



UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)

Financial Statements and
Other Information

June 30, 2008

(With Independent Auditors' Report Thereon)

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)
Fiscal year 2008 Official Roster

Board of Directors

Paul Roth, M.D. Albuquerque, New Mexico	Executive Vice President (Term expires 6/30/2009, Regent appointed) UNM Health Sciences Center Dean, UNM School of Medicine Chairman of the Board, UNMMG President and CEO, UNMMG
Robert Katz, M.D. Albuquerque, New Mexico	Senior Associate Dean of Clinical Affairs (Term expires 6/30/2009, Regent appointed) Chief Operating Officer, UNMMG
John "Mel" Eaves, Esq. Albuquerque, New Mexico	UNM Regent (Term expires 6/30/2010, Regent appointed)
Douglas Brown Albuquerque, New Mexico	Independent, non-UNM Faculty (Term expires 6/30/2010, Regent appointed)
Gerald Landgraf Albuquerque, New Mexico	Independent, non-UNM Faculty (Term expires 6/30/2009, Regent appointed)
John Wills, M.D. Albuquerque, New Mexico	Chair, Anesthesiology (Term expires 6/30/2010, Regent appointed)
Cheryl Willman, M.D. Albuquerque, New Mexico	Director, CRTIC (Term expires 6/30/2010, Regent appointed)
R. Steven Padilla, M.D. Albuquerque, New Mexico	Chair, Dermatology (Term expires 6/30/2009, Regent appointed)
Michael Richards, M.D. Albuquerque, New Mexico	Chair, Emergency Medicine (Term expires 6/30/2008, Regent appointed)
Arthur Kaufman, M.D. Albuquerque, New Mexico	Chair, Family & Community Medicine (Term expires 6/30/2008, Regent appointed)
Pope Moseley, M.D. Albuquerque, New Mexico	Chair, Internal Medicine (Term expires 6/30/2008, Regent appointed)
Gary Rosenburg, M.D. Albuquerque, New Mexico	Chair, Neurology (Term expires 6/30/2010, Regent appointed)
Howard Yonas, M.D. Albuquerque, New Mexico	Chair, Neurosurgery (Term expires 6/30/2009, Regent appointed)

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UNM MEDICAL GROUP, INC.
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Fiscal year 2008 Official Roster

Board of Directors

William Rayburn, M.D. Albuquerque, New Mexico	Chair, OB/GYN (Term expires 6/30/2010, Regent appointed)
Robert Schenk, M.D. Albuquerque, New Mexico	Chair, Orthopedics (Term expires 6/30/2010, Regent appointed)
Brian Hjelle, M.D. Albuquerque, New Mexico	Chair, Pathology (Term expires 6/30/2009, Regent appointed)
Loretta Cordova de Ortega, M.D. Albuquerque, New Mexico	Chair, Pediatrics (Term expires 6/30/2008, Regent appointed)
Sam Keith, M.D. Albuquerque, New Mexico	Chair, Psychiatry (Term expires 6/30/2008, Regent appointed)
Michael Williamson, M.D. Albuquerque, New Mexico	Chair, Radiology (Term expires 6/30/2009, Regent appointed)
John Russell, M.D. Albuquerque, New Mexico	Chair, Surgery (Term expires 6/30/2009, Regent appointed)

Non-voting Directors:

Stephen McKernan, Albuquerque, New Mexico	Chief Executive Officer, UNMH
Jeffrey Griffith, Ph.D. Albuquerque, New Mexico	Executive Dean, UNM School of Medicine
David Pitcher, M.D. Albuquerque, New Mexico	Executive Medical Director of Inpatient Operations
Carolyn Voss, M.D. Albuquerque, New Mexico	Executive Medical Director of Ambulatory Care Operations
David Gonzales, M.D. Albuquerque, New Mexico	Executive Medical Director of Quality / Safety

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UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)
Fiscal year 2008 Official Roster

Officers

Paul Roth, M.D. Albuquerque, New Mexico	Chairman of the Board President and CEO
Robert Katz, M.D. Albuquerque, New Mexico	Senior Associate Dean of Clinical Affairs Chief Operating Officer
R. Steven Padilla, M.D. Albuquerque, New Mexico	First Vice President
Anthony Masciotra, Jr. Albuquerque, New Mexico	Executive Director Chief Finance Officer
Frederick Rupp, M.D. Albuquerque, New Mexico	Secretary

UNM MEDICAL GROUP, INC.
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KPMG LLP
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Independent Auditors' Report

The Board of Directors
UNM Medical Group, Inc.
and
Mr. Hector Balderas, State Auditor:

We have audited the accompanying statement of net assets of the University of New Mexico Medical Group, Inc. (UNMMG), a component unit of the University of New Mexico, as of June 30, 2008, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year ended June 30, 2008. These financial statements are the responsibility of UNMMG's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of UNMMG'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 audit provides a reasonable basis for our opinion.

