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**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

Financial Statements

June 30, 2008 and 2007

(With Independent Auditors' Report Thereon)

# UNIVERSITY OF MISSOURI HEALTH SYSTEM

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**KPMG LLP**  
Suite 900  
10 South Broadway  
St. Louis, MO 63102-1761

## **Independent Auditors' Report**

The Board of Curators  
University of Missouri

We have audited the accompanying financial statements of the University of Missouri Health System (the Health System) as of and for the years ended June 30, 2008 and 2007, which collectively comprise the Health System's financial statements as listed in the table of contents. These financial statements are the responsibility of the Health System's 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Health System's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of the Health System are intended to present the financial position, and changes in financial position, and cash flows of only that portion of the business-type activities of the University of Missouri (the University) that is attributable to the transactions of the Health System. They do not purport to, and do not, present fairly the financial position of the University of Missouri as of June 30, 2008 and 2007, the changes in its financial position or 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 Health System as of June 30, 2008 and 2007, and the changes in its financial position 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 reports dated October 31, 2008, on our consideration of the Health System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of these reports 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. These reports are 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 3 through 9 is not a required part of the 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 such information and express no opinion on it.

KPMG LLP

St. Louis, Missouri  
October 31, 2008

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Management’s Discussion and Analysis**

**(Unaudited)**

**The Health System**

The University of Missouri (the “University”) owns and operates the University of Missouri Health System (the “Health System”), which is comprised of University of Missouri-Columbia Hospitals and Clinics (“UMHC”, made up of: University of Missouri Hospital, Ellis Fischel Cancer Center, and Children’s Hospital); University Physicians Medical Practice Plan (“University Physicians”); Missouri Rehabilitation Center (“MRC”); and Columbia Regional Hospital (“CRH”).

UMHC and CRH are the primary teaching hospitals for the University of Missouri-Columbia School of Medicine, the Sinclair School of Nursing, and the School of Health Related Professions. University Physicians is the organized practice plan for the faculty of the Columbia School of Medicine and provides outpatient care through a network of clinics located at the aforementioned hospitals and throughout Missouri. All of the facilities and the operations of the Health System are under the control of the University.

**Health System Accounting and Financial Reporting**

This report consists of three financial statements: (1) Statements of Net Assets, (2) Statements of Revenues, Expenses, and Changes in Net Assets, and (3) Statement of Cash Flows and the related notes to the financial statements. These statements provide information on the Health System as a whole and present a view of its finances. The statements include all accounts of the Health System and are based on the accrual basis of accounting.

**Statements of Net Assets Information**

The Health System’s Statements of Net Assets present the financial position of the Health System as of a fiscal year-end. These statements present the assets, liabilities, and net assets of the Health System. A summary of the statements of net assets at June 30, 2008, 2007, and 2006 is as follows (dollars in thousands):

	<b>Fiscal Year</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
<b>Assets:</b>			
Current assets	\$ 159,086	\$ 164,296	\$ 140,614
Other noncurrent assets	192,713	171,652	163,525
Capital assets	260,540	241,855	242,472
Total assets	<u>\$ 612,339</u>	<u>\$ 577,803</u>	<u>\$ 546,611</u>
<b>Liabilities:</b>			
Current liabilities	\$ 64,191	\$ 57,436	\$ 60,816
Noncurrent liabilities	213,776	218,842	223,721
Total liabilities	<u>277,967</u>	<u>276,278</u>	<u>284,537</u>
<b>Net assets:</b>			
Invested in capital assets, net of related debt	98,688	75,458	71,702
Restricted	4,303	4,009	3,753
Unrestricted	231,381	222,058	186,619
Total net assets	<u>334,372</u>	<u>301,525</u>	<u>262,074</u>
Total liabilities and net assets	<u>\$ 612,339</u>	<u>\$ 577,803</u>	<u>\$ 546,611</u>

## UNIVERSITY OF MISSOURI HEALTH SYSTEM

### Management's Discussion and Analysis

(Unaudited)

#### *Fiscal Year 2008 Compared to Fiscal Year 2007*

Total assets increased \$34.5 million from \$577.8 million in fiscal 2007 to \$612.3 million in fiscal 2008. Of this increase, \$5.8 million resulted from cash and investment increases due to the results of operations, and \$10.3 million is due to an increase in patient accounts receivable, net, with the remaining increase relating to capital assets. Other noncurrent assets increased by \$21.1 million principally due to restructured long-term investment pools by the University. Capital assets, net of accumulated depreciation, increased by \$18.6 million from \$241.9 in fiscal 2007 to \$260.5 in fiscal 2008. The Health System continues to invest in capital additions and improvements throughout its facilities. Investment in capital for fiscal 2008 was primarily comprised of \$11.0 million on renovations, \$13.0 million on new building construction, \$23.6 million on patient monitoring and diagnostic equipment, including a 64-Slice Somatom CT, Trilogy Linear Accelerator and the DaVinci Surgical System, and \$3.2 million for technology software.

Total liabilities increased by \$1.7 million from \$276.3 million in fiscal 2007 to \$278.0 million in fiscal 2008. This increase is primarily due to a \$2.2 million increase in accrued compensation and a \$4.5 million increase in third-party payor settlements. These liability increases were partially offset by a decrease in long-term debt liabilities of \$5.1 million.

For fiscal 2008, the Health System's total net assets were \$334.3 million, which was an increase of \$32.8 million over fiscal 2007 level of \$301.5 million.

#### *Fiscal Year 2007 Compared to Fiscal Year 2006*

Total assets increased \$31.2 million from \$546.6 million in fiscal 2006 to \$577.8 million in the current fiscal year. The majority of this increase, totaling \$28.1 million, resulted from cash and investment increases due to the results of operations and a \$19.3 million transfer of cash from the University, related to the sale of Missouri Care L.C., a component unit of the University. Capital assets, net of accumulated depreciation, decreased by \$0.6 million from \$242.5 in fiscal year 2006 to \$241.9 in fiscal year 2007. Although the current depreciation of the existing infrastructure offset the overall effect of the fiscal 2007 capital expansion, the Health System continues to focus on capital additions and improvements throughout its facilities. Investment in capital for fiscal 2007 comprised of \$11.8 million on renovations, \$6.7 million on additional clinical areas for burn patients and gastrointestinal cases, \$5.0 million on new building construction, \$3.7 million on patient monitoring and diagnostic equipment, \$3.6 million for technology software, and \$2.5 million for an operating room expansion.

Total liabilities decreased \$8.2 million from \$284.5 million in fiscal 2006 to \$276.3 million in fiscal 2007. Of this decrease, \$6.8 million relates to a decline in accounts payable, as fiscal 2006 saw higher spending on capital expenditures in the later months of the year. This year-end capital purchasing did not occur in fiscal 2007. Accrued employee compensation increased \$1.2 million, with \$0.4 million being vacation accruals.

For fiscal 2007, the Health System's total net assets were \$301.5 million, which was an increase of \$39.4 million over fiscal 2006 level of \$262.1 million.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Management's Discussion and Analysis**

**(Unaudited)**

**Statements of Revenues, Expenses, and Changes in Net Assets Information**

The Health System's Statements of Revenues, Expenses, and Changes in Net Assets present the results of operations and nonoperating activities. A summary of these statements for the years ended June 30, 2008, 2007, and 2006 is as follows (dollars in thousands):

	<b>Fiscal Year</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Net patient service revenues	\$ 663,227	\$ 620,241	\$ 593,807
Other operating revenues	17,812	18,818	16,335
Total operating revenues	<u>681,039</u>	<u>639,059</u>	<u>610,142</u>
Operating expenses:			
Salaries and benefits	276,329	266,680	251,029
Medical supplies and drugs	123,707	115,552	106,190
Administrative and support services	39,472	39,676	32,856
Depreciation	31,295	32,650	29,570
University Physicians distributions	119,260	109,422	94,862
Other expenses	84,228	77,854	76,505
Total operating expenses	<u>674,291</u>	<u>641,834</u>	<u>591,012</u>
Operating income (loss)	<u>6,748</u>	<u>(2,775)</u>	<u>19,130</u>
State appropriations	24,092	22,879	22,555
Interest expense	(7,905)	(8,380)	(9,307)
Other nonoperating revenues, net	13,554	11,129	6,020
Total net nonoperating revenues, net	<u>29,741</u>	<u>25,628</u>	<u>19,268</u>
Income before contributions and transfers	36,489	22,853	38,398
Transfers (to) from the University, net, and endowment additions	(3,642)	16,598	(5,218)
Change in net assets	32,847	39,451	33,180
Total net assets, beginning of year	<u>301,525</u>	<u>262,074</u>	<u>228,894</u>
Total net assets, end of year	<u>\$ 334,372</u>	<u>\$ 301,525</u>	<u>\$ 262,074</u>

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Management's Discussion and Analysis**

**(Unaudited)**

***Fiscal Year 2008 Compared to Fiscal Year 2007***

For fiscal 2008, the Health System had an increase in net assets of \$32.8 million compared to \$39.4 million for fiscal 2007. Operating revenues in fiscal year 2008 were \$42.0 million greater than prior year and represented a 6.6% increase.

