



UNIVERSITY OF ARKANSAS

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# **Financial Statements**

**June 30, 2006**

**UNIVERSITY OF ARKANSAS  
FOR MEDICAL SCIENCES**

University of Arkansas for Medical Sciences

Financial Statements

Years ended June 30, 2006 and 2005

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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, 2006, 2005 and 2004. 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 2,147 and faculty numbering 1,226;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 279 adult beds in use at June 30, 2006;
- 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 Institute on Aging;
- Multiple Myeloma Institute;
- Arkansas Biosciences Institute;
- Jackson T. Stephens Spine and Neurosciences Institute; and
- Psychiatric Research 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, 2006, with comparative information for the fiscal years ended June 30, 2005 and 2004.

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

**FINANCIAL HIGHLIGHTS**

UAMS' financial position remained strong at June 30, 2006, with assets of \$959,771,000 and liabilities of \$424,127,000. Net assets, which represent the residual interest in UAMS' assets after liabilities are deducted, were \$535,644,000 at June 30, 2006. 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, 2006, 2005 and 2004 as follows:

	<b>Year ended June 30</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
	<i>(in thousands)</i>		
Operating revenue	\$ <b>825,748</b>	\$ 763,828	\$ 712,956
Operating expenses	<b>(847,644)</b>	(776,700)	(724,168)
Nonoperating revenue	<b>46,593</b>	40,800	46,743
Other changes in net assets	<b>15,633</b>	19,867	11,438
Increase in net assets	<b>\$ 40,330</b>	\$ 47,795	\$ 46,969

***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.

University of Arkansas for Medical Sciences

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>2006</b>	<b>June 30 2005</b>	<b>2004</b>
<b>Assets</b>			
Current assets	\$ 249,316	\$ 218,011	\$ 208,790
Noncurrent assets:			
Investments	296,792	213,480	88,442
Capital assets, net	395,858	346,444	338,831
Other	17,805	17,258	16,041
<b>Total Assets</b>	<b>\$ 959,771</b>	<b>\$ 795,193</b>	<b>\$ 652,104</b>
 <b>Liabilities</b>			
Current liabilities	\$ 102,637	\$ 83,844	\$ 94,789
Noncurrent liabilities	321,490	216,035	109,796
<b>Total Liabilities</b>	<b>424,127</b>	<b>299,879</b>	<b>204,585</b>
 <b>Net Assets</b>			
Invested in capital assets, net of related debt	229,548	234,791	235,691
Restricted:			
Expendable	36,927	38,264	30,115
Nonexpendable	31,635	29,004	27,940
Unrestricted	237,534	193,255	153,773
<b>Total Net Assets</b>	<b>535,644</b>	<b>495,314</b>	<b>447,519</b>
<b>Total Liabilities and Net Assets</b>	<b>\$ 959,771</b>	<b>\$ 795,193</b>	<b>\$ 652,104</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 assets include investments, notes and student loans receivable (net), capital assets (net)

## University of Arkansas for Medical Sciences

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

and other noncurrent assets. Current liabilities consist primarily of accounts payable and accrued liabilities, deferred revenue, funds held in trust for others, estimated third-party payor settlements (Medicare and Medicaid), 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 \$164,578,000 for fiscal year 2006. A review of the Statements of Net Assets reveals that the increase was primarily due to an increase of \$31,305,000 in current assets and \$49,414,000 in capital assets (net), plus an increase in investments of \$83,312,000.

The increase in current assets was primarily due to an increase in cash and cash equivalents of \$23,572,000 and an increase in patient accounts receivable of \$6,982,000. The Enhanced Medicaid program accounted for \$12,327,000 of the increase in cash and cash equivalents. Additionally, \$7,562,000 was related to the recoupment of Federal Medicaid Match payments and Arkansas Department of Human Services (DHS) overhead payments from DHS to be used toward the construction of the new Arkansas State Hospital. The balance of the increase in cash and cash equivalents was generated from operating activities. The increase in patient accounts receivable was caused by the growth in net patient services revenue (see Statements of Revenue, Expenses and Changes in Net Assets section below). The increase in capital assets was primarily due to an increase in buildings and fixtures, equipment, and construction-in-progress. 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 \$111,577,000 of the increase in investments offset by \$36,963,000 for the use of these funds toward the projects. The balance of the increase is related to reinvested income and capital appreciation.

Total liabilities increased by \$124,248,000 for fiscal year 2006. Bonds, notes and capital leases payable increased by \$103,721,000, primarily from the new bond issues (see Note 9). In addition, trade accounts payable decreased by \$2,029,000, accrued wages increased by \$2,880,000, compensated absences increased by \$3,396,000, and miscellaneous payables increased by \$12,389,000.

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

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 \$33,829,000 of the increase in cash and cash equivalents. Additionally, \$10,485,000 was related to the recoupment of Federal Medicaid Match payments and DHS overhead payments from DHS toward the construction of the new Arkansas State Hospital. 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.

University of Arkansas for Medical Sciences

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		
	2006	2005	2004
<b>Operating Revenue</b>			
Student tuition and fees, net of scholarship allowances	\$ 14,463	\$ 13,146	\$ 12,191
Net patient services	635,435	583,680	535,148
Sponsored programs	138,657	133,490	135,401
Other	37,193	33,512	30,216
Total Operating Revenue	825,748	763,828	712,956
<b>Operating Expenses</b>			
Compensation and benefits	563,529	518,599	481,893
Supplies and other services	258,348	233,823	219,404
Scholarships and fellowships	119	192	196
Depreciation and amortization	25,648	24,086	22,675
Total Operating Expenses	847,644	776,700	724,168
<b>Operating Loss</b>	(21,896)	(12,872)	(11,212)
<b>Nonoperating Revenue (Expenses)</b>			
State appropriations, net	37,939	29,103	36,961
Gifts	4,586	7,182	6,610
Investment gain, net of investment expense	15,556	10,311	6,023
Other	(11,488)	(5,796)	(2,851)
Total Nonoperating Revenue (Expenses)	46,593	40,800	46,743
<b>Income Before Other Changes in Net Assets</b>	24,697	27,928	35,531
<b>Other Changes in Net Assets</b>			
Capital gifts	9,941	7,512	4,070
Capital appropriations	-	-	7,368
Interagency transfer	5,692	12,355	-
Total Other Changes in Net Assets	15,633	19,867	11,438
<b>Increase in Net Assets</b>	40,330	47,795	46,969
Net Assets – beginning of year	495,314	447,519	400,550
<b>Net Assets – end of year</b>	\$ 535,644	\$ 495,314	\$ 447,519

## University of Arkansas for Medical Sciences

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

The Statement of Revenue, Expenses and Changes in Net Assets reflects an increase of \$40,330,000 in net assets for fiscal year 2006. Highlights of the information presented in this statement show how the following affected operating revenue during fiscal year 2006:

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 the College of Nursing, and small tuition increases. Net patient services revenue increased by \$51,755,000. The increase in net patient services revenue is primarily due to increased volume in both inpatient and outpatient services as well as a slight increase in the case mix index. Sponsored programs, which includes federal grants and contracts, state and local grants and contracts, and nongovernmental grants and contracts, increased by \$5,167,000. Federal grants and contracts increased by \$4,214,000 and nongovernmental grants and contracts increased by \$4,415,000. This growth was offset by a decrease in state and local grants and contracts of \$3,462,000 due to decreased revenue from Tobacco Settlement Funds. Other revenue, which increased by \$3,681,000, includes auxiliary enterprises and other miscellaneous revenue sources.

The following factors affected operating expenses during fiscal year 2006:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2006, increasing by \$44,930,000. Compensation and benefits expense related to patient care increased by \$26,664,000 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. The balance of the increase in compensation and benefits was the result of normal salary increases and increased medical premiums. Supplies and other services increased by \$24,525,000. Supplies related to patient care increased by \$26,563,000 due to increased patient volume. Offsetting the increase in patient care supplies were decreases in instructional and operating supply expense.

