020 | 29,630            | 26,984            | (1,754)           | 54,860            | –               | –             | –               |
| 2021-2025 | 23,925            | 20,647            | (595)             | 43,977            | –               | –             | –               |
| 2026-2030 | 30,710            | 13,852            | (595)             | 43,967            | –               | –             | –               |
| 2031-2035 | 39,435            | 5,427             | (523)             | 44,339            | –               | –             | –               |
| Total     | <u>\$ 172,100</u> | <u>\$ 140,553</u> | <u>\$ (8,087)</u> | <u>\$ 304,566</u> | <u>\$ 1,450</u> | <u>\$ 209</u> | <u>\$ 1,659</u> |

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 10. Long-Term Obligations (continued)

The Board of Trustees of the University of Arkansas System Various Facility Revenue Bonds (UAMS Campus) Series 2004A and 2004B were issued in November 2004. The 2004A issue refunded \$58,265,000 of the Various Facility Revenue Bonds 1998 at par value. The bonds bear interest at various fixed interest rates from 4.0% to 5.0%, and principal payments are due annually with interest payments due semiannually until the year 2018. The 2004B issue provided \$95,915,000 for the current expansion of the UAMS Hospital to include a new Patient Bed Tower, new Residence Hall, new Psychiatry Building and a new Power Plant. The bonds bear interest at various fixed interest rates from 2.0% to 5.0%, and principal payments are due annually with interest payments due semiannually until the year 2034.

The Various Facility 1998 Bonds that were issued, in part, to refund the 1994 Bond issue provided \$2,017,000 to the University of Arkansas at Fayetteville (UAF) for improvements of certain facilities. Under the Series 2004A bond issue, UAF is still responsible for its portion of the principal, interest and agents' fees. Accordingly, a note receivable with a balance of \$1,605,000 and \$1,605,000 as of June 30, 2005 and 2004, respectively, has been recorded in the accompanying statements of net assets (see Note 17).

The refunding resulted in no difference in the reacquisition price and the net carrying amount of the refunded debt. In December 1993, the GASB issued Statement No. 23, *Accounting and Financial Reporting for Refunding of Debt Reported by Proprietary Activities* (GASB 23). For current and advance refunding resulting in defeasance of debt reported by entities such as UAMS, GASB 23 required, effective for financial statements issued for periods beginning after June 15, 1994, that the difference between the reacquisition price and the net carrying amount of the refunded debt be deferred and amortized as a component of interest expense, in a systematic and rational manner, over the remaining life of the old debt or the life of the new debt, whichever is shorter.

The Board of Trustees of the University of Arkansas System Parking System Revenue Construction Bonds (UAMS Campus) Series 2004 were issued in December 2004. This issue provides \$10,070,000 for the building of an additional parking deck to be built in conjunction with the new Patient Bed Tower. The bonds bear interest at various fixed rates from 2.125% to 5.0%, with principal payments due annually and interest due semiannually until the year 2035.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**10. Long-Term Obligations (continued)**

The 2.50% note under Act 908 arose from a \$20,000,000 line-of-credit arrangement with the State of Arkansas for defined costs associated with the Biomedical Research Building. Borrowings under this arrangement accrue interest at 2.50% and are to be repaid by a state tax on mixed drinks and certain federal grant indirect cost reimbursements. As repayment of principal and the related interest for this note is based on the amount collected on the state alcohol and tobacco tax, it is not included in the maturity schedule above.

The Arkansas Development Finance Authority note payable was issued in the amount of \$1,500,000 to fund various refurbishment projects. Interest is payable monthly through 2012 at a floating rate based on the J.J. Kenny Index Rate, which was 2.56% and 1.34% as of June 30, 2005 and 2004, respectively.