	<b>UMHC Key Statistics</b>		
	<b>Fiscal Year</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Admissions	20,260	20,574	20,411
Patient days	125,074	120,370	127,913
Clinic visits	510,897	548,634	580,308
Emergency room visits	42,995	41,243	39,366
Operating room cases	18,418	17,945	17,204

Consolidated admissions saw a decrease, 314, in fiscal 2008 or 1.5% from fiscal 2007. Although admissions have decreased, total patient days increased by 4,704 or 3.9% over fiscal 2007. This increase in patient days is due to an increase in Case Mix and invasive surgical procedures such as implants. Operating room cases and emergency room visits grew 2.6% and 4.2%, respectively, over fiscal 2007. Clinic visits are down by 6.9% from the prior year as a result of a reduction in the number of community clinics and the divestiture of the Health System behavioral health clinics in fiscal 2007.

In fiscal 2008, operating expenses were \$32.5 million higher than the prior year, which represents a 5.1% increase. Salary and benefit expense increased by 3.6% as a result of merit and staffing increases and market adjustments. Medical supplies and drugs increased 7.1% over prior years primarily due to increases in implant and related orthopedic procedures and overall increases in supply costs. University Physicians distributions increased by \$9.8 million or 9.0% over fiscal 2007 due to the higher patient revenue from physician services.

***Fiscal Year 2007 Compared to Fiscal Year 2006***

For fiscal 2007, the Health System had an increase in net assets of \$39.4 million including \$19.3 million in transfers from the University, related to the sale of Missouri Care, L.C., compared to \$33.2 million for fiscal year 2006. Operating revenues in fiscal year 2007 were \$28.9 million greater than prior year and represented a 4.7% increase.

	<b>UMHC Key Statistics</b>		
	<b>Fiscal Year</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
Admissions	20,574	20,411	19,276
Patient days	120,370	127,913	119,112
Clinic visits	548,634	580,308	588,084
Emergency room visits	41,243	39,366	37,979
Operating room cases	17,945	17,204	16,389

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Management's Discussion and Analysis**

**(Unaudited)**

Consolidated admissions saw a slight increase, 163, in fiscal 2007 or 0.8% over fiscal 2006. Although admissions have increased, total patient days decreased 7,543 or 5.9% over fiscal 2006. This decline in patient days is due to greater competition in the long-term care area for MRC and competing alternate facilities and changing service lines at CRH. Operating room cases and emergency room visits grew 4.3% and 4.8% respectively over fiscal 2006. Clinic visits are down 5.5% from the prior year as a result of a reduction in the number of community clinics and the divestiture of the Health System behavioral health clinics.

In fiscal 2007, operating expenses were \$50.8 million higher than the prior year, which represents an 8.6% increase. Salary and benefit expense increased 6.2% as a result of merit and staffing increases and market adjustments. Medical supplies and drugs increased 8.8% over prior years primarily due to increases in implant and related orthopedic procedures and overall increases in supply costs. University Physicians distributions increased \$14.6 million or 15.3% over fiscal 2006 due to the higher patient revenue from physician services.

**Statements of Cash Flows**

The Health System's Statements of Cash Flows provide the sources and uses of cash resources. The cash flow statements at June 30, 2008, 2007, and 2006 are summarized as follows (dollars in thousands):

	<b>Fiscal Year</b>		
	<b>2008</b>	<b>2007</b>	<b>2006</b>
Cash provided by (used in):			
Operating activities	\$ 34,480	\$ 22,773	\$ 57,264
Noncapital financing activities	21,689	40,991	20,660
Capital and related financing activities	(63,194)	(44,838)	(51,129)
Investing activities	(6,384)	(4,092)	(41,593)
Net increase (decrease) in cash and cash equivalents	(13,409)	14,834	(14,798)
Cash and cash equivalents, beginning of year	32,906	18,072	32,870
Cash and cash equivalents, end of year	\$ 19,497	\$ 32,906	\$ 18,072

***Fiscal Year 2008 Compared to Fiscal Year 2007***

During fiscal 2008, the Health System's cash decreased by \$13.4 million as compared to a \$14.8 million increase in fiscal 2007. For fiscal 2008, operating activities generated \$34.5 million, while \$63.2 million was used for capital purchases, principal payments, and interest. The Health System invested in new equipment technology, building, and other improvements totaling \$50.9 million.

For noncapital financing activities in fiscal 2008, the Health System had an increase in cash of \$21.7 million, which resulted from the receipt of \$24.1 million in state appropriations, and \$1.2 million in gifts. These revenue sources were offset by \$3.6 million in distributions to University departments for strategic initiatives, such as academic recruitment.

Investing activities decreased cash by \$6.4 million due principally to an increase in long-term investment holdings by the University.

## UNIVERSITY OF MISSOURI HEALTH SYSTEM

### Management's Discussion and Analysis

(Unaudited)

#### *Fiscal Year 2007 Compared to Fiscal Year 2006*

During fiscal 2007, the Health System's cash increased \$14.8 million as compared to a \$14.8 million decrease in fiscal 2006. For fiscal 2007, operating activities generated \$22.8 million, while \$44.8 million was used for capital purchases, principal payments and interest. The Health System invested in new equipment technology, building, and other improvements totaling \$32.8 million.

For noncapital financing activities in fiscal 2007, the Health System had an increase in cash of \$41.0 million, which resulted from the receipt of \$22.9 million in state appropriations, \$1.5 million in gifts, and a one-time transfer of \$19.3 million from the University related to the sale of Missouri Care L.C., a component unit of the University. These revenue sources were offset by \$2.7 million in distributions to University departments.

Investing activities decreased cash by \$4.1 million due principally to an increase in investments.

#### **Health System Outlook**

For fiscal 2008, the Health System continued to see increasing revenues. As in the prior years, the Health System is committed to improving patient care and has increased its focus on improvements in customer service and quality, and growth in clinical areas. The State's appropriation funding for operation and facilities have helped in providing for programs at Missouri Rehabilitation Center and uncompensated care at all facilities. State appropriation funding for fiscal 2009 remains consistent with fiscal 2008. An overall fee increase of 5% implemented in April 2008 continues in fiscal 2009, and pricing revisions continue as needed. For the future, the Health System continues to focus on its physician recruitment plans, patient satisfaction, and efforts to reduce the cost of operations.

In addition to focusing on clinical and diagnostic equipment, the Health System is in the beginning phase of strategic capital improvements, which include the construction of a \$48.3 million Orthopedic Institute and the replacement of the Ellis Fischel Cancer Center utilizing \$31.2 million in State capital funding. These capital initiatives will aid in providing quality care to patients, as well as enhanced facilities for physician recruitments with the School of Medicine.

In addition to these capital initiatives, the University has created a Consolidated Health Sciences Center composed of Health System, University Physicians, and the Schools of Medicine, Nursing, and Health Professions. These initiatives and vision will provide for the future growth and success of the Health System and the Schools.