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

## University of Arkansas for Medical Sciences

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

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 was recognized in federal grants and contracts in the 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.

## University of Arkansas for Medical Sciences

### 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, 2006, 2005 and 2004, is as follows (*in thousands*):

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Gross state appropriations revenue	\$ 89,380	\$ 83,324	\$ 81,061
Less Medicaid match payments	51,441	54,221	44,100
Net state appropriations revenue	<u>\$ 37,939</u>	<u>\$ 29,103</u>	<u>\$ 36,961</u>

#### ***Results of Operations***

In fiscal year 2006, UAMS experienced an increase of 8.1% in net assets. The major driver of the net assets growth was an 8.9% growth in net patient services revenue. Additionally, capital gifts continue to be an important component of UAMS' growth, totaling \$9,941,000 in fiscal year 2006.

Although the overall financial position improved in 2006, there were some occurrences that adversely affected the financial position:

Gross state appropriations accounted for approximately 10.0% of UAMS revenue for fiscal 2006 and 2005.

Compensation and employee benefits increased by 8.7%, which reflects a 10.3% increase in patient care and normal salary and benefit increases in other areas.

Supplies and other services increased by 10.5%, which reflects a 17.1% increase in patient care supplies with decreases in the functional classification of instruction and operations expense.

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.

University of Arkansas for Medical Sciences

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

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.

***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)*

	<b>Year ended June 30</b>		
	<b>2006</b>	<b>2005</b>	<b>2004</b>
<b>Cash and cash equivalents provided by (used in):</b>			
Operating activities	\$ <b>13,663</b>	\$ 42,960	\$ (13,137)
Noncapital financing activities	<b>50,378</b>	52,050	42,061
Capital and related financing activities	<b>27,287</b>	74,604	(29,474)
Investing activities	<b>(67,756)</b>	(114,727)	28,236
Net increase in cash and cash equivalents	<b>23,572</b>	54,887	27,686
Cash and cash equivalents – beginning of year	<b>113,382</b>	58,495	30,809
<b>Cash and cash equivalents – end of year</b>	<b>\$ 136,954</b>	\$ 113,382	\$ 58,495

University of Arkansas for Medical Sciences

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

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

*Capital Assets*

At June 30, 2006, UAMS had \$395,858,000 invested in capital assets, net of accumulated depreciation and amortization of \$238,953,000. Depreciation and amortization charges totaled \$25,648,000 for the fiscal year ended June 30, 2006.

UAMS' capital additions totaled \$79,557,000 in fiscal year 2006. 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 2006 and the sources that funded their acquisition included:

<b>Project</b>	<b>Amount of Additions</b>	<b>Funding Source</b>
	<i>(in thousands)</i>	
Patient Bed Tower, Residence Hall, West Parking Deck & Central Power Plant	\$ 34,871	2004 & 2006 Bond Issuance, Psychiatry Institute Foundation, UAMS
Jones Eye Institute – Walker Tower Addition	8,873	Pat & Willard Walker Foundation
Electronic Medical Records System	4,855	UAMS
Jackson T. Stephens Spine & Neuroscience 4 <sup>th</sup> & 6 <sup>th</sup> Floor Build-out	1,747	UAMS
Campus Bookstore	687	UAMS
Chemotherapy Unit	819	UAMS

The Pat & Willard Walker Tower addition to the Harvey & Bernice Jones Eye Institute was completed in fiscal year 2006, along with the Chemotherapy Unit in the Outpatient Center and the Campus Bookstore.

Construction-in-progress at June 30, 2006, included the Patient Bed Tower, the Residence Hall, the West Parking Deck, the Central Power Plant, and the Arkansas State Hospital. Also included is the purchase and installation of an Electronic Medical Records System, along with various renovation and maintenance projects. More detailed information about UAMS' capital assets is presented in Note 7 to the financial statements.

On February 23, 2005, UAMS and DHS entered into an agreement under which DHS agreed to transfer 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 \$24,360,000. See Note 10 to the financial statements.

University of Arkansas for Medical Sciences

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

**Debt Administration**

At June 30, 2006, UAMS had \$334,268,000 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 Outstanding (in thousands)</b>
Bonds payable	\$ 288,185
Notes payable	1,886
Obligations under capital leases	12,043
Compensated absences	32,154
	\$ 334,268

Moody's Investment Service raised the rating of the University of Arkansas System from A1 to Aa3 in August 2004, which was affirmed on June 9, 2006. 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 and 10 to the financial statements.

**ECONOMIC OUTLOOK**

UAMS' financial position continued to strengthen in fiscal year 2006 as evidenced by an approximate \$40,330,000 increase in Net Assets. UAMS benefits from its 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, build a new dormitory, and add 40 new inpatient psychiatric beds. UAMS refinanced \$58,265,000 of outstanding 1998 facility bonds and issued \$95,915,000 in new bonds in fiscal year 2005 and \$107,500,000 in fiscal year 2006. The new bonds are secured by a pledge of patient service revenue. The new facility will house 350 to 375 adult beds and additional bassinets, operating rooms, cardiac cath labs, radiology, and other ancillary areas. UAMS will shell an additional two

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

floors, which may hold another 120 adult beds. A psychiatry wing, the UAMS Psychiatric Research 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 fixed 30-year indentures. In addition to the facility bonds, UAMS issued \$10,070,000 in parking facility bonds in fiscal year 2005 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. To achieve the inpatient growth of 27%, UAMS was targeted to grow by 1.6% to 3.5% per year, or an average annual growth of 2.5%. The average over the past three years for inpatient growth has been 2.7%. To achieve the outpatient growth of 39%, UAMS was targeted to grow 3.0% to 3.9% per year, or an average annual growth of 3.4%. The average outpatient growth over the past three years has been 7.1%.

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. 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. An example is the Tobacco Settlement Funds.

Initiated Act Number 1 of 2000, the Tobacco Settlement Proceeds Act (the 2000 Act), was passed by popular vote on November 7, 2000. During fiscal 2006 and 2005, UAMS received \$7,816,000 and \$9,968,000, respectively, in operating funds from the Tobacco Settlement Funds for the College of Public Health, the Donald W. Reynolds Institute on Aging and the Department of Geriatrics, Delta Area Health Education Center, and the Arkansas Biosciences Institute.

## University of Arkansas for Medical Sciences

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

In fiscal year 2006, the Arkansas Development Finance Authority issued \$36,775,000 in Tobacco Settlement Revenue Bonds. The Authority has loaned the proceeds of the bonds to the University of Arkansas System Board of Trustees (UA Board) to fund an expansion to the Arkansas Cancer Research Center (ACRC). Funds received from the 2000 Act are pledged for debt service. The latest *Global Insights USA, Inc.* report, prepared in August 2006, on the *Forecast of U.S. Cigarette Consumption (2004-2046)* indicates that tobacco consumption in 2046 is expected to decline by 54% from the 2003 level. Arkansas received for fiscal year 2003 \$60,067,457 from the Tobacco Settlement Fund. Using the 54% decline from above, Arkansas should receive approximately \$27.4 million in 2046, with the first \$5 million dedicated to pay the debt service on the above bond issue. The UA Board has committed to make payments under a Loan Agreement and Promissory Note sufficient to pay the Maturity Amounts of the 2006 Bonds. However, no such payments will be made unless funds received from the 2000 Act are insufficient to make such payments. Certain pledged revenues from UAMS, excluding physician-generated revenues, State appropriations and revenues restricted as to use, were used to secure the Note. Additionally, \$1,000,000 from a federal grant has been awarded to fund architectural expenses for the ACRC expansion.

UAMS has experienced solid financial growth with a three-year average annual growth in Net Assets of 11.2%. 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, 2006 and 2005, 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, 2006 and 2005, 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 6, 2006, 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.