**11. Commitments**

*Capital Leases*

Scheduled maturities of capital lease commitments outstanding as of June 30, 2005, are as follows (*in thousands*):

|              | <b>Principal</b> | <b>Interest</b> | <b>Total</b>     |
|--------------|------------------|-----------------|------------------|
| 2006         | \$ 3,498         | \$ 337          | \$ 3,835         |
| 2007         | 2,815            | 194             | 3,009            |
| 2008         | 2,376            | 90              | 2,466            |
| 2009         | 918              | 23              | 941              |
| 2010         | 161              | 1               | 162              |
| 2011-2015    | —                | —               | —                |
| <b>Total</b> | <b>\$ 9,768</b>  | <b>\$ 645</b>   | <b>\$ 10,413</b> |

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**11. Commitments (continued)**

***Operating Leases***

The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2005 (*in thousands*):

|                                 |                  |
|---------------------------------|------------------|
| 2006                            | \$ 5,108         |
| 2007                            | 3,404            |
| 2008                            | 2,040            |
| 2009                            | 1,768            |
| 2010                            | 849              |
| 2011 and thereafter             | 846              |
| Total minimum payments required | <u>\$ 14,015</u> |

Rental expense for operating leases for the years ended June 30, 2005 and 2004, was approximately \$8,456,000 and \$7,143,000, respectively, and is included in supplies and other services in the accompanying Statements of Revenue, Expenses and Changes in Net Assets.

***Construction Projects***

Construction-in-progress at June 30, 2005, included the Pat & Willard Walker Tower Addition to the Jones Eye Institute and significant site preparation work for the residence hall along with various renovation and maintenance projects.

***Outstanding Commitments***

At June 30, 2005 and 2004, UAMS had outstanding purchase orders for normal operating supplies and equipment amounting to approximately \$60,958,000 and \$39,000,000, respectively.

On February 23, 2005, UAMS and the Arkansas Department of Human Services (DHS) entered into an agreement under which DHS agreed to transfer to UAMS certain land and buildings adjacent to the UAMS campus. In consideration of the transfer, UAMS agreed to construct a new Arkansas State Hospital building consisting of approximately 152,000 square feet with an estimated construction cost of \$22,927,000. Construction is expected to begin in March 2006 and be completed in May 2007.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**12. Restricted Net Assets**

Certain net assets are not available for general operations due to external restrictions placed on these funds by financial institutions, bondholders, donors, grantors and others. Restricted net assets consist of the following as of June 30 (*in thousands*):

|                                   | <b>2005</b>      | <b>2004</b>      |
|-----------------------------------|------------------|------------------|
| Expendable:                       |                  |                  |
| Grant funds                       | \$ 7,753         | \$ 7,284         |
| Debt reserves                     | 10,598           | 3,722            |
| Other externally restricted funds | 19,913           | 19,109           |
| Total expendable                  | <u>38,264</u>    | <u>30,115</u>    |
| Nonexpendable:                    |                  |                  |
| Endowments                        | 29,004           | 27,940           |
| Total restricted net assets       | <u>\$ 67,268</u> | <u>\$ 58,055</u> |

**13. Unrestricted Net Assets**

Certain unrestricted net assets are not available for general operations due to internal restrictions or designations placed on these funds by management or the Board of Trustees. Unrestricted net assets consist of the following as of June 30 (*in thousands*):

|   | <b>2005</b>       | <b>2004</b>       |
|---|-------------------|-------------------|
| Quasi-endowments                                  | \$ 1,803          | \$ 1,737          |
| Other internally restricted funds                 | 78,225            | 30,888            |
| Amount available for general operating activities | 113,227           | 121,148           |
| Total unrestricted net assets                     | <u>\$ 193,255</u> | <u>\$ 153,773</u> |

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **14. Retirement Benefits**

All active employees of UAMS who work 20 or more hours a week participate in either the Arkansas Teacher Retirement System (ATRS), Arkansas Public Employee Retirement System (APERS), the Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF) or the Fidelity Fund.

ATRS was established as an actuarial reserve system, with a financial base derived from employer and employee contributions and income from investments to pay future benefits. It pays retirement benefits based on length of service and an average of the three highest fiscal years' earnings. Benefit provisions are established and amended by State of Arkansas Statute (A.C.A. 266). UAMS' required contribution rate was 14% and 13% in 2005 and 2004, respectively. ATRS issues a publicly available financial report, which may be obtained by writing or calling: ATRS, 1400 West Third Street, Little Rock, AR 72201, (501) 682-1517. The gross payroll amount for UAMS employees covered by ATRS for the years ended June 30, 2005 and 2004, was \$151,000 and \$136,000, respectively. UAMS' total salaries were \$425,916,000 and \$365,816,000, respectively. Total employer contributions to ATRS in fiscal 2005 and 2004 were \$21,000 and \$18,000, respectively. Employee contributions to ATRS in fiscal years 2005 and 2004 were \$4,300 and \$5,000, respectively.