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**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Statements of Net Assets**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 19,497	\$ 32,906
Short-term investments – restricted	3,095	3,047
Short-term investments	17,727	19,985
Patient accounts receivable, less allowance for doubtful accounts of \$33,486 and \$34,214 in 2008 and 2007, respectively	96,092	85,819
Third-party and other receivables	7,421	6,564
Inventories and other assets	15,254	15,975
	159,086	164,296
Total current assets		
Noncurrent assets:		
Investments designated for capital	5,892	3,992
Restricted investments	925	464
Long-term investments	179,820	160,807
Capital assets:		
Depreciable	244,704	222,676
Nondepreciable	15,836	19,179
Other assets	6,076	6,389
	453,253	413,507
Total noncurrent assets		
Total assets	\$ 612,339	\$ 577,803

See accompanying notes to financial statements.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Statements of Net Assets**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

<b>Liabilities</b>	<b>2008</b>	<b>2007</b>
Current liabilities:		
Accounts payable	\$ 19,665	\$ 19,771
Estimated third-party payor settlements	5,600	1,108
University Physicians distributions payable	11,911	11,917
Accrued interest	1,217	1,239
Accrued employee compensation	20,715	18,506
Deferred revenue	287	298
Capital lease obligations, current	501	462
Long-term debt, current	4,295	4,135
	<hr/>	<hr/>
Total current liabilities	64,191	57,436
Noncurrent liabilities:		
Amount due University	55,000	55,000
Capital lease – less current portion	8,391	8,892
Long-term debt – less current portion	148,509	152,788
Deferred revenue – less current portion	1,876	2,162
	<hr/>	<hr/>
Total noncurrent liabilities	213,776	218,842
	<hr/>	<hr/>
Total liabilities	277,967	276,278
	<hr/>	<hr/>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	98,688	75,458
Restricted:		
Nonexpendable:		
Endowment	595	622
Expendable:		
Research and other	3,708	3,387
Unrestricted	231,381	222,058
	<hr/>	<hr/>
Total net assets	334,372	301,525
	<hr/>	<hr/>
Total liabilities and net assets	\$ 612,339	\$ 577,803
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See accompanying notes to financial statements.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**  
**Statements of Revenues, Expenses, and Changes in Net Assets**  
**Years ended June 30, 2008 and 2007**  
**(Dollars in thousands)**

	<u>2008</u>	<u>2007</u>
Operating revenues:		
Net patient service revenues	\$ 663,227	\$ 620,241
Sales by auxiliary enterprises and other	17,812	18,818
Total operating revenues	<u>681,039</u>	<u>639,059</u>
Operating expenses:		
Salaries and benefits	276,329	266,680
Medical supplies and drugs	123,707	115,552
Administrative and support services	39,472	39,676
Depreciation	31,295	32,650
University Physicians distributions	119,260	109,422
Other expenses	84,228	77,854
Total operating expenses	<u>674,291</u>	<u>641,834</u>
Operating income (loss)	<u>6,748</u>	<u>(2,775)</u>
Nonoperating revenues (expenses):		
State appropriations	24,092	22,879
Investment income	13,078	9,667
Private gifts	1,239	1,514
Interest expense	(7,905)	(8,380)
Loss on disposal, net	(763)	(52)
Total nonoperating revenues, net	<u>29,741</u>	<u>25,628</u>
Income before contributions and transfers	36,489	22,853
Transfers (to) from the University, net, and endowment additions	<u>(3,642)</u>	<u>16,598</u>
Change in net assets	32,847	39,451
Total net assets, beginning of year	<u>301,525</u>	<u>262,074</u>
Total net assets, end of year	<u>\$ 334,372</u>	<u>\$ 301,525</u>

See accompanying notes to financial statements.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Statements of Cash Flows**

**Years ended June 30, 2008 and 2007**

**(Dollars in thousands)**

	<u>2008</u>		<u>2007</u>
Cash flows from operating activities:			
Cash proceeds from patient service revenue	\$ 656,589	\$	\$ 618,382
Cash proceeds from other sales	18,069		18,985
Cash payments to employees	(213,113)		(207,182)
Cash payments for benefits	(61,007)		(58,267)
Cash payments to suppliers	(246,792)		(241,534)
Cash payments for University Physicians	(119,266)		(107,611)
	<u>34,480</u>		<u>22,773</u>
Cash flows from noncapital financing activities:			
Transfers (to) from the University, net, and endowment additions	(3,642)		16,598
State appropriations	24,092		22,879
Private gifts	1,239		1,514
	<u>21,689</u>		<u>40,991</u>
Cash flows from capital and related financing activities:			
Capital expenditures	(50,939)		(32,774)
Cash proceeds from sales of capital assets	621		806
Principal payments on long-term debt	(4,135)		(4,000)
Capital lease principal payments	(462)		(425)
Interest paid on long-term debt	(8,279)		(8,445)
	<u>(63,194)</u>		<u>(44,838)</u>
Cash flows from investing activities:			
Increase in investments	(20,335)		(14,016)
Cash proceeds from equity investees	1,171		706
Investment income	12,780		9,218
	<u>(6,384)</u>		<u>(4,092)</u>
Net change in cash and cash equivalents	(13,409)		14,834
Cash and cash equivalents, beginning of year	<u>32,906</u>		<u>18,072</u>
Cash and cash equivalents, end of year	\$ <u>19,497</u>	\$	\$ <u>32,906</u>

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Statements of Cash Flows**

**Years ended June 30, 2008 and 2007**

**(Dollars in thousands)**

	<u>2008</u>		<u>2007</u>
Reconciliation of net cash provided by operating activities			
to operating income (loss):			
Operating income (loss)	\$ 6,748	\$	(2,775)
Adjustments to reconcile operating income (loss) to net cash			
provided by operating activities:			
Depreciation	31,295		32,650
Provision for bad debts	51,174		52,590
Changes in assets and liabilities:			
Net patient receivables and third-party receivable	(57,812)		(54,449)
Inventories and other assets	977		(1,340)
Accounts payable and accrued expenses	2,098		(3,903)
Net cash provided by operating activities	<u>\$ 34,480</u>	\$	<u>22,773</u>
Supplemental disclosure of noncash activities:			
Increase in ownership interest of equity investments	\$ 1,666	\$	512

See accompanying notes to financial statements.

# UNIVERSITY OF MISSOURI HEALTH SYSTEM

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands)

### (1) Summary of Significant Accounting Policies

#### (a) *Nature of Organization*

The University of Missouri Health System (the Health System) is a part of the University of Missouri (the University). As a component unit of the State, the University is exempt from federal income tax under Section 115 of the Internal Revenue Code.

The Health System consists of the University of Missouri Hospital and Clinics (UMHC), a tertiary referral center located in Columbia, Missouri, comprised of University Hospital, Children's Hospital, and Ellis Fischel Cancer Center; Columbia Regional Hospital (CRH), a Community Hospital; Missouri Rehabilitation Center (MRC) in Mt. Vernon, Missouri; and the University Physicians Medical Practice Plan (University Physicians). University Physicians is the organized practice plan for the University of Missouri-Columbia School of Medicine. The net revenues, expenses, patient accounts receivable, and distributions payable for University Physicians are reflected in the financial statements. Intercompany transactions within the Health System have been eliminated.

The Health System has ownership interest of approximately 30% in the Institute for Outpatient Surgery LLC (IOS or LLC) and 25% ownership interest in a joint venture with HealthSouth. These investments are accounted for using the equity method and are recorded in long-term investments in the Statements of Net Assets.

#### (b) *Basis of Accounting*

The financial statements of the Health System are prepared in accordance with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Health System applies all applicable GASB pronouncements and Financial Accounting Standards Board (FASB) Statements and Interpretations issued on or before November 30, 1989, except those that conflict with a GASB pronouncement.

The Health System's resources are classified for accounting and reporting purposes into the following four net asset categories:

*Invested in capital assets, net of related debt* – Capital assets, net of accumulated depreciation and outstanding principal debt balances attributable to the acquisition, construction, or improvement of those assets.

*Restricted – Nonexpendable* – Net assets subject to externally imposed constraints that must be maintained permanently by the Health System. Such net assets include the Health System's permanent endowment funds.