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

In accordance with *Government Auditing Standards*, we have also issued our report dated December 18, 2008 on our consideration of UNMMG's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 6 is 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.

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise UNMMG's basic financial statements. The accompanying schedules of pledged collateral by banks and deposit and investment account balances (schedules 1 and 2, respectively) are presented for purposes of additional analysis and are not a required part of the financial statements referred to above. The accompanying schedules of pledged collateral by banks and deposit and investment account balances have been subjected to the auditing procedures applied in the audit of the basic financial statements referred to above and, in our opinion, are fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

KPMG LLP

December 18, 2008

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)

Management's Discussion and Analysis

June 30, 2008

The following discussion and analysis provides an overview of the financial position and activities of the UNM Medical Group, Inc. (UNMMG) as of and for the year ended June 30, 2008. This discussion should be read in conjunction with the accompanying financial statements and notes. Management has prepared the basic financial statements and the related note disclosures along with this discussion and analysis. As such, the financial statements, notes, and this discussion are the responsibility of UNMMG management.

Using the Annual Financial Report

This annual report consists of financial statements prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). As a special-purpose government engaged in business-type activities, UNMMG's financial statements present financial information in a form similar to that used by corporations. They are prepared under the accrual basis of accounting, whereby revenues are recognized when the service is provided, and expenses are recognized when others provide the service, regardless of when cash is exchanged.

The statement of net assets includes all assets and liabilities.

The statement of revenues, expenses, and changes in net assets presents the revenues earned and expenses incurred during the year. Activities are reported as either operating or nonoperating. The utilization of capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life.

The statement of cash flows presents information related to cash inflows and outflows summarized by operating, capital and noncapital financing, and investing activities, which helps measure the ability to meet financial obligations as they mature.

Overview of Entity

In June 2007, Regents of the University of New Mexico (UNM) and the faculty members of University Physicians Associates (UPA) voted to approve the merger of UPA into the newly formed UNMMG, a New Mexico nonprofit corporation organized under and pursuant to the New Mexico University Research Park and Economic Development Act. The purpose of the merger was to align the clinical, educational, and operational mission of the UPA with the strategic goals of the University of New Mexico Health Sciences Center (UNM HSC) in advancing leading healthcare services across New Mexico through the establishment of an integrated medical practice. The effective date of the merger was July 1, 2007. At the effective date, all the property, rights, privileges, debts, liabilities, and duties of the UPA were assumed by the UNMMG. Therefore, UNMMG assumed all assets and liabilities of UPA as of July 1, 2007, which were recorded by UNMMG as the beginning balances for fiscal year 2008. As UPA's assets equaled its liabilities, there were no net assets assumed by UNMMG. UNMMG is the surviving corporation and the Regents of UNM are its sole members. Pursuant to an agreement with UNM Regents, UNMMG is responsible for the practice oversight and management of the professional medical practice of UNM.

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Management's Discussion and Analysis

June 30, 2008

Condensed Summary of Net Assets

	2008	2007
Assets:		
Current assets	\$ 34,053,524	17,990,088
Capital assets	505,316	445,875
Other noncurrent assets	4,487,900	1,705,776
Total assets	39,046,740	20,141,739
Liabilities:		
Current liabilities	23,531,434	20,141,739
Total liabilities	23,531,434	20,141,739
Net assets:		
Invested in capital assets	505,316	—
Unrestricted	15,009,990	—
Total net assets	\$ 15,515,306	—

Pursuant to the merger described previously, UNMMG assumed all assets and liabilities of UPA as of July 1, 2007, which were recorded as the beginning balances for fiscal year 2008. As UNMMG represents a new operating entity, the 2007 balances above are presented for informational purposes only.