APERS is a cost-sharing multiple-employer defined benefit plan administered by the State of Arkansas which pays retirement benefits based on length of service and an average of the five highest fiscal years' earnings. Vesting is effective after ten years of participation in the plan. Benefit provisions are established and amended by State of Arkansas Statute (A.C.A. 24). UAMS' required contribution rate was 11% and 10% in 2005 and 2004, respectively. APERS issues a publicly available financial report, which may be obtained by writing or calling: APERS, One Union National Plaza, 124 W. Capitol, 5<sup>th</sup> Floor, Little Rock, AR 72201, (501) 682-7855. The gross payroll amount for UAMS employees covered by APERS for the years ended June 30, 2005 and 2004, was \$3,846,000 and \$3,915,000, respectively. Total employer contributions to APERS in fiscal 2005 and 2004 were \$456,000 and \$371,000, respectively.

TIAA-CREF and the Fidelity Fund retirement accounts were established by the Board of Trustees of the University of Arkansas System. These funds represent a defined contribution plan as set forth in Sections 403(b) and 457(b) of the Internal Revenue Code. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings.

## University of Arkansas for Medical Sciences

### Notes to Financial Statements (continued)

#### **14. Retirement Benefits (continued)**

UAMS automatically contributes 5% of an employee's regular salary to a TIAA-CREF or Fidelity Fund retirement account, allocated between the two funds according to the employee's choice. In addition, employees may make voluntary contributions of any amount up to the individual maximum allowance.

For any contributions an employee makes in excess of 5% of regular salary, UAMS makes an equal contribution up to a maximum total UAMS contribution of 10% of regular salary. All contributions for faculty members and nonclassified employees are vested immediately. For classified employees, UAMS contributions will be vested when one of the following occurs: three years of service is completed; the normal retirement age of 70 is attained; or the participant contributes at least 5% of regular salary for at least six months. UAMS' automatic contributions during fiscal 2005 and 2004 were calculated on base salary of \$342,930,000 and \$333,021,000, respectively. Total employer contributions during fiscal 2005 and 2004 to TIAA-CREF and the Fidelity Fund were \$29,683,000 and \$27,106,000, respectively. Employee contributions to TIAA-CREF and the Fidelity Fund in the fiscal years 2005 and 2004 were \$31,341,000 and \$27,978,000, respectively.

In addition to providing retirement benefits, UAMS arranges health, dental, and life insurance for retired and disabled employees and their families. Substantially all of UAMS' employees may become eligible for those benefits if they meet normal retirement requirements while still working for UAMS. The number of eligible retirees was approximately 460 and 439 as of June 30, 2005 and 2004, respectively. The participants of this program incur the total premium for this insurance. There is no direct expense for these services incurred by UAMS.

#### **15. Other Post-Employment Benefits**

UAMS pays for some health and dental benefits and stipends for certain former employees as a part of their separation agreements. These benefits are limited to specific time periods, generally two to ten years. Ten and 13 former employees were eligible and receiving these benefits, as of June 30, 2005 and 2004, respectively. UAMS recorded approximately \$49,000 and \$58,000 in other post-employment benefits related to these former employees for the years ended June 30, 2005 and 2004, respectively.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**16. Affiliated Entities (Unaudited)**

The University of Arkansas Foundation, Inc. (the Foundation) operates as a nonprofit benevolent corporation for charitable educational purposes. It was established to benefit the University of Arkansas, or its students, faculty and staff. The Board of Directors of the Foundation includes four members who are also members, or former members, of the University of Arkansas System Board of Trustees. Based on information provided by the Foundation, during the years ended June 30, 2005 and 2004, revenue of \$50,092,000 and \$53,745,000, respectively, was received by the Foundation for the benefit of UAMS. Support, by the Foundation on behalf of UAMS, was \$17,571,000 and \$12,672,000 for the years ended June 30, 2005 and 2004, respectively.