*Ernst & Young LLP*

October 6, 2006

University of Arkansas for Medical Sciences

Statements of Net Assets  
(in thousands)

	June 30	
	2006	2005
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents (Note 4)	\$ 136,954	\$ 113,382
Patient accounts receivable, net (Note 2)	85,777	78,795
Nonpatient accounts receivable, net	15,002	15,248
Inventories	8,086	7,618
Notes and student loans receivable, net (Notes 6 and 16)	3,237	2,479
Prepaid expenses	260	489
Total Current Assets	249,316	218,011
Noncurrent Assets:		
Investments (Note 5)	110,038	104,235
Notes and student loans receivable, net (Notes 6 and 16)	13,747	13,849
Deposits and funds held in trust by others	186,754	109,245
Capital assets, net (Notes 7, 9 and 10)	395,858	346,444
Other noncurrent assets	4,058	3,409
Total Noncurrent Assets	710,455	577,182
Total Assets	\$ 959,771	\$ 795,193
<b>LIABILITIES</b>		
Current Liabilities:		
Accounts payable and accrued liabilities (Note 8)	\$ 68,412	\$ 55,172
Deferred revenue	2,260	2,163
Funds held in trust for others	1,547	442
Estimated third-party payor settlements (Note 2)	17,529	14,829
Compensated absences payable, current portion (Note 9)	1,601	1,545
Bonds, notes and capital leases payable, current portion (Notes 9 and 10)	11,288	9,693
Total Current Liabilities	102,637	83,844
Noncurrent Liabilities:		
Deposits	111	122
Compensated absences payable, net of current portion (Note 9)	30,553	27,213
Bonds, notes and capital leases payable, net of current portion (Notes 9 and 10)	290,826	188,700
Total Noncurrent Liabilities	321,490	216,035
Total Liabilities	424,127	299,879
Commitments and Contingencies (Notes 9, 10, 13, 14 and 17)		
<b>NET ASSETS</b>		
Invested in capital assets, net of related debt	229,548	234,791
Restricted (Note 11):		
Expendable	36,927	38,264
Nonexpendable	31,635	29,004
Unrestricted (Note 12)	237,534	193,255
Total Net Assets	535,644	495,314
Total Liabilities and Net Assets	\$ 959,771	\$ 795,193

See accompanying notes.

# University of Arkansas for Medical Sciences

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

	Year ended June 30	
	2006	2005
<b>REVENUE</b>		
Operating Revenue:		
Student tuition and fees (net of scholarship allowances of \$2,479 in 2006 and \$2,116 in 2005)	\$ 14,463	\$ 13,146
Net patient services (Note 2)	635,435	583,680
Sponsored programs:		
Federal grants and contracts	87,010	82,796
State and local grants and contracts	11,041	14,503
Nongovernmental grants and contracts	40,606	36,191
Sales and services of educational departments	21,458	20,762
Auxiliary enterprises:		
Housing and food service	2,466	3,113
Bookstore	726	785
Other auxiliary enterprises	3,280	2,985
Other	9,263	5,867
Total Operating Revenue	825,748	763,828
<b>EXPENSES</b>		
Operating Expenses (Note 18):		
Compensation and benefits (Note 13)	563,529	518,599
Supplies and other services (Note 10)	258,348	233,823
Scholarships and fellowships	119	192
Depreciation and amortization (Note 7)	25,648	24,086
Total Operating Expenses	847,644	776,700
Operating Loss	(21,896)	(12,872)
<b>NONOPERATING REVENUE (EXPENSES)</b>		
State appropriations, net (Note 3)	37,939	29,103
Gifts	4,586	7,182
Investment gain, net of investment expense (Note 5)	15,556	10,311
Interest on capital	(7,321)	(4,964)
Loss on disposal of capital assets	(4,167)	(832)
Total Nonoperating Revenue (Expenses)	46,593	40,800
Income Before Other Changes in Net Assets	24,697	27,928
<b>OTHER CHANGES IN NET ASSETS</b>		
Capital gifts	9,941	7,512
Interagency transfer	5,692	12,355
Total Other Changes in Net Assets	15,633	19,867
Increase in Net Assets	40,330	47,795
Net Assets – beginning of year	495,314	447,519
Net Assets – end of year	\$ 535,644	\$ 495,314

*See accompanying notes.*

University of Arkansas for Medical Sciences

Statements of Cash Flows  
(in thousands)

	Year ended June 30	
	2006	2005
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Student tuition and fees (net of scholarships)	\$ 15,230	\$ 13,742
Patient and insurance payments	666,043	633,304
Research grants and contracts	138,791	138,521
Collection of loans and interest	1,527	2,055
Auxiliary enterprise revenue:		
Housing and food service	2,483	3,090
Bookstore	726	785
Other auxiliary enterprises	3,129	2,972
Other receipts	29,920	23,821
Payments to suppliers	(275,556)	(251,006)
Payments to employees	(457,453)	(425,253)
Payments of employee benefits	(99,760)	(88,311)
Loans issued to students	(2,286)	(2,397)
Scholarships and fellowships	(119)	(192)
Other payments	(9,012)	(8,171)
Net cash and cash equivalents provided by operating activities	13,663	42,960
<b>CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES</b>		
State appropriations	44,102	44,218
Gifts and grants	4,586	7,182
Loan proceeds	482	450
Other agency funds (net)	1,105	29
Repayments of loans	103	171
Net cash and cash equivalents provided by noncapital financing activities	50,378	52,050
<b>CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES</b>		
Proceeds from issuance of debt	112,622	164,916
Proceeds from sale of capital assets	396	62
Purchases of capital assets	(63,225)	(21,736)
Principal paid on capital debt and leases	(14,742)	(63,877)
Interest and paying agent fees paid on debt and capital leases	(7,764)	(4,761)
Net cash and cash equivalents provided by capital and related financing activities	27,287	74,604

University of Arkansas for Medical Sciences

Statements of Cash Flows (continued)

(in thousands)

	Year ended June 30	
	2006	2005
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Proceeds from sales and maturities of investments	\$ 54,194	\$ 65,188
Interest on investments (net of fees)	4,830	2,382
Purchases of investments	(126,780)	(182,297)
Net cash and cash equivalents used in investing activities	<u>(67,756)</u>	<u>(114,727)</u>
Net increase in cash and cash equivalents	23,572	54,887
Cash and cash equivalents – beginning of year	113,382	58,495
Cash and cash equivalents – end of year	<u>\$ 136,954</u>	<u>\$ 113,382</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Operating loss	\$ (21,896)	\$ (12,872)
Adjustments to reconcile operating loss to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	25,648	24,086
Changes in operating assets and liabilities:		
Patient and nonpatient accounts receivable, net	(7,319)	43,977
Inventories	(468)	(485)
Other assets	(529)	(646)
Accounts payable and accrued liabilities	12,045	(14,553)
Deferred revenue	97	491
Deposits	(11)	(1)
Compensated absences payable	3,396	2,405
Other liabilities	2,700	558
Net cash and cash equivalents provided by operating activities	<u>\$ 13,663</u>	<u>\$ 42,960</u>
<b>Noncash transactions:</b>		
Fixed assets acquired by capital gift	\$ 9,941	\$ 7,512
Fixed assets acquired by incurring capital lease obligations	\$ 6,346	\$ 3,284
Proceeds receivable from issuance of Tobacco Settlement Revenue Bonds	\$ 36,775	–
Debt obligation from issuance of Tobacco Settlement Revenue Bonds	\$ (36,775)	–

See accompanying notes.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements

June 30, 2006

### 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 System's ten-member Board of Trustees (UA Board).

***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 2,147 and faculty numbering 1,226;
- The University Hospital of Arkansas, (the Hospital) a tertiary care referral center with 279 adult beds in use at June 30, 2006;
- Regional programs including Tele-education, Rural Hospital Program and seven Area Health Education Centers (AHECs) located throughout the state;
- The Arkansas Cancer Research Center;
- Jones Eye Institute;
- Donald W. Reynolds Institute on Aging;
- Multiple Myeloma Institute;
- Arkansas Biosciences Institute;

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

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

- Jackson T. Stephens Spine and Neurosciences Institute; and
- Psychiatric Research Institute.

