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UNIVERSITY OF ARKANSAS

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**Financial Statements**  
**Years Ended June 30, 2008 and 2007**

University of Arkansas for Medical Sciences

Financial Statements

Years ended June 30, 2008 and 2007

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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, 2008 and 2007. 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 2,538 and faculty numbering 1,294;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 299 adult beds in use at June 30, 2008;
- Regional programs including Tele-education, Rural Hospital Program, and eight Area Health Education Centers (AHEC) located throughout the state;
- The Winthrop P. Rockefeller Cancer Institute;
- Harvey and Bernice Jones Eye Institute;
- Donald W. Reynolds Institute on Aging;
- Myeloma Institute for Research and Therapy;
- Psychiatric Research 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, revenues, 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 financial statements: the Statements of Net Assets, the Statements of Revenues, 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 revenues 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 Revenues, Expenses, and Changes in Net Assets reflect the results of UAMS' operations. The purpose of these statements is to present the revenues 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, 2008 and 2007, with comparative information for the fiscal year ended June 30, 2006.

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

**FINANCIAL HIGHLIGHTS**

UAMS' financial position continued to strengthen in fiscal year 2008 with assets of \$1,094,295,000 and liabilities of \$456,105,000. Net assets, which represent the residual interest in UAMS' assets after liabilities are deducted, were \$638,190,000 at June 30, 2008. Changes in net assets represent the activities of UAMS, which result from revenues, expenses, gains, and losses, and are summarized for the years ended June 30, 2008, 2007, and 2006 as follows:

	Year ended June 30		
	2008	2007	2006
	<i>(in thousands)</i>		
Operating revenues	\$ 964,874	\$ 865,131	\$ 825,748
Operating expenses	(987,807)	(917,032)	(847,644)
Nonoperating revenues	60,695	71,477	46,593
Other changes in net assets	40,229	4,979	15,633
Increase in net assets	\$ 77,991	\$ 24,555	\$ 40,330

***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:

	<b>June 30</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<i>(in thousands)</i>		
<b>Assets</b>			
Current assets	\$ 342,620	\$ 283,407	\$ 249,316
Noncurrent assets:			
Investments	102,580	178,921	296,792
Capital assets, net	625,458	521,465	395,858
Other	23,637	13,897	17,805
<b>Total Assets</b>	<b>1,094,295</b>	997,690	959,771
<b>Liabilities</b>			
Current liabilities	122,322	115,186	102,637
Noncurrent liabilities	333,783	322,305	321,490
<b>Total Liabilities</b>	<b>456,105</b>	437,491	424,127
<b>Net Assets</b>			
Invested in capital assets, net of related debt	342,789	323,739	229,548
Restricted:			
Expendable	82,045	50,661	36,927
Nonexpendable	30,337	36,769	31,635
Unrestricted	183,019	149,030	237,534
<b>Total Net Assets</b>	<b>638,190</b>	560,199	535,644
<b>Total Liabilities and Net Assets</b>	<b>\$ 1,094,295</b>	\$ 997,690	\$ 959,771

Current assets consist 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 in trust for others, estimated third-party payor settlements (Medicare and Medicaid), the current portion of compensated absences payable, the current portion of other postemployment benefits, and the current portion of bonds, notes, and capital leases payable. Noncurrent liabilities include primarily compensated absences payable, net of

## University of Arkansas for Medical Sciences

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

current portion, other postemployment benefits, 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 sound financial foundation.

#### ***Fiscal Year 2008***

UAMS' total assets increased by \$96,605,000 for fiscal year 2008. A review of the Statements of Net Assets reveals that the increase was primarily due to an increase of \$103,993,000 in capital assets (net), an increase in current assets of \$59,213,000, an increase in noncurrent notes and student loans receivable (net) of \$9,923,000, and a decrease in long-term investments of \$76,341,000.

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 cash and cash equivalents of \$21,990,000, which was due to payments from the Arkansas Physician Supplemental Medicaid Payment Program (APSP) of \$28,695,000, offset by transfers to current investment funds. In fiscal year 2007, the Center for Medicare and Medicaid Services (CMS) did not authorize the release of the physician supplemental payments totaling approximately \$12,717,000, net of Medicaid match payments. These funds along with the amount due for fiscal year 2008 were released and received by UAMS during fiscal year 2008. Additionally, funds were received from the State of Arkansas and private foundations dedicated to the construction of the Winthrop P. Rockefeller Cancer Institute, which increased current assets. The increase in notes receivable (net) was due to an agreement between UAMS and the Arkansas State Hospital (ASH) and the Arkansas Department of Health (ADH) where ASH and ADH agreed to make monthly payments to UAMS for their share of the West Central Energy Plant construction costs. Use of construction funds related to the major building projects discussed in the Economic Outlook section of this Management's Discussion and Analysis accounted for \$75,674,000 of the decrease in long-term investments.

Total liabilities increased by \$18,614,000 for fiscal year 2008. The increase was primarily due to an increase of \$8,222,000 in accounts payable and accrued liabilities primarily due to an increase of \$3,119,000 in trade accounts payable and \$5,016,000 in interagency payables. Due to the implementation of GASB Statement No. 45, which establishes standards for the measurement, recognition, and display of OPEB (other post employment benefits), a liability was recorded in fiscal year 2008 of \$9,801,000. See note 13 for further discussion on OPEB and GASB 45.

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

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

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

*Statements of Revenues, 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 Revenues, Expenses, and Changes in Net Assets. A summary of UAMS' revenue, expenses, and changes in net assets is as follows:

	<b>Year ended June 30</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
	<i>(in thousands)</i>		
<b>Operating Revenues</b>			
Student tuition and fees, net of scholarship allowances	\$ 19,951	\$ 13,566	\$ 14,463
Net patient services	765,358	672,528	635,435
Sponsored programs	137,003	140,148	138,657
Other	42,562	38,889	37,193
Total Operating Revenues	964,874	865,131	825,748
<b>Operating Expenses</b>			
Compensation and benefits	657,101	600,490	563,529
Supplies and other services	299,028	289,236	258,348
Scholarships and fellowships	244	143	119
Depreciation and amortization	31,434	27,163	25,648
Total Operating Expenses	987,807	917,032	847,644
<b>Operating Loss</b>	(22,933)	(51,901)	(21,896)
<b>Nonoperating Revenues (Expenses)</b>			
State appropriations, net	45,763	47,303	37,939
Gifts	13,864	9,241	4,586
Investment gain, net of expense	9,814	26,335	15,556
Other	(8,746)	(11,402)	(11,488)
Total Nonoperating Revenues (Expenses)	60,695	71,477	46,593
<b>Income Before Other Changes in Net Assets</b>	37,762	19,576	24,697
<b>Other Changes in Net Assets</b>			
Capital gifts and appropriations	57,735	3,734	9,941
Bond proceeds from Act 1282 of 2005	12,730	-	-
Interagency disposition	(30,236)	1,245	5,692
Total Other Changes in Net Assets	40,229	4,979	15,633
<b>Increase in Net Assets</b>	77,991	24,555	40,330
Net Assets – beginning of year	560,199	535,644	495,314
<b>Net Assets – end of year</b>	\$ 638,190	\$ 560,199	\$ 535,644

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

#### *Fiscal Year 2008*

The Statement of Revenues, Expenses, and Changes in Net Assets reflects an increase of \$77,991,000 in net assets for fiscal year 2008. Highlights of the information presented in this statement show how the following affected operating revenue:

Net patient services revenue increased by \$92,830,000. The gross amount of the Arkansas Physician Supplemental Payment Program accounted for \$43,415,000 of this increase. As discussed above, funds related to this program for fiscal years 2007 and 2008 were received in 2008. The portion related to fiscal year 2007 was not accrued in that year due to the uncertainty surrounding the payment of these funds at June 30, 2007. The balance of the increase in net patient services revenue is due to growth in patient volume, increases in reimbursement rates, and changes in reimbursement for Medicaid disproportionate share, Medicaid Upper Payment Limit, and Cost report settlements. Sponsored Programs, which include federal grants and contracts, state and local grants and contracts, and nongovernmental grants and contracts, decreased by \$3,145,000. State and local grants and contracts increased by \$360,000 while federal grants and contracts decreased by \$1,916,000 and nongovernmental grants and contracts decreased by \$1,589,000. The decrease in federal grants and contracts was due to a reduction of 2.9% in federal funding for all National Institute of Health awards as well as a decrease in the amount of new awards funded. Other revenue, which increased by \$3,673,000, includes auxiliary enterprises and other miscellaneous revenue sources.

The following factors affected operating expenses in 2008:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2008, increasing by \$56,611,000. Compensation and benefits expense related to patient care increased by \$25,263,000 due to necessary staffing to support increased patient volumes. Additionally, as a result of implementing GASB No. 45 as discussed above and in note 12, UAMS accrued \$9,801,000 in retiree healthcare expenses for fiscal year 2008. The balance of the increase in compensation and benefits was the result of normal salary increases and increases in staffing levels. Total supplies and other services increased by \$9,792,000. Supplies and other services related to patient care increased by \$3,100,000 due to the increase in patient volume discussed above. Overall supplies and other services increased 3.4% for the campus.

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

The following factors affected nonoperating revenue (expense) in 2008:

Nonoperating revenue decreased by \$10,782,000. This was primarily caused by a decrease in investment gain, net of expense of \$16,521,000. The main driver of the decrease in investment gain was a change in the market value of investments. Unrealized gains were \$5,766,000 in fiscal year 2007 compared to unrealized losses of \$7,246,000 in fiscal year 2008, a decrease of \$13,012,000. Additional investment income earned on investments decreased by \$3,510,000 primarily due to a decrease in invested construction funds and a decrease in the average rate of return paid on investments. Offsetting this decrease was an increase in gift revenue of \$4,623,000 from the University of Arkansas and private foundations.

#### *Fiscal Year 2007*

The Statement of Revenues, 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

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

\$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 were additional state appropriations of \$9,364,000, realized and unrealized gains on investments of \$6,498,000, interest income of \$4,353,000, 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.

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

Net state appropriations revenue for the years ended June 30, 2008, 2007, and 2006 is as follows (*in thousands*):

	<b>2008</b>	<b>2007</b>	<b>2006</b>
Gross state appropriations revenue	\$ 109,557	\$ 97,101	\$ 89,380
Less Medicaid match payments	63,794	49,798	51,441
Net state appropriations revenue	\$ 45,763	\$ 47,303	\$ 37,939

***Results of Operations***

***Fiscal Year 2008***

In fiscal year 2008, UAMS experienced an increase of 13.9% in net assets. The primary driver of the net asset growth was a 13.8% growth in net patient services revenue. Additionally, gifts continue to be an important component of UAMS’ growth. Gifts supporting operating activities totaling \$13,864,000 were received in fiscal year 2008. Additionally, capital gifts totaling \$10,281,000 primarily for the construction of the Psychiatric Research Institute and capital appropriations totaling \$60,184,000 for the expansion of the Winthrop P. Rockefeller Cancer Institute were received in fiscal year 2008.

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

Although the overall financial position improved in 2008, there were some occurrences that adversely affected the financial position.

Gross state appropriations accounted for approximately 10.6% and 10.2% of UAMS revenue for fiscal years 2008 and 2007, respectively.

Compensation and employee benefits increased by 9.4%, which reflects additional staffing needed to support the growth in patient volume as well as a new expense of \$9,801,000 related to accrued OPEB expenses.

Investment income decreased significantly by 62.7% from fiscal year 2007 primarily due to changing market conditions.

The new ASH was completed in May 2008 and transferred to the Arkansas DHS resulting in a reduction in net assets of \$32,171,000.

#### ***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.

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

**CAPITAL ASSETS AND DEBT ADMINISTRATION**

*Capital Assets*

At June 30, 2008, UAMS had \$625,458,000 invested in capital assets, net of accumulated depreciation and amortization of \$290,308,000. Depreciation and amortization charges totaled \$31,434,000 the fiscal year ended June 30, 2008.

UAMS' capital additions totaled \$167,881,000 in fiscal year 2008. 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 2008 and the sources that funded their acquisition included:

<b>Project</b>	<b>Amount of Additions</b>	<b>Funding Source</b>
	<i>(in thousands)</i>	
Patient Bed Tower, South Parking Deck, Central Power Plant, Psychiatric Research Institute, and ASH	\$ 117,854	2004B & 2006 Bond Issuance, Psychiatry Institute Foundation, UAMS
Winthrop P. Rockefeller Cancer Institute Tower	20,002	Winthrop P. Rockefeller Cancer Institute Foundation, State Appropriation, UAMS
Education West Building	9,111	Higher Education Bonds
Electronic Medical Records System	5,537	UAMS

The West Central Energy Plant, the South Parking Deck adjacent to the new bed tower, and the Walker Annex attached to the Winthrop P. Rockefeller Cancer Institute were all put into service in fiscal year 2008. Additionally, the Electronic Medical Records System went into service in April 2008. The Arkansas State Hospital building was completed in May 2008 and transferred to DHS.

Construction in progress at June 30, 2008 included the Patient Bed Tower, the Psychiatric Research Institute, and the Winthrop P. Rockefeller Cancer Institute Tower. 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, 2008, UAMS had \$339,271,000 in outstanding obligations (for additional information, see the Economic Outlook section of this Management's Discussion and Analysis), as shown in the following table:

<b>Obligation</b>	<b>Amount Outstanding (in thousands)</b>
Bonds payable	\$ 274,775
Notes payable	2,720
Obligations under capital leases	23,600
Compensated absences	38,177
Other postemployment benefits	9,801
	<u>\$ 349,073</u>

Moody's Investment Service raised the rating of the University of Arkansas System from A1 to Aa3 in August 2004, which was affirmed on June 12, 2008. 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 8 and 9 to the financial statements.

#### **ECONOMIC OUTLOOK**

UAMS' financial position continued to improve in fiscal year 2008 as evidenced by an approximate \$77,991,000 increase in Net Assets. One of UAMS' 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 actively 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 \$296,000,000. 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 fixed 30-year indentures and are secured by a pledge of patient service revenue. The balance of the funding will be provided by private sources and UAMS reserves. The 540,000 square-foot expansion to the Hospital will include new patient rooms, a new emergency

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

department, clinical lab, and radiology department along with room to expand other services. In addition, the new facility will include additional surgical and interventional suites, an intensive care unit, and an intermediate care unit. The Hospital expansion will include 234 adult beds and 64 neonatal beds initially, with space for growth that would bring the total capacity to 393 private adult patient rooms between the new facility and the Hospital's existing Ward Tower. A psychiatry wing, the Psychiatric Research Institute (PRI), will house 40 psychiatric inpatient beds, psychiatry clinics, offices, and research areas. The new patient tower is expected to open January 2009. The PRI will start outpatient services in December 2008 with inpatient services starting after the opening of the new patient tower in January 2009. The West Central Energy Plant began operating in October 2007. The new power plant can meet all the power needs of the west side of the UAMS campus during peak operating periods and will reduce operating costs. 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 situated to maintain a consistent 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. The average inpatient growth over the past three years has been 4.3%. With the expansion to the patient tower opening in January 2009, the growth rate is projected to increase significantly. The average outpatient growth over the past three years has been 4.0%.