**17. Related Party Transactions**

Notes receivable from related parties at June 30 are as follows (*in thousands*):

|  | <u>2005</u>     | <u>2004</u>     |
|--|-----------------|-----------------|
| University of Arkansas at Fayetteville                           | \$ 1,605        | \$ 1,605        |
| University of Arkansas System                                    | 626             | 844             |
| Total included in notes and student loans receivable<br>(Note 6) | <u>\$ 2,231</u> | <u>\$ 2,449</u> |

In addition to the above transactions, UAMS conducts various activities with University of Arkansas System campuses and the State of Arkansas. These activities take place in the normal course of business and are on an arm's-length basis.

## University of Arkansas for Medical Sciences

### Notes to Financial Statements (continued)

#### **18. Contingencies**

Amounts received and expended by UAMS under various federal and state programs are subject to audit by governmental agencies. Management believes that adjustments, if any, which might result from such audits would not have a significant impact on the financial position of UAMS. Immunity provisions in Arkansas law prohibit suits naming the Board of Trustees of the University of Arkansas System or UAMS as a defendant in Arkansas State courts. Employees of UAMS acting in good faith in the course and scope of their employment may be sued in state courts, but only to the extent of maintained insurance coverage. UAMS maintains malpractice insurance for certain employees under a claims-made policy. Premiums are accrued based on a retrospective rating plan. UAMS incurred costs of \$4,488,000 and \$4,094,000 for this insurance during the years ended June 30, 2005 and 2004, respectively. A party may bring an action against UAMS through the Arkansas State Claims Commission (the Claims Commission). The Claims Commission may award a claim of up to \$7,500 without further review or appropriation. Awards that the Claims Commission approves in excess of \$7,500 must be approved and appropriated by the Arkansas State Legislature. Appropriations of this type, if any, reduce appropriations from the state to UAMS in the period in which the claim is appropriated.

UAMS is involved in litigation and regulatory investigations arising in the normal course of business. Management and counsel believe that these matters will be resolved without material adverse effect on UAMS' financial statements.

UAMS employees and their eligible dependents may participate in the University of Arkansas System sponsored self-funded health plan, which is administered by third parties who are responsible for the processing of claims and administration of cost containment. The monthly premiums are established by the University of Arkansas System at a level sufficient to cover claims expected in the plan. UAMS and the employees share the cost of the monthly insurance premium with the total premium and the portion paid by UAMS varying depending on the insurance coverage chosen by the employee. The employee's portion and UAMS' portion of the premium are remitted the following month to the University of Arkansas System with UAMS recognizing as expense its portion of the premiums in the month to which it relates. UAMS has not recorded any other amounts in the financial statements related to the health plan.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**19. Functional Classification of Expenses**

For financial reporting purposes, UAMS classifies its operating expenses by their natural classification. The tables below summarize these expenses by their functional classification (*in thousands*):

|                                    | Year ended June 30, 2005        |                                   |                                    |                                     |                   |
|------------------------------------|---------------------------------|-----------------------------------|------------------------------------|-------------------------------------|-------------------|
|                                    | Compensation<br>and<br>Benefits | Supplies<br>and<br>Other Services | Scholarships<br>and<br>Fellowships | Depreciation<br>and<br>Amortization | Total             |
| Patient care                       | \$ 259,631                      | \$ 155,225                        | \$ -                               | \$ -                                | \$ 414,856        |
| Instruction                        | 130,405                         | 16,498                            | -                                  | -                                   | 146,903           |
| Research                           | 55,396                          | 25,269                            | -                                  | -                                   | 80,665            |
| Public services                    | 7,557                           | 1,972                             | -                                  | -                                   | 9,529             |
| Academic support                   | 10,615                          | 2,354                             | -                                  | -                                   | 12,969            |
| Student services                   | 1,732                           | 1,384                             | -                                  | -                                   | 3,116             |
| Institutional support              | 40,830                          | 8,612                             | -                                  | -                                   | 49,442            |
| Operation and maintenance of plant | 10,755                          | 17,177                            | -                                  | -                                   | 27,932            |
| Scholarships and awards            | -                               | -                                 | 192                                | -                                   | 192               |
| Auxiliary                          | 1,525                           | 3,445                             | -                                  | -                                   | 4,970             |
| Depreciation and amortization      | -                               | -                                 | -                                  | 24,086                              | 24,086            |
| Other                              | 153                             | 1,887                             | -                                  | -                                   | 2,040             |
| <b>Total</b>                       | <b>\$ 518,599</b>               | <b>\$ 233,823</b>                 | <b>\$ 192</b>                      | <b>\$ 24,086</b>                    | <b>\$ 776,700</b> |