The Little Rock campus includes approximately 3,800,000 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 market value of the units of the external investment pool (the Pool) is based on the fair value of the underlying investments held by the Pool.

The UA Board and the University of Arkansas Foundation (the Foundation) Board of Trustees are the sponsors of 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 University of Arkansas System issues a publicly available audited financial report that includes additional disclosures about the Pool, 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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

**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.

**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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

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.

***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.

***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 UA Board 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 UA Board. 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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

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 UA Board. 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, 2006 and 2005 are recorded net of an allowance for doubtful accounts of \$858,890,000 and \$803,054,000, respectively.

Net patient services revenue for the years ended June 30, 2006 and 2005, is as follows (*in thousands*):

	<u>2006</u>	<u>2005</u>
Gross patient revenue	\$ 1,269,940	\$ 1,180,647
Less patient services contractual allowances	583,226	520,594
Less provision for bad debts	51,279	76,373
Net patient services revenue	<u>\$ 635,435</u>	<u>\$ 583,680</u>

UAMS provided approximately \$81,000,000 and \$53,000,000 in charity care, based on established rates, during the years ended June 30, 2006 and 2005, 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, 2006 and 2005, includes approximately \$43,219,000 and \$46,383,000, 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, 2006 and 2005, includes approximately \$27,373,000 and \$25,265,000, 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, 2006, the Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2004.
- 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, 2006, the Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2003.

#### FGP and AHECs:

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

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 original estimated settlements resulted in an increase to net patient services revenue of \$2,916,000 and \$4,908,000 for the years ended June 30, 2006 and 2005, 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 (DHS). UAMS reduced the amount of state appropriations, net for 2005 by \$12,355,000 and increased other changes in net assets – interagency transfer by a like amount. UAMS retained this amount of Medicaid match payments in 2005 and an amount of \$5,692,000 in 2006 as these amounts are being utilized towards the construction of the new Arkansas State Hospital. (See Note 10.)

Net state appropriations revenue for the years ended June 30, 2006 and 2005, is as follows (*in thousands*):

	<u>2006</u>	<u>2005</u>
Gross state appropriations revenue	\$ 89,380	\$ 83,324
Less Medicaid match payments	51,441	54,221
Net state appropriations revenue	<u>\$ 37,939</u>	<u>\$ 29,103</u>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**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, 2006 and 2005, 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 Amount	Bank Balance	Category		
			1	2	3
Cash at June 30, 2006	\$ 1,677	\$ 6,550	\$ 6,550	\$ -	\$ -
Cash at June 30, 2005	\$ 6,254	\$ 4,104	\$ 4,104	\$ -	\$ -

At June 30, 2006 and 2005, Category 1 is composed of \$426,000 and \$330,000, respectively, of insured deposits and \$6,124,000 and \$3,774,000, respectively, of securities that are held in joint custody by the Federal Reserve Bank.

University of Arkansas for Medical Sciences

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>2006</b>	<b>2005</b>
Reported amount of deposits under GASB 3	\$ 1,677	\$ 6,254
Cash equivalents disclosed as investments under GASB 3	<u>135,277</u>	107,128
Cash and cash equivalents as reported in the statements of net assets	<u><u>\$ 136,954</u></u>	<u>\$ 113,382</u>

**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, 2006 (*in thousands*):

*Statement of Invested Assets*

<u>Investment Type</u>	<u>Fair Value</u>
<b>Short Term</b>	<b>\$ 19,500</b>
Certificates of Deposit	19,500
<b>Equity</b>	<b>67</b>
U.S.	67
<b>Commingled Funds</b>	<b>119,208</b>
U.S. Equity	2,360
U.S. Fixed Income	840
Short Term Common Fund	115,777
Money Market Funds	231
<b>Other Investments</b>	<b>293,294</b>
Guaranteed Investment Trust	9,898
External Investment Pool	107,295
2006 Bond Proceeds – Certificates of Deposit and Cash	102,942
2004 Bond Proceeds – Money Market Funds	73,159
<b>Cash</b>	<b>1,677</b>
<b>Total</b>	<b>\$ 433,746</b>

The activities during fiscal year 2006 affecting UAMS' investments are summarized below (*in thousands*):

	<b>Total Return Pool</b>	<b>Short/ Intermediate Pool</b>	<b>Other Investments</b>	<b>Total</b>
June 30, 2005	\$ 49,636	\$ 51,914	\$ 219,058	\$ 320,608
Income	1,019	2,411	7,220	10,650
Realized gains (losses)	5,518	(171)	20	5,367
Unrealized gains (losses)	(1,180)	(234)	94	(1,320)
Expenses paid	(183)	(123)	(5)	(311)
Transfers in (out)	(1,312)	–	98,387	97,075
June 30, 2006	<b>\$ 53,498</b>	<b>\$ 53,797</b>	<b>\$ 324,774</b>	<b>\$ 432,069</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

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

	<b>Total Return Pool</b>	<b>Short/ Intermediate Pool</b>	<b>Other 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	<u>\$ 49,636</u>	<u>\$ 51,914</u>	<u>\$ 219,058</u>	<u>\$ 320,608</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>2006</b>	<b>2005</b>
Reported amount of investments and funds held in trust under GASB 3	<b>\$ 432,069</b>	\$ 320,608
Cash equivalents disclosed as investments under GASB 3	<b>(135,277)</b>	(107,128)
Investments and funds held in trust as reported in the statements of net assets	<u><b>\$ 296,792</b></u>	<u>\$ 213,480</u>

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.

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Notes to Financial Statements (continued)

**5. Investments (continued)**

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

	<b>June 30</b>	
	<b>2006</b>	<b>2005</b>
Fair value at June 30	\$ <b>26,977</b>	\$ 25,585
Number of units in Pool at June 30	<b>463,163</b>	463,101
Fair value per unit at June 30	\$ <b>58.25</b>	\$ 55.25
Realized gains for the year	<b>2,800</b>	1,567
Income earned for the year	\$ <b>516</b>	\$ 598
Realized gains per unit	\$ <b>6.05</b>	\$ 3.38
Income earned per unit	<b>1.11</b>	1.29
Total income per unit	<u><u>\$ <b>7.16</b></u></u>	<u><u>\$ 4.67</u></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 2006 and 2005 were included as a change in the fair value of investments reported in fiscal 2006 and 2005, 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 for Short Term Investments (Short Term 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 include the Total Return Pool, the Intermediate Pool, and the Cash Pool. UAMS owns \$107,295,000, or 8.6%, 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)*

<u>Investment Type</u>	<u>Fair Value</u>
<b>Fixed Income</b>	<b>\$ 353,681</b>
<b>U.S. Government</b>	<b>91,322</b>
U.S. Government Treasuries, Notes, Bonds	48,595
U.S. Government TIPS	26,870
U.S. Government Agency	15,577
Other U.S. Government	280
<b>Mortgage Backed</b>	<b>72,044</b>
Government Pass-Through	59,892
Corporate Pass-Through	12,152
<b>Collateralized Mortgage Obligations</b>	<b>46,792</b>
Government CMOs	7,357
Corporate CMOs	39,435
<b>Corporate</b>	<b>129,952</b>
Corporate Bonds	92,410
Corporate Asset Backed	31,413
Private Placements	6,129
<b>Municipals</b>	<b>3,027</b>
<b>Yankee Bonds</b>	<b>2,283</b>
<b>Non-U.S. Fixed Income</b>	
<b>Developed Markets</b>	<b>3,128</b>
Dev. Government/Sovereign	847
Dev. Corporate	2,281
<b>Emerging Markets</b>	<b>5,133</b>
Emerging Government/Sovereign	1,759
Emerging Corporate	3,374
<b>Convertible Bonds</b>	<b>8,766</b>
<b>Equity</b>	<b>204,729</b>
U.S.	195,485
Non-U.S.	9,244
<b>Alternative Investments</b>	<b>162,223</b>
Private Equity	162,223
<b>Real Estate</b>	<b>47,410</b>
<b>Commingled Funds</b>	<b>513,152</b>
U.S. Equity	223,501
Non-U.S. Equity	184,843
U.S. Fixed Income	37,820
Money Market Funds	66,988
<b>Other Investments</b>	<b>46</b>
<b>Cash</b>	<b>(45,895)</b>
<b>Total</b>	<b>\$ 1,244,112</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.