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.

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 is continuing significant investments in information technology in order

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

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 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 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. Arkansas received \$57,309,111 from the Tobacco Settlement Fund in fiscal year 2008, a 4.6% decrease from fiscal year 2003. 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 consistent financial growth with a three-year average annual growth in Net Assets of 8.9%.

#### **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.



**KPMG LLP**  
Suite 3100  
717 North Harwood Street  
Dallas, TX 75201-6585

## **Independent Auditors' Report**

The Board of Trustees  
University of Arkansas System:

We have audited the accompanying statements of net assets of the University of Arkansas for Medical Sciences (UAMS), a campus of the University of Arkansas System, as of June 30, 2008 and 2007, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years 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 audits.

We conducted our audits 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 audits 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 audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of UAMS are intended to present the statements of net assets, and the statements of revenues, expenses, and changes in net assets and cash flows of only that portion of the University of Arkansas System that is attributable to the transactions of UAMS. They do not purport to, and do not, present fairly the statements of net assets of the University of Arkansas System as of June 30, 2008, the changes in its net assets and cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of UAMS as of June 30, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in note 13 to the financial statements, UAMS adopted the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, as of July 1, 2007.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 13, 2008 on our consideration of UAMS' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audits.

The management's discussion and analysis on pages 1 through 15 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 13, 2008

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

	<b>June 30</b>	
	<b>2008</b>	<b>2007</b>
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents (Note 4)	\$ 50,490	\$ 28,500
Investments (Note 5)	166,720	142,231
Patient accounts receivable, net (Note 2)	88,492	84,779
Nonpatient accounts receivable, (net of allowances of \$815 in 2008 and \$1,355 in 2007)	23,530	14,201
Inventories	8,545	9,462
Notes and student loans receivable, net (Notes 6 and 15)	2,686	4,063
Prepaid expenses	2,157	171
Total Current Assets	342,620	283,407
Noncurrent Assets:		
Investments (Note 5)	73,820	75,829
Notes and student loans receivable, net (Notes 6 and 15)	20,238	10,315
Deposits and funds held in trust by others (Note 5)	28,760	103,092
Capital assets, net (Notes 7, 9, and 10)	625,458	521,465
Other noncurrent assets	3,399	3,582
Total Noncurrent Assets	751,675	714,283
Total Assets	\$ 1,094,295	\$ 997,690
<b>Liabilities</b>		
Current Liabilities:		
Accounts payable and accrued liabilities (Note 8)	\$ 91,985	\$ 83,763
Deferred revenue	2,396	2,173
Funds held in trust for others	492	205
Estimated third-party payor settlements (Note 2)	12,049	16,335
Compensated absences payable, current portion (Note 9)	2,106	1,792
Liability for other postemployment benefits	686	-
Bonds, notes, and capital leases payable, current portion (Notes 9 and 10)	12,608	10,918
Total Current Liabilities	122,322	115,186
Noncurrent Liabilities:		
Deposits	110	122
Compensated absences payable, net of current portion (Note 9)	36,071	32,882
Liability for other postemployment benefits	9,115	-
Bonds, notes, and capital leases payable, net of current portion (Notes 9 and 10)	288,487	289,301
Total Noncurrent Liabilities	333,783	322,305
Total Liabilities	456,105	437,491
Commitments and Contingencies (Notes 10, 12, 13, and 16)		
<b>Net Assets</b>		
Invested in capital assets, net of related debt	342,789	323,739
Restricted :		
Expendable	82,045	50,661
Nonexpendable	30,337	36,769
Unrestricted	183,019	149,030
Total Net Assets	638,190	560,199
Total Liabilities and Net Assets	\$ 1,094,295	\$ 997,690

*See accompanying notes to financial statements.*

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

	Year ended June 30	
	2008	2007
Revenues		
Operating Revenues:		
Student tuition and fees (net of scholarship allowances of \$2,661 in 2008 and \$2,710 in 2007)	\$ 19,951	\$ 13,566
Net patient services (Notes 2 and 9)	765,358	672,528
Sponsored programs:		
Federal grants and contracts	78,311	80,227
State and local grants and contracts	14,219	13,859
Nongovernmental grants and contracts	44,473	46,062
Sales and services of educational departments	25,443	24,877
Auxiliary enterprises:		
Housing and food service	3,905	3,092
Bookstore	665	771
Other auxiliary enterprises	2,747	3,506
Other operating revenue	9,802	6,643
Total Operating Revenues	964,874	865,131
Expenses		
Operating Expenses (Note 17):		
Compensation and benefits	657,101	600,490
Supplies and other services	299,028	289,236
Scholarships and fellowships	244	143
Depreciation and amortization (Note 7)	31,434	27,163
Total Operating Expenses	987,807	917,032
Operating Loss	(22,933)	(51,901)
Nonoperating Revenues (Expenses)		
State appropriations, net (Note 3)	45,763	47,303
Gifts	13,864	9,241
Investment gain, net of investment expense (Note 5)	9,814	26,335
Interest on debt	(8,631)	(10,804)
Loss on disposal of capital assets	(115)	(598)
Total Nonoperating Revenues (Expenses)	60,695	71,477
Income Before Other Changes in Net Assets	37,762	19,576
OTHER CHANGES IN NET ASSETS		
Capital gifts	10,281	1,242
Capital appropriations	47,454	2,492
Proceeds from Act 1282 of 2005	12,730	-
Interagency disposition	(30,236)	1,245
Total Other Changes in Net Assets	40,229	4,979
Increase in Net Assets	77,991	24,555
Net Assets – beginning of year	560,199	535,644
Net Assets – end of year	\$ 638,190	\$ 560,199

*See accompanying notes to financial statements.*

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

	Year ended June 30	
	2008	2007
Cash Flows from Operating Activities		
Tuition and fees (net of scholarships)	\$ 20,756	\$ 16,935
Patient and insurance payments	768,343	709,873
Research grants and contracts	138,356	139,659
Collection of loans and interest	3,507	1,769
Auxiliary enterprise revenue:		
Housing and food service	3,917	3,090
Bookstore	665	771
Other auxiliary enterprises	2,741	3,642
Other receipts	28,184	20,253
Payments to suppliers	(299,935)	(306,631)
Payments to employees	(517,693)	(493,023)
Payments of employee benefits	(121,564)	(102,944)
Loans issued to students	(945)	(2,148)
Scholarships and fellowships	(244)	(143)
Other payments	(11,271)	(9,293)
Net cash and cash equivalents provided by (used in) operating activities	<b>14,817</b>	<b>(18,190)</b>
Cash Flows from Noncapital Financing Activities		
State appropriations	42,334	49,250
Gifts and grants	24,146	9,241
Loan proceeds	-	292
Other agency funds (net)	287	(1,342)
Repayments of loans	-	31
Net cash and cash equivalents provided by noncapital financing activities	<b>66,767</b>	<b>57,472</b>
Cash Flows from Capital and Related Financing Activities		
Capital appropriations	28,605	2,492
Proceeds from sale of capital assets	-	49
Proceeds from Act 1282 of 2005	12,730	-
Purchases of capital assets	(130,186)	(127,356)
Principal paid on capital debt and leases	(18,431)	(11,345)
Interest and paying agent fees paid on debt and capital leases	(13,979)	(13,551)
Net cash and cash equivalents used in capital and related financing activities	<b>(121,261)</b>	<b>(149,711)</b>

