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UNIVERSITY OF ARKANSAS

Financial Statements
Years Ended June 30, 2007 and 2006

University of Arkansas for Medical Sciences

Financial Statements

Years ended June 30, 2007 and 2006

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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, 2007 and 2006. 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 2,233 and faculty numbering 1,236;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 297 adult beds in use at June 30, 2007;
- Regional programs including Tele-education, Rural Hospital Program, and seven Area Health Education Centers (AHEC) located throughout the state;
- The Winthrop P. Rockefeller Cancer Institute;
- Jones Eye Institute;
- Donald W. Reynolds Institute on Aging;
- Multiple Myeloma Institute;
- Arkansas Biosciences Institute; and
- Jackson T. Stephens Spine and Neurosciences Institute.

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

University of Arkansas for Medical Sciences

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

OVERVIEW OF THE FINANCIAL STATEMENTS

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

The Statements of Net Assets present the financial position of UAMS and include all assets and liabilities. The difference between total assets and total liabilities is net assets, which 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 years ended June 30, 2007 and 2006, with comparative information for the fiscal year ended June 30, 2005.

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

FINANCIAL HIGHLIGHTS

UAMS' financial position remained strong at June 30, 2007 with assets of \$997,690,000 and liabilities of \$437,491,000. Net assets, which represent the residual interest in UAMS' assets after liabilities are deducted, were \$560,199,000 at June 30, 2007. 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, 2007, 2006, and 2005 as follows:

	Year ended June 30		
	2007	2006	2005
	<i>(in thousands)</i>		
Operating revenue	\$ 865,131	\$ 825,748	\$ 763,828
Operating expenses	(917,032)	(847,644)	(776,700)
Nonoperating revenue	71,477	46,593	40,800
Other changes in net assets	4,979	15,633	19,867
Increase in net assets	\$ 24,555	\$ 40,330	\$ 47,795

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. Assets and liabilities are generally measured using current values, except for capital assets, which are stated at historical cost, or fair value at the date of donation, less an allowance for depreciation and amortization.

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

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

From the data presented, readers of the Statements of Net Assets are able to determine the assets available to continue the operations of UAMS. They are also able to determine how much UAMS owes vendors 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:

	June 30		
	2007	2006	2005
	<i>(in thousands)</i>		
Assets			
Current assets	\$ 283,407	\$ 249,316	\$ 218,011
Non-current assets:			
Investments	178,921	296,792	213,480
Capital assets, net	521,465	395,858	346,444
Other	13,897	17,805	17,258
Total Assets	997,690	959,771	795,193
Liabilities			
Current liabilities	115,186	102,637	83,844
Non-current liabilities	322,305	321,490	216,035
Total Liabilities	437,491	424,127	299,879
Net Assets			
Invested in capital assets, net of related debt	323,739	229,548	234,791
Restricted:			
Expendable	50,661	36,927	38,264
Nonexpendable	36,769	31,635	29,004
Unrestricted	149,030	237,534	193,255
Total Net Assets	560,199	535,644	495,314
Total Liabilities and Net Assets	\$ 997,690	\$ 959,771	\$ 795,193

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, short-term investments, accounts receivable (net), inventories, prepaid expenses, and notes and student loans receivable (net). Noncurrent assets include long-term investments, notes and student loans receivable (net), capital assets (net), and other noncurrent assets. Current liabilities consist primarily of accounts payable and accrued liabilities, deferred revenue, funds held

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

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.

Fiscal Year 2007

UAMS' total assets increased by \$37,919,000 for fiscal year 2007. A review of the Statements of Net Assets reveals that the increase was primarily due to an increase of \$125,607,000 in capital assets (net) and an increase in current assets of \$34,091,000 offset by a decrease in long-term investments of \$117,871,000.

The increase in capital assets was primarily due to an increase in construction in progress, buildings and fixtures, and equipment. A summary of additions to major capital projects is presented in the Capital Assets section of this Management's Discussion and Analysis. The increase in current assets was primarily due to an increase in short-term investments of \$51,547,000. This increase was caused by a revision to the investment policy, which changed the classification of the Intermediate Pool investments to short term. In prior years, the Intermediate Pool investments were classified as long term. This increase was offset by a decrease in cash and cash equivalents of \$17,770,000. Cash used in the construction of the new Arkansas State Hospital accounted for \$16,086,000 of the decrease. The balance of the decrease in cash and cash equivalents was due to a transfer of \$5,000,000 to investments offset by cash generated from operating activities. Use of 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 accounted for \$91,837,000 of the decrease in long-term investments. The reclassification of the Intermediate Pool investments from long-term to short-term as discussed above accounted for an additional decrease of \$51,547,000. This was offset by an increase of \$20,384,000 related to reinvested income and capital appreciation on investments and a net transfer of \$5,000,000 from operating cash to investments.

Total liabilities increased by \$13,364,000 for fiscal year 2007. The increase was primarily due to an increase of \$15,351,000 in accounts payable and accrued liabilities offset by a decrease of \$1,895,000 in bonds, notes, and capital leases payable. The

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

increase in accounts payable and accrued liabilities was primarily due to the accrual of \$15,065,000 related to outstanding invoices for construction projects.

Fiscal Year 2006

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 Arkansas Physician Supplemental Payment Program (APSP) accounted for \$12,237,000 of the increase in cash and cash equivalents. Additionally, \$7,562,000 was related to the recoupment of payments due to the Arkansas Department of Human Services (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 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 10 to the financial statements). In addition, trade accounts payable increased 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)

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:

	Year ended June 30		
	2007	2006	2005
	<i>(in thousands)</i>		
Operating Revenue			
Student tuition and fees, net of scholarship allowances	\$ 13,566	\$ 14,463	\$ 13,146
Net patient services	672,528	635,435	583,680
Sponsored programs	140,148	138,657	133,490
Other	38,889	37,193	33,512
Total Operating Revenue	865,131	825,748	763,828
Operating Expenses			
Compensation and benefits	600,490	563,529	518,599
Supplies and other services	289,236	258,348	233,823
Scholarships and fellowships	143	119	192
Depreciation and amortization	27,163	25,648	24,086
Total Operating Expenses	917,032	847,644	776,700
Operating Loss	(51,901)	(21,896)	(12,872)
Nonoperating Revenue (Expenses)			
State appropriations, net	47,303	37,939	29,103
Gifts	9,241	4,586	7,182
Investment gain, net of expense	26,335	15,556	10,311
Other	(11,402)	(11,488)	(5,796)
Total Nonoperating Revenue (Expenses)	71,477	46,593	40,800
Income Before Other Changes in Net Assets	19,576	24,697	27,928
Other Changes in Net Assets			
Capital gifts and appropriations	3,734	9,941	7,512
Interagency transfer	1,245	5,692	12,355
Total Other Changes in Net Assets	4,979	15,633	19,867
Increase in Net Assets	24,555	40,330	47,795
Net Assets – beginning of year	535,644	495,314	447,519
Net Assets – end of year	\$ 560,199	\$ 535,644	\$ 495,314

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

Fiscal Year 2007

The Statement of Revenue, Expenses, and Changes in Net Assets reflects an increase of \$24,555,000 in net assets for fiscal year 2007. Highlights of the information presented in this statement show how the following affected operating revenue:

Net patient services revenue increased by \$37,093,000. The increase in net patient services revenue is primarily due to increased volume in both inpatient and outpatient services. Sponsored Programs, which include federal grants and contracts, state and local grants and contracts, and nongovernmental grants and contracts, increased by \$1,491,000. State and local grants and contracts increased by \$2,818,000 and nongovernmental grants and contracts increased by \$5,456,000. This growth was offset by a decrease in federal grants and contracts of \$6,783,000 due to several factors including: federal funding for all National Institute of Health awards in fiscal year 2007 was reduced by over 2%, a reduction in UAMS' indirect cost recovery rate (IDC) from 46% to 42%, and a net decrease in grant volume. Other revenue, which increased by \$1,696,000, includes auxiliary enterprises and other miscellaneous revenue sources.