|                                    | Year ended June 30, 2004        |                                   |                                    |                                     |                   |
|------------------------------------|---------------------------------|-----------------------------------|------------------------------------|-------------------------------------|-------------------|
|                                    | Compensation<br>and<br>Benefits | Supplies<br>and<br>Other Services | Scholarships<br>and<br>Fellowships | Depreciation<br>and<br>Amortization | Total             |
| Patient care                       | \$ 245,033                      | \$ 142,728                        | \$ -                               | \$ -                                | \$ 387,761        |
| Instruction                        | 117,070                         | 19,510                            | -                                  | -                                   | 136,580           |
| Research                           | 51,137                          | 24,528                            | -                                  | -                                   | 75,665            |
| Public services                    | 7,360                           | 2,402                             | -                                  | -                                   | 9,762             |
| Academic support                   | 10,288                          | 3,480                             | -                                  | -                                   | 13,768            |
| Student services                   | 1,706                           | 1,346                             | -                                  | -                                   | 3,052             |
| Institutional support              | 38,858                          | 9,635                             | -                                  | -                                   | 48,493            |
| Operation and maintenance of plant | 8,999                           | 14,216                            | -                                  | -                                   | 23,215            |
| Scholarships and awards            | -                               | -                                 | 196                                | -                                   | 196               |
| Auxiliary activities               | 746                             | 1,123                             | -                                  | -                                   | 1,869             |
| Depreciation and amortization      | -                               | -                                 | -                                  | 22,675                              | 22,675            |
| Other                              | 696                             | 436                               | -                                  | -                                   | 1,132             |
| <b>Total</b>                       | <b>\$ 481,893</b>               | <b>\$ 219,404</b>                 | <b>\$ 196</b>                      | <b>\$ 22,675</b>                    | <b>\$ 724,168</b> |

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **20. Subsequent Events**

In fiscal year 2005, UAMS embarked upon a \$168,000,000 building project to replace the 50-year-old hospital bed units, build a new dormitory, and add 40 new inpatient psychiatric bed units. UAMS refinanced \$58,265,000 of outstanding 1998 facility bonds and issued \$150,000,000 in new bonds in fiscal year 2005 with plans to issue \$100,000,000 more in fiscal year 2007. The new bonds are secured by a pledge of patient service revenue. The new facility will house 350 to 375 bed units and additional bassinets, operating rooms, cardiac cath labs, radiology, and other ancillary areas. UAMS will shell an additional two floors, which may hold another 120 beds. A psychiatry wing, The UAMS Psychiatry Institute, will house 40 psychiatric inpatient beds, psychiatry clinics, offices, and research areas. UAMS will build a power plant capable of maximum power generation which can meet all the power needs of the west side of the UAMS campus during peak operating periods and reduce operating costs. The new bonds are expected to be fixed 30-year indentures. In addition to the facility bonds, UAMS issued \$10,070,000 in parking facility bonds to add to UAMS' parking capacity. Parking systems revenues are pledged for debt service.

### **21. New Accounting Pronouncements**

In November 2003, the GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which becomes effective in fiscal year 2006. In April 2004, the GASB issued Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*, which becomes effective in fiscal year 2006. In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, which becomes effective in fiscal year 2008. In December 2004, the GASB issued Statement No. 46, *Net Assets Restricted by Enabling Legislation—an amendment of GASB Statement No. 34*, which becomes effective in fiscal year 2006. Management has not yet determined the effect of the implementation of these statements on UAMS' financial statements.

In addition, the GASB has issued the following exposure drafts: (1) *Communication Methods*, with, as yet, no proposed implementation date; (2) *Sales and Pledges of Receivables and Future Revenues*, with a proposed implementation date of fiscal year 2008; and (3) *Accounting for Termination Benefits*, with a proposed implementation date in fiscal year 2006. Management has not yet determined the effect of the implementation of these proposed exposure drafts on UAMS' financial statements.