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UNIVERSITY OF ARKANSAS

Financial Statements

Years Ended June 30, 2011 and 2010

**University of Arkansas
for Medical Sciences**

University of Arkansas for Medical Sciences

Financial Statements

Years ended June 30, 2011 and 2010

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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, 2011 and 2010. UAMS is a state-assisted academic health center composed of:

- The Colleges of Medicine, Pharmacy, Nursing, Health Related Professions, Public Health, Graduate School, and Northwest Arkansas Satellite Campus with a combined enrollment of 2,836 and faculty numbering 1,444;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 373 acute care adult beds in use at June 30, 2011;
- Regional programs including Tele-education, Rural Hospital Program, and eight Area Health Education Centers (AHECs) 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 (PRI); 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, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, 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.

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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, 2011 and 2010, with comparative information for the fiscal year ended June 30, 2009.

University of Arkansas for Medical Sciences

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

FINANCIAL HIGHLIGHTS

UAMS' net assets continued to grow in fiscal year 2011 with assets of \$1,228,123,000 and liabilities of \$496,710,000. Net assets, which represent the residual interest in UAMS' assets after liabilities are deducted, were \$731,413,000 at June 30, 2011. 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, 2011, 2010, and 2009 as follows:

	Year ended June 30		
	2011	2010	2009
	<i>(in thousands)</i>		
Operating revenues	\$ 1,111,413	\$ 1,057,249	\$ 988,358
Operating expenses	(1,140,792)	(1,115,278)	(1,067,034)
Nonoperating revenues	71,609	78,354	35,561
Other changes in net assets	17,237	9,207	47,339
Increase in net assets	\$ 59,467	\$ 29,532	\$ 4,224

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 are 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.

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.

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

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

	June 30		
	2011	2010	2009
	<i>(in thousands)</i>		
Assets			
Current assets	\$ 321,028	\$ 296,648	\$ 283,988
Noncurrent assets:			
Investments	93,155	64,956	55,426
Capital assets, net	738,232	738,483	731,054
Other	75,708	24,888	29,775
Total Assets	1,228,123	1,124,975	1,100,243
Liabilities			
Current liabilities	106,719	108,741	104,367
Noncurrent liabilities	389,991	344,288	353,462
Total Liabilities	496,710	453,029	457,829
Net Assets			
Invested in capital assets, net of related debt	448,381	442,187	425,812
Restricted:			
Expendable	88,905	81,448	86,192
Nonexpendable	27,126	22,726	23,308
Unrestricted	167,001	125,585	107,102
Total Net Assets	731,413	671,946	642,414
Total Liabilities and Net Assets	\$ 1,228,123	\$ 1,124,975	\$ 1,100,243

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), deposits and funds held in trust by others, 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, bonds, notes, and capital leases payable. Noncurrent liabilities include primarily compensated absences payable, other postemployment benefits, and bonds, notes, and capital leases payable, net of current portion. Net assets represent the residual interest in UAMS' assets after liabilities are deducted.

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

Fiscal Year 2011

UAMS' total assets increased by \$103,148,000 for fiscal year 2011. A review of the Statements of Net Assets reveals that the increase consisted of an increase in current assets of \$24,380,000, an increase in long-term investments of \$28,199,000, a decrease of \$251,000 in capital assets, net, an increase in noncurrent deposits and funds held in trust by others of \$52,125,000, and a decrease in noncurrent notes and student loans receivable, net, of \$1,420,000.

The increase in current assets consisted of an increase in investments included in current assets of \$23,347,000, an increase in nonpatient accounts receivable, net, of \$5,405,000, an increase in inventories of \$2,827,000, and an increase in prepaid expenses of \$1,819,000 offset by a decrease in cash and cash equivalents of \$6,814,000 a decrease in patient accounts receivable, net, of \$2,395,000. The decrease in cash and cash equivalents was due to the purchase of investments discussed below offset by improved operating cash flow. The decrease in patient accounts receivable, net, was due to a decrease in days in patient accounts receivable in the Hospital offset by increased activity at Faculty Group Practice (FGP). The increase in inventory is due to supplies necessary to support patient services. The increase in prepaid expense is primarily due to pre-payment of software maintenance and licenses fees. The increase in nonpatient accounts receivable is primarily due to accrued contract and grant revenue. The increase in investments included in current assets is due to a \$20,000,000 cash purchase of investments, and an increase in market value of the investments. The increase in noncurrent deposits and funds held in trust by others was due to the issuance of bonds and notes for capital construction and purchases. The funds are held in escrowed and drawn as needed to fund the capital projects. The decrease in noncurrent notes and student loans receivable, net, was due to scheduled repayments.

The increase in long-term investments is due to a cash purchase of investments of \$16,700,000, and an increase in market value of the investments.

Total liabilities increased by \$43,681,000 for fiscal year 2011. The increase was primarily due to an increase of \$45,584,000 in bond, notes, and capital leases due to the issuance of the Various Facility Revenue Bonds, Series 2010A and 2010B. The issues provide \$46,360,000 for Patient Tower Building Improvements, Winthrop P. Rockefeller Cancer Institute Improvements, Central Energy Improvements, Operating Room and Surgical Suite Improvements, and various other acquisitions and improvements. Current liabilities decreased by \$2,022,000 primarily due to a decrease of \$3,418,000 in accounts payable and accrued expenses and a decrease of \$3,826,000 in estimated third-party payor settlements. Deferred revenues increased by \$2,686,000. Offsetting the \$2,022,000 decrease in current liabilities was an increase in noncurrent liabilities of \$45,703,000.

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

Fiscal Year 2010

UAMS' total assets increased by \$24,732,000 for fiscal year 2010. A review of the Statements of Net Assets reveals that the increase consisted of an increase in current assets of \$12,660,000, an increase in long-term investments of \$9,530,000, an increase of \$7,429,000 in capital assets, net, a decrease in noncurrent deposits and funds held in trust by others of \$3,629,000, and a decrease in noncurrent notes and student loans receivable, net, of \$1,183,000.

The increase in current assets consisted of an increase in cash and cash equivalents of \$16,280,000, an increase in patient accounts receivable, net, of \$7,713,000, an increase in inventories of \$2,147,000, and an increase in prepaid expenses of \$662,000 offset by a decrease in nonpatient accounts receivable, net, of \$9,064,000, and investments included in current assets of \$5,382,000. The increase in cash and cash equivalents was provided by the sales and maturities of investments discussed below and improved operating cash flow. The increase in patient accounts receivable, net, was due to the full-year effect of increased patient admissions after the opening of the new patient tower in mid-January 2009 and an increase in days in patient accounts receivable. The increase in inventory is due to supplies necessary for increased patient volume. The increase in prepaid expense is primarily due to library subscriptions, which are paid in advance in return for credits in the accounts. The decrease in nonpatient accounts receivable is primarily due to the timing of the receipt of state appropriations. The decrease in investments included in current assets is due to \$10,522,000 in the Common Fund, which was classified as an investment in current assets in 2009, being liquidated and moved into cash and cash equivalents as released by the trustee bank. The Common Fund was fully liquidated in fiscal year 2010. The Common Fund liquidation was offset by increased market value of other investments in current assets. The decrease in noncurrent deposits and funds held in trust by others of \$3,629,000 was due to the use of escrowed funds for equipment purchases and debt service. The decrease in noncurrent notes and student loans receivable, net, of \$1,183,000 was due to scheduled repayments.

The increase in long-term investments is due to a cash purchase of investments of \$829,000, a transfer of \$200,000 from investments included in current assets, and an increase in market value of the investments.

The increase in capital assets was primarily due to an increase in construction in progress, buildings and fixtures, and equipment offset by depreciation and amortization charges. A summary of additions to major capital projects is presented in the Capital Assets section of this Management's Discussion and Analysis.

Total liabilities decreased by \$4,800,000 for fiscal year 2010. The decrease was primarily due to a decrease of \$12,621,000 in bond, notes, and capital leases, an increase in

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

Fiscal Year 2010 (continued)

estimated third-party payor settlements, and an increase in liability for other postemployment benefits. Other current liabilities increased by \$337,000 primarily due to an increase of \$2,897,000 in deferred revenue and a decrease of \$2,676,000 in accounts payable and accrued liabilities. Offsetting the \$4,374,000 increase in current liabilities was a decrease in noncurrent liabilities of \$9,174,000.

The decrease in noncurrent liabilities was primarily due to a decrease of \$12,102,000 in bonds, notes, and capital leases payable, which was offset by an increase of \$3,212,000 in compensated absences and other postemployment benefits.