The following factors affected operating expenses 2007:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2007, increasing by \$36,961,000. Compensation and benefits expense related to patient care increased by \$23,385,000 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 \$30,888,000. Supplies and other services related to patient care increased by \$29,933,000 due to increased utilization of contract nurses, and increased drug and medical supply expenses. The primary driver of these increased expenses was an increase in patient volume.

The following factors affected nonoperating revenue (expense) in 2007:

Nonoperating revenue increased by \$24,884,000. The primary drivers of the increase was additional state appropriations of \$9,364,000, realized and unrealized gains on investments of \$6,498,000, interest income of \$4,353,000

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

including income from invested construction funds of \$3,257,000, gift revenue of \$4,655,000 and a decrease in loss of disposal of capital assets of \$3,569,000. Offsetting these positive variances was an increase in interest on debt of \$3,486,000 primarily due to the full year effect of the Various Facility Revenue and Refunding Bonds, Series 2006.

Fiscal Year 2006

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:

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 include 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:

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 were decreases in instructional and operating supply expense.

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

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

Net state appropriations revenue for the years ended June 30, 2007, 2006, and 2005 is as follows (*in thousands*):

	2007	2006	2005
Gross state appropriations revenue	\$ 97,101	\$ 89,380	\$ 83,324
Less Medicaid match payments	49,798	51,441	54,221
Net state appropriations revenue	\$ 47,303	\$ 37,939	\$ 29,103

Results of Operations

Fiscal Year 2007

In fiscal year 2007, UAMS experienced an increase of 4.6 % in net assets. The major driver of the net asset growth was a 5.8% growth in net patient services revenue. Additionally, gifts are an important component of UAMS' growth, totaling \$10,483,000 in fiscal year 2007.

Although the overall financial position improved in 2007, there were some occurrences that adversely affected the financial position.

Gross state appropriations accounted for approximately 10.2% and 10.0% of UAMS revenue for fiscal years 2007 and 2006, respectively.

Compensation and employee benefits increased by 6.5%, which reflects an 8.2% increase in patient care and normal salary and benefit increases in other areas.

Supplies and other services increased by 12.0%, which reflects a 16.3% increase in patient care supplies with decrease in instruction and operations.

Fiscal Year 2006

In fiscal year 2006, UAMS experienced an increase of 8.1% in net assets. The major driver of the net asset 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.

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

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 was due to 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 decrease in instruction and operations.

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.

	Year ended June 30		
	2007	2006	2005
	<i>(in thousands)</i>		
Cash and cash equivalents provided by (used in):			
Operating activities	\$ (18,190)	\$ 13,663	\$ 42,960
Noncapital financing activities	57,472	50,378	52,050
Capital and related financing activities	(149,711)	27,287	74,604
Investing activities	92,659	(67,756)	(114,727)
Net increase (decrease) in cash and cash equivalents	(17,770)	23,572	54,887
Cash and cash equivalents – beginning of year	136,954	113,382	58,495
Cash and cash equivalents – end of year	\$ 119,184	\$ 136,954	\$ 113,382

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

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2007, UAMS had \$521,465,000 invested in capital assets, net of accumulated depreciation and amortization of \$261,427,000. Depreciation and amortization charges totaled \$27,163,000, the fiscal year ended June 30, 2007.

UAMS' capital additions totaled \$153,976,000 in fiscal year 2007. 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 2007 and the sources that funded their acquisition included:

Project	Amount of Additions	Funding Source
	<i>(in thousands)</i>	
Patient Bed Tower, West Parking Deck & Central Power Plant, Psychiatric Research Institute, Arkansas State Hospital	108,950	2004 & 2006 Bond Issuance, Psychiatry Institute Foundation, UAMS
Electronic Medical Records System	7,122	UAMS
ACRC Tower	2,579	ACRC Foundation, State Appropriation, UAMS

The Residence Hall was completed in fiscal year 2007, and significant progress was made in the hospital expansion project, with the Central Energy Plant over 95% complete, and the Patient Bed Tower and Psychiatric Research Center both topping out in June, 2007.

Construction in progress at June 30, 2007, included the Patient Bed Tower, the West Parking Deck, the Central Power Plant, the ACRC Tower, 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.

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

Debt Administration

At June 30, 2007, UAMS had \$334,893,000 in outstanding obligations (for additional information, see the Economic Outlook section of this Management Discussion and Analysis), as shown in the following table:

Obligation	Amount Outstanding (in thousands)
Bonds payable	\$ 281,490
Notes payable	1,138
Obligations under capital leases	17,591
Compensated absences	34,674
	\$ 334,893

Moody's Investment Service raised the rating of the University of Arkansas System from A1 to Aa3 in August 2004, which was affirmed on September 13, 2007. 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 2007 as evidenced by an approximate \$24,555,000 increase in Net Assets. One of UAMS' greatest financial strengths is the diverse stream of revenue that 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. Projected cost of the series of projects is approximately \$273,000,000. The projects include a new building to replace the 50-year-old hospital, a new dormitory, a central power plant, and a new psychiatric wing. 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 balance of the funding will be provided by private

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

sources and UAMS reserves. With the opening of the new patient tower, UAMS will have approximately 333 adult beds and 64 nursery beds. Additionally, new operating rooms, cardiac cath labs, radiology, and other ancillary areas are included in the construction. UAMS will shell an additional floor, which may hold another 60 adult beds. A psychiatry wing, The UAMS Psychiatry Institute, will house 40 psychiatric inpatient beds, psychiatry clinics, offices, and research areas. UAMS will build a power plant capable of maximum power generation, which can meet all the power needs of the west side of the UAMS campus during peak operating periods and reduce operating costs. The new bonds issued in fiscal years 2005 and 2006 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. In 2003, 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 3.1%. To achieve a 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 5.7%.

Recently, the Federal Administration has proposed various regulations in both Medicare and Medicaid programs, which, if implemented, could result in reduced reimbursements from current levels to hospital and physician providers. Many of these proposed cuts would particularly impact state-operated teaching hospitals like UAMS Medical Center. The healthcare industry vigorously opposes many of the proposed cuts and is working with Congress to legislatively prohibit these cuts from being implemented. The outcome of this effort is unknown at this time and, therefore, the magnitude of payment reductions ultimately implemented, if any, is uncertain. If these efforts prove unsuccessful, the impact of the proposed cuts could potentially amount to several million dollars in payment reductions to UAMS. To mitigate the unfavorable impact of any actual cuts, UAMS would be required to seek other revenue and growth opportunities, reduce costs, or some combination of both.