(Continued)

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

	Year ended June 30	
	2008	2007
Cash Flows from Investing Activities		
Proceeds from sales and maturities of investments	\$ 203,839	\$ 314,252
Interest on investments (net of fees)	3,009	5,951
Purchases of investments	(145,181)	(202,451)
Net cash and cash equivalents provided by investing activities	61,667	117,752
Net increase in cash and cash equivalents	21,990	7,323
Cash and cash equivalents – beginning of year	28,500	21,177
Cash and cash equivalents – end of year	\$ 50,490	\$ 28,500
Operating loss	\$ (22,933)	\$ (51,901)
Adjustments to reconcile net operating loss to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	31,434	27,163
Changes in assets and liabilities:		
Patient and nonpatient accounts receivable, net	(11,548)	(11,196)
Inventories	917	(1,376)
Other assets	(560)	2,664
Accounts payable and accrued liabilities	8,278	15,207
Deferred revenue	223	(87)
Deposits	(12)	10
Compensated absences payable	3,502	2,520
Other liabilities	5,516	(1,194)
Net cash and cash equivalents provided by (used in) operating activities	\$ 14,817	\$ (18,190)
Noncash transactions:		
Fixed assets acquired by capital gift	\$ 10,281	\$ 1,242
Fixed asset acquisition paid for by State of Arkansas	\$ 18,849	\$ 2,492
Fixed assets acquired by incurring capital lease obligations	\$ 11,177	\$ 10,334
Fixed assets acquired by notes payable	\$ 9,292	\$ -

*See accompanying notes to financial statements.*

# University of Arkansas for Medical Sciences

## Notes to Financial Statements

June 30, 2008 and 2007

### 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 2,538 and faculty numbering 1,294;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 299 adult beds in use at June 30, 2008;
- Regional programs including Tele-education, Rural Hospital Program, and eight Area Health Education Centers (AHEC) located throughout the state;
- The Winthrop P. Rockefeller Cancer Institute;
- Harvey and Bernice Jones Eye Institute;
- Donald W. Reynolds Institute on Aging;
- Multiple Myeloma Institute for Research and Therapy;
- Psychiatric Research 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 and management concurs. 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 estimated 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 are 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)

**Reclassifications** – Certain reclassifications have been made to the June 30, 2007 financial statements. Cash equivalents of approximately \$90,684,000 were reclassified to current investments to properly disclose liquidity of certain investments. Net cash and cash equivalents provided by investing activities were reclassified as purchases and sales of investments.

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

The Hospital is a division of UAMS, and the Faculty Group Practice (FGP) is the collective body of the 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, 2008 and 2007 are recorded net of an allowance for doubtful accounts of \$316,378,000 and \$876,393,000, respectively.

Net patient services revenue for the years ended June 30, 2008 and 2007 is as follows (*in thousands*):

	<u>2008</u>	<u>2007</u>
Gross patient revenue	\$ <b>1,611,456</b>	\$ 1,396,283
Less patient services contractual allowances	<b>767,059</b>	665,057
Less provision for bad debts	<b>79,039</b>	58,698
Net patient services revenue	<u><u>\$ <b>765,358</b></u></u>	<u><u>\$ 672,528</u></u>

UAMS provided approximately \$84,901,000 and \$101,000,000 in charity care, based on established rates, during the years ended June 30, 2008 and 2007, 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, 2008 and 2007 includes approximately \$61,124,000 and \$50,816,000, 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, 2008 and 2007 includes approximately \$43,415,000 and \$1,245,363, 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, 2008, the Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2006.
- 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, 2008, the Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2006.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

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

FGP and AHECs:

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

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net adjustments to estimated settlements resulted in a decrease to net patient services revenue of \$1,509,000 and an increase of \$3,277,000 for the years ended June 30, 2008 and 2007, 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, 2008 and 2007 is as follows (in thousands):

	<b>2008</b>	<b>2007</b>
Gross state appropriations revenue	\$ <b>109,557</b>	\$ 97,101
Less Medicaid match payments	<b>63,794</b>	49,798
Net state appropriations revenue	<b>\$ 45,763</b>	\$ 47,303

**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, 2008 and 2007 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.

	<b>Carrying Amount</b>	<b>Bank Balance</b>	<b>Category</b>		
			<b>1</b>	<b>2</b>	<b>3</b>
Cash at June 30, 2008	\$ <b>50,490</b>	\$ <b>54,475</b>	\$ <b>54,475</b>	\$ -	\$ -
Cash at June 30, 2007	\$ <b>28,500</b>	\$ <b>31,875</b>	\$ <b>31,875</b>	\$ -	\$ -

At June 30, 2008 and 2007, Category 1 is composed of \$741,000 and \$452,000, respectively, of insured deposits and \$53,734,000 and \$31,423,000, respectively, of securities that are held in custody by the Federal Reserve Bank.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

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

	<b>June 30</b>	
	<b>2008</b>	<b>2007</b>
Reported amount of deposits under GASB 3	<b>\$ 50,490</b>	\$ 28,500
Cash and cash equivalents as reported in the statements of net assets	<b>\$ 50,490</b>	\$ 28,500

**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.

The following table lists the invested assets of UAMS at June 30, 2008 (*in thousands*):

***Statement of Invested Assets***

<b>Investment Type</b>	<b>Fair Value</b>
<b>Equity</b>	<b>\$ 78</b>
U.S.	78
<b>Commingled Funds</b>	<b>116,339</b>
U.S. Equity	2,329
U.S. Fixed Income	905
Short Term Common Fund	111,748
Money Market Funds	1,357
<b>Other Investments</b>	<b>152,883</b>
Escrow Accounts	1,699
External Investment Pool	125,965
2006 Bond Funds held in Trust	24,458
2004 Bond Funds held in Trust	761
<b>Total</b>	<b>\$ 269,300</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

The activities during fiscal year 2008 affecting UAMS' investments are summarized below (*in thousands*):

	<b>Total Return Pool</b>	<b>Short/ Intermediate Pool</b>	<b>Other Investments</b>	<b>Total</b>
June 30, 2007	\$ 72,721	\$ 51,547	\$ 196,884	\$ 321,152
Income	1,356	2,529	6,838	10,723
Realized gains	6,031	329	38	6,398
Unrealized gains (losses)	(7,528)	653	(371)	(7,246)
Expenses paid	(372)	(86)	(57)	(515)
Purchases (sales)	(1,215)	-	(59,997)	(61,212)
June 30, 2008	<u>\$ 70,993</u>	<u>\$ 54,972</u>	<u>\$ 143,335</u>	<u>\$ 269,300</u>

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

	<b>Total Return Pool</b>	<b>Short/ Intermediate Pool</b>	<b>Other Investments</b>	<b>Total</b>
June 30, 2006	\$ 53,498	\$ 53,797	\$ 305,274	\$ 412,569
Income	962	2,400	12,343	15,705
Realized gains	2,820	1,928	31	4,779
Unrealized gains (losses)	6,862	(1,472)	376	5,766
Expenses paid	(273)	(106)	(230)	(609)
Purchases (sales)	8,852	(5,000)	(120,910)	(117,058)
June 30, 2007	<u>\$ 72,721</u>	<u>\$ 51,547</u>	<u>\$ 196,884</u>	<u>\$ 321,152</u>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

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

	<b>June 30</b>	
	<b>2008</b>	<b>2007</b>
Reported amount of investments and funds held in trust under GASB 3	<b>\$ 269,300</b>	\$ 321,152
Investments and funds held in trust as reported in the statements of net assets	<b>\$ 269,300</b>	\$ 321,152

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.