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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:

	Year ended June 30		
	2011	2010	2009
	<i>(in thousands)</i>		
Operating Revenues			
Student tuition and fees, net of scholarship allowances	\$ 23,576	\$ 22,300	\$ 20,374
Net patient services	868,685	834,821	781,472
Sponsored programs	172,468	155,127	145,962
Other	46,684	45,001	40,550
Total Operating Revenues	1,111,413	1,057,249	988,358
Operating Expenses			
Compensation and benefits	757,978	740,442	707,091
Supplies and other services	331,131	325,738	316,792
Scholarships and fellowships	258	234	3
Depreciation and amortization	51,425	48,864	43,148
Total Operating Expenses	1,140,792	1,115,278	1,067,034
Operating Loss	(29,379)	(58,029)	(78,676)
Nonoperating Revenues (Expenses)			
State appropriations, net	47,709	56,817	44,390
Gifts	19,516	17,754	18,143
Investment gain (loss), net of expense	17,738	15,953	(14,585)
Other	(13,354)	(12,170)	(12,387)
Total Nonoperating Revenues, net	71,609	78,354	35,561
Income (Loss) before Other Changes in Net Assets	42,230	20,325	(43,115)

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

	Year ended June 30		
	2011	2010	2009
	<i>(in thousands)</i>		
Other Changes in Net Assets			
Capital gifts and appropriations	\$ 15,758	\$ 9,882	\$ 49,501
Federal Perkins Loan Capital Contribution	-	-	(2,162)
Federal grants/capital projects	1,479	-	-
Interagency disposition	-	(675)	-
Total Other Changes in Net Assets	<u>17,237</u>	<u>9,207</u>	<u>47,339</u>
Increase in Net Assets	59,467	29,532	4,224
Net Assets – beginning of year	671,946	642,414	638,190
Net Assets – end of year	<u>\$ 731,413</u>	<u>\$ 671,946</u>	<u>\$ 642,414</u>

Fiscal Year 2011

The Statement of Revenues, Expenses, and Changes in Net Assets reflects income before other changes in net assets of \$42,230,000, and an increase of \$59,467,000 in net assets for fiscal year 2011. Highlights of the information presented in this statement show how the following affected operating revenue:

Net patient services revenue increased by \$33,864,000 or 4.1 %. The increase in net patient service revenue is due to growth in Hospital patient discharges and in outpatient visits. Hospital patient service revenue was up \$15,142,000 or 2.9%, College of Medicine patient service revenue was up \$17,911,000 or 8.8%, and other UAMS divisions had a modest increase in patient service revenue. Sponsored Programs, which include federal grants and contracts, state and local grants and contracts, and nongovernmental grants and contracts, increased by \$17,342,000. Federal grants and contracts increased by \$11,321,000, of which \$6,115,000 was related to the American Recovery and Reinvestment Act (ARRA) with the balance being from normal grant activity. Nongovernmental grants and contracts increased by \$5,868,000 primarily due to increased contract activity in the College of Medicine and in the Arkansas Center for Health Improvement. The total operating revenue increase was 5.1%.

The following factors affected operating expenses in 2011:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2011, increasing by \$17,536,000 or 2.4%. Compensation and benefits expense related to patient care decreased by \$235,000, due to the staffing adjustments that were undertaken in fiscal year 2010. Compensation and benefits

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

Fiscal Year 2011 (continued)

related to instruction, academic support and student services increased by \$5,531,000 or 4.1%, due to increased faculty and staff, which supports increased enrolment and programs and normal salary increases and increased benefit expense. Compensation and benefits related to research increased by \$3,457,000 or 5.3% primarily due to the ARRA funding. The balance of the increase in compensation and benefits was the result of normal salary increases and increased benefits expense. Total supplies and other services increased by \$5,394,000 or 1.7%. Supplies and other services related to patient care decreased by \$2,434,000 or 1.1% due to the continuation of cost controls implemented in fiscal year 2010. Supplies and other services related to instruction, academic support, and student services increased by \$3,207,000 primarily to support increased enrolment and programs. Supplies and other services related to research increased by \$2,064,000 primarily due to the ARRA funding. The balance of the change in supplies and other services were primarily related to operations and maintenance of plant and other services.

The following factors affected nonoperating revenue (expense) in 2011:

Nonoperating revenue (expense) decreased by \$6,745,000. This was primarily caused by a decrease in \$9,108,000 in net state appropriations. Gross state appropriations were up by \$303,000 or 0.3%. Offsetting this small increase was an increase in Medicaid match payments, which are reported as a decrease to state appropriated revenue. The decrease in net state appropriations were partially offset by increased investment income and gifts from the University of Arkansas and private foundations.

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, 2011, 2010, and 2009 was as follows:

	2011	2010	2009
	<i>(in thousands)</i>		
Gross state appropriations revenue	\$114,515	\$ 114,213	\$106,404
Less Medicaid match payments	66,806	57,396	62,014
Net state appropriations revenue	\$ 47,709	\$ 56,817	\$ 44,390

University of Arkansas for Medical Sciences

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

Fiscal Year 2010

The Statement of Revenues, Expenses, and Changes in Net Assets reflects income before other changes in net assets of \$20,325,000, and an increase of \$29,532,000 in net assets for fiscal year 2010. Highlights of the information presented in this statement show how the following affected operating revenue:

Net patient services revenue increased by \$52,681,000 or 6.7%. The increase in net patient service revenue is due to growth in patient volume in part due to the full-year effect from the opening of the patient bed tower and the PRI building in the third quarter of fiscal year 2009. Hospital patient service revenue was up \$33,998,000 or 6.7%, College of Medicine patient service revenue was up \$12,953,000 or 5.5%, PRI patient service revenue was up \$5,259,000 or 54.4%, and other UAMS divisions had a modest increase in patient service revenue. Sponsored Programs, which include federal grants and contracts, state and local grants and contracts, and nongovernmental grants and contracts, increased by \$9,165,000. Federal grants and contracts increased by \$11,145,000, of which \$9,030,000 was related to the ARRA with the balance being from normal grant activity, state and local grants and contracts increased by \$1,377,000, and nongovernmental grants and contracts decreased by \$3,357,000 due to decreased activity in several of the divisions. Other revenue, which increased by \$4,452,000, includes auxiliary enterprises, which increased by \$1,715,000 primarily from housing and food services and other miscellaneous revenue sources. The total operating revenue increase was 6.9%.

The following factors affected operating expenses in 2010:

Compensation and benefits expense was a major driver in operating expense in fiscal year 2010, increasing by \$33,351,000 or 4.7%. Compensation and benefits expense related to patient care increased by \$13,284,000 or 3.5% due to staffing to support increased patient volume discussed above under net patient service revenue, coupled with a decrease of 393 full-time equivalent employees (FTEs) in the second half of the year. Compensation and benefits related to research increased by \$6,349,000 or 10.8% primarily due to the ARRA funding. The balance of the increase in compensation and benefits was the result of normal salary increases and increased benefits expense. Total supplies and other services increased by \$8,279,000 or 2.6%. Supplies and other services related to patient care increased by \$1,974,000 due to the increase in patient volume discussed above. Supplies and other services related to research increased by \$2,370,000 primarily due to the ARRA funding.

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

Fiscal Year 2010 (continued)

The following factors affected nonoperating revenue (expense) in 2010:

Nonoperating revenue (expense) increased by \$42,793,000. This was primarily caused by an increase in investment income, net of expense, of \$30,538,000. The main driver of the increase in investment gain was a rebound in the market value of investments. The net gain on investments for 2010 was \$15,953,000. Realized and unrealized gains in fiscal year 2010 were \$31,883,000 more than fiscal year 2009. Additional investment income earned on investments decreased by \$1,292,000 primarily due to a decrease in invested funds held in trust and a decrease in the average rate of return received on investments. An increase of \$12,427,000 in net state appropriations and \$2,040,000 from a state appropriation of the ARRA funds was offset by an increase in interest expense of \$2,046,000 and a decrease of \$389,000 from the University of Arkansas and private foundations.

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 DHS.

Net state appropriations revenue for the years ended June 30, 2010, 2009, and 2008 was as follows:

	2010	2009	2008
	<i>(in thousands)</i>		
Gross state appropriations revenue	\$ 114,213	\$106,404	\$109,557
Less Medicaid match payments	57,396	62,014	63,794
Net state appropriations revenue	\$ 56,817	\$ 44,390	\$ 45,763

Results of Operations

Fiscal Year 2011

In fiscal year 2011, UAMS experienced income before other changes in net assets of \$42,230,000 and an increase in net assets of \$59,467,000. Investment income accounted for \$17,738,000 of the income. Excluding the investment income, UAMS had income of \$24,492,000 from ongoing operations, which will be discussed below. The primary driver of other changes in net assets was capital gifts for the expansion of the Winthrop P. Rockefeller Cancer Institute, the Institute on Aging, and other renovation and construction projects.

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

Although the overall financial position improved in 2011, there were some occurrences that adversely affected the financial position:

Total compensation and employee benefits increased by \$17,536,000 or 2.4%. The overall increase in compensation and employee benefits was driven in part by spending related to the ARRA programs. UAMS implemented cost-saving measures in fiscal year 2010 that contributed to the slowing of the increase in compensation and benefits from prior years. This included a reduction in average FTEs of 189 in fiscal year 2011 from fiscal year 2010.

Net patient service revenue increased by \$33,864,000 or 4.1%. The increase in net patient service revenue is due to growth in Hospital patient discharges and in outpatient visits. However, volumes and revenue from both inpatient and outpatient services were below anticipated levels for the second year in a row.