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

UAMS participates in the Arkansas Physician Supplemental Payment Program (APSPP). The APSPP was designed to cover part of the Medicaid payment deficit over commercial insurance for physician services. From 2005 to 2007 the HHS – Office of Inspector General (OIG) audited the APSPP calculations. The Center for Medicare and Medical Services (CMS) has not authorized release of the supplemental Medicaid funds for fiscal year 2007, totaling approximately \$18,000,000 net of Medicaid match payments. UAMS has not yet received funds for fiscal year 2008. These funds were considered in the financial planning for the new hospital construction. At this time the collection of these funds are uncertain, therefore, they have not been accrued in the fiscal year 2007 financial statements.

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, was passed by popular vote on November 7, 2000. During fiscal years 2007, 2006, and 2005, UAMS received \$8,940,000, \$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 Center on Aging and the Department of Geriatrics, Delta Area Health Education Center, and the Arkansas Biosciences Institute.

In fiscal year 2006, the Arkansas Development Finance Authority issued \$36,775,000 in Tobacco Settlement Revenue Bonds. The Authority has made the proceeds of the bonds available to the University of Arkansas Board of Trustees (UA Board) to partially fund an approximate \$125,000,000 expansion to the Winthrop P. Rockefeller Cancer Institute. Additional funding will come from a mix of public and private funds. Funds received from the Arkansas Tobacco Settlement Funds Act of 2000 are pledged for debt service and are the primary source of payment for the bonds. In accordance with a Loan Agreement dated June 1, 2006 between the UA Board and the Authority, the UA Board will be required to make debt service payments on the Series 2006 bond issue in the event of a shortfall in tobacco settlement revenues. However, no such payments will be made unless the Debt Service Revenues are insufficient to make such payments. Management

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

believes the Debt Service Revenues will be sufficient to service the entire principal and interest due. 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. For fiscal year 2003, Arkansas received \$60,067,457 from the Tobacco Settlement Fund. Using the 54% decline from above, Arkansas should receive approximately \$27.6 million in 2046 with the first \$5 million dedicated to pay the debt service on the above bond issue. The revenues pledged by UAMS to secure the Loan Agreement consist of inpatient service fees and fees collected from other ancillary, therapeutic, and diagnostic services provided within the walls of the hospital but excludes physician-generated revenues, State appropriations, and revenues restricted for other purposes.

UAMS has experienced solid financial growth with a three-year average annual growth in Net Assets of 7.8%. 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 Melony Goodhand, Vice Chancellor for Finance & Chief Financial Officer, 4301 West Markham, #632, Little Rock, Arkansas 72205.



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Independent Auditors' Report

The Board of Trustees
University of Arkansas System:

We have audited the accompanying statement of net assets of the University of Arkansas for Medical Sciences (UAMS) as of June 30, 2007, and the related statements of revenue, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of UAMS' management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of UAMS as of June 30, 2006, and for the year then ended were audited by other auditors. Those auditors expressed an unqualified opinion on those financial statements in their report dated October 6, 2006.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America 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. An audit includes 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, as well as evaluating the overall financial statement presentation. We believe that our audit provides 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 UAMS as of June 30, 2007, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 12, 2007 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 audit.

The management's discussion and analysis on pages 1 through 16 are not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. 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.

KPMG LLP

October 12, 2007

University of Arkansas for Medical Sciences
Statements of Net Assets
(in thousands)

	June 30	
	2007	2006
Assets		
Current Assets:		
Cash and cash equivalents (Note 4)	\$ 119,184	\$ 136,954
Investments (Note 5)	51,547	-
Patient accounts receivable, net (Note 2)	84,779	85,777
Nonpatient accounts receivable, (net of allowances of \$1,355 in 2007 and \$994 in 2006)	14,201	15,002
Inventories	9,462	8,086
Notes and student loans receivable, net (Notes 6 and 14)	4,063	3,237
Prepaid expenses	171	260
Total Current Assets	283,407	249,316
Noncurrent Assets:		
Investments (Note 5)	75,829	110,038
Notes and student loans receivable, net (Notes 6 and 14)	10,315	13,747
Deposits and funds held in trust by others (Note 5)	103,092	186,754
Capital assets, net (Notes 7, 9, and 10)	521,465	395,858
Other noncurrent assets	3,582	4,058
Total Noncurrent Assets	714,283	710,455
Total Assets	\$ 997,690	\$ 959,771
Liabilities		
Current Liabilities:		
Accounts payable and accrued liabilities (Note 8)	\$ 83,763	\$ 68,412
Deferred revenue	2,173	2,260
Funds held in trust for others	205	1,547
Estimated third-party payor settlements (Note 2)	16,335	17,529
Compensated absences payable, current portion (Note 9)	1,792	1,601
Bonds, notes and capital leases payable, current portion (Notes 9 and 10)	10,918	11,288
Total Current Liabilities	115,186	102,637
Noncurrent Liabilities:		
Deposits	122	111
Compensated absences payable, net of current portion (Note 9)	32,882	30,553
Bonds, notes and capital leases payable, net of current portion (Notes 9 and 10)	289,301	290,826
Total Noncurrent Liabilities	322,305	321,490
Total Liabilities	437,491	424,127
Commitments and Contingencies (Notes 10, 11, 12, and 15)		
Net Assets		
Invested in capital assets, net of related debt	323,739	229,548
Restricted :		
Expendable	50,661	36,927
Nonexpendable	36,769	31,635
Unrestricted	149,030	237,534
Total Net Assets	560,199	535,644
Total Liabilities and Net Assets	\$ 997,690	\$ 959,771

See accompanying notes to financial statements.

University of Arkansas for Medical Sciences
 Statements of Revenue, Expenses and Changes in Net Assets
(in thousands)

	Year ended June 30	
	2007	2006
Revenue		
Operating Revenue:		
Student tuition and fees (net of scholarship allowances of \$2,710 in 2007 and \$2,479 in 2006)	\$ 13,566	\$ 14,463
Net patient services (Notes 2 and 9)	672,528	635,435
Sponsored programs:		
Federal grants and contracts	80,227	87,010
State and local grants and contracts	13,859	11,041
Nongovernmental grants and contracts	46,062	40,606
Sales and services of educational departments	24,877	21,458
Auxiliary enterprises:		
Housing and food service	3,092	2,466
Bookstore	771	726
Other auxiliary enterprises	3,506	3,280
Other operating revenue	6,643	9,263
Total Operating Revenue	865,131	825,748
Expenses		
Operating Expenses (Note 16):		
Compensation and benefits	600,490	563,529
Supplies and other services	289,236	258,348
Scholarships and fellowships	143	119
Depreciation and amortization (Note 7)	27,163	25,648
Total Operating Expenses	917,032	847,644
Operating Loss	(51,901)	(21,896)
Nonoperating Revenue (Expenses)		
State appropriations, net (Note 3)	47,303	37,939
Gifts	9,241	4,586
Investment gain, net of investment expense (Note 5)	26,335	15,556
Interest on debt	(10,804)	(7,321)
Loss on disposal of capital assets	(598)	(4,167)
Total Nonoperating Revenue (Expenses)	71,477	46,593
Income Before Other Changes in Net Assets	19,576	24,697
OTHER CHANGES IN NET ASSETS		
Capital gifts	1,242	9,941
Capital appropriations	2,492	-
Interagency transfer	1,245	5,692
Total Other Changes in Net Assets	4,979	15,633
Increase in Net Assets	24,555	40,330
Net Assets – beginning of year	535,644	495,314
Net Assets – end of year	\$ 560,199	\$ 535,644

See accompanying notes to financial statements.