*EXTERNAL INVESTMENT POOL*

*Credit Risk – S&P Quality Ratings*

Investment Type and Fair Value (in thousands)	TSY	AGY	AAA	AA	A	BBB	BB	B	NR
<b>Fixed Income</b>	<b>\$ 35,877</b>	<b>\$ 68,401</b>	<b>\$ 134,881</b>	<b>\$ 16,341</b>	<b>\$ 39,977</b>	<b>\$ 42,118</b>	<b>\$ 1,527</b>	<b>\$ 1,277</b>	<b>\$ 13,282</b>
<b>U.S. Government</b>	<b>35,877</b>	<b>6,185</b>	<b>46,941</b>	<b>340</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>1,979</b>
U.S. Government Treas., Notes, Bonds	18,638	–	29,957	–	–	–	–	–	–
U.S. Government TIPS	14,802	–	12,068	–	–	–	–	–	–
U.S. Government Agency	2,437	6,185	4,916	340	–	–	–	–	1,699
Other U.S. Government	–	–	–	–	–	–	–	–	280
<b>Mortgage Backed</b>	<b>–</b>	<b>56,620</b>	<b>12,109</b>	<b>117</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>3,198</b>
Government Pass-Through	–	56,620	2,688	–	–	–	–	–	584
Corporate Pass-Through	–	–	9,421	117	–	–	–	–	2,614
<b>Collateralized Mortgage Obligations</b>	<b>–</b>	<b>5,297</b>	<b>38,570</b>	<b>–</b>	<b>674</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>2,251</b>
Government CMOs	–	5,297	1,561	–	–	–	–	–	499
Corporate CMOs	–	–	37,009	–	674	–	–	–	1,752
<b>Corporate</b>	<b>–</b>	<b>299</b>	<b>34,609</b>	<b>14,420</b>	<b>36,477</b>	<b>35,821</b>	<b>1,527</b>	<b>1,277</b>	<b>5,522</b>
Corporate Bonds	–	–	6,373	12,090	34,860	33,804	1,478	1,277	2,528
Corporate Asset Backed	–	–	27,620	–	359	872	–	–	2,562
Private Placements	–	299	616	2,330	1,258	1,145	49	–	432
<b>Municipals</b>	<b>–</b>	<b>–</b>	<b>2,482</b>	<b>545</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Yankee Bonds</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>1,101</b>	<b>1,182</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Non-U.S Fixed Income</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>
<b>Developed Markets</b>	<b>–</b>	<b>–</b>	<b>170</b>	<b>919</b>	<b>953</b>	<b>754</b>	<b>–</b>	<b>–</b>	<b>332</b>
Developed Government/Sovereign	–	–	170	273	325	–	–	–	79
Developed Corporate	–	–	–	646	628	754	–	–	253
<b>Emerging Markets</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>772</b>	<b>4,361</b>	<b>–</b>	<b>–</b>	<b>–</b>
Emerging Government/Sovereign	–	–	–	–	–	1,759	–	–	–
Emerging Corporate	–	–	–	–	772	2,602	–	–	–
<b>Convertible Bonds</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>–</b>	<b>2,859</b>	<b>2,701</b>	<b>–</b>	<b>–</b>	<b>3,206</b>
<b>Total</b>	<b>\$ 35,877</b>	<b>\$ 68,401</b>	<b>\$ 134,881</b>	<b>\$ 16,341</b>	<b>\$ 42,836</b>	<b>\$ 44,819</b>	<b>\$ 1,527</b>	<b>\$ 1,277</b>	<b>\$ 16,488</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

**EXTERNAL INVESTMENT POOL**

Years to Maturity 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>\$ 353,681</b>	<b>\$ 15,355</b>	<b>\$ 93,975</b>	<b>\$ 45,879</b>	<b>\$ 198,472</b>
<b>U.S. Government</b>	<b>91,322</b>	<b>6,932</b>	<b>28,394</b>	<b>31,878</b>	<b>24,118</b>
U.S. Government Treas., Notes, Bonds	48,595	1,758	15,498	20,736	10,603
U.S. Government TIPS	26,870	–	5,384	10,244	11,242
U.S. Government Agency	15,577	5,174	7,512	618	2,273
Other U.S. Government	280	–	–	280	–
<b>Mortgage Backed</b>	<b>72,044</b>	<b>–</b>	<b>711</b>	<b>3,071</b>	<b>68,262</b>
Government Pass-Through	59,892	–	154	2,954	56,784
Corporate Pass-Through	12,152	–	557	117	11,478
<b>Collateralized Mortgage Obligations</b>	<b>46,792</b>	<b>–</b>	<b>2,060</b>	<b>871</b>	<b>43,861</b>
Government CMOs	7,357	–	463	871	6,023
Corporate CMOs	39,435	–	1,597	–	37,838
<b>Corporate</b>	<b>129,952</b>	<b>7,674</b>	<b>56,181</b>	<b>8,866</b>	<b>57,231</b>
Corporate Bonds	92,410	6,655	34,582	7,258	43,915
Corporate Asset Backed	31,413	–	19,922	66	11,425
Private Placements	6,129	1,019	1,677	1,542	1,891
<b>Municipals</b>	<b>3,027</b>	<b>545</b>	<b>2,227</b>	<b>255</b>	<b>–</b>
<b>Yankee Bonds</b>	<b>2,283</b>	<b>–</b>	<b>1,928</b>	<b>46</b>	<b>309</b>
<b>Non-U.S. Fixed Income</b>					
<b>Developed Markets</b>	<b>3,128</b>	<b>204</b>	<b>2,474</b>	<b>168</b>	<b>282</b>
Developed Government/Sovereign	847	79	597	–	171
Developed Corporate	2,281	125	1,877	168	111
<b>Emerging Markets</b>	<b>5,133</b>	<b>–</b>	<b>–</b>	<b>724</b>	<b>4,409</b>
Emerging Government/Sovereign	1,759	–	–	–	1,759
Emerging Corporate	3,374	–	–	724	2,650
<b>Convertible Bonds</b>	<b>8,766</b>	<b>3,927</b>	<b>4,010</b>	<b>–</b>	<b>829</b>
<b>Total</b>	<b>\$ 362,447</b>	<b>\$ 19,282</b>	<b>\$ 97,985</b>	<b>\$ 45,879</b>	<b>\$ 199,301</b>

University of Arkansas for Medical Sciences

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 in the Pool should range between 80% to 115% of the benchmark's (the Lehman Brothers Intermediate Govt/Credit Bond Index) duration.