Gross state appropriations increased by \$303,000, and continue to decline as a share of UAMS revenue to approximately 9.6% and 9.9% for fiscal years 2011 and 2010, respectively.

Fiscal Year 2010

In fiscal year 2010, UAMS experienced income before other changes in net assets of \$20,325,000 and an increase in net assets of \$29,532,000. Investment income accounted for \$15,953,000 of the income. Excluding the investment income, UAMS had income of \$4,372,000 from ongoing operations, which will be discussed below. The primary driver of other changes in net assets was capital gifts for the expansion of the Winthrop P. Rockefeller Cancer Institute.

Although the overall financial position improved in 2010, there were some occurrences that adversely affected the financial position:

Total compensation and employee benefits increased by \$33,351,000 or 4.7%, with \$13,284,000 or 3.5%, of this increase was related to patient care. The overall increase in compensation and employee benefits was driven in part by spending related to the ARRA programs. UAMS implemented cost saving measures in the second quarter of fiscal year 2010 that contributed to the slowing of the increase in compensation and benefits from prior years. This included a reduction in FTEs of 393 over the second half of the year with the total FTE headcount decreasing from 9,800 at September 30, 2009 to 9,407 at June 30, 2010.

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

Fiscal Year 2010 (continued)

Net patient service revenue increased by \$52,681,000 or 6.7%. The increase in net patient service revenue is due to growth in patient volume in part from the opening of the new patient bed tower and the PRI building in the third quarter of fiscal year 2009. Volumes and revenue from both inpatient and outpatient services were below anticipated levels.

Gross state appropriations increased by \$7,809,000, primarily due to additional appropriations for fiscal year 2010 to support the UAMS – Healthcare Initiative, which is composed of the following:

<u>Program</u>	<u>Appropriation</u>
Area Health Education Centers	\$3,400,000
Arkansas Health Data Initiative	700,000
UAMS Northwest Arkansas Medical School	3,000,000
	<u>\$7,100,000</u>

Even with this increase in appropriation, gross state appropriation declined as a share of UAMS revenue to approximately 9.9% and 10.1% for fiscal years 2010 and 2009, respectively.

University of Arkansas for Medical Sciences

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

CAPITAL ASSETS AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2011, UAMS had \$738,232,000 invested in capital assets, net of accumulated depreciation and amortization of \$417,039,000. Depreciation and amortization charges totaled \$51,425,000 for the fiscal year ended June 30, 2011.

UAMS' capital additions totaled \$52,081,000 in fiscal year 2011. 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 2011 and the sources that funded their acquisition included:

Project	Amount of Additions <i>(in thousands)</i>	Funding Source
Winthrop P. Rockefeller Cancer Institute Tower	\$ 15,053	Winthrop P. Rockefeller Cancer Institute Foundation, State Appropriation, UAMS
Donald W. Reynolds Institute on Aging	6,131	Donald W. Reynolds Foundation
Information Technology Data Center	5,522	UAMS
Land for future clinical expansion in West Little Rock	3,712	UAMS

Construction in progress at June 30, 2011 included the Donald W. Reynolds Institute on Aging expansion, the Jones Eye Institute expansion, and the Central Energy Plant upgrade. More detailed information about UAMS' capital assets is presented in Note 7 to the financial statements.

Debt Administration

At June 30, 2011, UAMS had \$407,672,000 in outstanding obligations, as shown in the following table:

Obligation	Amount Outstanding <i>(in thousands)</i>
Bonds payable	\$ 301,704
Notes payable	7,363
Obligations under capital leases	35,698
Compensated absences	43,634
Other postemployment benefits	19,273
	\$ 407,672

University of Arkansas for Medical Sciences

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

Moody's Investors Service raised the rating of the University of Arkansas System from Aa3 to Aa2 in May 2010, which was affirmed on May 31, 2011. 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' net assets increased in fiscal year 2011 as evidenced by a \$59,467,000 increase in net assets. As discussed above in results of operations for fiscal year 2011, excluding capital gifts and appropriations, UAMS had a gain of \$42,230,000 for the fiscal year. Investment income accounted for \$17,738,000 of the gain. Excluding investment income, UAMS had a gain of \$24,492,000 from ongoing operations.

UAMS has a 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. However, UAMS is highly dependent on patient service revenue, which is 72.6% of total revenue.

UAMS' hospital and clinics are experiencing the same challenges as the general healthcare sector in the current economic environment, including potential reimbursement pressures from third-party payors, rising charity care, and softening volumes. To mitigate the unfavorable impact of the current economic environment, UAMS will be required to seek other revenue and growth opportunities, reduce costs, or some combination of both.

With the larger emergency room capacity of the new hospital, UAMS has experienced more emergency room visits as noted by the average monthly visits increasing from 3,286 in fiscal year 2008 to 4,307 and 4,516 in fiscal years 2010 and 2011, respectively.

In September 2010, UAMS was the first hospital in Arkansas to receive a Level 1 designation from the Arkansas Department of Health for providing the highest level of trauma care. The system is intended to provide faster care for trauma patients who need urgent treatment. The statewide trauma care system is funded by an increase in state tobacco taxes. Additionally, utilization of Hospital services by self-pay patients has increase by approximately 2.0% in the first two months of fiscal year 2012 compared to the same period in the prior fiscal year. This increase in self-pay patients has negatively impacted net patient service revenue by approximately \$1,800,000 in the first two months of fiscal year 2012.

University of Arkansas for Medical Sciences

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

Management recognizes the absolute necessity of cost control. To assist management, Navigant Consulting Inc. of Chicago (Navigant) was hired in February 2010 to identify expense reduction targets and income generating opportunities. Navigant has provided management with recommendations to enhance the UAMS bottom line and was actively engaged with UAMS staff in implementing the necessary changes during fiscal year 2011. As an example, Navigant has assisted UAMS in improving patient billing procedures, staffing patterns, and medical supply contracts and utilization. UAMS will use some of the savings to continue significant investments in clinical and campus infrastructure in order to generate necessary productivity gains, more closely manage clinical practice and outcomes, continue to increase patient safety, and to remain compliant with an ever-growing regulatory burden. UAMS is actively involved in planning for the opportunities and challenges provided by the *Patient Protection and Affordable Care Act* (PPACA). Opportunities include having more UAMS patients insured, and attempting to stop the eroding payor mix. Challenges include the possible reduction in federal payments to safety net providers, such as UAMS, who provide care to indigent patients, and the infrastructure cost required to comply with PPACA and to participate in new opportunities, such as the Accountable Care Organization.

On the national scene, many of UAMS revenue streams are at risk. National Institute of Health (NIH) funding is being threatened with budget cuts. NIH provides \$76,702,000 in funds to UAMS. Medicare reimbursement is at risk on many fronts. Physician payments and annual updates are being reviewed with a goal of reducing payments. All Medicare patient care reimbursements are the subject of heightened audits by contractors incited to take back money from providers. Graduate Medical Education and specifically Indirect Medical Education are targeted for 10% reductions. The drive for national deficit reduction is almost certain to impact federal reimbursement in the form of Medicaid, Medicare, NIH, and other agency funding.

State operating support, which represents 9.6% of UAMS' revenue, is also under pressure due to the current economic conditions.

On the positive side, as of June 30, 2011, UAMS has been awarded \$137,855,000 in the ARRA stimulus funds including \$102,131,000 for the Broadband Technology Opportunities Program.

Management understands its current operating challenges and is committed to maintaining an operating margin that will position UAMS to deal with the impact of healthcare reform and allow for investment in technology, research, and human capital.

University of Arkansas for Medical Sciences

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

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, 2011 and 2010, 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 to the financial statements, 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, 2011 and 2010, the changes in its net assets and its 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 the University of Arkansas for Medical Sciences as of June 30, 2011 and 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2011 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 18 and the schedule of funding progress on page 56 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 14, 2011