University of Arkansas for Medical Sciences
 Statements of Cash Flows
(in thousands)

	Year ended June 30	
	2007	2006
Cash Flows from Operating Activities		
Tuition and fees (net of scholarships)	\$ 16,935	\$ 15,230
Patient and insurance payments	709,873	666,043
Research grants and contracts	139,659	138,791
Collection of loans and interest	1,769	1,527
Auxiliary enterprise revenue:		
Housing and food service	3,090	2,483
Bookstore	771	726
Other auxiliary enterprises	3,642	3,129
Other receipts	20,253	29,920
Payments to suppliers	(306,631)	(275,556)
Payments to employees	(493,023)	(457,453)
Payments of employee benefits	(102,944)	(99,760)
Loans issued to students	(2,148)	(2,286)
Scholarships and fellowships	(143)	(119)
Other payments	(9,293)	(9,012)
Net cash and cash equivalents provided by (used in) operating activities	(18,190)	13,663
Cash Flows from Noncapital Financing Activities		
State appropriations	49,250	44,102
Gifts and grants	9,241	4,586
Loan proceeds	292	482
Other agency funds (net)	(1,342)	1,105
Repayments of loans	31	103
Net cash and cash equivalents provided by noncapital financing activities	57,472	50,378
Cash Flows from Capital and Related Financing Activities		
Proceeds from issuance of debt	-	112,622
Capital appropriations	2,492	--
Proceeds from sale of capital assets	49	396
Purchases of capital assets	(127,356)	(63,225)
Principal paid on capital debt and leases	(11,345)	(14,742)
Interest and paying agent fees paid on debt and capital leases	(13,551)	(7,764)
Net cash and cash equivalents provided by (used by) capital and related financing activities	(149,711)	27,287

(Continued)

University of Arkansas for Medical Sciences
 Statements of Cash Flows (continued)
 (in thousands)

	Year ended June 30	
	2007	2006
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	\$ 122,778	\$ 54,194
Interest on investments (net of fees)	5,951	4,830
Purchase of investments	(36,070)	(126,780)
Net cash and cash equivalents (used in) provided by investing activities	92,659	(67,756)
Net increase in cash and cash equivalents	(17,770)	23,752
Cash and cash equivalents – beginning of year	136,954	113,382
Cash and cash equivalents – end of year	\$ 119,184	\$ 136,954
Operating loss	\$ (51,901)	\$ (21,896)
Adjustments to reconcile net operating loss to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	27,163	25,648
Changes in assets and liabilities:		
Patient and nonpatient accounts receivable, net	(11,196)	(7,319)
Inventories	(1,376)	(468)
Other assets	2,664	(529)
Accounts payable and accrued liabilities	15,207	12,045
Deferred revenue	(87)	97
Deposits	10	(11)
Compensated absences payable	2,520	3,396
Other liabilities	(1,194)	2,700
Net cash and cash equivalents provided by (used in) operating activities	\$ (18,190)	\$ 13,663
Noncash transactions:		
Fixed assets acquired by capital gift	\$ 1,242	\$ 9,941
Fixed asset acquisition paid for by State of Arkansas	\$ 2,492	-
Fixed assets acquired by incurring capital lease obligations	\$ 10,334	\$ 6,346

See accompanying notes to financial statements.

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' ten-member Board of Trustees.

Basis of Presentation – UAMS accounts for its activities through the use of an enterprise fund. Enterprise funds are used to account for activities similar to those found in the private sector, where the determination of a change in financial position is necessary or useful for sound financial administration. The accounting records of UAMS are organized on the basis of funds as prescribed by U.S. generally accepted accounting principles (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 2,233 and faculty numbering 1,236;
- The University Hospital of Arkansas, a tertiary care referral center with 297 adult beds in use at June 30, 2007;
- Regional programs including Tele-education, Rural Hospital Program and seven Area Health Education Centers (AHEC) located throughout the state;
- The Winthrop P. Rockefeller Cancer Institute;
- Jones Eye Institute;
- Donald W. Reynolds Institute on Aging;
- Multiple Myeloma Institute;
- Arkansas Biosciences Institute; and
- Jackson T. Stephens Spine and Neurosciences Institute.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

The Little Rock campus includes approximately 3,800,000 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 of marketable securities are reported at fair value as established by major securities markets. The fair value of venture capital, real estate funds, and other investments is based on the most current information reported to UAMS by the respective investment managers. All investment income, including changes in the fair value of investments, is reported as nonoperating revenue.

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

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

Notes and Student Loans Receivable – The net unpaid balances of student loans receivable net of allowances and notes receivable from related parties.

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 and sick 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.

Deferred Revenue – Consists of student tuition and fees applicable to subsequent accounting periods.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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

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, 2006 through June 30, 2010. The recovery of indirect costs will be recorded at a previously negotiated provisional rate after July 1, 2010, 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 Board of Trustees for the same purposes as endowment funds, any portion of quasi-endowment funds may be expended. As such, the expired portion of term endowments and all quasi-endowments are reflected as unrestricted net assets in the statements of net assets. UAMS employs a total-return policy in determining the amount of investment income to be spent.

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

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

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

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

2. Net Patient Services Revenue and Charity Care

The University Hospital of Arkansas (the Hospital) is a division of UAMS, and the Faculty Group Practice (FGP) is the collective body of the College of Medicine faculty involved in professional practice at UAMS. FGP is an integral component of UAMS, functioning as an unincorporated division of the College of Medicine. As such, it is subject to the policies and regulations of the College of Medicine, UAMS and the Board of Trustees of the University of Arkansas System. Patient care operations are included in the accompanying financial statements under accounting principles generally followed by governmental colleges and universities. Patient accounts receivable at June 30, 2007 and 2006 are recorded net of an allowance for doubtful accounts of \$876,393,000 and \$858,890,000, respectively.

Net patient services revenue for the years ended June 30, 2007 and 2006, is as follows (*in thousands*):

	2007	2006
Gross patient revenue	\$ 1,396,283	\$ 1,269,940
Less patient services contractual allowances	665,057	583,226
Less provision for bad debts	58,698	51,279
Net patient services revenue	\$ 672,528	\$ 635,435

UAMS provided approximately \$101,000,000 and \$81,000,000 in charity care, based on established rates, during the years ended June 30, 2007 and 2006, 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, 2007 and 2006, includes approximately \$50,816,000 and \$43,219,000, 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, 2007 and 2006, includes approximately \$1,245,363 and \$27,373,000, respectively, of net revenue from the Supplemental 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, 2007, the Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2005.
- 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, 2007, the Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2005.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

FGP and AHECs:

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

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net adjustments to estimated settlements resulted in an increase to net patient services revenue of \$3,277,000 and a decrease of \$3,459,000 for the years ended June 30, 2007 and 2006, respectively. Management believes that UAMS is in compliance with all applicable laws and regulations and is not aware of any pending or threatened investigations involving allegations of potential wrongdoing. While no such regulatory inquiries have been made, compliance with such laws and regulations can be subject to future government review and interpretation, as well as significant regulatory action including fines, penalties, and exclusion from the Medicare and Medicaid programs.