Current assets included cash and other assets that were deemed to be consumed or convertible to cash within one year. As of June 30, 2008, total current assets of \$34.1 million consisted primarily of \$16.1 million of cash and cash equivalents and \$17.2 million of net patient receivables. Noncurrent assets represent capital assets of \$0.5 million and other assets of \$4.5 million primarily consisting of board-designated investments in cash and cash equivalents and certificates of deposit.

Current liabilities are generally defined as amounts due within one year. As of June 30, 2008, total current liabilities of \$23.5 million include purchased services payable to UNM HSC of \$19.7 million. Also included in current liabilities are amounts payable to UNM for operating expenses in the amount of \$2.0 million and other current liabilities of \$1.8 million.

At June 30, 2008, UNMMG's current ratio, the amount of current assets available to cover current liabilities, was 1.45. Payment of UNMMG's current liabilities is dependent on UNMMG's ability to collect patient and other receivables.

UNM MEDICAL GROUP, INC.
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Management's Discussion and Analysis

June 30, 2008

Condensed Summary of Revenues, Expenses, and Changes in Net Assets

Net operating revenues	\$ 87,867,917
Operating expenses:	
Purchased clinical services	65,992,167
Salaries and benefits	7,110,700
Other	<u>10,151,348</u>
Total operating expenses	<u>83,254,215</u>
Operating income	<u>4,613,702</u>
Nonoperating revenues:	
Interest income	445,683
Forgiveness of liability due to UNM HSC	<u>10,455,921</u>
Total nonoperating revenues	<u>10,901,604</u>
Change in net assets	15,515,306
Net assets, beginning of year	<u>—</u>
Net assets, end of year	<u><u>\$ 15,515,306</u></u>

Net operating revenues, generated primarily through the delivery of professional clinical services, are reduced by contractual allowances and by a provision for uncollectible accounts. A condensed summary of the net operating revenue calculation follows:

Patient service charges billed at established rates, including charity care	\$ 241,853,942
Adjustments to charges:	
Contractual adjustments	(94,703,432)
Charity care	<u>(39,121,826)</u>
Net patient billings	108,028,684
Provision for uncollectible accounts	<u>(21,029,154)</u>
Net patient service revenues	86,999,530
Other revenue	<u>868,387</u>
Total net operating revenues	<u><u>\$ 87,867,917</u></u>

Total operating expenses of \$83.3 million for the year ended June 30, 2008 consisted primarily of cost related to the purchase of clinical services from UNM HSC and the associated dean's tax from School of Medicine (SOM), which totaled \$70.2 million.

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Management's Discussion and Analysis

June 30, 2008

UNM HSC and SOM allocate the administrative support costs in exchange for administrative services provided to the clinical departments and UNMMG via the assessment of a gap tax and dean's tax, respectively. The gap tax is assessed annually by the UNM HSC and is equal to approximately \$0.4 million reported on the statement of revenues, expenses, and changes in net assets. The dean's tax is a fixed percentage assessment on clinical revenues assessed by the SOM equal to approximately \$4.2 million reported on the statement of revenues, expenses, and changes in net assets.

Nonoperating revenues of \$10.9 million for the year ended June 30, 2008 consisted principally of the forgiveness of UPA's liability due to UNM HSC, which represented clinical revenues due from UPA to UNM HSC that were assumed as part of the merger of UPA and UNMMG of \$10.5 million and subsequently forgiven. Also included in nonoperating revenues is interest income on certificates of deposit and U.S. Treasury bills of \$0.4 million.

Capital Assets

At June 30, 2008, UNMMG had \$0.5 million invested in capital assets, net of accumulated depreciation and amortization of approximately \$2.4 million. Capital assets consist primarily of furniture and equipment. Capital assets used to provide clinical services are owned by the University of New Mexico Hospital (UNMH) and are not reported on UNMMG's financial statements.

In 2008, UNMMG signed a letter of intent to negotiate exclusively with Legacy Hospital Partners, Inc. to build a new acute care teaching facility in Sandoval County. The letter of intent establishes milestones to be accomplished by both parties in order to move forward in the construction of the facilities. Construction is expected to commence in the first quarter of calendar year 2009 with expected completion in the winter of 2010. UNMMG has not entered into any arrangements for funding at this time.