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

	June 30	
	2011	2010
Assets:		
Current Assets:		
Cash and cash equivalents (Note 4)	\$ 86,736	\$ 93,550
Investments (Note 5)	72,674	49,327
Patient accounts receivable, net (Note 2)	105,834	108,229
Nonpatient accounts receivable (net of allowances of \$337 in 2011 and \$922 in 2010)	27,442	22,037
Inventories	20,575	17,748
Notes and student loans receivable, net (Notes 6 and 14)	2,678	2,487
Prepaid expenses	5,089	3,270
Total Current Assets	321,028	296,648
Noncurrent Assets:		
Investments (Note 5)	93,155	64,956
Notes and student loans receivable, net (Notes 6 and 14)	16,969	18,389
Deposits and funds held in trust by others (Note 5)	55,495	3,370
Capital assets, net (Note 7)	738,232	738,483
Other noncurrent assets	3,244	3,129
Total Noncurrent Assets	907,095	828,327
Total Assets	\$ 1,228,123	\$ 1,124,975
Liabilities:		
Current Liabilities:		
Accounts payable and accrued liabilities (Note 8)	\$ 70,837	\$ 74,255
Deferred revenue	8,475	5,789
Funds held in trust for others	550	1,938
Estimated third-party payor settlements (Note 2)	7,245	11,071
Compensated absences payable, current portion (Note 9)	2,596	2,102
Bonds, notes, and capital leases payable, current portion (Notes 9 and 10)	17,016	13,586
Total Current Liabilities	106,719	108,741
Noncurrent Liabilities:		
Deposits	20	59
Compensated absences payable, net of current portion (Note 9)	41,038	40,072
Liability for other postemployment benefits (Notes 9 and 12)	19,273	16,651
Federal Capital Contribution for Perkins Loan Program	1,911	1,911
Bonds, notes, and capital leases payable, net of current portion (Notes 9 and 10)	327,749	285,595
Total Noncurrent Liabilities	389,991	344,288
Total Liabilities	496,710	453,029
Commitments and Contingencies (Notes 10, 11, 12, and 15)		
Net Assets:		
Invested in capital assets, net of related debt	448,381	442,187
Restricted:		
Expendable	88,905	81,448
Nonexpendable	27,126	22,726
Unrestricted	167,001	125,585
Total Net Assets	731,413	671,946
Total Liabilities and Net Assets	\$ 1,228,123	\$ 1,124,975

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	
	2011	2010
Revenues:		
Operating Revenues:		
Student tuition and fees (net of scholarship allowances of \$4,759 in 2011 and \$3,872 in 2010)	\$ 23,576	\$ 22,300
Net patient services (Note 2)	868,685	834,821
Sponsored programs:		
Federal grants and contracts	100,930	89,609
State and local grants and contracts	20,152	19,999
Nongovernmental grants and contracts	51,386	45,518
Sales and services of educational departments	29,746	27,159
Auxiliary enterprises:		
Housing and food service	6,176	7,213
Bookstore	665	719
Other auxiliary enterprises	2,531	2,468
Other operating revenue	7,566	7,443
Total Operating Revenues	1,111,413	1,057,249
Expenses:		
Operating Expenses (Note 16):		
Compensation and benefits	757,978	740,442
Supplies and other services	331,131	325,738
Scholarships and fellowships	258	234
Depreciation and amortization (Note 7)	51,425	48,864
Total Operating Expenses	1,140,792	1,115,278
Operating Loss	(29,379)	(58,029)
Nonoperating Revenues (Expenses):		
State appropriations, net (Note 3)	47,709	56,817
State appropriation of ARRA funds	2,040	2,040
Gifts	19,516	17,754
Investment income, net of investment expense (Note 5)	17,738	15,953
Interest on debt	(15,015)	(13,984)
Loss on disposal of capital assets	(379)	(226)
Total Nonoperating Revenues, net	71,609	78,354
Income Before Other Changes in Net Assets	42,230	20,325

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

	Year ended June 30	
	2011	2010
Other Changes in Net Assets:		
Capital gifts	\$ 15,405	\$ 9,696
Capital appropriations	353	186
Federal grants capital projects	1,479	-
Other		(675)
Total Other Changes in Net Assets	17,237	9,207
Increase in Net Assets	59,467	29,532
Net Assets – beginning of year	671,946	642,414
Net Assets – end of year	\$ 731,413	\$ 671,946

See accompanying notes to financial statements.

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

	Year ended June 30	
	2011	2010
Cash Flows from Operating Activities:		
Tuition and fees (net of scholarships)	\$ 26,270	\$ 25,009
Patient and insurance payments	862,751	831,384
Sponsored programs	170,334	154,250
Collection of loans and interest	2,195	1,921
Auxiliary enterprise revenue:		
Housing and food service	6,176	7,211
Bookstore	665	719
Other auxiliary enterprises	2,734	2,655
Other receipts	36,395	32,867
Payments to suppliers	(326,721)	(319,416)
Payments to employees	(607,697)	(598,910)
Payments of employee benefits	(145,613)	(141,018)
Loans issued to students	(3,114)	(2,156)
Scholarships and fellowships	(258)	(234)
Other payments	(10,274)	(8,459)
Net cash and cash equivalents provided by (used in) operating activities	13,843	(14,177)
Cash Flows from Noncapital Financing Activities:		
State appropriations	48,208	66,536
Gifts and grants	38,442	19,795
Other agency funds (net)	(1,388)	(551)
Net cash and cash equivalents provided by noncapital financing activities	85,262	85,780
Cash Flows from Capital and Related Financing Activities		
Proceeds from issuance of debt	55,114	8,165
Capital appropriations	300	100
Proceeds from sale of capital assets	67	47
Purchases of capital assets	(39,166)	(41,258)
Principal paid on capital debt and leases	(21,385)	(23,642)
Interest and paying agent fees paid on debt and capital leases	(14,916)	(14,169)
Net cash and cash equivalents used in capital and related financing activities	(19,986)	(70,757)

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

	Year ended June 30	
	2011	2010
Cash Flows from Investing Activities:		
Proceeds from sales and maturities of investments	\$ 20,486	\$ 41,683
Interest on investments (net of fees)	670	1,592
Purchases of investments	(107,089)	(27,841)
Net cash and cash equivalents provided by (used in) investing activities	(85,933)	15,434
Net increase (decrease) in cash and cash equivalents	(6,814)	16,280
Cash and cash equivalents – beginning of year	93,550	77,270
Cash and cash equivalents – end of year	\$ 86,736	\$ 93,550
Operating loss	\$ (29,379)	\$ (58,029)
Adjustments to reconcile net operating loss to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	51,425	48,864
Changes in assets and liabilities:		
Patient and nonpatient accounts receivable, net	(3,181)	(10,869)
Inventories	(2,827)	(2,147)
Other assets	(1,467)	(629)
Accounts payable and accrued liabilities	(3,632)	(2,415)
Deferred revenue	2,686	2,897
Deposits	(38)	(33)
Compensated absences payable	1,460	387
Other liabilities	(1,204)	7,797
Net cash and cash equivalents provided by (used in) operating activities	\$ 13,843	\$ (14,177)
Noncash transactions:		
Fixed assets acquired by capital gift	\$ 15,405	\$ 9,696
Fixed asset acquisition paid for by State of Arkansas	52	86
Fixed assets acquired by incurring capital lease obligations	11,855	2,845
Fixed assets acquired by notes payable	5,878	11

See accompanying notes to financial statements.

University of Arkansas for Medical Sciences

Notes to Financial Statements

June 30, 2010 and 2009

1. Summary of Significant Accounting Policies

The University of Arkansas (University) 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's ten-member Board of Trustees (UA Board).

Basis of Presentation – UAMS accounts for its activities through the use of an enterprise fund. Enterprise funds are used to account for activities similar to those found in the private sector, where the determination of a change in financial position is necessary or useful for sound financial administration. The accounting records of UAMS are organized on the basis of funds as prescribed by 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, Graduate School and Northwest Arkansas Satellite Campus;
- The University Hospital of Arkansas (the Hospital), a tertiary care referral center with 373 acute care adult beds in use at June 30, 2011;
- Regional programs including Tele-education, Rural Hospital Program, and eight Area Health Education Centers (AHECs) 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 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 4,947,000 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 and other investments is based on the most current information reported to UAMS by the respective investment managers. All investment income, including changes in the fair value of investments, is reported as nonoperating revenue.

The UA Board and the University of Arkansas Foundation Board of Trustees established an external investment pool (the Pool). This arrangement commingles (pools) the moneys of more than one legally separate entity and invests, on the participants' behalf, in an investment portfolio. The governmental external investment pool is exempt from registration with the SEC. The UA Board and the University of Arkansas Foundation Board of Trustees are the sponsors of this investment pool and are responsible for operation and oversight for the pool. All participation in this investment pool 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. Detailed disclosure information about the Pool may be obtained by writing or calling the University of Arkansas System, 2404 North University Avenue, Little Rock, Arkansas 72207-3608, 501-686-2500.

In January 2010, the University of Arkansas Investment Committee approved an agreement that delegated authority to the UA Foundation to manage University funds held in the Pool. The agreement included delegation of all responsibility for all investment guidelines and performance objectives for accounts within the Pool. The agreement also delegated to the UA Foundation authority for further delegation of

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

portfolio implementation decisions to one or more investment managers. In January 2010, the UA Foundation entered into such an agreement with Cambridge Associates, LLC.

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

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

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

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

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 all capital assets other than software. The software capitalization threshold is \$500,000 for purchased and internally developed software. 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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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, etc.). 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 – Deferred revenue consists of student tuition and fees applicable to subsequent accounting periods.

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), state appropriation of the ARRA funds, nonoperating gifts, grants and bequests, capital contributions, loss on disposal of capital assets, investment income, interest on debt, 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 moneys 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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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 were effective from July 1, 2010 through June 30, 2013.

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.

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 UA Board. Externally restricted funds may only be utilized in accordance with the purposes established by the donor or grantor, whereas unrestricted funds may be used by UAMS in achieving any of its institutional purposes.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

1. Summary of Significant Accounting Policies (continued)

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.