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

	<b>June 30</b>	
	<b>2008</b>	<b>2007</b>
Fair value at June 30	<b>\$ 29,674</b>	\$ 31,026
Number of units in Pool at June 30	<b>463,285</b>	463,224
Fair value per unit at June 30	<b>64.05</b>	66.98
Realized gains for the year	<b>2,528</b>	1,393
Income earned for the year	<b>569</b>	477
Realized gains per unit	<b>5.46</b>	3.01
Income earned per unit	<b>1.23</b>	1.03
Total income per unit	<b>\$ 6.69</b>	\$ 4.04

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 2008 and 2007 were included as a change in the fair value of investments reported in fiscal 2008 and 2007, respectively.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

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, 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 9.1% of the total of these pools.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

*EXTERNAL INVESTMENT POOL*

*Statement of Invested Assets (in thousands)*

Investment Type	Fair Value
<b>Fixed Income</b>	<b>\$ 215,785</b>
<b>U.S. Government</b>	<b>13,281</b>
U.S. Government Treasuries, Notes, Bonds	8,809
U.S. Government TIPS	1,126
U.S. Government Agency	2,770
Other U.S. Government	576
<b>Mortgage Backed</b>	<b>54,179</b>
Government Pass-Through	54,179
<b>Collateralized Mortgage Obligations</b>	<b>7,340</b>
Government CMOs	7,340
<b>Corporate</b>	<b>137,846</b>
Corporate Bonds	60,836
Corporate Asset Backed	67,005
Private Placements	10,005
<b>Municipals</b>	<b>2,868</b>
<b>Other Fixed Income</b>	<b>271</b>
<b>Convertible Preferred Stock</b>	<b>114</b>
<b>Equity</b>	<b>183,294</b>
Common Stock	170,393
Real Estate Investment Trusts	11,174
Preferred Stock	297
Other Equities	1,430
<b>Other Assets</b>	<b>989,412</b>
Mutual Funds	921,835
Venture Capital	67,577
<b>Short-Term Investments</b>	<b>15,519</b>
Pooled & Mutual Funds	13,907
Government Agencies	1,612
<b>Cash and Cash Equivalents</b>	<b>(19,195)</b>
<b>Total</b>	<b>\$ 1,384,929</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

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

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

<b>Investment Type and Fair Value (in thousands)</b>	<b>TSY</b>	<b>AGY</b>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>BB</b>	<b>B</b>	<b>NR, CCC &amp; Below</b>
<b>Fixed Income</b>	<b>\$ 1,660</b>	<b>\$62,191</b>	<b>\$80,960</b>	<b>\$18,633</b>	<b>\$27,624</b>	<b>\$16,169</b>	<b>\$1,384</b>	<b>\$1,680</b>	<b>\$5,598</b>
<b>U.S. Government</b>	<b>1,660</b>	<b>1,095</b>	<b>9,588</b>	<b>362</b>	<b>48</b>	<b>528</b>			
U.S. Government Treas., Notes, Bonds	1,660		8,462						
U.S. Government TIPS			1,126						
U.S. Government Agency		1,095		362					
Other U.S. Government					48	528			
<b>Mortgage Backed</b>		<b>53,483</b>	<b>697</b>						
Government Pass-Through		53,483	697						
Corporate Pass-Through									
<b>Collateralized Mortgage Obligations</b>		<b>3,333</b>	<b>3,829</b>						<b>178</b>
Government CMOs		3,333	3,829						178
<b>Corporate</b>		<b>4,280</b>	<b>63,806</b>	<b>18,200</b>	<b>27,576</b>	<b>15,641</b>	<b>1,360</b>	<b>1,566</b>	<b>5,417</b>
Corporate Bonds			3,606	15,266	25,914	12,896	640	1,566	947
Corporate Asset Backed		4,280	58,789	1,067	126	865	388		3,491
Private Placements			3,411	1,867	1,536	1,880	332		979
<b>Municipals</b>			<b>2,797</b>	<b>71</b>					
<b>Other Fixed Income</b>			<b>243</b>				<b>24</b>		<b>3</b>
<b>Convertible Preferred Stock</b>								<b>114</b>	
<b>Total</b>	<b>\$1,660</b>	<b>\$62,191</b>	<b>\$80,960</b>	<b>\$18,633</b>	<b>\$27,624</b>	<b>\$16,169</b>	<b>\$1,384</b>	<b>\$1,680</b>	<b>\$5,598</b>

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
<b>Fixed Income</b>	<b>\$ 215,785</b>	<b>\$ 1,439</b>	<b>\$ 34,875</b>	<b>\$ 20,421</b>	<b>\$ 159,050</b>
<b>U.S. Government</b>	<b>13,281</b>		<b>4,443</b>	<b>272</b>	<b>8,566</b>
U.S. Government Treas., Notes, Bonds	8,809		4,212	224	4,373
U.S. Government TIPS	1,126				1,126
U.S. Government Agency	2,770		231		2,539
Other U.S. Government	576			48	528
<b>Mortgage Backed</b>	<b>54,179</b>		<b>1,303</b>	<b>265</b>	<b>52,611</b>
Government Pass-Through	54,179		1,303	265	52,611
<b>Collateralized Mortgage Obligations</b>	<b>7,340</b>		<b>178</b>	<b>2,255</b>	<b>4,907</b>
Government CMOs	7,340		178	2,255	4,907
<b>Corporate</b>	<b>137,846</b>	<b>1,231</b>	<b>27,227</b>	<b>16,737</b>	<b>92,651</b>
Corporate Bonds	60,836	808	21,585	13,705	24,738
Corporate Asset Backed	67,005	317	1,545	747	64,396
Private Placements	10,005	106	4,097	2,285	3,517
<b>Municipals</b>	<b>2,868</b>	<b>208</b>	<b>1,700</b>	<b>889</b>	<b>71</b>
<b>Other Fixed Income</b>	<b>271</b>		<b>24</b>	<b>3</b>	<b>244</b>
<b>Convertible Preferred Stock</b>	<b>114</b>				<b>114</b>
<b>Total</b>	<b>\$ 215,899</b>	<b>\$ 1,439</b>	<b>\$ 34,875</b>	<b>\$ 20,421</b>	<b>\$ 159,164</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**5. Investments (continued)**

In accordance with the Policy, the Pool 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.