Factors Impacting Future Periods

The Medicare Improvements for Patients and Providers Act of 2008 was enacted on July 15, 2008 resulting in a revised Medicare Physician Fee Schedule (MPFS), retroactive to July 1, 2008. The revised MPFS replaces the originally proposed 10.6% rate reduction with an increase of 0.5%. This revision is expected to have a minimal impact to UNMMG.

The Centers for Medicare and Medicaid Services (CMS) also issued proposed changes to the MPFS for 2009. After reviewing public comments, CMS will publish a final rule by November 1, 2008 to become effective for services furnished beginning January 1, 2009. Finalized information is not available at this time.

Contacting UNMMG's Financial Management

This financial report is designed to provide the public with a general overview of UNMMG's finances. If you have questions about this report or need additional financial information, contact the UNMMG's Controller's office at 1650 University Blvd., Suite 115, Albuquerque, NM 87102.

UNM MEDICAL GROUP, INC.
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Statement of Net Assets

June 30, 2008

Assets

Current assets:	
Cash and cash equivalents	\$ 16,091,416
Receivables:	
Net patient receivables (net of allowance for uncollectible accounts of \$15,366,860 and contractual allowance of \$13,589,012)	17,243,494
Other	718,614
Total net receivables	<u>17,962,108</u>
Total current assets	<u>34,053,524</u>
Noncurrent assets:	
Board-designated assets:	
Cash and cash equivalents (note 4)	3,313,168
Investments (note 4)	957,755
Total board-designated assets	<u>4,270,923</u>
Capital assets, net (note 5)	505,316
Other assets	216,977
Total noncurrent assets	<u>4,993,216</u>
Total assets	<u>39,046,740</u>

Liabilities

Current liabilities:	
Purchased services payable due to UNM HSC (note 11)	19,700,345
Operating expenses due to UNM (note 11)	2,021,407
Accrued liabilities (note 7)	1,347,938
Refunds payable (note 6)	461,744
Total current liabilities	<u>23,531,434</u>

Commitments and contingencies (notes 12, 13, and 14)

Net Assets

Invested in capital assets	505,316
Unrestricted	15,009,990
Total net assets	<u>\$ 15,515,306</u>

The notes are an integral part of these financial statements.

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)
Statement of Revenues, Expenses, and Changes in Net Assets
Year ended June 30, 2008

Operating revenues:	
Patient service revenues, net (note 9)	\$ 86,999,530
Other revenue	868,387
Total net operating revenues	87,867,917
Operating expenses:	
Purchased clinical services from UNM HSC	65,992,167
Salaries and benefits	7,110,700
Dean's tax (note 11)	4,203,776
Malpractice insurance (note 8)	1,838,403
Other administrative	1,530,565
Data processing	662,728
Patient registration and enrollment support	528,698
Gap tax (note 11)	447,178
Depreciation and amortization	344,755
Consulting	246,607
Occupancy	236,159
Postage and shipping	112,479
Total operating expenses	83,254,215
Operating income	4,613,702
Nonoperating revenues:	
Interest income	445,683
Forgiveness of liability due to UNM HSC (note 1)	10,455,921
Total nonoperating revenues	10,901,604
Change in net assets	15,515,306
Net assets, beginning of year	—
Net assets, end of year	\$ 15,515,306

The notes are an integral part of these financial statements.

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Statement of Cash Flows

Year ended June 30, 2008

Cash flows from operating activities:	
Payments from insurance and patients	\$ 83,208,289
Payments to UNM HSC	(57,048,144)
Payments to employees	(5,546,980)
Payments for employee benefits	(1,822,814)
Payments to suppliers	(4,787,936)
Other payments	(130,900)
	<u>13,871,515</u>
Net cash provided by operating activities	<u>13,871,515</u>
Cash flows from capital financing activities – purchase of capital assets	<u>(404,195)</u>
Cash flows from investing activities:	
Investment income	445,683
Purchase of investments	(957,755)
	<u>(512,072)</u>
Net cash used in investing activities	<u>(512,072)</u>
Net increase in cash and cash equivalents	12,955,248
Cash and cash equivalents, beginning of year	<u>6,449,336</u>
Cash and cash equivalents, end of year	<u>\$ 19,404,584</u>
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	\$ 4,613,702
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation and amortization	344,755
Changes in assets and liabilities:	
Patient receivables	(5,191,439)
Other receivables	389,783
Purchase services due to UNM HSC	19,700,345
UPA distribution payable to UNM HSC	(5,614,902)
Operating expense due to UNM	(259,094)
Accrued liabilities	(122,765)
Refunds payable	142,030
Other assets	(130,900)
	<u>13,871,515</u>
Net cash provided by operating activities	<u>\$ 13,871,515</u>

Noncash investing, capital, and financing activities:

During 2008, liabilities assumed from UPA related to all distributions of clinical revenues due to UNM HSC as of June 30, 2007 were forgiven in the amount of \$10,455,921. This forgiveness is reported as nonoperating revenue on the statement of revenues, expenses, and changes in net assets.