*EXTERNAL INVESTMENT POOL*

<b>Investment Type (in thousands)</b>	<b>Fair Value</b>	<b>Effective Duration (Years)</b>
<b>Fixed Income</b>	<b>\$ 353,681</b>	<b>3.98</b>
<b>U.S. Government</b>	<b>91,322</b>	<b>6.54</b>
U.S. Government Treasuries, Notes, Bonds	48,595	6.44
U.S. Government TIPS	26,870	9.41
U.S. Government Agency	15,577	1.95
Other U.S. Government	280	4.75
<b>Mortgage Backed</b>	<b>72,044</b>	<b>3.98</b>
Government Pass-Through	59,892	4.16
Corporate Pass-Through	12,152	3.12
<b>Collateralized Mortgage Obligations (CMOs)</b>	<b>46,792</b>	<b>1.60</b>
Government CMOs	7,357	1.31
Corporate CMOs	39,435	1.66
<b>Corporate</b>	<b>129,952</b>	<b>2.94</b>
Corporate Bonds	92,410	3.36
Corporate Asset Backed	31,413	1.44
Private Placements	6,129	3.63
<b>Municipals</b>	<b>3,027</b>	<b>2.48</b>
<b>Yankee Bonds</b>	<b>2,283</b>	<b>3.61</b>
<b>Non-U.S. Fixed Income</b>		
<b>Developed Markets</b>	<b>3,128</b>	<b>3.99</b>
Developed Government/Sovereign	847	4.70
Developed Corporate	2,281	3.72
<b>Emerging Markets</b>	<b>5,133</b>	<b>5.03</b>
Emerging Government/Sovereign	1,759	10.94
Emerging Corporate	3,374	3.10
<b>Convertible Bonds</b>	<b>8,766</b>	<b>4.53</b>
<b>Total</b>	<b>\$ 362,447</b>	<b>3.99</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

***GUARANTEED INVESTMENT CONTRACTS (GICS)***

UAMS invested the construction funds from the 2004 Parking Deck Bond Issue 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</b> <i>(in thousands)</i>	<b>Fair Value</b>	<b>Credit Risk</b>		
		<b>AAA/Aaa</b>	<b>AA/Aa</b>	<b>Not Rated</b>
Guaranteed Investment Contract	\$9,898	\$ –	\$ –	\$9,898

***COMMON FUND***

UAMS invests daily operating funds in the 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:

<b>Investment Type</b> <i>(in thousands)</i>	<b>Fair Value</b>	<b>Credit Risk</b>		
		<b>AAA/Aaa</b>	<b>AA/Aa</b>	<b>Not Rated</b>
Bank Common Trust Fund	\$115,777	\$ -	\$ -	\$115,777

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 UA 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 UA 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, 2006 and 2005, net of allowances of \$2,782,000 and \$2,524,000, respectively, are as follows (*in thousands*):

	<b>June 30</b>	
	<b>2006</b>	<b>2005</b>
Perkins loans	\$ 2,535	\$ 2,464
Health professional loans	4,521	4,488
Institutional funds loans	6,130	6,281
University of Arkansas at Fayetteville	1,514	1,605
University of Arkansas System note receivable	417	626
Miscellaneous	1,867	864
Total notes and student loans receivable, net	<b>16,984</b>	16,328
Less current portion	<b>(3,237)</b>	(2,479)
Notes and student loans receivable, noncurrent, net	<b>\$ 13,747</b>	\$ 13,849

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**7. Capital Assets**

Balances as of June 30, 2005 and 2006, and changes in capital assets during fiscal 2006 were as follows (*in thousands*):

	June 30, 2005	Additions	Transfers	Dispositions	June 30, 2006
Nondepreciable:					
Land	\$ 6,096	\$ 41	\$ 17	\$ –	\$ 6,154
Construction-in-progress	12,427	42,922	(8,873)	(2,073)	44,403
Depreciable:					
Buildings and fixtures	408,210	17,203	9,017	(5,493)	428,937
Improvements other than buildings	2,453	–	–	–	2,453
Equipment	118,908	13,045	654	(3,733)	128,874
Leased property	17,011	6,346	(815)	(1,109)	21,433
Other	2,557	–	–	–	2,557
Total capital assets	567,662	79,557	–	(12,408)	634,811
Less accumulated depreciation and amortization:					
Buildings and fixtures	127,757	11,824	(156)	(3,789)	135,636
Improvements other than buildings	2,070	68	–	–	2,138
Equipment	82,676	9,921	693	(3,376)	89,914
Leased property	6,590	3,382	(413)	(748)	8,811
Other	2,125	453	(124)	–	2,454
Total accumulated depreciation and amortization	221,218	25,648	–	(7,913)	238,953
Capital assets, net	\$ 346,444	\$ 53,909	\$ –	\$ (4,495)	\$ 395,858

The buildings and fixtures above include \$972,000 and \$1,987,000 of net assets under capital leases at June 30, 2006 and 2005, respectively.

Capitalized interest of \$2,509,000, net of interest income of \$2,700,000, and \$1,787,000 was recognized during the years ended June 30, 2006 and 2005, respectively. \$2,327,000 was related to the borrowing for the Various Facility Construction Revenue Bonds, Series 2004B, and \$182,000 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, 2006 and 2005, was approximately \$1,730,000. UAMS has not reported library holdings in the accompanying Statements of Net Assets because appraisals have not been obtained.

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>2006</b>	<b>2005</b>
Trade payables	\$ 7,580	\$ 9,609
Accrued wages	31,596	28,716
Miscellaneous payables	29,236	16,847
Total accounts payable and accrued liabilities	<u>\$ 68,412</u>	<u>\$ 55,172</u>

**9. Long-Term Obligations**

Changes in long-term obligations during fiscal year 2006 were as follows (*in thousands*):

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>
Bonds payable	\$ 180,187	\$112,547	\$ 4,549	\$ 288,185
Notes payable	8,438	75	6,627	1,886
Capital leases	9,768	6,346	4,071	12,043
Total debt	198,393	118,968	15,247	302,114
Compensated absences	28,758	3,396	-	32,154
Total obligations	<u>\$ 227,151</u>	<u>\$122,364</u>	<u>\$ 15,247</u>	<u>\$ 334,268</u>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

The current and long-term portions of the categories noted above were as follows at June 30, 2006 (*in thousands*):

	<b>Current</b>	<b>Long-Term</b>	<b>Total</b>
Bonds payable	\$ 6,065	\$ 282,120	\$ 288,185
Notes payable	1,201	685	1,886
Capital leases (Note 10)	4,022	8,021	12,043
Total debt	11,288	290,826	302,114
Compensated absences	1,601	30,553	32,154
Total obligations	\$ 12,889	\$ 321,379	\$ 334,268

UAMS has bonds outstanding for the Patient Bed Tower, Central Arkansas Radiation Therapy Institute (CARTI) Building, and the East Parking Deck. In addition, bonds have been issued for the following new construction projects: Patient Bed Tower, Residence Hall, Psychiatric Research Institute 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, 2006 and 2005 (*in thousands*):

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

	June 30	
	2006	2005
<b><i>Bonds Payable:</i></b>		
Various Facility Revenue and Refunding Bonds, Series 2006, \$107,500,000 original amount, plus a premium of \$5,048,000, due annually to 2036 with \$35,305,000 in term bonds due 2036, various fixed interest rates of 3.4% to 5.0% collateralized by pledged revenue.	<b>PAR</b> <b>Premium</b>	<b>\$ 107,500</b> <b>5,006</b>
	\$	-
		-
Parking System Revenue Construction and Refunding Bonds, Series 1998, \$14,260,000 original amount, due annually to 2013 with \$5,740,000 in term bonds due 2019, various interest rates of 4.45% to 5.05% and 4.40% to 5.05% during fiscal years 2006 and 2005, respectively, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.	<b>PAR</b>	<b>11,225</b>
		11,785
Various Facility Revenue Refunding Bonds, Series 2004A, \$54,085,000 original amount plus a premium of \$4,797,000, due annually to 2018, various fixed interest rates of 4.0% to 5.0% collateralized by pledged revenue.	<b>PAR</b> <b>Premium</b>	<b>51,095</b> <b>4,243</b>
		54,085
		4,586
Various Facility Revenue Construction Bonds, Series 2004B, \$95,915,000 original amount, plus a premium of \$3,412,000, due annually to 2034, with \$42,855,000 in term bonds due 2034, various fixed interest rates of 2.0% to 5.0% over the life of the issue, collateralized by pledged revenue.	<b>PAR</b> <b>Premium</b>	<b>95,665</b> <b>3,228</b>
		95,915
		3,342
Parking System Revenue Construction Bonds, Series 2004, \$10,070,000 original amount plus unamortized premium of \$153,000 at June 30, 2006, due annually to 2035, various fixed interest rates of 2.125% to 5.0% over the life of the issue, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.	<b>PAR</b> <b>Premium</b>	<b>10,070</b> <b>153</b>
		10,070
		159
Various Facility Revenue Bonds, Series 1995, \$2,045,000 original amount, various interest rates of 4.25% to 5.25%, due annually to 2006 and collateralized by tuition and certain Hospital revenue.	<b>PAR</b>	-
		245
Total Bonds Payable		\$ 288,185
		\$ 180,187