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

3. Net State Appropriations Revenue

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

3. Net State Appropriations Revenue (continued)

Net state appropriations revenue for the years ended June 30, 2007 and 2006 is as follows (in thousands):

	2007	2006
Gross state appropriations revenue	\$ 97,101	\$ 89,380
Less Medicaid match payments	49,798	51,441
Net state appropriations revenue	\$ 47,303	\$ 37,939

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, 2007 and 2006 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, 2007	\$ 500	\$ 3,875	\$ 3,875	\$ -	\$ -
Cash at June 30, 2006	\$ 1,677	\$ 6,550	\$ 6,550	\$ -	\$ -

At June 30, 2007 and 2006, Category 1 is composed of \$452,000 and \$426,000, respectively, of insured deposits and \$3,423,000 and \$6,124,000, 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)*:

	June 30	
	2007	2006
Reported amount of deposits under GASB 3	500	\$ 1,677
Cash equivalents disclosed as investments under GASB 3	118,684	135,277
Cash and cash equivalents as reported in the statements of net assets	\$ 119,184	\$ 136,954

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, 2007 (*in thousands*):

Statement of Invested Assets

<u>Investment Type</u>	<u>Fair Value</u>
Short Term	\$ 28,000
Certificate of Deposits	28,000
Equity	67
U.S.	67
Commingled Funds	95,626
U.S. Equity	2,750
U.S. Fixed Income	853
Short Term Common Fund	90,684
Money Market Funds	1,339
Other Investments	225,459
Escrow Accounts	297
External Investment Pool	124,269
2006 Bond Proceeds	81,579
2004 Bond Proceeds	19,314
Cash	500
Total	\$ 349,652

The activities during fiscal year 2007 affecting UAMS' investments are summarized below (*in thousands*):

	Total Return Pool	Short/ Intermediate Pool	Other Investments	Total
June 30, 2006	\$ 53,498	\$ 53,797	\$ 324,774	\$ 432,069
Income	962	2,400	12,343	15,705
Realized gains (losses)	2,820	1,928	31	4,779
Unrealized gains	6,862	(1,472)	376	5,766
Expenses paid	(273)	(106)	(230)	(609)
Purchases (sales)	8,852	(5,000)	(112,410)	(108,558)
June 30, 2007	\$ 72,721	\$ 51,547	\$ 224,884	\$ 349,152

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

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

	Total Return Pool	Short/ Intermediate Pool	Other Investments	Total
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	<u>\$ 53,498</u>	<u>\$ 53,797</u>	<u>\$ 324,774</u>	<u>\$ 432,069</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*):

	June 30	
	2007	2006
Reported amount of investments and funds held in trust under GASB 3	\$ 349,152	\$ 432,069
Cash equivalents disclosed as investments under GASB 3	(118,684)	(135,277)
Investments and funds held in trust as reported in the statements of net assets	\$ 230,468	\$ 296,792

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

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

	June 30	
	2007	2006
Fair value at June 30	\$ 31,026	\$ 26,977
Number of units in Pool at June 30	463,224	463,163
Fair value per unit at June 30	66.98	58.25
Realized gains for the year	1,393	2,800
Income earned for the year	477	516
Realized gains per unit	3.01	6.05
Income earned per unit	1.03	1.11
Total income per unit	\$ 4.04	\$ 7.16

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 2007 and 2006 were included as a change in the fair value of investments reported in fiscal 2007 and 2006, respectively.

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

The following tables contain information on the risk disclosure for the Pool, which commingles (pools) the monies of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. The Pool was originally established in 1997 by the University of Arkansas and the University of Arkansas Foundation. During 1998, the Walton Arts Foundation joined the Pool, and during 2003, the Fayetteville Campus Foundation joined the Pool. The participants of the Pool have adopted investment guidelines and performance objectives for the accounts within the Pool. This information is provided in total for the pools, which includes the Total Return Pool, the Intermediate Pool, and the Cash Pool. UAMS owns 8.9% of the total of these pools.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

EXTERNAL INVESTMENT POOL

Statement of Invested Assets (in thousands)

Investment Type	Fair Value
Fixed Income	\$ 236,719
U.S. Government	40,257
U.S. Government Treasuries, Notes, Bonds	30,823
U.S. Government TIPS	524
U.S. Government Agency	7,798
Other U.S. Government	1,112
Mortgage Backed	119,510
Government Pass-Through	67,445
Corporate Pass-Through	52,065
Collateralized Mortgage Obligations	7,360
Government CMOs	7,360
Corporate	66,193
Corporate Bonds	47,860
Corporate Asset Backed	10,589
Private Placements	7,744
Municipals	2,847
Other Fixed Income	552
Convertible Preferred Stock	183
Equity	420,494
Common Stock	290,836
Real Estate Investment Trusts	290
Preferred Stock	235
Commingled Equity Funds	126,678
Other Equities	2,455
Other Assets	736,575
Mutual Funds	715,726
Venture Capital	20,849
Short-Term Investments	51,849
Pooled & Mutual Funds	51,095
Government Agencies	754
Cash and Cash Equivalents	(42,587)
Total	\$ 1,403,233

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

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

Credit Risk – S&P Quality Ratings

Investment Type and Fair Value (in thousands)	TSY	AGY	AAA	AA	A	BBB	BB	B	NR
Fixed Income	\$ 4,628	\$73,120	\$99,883	\$12,158	\$19,135	\$14,792	\$1,801	\$1,637	\$9,565
U.S. Government	3,591	4,801	30,410	625	372	458			
U.S. Government Treas., Notes, Bonds	3,591		27,232						
U.S. Government TIPS			524						
U.S. Government Agency		4,801	2,654	343					
Other U.S. Government				282	372	458			
Mortgage Backed		66,687	46,032						6,791
Government Pass-Through		66,687	758						
Corporate Pass-Through			45,274						6,791
Collateralized Mortgage Obligations	1,037	1,632	4,462						229
Government CMOs	1,037	1,632	4,462						229
Corporate			15,984	11,456	18,763	14,334	1,683	1,637	2,336
Corporate Bonds			3,654	10,451	17,885	13,009	1,167	1,637	57
Corporate Asset Backed			8,877			454	160		1,097
Private Placements			3,453	1,005	878	871	356		1,182
Municipals			2,770	77					
Other Fixed Income			225				118		209
Convertible Preferred Stock								183	
Total	\$4,628	\$73,120	\$99,883	\$12,158	\$ 19,135	\$ 14,792	\$ 1,801	\$ 1,820	\$ 9,565

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

Years to Maturity Investment Type (in thousands)	Investment Maturities (in years)				
	Fair Value	Less than 1	1–5	6–10	More than 10
Fixed Income	\$ 236,719	\$ 5,320	\$ 45,603	\$ 19,611	\$ 166,185
U.S. Government	40,257	822	10,801	8,789	19,845
U.S. Government Treas., Notes, Bonds	30,823	90	9,185	8,131	13,417
U.S. Government TIPS	524				524
U.S. Government Agency	7,798	450	1,290	612	5,446
Other U.S. Government	1,112	282	326	46	458
Mortgage Backed	119,510	1,263	1,754	2,263	114,230
Government Pass-Through	67,445		1,109	2,263	64,073
Corporate Pass-Through	52,065	1,263	645		50,157
Collateralized Mortgage Obligations	7,360		197	1,189	5,974
Government CMOs	7,360		197	1,189	5,974
Corporate	66,193	3,234	30,901	6,419	25,639
Corporate Bonds	47,860	2,646	20,212	5,550	19,452
Corporate Asset Backed	10,589		7,746		2,843
Private Placements	7,744	588	2,943	869	3,344
Municipals	2,847		1,951	819	77
Other Fixed Income	552			132	420
Convertible Preferred Stock	183				183
Total	\$ 236,902	\$ 5,320	\$ 45,603	\$ 19,611	\$ 166,368

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 should range between 80% and 115% of the benchmark's (the Lehman Brothers Intermediate Government Credit LB Int. G/c Index) duration.