*Restricted – Expendable* – Net assets whose use by the Health System is subject to externally imposed constraints that can be fulfilled by actions of the Health System pursuant to those stipulations or that expire by the passage of time. The Health System's policy is to utilize specifically restricted net assets prior to unrestricted net assets when both are available for use.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

*Unrestricted* – Net assets that are not subject to externally imposed constraints nor related to capital assets. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Curators.

**(c) *Cash and Cash Equivalents***

The Health System participates in the University's pooled cash accounts. Participating funds have an equity investment in the pool. For purposes of the financial statements, cash and cash equivalents consists of cash and short-term investments with original purchased maturities of three months or less. All of the Health System's cash and cash equivalents are included in the University's pooled funds. These assets are stated at fair value.

**(d) *Inventories***

Inventories, consisting primarily of drugs and medical supplies, are stated at the lower of cost (determined using the first-in, first-out method) or market.

**(e) *Short-Term Investments***

The Health System participates in the University's pooled investment accounts. Short-term investments consist of general pool investments, U.S. and foreign government obligations, corporate bonds and notes, and other investments, which are used for current operations and primarily have a maturity less than one year.

**(f) *Investments Designated for Capital***

The Health System has set aside certain assets to be used for capital projects.

**(g) *Long-Term Investments***

Long-term investments consist of general pool investments in U.S. and foreign government obligations, corporate bonds and notes, and other investments with maturity greater than one year. Also included in long-term investments is the Health Systems' equity ownership in the IOS and HealthSouth. The investment is recorded based on the equity method of accounting. The Health System's equity income or loss on this investment is recorded as investment income. The Health System recognized income from IOS of \$817 and \$484 in 2008 and 2007, respectively, and received distributions of \$708 and \$706 in 2008 and 2007, respectively. The Health System also recognized income from the joint venture of HealthSouth of \$849 and \$28 in 2008 and 2007, respectively, and received distributions of \$463 and \$0 for 2008 and 2007, respectively. The total assets, total liabilities, and net income of IOS was \$3,555, \$478, and \$2,377, respectively, at June 30, 2008 and \$3,791, \$1,061, and \$1,607, respectively, at June 30, 2007. The total assets, total liabilities, and net income of HealthSouth was \$13,463, \$11,785, and \$1,698, respectively, at June 30, 2008 and \$12,191, \$11,671, and \$91, respectively, at June 30, 2007. The Health System's current percentage of equity in IOS and HealthSouth, respectively, is approximately 31.5% and 25.0% at June 30, 2008.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

**(h) Capital Assets**

These assets are carried, if purchased, at cost or, if donated, at fair value at date of gift. Depreciation expense is computed using the straight-line method over the estimated useful lives of the respective assets – generally ten to forty years for buildings and improvements, eight to twenty-five years for infrastructure, and three to fifteen years for equipment. Land is not depreciated. Net interest expense incurred during the construction of debt-financed facilities is generally included in the capitalization of the related facilities.

**(i) Long-Term Debt**

Unamortized bond discounts and deferred financing fees are amortized on a straight-line basis over the lives of the bonds, which approximate the effective-interest method. The Health System amortizes on a straight-line basis the loss on defeased debt over the remaining life of the defeased bonds.

**(j) Deferred Revenues**

Deferred revenue primarily consists of the sale of the Health Pavilion capital lease to IOS in July 2002, which is being amortized over the remaining life of the lease through 2020.

**(k) Net Patient Service Revenues**

The Health System has agreements with third-party payors that provide for payments at amounts different from established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discount charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as estimates are refined and final settlements are determined. Net patient service revenue is also shown net of estimated uncollectible accounts.

Amounts receivable under Medicare and Medicaid reimbursement agreements are subject to examination and certain retroactive adjustments by the related programs. These adjustments decreased net patient services revenues by \$3,019 for the year ended June 30, 2008, and increased net patient service revenues by \$4,907 for the year ended June 30, 2007.

Both UMHC and CRH Medicare cost reports have been settled through June 30, 2005; MRC Medicare reports have been settled through June 30, 2006. The Medicaid program reimburses inpatient services on a prospective established per diem rate. The Medicaid program reimburses outpatient services under a combination of prospective and fee schedule amounts.

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A percentage breakdown of gross patient accounts receivable by major payor classification of the Health System for the years ended June 30, 2008 and 2007 is as follows:

	<u>2008</u>	<u>2007</u>
Medicare	30%	29%
Commercial insurance	8	9
Medicaid	19	18
Self-pay and other	17	20
Managed care agreements	26	24
	<u>100%</u>	<u>100%</u>

Patient services revenue includes federal reimbursement allowance (FRA) for uncompensated care. The Health System recognizes FRA revenue in the period received.

The gross to net patient revenue detail is reflected below for both 2008 and 2007. Only net patient revenue is reflected on the Statements of Revenues, Expenses, and Changes in Net Assets.

	<u>2008</u>	<u>2007</u>
Gross patient revenue	\$ 1,425,432	\$ 1,291,530
Less deductions for contractual allowances	(711,031)	(618,699)
Less deductions for bad debt allowances	(51,174)	(52,590)
Net patient revenue	<u>\$ 663,227</u>	<u>\$ 620,241</u>

**(l) Operating Revenues and Expenses**

The Health System's policy for defining operating activities as reported on the Statements of Revenues, Expenses, and Changes in Net Assets are those activities that generally result from exchange transactions, such as payments received for providing services and payments made for services or goods received. Nearly all of the Health System's expenses are from exchange transactions. Certain significant revenue streams relied upon for operations are recorded as nonoperating revenues, as defined by GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, including state appropriations and investment income.

**(m) Appropriation and Private Gifts**

The State of Missouri provides direct appropriations to the Health System, which totaled \$24,092 and \$22,879 for the years ended June 30, 2008 and 2007, respectively.

The Health System recognizes gifts in the period when all eligibility requirements are met. For recognition purposes, GASB defines eligibility requirements. The Health System received expendable gifts in 2008 and 2007 of \$1,239 and \$1,514, respectively.

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**Notes to Financial Statements**

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**(Dollars in thousands)**

**(n) *Uncompensated Care***

In line with its mission, the Health System provides some services to patients without regard to their ability to pay for those services. For some of its patient services, the Health System receives no payment or payment that is less than the full cost of providing the services. The following are descriptions of uncompensated care:

*Charity Care* – The Health System provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because the Health System does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient revenues.

*Unreimbursed Cost under State and Local Government Assistance Programs* – In addition, the Health System provides services to other patients under certain state and local government assistance programs, which pay providers amounts generally less than the cost of rendering the services. These cost amounts have been reduced by all payments received on these accounts, including amounts received from the State of Missouri Federal Reimbursement Allowance Program (FRA Program). Under the FRA Program, the Health System received net payments of \$28,893 and \$26,103, in fiscal 2008 and 2007, respectively.

*Uncollectible Accounts* – Furthermore, services provided to certain patients of the Health System, who do not either apply for or qualify for charity care, are uncollectible.

The estimated cost of services provided by the Health System for charity care, estimated unreimbursed costs of providing services to state and local government assistance programs, and uncollectible accounts, for the years ended June 30, 2008 and June 30, 2007, respectively, are as follows:

	<b>2008</b>	<b>2007</b>
Cost of charity care	\$ 5,789	\$ 9,222
Unreimbursed cost under state and local government assistance programs, net of Medicaid disproportionate share funding, less Medicaid provider taxes	13,305	13,947
Cost of uncollectible accounts	25,352	25,127
Total	\$ 44,446	\$ 48,296

**(o) *University Physician Distributions***

In accordance with the University Physicians Medical Practice Plan, net collections of University Physicians billings are distributed to the University of Missouri-Columbia School of Medicine in support of departmental expenses, physician salaries and incentives, and overhead expenses. At June 30, 2008, University Physician distributions payable reflects the amount owed physicians for patients accounts receivable not yet distributed.