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

	June 30	
	2006	2005
<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.	\$ 1,054	\$ 6,988
Floating rate, Arkansas Development Finance Authority note, \$1,500,000 original amount, due monthly through 2012, collateralized by general operating revenue.	674	763
Project Mercury Note Payable – Refinanced, \$2,300,000 original amount, 4.35% rate, due monthly to July 2005, collateralized by general operating revenue.	–	67
Miscellaneous Notes Payable	158	620
Total Notes Payable	<u>\$ 1,886</u>	<u>\$ 8,438</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, 2006 (*in thousands*):

	Bonds Payable				Notes Payable		
	Principal	Interest	Premium Amortized	Total	Principal	Interest	Total
2007	\$ 6,065	\$ 13,087	\$ 630	\$ 19,782	\$ 147	\$ 29	\$ 176
2008	6,085	13,062	630	19,777	152	24	176
2009	6,325	12,830	630	19,785	141	19	160
2010	6,565	12,585	630	19,780	134	14	148
2011	6,840	12,310	630	19,780	134	9	143
2012–2016	39,495	56,228	3,150	98,873	124	4	128
2017–2021	42,245	45,863	2,254	90,362	–	–	–
2022–2026	43,625	35,708	1,437	80,770	–	–	–
2027–2031	55,880	23,458	1,437	80,775	–	–	–
2032–2036	62,430	7,997	1,202	71,629	–	–	–
Total	<u>\$ 275,555</u>	<u>\$ 233,128</u>	<u>\$ 12,630</u>	<u>\$ 521,313</u>	<u>\$ 832</u>	<u>\$ 99</u>	<u>\$ 931</u>

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

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

The Board of Trustees of the University of Arkansas System Various Facility Revenue Bonds (UAMS Campus) Series 2006 were issued in March 2006. The 2006 issue provided an additional \$107,500,000 for the current expansion of the UAMS Hospital to include a new Patient Bed Tower, new Residence Hall, new Psychiatric Research Institute Building and a new Power Plant.

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 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 Psychiatric Research Institute Building and a new Power Plant.

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 \$1,514,000 and \$1,605,000 as of June 30, 2006 and 2005, respectively, has been recorded in the accompanying Statements of Net Assets (see Note 16).

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.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **9. 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 (the 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 3.45% and 2.56% as of June 30, 2006 and 2005, respectively.

In fiscal year 2006, the Authority issued \$36,775,000 in Tobacco Settlement Revenue Bonds (Tobacco Bonds). The Authority has loaned the proceeds of these Tobacco Bonds to the UA Board to fund an expansion of the Arkansas Cancer Research Center (ACRC). Funds received from the Arkansas Tobacco Settlement Funds Act of 2000 (the 2000 Act) are pledged for debt service under a Supplemental Funds Transfer Agreement, described below. The UA Board entered into this loan for the purpose of providing further security for the Tobacco Bonds and to agree to fund the debt service to the Authority to the extent funds under the 2000 Act are insufficient or unavailable.

The Tobacco Bonds have an approximate yield to maturity from 4.77% to 5.1% and principal and accumulated interest are payable beginning in 2021 through 2031 for \$22,158,175 of serial bonds and beginning in 2036 through 2046 for \$14,616,985 of term bonds.

Subsequent to the payment in full of all principal and interest on the Authority's Series 2001 Tobacco Settlement Revenue Bonds, the first \$5,000,000 of funds received from the 2000 Act each year are pledged for debt service under the Supplemental Funds Transfer Agreement for so long as the 2006 Bonds are outstanding.

Management believes that the funds to be received from the Act that are pledged for debt service for these Tobacco Bonds are sufficient to service the principal and interest due. Accordingly, the financial statements present the Tobacco Bonds, net of the present value of the funds to be received under the 2000 Act, as such funds are available to offset the debt service.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**10. Commitments**

*Capital Leases*

Scheduled maturities of capital lease commitments outstanding as of June 30, 2006, are as follows (*in thousands*):

	<b>Principal</b>	<b>Imputed Interest</b>	<b>Total</b>
2007	\$ 4,022	\$ 429	\$ 4,451
2008	3,632	268	3,900
2009	2,203	141	2,344
2010	1,391	64	1,455
2011	767	14	781
2012–2016	28	–	28
Total	<u>\$ 12,043</u>	<u>\$ 916</u>	<u>\$ 12,959</u>

*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, 2006 (*in thousands*):

2007	\$ 5,876
2008	4,365
2009	3,360
2010	1,778
2011	1,108
2012 and thereafter	5,167
Total minimum payments required	<u>\$ 21,654</u>

Rental expense for operating leases for the years ended June 30, 2006 and 2005, was approximately \$8,882,000 and \$8,456,000, respectively, and is included in supplies and other services in the accompanying Statements of Revenue, Expenses and Changes in Net Assets.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**10. Commitments (continued)**

*Construction Projects*

Construction-in-progress at June 30, 2006, included the Patient Bed Tower, the Residence Hall, the West Parking Deck, the Central Power Plant, the Psychiatric Research Institute Building, and the Arkansas State Hospital along with the purchase and installation of an Electronic Medical Records System and various renovation and maintenance projects.

*Outstanding Commitments*

At June 30, 2006 and 2005, UAMS had outstanding purchase orders for normal operating supplies and equipment amounting to approximately \$29,181,400 and \$60,958,000, respectively. Outstanding construction commitments were \$32,978,000 and \$10,916,000 as of June 30, 2006 and 2005, respectively.

On February 23, 2005, UAMS and 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 \$24,360,000.

UAMS committed \$6,100,000 in unrestricted net assets to this project and reduced the Medicaid match payments made to DHS as additional consideration (see Note 3). Upon completion of the new Arkansas State Hospital and the offer and acceptance of it by UAMS and DHS, respectively, in accordance with the contract, the cost to construct the hospital will be reflected as a reduction of net assets invested in capital assets and property and equipment (see Note 12).

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**11. 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>2006</b>	<b>2005</b>
Expendable:		
Grant funds	\$ <b>6,550</b>	\$ 7,753
Debt reserves	<b>10,337</b>	10,598
Other externally restricted funds	<b>20,040</b>	19,913
Total expendable	<b>36,927</b>	38,264
Nonexpendable:		
Endowments	<b>31,635</b>	29,004
Total restricted net assets	<b>\$ 68,562</b>	\$ 67,268

**12. 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 UA Board. Unrestricted net assets consist of the following as of June 30 (*in thousands*):

	<b>2006</b>	<b>2005</b>
Quasi-endowments	\$ <b>1,965</b>	\$ 1,803
Other internally restricted funds	<b>105,231</b>	78,225
Amount available for general operating activities	<b>130,338</b>	113,227
Total unrestricted net assets	<b>\$ 237,534</b>	\$ 193,255

In 2006 and 2005, UAMS retained \$5,692,000 and \$12,355,000, respectively, of Medicaid match payments owed to the DHS under various interagency agreements to be utilized towards the construction of a new Arkansas State Hospital (see Notes 3 and 10). The amounts reflected in the 2005 Statements of Revenue, Expenses and Changes in Net Assets as other changes in net assets – interagency transfer and nonoperating revenue (expenses) state appropriations, net was understated and overstated, respectively, by \$12,355,000. As these amounts are expended in the construction of the new building, the amounts will be transferred from unrestricted net assets to net assets invested in capital assets, net of related debt. Upon the completion of the Arkansas State Hospital and transfer to DHS, UAMS will reduce net assets invested in capital assets, net of related debt and property and equipment for the amount of the assets transferred.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 13. 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% in 2006 and 2005. 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, 2006 and 2005, was \$166,000 and \$151,000, respectively. UAMS' total salaries in fiscal 2006 and 2005 were \$458,256,000 and \$425,916,000, respectively. Total employer contributions to ATRS in fiscal 2006 and 2005 were \$24,000 and \$21,000, respectively. Employee contributions to ATRS in fiscal years 2006 and 2005 were \$6,800 and \$4,300, 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 13% and 11% in 2006 and 2005, 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, 2006 and 2005, was \$4,237,000 and \$3,846,000, respectively. Total employer contributions to APERS in fiscal 2006 and 2005 were \$515,000 and \$456,000, respectively.