Investment Type (<i>in thousands</i>)	Fair Value	Effective Duration (Years)
Fixed Income	\$ 236,719	4.78
U.S. Government	40,257	7.41
U.S. Government Treasuries, Notes, Bonds	30,823	8.17
U.S. Government TIPS	524	7.03
U.S. Government Agency	7,798	4.64
Other U.S. Government	1,112	6.03
Mortgage Backed	119,510	3.67
Government Pass-Through	67,445	4.54
Corporate Pass-Through	52,065	2.54
Collateralized Mortgage Obligations	7,360	3.96
Government CMOs	7,360	3.96
Corporate	66,193	5.03
Corporate Bonds	47,860	5.86
Corporate Asset Backed	10,589	1.82
Private Placements	7,744	4.27
Municipals	2,847	4.22
Other Fixed Income	552	8.84
Convertible Preferred Stock	183	2.92
Total	\$ 236,902	4.78

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

COMMON FUND

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

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

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

Investment Type (in thousands)	Fair Value	Credit Risk		
		AAA/Aaa	AA/Aa	Not Rated
Bank Common Trust Fund	\$90,684	\$90,684		

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

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

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 that 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.

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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

6. Notes and Student Loans Receivable, Net

The net unpaid balances of notes and student loans receivable on June 30, 2007 and 2006, net of allowances of \$5,736,000 and \$2,782,000, respectively, are as follows (*in thousands*):

	June 30	
	2007	2006
Perkins Loans	\$ 2,425	\$ 2,535
Health Professional Loans	5,017	4,521
Institutional funds loans	3,130	6,130
University of Arkansas at Fayetteville	1,420	1,514
University of Arkansas System note receivable	209	417
Miscellaneous	2,177	1,867
Total notes and student loans receivable, net	14,378	16,984
Less current portion	(4,063)	(3,237)
Notes and student loans receivable, noncurrent, net	\$ 10,315	\$ 13,747

7. Capital Assets

Balances as of June 30, 2006 and 2007, and changes in capital assets during fiscal 2007 were as follows (*in thousands*):

	June 30, 2006	Additions	Transfers	Dispositions	June 30, 2007
Nondepreciable:					
Land	\$ 6,113	\$ 252	\$ -	\$ -	\$ 6,365
Construction in progress	44,403	121,250	(9,146)	-	156,507
Depreciable:					
Buildings and fixtures	428,978	19,358	8,785	(717)	456,404
Improvements other than buildings	2,453	-	-	-	2,453
Equipment	128,874	11,192	2,876	(4,356)	138,586
Leased property	21,433	1,924	(2,515)	(822)	20,020
Other	2,557	-	-	-	2,557
Total capital assets	634,811	153,976	-	(5,895)	782,892
Less accumulated depreciation and amortization:					
Buildings and fixtures	135,636	13,065	49	(367)	148,383
Improvements other than buildings	2,138	68	-	-	2,206
Equipment	89,914	10,850	2,097	(4,083)	98,778
Leased property	8,811	3,180	(2,146)	(239)	9,606
Other	2,454	-	-	-	2,454
Total accumulated depreciation and amortization	238,953	27,163	-	(4,689)	261,427
Capital assets, net	\$ 395,858	\$ 126,813	\$ -	\$ (1,206)	\$ 521,465

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

7. Capital Assets (continued)

The buildings and fixtures above include \$8,009,000 and \$972,000 of net assets under capital leases at June 30, 2007 and 2006.

Capitalized interest of \$3,076,000 net of interest income of \$7,296,000 for the year ended June 30, 2007 and capitalized interest of \$2,509,000 net of interest income of \$2,700,000 for the year ended June 30, 2006 was recognized during the respective years. \$1,918,000 was related to the borrowing for the Various Facility Construction Revenue Bonds, Series 2004B. \$878,000 was related to the borrowing for the Various Facility Construction Revenue Bonds, Series 2006. Additionally, \$280,000 was related to the borrowing for the Parking System Revenue Construction Bonds, Series 2004.

Library holdings comprise books and periodicals, including old and rare books, held by UAMS. The estimated value of the holdings at June 30, 2007 and 2006 was \$1,725,000 and \$1,731,000, respectively. UAMS has not reported library holdings in the accompanying statements of net assets.

8. Accounts Payable and Accrued Liabilities

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

	June 30	
	2007	2006
Trade payables	\$ 10,436	\$ 7,580
Accrued wages	33,597	31,596
Miscellaneous payables	39,730	29,236
Total accounts payable and accrued liabilities	<u>\$ 83,763</u>	<u>\$ 68,412</u>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations

Changes in long-term obligations during fiscal year 2007 were as follows (*in thousands*):

	Beginning Balance	Additions	Reductions	Ending Balance
Bonds payable	\$ 288,185	\$ -	\$ (6,695)	\$ 281,490
Notes payable	1,886	862	(1,610)	1,138
Capital leases	12,043	10,334	(4,786)	17,591
Total debt	302,114	11,196	(13,091)	300,219
Compensated absences	32,154	2,520	-	34,674
Total obligations	<u>\$ 334,268</u>	<u>\$ 13,716</u>	<u>\$ (13,091)</u>	<u>\$ 334,893</u>

The current and long-term portions of the categories noted above were as follows at June 30, 2007 (*in thousands*):

	Current	Long-Term	Total
Bonds payable	\$ 6,085	\$ 275,405	\$ 281,490
Notes payable	474	664	1,138
Capital leases	4,359	13,232	17,591
Total debt	10,918	289,301	300,219
Compensated absences	1,792	32,882	34,674
Total obligations	<u>\$ 12,710</u>	<u>\$ 322,183</u>	<u>\$ 334,893</u>

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, Psychiatry Building, and the power plant. The income from the revenue-producing facilities, along with a portion of tuition and fees, is pledged to meet the principal and interest payments of certain bonds. Separate accounting is not required for these facilities under the provisions of the debt instruments; accordingly, segment reporting is not required for financial reporting purposes. A summary of the principal amount of outstanding debt is as follows at June 30, 2007 and 2006 (*in thousands*):

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations (continued)

	June 30	
	2007	2006
<i>Bonds Payable:</i>		
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 4.50% to 5.05% and 4.45% to 5.05% during fiscal years 2007 and 2006, respectively, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.	PAR	11,225
	10,640	
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.	PAR	51,095
	47,980	
	Premium	4,243
	3,901	
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.	PAR	\$ 95,665
	\$ 95,410	
	Premium	3,228
	3,114	
Parking System Revenue Construction Bonds, Series 2004, \$10,070,000 original amount plus unamortized premium of \$154,000 at June 30, 2006, due annually to 2035, various fixed interest rates of 2.25% to 5.0% over the life of the issue, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.	PAR	10,070
	9,885	
	Premium	153
	148	
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.	PAR	107,500
	105,575	
	Premium	5,006
	4,837	
Total Bonds Payable	\$281,490	\$ 288,185