<b>Investment Type (<i>in thousands</i>)</b>	<b>Fair Value</b>	<b>Effective Duration (Years)</b>
<b>Fixed Income</b>	<b>\$ 215,785</b>	<b>4.83</b>
<b>U.S. Government</b>	<b>13,281</b>	<b>8.49</b>
U.S. Government Treasuries, Notes, Bonds	8,809	9.18
U.S. Government TIPS	1,126	6.98
U.S. Government Agency	2,770	6.47
Other U.S. Government	576	10.69
<b>Mortgage Backed</b>	<b>54,179</b>	<b>3.52</b>
Government Pass-Through	54,179	3.52
<b>Collateralized Mortgage Obligations</b>	<b>7,340</b>	<b>4.66</b>
Government CMOs	7,340	4.66
<b>Corporate</b>	<b>137,846</b>	<b>5.11</b>
Corporate Bonds	60,836	6.32
Corporate Asset Backed	67,005	3.75
Private Placements	10,005	5.60
<b>Municipals</b>	<b>2,868</b>	<b>3.48</b>
<b>Other Fixed Income</b>	<b>271</b>	<b>9.88</b>
<b>Convertible Preferred Stock</b>	<b>114</b>	<b>1.83</b>
<b>Total</b>	<b>\$ 215,899</b>	<b>4.83</b>

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. For additional information concerning the Common Fund see note 18.

*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:

<b>Investment Type (in thousands)</b>	<b>Fair Value</b>	<b>Credit Risk</b>		
		<b>AAA/Aaa</b>	<b>AA/Aa</b>	<b>Not Rated</b>
Bank Common Trust Fund	\$111,748			\$111,748

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, 2008 and 2007, net of allowances of \$4,540,000 and \$5,736,000, respectively, are as follows (*in thousands*):

	June 30	
	2008	2007
Perkins Loans	\$ 2,129	\$ 2,425
Health Professional Loans	5,227	5,017
Institutional funds loans	3,110	3,130
University of Arkansas at Fayetteville	1,323	1,420
University of Arkansas System note receivable	-	209
Arkansas State Hospital note receivable	8,350	-
Arkansas Department of Health note receivable	2,406	-
Miscellaneous	379	2,177
Total notes and student loans receivable, net	22,924	14,378
Less current portion	(2,686)	(4,063)
Notes and student loans receivable, noncurrent, net	\$ 20,238	\$ 10,315

**7. Capital Assets**

Balances as of June 30, 2007 and 2008 and changes in capital assets during fiscal 2008 were as follows (*in thousands*):

	June 30, 2007	Additions	Transfers	Dispositions	June 30, 2008
Nondepreciable:					
Land	\$ 6,365	\$ -	\$ 677	\$ -	\$ 7,042
Construction in progress	156,507	121,237	(62,156)	-	215,588
Depreciable:					
Buildings and fixtures	456,404	22,791	50,618	(32,289)	497,524
Improvements other than buildings	2,453	-	-	-	2,453
Equipment	138,586	16,266	3,079	(1,788)	156,143
Leased property	20,020	2,905	(3,081)	(930)	18,914
Other	2,557	4,682	10,863	-	18,102
Total capital assets	782,892	167,881	-	(35,007)	915,767
Less accumulated depreciation and amortization:					
Buildings and fixtures	148,383	14,740	16	-	163,139
Improvements other than buildings	2,206	51	-	-	2,257
Equipment	98,778	12,050	3,320	(1,871)	112,277
Leased property	9,606	3,506	(3,336)	(890)	8,886
Other	2,454	1,295	-	-	3,749
Total accumulated depreciation and amortization	261,427	31,642	-	(2,761)	290,308
Capital assets, net	\$521,465	\$136,239	\$ -	\$(32,246)	\$625,458

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**7. Capital Assets (continued)**

The buildings and fixtures above include \$14,667,000 and \$8,009,000 of net assets under capital leases at June 30, 2008 and 2007, respectively.

Capitalized interest of \$5,570,000 net of interest income of \$2,564,000 for the year ended June 30, 2008 and capitalized interest of \$3,076,000 net of interest income of \$7,296,000 for the year ended June 30, 2007 were 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, 2008 and 2007 was \$1,698,000 and \$1,725,000, 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*):

	<b>June 30</b>	
	<b>2008</b>	<b>2007</b>
Trade payables	\$ 12,965	\$ 10,436
Accrued wages	38,144	33,597
Miscellaneous payables	40,876	39,730
Total accounts payable and accrued liabilities	<b>\$ 91,985</b>	<b>\$ 83,763</b>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**9. Long-Term Obligations**

Changes in long-term obligations during fiscal year 2008 were as follows (*in thousands*):

	<b>Beginning Balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending Balance</b>
Bonds payable	\$ 281,490	\$ -	\$ (6,715)	\$ 274,775
Notes payable	1,138	9,292	(7,710)	2,720
Capital leases	17,591	11,177	(5,168)	23,600
Total debt	300,219	20,469	(19,593)	301,095
Compensated absences	34,674	3,502	-	38,176
Other postemployment benefits	-	9,801	-	9,801
<b>Total obligations</b>	<b>\$ 334,893</b>	<b>\$ 33,772</b>	<b>\$ (19,593)</b>	<b>\$ 349,072</b>

The current and long-term portions of the categories noted above were as follows at June 30, 2008 (*in thousands*):

	<b>Current</b>	<b>Long Term</b>	<b>Total</b>
Bonds payable	\$ 6,325	\$ 268,450	\$ 274,775
Notes payable	2,011	709	2,720
Capital leases	4,272	19,328	23,600
Total debt	12,608	288,487	301,095
Compensated absences	2,106	36,070	38,176
Other postemployment benefits	686	9,115	9,801
<b>Total obligations</b>	<b>\$ 15,400</b>	<b>\$ 333,672</b>	<b>\$ 349,072</b>

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, 2008 and 2007 (*in thousands*):

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

	<b>June 30</b>	
	<b>2008</b>	<b>2007</b>
<b><i>Bonds Payable:</i></b>		
Parking System Revenue Construction and Refunding Bonds, Series 1998, \$14,260,000 original amount, due annually to 2013 with \$5,740,000 in term bonds due 2019, various interest rates of 4.55% to 5.05% and 4.50% to 5.05% during fiscal years 2008 and 2007, respectively, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.	<b>PAR</b>	<b>\$ 10,030</b> \$ 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.	<b>PAR</b> <b>Premium</b>	<b>44,740</b> 47,980 <b>3,558</b> 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.	<b>PAR</b> <b>Premium</b>	<b>95,150</b> 95,410 <b>3,000</b> 3,114
Parking System Revenue Construction Bonds, Series 2004, \$10,070,000 original amount plus a premium of \$162,000 due annually to 2035, various fixed interest rates of 2.25% to 5.00% over the life of the issue, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.	<b>PAR</b> <b>Premium</b>	<b>9,695</b> 9,885 <b>142</b> 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.	<b>PAR</b> <b>Premium</b>	<b>103,790</b> 105,575 <b>4,670</b> 4,837
Total Bonds Payable		<b>\$274,775</b> \$281,490

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

	June 30	
	2008	2007
<i>Notes Payable:</i>		
Floating rate, Arkansas Development Finance Authority note, \$1,500,000 original amount, due monthly through 2012, was refinanced through Bank of America in May 2008 by the University of Arkansas System. UAMS' portion of the note is \$494,774.76. Interest rate of 4.22% at June 30, 2008.	\$ 495	\$ 579
Miscellaneous Notes Payable	2,225	559
Total Notes Payable	\$ 2,720	\$ 1,138

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, 2008 (*in thousands*):