The notes are an integral part of these financial statements.

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Notes to Financial Statements

June 30, 2008

(1) Description of Business

UNM Medical Group, Inc. (UNMMG) is a New Mexico not-for-profit corporation that was organized to promote, advance, and support the clinical scientific, educational, research, and charitable purposes of the School of Medicine (SOM) and the University of New Mexico Health Sciences Center (UNM HSC). UNMMG is a component unit of the University of New Mexico (UNM) and is reported as such in the basic financial statements of UNM. UNMMG has no component units.

In June 2007, Regents of the UNM and the faculty members of University Physicians Associates (UPA) voted to approve the merger of UPA into the newly formed UNMMG, a New Mexico nonprofit corporation organized under and pursuant to the New Mexico University Research Park and Economic Development Act. The purpose of the merger was to align the clinical, educational, and operational mission of the UPA with the strategic goals of the University of New Mexico Health Sciences Center (UNM HSC) in advancing leading healthcare services across New Mexico through the establishment of an integrated medical practice. The effective date of the merger was July 1, 2007. At the effective date, all the property, rights, privileges, debts, liabilities, and duties of the UPA were assumed by the UNMMG. Therefore, UNMMG assumed all assets and liabilities of UPA as of July 1, 2007, which were recorded by UNMMG as the beginning balances for fiscal year 2008. As UPA's assets equaled its liabilities, there were no net assets assumed by UNMMG. UNMMG is the surviving corporation and the Regents of the University of New Mexico are its sole members. Pursuant to an agreement UNM Regents, UNMMG is responsible for the practice oversight and management of the professional medical practice of UNM.

During 2008, liabilities assumed from UPA related to distributions of clinical revenues due to UNM HSC as of June 30, 2007 for the exception of two matters (i) the repayment of certain prior years distributions that were due to UNM HSC on behalf of SOM in the amount of \$1,113,767, and (ii) prior years outstanding operating expense liabilities in the amount of \$450,762, were forgiven in the amount of \$10,455,921. This forgiveness is reported as nonoperating revenue on the statement of revenues, expenses, and changes in net assets.

Pursuant to the affiliation and management services agreement with the UNM Regents, UNMMG is responsible for the delivery of patient clinical services, practice oversight and management of the professional medical practice of UNM, which includes the SOM's faculty and staff physicians and other professional healthcare providers under the patient care management, supervision, and quality control of the SOM's clinical departments.

(2) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting, in accordance with U.S. generally accepted accounting principles for state and local governments as prescribed by the Governmental Accounting Standards Board (GASB). As a special-purpose government engaged in business-type activities, UNMMG's financial statements present financial information in a form similar to that used by corporations.

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June 30, 2008

Pursuant to GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, UNMMG has elected not to apply Statements of Financial Accounting Standards issued by the Financial Accounting Standards Board (FASB) after November 1989.

(b) Net Assets

For accounting and reporting purposes, UNMMG reports its net assets in the following three net asset categories as applicable:

- *Invested in capital assets, net of related debt:* Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction, or improvement of those assets.
- *Restricted net assets – expendable:* Net assets whose use by UNMMG is subject to externally imposed constraints that can be fulfilled by actions of UNMMG pursuant to those constraints or that expires by the passage of time.
- *Unrestricted:* Net assets that are not subject to externally imposed constraints. Unrestricted net assets may be designated for specific purposes by action of the UNMMG Board of Directors (the Board).

(c) Use of Estimates

The preparation of financial statements in accordance with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the financial statement dates, and the reported amount of revenues and expenses during the reporting periods. Due to uncertainties inherent in the estimation process, actual results could differ from those estimates.

(d) Cash and Cash Equivalents

UNMMG considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. One-hundred percent (100%) of the deposit balance at June 30, 2008 was collateralized with securities held in the name of UNMMG.