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations (continued)

	June 30	
	2007	2006
Notes Payable:		
2.50% note payable to the State of Arkansas under Act 908 of 1989, \$20,000,000 original amount, collateralized by certain tax revenue.	\$ 0	\$ 1,054
Floating rate, Arkansas Development Finance Authority note, \$1,500,000 original amount, due monthly through 2012, with an interest rate of 3.75% at June 30, 2007, collateralized by general operating revenue.	579	674
Miscellaneous Notes Payable	559	158
Total Notes Payable	\$ 1,138	\$ 1,886

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, 2007 (*in thousands*):

	Bonds Payable				Notes Payable		
	Principal	Interest	Premium Amortized	Total	Principal	Interest	Total
2008	\$ 6,085	\$ 13,062	\$ 630	\$ 19,777	\$ 474	\$ 31	\$ 505
2009	6,325	12,830	630	19,785	250	19	269
2010	6,565	12,585	630	19,780	143	13	156
2011	6,840	12,310	630	19,780	144	7	151
2012	7,155	11,993	630	19,778	127	3	130
2013-2017	41,455	54,262	3,150	98,867	-	-	-
2018-2022	41,015	43,819	1,911	86,745	-	-	-
2023-2027	45,840	33,494	1,437	80,771	-	-	-
2028-2032	58,715	20,623	1,437	80,775	-	-	-
2033-2037	49,495	5,062	915	55,472	-	-	-
Total	\$ 269,490	\$ 220,040	\$ 12,000	\$ 501,530	\$ 1,138	\$ 73	\$ 1,211

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 Psychiatry Building, and a new power plant. The bonds bear interest at various fixed interest rates from 3.4% to 5.0%, and principal payments are due annually with interest payments due semiannually until the year 2036.

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

The Various Facility 1998 Bonds that were issued, in part, to refund the 1994 Bond issue provided \$2,017,000 to the University of Arkansas at Fayetteville (UAF) for improvements of certain facilities. Under the Series 2004A bond issue, UAF is still responsible for its portion of the principal, interest, and agents' fees. Accordingly, a note receivable with a balance of \$1,420,000 and \$1,514,000 as of June 30, 2007 and 2006, respectively, has been recorded in the accompanying Statements of Net Assets (see Note 14).

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.

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

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 accrued interest at 2.50% and were repaid by a state tax on mixed drinks and certain federal grant indirect cost reimbursements. Repayment of principal and the related interest for this note was based on the amount collected on the state alcohol and tobacco tax, and was not included in the maturity schedule above. The debt was completely repaid as of December, 2006.

The Arkansas Development Finance Authority note payable was issued in the amount of \$1,500,000 to fund various refurbishment projects. Interest is payable monthly through 2012 at a floating rate based on the J.J. Kenny Index Rate, which was 3.45% at both June 30, 2007 and 2006.

10. Commitments

Capital Leases

Scheduled maturities of capital lease commitments outstanding as of June 30, 2007 are as follows (*in thousands*):

	Principal	Interest	Total
2008	\$ 4,359	\$ 1,031	\$ 5,390
2009	3,058	848	3,906
2010	2,303	706	3,009
2011	1,752	586	2,338
2012	786	500	1,286
2013-2017	5,333	1,597	6,930
Total	\$ 17,591	\$ 5,268	\$ 22,859

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

10. Commitments (continued)

Operating Leases

The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2007 (*in thousands*):

2008	\$ 6,572
2009	5,309
2010	3,379
2011	2,232
2012	1,732
2013 and thereafter	6,867
Total minimum payments required	<u>\$ 26,091</u>

Rental expense for operating leases for the years ended June 30, 2007 and 2006 was approximately \$10,122,000 and \$8,882,000, respectively, and is included in supplies and other services in the accompanying Statements of Revenue, Expenses, and Changes in Net Assets.

Construction Projects

Construction in progress at June 30, 2007, included the Patient Bed Tower, the West Parking Deck, the Central Power plant, and the Arkansas State Hospital along with the purchase and installation of an Electronic Medical Records System and various renovation and maintenance projects. At June 30, 2007, construction contracts outstanding were approximately \$187,443,000.

Outstanding Commitments

At June 30, 2007 and 2006, UAMS had outstanding purchase orders for normal operating supplies and equipment amounting to approximately \$40,015,797 and \$29,181,400, respectively.

On February 23, 2005, UAMS and the Arkansas Department of Human Services (DHS) entered into an agreement under which DHS agreed to transfer to UAMS certain land and buildings adjacent to the UAMS campus. In consideration of the transfer, UAMS agreed to construct a new Arkansas State Hospital building consisting of approximately 152,000

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

10. Commitments (continued)

square feet with an estimated construction cost of \$32,171,000. Construction began in March 2006 and is expected to be completed in May 2008.

UAMS committed \$6,100,000 in unrestricted net assets to this project and reduced administrative fee contractual payments due to DHS as additional consideration. 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.

11. 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 2007 and 2006. 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, 2007 and 2006 was \$192,000 and \$166,000, respectively. UAMS' total salaries were \$498,681,000 and \$458,256,000 for fiscal years 2007 and 2006, respectively. Total employer contributions to ATRS in fiscal years 2007 and 2006 were \$27,000 and \$24,000, respectively. Employee contributions to ATRS in fiscal years 2007 and 2006 were \$7,800 and \$6,800, 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% in both 2007

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Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

and 2006. APERS issues a publicly available financial report, which may be obtained by writing or calling: APERS, One Union National Plaza, 124 W. Capitol, 5th Floor, Little Rock, AR 72201, (501) 682-7855. The gross payroll amount for UAMS employees covered by APERS for the years ended June 30, 2007 and 2006, was \$4,112,000 and \$4,237,000, respectively. Total employer contributions to APERS in fiscal years 2007 and 2006 were \$516,000 and \$515,000, respectively.

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

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 up to a maximum of \$22,500 per employee. 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 years 2007 and 2006 were calculated on base salary of \$485,959,000 and \$398,214,000, respectively. Total employer contributions during fiscal years 2007 and 2006 to TIAA-CREF and the Fidelity Fund were \$34,515,000 and \$34,153,000, respectively. Employee contributions to TIAA-CREF and the Fidelity Fund in the fiscal years 2007 and 2006 were \$26,501,000 and \$33,113,000, 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 497 and 495 as of June 30, 2007 and 2006, respectively. The participants of this program incur the total premium for this insurance. There is no direct expense for these services incurred by UAMS.

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Notes to Financial Statements (continued)

12. 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. Nine and eight former employees were eligible for receiving these benefits, as of June 30, 2007 and 2006, respectively. UAMS recorded \$49,000 in other post-employment benefits related to these former employees for both years ended June 30, 2007 and 2006.