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**Notes to Financial Statements**

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**(Dollars in thousands)**

**(p) Use of Estimates**

The preparation of the basic financial statements in conformity with accounting principles generally accepted in the United States of America 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. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

**(q) New Accounting Pronouncements**

The GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, effective for fiscal years beginning after December 15, 2007. The statement addresses accounting and financial reporting standards for pollution remediation obligations, which are obligations to address current and potential effects of existing pollution through pollution remediation activities, such as site assessments and cleanups. The statement requires disclosures about the nature of remediation, size of the obligation, and the methods and assumptions used in evaluating the potential obligation. The Health System has not yet determined the effect that adoption of GASB Statement No. 49 may have on the financial statements.

The GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for fiscal years beginning after June 15, 2009. The statement requires all intangible assets not specifically excluded by its scope provisions be classified as capital assets. The statement also requires that an intangible asset be recognized in the statement of net assets only if it is considered identifiable. The Health System has not yet determined the effect that adoption of GASB Statement No. 51 may have on its financial statements.

The GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, effective for fiscal years beginning after June 15, 2009. The statement requires derivative instruments to be measured at fair value at the reporting date, with changes in fair value generally being reported as investment gains or losses. However, changes in fair value of hedging derivative instruments would be deferred until the related instrument ends or ceases to significantly reduce risk. The University has not yet determined the effect that adoption of GASB Statement No. 53 may have on its financial statements, and as the Health System participates in the investment pools of the University, the Health System has also not determined the financial statement effect of implementing this Statement.

**(r) Reclassifications**

Certain prior year amounts have been reclassified to conform to current year presentation. As of June 30, 2007, the Health System presented certain investments as cash and cash equivalents within the financial statements based on the investments' current maturities rather than their original maturities. The Health System's portion of the University's investments has been reclassified as short-term investments in the accompanying Statement of Net Assets and as investing activities in the Statement of Cash Flows.

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**Notes to Financial Statements**

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**(Dollars in thousands)**

**(2) Cash and Cash Equivalents**

**(a) Cash and Cash Equivalents – University**

The Health System participates in the University’s pooled cash and investment accounts, stated at fair value, and holds an equity investment in the pool.

**(b) Custodial Credit Risk – Deposits – University**

The custodial credit risk for deposits is the risk that in the event of bank failure, the University’s deposits may not be recovered. State law requires collateralization of all deposits with federal depository insurance, bonds, and other obligations of the U.S. Treasury, U.S. Agencies, and instrumentalities of the State of Missouri; bonds of any city, county, school district, or special road district of the State of Missouri; bonds of any state; or a surety bond having an aggregate value at least equal to the amount of the deposits. The following chart presents the Health System’s share of the University’s cash and cash equivalent balances as of June 30, 2008 and 2007:

<u>2008</u>	<u>Uninsured and uncollateralized</u>	<u>Unsecured and collateralized with securities held by pledging institution’s Trust Department not in the University’s name</u>	<u>Collateralized and fully insured bank balances</u>	<u>Total carrying value</u>
Cash	\$ —	\$ —	\$ 7,163	\$ 7,163
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 7,163</u>	<u>\$ 7,163</u>

<u>2007</u>	<u>Uninsured and uncollateralized</u>	<u>Unsecured and collateralized with securities held by pledging institution’s Trust Department not in the University’s name</u>	<u>Collateralized and fully insured bank balances</u>	<u>Total carrying value</u>
Cash	\$ —	\$ —	\$ 5,152	\$ 5,152
Total	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 5,152</u>	<u>\$ 5,152</u>

**(3) Investments**

**(a) Investments**

The investment policies of the University are established by its governing board, the Board of Curators. The policies are established to ensure that the University funds are managed in accordance with Section 105.688 of the Revised Statutes of Missouri. The University is authorized to use outside managers for its investments and may pool funds for investment purposes. Further, the policy provides that the University’s short-term funds may be invested in the following instruments: repurchase agreements collateralized by U.S. Government issues and U.S. Government Agency issues; U.S. Government securities (including principal or interest payments that have been “stripped” from U.S.

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**(Dollars in thousands)**

Treasury instruments), U.S. Government Agency securities and U.S. Government guaranteed securities, including but not limited to direct obligations of the U.S. Government, Federal Farm Credit Banks, Federal Home Loan Banks, Federal National Mortgage Association, Federal Home Loan Mortgage Corporation, Resolution Funding Corporation and Student Loan Marketing Association; investment grade (A or better) corporate bonds; variable rate securities of authorized investment instruments; collateralized certificates of deposit at banks with which the University has a depository agreement; commercial paper with credit ratings of A-1+ or A-1 by Standard & Poor's Rating Group and P-1 by Moody's Investors Service; bankers' acceptances; and other similar short-term investment instruments of like or better quality. The University's security investments are held in book-entry form in brokerage, custody, and safekeeping accounts in the University's name.

At June 30, 2008 and 2007, the Health System's share of the University's investments, by investment type, is as follows:

	<b>Carrying value as of June 30, 2008</b>	<b>Carrying value as of June 30, 2007</b>
Government obligations	\$ 93,839	\$ 77,852
Corporate bonds and notes	38,343	22,735
Commercial paper	—	375
Corporate stocks	73,749	86,300
Other	1,528	1,033
Total short-term and long-term investments	207,459	188,295
Government obligations	—	24
Commercial paper	12,142	27,711
Repurchase agreements	192	19
Total cash equivalents	12,334	27,754
Total investments	\$ 219,793	\$ 216,049

Corporate stocks include investments held by the University related to the \$55,000 Amount due University (see note 10). The Health System does not earn investment income on these funds based on the loan agreement.

**(b) Custodial Credit Risk**

The custodial credit risk for investments is the risk that in the event of failure of the counterparty to a transaction, the University will not be able to recover the value of the investments. In accordance with University policy, the University minimizes its custodial credit risk on deposits by establishing limitations on the types of instruments held with qualifying institutions. Repurchase agreements must be collateralized by U.S. Government issues and/or U.S. Government Agency issues. Certificates of deposit must be collateralized and held at a bank with which the University has a depository agreement. The University's investment of \$12,142 in commercial paper is uninsured and

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uncollateralized. The University's investment of \$192 in repurchase agreements is held by the investment's counterparty, not in the name of the University. All of the remaining University investments are insured and registered and are held by the University or an agent in its name.

**(c) Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University's Pooled General Investments consist of primarily fixed income securities, with a specific limitation that no more than 15% of the pool consists of variable rate securities. As a means of ensuring the safety of principal invested in the Pooled Endowment Investments, the University's investment policy requires diversification of the investment portfolio.

At June 30, 2008 and 2007, the maturities of the Health System's share of the University's investments are as follows:

	<b>As of June 30, 2008</b>				
	<b>Less than 1 year</b>	<b>1 to 5 years</b>	<b>6 to 10 years</b>	<b>More than 10 years</b>	<b>Carrying value</b>
U.S. agency obligations	\$ 12,754	\$ 41,603	\$ 10,684	\$ 5,792	\$ 70,833
U.S. treasury obligations	638	2,906	5,242	3,776	12,562
Foreign government obligations	407	2,941	4,514	2,582	10,444
U.S. corporate bonds and notes	6,952	15,836	9,953	2,888	35,629
Foreign corporate bonds and notes	71	968	605	1,070	2,714
Total	<u>\$ 20,822</u>	<u>\$ 64,254</u>	<u>\$ 30,998</u>	<u>\$ 16,108</u>	<u>\$ 132,182</u>

	<b>As of June 30, 2007</b>				
	<b>Less than 1 year</b>	<b>1 to 5 years</b>	<b>6 to 10 years</b>	<b>More than 10 years</b>	<b>Carrying value</b>
U.S. agency obligations	\$ 17,700	\$ 36,847	\$ 2,946	\$ 4,025	\$ 61,518
U.S. treasury obligations	1,448	1,027	977	1,121	4,573
Foreign government obligations	317	4,199	3,502	3,743	11,761
U.S. corporate bonds and notes	3,108	14,301	1,080	2,648	21,137
Foreign corporate bonds and notes	84	252	262	1,000	1,598
Total	<u>\$ 22,657</u>	<u>\$ 56,626</u>	<u>\$ 8,767</u>	<u>\$ 12,537</u>	<u>\$ 100,587</u>

**(d) Credit Risk**

The credit risk of investments is the risk that the issuer or other counterparty will not meet its obligations. This credit risk is measured by the credit quality ratings of investments in debt securities as described by a national recognized statistical rating organization, such as Standard and Poor's (S&P)

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and Moody's Investors Service (Moody's). University policy provides that investments in corporate bonds and other fixed income securities must have a rating of A or better.