TIAA-CREF and the Fidelity Fund retirement accounts were established by the UA Board. 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)

#### **13. 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 2006 and 2005 were calculated on base salaries of \$398,214,000 and \$342,930,000, respectively. Total employer contributions during fiscal 2006 and 2005 to TIAA-CREF and the Fidelity Fund were \$34,153,000 and \$29,683,000, respectively. Employee contributions to TIAA-CREF and the Fidelity Fund in the fiscal years 2006 and 2005 were \$33,113,000 and \$31,341,000, 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 495 and 460 as of June 30, 2006 and 2005, respectively. The participants of this program incur the total premium for this insurance. There is no direct expense for these services incurred by UAMS.

#### **14. 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. Eight and 10 former employees were eligible and receiving these benefits as of June 30, 2006 and 2005, respectively. UAMS recorded approximately \$46,000 and \$49,000 in other post-employment benefits related to these former employees for the years ended June 30, 2006 and 2005, respectively.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 15. Affiliated Entities (Unaudited)

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 UA Board. Based on information provided by the Foundation, during the years ended June 30, 2006 and 2005, revenue of \$36,006,000 and \$50,092,000, respectively, was received by the Foundation for the benefit of UAMS. Support, by the Foundation on behalf of UAMS, was \$18,554,000 and \$17,571,000 for the years ended June 30, 2006 and 2005, respectively.

### 16. Related Party Transactions

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

	<u>2006</u>	<u>2005</u>
University of Arkansas at Fayetteville	\$ 1,514	\$ 1,605
University of Arkansas System	417	626
Total included in notes and student loans receivable (Note 6)	<u>\$ 1,931</u>	<u>\$ 2,231</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.

### 17. 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 UA Board 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 \$4,489,000 and \$4,488,000 for this insurance during the years ended June 30, 2006 and 2005, respectively. A party may bring an action against UAMS through the Arkansas State Claims Commission

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **17. Contingencies (continued)**

(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 is currently negotiating a possible refund of certain charges for medications which were inadvertently billed to patients and their insurance providers without a prior waiver. While the total amount to be refunded has not been established, management believes that the maximum potential refund is just under \$700,000, with the actual amount expected to be an amount less than the maximum. No amounts have been recorded related to this matter as the actual amount to be refunded has not yet been determined.

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)

**18. 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, 2006				
	Compensation and Benefits	Supplies and Other Services	Scholarships and Fellowships	Depreciation and Amortization	Total
Patient care	\$ 286,295	\$ 181,788	\$ -	\$ -	\$ 468,083
Instruction	130,126	11,171	-	-	141,297
Research	49,146	31,706	-	-	80,852
Public services	12,402	7,313	-	-	19,715
Academic support	10,273	3,166	-	-	13,439
Student services	1,738	1,533	-	-	3,271
Institutional support	56,009	1,297	-	-	57,306
Operation and maintenance of plant	14,061	14,826	-	-	28,887
Scholarships and awards	-	-	119	-	119
Auxiliary	1,673	2,849	-	-	4,522
Depreciation and amortization	-	-	-	25,648	25,648
Other	1,806	2,699	-	-	4,505
<b>Total</b>	<b>\$ 563,529</b>	<b>\$ 258,348</b>	<b>\$ 119</b>	<b>\$ 25,648</b>	<b>\$ 847,644</b>

	Year ended June 30, 2005				
	Compensation and Benefits	Supplies and Other Services	Scholarships and Fellowships	Depreciation and 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 activities	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>

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 19. New Accounting Pronouncements

In November 2003, GASB issued Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, which became effective with the fiscal year ending June 30, 2006. The Statement established guidance for accounting and reporting for the impairment of capital assets and for insurance recoveries. For the purposes of this Statement, asset impairment is a significant, unexpected decline in the service utility of a capital asset. The events or changes in circumstances affecting a capital asset that may indicate impairment are prominent, that is, conspicuous or known to UAMS management.

During the fiscal year ended June 30, 2006, there have been no prominent or conspicuous events that would indicate impairment of any material capital assets, nor have there been any material insurance recoveries during the fiscal year.

In August 2004, GASB issued Statement No. 45, which establishes standards for the measurement, recognition, and display of OPEB (other postemployment benefits). This reporting requirement will become effective, for the University of Arkansas System, for the June 30, 2008, fiscal year-end.

#### ***Health***

The University of Arkansas System offers employees who meet certain requirements the opportunity to maintain University of Arkansas health insurance upon retirement at substantially the same premium rates as the active population. At the end of fiscal year 2006, the University of Arkansas System had approximately 1,100 retired employees enrolled in the University of Arkansas Health Insurance Plan.

In the fall of 2005, the University of Arkansas System requested retiree claims data from their third party administrator, Qualchoice. The retiree data was collected and forwarded to an actuarial firm for an initial evaluation of the potential for a liability under GASB 45. An important distinction of the University of Arkansas System's retiree benefit design is that the premium is totally paid by the retiree, that is, there is no employer contribution to the health insurance premium for retirees and, therefore, no *overt* employer subsidy. Further, an evaluation of the retiree data, the claims experience of the retiree population in total (both Medicare eligible and pre-Medicare eligible retirees), revealed that premium revenue from this population is sufficient to pay claims costs. Consequently, there is no *inherent* employer subsidy. The University of Arkansas System has concluded that, at this time, it has no GASB liability for postemployment health benefits.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **19. New Accounting Pronouncements (continued)**

#### ***Life***

The University of Arkansas System offers employees who meet certain requirements the option to purchase a \$10,000 basic life insurance policy upon retirement. The cost of the policy is borne entirely by the retiree; there is no employer contribution towards the premium. However, the premium rates are established on a combined basis with the active employee population, thereby creating an inherent subsidy of the benefit. The University of Arkansas System is currently evaluating the potential liability under GASB 45 for this postemployment benefit.

#### ***Dental***

The University of Arkansas offers employees who meet certain requirements the opportunity to maintain University of Arkansas dental insurance upon retirement at substantially the same premium rates as the active population. The dental premium is paid entirely by the retiree. Retiree premium rates are based on the claims experience of the combined active and retiree population. The University of Arkansas System is currently evaluating the potential liability under GASB 45 for this postemployment benefit.

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*, which became effective with the fiscal year ending June 30, 2006. The Statement established guidance for accounting and reporting of the costs and liabilities associated with termination benefits, such as those associated with early retirement incentives. The University of Arkansas System has not extended a large-scale or age-related early retirement offering during the fiscal year ended June 30, 2006. The University of Arkansas System has, from time to time, negotiated early retirement agreements with faculty which may include the provision of health care or other benefits for future periods. The number of early retirement agreements is small and the obligation for future benefits is considered immaterial. Acts 971 and 1288 of 2005 authorized the compensation for accumulated unused sick leave for certain employees upon retirement. The University of Arkansas System has accrued a liability for these amounts in *Compensated Absences Payable*.