13. Affiliated Entities (Unaudited)

The University of Arkansas Foundation, Inc. (the Foundation) operates as a nonprofit benevolent corporation for charitable educational purposes. It was established to benefit the University of Arkansas, or its students, faculty, and staff. The Board of Directors of the Foundation includes four members who are also members, or former members, of the University of Arkansas System Board of Trustees. Based on information provided by the Foundation, during the years ended June 30, 2007 and 2006, revenue of \$56,851,000 and \$36,006,000, was received by the Foundation for the benefit of UAMS. Support, by the Foundation on behalf of UAMS, was \$9,475,000 and \$18,554,000 for the years ended June 30, 2007 and 2006, respectively.

14. Related-Party Transactions

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

	<u>2007</u>	<u>2006</u>
University of Arkansas at Fayetteville	\$ 1,420	\$ 1,514
University of Arkansas System	209	417
Total included in notes and student loans receivable (Note 6)	<u>\$ 1,629</u>	<u>\$ 1,931</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.

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Notes to Financial Statements (continued)

15. Contingencies

Amounts received and expended by UAMS under various federal and state programs are subject to audit by governmental agencies. Management believes that adjustments, if any, which might result from such audits would not have a significant impact on the financial position of UAMS. Immunity provisions in Arkansas law prohibit suits naming the Board of Trustees of the University of Arkansas System or UAMS as a defendant in Arkansas State courts. Employees of UAMS acting in good faith in the course and scope of their employment may be sued in state courts, but only to the extent of maintained insurance coverage. UAMS maintains malpractice insurance for certain employees under a claims-made policy. Premiums are accrued based on a retrospective rating plan. UAMS incurred costs of \$4,513,000 and \$4,489,000 for this insurance during the years ended June 30, 2007 and 2006, respectively. A party may bring an action against UAMS through the Arkansas State Claims Commission (the Claims Commission). The Claims Commission may award a claim of up to \$7,500 without further review or appropriation. Awards that the Claims Commission approves in excess of \$7,500 must be approved and appropriated by the Arkansas State Legislature. Appropriations of this type, if any, reduce appropriations from the state to UAMS in the period in which the claim is appropriated.

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

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

In fiscal year 2006, the Arkansas Development Finance Authority (the Authority) issued \$36,775,000 in Tobacco Settlement Revenue Bonds. The Authority has made the proceeds of the bonds available to the University of Arkansas Board of Trustees (UA Board) to fund an expansion to the Arkansas Cancer Research Center (ACRC). The

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Notes to Financial Statements (continued)

15. Contingencies (continued)

bonds have an approximate yield to maturity of 4.77% to 5.10% and principal and accumulated interest are payable beginning in 2021 through 2031 for \$22,158,000 of serial bonds and beginning in 2036 through 2046 for \$14,617,000 of term bonds.

Funds received from the Arkansas Tobacco Settlement Funds Act of 2000 are pledged for debt service and are the primary source of payment for the bonds. In accordance with a Loan Agreement dated June 1, 2006 between the UA Board and the Authority, the UA Board will be required to make debt service payments on the Series 2006 bond issue in the event of a shortfall in tobacco settlement revenues. However, no such payments will be made unless the Debt Service Revenues are insufficient to make such payments. Management believes the Debt Service Revenues will be sufficient to service the entire principal and interest due. 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. For fiscal year 2003, Arkansas received \$60,067,457 from the Tobacco Settlement Fund. Using the 54% decline from above, Arkansas should receive approximately \$27.6 million in 2046 with the first \$5 million dedicated to pay the debt service on the above bond issue.

If Debt Service Revenues would have been considered insufficient at June 30, 2007, UAMS would have incurred a liability of \$5,850,000 related to issue. This amount includes draw down of funds related to the project, issuance costs, discounts, accreted interest, and other expenses related to the issue.

The revenues pledged by UAMS to secure the Loan Agreement consist of inpatient service fees and fees collected from other ancillary, therapeutic, and diagnostic services provided within the walls of the hospital but excludes (a) physician-generated revenues, (b) State appropriations, and (c) revenues restricted for other purposes.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

16. 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, 2007				
	Compensation and Benefits	Supplies and Other Services	Scholarships and Fellowships	Depreciation and Amortization	Total
Patient care	\$ 309,680	\$ 211,721	\$ –	\$ –	\$ 521,401
Instruction	138,969	10,190	–	–	149,159
Research	46,631	31,502	–	–	78,133
Public services	13,716	6,885	–	–	20,601
Academic support	11,089	3,368	–	–	14,457
Student services	1,809	1,586	–	–	3,395
Institutional support	59,626	415	–	–	60,041
Operation and maintenance of plant	15,473	16,214	–	–	31,687
Scholarships and awards	–	–	143	–	143
Auxiliary	2,041	2,678	–	–	4,719
Depreciation and amortization	–	–	–	27,163	27,163
Other	1,456	4,677	–	–	6,133
Total	\$ 600,490	\$ 289,236	\$ 143	\$ 27,163	\$ 917,032

	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 activities	1,673	2,849	–	–	4,522
Depreciation and amortization	–	–	–	25,648	25,648
Other	1,806	2,699	–	–	4,505
Total	\$ 563,529	\$ 258,348	\$ 119	\$ 25,648	\$ 847,644

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Notes to Financial Statements (continued)

17. Subsequent Event

On December 15, 2006 UAMS entered into a Memorandum of Understanding (MOU) with the Arkansas State Hospital (ASH) and the Arkansas Department of Health (ADH) to expand the capacity of the new UAMS power plant, which was under construction, to meet their power needs more efficiently. The agreed-upon cost for ASH and ADH was \$8,250,000 and \$2,350,000, respectively, which was to be paid in full on August 31, 2007. The ASH and ADH were unable to obtain funding to pay the \$8,250,000 and \$2,350,000. To provide funding to complete the power plant, UAMS borrowed \$8,250,000 via a capital equipment lease with a term of 180 months and is financing the \$2,350,000 from internal funds. On August 29, 2007, the second amendment to the MOU provided for monthly payments to UAMS of \$62,691 by ASH for 180 months at a 4.4% interest rate and \$26,090 by ADH for 120 months at a 6% interest rate rather than payment in full on August 31, 2007.

18. 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 ended 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 University management.

During the fiscal years ended June 30, 2007 and 2006, there neither have been prominent or conspicuous events that would indicate impairment of any material capital assets nor have there been any material insurance recoveries during the fiscal years.

In August 2004, the Governmental Accounting Standards Board issued Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which establishes standards for the measurement, recognition, and display of OPEB (other postemployment benefits). The GASB 45 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 UA health insurance upon retirement at substantially the same

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

18. New Accounting Pronouncements (continued)

premium rates as the active population. At the end of fiscal year 2007, the University of Arkansas System had approximately 1,100 retired employees enrolled in the UA Health Insurance Plan.

In the fall of 2005, the University requested retiree claims data from our 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'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 has concluded that at this time, it has no GASB liability for postemployment health benefits.

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 toward 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 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 UA 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 is currently evaluating the potential liability under GASB 45 for this postemployment benefit.

In June, 2005, 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 has not extended a large-scale or age-related early retirement offering during

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Notes to Financial Statements (continued)

18. New Accounting Pronouncements (continued)

the fiscal year ended June 30, 2006. The University has, from time to time, negotiated early retirement agreements with faculty, which may include the provision of healthcare 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 has accrued a liability for these amounts in *Compensated Absences Payable*.