The University has elected to use Moody's investment ratings in the following credit risk report. Several securities within the Pooled Endowment have Moody's ratings of Baa or Ba and S&P's ratings in the A range (A-, A, and A+), which places those bonds within the parameters specified in the University's policy.

The following represents the Health System's share of the University's investment exposure to credit risk, based on Moody's investment ratings:

	<b>As of June 30, 2008</b>					
	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Unrated</b>	<b>Total</b>
U.S. agency obligations	\$ 51,955	\$ 362	\$ 46	\$ —	\$ 18,470	\$ 70,833
U.S. treasury obligations	12,562	—	—	—	—	12,562
Foreign government obligations	6,453	77	3,640	110	164	10,444
U.S. corporate bonds and notes	6,164	12,370	15,563	863	669	35,629
Foreign corporate bonds and notes	1,283	569	607	86	169	2,714
Total	<u>\$ 78,417</u>	<u>\$ 13,378</u>	<u>\$ 19,856</u>	<u>\$ 1,059</u>	<u>\$ 19,472</u>	<u>\$ 132,182</u>

  

	<b>As of June 30, 2007</b>					
	<b>Aaa</b>	<b>Aa</b>	<b>A</b>	<b>Baa</b>	<b>Unrated</b>	<b>Total</b>
U.S. agency obligations	\$ 57,101	\$ 15	\$ —	\$ —	\$ 4,402	\$ 61,518
U.S. treasury obligations	4,573	—	—	—	—	4,573
Foreign government obligations	7,651	16	2,843	209	1,042	11,761
U.S. corporate bonds and notes	3,564	8,661	7,207	463	1,242	21,137
Foreign corporate bonds and notes	326	99	385	44	744	1,598
Total	<u>\$ 73,215</u>	<u>\$ 8,791</u>	<u>\$ 10,435</u>	<u>\$ 716</u>	<u>\$ 7,430</u>	<u>\$ 100,587</u>

**(e) Foreign Currency Risk**

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a foreign investment. University policy allows 15 – 25% of the investment portfolio to be invested in international investments: 13.8% and 14.8% were denominated in foreign currency in fiscal years 2008 and 2007, respectively. To reduce the risk related to fluctuations in currency exchange rates, the University has entered into forward foreign currency contracts throughout the year. As of June 30, 2008 and 2007, 11.0% or \$6,100 and 9.0% or \$4,995, respectively, of the Health System's share of the University's total investment portfolio is invested in forward foreign currency contracts. These contracts are marked to market and the changes in their market value are recorded in investment and endowment income on the Statements of Revenues, Expenses, and Changes in Net Assets.

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**(Dollars in thousands)**

**Foreign Currency Risk**  
**International Investment Securities at Fair Value**  
*(in thousands of dollars)*

<b>Currency</b>	<b>Cash and Cash Equivalents</b>	<b>Foreign Government Obligations</b>	<b>Foreign Corporate Bonds and Notes</b>	<b>Corporate Stock</b>	<b>2008 Total</b>	<b>2007 Total</b>
Australian Dollar	\$ 9	\$ 252	\$ 108	\$ 433	\$ 802	\$ 792
Brazil Real Total	—	—	9	9	18	—
British Pound Sterling	(788)	888	13	2,537	2,650	4,829
Canadian Dollar	955	295	57	165	1,472	1,250
Chilean Peso	—	—	—	4	4	4
Chinese Yan Renminbi	—	—	—	251	251	397
Danish Krone	1	—	65	30	96	96
Euro Currency Unit	1,237	4,163	1,990	5,883	13,273	12,591
Hong Kong Dollar	9	—	—	391	400	713
Hungarian Forint	—	—	—	—	—	141
Israeli Shekel	—	136	—	(46)	90	215
Japanese Yen	—	3,182	392	1,479	5,053	6,641
Malaysian Ringgit	—	282	—	201	483	230
Mexican New Peso	5	110	—	26	141	218
New Taiwan Dollar	—	—	—	23	23	22
New Zealand Dollar	3	—	—	(58)	(55)	(396)
Norwegian Krone	11	52	—	426	489	124
Polish Zloty	3	306	—	(29)	280	264
Russian Rubel	—	—	—	12	12	—
South African Comm Rand	—	—	—	29	29	48
Singapore Dollar	2	446	—	160	608	497
South Korean Won	—	85	—	(16)	69	199
Swedish Krona	8	247	80	326	661	749
Swiss Franc	11	—	—	1,687	1,698	2,128
UAE Dirham	—	—	—	38	38	—
<b>Total</b>	<b>\$ 1,466</b>	<b>\$ 10,444</b>	<b>\$ 2,714</b>	<b>\$ 13,961</b>	<b>\$ 28,585</b>	<b>\$ 31,752</b>

**(f) Concentration of Credit Risk**

The concentration of credit risk is the risk of loss attributed to the magnitude of investments in a single issuer (not including investments issued or guaranteed by the U.S. Government, investments in mutual funds, or external investment pools).

For University funds invested through the Pooled General Investments category, the following restrictions apply: 1) corporate bonds should not exceed 20% of the portfolio; 2) variable rate securities should not exceed 15% of the portfolio; and 3) investments in obligations of the U.S. Government, U.S. Government Agency issues, or U.S. Government guaranteed securities are unlimited.

For University funds invested through the Pooled Endowment Investments category, target asset mixes are evaluated to ensure diversification. The investment policy allows a portfolio consisting of no more than 37% U.S. equity, 24% international equity, 12.5% emerging markets equity, 10% private equity,

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10% absolute return funds, 12.5% real estate, 22% global fixed income, and 12% Treasury Inflation Protected Securities (TIPS).

Within the Pooled Endowment Investments category due to donor restrictions, certain monies can only be invested in fixed income securities. The Fixed Income Pool portfolio for these monies consists of U.S. Government, U.S. Government Agency issues, corporate fixed income, commercial paper, and repurchase agreements.

As of June 30, 2008, of the Health System's share of the University's total cash and investments, 14.5% are issues of the Federal Home Loan Bank (FHLB), 5.7% are issues of the Federal National Mortgage Association (FNMA), and 6.2% are issues of the Federal Home Loan Mortgage Corporation (FHLMC). As of June 30, 2007, of the Health System's share of the University's total cash and investments, 16.3% are issues of FHLB and 7.4% are issues of FNMA.

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**(Dollars in thousands)**

**(4) Capital Assets**

Capital assets activity is summarized as follows:

	<b>2008</b>			
	<u>Beginning balance</u>	<u>Additions/ Transfers</u>	<u>Retirements</u>	<u>Ending balance</u>
Capital assets, nondepreciable:				
Land	\$ 4,973	\$ —	\$ 27	\$ 4,946
Construction in progress	14,206	(2,645)	671	10,890
Total capital assets, nondepreciable	<u>19,179</u>	<u>(2,645)</u>	<u>698</u>	<u>15,836</u>
Capital assets, depreciable:				
Buildings and improvements	275,014	27,412	13,130	289,296
Infrastructure	2,952	77	153	2,876
Equipment	202,283	26,631	13,692	215,222
Total capital assets, depreciable	<u>480,249</u>	<u>54,120</u>	<u>26,975</u>	<u>507,394</u>
Less accumulated depreciation:				
Buildings and improvements	122,266	10,030	12,659	119,637
Infrastructure	1,246	171	153	1,264
Equipment	134,061	21,094	13,366	141,789
Total accumulated depreciation	<u>257,573</u>	<u>31,295</u>	<u>26,178</u>	<u>262,690</u>
Total capital assets, depreciable, net	<u>222,676</u>	<u>22,825</u>	<u>797</u>	<u>244,704</u>
Total capital assets, net	<u>\$ 241,855</u>	<u>\$ 20,180</u>	<u>\$ 1,495</u>	<u>\$ 260,540</u>