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 UA Board. Patient care operations are included in the accompanying financial statements under accounting principles generally followed by governmental colleges and universities. Patient accounts receivable at June 30, 2011 and 2010 are recorded net of an allowance for doubtful accounts of \$501,990,000 and \$489,539,000, respectively.

Net patient services revenue for the years ended June 30, 2011 and 2010 is as follows (*in thousands*):

	2011	2010
Gross patient revenue	\$ 1,898,508	\$ 1,816,865
Less patient services contractual allowances	963,433	894,369
Less provision for bad debts	66,390	87,675
Net patient services revenue	<u>\$ 868,685</u>	<u>\$ 834,821</u>

UAMS provided approximately \$109,050,000 and \$106,226,000 in charity care, based on established rates, during the years ended June 30, 2011 and 2010, 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, 2011 and 2010 includes approximately \$74,890,000 and \$69,416,000, 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, 2011 and 2010 includes approximately \$26,027,000 and \$25,732,000, respectively, of net revenue from the Supplemental Medicaid program.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

The Hospital, FGP, and AHECs have agreements with governmental and other third-party payors that provide for reimbursement at amounts different from their established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the billings at established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with significant third-party payors is as 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, 2011, the Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2008.
- 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 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, 2011, the Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2008.

FGP and AHECs:

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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The net adjustments to estimated settlements resulted in an increase to net patient services revenue of \$101,000 and a decrease to net patient services revenue of \$2,939,000 for the years ended June 30, 2011 and 2010, 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 revenues, expenses, and changes in net assets as Nonoperating Revenue, net of the Medicaid match payments required under various contracts between UAMS and the DHS.

Net state appropriations revenue for the years ended June 30, 2011 and 2010 is as follows (*in thousands*):

	<u>2011</u>	<u>2010</u>
Gross state appropriations revenue	\$ 114,515	\$ 114,213
Less Medicaid match payments	66,806	57,396
Net state appropriations revenue	<u>\$ 47,709</u>	<u>\$ 56,817</u>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

4. Cash and Cash Equivalents

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

UAMS' deposits at June 30, 2011 and 2010 are categorized below to give an indication of the level of risk assumed by UAMS at each year-end. Category 1 includes deposits that are insured or collateralized with securities held by UAMS or by its agent in UAMS' name. Category 2 includes uninsured deposits collateralized with securities held by the pledging financial institution's trust department or agent in UAMS' name. Category 3 includes uncollateralized deposits or deposits collateralized with securities held by the pledging financial institution, or by its trust department or agent, but not in UAMS' name. Amounts are shown in thousands.

	Carrying Amount	Bank Balance	Category		
			1	2	3
Cash at June 30, 2011	\$ 86,736	\$ 103,415	\$ 103,415	\$ -	\$ -
Cash at June 30, 2010	93,550	108,666	108,666	-	-

At June 30, 2011 and 2010, Category 1 is composed of \$1,689,000 and \$1,005,000, respectively, of insured deposits and \$101,726,000 and \$107,661,000, respectively, of securities that are held in custody by the Federal Reserve Bank.

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

	June 30	
	2011	2010
Reported amount of deposits under GASB 3 as reported in the statements of net assets	\$ 86,736	\$ 93,550
Cash and Cash Equivalents	\$ 86,736	\$ 93,550

Deposits and Funds Held in Trust as reported in the Statements of Net Assets include money market accounts of \$48,170,000.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

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; U.S. 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 (*in thousands*):

Investment Type	2011 Fair Value	2010 Fair Value
Commingled Funds	\$ 3,353	\$ 3,311
U.S. Equity	2,427	1,482
U.S. Fixed Income	926	931
Money Market Funds	–	498
Other Investments	169,802	114,342
Escrow Accounts	6,796	1,762
External Investment Pool	163,006	11,902
2004 Bond Funds held in Trust	–	678
Total	\$ 173,155	\$ 117,653

The activities during fiscal year 2011 affecting UAMS' investments are summarized below (*in thousands*):

	Total Return Pool	Short/ Intermediate Pool	Other Investments	Total
June 30, 2010	\$ 62,575	\$ 49,327	\$ 5,751	\$ 117,653
Income	963	2,113	80	3,156
Realized gains	889	1,176	12	2,077
Unrealized gains	10,875	361	466	11,702
Expenses paid	(309)	(34)	(4)	(347)
Sales	15,339	19,731	3,844	38,914
June 30, 2011	\$ 90,332	\$ 72,674	\$ 10,149	\$ 173,155

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

The activities during fiscal year 2010 affecting UAMS' investments are summarized below (*in thousands*):

	Total Return Pool	Short/ Intermediate Pool	Other Investments	Total
June 30, 2009	\$ 53,223	\$ 44,187	\$ 19,724	\$ 117,134
Income	986	2,180	301	3,467
Realized gains (losses)	(2,666)	2,068	141	(457)
Unrealized gains	10,422	1,171	631	12,224
Expenses paid	(419)	(79)	(12)	(510)
Sales	1,029	(200)	(15,034)	(14,205)
June 30, 2010	<u>\$ 62,575</u>	<u>\$ 49,327</u>	<u>\$ 5,751</u>	<u>\$ 117,653</u>

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

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

	June 30	
	2011	2010
Fair value at June 30	\$ 26,367	\$ 23,121
Number of units in Pool at June 30	463,474	463,402
Fair value per unit at June 30	\$ 56.89	\$ 49.89
Realized gains for the year	309	(1,006)
Income earned for the year	328	375
Realized gains per unit	0.66	(2.17)
Income earned per unit	0.71	0.81
Total income (loss) per unit	<u>\$ 1.37</u>	<u>\$ (1.36)</u>

The calculation of realized gains and losses is independent of the calculation of the net change in the fair value of investments. Additionally, realized gains and losses on investments held in more than one fiscal year and sold in fiscal years 2011 and 2010 were included as a change in the fair value of investments reported in fiscal years 2011 and 2010.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

The following table contains information on the risk disclosure for the Pool, which commingles (pools) the moneys 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 and the University of Arkansas Foundation. During 1998, the Walton Arts Foundation joined the Pool, and during 2003, the Fayetteville Campus Foundation joined the Pool. The participants of the Pool have adopted investment guidelines and performance objectives for the accounts within the Pool. This information is provided in total for the pools, which include the Total Return Pool, the Intermediate Pool, and the Cash Pool. UAMS owned 11.5% of the total of these pools as of June 30, 2011 and 9.4% as of June 30, 2010.

EXTERNAL INVESTMENT POOL

Statement of Invested Assets (in thousands)

Investment Type	2011 Fair Value	2010 Fair Value
Fixed Income	\$ 498,074	\$ 440,838
Government Bonds	85,816	101,154
Corporate Bonds	80	86
Other Fixed Income	412,178	339,598
Venture Capital and Partnerships	494,674	390,370
Partnerships	494,674	390,370
Equity	345,171	284,861
Common Stock	345,097	284,831
Preferred Stock	74	30
Hedge Fund	73,769	59,317
Hedge Equity	73,769	59,317
Other	81	62
Cash/Cash Equivalents	8,103	11,606
Short Term Investment Funds	12,843	15,030
Cash	(4,743)	(3,958)
Invested Cash	3	534
Total	\$ 1,419,872	\$ 1,187,054

In accordance with the Policy, the Pool 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 U.S. Treasury and Agency obligations, the portfolio shall contain no more than 5% exposure to any issuer. The following tables present the credit risk associated with the portfolio.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

5. Investments (continued)

Credit Risk – S&P Quality Ratings at June 30, 2011

Investment Type	S&P Quality Rating by Fair Value (in thousands)						
	Total Fair Value	AAA	AA	A	BBB	NR, CCC, and Below	U.S. Government Guaranteed
Corporate Bonds	\$ 80	\$ -	\$ -	\$ -	\$ -	\$ 80	\$ -
Government Bonds	85,816	2,943	2,594	621	646	30,917	48,095
Other Fixed Income	412,178	-	-	-	-	412,178	-
Short Term Investment Funds	12,843	-	-	-	-	12,843	-
Total	\$ 510,917	\$ 2,943	\$ 2,594	\$ 621	\$ 646	\$ 456,018	\$ 48,095

Investment Type	Investment Maturities in Years (in thousands)					
	Total Fair Value	Less than 1	1 – 5	6 –10	More than 10	Maturity not Determined
Corporate Bonds	\$ 80	\$ 52	\$ 28	\$ -	\$ -	\$ -
Government Bonds	85,816	-	17,926	56,954	10,936	-
Other Fixed Income	412,178	-	-	-	-	412,178
Short Term Investment Funds	12,843	-	-	-	-	12,843
Total	\$ 510,917	\$ 52	\$ 17,954	\$ 56,954	\$ 10,936	\$ 425,021

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 benchmarks (the Lehman Brothers Intermediate Government Credit LB Int. G/C Index) duration.