	Bonds Payable				Notes Payable		
	Principal	Interest	Premium Amortized	Total	Principal	Interest	Total
2009	\$ 6,325	\$ 12,830	\$ 630	\$ 19,785	\$ 2,011	\$ 108	\$ 2,119
2010	6,565	12,585	630	19,780	285	90	375
2011	6,840	12,310	630	19,780	210	75	285
2012	7,155	11,993	630	19,778	187	62	249
2013	7,510	11,638	630	19,778	27	53	80
2014-2018	43,515	52,195	3,150	98,860	-	191	191
2019-2023	39,725	41,831	1,568	83,124	-	55	55
2024-2028	48,175	31,168	1,437	80,780	-	-	-
2029-2033	61,685	17,644	1,437	80,766	-	-	-
2034-2038	35,910	2,784	628	39,322	-	-	-
Total	\$ 263,405	\$ 206,978	\$ 11,370	\$ 481,753	\$ 2,720	\$ 634	\$ 3,354

# 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 was 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 was 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 \$1,323,000 and \$1,420,000 as of June 30, 2008 and 2007, 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 was 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 Arkansas Development Finance Authority note payable was issued in the amount of \$1,500,000 to fund various refurbishment projects. This note was refinanced through Bank of America by the University of Arkansas System in May 2008. UAMS' portion of the note is \$494,774.46 at 4.22% interest.

**10. Commitments**

*Capital Leases*

Scheduled maturities of capital lease commitments outstanding as of June 30, 2008 are as follows (*in thousands*):

	<b>Principal</b>	<b>Interest</b>	<b>Total</b>
2009	\$ 4,250	\$ 1,260	\$ 5,510
2010	3,487	1,073	4,560
2011	2,870	907	3,777
2012	1,834	778	2,612
2013	1,433	673	2,106
2014-2018	9,726	2,211	11,937
Total	<u>\$ 23,600</u>	<u>\$ 6,902</u>	<u>\$ 30,502</u>

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, 2008 (*in thousands*):

2009	\$ 5,872
2010	3,181
2011	1,693
2012	1,080
2013	1,082
2014-2018	<u>2,177</u>
Total minimum payments required	<u><u>\$ 15,085</u></u>

Rental expense for operating leases for the years ended June 30, 2008 and 2007 was approximately \$10,154,000 and \$10,122,000, 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, 2008 included the Patient Bed Tower, the Psychiatric Research Institute, the Education West Building, and the Winthrop Rockefeller Cancer Institute. At June 30, 2008, construction contracts outstanding were approximately \$87,417,000.

***Outstanding Commitments***

At June 30, 2008 and 2007, UAMS had outstanding purchase orders for normal operating supplies and equipment amounting to approximately \$66,658,000 and \$40,015,797, respectively. The large number of outstanding purchase orders at June 30, 2008 is due to the construction of the Patient Bed Tower.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### **11. Interagency Disposition**

The majority of the balance was due at an agreement executed on February 23, 2005 between UAMS and the Arkansas Department of Human Services (DHS) in which DHS agreed to transfer to UAMS certain land and buildings adjacent to the UAMS campus in consideration for construction of a new Arkansas State Hospital building with an estimated construction cost of \$32,327,000. The construction began and the land was transferred to UAMS in fiscal year 2005. The majority of the project was funded by reducing the administrative fee contractual payments due to DHS by approximately \$26,227,000 over a four-year period with the remaining \$6,100,000 paid with UAMS unrestricted net assets. In the current fiscal year, the Hospital building was completed and transferred to DHS.

### **12. 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 2008, 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, 2008 and 2007 was \$249,300 and \$192,000, respectively. UAMS' total salaries were \$529,094,600 and \$498,681,000 for fiscal years 2008 and 2007, respectively. Total employer contributions to ATRS in fiscal years 2008, 2007 and 2006 were \$35,000, \$27,000 and \$24,000, respectively. Employee contributions to ATRS in fiscal years 2008 and 2007 were \$11,400 and \$7,800, 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 10 years of participation in the plan. Benefit provisions are established and amended by State of

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 12. Retirement Benefits (continued)

Arkansas Statute (A.C.A. 24). UAMS' required contribution rate was 13% in 2008, 2007 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, 5<sup>th</sup> Floor, Little Rock, AR 72201, (501) 682-7855. The gross payroll amount for UAMS employees covered by APERS for the years ended June 30, 2008 and 2007 was \$4,701,000 and \$4,112,000, respectively. Total employer contributions to APERS in fiscal years 2008, 2007 and 2006 were \$589,500, \$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 \$23,000 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 2008 and 2007 were calculated on base salary of \$516,719,000 and \$485,959,000, respectively. Total employer contributions during fiscal years 2008 and 2007 to TIAA-CREF and the Fidelity Fund were \$37,181,000 and \$34,515,000, respectively. Employee contributions to TIAA-CREF and the Fidelity Fund in the fiscal years 2008 and 2007 were \$41,320,000 and \$26,501,000, 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 536 and 497 as of June 30, 2008 and 2007, respectively. The participants of this program incur the total premium for this insurance. There is no direct expense for these services incurred by UAMS.

# University of Arkansas for Medical Sciences

## Notes to Financial Statements (continued)

### 13. Other Postemployment Benefits (OPEB)

The University of Arkansas (University) offers postemployment health (including prescription drugs) and dental benefits along with life insurance (\$10,000 available coverage) to eligible retirees. Health and dental benefits are provided in the University's self-funded plan sponsored by the Board of Trustees of the University of Arkansas System for current and retired employees of UAF, Little Rock (UALR), Medical Sciences (UAMS), Monticello (UAM), Pine Bluff (UAPB) and Batesville (UACCB) campuses, the Cooperative Extension Service of the Division of Agriculture (CES), the Arkansas School for Mathematics, Sciences and the Arts (ASMSA), and the University of Arkansas System Administration (SYSTEM). The plan is considered a single-employer plan. The System Administration manages and administers the plan. Although benefits are also provided under the University's plan for the University of Arkansas Foundation, Inc. and the University of Arkansas Winthrop Rockefeller Institute, no postemployment benefit is accrued by the University for these private entities. Financial activities of the plan are reported in the University of Arkansas consolidated financial report.

In June 2004, GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, which became effective for the fiscal year ended June 30, 2008. This statement requires governmental entities to recognize and match other postretirement benefit costs with related services received and also to provide information regarding the actuarially calculated liability and funding level of the benefits associated with past services. As a result of the implementation of this statement, UAMS accrued \$9,801,000 in retiree healthcare expense during the fiscal year ended June 30, 2008.

For those campuses in the University's self-funded plan, retirees qualify for postretirement benefits as follows:

**Participation:** Employees who retire with a combination of age and years of service of at least 70 with at least 10 years of coverage under the plan are eligible to participate. Retirees may cover spouses and eligible dependent children. Surviving spouses can continue coverage after retiree's death. Retirees can continue coverage past Medicare eligibility age (age 65 or disabled) with the University plan paying secondary to Medicare.