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	<b>2007</b>			
	<b>Beginning balance</b>	<b>Additions/ Transfers</b>	<b>Retirements</b>	<b>Ending balance</b>
Capital assets, nondepreciable:				
Land	\$ 4,973	\$ —	\$ —	\$ 4,973
Construction in progress	5,534	8,672	—	14,206
Total capital assets, nondepreciable	<u>10,507</u>	<u>8,672</u>	<u>—</u>	<u>19,179</u>
Capital assets, depreciable:				
Buildings and improvements	264,484	11,470	940	275,014
Infrastructure	2,387	565	—	2,952
Equipment	200,300	12,740	10,757	202,283
Total capital assets, depreciable	<u>467,171</u>	<u>24,775</u>	<u>11,697</u>	<u>480,249</u>
Less accumulated depreciation:				
Buildings and improvements	113,526	9,436	696	122,266
Infrastructure	1,080	166	—	1,246
Equipment	120,600	23,048	9,587	134,061
Total accumulated depreciation	<u>235,206</u>	<u>32,650</u>	<u>10,283</u>	<u>257,573</u>
Total capital assets, depreciable, net	<u>231,965</u>	<u>(7,875)</u>	<u>1,414</u>	<u>222,676</u>
Total capital assets, net	<u>\$ 242,472</u>	<u>\$ 797</u>	<u>\$ 1,414</u>	<u>\$ 241,855</u>

The estimated cost to complete construction in progress at June 30, 2008 is \$193,190 of which \$17,008 is available from unrestricted net assets. The remaining costs are expected to be funded from \$31,182 of state appropriations, \$25,000 of gifts, and \$120,000 of bond proceeds. Included in capital equipment is a building facility under a capital lease of \$8,332 and related accumulated depreciation of \$3,645 and \$3,229 at June 30, 2008 and 2007, respectively.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

**(5) Long-Term Debt**

Long-term debt activity is summarized as follows:

	<b>2008</b>					
	<u>Beginning of year</u>	<u>Issuance</u>	<u>Bond payments</u>	<u>Defeasance</u>	<u>Amortization</u>	<u>End of year</u>
System Facilities Revenue Bonds						
2006A	\$ 157,285	\$ —	\$ (4,135)	\$ —	\$ —	\$ 153,150
Less unamortized discounts	(362)	—	—	—	16	(346)
Total long-term debt	<u>156,923</u>	<u>\$ —</u>	<u>\$ (4,135)</u>	<u>\$ —</u>	<u>\$ 16</u>	<u>152,804</u>
Less current portion	<u>4,135</u>					<u>4,295</u>
Long-term debt	<u>\$ 152,788</u>					<u>\$ 148,509</u>
	<b>2007</b>					
	<u>Beginning of year</u>	<u>Issuance</u>	<u>Bond payments</u>	<u>Defeasance</u>	<u>Amortization</u>	<u>End of year</u>
System Facilities Revenue Bonds						
2006A	\$ 161,285	\$ —	\$ (4,000)	\$ —	\$ —	\$ 157,285
Less unamortized discounts	(378)	—	—	—	16	(362)
Total long-term debt	<u>160,907</u>	<u>\$ —</u>	<u>\$ (4,000)</u>	<u>\$ —</u>	<u>\$ 16</u>	<u>156,923</u>
Less current portion	<u>4,000</u>					<u>4,135</u>
Long-term debt	<u>\$ 156,907</u>					<u>\$ 152,788</u>

In 2006, the University issued \$161,285 of System Facilities Revenue Bond Series 2006A to advance refund and defease the Health Facilities Revenue Bonds, Series 1996 and Series 1998 and to finance certain costs of issuance. The System Facilities Revenue Bond Series 2006A was issued with an interest cost of 3.1% to 5%.

An \$8,992 loss in connection with the defeasance of the Health Facilities 1996 and 1998 Series is included as a reduction of debt outstanding and will be amortized over the remaining life of the original Health Facilities 1996 and 1998 Series. The defeasance decreased the aggregate debt service payments by \$19,167.

At June 30, 2008 and 2007, defeased bonds aggregating \$50,970 and \$53,275, respectively, are outstanding. Neither the escrowed investments nor the liabilities related to the refunded bonds appear in the accompanying balance sheets.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

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**(Dollars in thousands)**

Future minimum maturities on long-term debt as of June 30, 2008 for the next five fiscal years ending June 30 and beyond are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2009	\$ 4,295	\$ 7,198	\$ 11,493
2010	4,500	7,000	11,500
2011	4,710	6,794	11,504
2012	4,925	6,567	11,492
2013	5,175	6,326	11,501
2014 – 2018	29,920	27,577	57,497
2019 – 2023	38,260	19,224	57,484
2024 – 2028	49,495	8,618	58,113
2029	11,870	252	12,122
Total	<u>\$ 153,150</u>	<u>\$ 89,556</u>	<u>\$ 242,706</u>

**(6) Lease Obligations**

The Health System leases various facilities and equipment through operating and capital leases. Facilities under capitalized leases are recorded at the present value of future minimum lease payments. Total rental expenses for operating leases for the years ended June 30, 2008 and 2007 was \$1,940 and \$1,757, respectively.

On September 30, 1999, the Health System entered into a capital lease obligation for a facility, which is used by CRH. Expenditures incurred on operating leases for rental payments are charged to current expenses.

Capital lease activity is summarized as follows:

	<b>2008</b>			
	<u>Beginning of year</u>	<u>Payments</u>	<u>Reclass to short-term</u>	<u>End of year</u>
Total capital lease obligation	\$ 9,354	\$ 462	\$ —	\$ 8,892
Less current capital lease obligation	462	—	39	501
Long-term capital lease obligation	<u>\$ 8,892</u>	<u>\$ 462</u>	<u>\$ 39</u>	<u>\$ 8,391</u>
	<b>2007</b>			
	<u>Beginning of year</u>	<u>Payments</u>	<u>Reclass to short-term</u>	<u>End of year</u>
Total capital lease obligation	\$ 9,779	\$ 425	\$ —	\$ 9,354
Less current capital lease obligation	425	—	37	462
Long-term capital lease obligation	<u>\$ 9,354</u>	<u>\$ 425</u>	<u>\$ 37</u>	<u>\$ 8,892</u>

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

The future minimum payments on all significant leases with initial or remaining terms of one year or more at June 30, 2008 are as follows:

	<u>Capital</u>	<u>Operating</u>
Fiscal year:		
2009	\$ 1,374	\$ 2,270
2010	1,374	1,465
2011	1,374	1,201
2012	1,374	1,120
2013	1,374	793
2014 – 2018	6,870	2,307
2019 – 2020	1,718	—
	<u>15,458</u>	<u>\$ 9,156</u>
Total future minimum payments		
	15,458	\$ 9,156
Less amount representing interest	<u>6,566</u>	
Present value of future minimum lease payments	<u>\$ 8,892</u>	

In addition to the above lease obligations, the Health System has outstanding commitments for the acquisition, usage, and ongoing support of certain software for its patient clinical systems. As of June 30, 2008, these commitments totaled \$8,296 and will be paid in the following amounts: \$3,644 in 2009, \$3,708 in 2010, and \$944 in 2011.

*Description of Sublease Arrangement with IOS* – Concurrent with the fiscal 2003 sale of assets to IOS, the Health System entered into an agreement with IOS whereby IOS subleased certain building space from the Health System for a period of approximately 17 years at current market rates. The Health System recorded the transaction as a direct financing lease and recorded a minimum lease payment to be received of \$6,375, unearned rental income of \$3,233, and wrote off \$3,142 of building and improvements related to the sublease. The total minimum lease payments to be received is reflected in the other assets lines in the Statements of Net Assets.

Total minimum lease payments to be received:	
Current	\$ 418
Noncurrent	4,285
Total	<u>4,703</u>
Less unearned rental income	<u>(2,162)</u>
Present value of future minimum lease payments	<u>\$ 2,541</u>

During 2008, the Health System received \$418 of rental income from IOS. At June 30, 2008, minimum lease payments for each of the five succeeding fiscal years are as follows: \$418 in 2009, \$418 in 2010, \$418 in 2011, \$418 in 2012, \$418 in 2013, and \$2,613 thereafter.