Investment Type	2011 Fair Value (in thousands)	Effective Duration (Years)	2010 Fair Value (in thousands)	Effective Duration (Years)
Corporate Bonds	\$ 80	2.68	\$ 86	2.68
Government Bonds	85,816	7.52	101,154	7.52
Other Fixed Income	412,178	N/A	339,598	N/A
Short Term Investment Funds	12,843	N/A	15,030	N/A
Total	\$ 510,917		\$ 455,863	N/A

Credit Risk – S&P Quality Ratings – at June 30, 2010

Investment Type	S&P Quality Rating by Fair Value (in thousands)						
	Total Fair Value	AAA	AA	A	BBB	NR, CCC and Below	U.S. Government Guaranteed
Corporate Bonds	\$ 86	\$ -	\$ -	\$ -	\$ -	\$ 86	\$ -
Government Bonds	101,154	29,452	7,148	11,569	42	4,833	48,110
Other Fixed Income	339,598	-	-	-	-	339,598	-
Short Term Investment Funds	15,030	-	-	-	-	15,030	-
Total	\$ 455,868	\$ 29,452	\$ 7,148	\$ 11,569	\$ 42	\$ 359,547	\$ 48,110

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

Investment Type	Investment Maturities in Years (<i>in thousands</i>)					
	Total Fair Value	Less than 1	1 – 5	6 –10	More than 10	Maturity not Determined
Corporate Bonds	\$ 86	\$ -	\$ 86	\$ -	\$ -	\$ -
Government Bonds	101,154	50	25,524	61,975	13,605	-
Other Fixed Income	339,598	-	-	-	-	339,598
Short Term Investment Funds	15,030	-	-	-	-	15,030
Total	\$ 455,868	\$ 50	\$ 25,610	\$ 61,975	\$ 13,605	\$ 354,628

ARKANSAS CODE

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

28-69-604 Rule of construction. Subject to the intent of a donor expressed in the gift instrument, an institution may appropriate for expenditure or accumulate so much of an endowment fund as the institution determines is prudent for the uses, benefits, purposes, and duration for which the endowment fund is established. Unless stated otherwise in the gift instrument, the assets in an endowment fund are donor-restricted assets until appropriated for expenditures by the institution.

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, 2011 and 2010, net of allowances of \$4,355,000 and \$4,549,000, respectively, are as follows (*in thousands*):

	June 30	
	2011	2010
Perkins loans	\$ 1,586	\$ 1,765
Health Professional loans	5,161	5,491
Institutional funds loans	3,255	3,132
University of Arkansas at Fayetteville	1,008	1,117
Arkansas State Hospital note receivable	6,916	7,412
Arkansas Department of Health note receivable	1,711	1,952
Miscellaneous	10	7
Total notes and student loans receivable, net	19,647	20,876
Less current portion	(2,678)	(2,487)
Notes and student loans receivable, noncurrent, net	\$ 16,969	\$ 18,389

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

7. Capital Assets

Capital assets of UAMS at June 30 were as follows (*in thousands*):

	June 30, 2010	Additions	Transfers	Dispositions	June 30, 2011
Nondepreciable:					
Land	\$ 7,029	\$ 3,768	\$ -	\$ -	\$ 10,797
Construction in progress	102,021	8,194	(96,304)	-	13,911
Depreciable:					
Buildings and fixtures	764,965	21,032	95,234	-	881,231
Improvements other than buildings	2,453	-	-	-	2,453
Equipment	192,056	16,670	3,134	(9,440)	202,420
Leased property	26,114	2,371	(2,064)	(943)	25,478
Other	18,935	46	-	-	18,981
Total capital assets	1,113,573	52,081	-	(10,383)	1,155,271
Less accumulated depreciation and amortization:					
Buildings and fixtures	211,990	27,305	-	-	239,295
Improvements other than buildings	2,360	51	-	-	2,411
Equipment	135,036	15,528	4,237	(8,990)	145,811
Leased property	11,253	4,750	(4,237)	(750)	11,016
Other	14,451	4,055	-	-	18,506
Total accumulated depreciation and amortization	375,090	51,689	-	(9,740)	417,039
Capital assets, net	\$738,483	\$ 392	\$ -	\$ (643)	\$738,232

	June 30, 2009	Additions	Transfers	Dispositions	June 30, 2010
Nondepreciable:					
Land	\$ 7,029	\$ -	\$ -	\$ -	\$ 7,029
Construction in progress	79,485	29,466	(6,930)	-	102,021
Depreciable:					
Buildings and fixtures	747,360	10,644	6,965	(4)	764,965
Improvements other than buildings	2,453	-	-	-	2,453
Equipment	179,572	14,698	3,449	(5,663)	192,056
Leased property	27,757	2,021	(3,484)	(180)	26,114
Other	18,924	11	-	-	18,935
Total capital assets	1,062,580	56,840	-	(5,847)	1,113,573
Less accumulated depreciation and amortization:					
Buildings and fixtures	188,306	23,686	-	(3)	211,989
Improvements other than buildings	2,309	51	-	-	2,360
Equipment	121,953	15,191	3,369	(5,476)	135,037
Leased property	9,859	4,883	(3,369)	(120)	11,253
Other	9,099	5,352	-	-	14,451
Total accumulated depreciation and amortization	331,526	49,163	-	(5,599)	375,090
Capital assets, net	\$731,054	\$ 7,677	\$ -	\$ (248)	\$738,483

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

7. Capital Assets (continued)

In addition to the leased property noted, the buildings and fixtures above include \$20,949,000 and \$14,357,000 of net assets under capital leases at June 30, 2011 and 2010, respectively.

There was no capitalized interest for the years ended June 30, 2011 and 2010.

Library holdings comprise books and periodicals, including old and rare books, held by UAMS. The estimated value of the holdings at June 30, 2011 and 2010 was \$1,620,000 and \$1,673,000, respectively. UAMS has not reported library holdings in the accompanying statements of net assets.

8. Accounts Payable and Accrued Liabilities

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

	June 30	
	2011	2010
Trade payables	\$ 12,905	\$ 12,870
Accrued wages	41,779	41,177
Miscellaneous payables	16,153	20,208
Total accounts payable and accrued liabilities	\$ 70,837	\$ 74,255

9. Long-Term Obligations

Changes in long-term obligations during fiscal year 2011 were as follows (*in thousands*):

	Beginning Balance	Additions	Reductions	Ending Balance
Bonds payable	\$ 260,056	\$ 49,236	\$ 7,588	\$ 301,704
Notes payable	8,184	5,878	6,699	7,363
Capital leases	30,941	11,855	7,098	35,698
Total debt	299,181	66,969	21,385	344,765
Compensated absences	42,174	1,460	-	43,634
Other postemployment benefits	16,651	2,695	73	19,273
Total obligations	\$ 358,006	\$ 71,124	\$ 21,458	\$ 407,672

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations (continued)

The current and long-term portions of the categories noted above were as follows at June 30, 2011 (*in thousands*):

	Current	Long Term	Total
Bonds payable	\$ 8,735	\$ 292,969	\$ 301,704
Notes payable	1,383	5,980	7,363
Capital leases	6,898	28,800	35,698
Total debt	17,016	327,749	344,765
Compensated absences	2,596	41,038	43,634
Other postemployment benefits	-	19,273	19,273
Total obligations	<u>\$ 19,612</u>	<u>\$ 388,060</u>	<u>\$ 407,672</u>

Changes in long-term obligations during fiscal year 2010 were as follows (*in thousands*):

	Beginning Balance	Additions	Reductions	Ending Balance
Bonds payable	\$ 267,819	\$ 8,160	\$ 15,923	\$ 260,056
Notes payable	9,944	11	1,771	8,184
Capital leases	34,039	2,845	5,943	30,941
Total debt	311,802	11,016	23,637	299,181
Compensated absences	41,787	387	-	42,174
Other postemployment benefits	13,710	2,941	-	16,651
Total obligations	<u>\$ 367,299</u>	<u>\$ 14,344</u>	<u>\$ 23,637</u>	<u>\$ 358,006</u>

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

The current and long-term portions of the categories noted above were as follows at June 30, 2010 (*in thousands*):

	<u>Current</u>	<u>Long Term</u>	<u>Total</u>
Bonds payable	\$ 6,145	\$ 253,911	\$ 260,056
Notes payable	1,732	6,452	8,184
Capital leases	5,709	25,232	30,941
Total debt	13,586	285,595	299,181
Compensated absences	2,102	40,072	42,174
Other postemployment benefits	-	16,651	16,651
Total obligations	<u>\$ 15,688</u>	<u>\$ 342,318</u>	<u>\$ 358,006</u>

UAMS has bonds outstanding for the Patient Bed Tower, Central Arkansas Radiation Therapy Institute Building, Residence Hall, Psychiatry Building, power plant, the East Parking Deck and land and capital improvements. 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, 2011 and 2010 (*in thousands*):

	<u>June 30</u>	
	<u>2011</u>	<u>2010</u>
<i>Bonds Payable:</i>		
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 4.00% to 5.00% collateralized by pledged revenue.	PAR Premium	34,180 2,530 37,855 2,873
Various Facility Revenue Construction Bonds, Series 2004B, \$95,915,000 original amount, plus a premium of \$3,412,000, due annually to 2034, various fixed interest rates of 2.0% to 5.0% over the life of the issue, collateralized by pledged revenue.	PAR Premium	94,320 2,659 94,605 2,773