**Benefit Provided:** Retirees participate in the plan at the same premium rate as an active employee.

**Required Contribution Ratio:** Retirees pay 100% of premium. Employer costs are funded on a pay-as-you-go basis.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**13. Other Postemployment Benefits (OPEB) (continued)**

**Summary of Key Actuarial Methods and Assumptions**

**University Self-Funded Plan**

Valuation date	July 1, 2007 valuation for the fiscal year ended June 30, 2008
Valuation year	July 1, 2006 – July 1, 2007
Actuarial cost method	Projected unit credit
Amortization method	30 years closed, level % of payroll
Asset valuation method	N/A
Discount rate	4.50%
Projected payroll growth rate	4.00%
Medical inflation rate	Initial rate of 9% for 5 years; ultimate rate of 5%
Dental inflation rate	Initial rate of 4% for 2 years; ultimate rate of 3%
Projected increase/retiree premiums	3%

**General Overview of the Valuation Methodology**

The process of determining the liability for retiree medical benefits is based on many assumptions about future events. The results are highly dependent on two key assumptions: the rate at which it is assumed that medical costs will increase over time and the discount rate used to translate future payments into current dollars. The annual payments for retiree medical benefits are expected to rise sharply in coming years, both because medical costs are expected to rise over time and because more employees will retire and start to receive University-paid medical, dental, and life benefits.

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future.

Calculations are based on the types of benefits provided under the terms of each plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. The projection of benefits for financial reporting purposes does not explicitly incorporate the potential effects of legal or contractual funding limitations on the pattern of cost sharing between the University and plan members in the future.

Actuarial calculations reflect a long-term perspective. Actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**Determination of Annual Required Contribution (ARC) and End of Year Accrual**

Unfunded actuarial accrued liability at 7-1-07	\$ 78,087
<u>Annual Required Contribution (ARC)</u>	
Normal cost	7,248
Amortization of the unfunded actuarial accrued liability over 30 years using level percent of payroll amortization	2,788
Interest	452
ARC for FY08	10,488
Less: Expected Employer Contributions	(687)
End of year accrual	\$ 9,801

**Schedule of Employer Contributions**

Fiscal Year Ended	Annual Required Contributions	Expected Contributions	Percentage Contributed
6-30-08	\$ 10,488	\$ 687	6.55%

Since there is no funding, the expected contributions are any retiree premiums actually paid by the University plus expected implicit subsidy payments. The implicit rate subsidy is the difference between the true cost of medical benefits and the cost sharing premiums paid by the retiree. Expected contributions were based on actual contributions for the fiscal year ended June 30, 2007 as it was expected that actual contributions for the fiscal year ended June 30, 2008 would not have been materially different.

**Schedule of Funding Progress (Unaudited)**

Fiscal Year Ended	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as Percentage of Covered Payroll
6-30-08	\$ -	\$ 78,087	\$ 78,087	-	\$ 467,273	17%

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**14. 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, 2008 and 2007, revenue of \$28,744,000 and \$56,851,000 was received by the Foundation for the benefit of UAMS. Support, by the Foundation on behalf of UAMS, was \$20,756,000 and \$9,475,000 for the years ended June 30, 2008 and 2007, respectively.

**15. Related-Party Transactions**

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

	<b>2008</b>	<b>2007</b>
University of Arkansas at Fayetteville	\$ 1,323	\$ 1,420
University of Arkansas System	-	209
Arkansas State Hospital	8,350	-
Arkansas Department of Health	2,406	-
Total included in notes and student loans receivable (Note 6)	<u>\$ 12,079</u>	<u>\$ 1,629</u>

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

## University of Arkansas for Medical Sciences

### Notes to Financial Statements (continued)

#### **16. 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 \$4,265,000 and \$4,513,000 for this insurance during the years ended June 30, 2008 and 2007, 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

## University of Arkansas for Medical Sciences

### Notes to Financial Statements (continued)

#### **16. 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, 2008, UAMS would have incurred a liability of \$26,644,000 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 exclude (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)

**17. 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, 2008				
	Compensation and Benefits	Supplies and Other Services	Scholarships and Fellowships	Depreciation and Amortization	Total
Patient care	\$ 334,943	\$ 214,821	\$ -	\$ -	\$ 549,764
Instruction	112,172	9,735	-	-	121,907
Research	66,180	34,187	-	-	100,367
Public services	14,856	7,925	-	-	22,781
Academic support	10,679	3,775	-	-	14,454
Student services	1,878	1,853	-	-	3,731
Institutional support	96,295	3,547	-	-	99,842
Operation and maintenance of plant	16,749	15,698	-	-	32,447
Scholarships and awards	-	-	244	-	244
Auxiliary	2,516	2,228	-	-	4,744
Depreciation and amortization	-	-	-	31,434	31,434
Other	833	5,259	-	-	6,092
<b>Total</b>	<b>\$ 657,101</b>	<b>\$ 299,028</b>	<b>\$ 244</b>	<b>\$ 31,434</b>	<b>\$ 987,807</b>

	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
<b>Total</b>	<b>\$ 600,490</b>	<b>\$ 289,236</b>	<b>\$ 143</b>	<b>\$ 27,163</b>	<b>\$ 917,032</b>

## University of Arkansas for Medical Sciences

### Notes to Financial Statements (continued)

#### **18. Subsequent Events**

##### Common Fund Short-Term Fund Liquidity

As discussed in Note 5, UAMS invests cash balances in excess of current requirements in the Common Fund Short-Term Fund (the Fund). The Fund invests in securities with maturities from one day to five and one-half years, but is structured in a manner to allow funds to be available on a daily basis. Accordingly the University considers these assets current investments. On September 29, 2008, as an investor in the Fund, UAMS received notice from Wachovia Bank, in its capacity as Trustee of the Fund, of its decision to initiate the termination of the Fund, to stop accepting deposits, to establish procedures for an orderly liquidation and distribution of the Fund's assets and to resign as Trustee of the Fund. The Trustee took this action upon recognizing that market conditions had become increasingly disrupted, and to ensure fair and equitable treatment of all investors in the Fund. Accordingly, Fund assets, which the Trustee considered less liquid in the current market environment and representing approximately 90% of the Fund's portfolio as of September 26, 2008, were placed in a separate account within the Fund identified as the "Intermediate/Longer-Term Tranche." The assets held in the Intermediate/Longer-Term Tranche were effectively frozen, and were not available for drawdown by investors. A separate pool, identified as the "Immediate Tranche," was also established and held the Fund assets that were readily converted to cash on a same or next-day basis, and available for drawdown. At close of business October 6, 2008, UAMS had \$59,053,000 invested in the Fund, with \$59,053,000 allocated to the Intermediate/Longer-Term Tranche.

Assets held in the Intermediate/Longer-Term Tranche will be liquidated as market conditions permit or as they mature, at which point, they will be transferred to the Immediate Tranche.

Actual performance has exceeded projections based solely on maturity dates. As of October 2, 2008, 36.2% of the Fund's assets were allocated to the Immediate Tranche and were readily available on a same or next-day basis.

Under the terms of the Trustee agreement, Common Fund may designate a successor Trustee who may establish a fund substantially identical to the Fund. Upon establishment, the assets held by Wachovia in their capacity as Trustee, would be transferred to the successor Trustee. Common Fund has indicated its intent to name a successor Trustee as soon as possible, and to establish a substantially identical Fund. Future liquidity projections will likely be positively impacted when this action is completed and with stabilized or improved market conditions.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

**19. New Accounting Pronouncements**

In November 2006, GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, which establishes standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. This statement's reporting requirement will become effective, for UAMS, for the June 30, 2009 fiscal year-end.

In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, which establishes standards to require that all intangible assets, not specifically excluded by its scope provisions, to be classified as capital assets. Additionally, this statement establishes a specified-conditions approach to recognizing intangible assets that are internally generated and provides guidance on recognizing internally generated computer software as an intangible asset. This statement's reporting requirement will become effective, for UAMS, for the June 30, 2010 fiscal year-end.