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

**(7) Insurance**

**(a) Malpractice**

The Health System participates in the University's Medical, Professional, and Patient General Liability Trust (the Trust), which was established by the Board of Curators of the University effective July 1, 1978.

Payments from the Trust are limited to the settlement of medical, professional, and patient general liability claims and expenses. The assets of the Trust and the related estimated liabilities have been recorded by the University as part of its unrestricted funds.

The amounts funded by the Health System are actuarially determined, based principally on previous claim experience, to provide for settlement of claims arising out of the Health System's operations. The amounts contributed by the Health System to the Trust were \$4,331 and \$4,608 for the years ended June 30, 2008 and 2007, respectively, and are reflected as other expense in the accompanying basic financial statements.

Currently various claims are pending against the University; however, in the opinion of the University's administration and its legal counsel, liabilities, if any, arising from these claims are adequately covered by the Trust. The settlement of these claims is not expected to have a material effect on the Health System's liquidity, operations, and financial position.

**(b) Other**

The Health System is exposed to various risks of loss related to torts, theft of, damage to, and destruction of assets; injuries to employees; natural disasters; and various medically related benefit programs for employees. They participate in the University's plan, which funds these losses through a combination of self-insured retentions and commercially purchased insurance. The amount of self-insurance funds and commercial insurance maintained are based upon analysis of historical information and actuarial estimates. Settled claims have not exceeded commercial coverage in any of the past three fiscal years. The Health System is charged a premium annually from the University for such coverage.

**(8) Retirement Plan**

**(a) Plan Description**

All qualified employees of the Health System participate in the University of Missouri Retirement, Disability, and Death Benefits Plan (the Plan), a single employer defined benefit plan.

All full-time employees of the Health System are eligible for benefits after five years of service. The annual lifetime pension of a member is calculated by multiplying the number of years of service by 2.2% of the compensation base. The compensation base is the average regular annual salary of the member for the five consecutive highest salary years. Benefits to pensioners may be increased at certain times to reflect cost-of-living changes. Full benefits are available to members who retire at age 65 or thereafter. Faculty and staff who have completed 25 years in service can retire at age 62 without an early retirement reduction in their benefits. Early retirement benefits are available at reduced rates to members age 55 to 60 with at least ten years of credited service and members age 60 to

**UNIVERSITY OF MISSOURI HEALTH SYSTEM**

**Notes to Financial Statements**

**June 30, 2008 and 2007**

**(Dollars in thousands)**

65 with at least five years of credited service. Total Health System payroll was \$218,912 for the year ended June 30, 2008, of which \$171,880 was covered by the Plan in 2008.

**(b) Contributions**

Contributions to the Plan are based upon actuarially determined rates using the entry age normal method. The Health System's contributions to the Plan are included in expenses within the Statements of Revenues, Expenses, and Changes in Net Assets. Contributions to the Plan during the years ended June 30, 2008, 2007, and 2006, based on actuarially determined contribution rates, totaled \$13,750, \$14,371, and \$12,371, respectively. Contributions represented 8.0% of the Health System's current year covered payroll costs and 19.02% of the total current year actuarially determined contribution requirement for all University employees.

**(c) Additional Information**

Historical trend information and funding status information designed to provide information about the Plan's progress made in accumulating sufficient assets to pay benefits and disclose "actuarial accrued liability" and the funding excess or unfunded liability when due is presented in the University's annual report, which can be obtained at the Office of Finance and Administration, 215 University Hall, Columbia, Missouri 65211.

**(9) Other Postemployment Benefits**

In addition to the pension benefits described in note 8, the Health System participates in the University's postemployment benefits plan, which is a single-employer, defined benefit postemployment plan. The plan provides medical, dental, life insurance, and long-term disability benefits to claimants who were vested in the University's retirement plan at the time their disability began and vested employees who retire directly from the Health System after attaining age 55 and before reaching age 60 with ten years or more of service, or who retire after attaining age 60 with five or more years of service. Section 172.300 of the Revised Statutes of Missouri gives the University's Board of Curators sole authority and discretion to determine the terms and conditions governing the postemployment benefits to which employees are entitled.

In June 2008, the University established an Other Post-Employment Benefits Trust Fund, the assets of which are irrevocable and legally protected from creditors and dedicated to providing postemployment benefits in accordance with terms of the plan. Postemployment benefits, other than long-term disability, were previously funded on a current basis and expenses were recorded on a pay-as-you-go basis. Additional information regarding the University's postemployment benefits plan is disclosed in the University's annual financial report, which can be obtained at the Office of Finance and Administration, 215 University Hall, Columbia, Missouri 65211.

As of June 30, 2008 and 2007, 648 and 634 members receiving postemployment benefits were formerly employees of the Health System. Individual member's contributions depend on the medical, dental, and life insurance coverage options they have chosen. For fiscal year 2008, all University members contributed \$11,860 or approximately 46.5% of the total premiums. The Health System paid the University \$2,456 and \$2,693 for the years ended June 30, 2008 and 2007, respectively. The Health System assumes no liability for postemployment benefits provided by the University other than its annual required contributions.

# UNIVERSITY OF MISSOURI HEALTH SYSTEM

## Notes to Financial Statements

June 30, 2008 and 2007

(Dollars in thousands)

### (10) Related-Party Transactions

The Health System and the other divisions of the University provide a variety of support services to each other and these transactions are recorded as revenues and expenses in the financial statements. The cost of these services is allocated to the user on methods, which vary according to the service being furnished. These services are paid for by inter-University payments of funds, which are net reductions of operating expenses of the unit providing the service, and are included in the operating costs of the unit receiving the service. Administrative and purchased services paid for by the University and allocated to the Health System during the year ended June 30, 2008 and 2007 were \$46,867 and \$48,548 respectively. Administrative and purchased services paid for by the Health System and allocated to the University during the years ended June 30, 2008 and 2007 were \$9,222 and \$8,954, respectively, and are included as a reduction of other expenses in the accompanying basic financial statements. These amounts exclude University Physicians distributions. The Health System also received revenues of \$0 and \$16,192 from University subsidiaries during 2008 and 2007, respectively.

The Health System obtained \$50,000 of investments via a loan from the University in fiscal 2001. The University committed to loan future funds if the days cash on hand goes below 85 days. The loan is to be repaid upon demand in whole or in part at such time that days cash on hand of the Health System is not less than 85 days. An additional \$5,000 loan was made accordingly in fiscal 2002. Based upon the loan agreement, the Health System does not pay interest expense on the loan or receive interest income on the related assets. There were no additions to or repayments on the loan in 2008 or 2007. Management does not anticipate repayment of the loan in fiscal year 2009.

Certain operational services of the Health System, such as pharmacy, housekeeping, laundry, and other miscellaneous services are provided to the IOS. These services are invoiced at cost and are recorded in operating revenues. Total services provided by the Health System to IOS in fiscal 2008 and 2007 totaled \$224 and \$218, respectively.

### (11) Transfers

In addition to services purchased from the divisions of the University, the Health System also provides support to certain of these divisions through transfers. These transfers were approximately \$3,600 and \$2,700 at June 30, 2008 and 2007, respectively, and principally provide funding for recruitments and operational support to divisions. In fiscal 2007, these transfers to the University were offset by \$19,317 of funds received from the University related to the sale of Missouri Care L.C., a component unit of the University. Missouri Care was a not-for-profit health maintenance organization which provided services to individuals throughout mid-Missouri, under certification from the Missouri Department of Social Services.

### (12) Subsequent Event

Since June 30, 2008, the global financial markets have been experiencing a severe downturn, which in turn has resulted in unrealized decreases in the fair value of the Health System's share of the University's long-term investment portfolio. As of the date of this report, it is unclear how long this downward pressure on investment values might continue and what other implications there will be for the overall U.S. and global economy. The University's management and its investment advisors are monitoring the situation to determine appropriate strategies and actions. The University's investment strategy generally has been to take a long-term approach to maximizing investment return.