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations (continued)

<p>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 2.125% to 5.000% over the life of the issue, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.</p>	PAR	8,420	9,300
	Premium	127	132
<p>Various Facility Revenue 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 3.40% to 5.00% collateralized by pledged revenue.</p>	PAR	98,045	100,025
	Premium	4,164	4,333
<p>Parking System Revenue Refunding Bonds, Series 2010, \$7,605,000 original amount plus a premium of \$ due annually to 2019, various fixed interest rates of 2.0% to 4.5% over the life of the issue, collateralized by a pledge of gross revenue derived from all parking facilities owned by UAMS.</p>	PAR	7,605	7,605
	Premium	495	555
<p>Various Facility Revenue Bonds, Series 2010A, \$42,680,000 original amount plus a premium of \$2,876,000 due annually to 2030, various fixed interest rates of 2.00% to 5.00%, collateralized by pledged revenue.</p>	PAR	42,680	-
	Premium	2,799	-
<p>Various Facility Revenue Bonds, Series 2010B (taxable), \$3,680,000 original amount, due annually to 2013, various fixed interest rates of 1.20% to 1.93% over the life of the issue, collateralized by pledged revenue.</p>	PAR	3,680	-
<p>Total Bonds Payable</p>		\$301,704	\$260,056
		2011	2010
Notes Payable:			
<p>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 was \$495,000 at a fixed rate of 4.22%.</p>	\$	132	\$ 248
<p>Miscellaneous Notes Payable</p>		7,231	7,936
<p>Total Notes Payable</p>	\$	7,363	\$8,184

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations (continued)

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, 2011 (*in thousands*):

	Bonds Payable				Notes Payable		
	Principal	Interest	Premium Amortized	Total	Principal	Interest	Total
2012	\$ 8,735	\$ 13,867	\$ 836	\$ 23,438	\$ 1,379	\$ 76	\$ 1,455
2013	9,115	13,504	836	23,455	1,380	48	1,428
2014	9,495	13,113	836	23,444	1,064	26	1,090
2015	9,920	12,691	836	23,447	762	16	778
2016	10,375	12,240	836	23,451	678	9	687
2017–2021	51,745	53,799	3,160	108,704	1,950	4	1,954
2022–2026	56,005	41,125	2,158	99,288	150	-	150
2027–2031	71,665	25,360	2,074	99,099	-	-	-
2032–2036	61,875	7,940	1,202	71,017	-	-	-
Total	\$ 288,930	\$ 193,639	\$ 12,774	\$ 495,343	\$ 7,363	\$ 179	7,542

The Board of Trustees of the University of Arkansas System Various Facility Revenue Bonds (UAMS Campus), Series 2010A and 2010B was issued in December 2010. The 2010A issue provided \$42,680,000 for Patient Tower Building Improvements, Winthrop P. Rockefeller Cancer Institute Improvements, Central Energy Improvements, Operating Room and Surgical Suite Improvements, and various other acquisitions and improvements. 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 2030. The 2010B (Taxable) issue provided \$3,680,000 for acquiring land and properties for expansion and other University related purposes. The bonds bear interest at various fixed interest rates from 1.20% to 1.93% and principal payments are due annually with interest payments due semiannually until the year 2013.

The Board of Trustees of the University of Arkansas Parking System Revenue Refunding Bonds (UAMS Campus), Series 2010 was issued in June 2010. The 2010 Bonds were issued to refund the 1998 Parking System Revenue Construction and Refunding Bonds, Series 1998. The \$7,605,000 issue enabled UAMS to take advantage of lower rates, with the 2010 Bonds bearing interest at various fixed rates from 2.0% to 4.5%. Principal payments are due annually, with interest payments due semiannually until the year 2019. The refunding resulted in a net present value benefit of \$770,000 and a deferred refunding loss of \$230,000, which will be amortized as a component of interest expense until June 30, 2020. For current and advance refunding resulting in defeasance of debt,

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

9. Long-Term Obligations (continued)

the difference between the reacquisition price and the net carrying amount of the refunded debt is deferred and amortized as a component of interest expense, in a systematic and rational manner, over the remaining life of the old debt or the life of the new debt, whichever is shorter.

The Board of Trustees of the University of Arkansas System Various Facility Revenue Bonds (UAMS Campus), Series 2006 was issued in March 2006. The 2006 issue provided an additional \$107,500,000 for the recent 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 \$1,008,000 and \$1,117,000 as of June 30, 2011 and 2010, respectively, has been recorded in the accompanying statements of net assets (note 14). The refunding resulted in no difference in the reacquisition price and the net carrying amount of the refunded debt. The difference between the reacquisition price and the net carrying amount of the refunded debt is 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)

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 5.000%, with principal payments due annually and interest due semiannually until the year 2035.

The Arkansas Development Finance Authority's (the 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 was \$495,000 at 4.22% interest.

10. Commitments

Capital Leases

Scheduled maturities of capital lease commitments outstanding as of June 30, 2011 are as follows (*in thousands*):

	Principal	Interest	Total
2012	\$ 6,898	\$ 1,539	\$ 8,437
2013	6,679	1,254	7,933
2014	5,616	975	6,591
2015	4,647	740	5,387
2016	4,254	507	4,761
2017–2021	7,604	976	8,580
Total	<u>\$ 35,698</u>	<u>\$ 5,991</u>	<u>\$ 41,689</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, 2011 (*in thousands*):

2012	\$ 6,557
2013	4,946
2014	2,784
2015	1,781
2016	799
2017–2021	322
Total minimum payments required	<u>\$ 17,189</u>

Rental expense for operating leases for the years ended June 30, 2011 and 2010 was approximately \$10,051,716 and \$8,897,945, respectively, and is included in supplies and other services in the accompanying statements of revenues, expenses, and changes in net assets.

Construction Projects

Construction in progress at June 30, 2011 included the Central Energy Plant upgrade. At June 30, 2011, construction contracts outstanding were approximately \$37,846,000.

Outstanding Commitments

At June 30, 2011 and 2010, UAMS had outstanding purchase orders for normal operating supplies and equipment amounting to approximately \$267,699,000 and \$162,745,000, respectively.

11. Retirement Benefits

All active employees of UAMS who work 20 or more hours a week participate in the Arkansas Teacher Retirement System (ARTRS), Arkansas Public Employee Retirement System (APERS), or the University of Arkansas Optional Retirement Plan (UAORP), which is funded through the Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF) and Fidelity Investments, ARTRS was

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

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 has been 14% since 2007. ARTRS issues a publicly available financial report, which may be obtained by writing or calling: ARTRS, 1400 West Third Street, Little Rock, Arkansas 72201, 501-682-1517. The gross payroll amount for UAMS employees covered by ARTRS for the years ended June 30, 2011 and 2010 was \$547,800 and \$427,300, respectively. UAMS' total salaries were \$611,514,000 and \$601,927,000 for fiscal years 2011 and 2010, respectively. Total employer contributions to ARTRS in fiscal years 2011, 2010, and 2009 were \$77,000, \$60,000, and \$48,000, respectively. Employee contributions to ARTRS in fiscal years 2011 and 2010 were \$25,000 and \$17,600, 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 Arkansas Statute (A.C.A. 24). UAMS' required contribution rate was 12.46% in 2011 and 11.00% in 2010. APERS issues a publicly available financial report, which may be obtained by writing or calling: APERS, One Union National Plaza, 124 W. Capitol, 5th Floor, Little Rock, Arkansas 72201, 501-682-7855. The gross payroll amount for UAMS employees covered by APERS for the years ended June 30, 2011 and 2010 was \$6,326,000 and \$5,687,000, respectively. Total employer contributions to APERS in fiscal years 2011, 2010, and 2009 were \$788,200, \$619,900, and \$595,900, respectively. Employee contributions to APERS in fiscal years 2011 and 2010 were \$157,600 and \$112,100, respectively.

The UAORP was 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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

11. Retirement Benefits (continued)

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 \$24,500 per employee, which is the IRS maximum since tax year 2009. 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; when the participant reaches the age of 70; or the participant contributes at least 5% of regular salary for at least six months. The eligible salary earnings for UAMS employees covered by UAORP for the years ended June 30, 2011 and 2010 was \$545,843,000 and \$539,169,000, respectively. Total employer contributions during fiscal years 2011 and 2010 to TIAA-CREF and Fidelity were \$42,878,000 and \$42,430,000, respectively. Employee contributions to TIAA-CREF and the Fidelity Fund in the fiscal years 2011 and 2010 were \$46,880,000 and \$45,946,000, 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 633 and 572 as of June 30, 2011 and 2010, respectively. The participants of this program incur the total premium for this insurance. There is no direct expense for these services incurred by UAMS.

12. Other Postemployment Benefits (OPEB)

The 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 Fayetteville (UAF), Little Rock (UALR), Medical Sciences (UAMS), Monticello (UAM), Pine Bluff (UAPB), Phillips (PCCUA) 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 defined benefit 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. (the Foundation) 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's consolidated financial report.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

12. Other Postemployment Benefits (OPEB) (continued)

Governmental entities recognize and match other postretirement benefit costs with related services received and also provide information regarding the actuarially calculated liability and funding level of the benefits associated with past services. Accordingly, UAMS accrued \$2,622,000 and \$2,941,000 in retiree healthcare expense during the fiscal years ended June 30, 2011 and 2010, respectively.

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 years 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.

Summary of Key Actuarial Methods and Assumptions

University Self-Funded Plan

Valuation date	July 1, 2010 valuation for the fiscal year ended June 30, 2011
Valuation year	Census data was collected as of January 1, 2010. Liabilities were measured as of January 1, 2010 and rolled forward six months to the July 1, 2010 valuation date.
Actuarial cost method	Projected unit credit
Amortization method	30 years open, level % of payroll
Asset valuation method	N/A
Discount rate	4.5%
Projected payroll growth rate	4.0%

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

12. Other Postemployment Benefits (OPEB) (continued)

Medical inflation rate	Initial rate of 9.0%, with a 0.5% decrease each year to an ultimate rate of 5.0%.
Dental inflation rate	Dental benefits were excluded from the valuation since expected retiree contributions are sufficient to fully cover expected costs.

General Overview of the Valuation Methodology

The process of determining the liability for retiree medical benefits is based on many assumptions about future events. Future increases in healthcare costs are affected by many factors, including: medical inflation; change in utilization patterns; technological advances; cost shifting; cost leveraging; and changes to government medical programs, such as Medicare.

The required frequency of valuations per GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, depends on the number of members in the plan. Even though the University's self-funded plan only requires it every two years, a valuation has been performed each year since the year of implementation. No decision has been made at this time as to whether annual or biennial valuations will be made 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.

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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

12. Other Postemployment Benefits (OPEB) (continued)

Changes in Actuarial Assumptions and Methods

In fiscal year 2010, the withdrawal rates, the medical and Rx coverage election percentage for retirees not eligible for Medicare, and the election percentage assumptions for the life insurance were changed to better reflect recent plan experience and future expectations. In fiscal year 2011, the mortality rates were changes from the RP-2000 Combined Health Mortality Table projected to 2009 by scale AA to the RP-2000 Combined Health Mortality Table projected to 2011 by scale AA to better reflect anticipated future mortality improvements.

Medical Coverage – Retirees Not Eligible for Medicare

Claim experience for the period 10-01-2007 through 09-30-2009 was used to develop the claims cost for non-Medicare-eligible retirees. The paid claims data was converted to an incurred basis using a completion factor approach. This experience includes 890 life years of exposure and was deemed to be 60% credible. The experience was combined with the active claims experience adjusted for demographic differences to produce the per capita claims costs used in the valuation. Adjustment factors were then applied to develop expected claims by age to be used in the valuation. Expected retiree premiums were developed to represent the expected cost-sharing level anticipated by the University. Retiree premiums were also age-adjusted for use in the valuation.

Medical Coverage – Retirees Eligible for Medicare

Medical and prescription drug claims for the period 10-1-2007 through 09-30-2009 was used to develop per capita claims cost for Medicare-eligible retirees. This experience includes 3,600 life years of exposure and was deemed to be fully credible. Based on this analysis, it was concluded that the retiree contributions are sufficient to fully cover the expected claims costs as intended. As such, the cost for Medicare eligible retirees was excluded from this valuation.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

12. Other Postemployment Benefits (OPEB) (continued)

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

	July 1	
	2010	2009
Unfunded actuarial accrued liability	<u>\$25,114</u>	<u>\$29,252</u>
<u>Annual Required Contribution (ARC):</u>		
Normal Cost	\$1,920	\$2,248
Amortization of the unfunded actuarial accrued liability over 30 years using level percentage of payroll amortization	896	1,044
Interest	<u>127</u>	<u>148</u>
Annual Required Contribution (ARC)	2,943	3,440
<u>Annual OPEB Cost:</u>		
Interest on net OPEB obligation	749	617
ARC amortization adjustment	<u>(621)</u>	<u>(511)</u>
Annual OPEB Cost	3,071	3,546
Less: Expected Employer Contributions	<u>(449)</u>	<u>(605)</u>
End-of-year accrual	<u><u>\$2,622</u></u>	<u><u>\$2,941</u></u>

Schedule of Employer Contributions

Fiscal Year Ended	Annual Contributions	Expected Contributions	Percentage Contributed
June 30, 2011	\$ 3,071	449	14.62 %
June 30, 2010	3,546	605	17.06
June 30, 2009	4,475	566	12.65

Since there is no funding, the expected contributions are any retiree premiums actually paid by UAMS 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.

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

12. Other Postemployment Benefits (OPEB) (continued)

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
June 30, 2011	\$ -	\$ 25,114	\$ 25,114	-	\$552,717	5 %
June 30, 2010	-	29,252	29,252	-	531,191	6
June 30, 2009	-	34,858	34,858	-	505,421	7

13. Affiliated Entities (Unaudited)

The Foundation operates as a nonprofit benevolent corporation for charitable educational purposes. It was established to benefit the University, 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, 2011 and 2010, respectively, revenue of \$49,273,000 and \$81,301,000 was received by the Foundation for the benefit of UAMS. Revenue for the year ended June 30, 2010 was negative due to a loss on investments. Support, by the Foundation on behalf of UAMS, was \$29,981,000 and \$23,352,000 for the years ended June 30, 2011 and 2010, respectively.

14. Related-Party Transactions

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

	2011	2010
University of Arkansas at Fayetteville	\$ 1,008	\$ 1,117
Arkansas State Hospital	6,916	7,412
Arkansas Department of Health	1,711	1,952
Total included in notes and student loans receivable (Note 6)	\$ 9,635	\$ 10,481

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

14. Related-Party Transactions (continued)

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.

15. Contingencies

Amounts received and expended by UAMS under various federal and state programs are subject to audit by governmental agencies. Management believes that adjustments, if any, which might result from such audits would not have a significant impact on the financial position of UAMS. Immunity provisions in Arkansas law prohibit suits naming the Board of Trustees of the University of Arkansas System or UAMS as a defendant in Arkansas State courts. Employees of UAMS acting in good faith in the course and scope of their employment may be sued in state courts, but only to the extent of maintained insurance coverage. UAMS maintains malpractice insurance for certain employees under a claims-made policy. Premiums are accrued based on a retrospective rating plan. UAMS incurred costs of \$3,221,000 and \$2,988,000 for this insurance during the years ended June 30, 2011 and 2010, 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

University of Arkansas for Medical Sciences

Notes to Financial Statements (continued)

15. Contingencies (continued)

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 Authority issued \$36,775,000 in Tobacco Settlement Revenue Bonds. The Authority has made the proceeds of the bonds available to the UA Board to fund an expansion to the Arkansas Cancer Research Center. The 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, 2011, UAMS would have incurred a liability of \$47,091,000 related to issue. This amount includes drawdown 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)

16. Functional Classification of Expenses

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

	Year ended June 30, 2011				
	Compensation and Benefits	Supplies and Other Services	Scholarships and Fellowships	Depreciation and Amortization	Total
Patient care	\$ 389,505	\$ 222,594	\$ -	\$ -	\$ 612,099
Instruction	127,138	12,229	-	-	139,367
Research	68,494	38,719	-	-	107,213
Public services	18,297	12,900	-	-	31,197
Academic support	10,126	2,922	-	-	13,048
Student services	2,022	2,081	-	-	4,103
Institutional support	109,861	4,208	-	-	114,069
Operation and maintenance of plant	28,988	19,347	-	-	48,335
Scholarships and awards	-	-	258	-	258
Auxiliary	2,918	1,898	-	-	4,816
Depreciation and amortization	-	-	-	51,425	51,425
Other	629	14,233	-	-	14,862
Total	\$ 757,978	\$ 331,131	\$ 258	\$ 51,425	\$ 1,140,792

	Year ended June 30, 2010				
	Compensation and Benefits	Supplies and Other Services	Scholarships and Fellowships	Depreciation and Amortization	Total
Patient care	\$ 389,740	\$ 225,028	\$ -	\$ -	\$ 614,768
Instruction	121,826	9,681	-	-	131,507
Research	65,037	36,655	-	-	101,692
Public services	16,304	9,073	-	-	25,377
Academic support	10,066	2,425	-	-	12,491
Student services	1,863	1,919	-	-	3,782
Institutional support	105,601	7,584	-	-	113,185
Operation and maintenance of plant	26,822	23,877	-	-	50,699
Scholarships and awards	-	-	234	-	234
Auxiliary	2,777	1,691	-	-	4,468
Depreciation and amortization	-	-	-	48,864	48,864
Other	406	7,805	-	-	8,211
Total	\$ 740,442	\$ 325,738	\$ 234	\$ 48,864	\$ 1,115,278