(e) Revenue Recognition and Net Patient Receivables

UNMMG revenue is a result of providing professional medical services to patients in healthcare facilities of the UNM HSC and other locations contracted with UNM.

Net patient revenue and receivables are recorded at the estimated net realizable amount due from patients, third-party payors, and others for services rendered.

Contractual adjustments resulting from agreements with various organizations to provide services for amounts that differ from billed charges, including services under Medicare, Medicaid, and certain managed care programs, are recorded as deductions from patient revenues. Allowances for

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Notes to Financial Statements

June 30, 2008

contractual adjustments and doubtful accounts are based on an analysis of historical collectibility of patient accounts.

Accounts, when determined to be uncollectible, are charged against the allowance for uncollectible accounts.

(f) Capital Assets

Capital assets consist primarily of furniture and equipment. Capital assets with a cost of \$5,000 or greater are capitalized and depreciated over useful lives ranging from three to five years. Depreciation is calculated on a straight-line basis over the estimated useful lives of the assets. Repairs and maintenance costs are charged to expense as incurred. Capital assets used to provide clinical services are owned by the University of New Mexico Hospital (UNMH) and are not reported in UNMMG's financial statements.

(g) Operating Revenues and Expenses

UNMMG's statement of revenues, expenses, and changes in net assets distinguishes between operating and nonoperating revenues and expenses. Operating revenues result primarily from the delivery of professional medical services and the related billing of those services to patients and third-party payors and are considered exchange transactions as each party receives and gives up equal value. Operating expenses are all expenses incurred to provide medical services.

(h) Purchase of Clinical Services from UNM HSC

UNMMG has entered into a purchased services agreement with UNM HSC to purchase the clinical effort of various clinical providers primarily from the SOM. This clinical effort is the basis of the clinical services rendered and billed by the UNMMG. The cost of the clinical purchased services is negotiated by UNM HSC and the UNMMG Board and is reported as an operating expense. The cost is agreed upon annually and UNMMG is billed monthly by UNM HSC. In the event that additional clinical effort is required to support the clinical, educational, and research mission of the medical group, the executive committee of the UNMMG will determine and approve the purchase of any additional services.

(i) Salaries and Benefits

The employees who work at UNMMG are employed by UNM. All related salaries and benefits including all retirement benefits are paid by UNM. UNM allocates the salary and benefit costs of these employees to UNMMG via the monthly operating expense invoice. UNMMG does not have any further obligation or responsibility to pay these individuals beyond the allocated cost from UNM.

(j) Income Taxes

UNMMG is a governmental not-for-profit organization. UNMMG has filed with the Internal Revenue Service for classification of exemption from federal and state income taxes as an organization described in Section 501(c)(3) of the Internal Revenue Code.

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Notes to Financial Statements

June 30, 2008

(k) Charity Care

UNMMG provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UNMMG does not pursue collection of amounts determined to qualify as charity care, they are deducted from gross revenue.

(3) Cash and Cash Equivalents

UNMMG's cash and cash equivalents are held in demand accounts and repurchase agreements with a local financial institution in the name of UNMMG. State statute requires financial institutions to pledge qualifying collateral to UNMMG to cover at least 50% of the uninsured deposits.

The State of New Mexico (the State) requires that securities underlying repurchase agreements have a market value of at least 102% of the cost of the repurchase agreement. The market value of the securities underlying the repurchase agreements was at or above the required level during the year ended June 30, 2008.

Bank balances are categorized as follows:

Repurchase agreements	\$ 9,781,841
Amount insured by Federal Deposit Insurance Corporation	100,000
Amount collateralized with securities held in the UNMMG's name	<u>11,119,097</u>
Total bank balances	<u><u>\$ 21,000,938</u></u>

(4) Board-Designated Assets

Board-designated assets are classified in the accompanying statement of net assets as noncurrent assets, as these assets are designated by the Board for future use subject to approval by the Board. At June 30, 2008, these assets comprised investments in certificates of deposit recorded at cost, which approximated fair value, and cash and cash equivalents and were collateralized with securities held in the name of UNMMG.

In 2008, the Board also voted to appropriate additional assets to fund future clinical initiatives and improvement in quality measurements and outcomes for the medical group (i.e., quality and investment withhold).

Assets are designated for the following purposes:

Hardware and technology	\$ 1,463,152
Quality withhold	600,000
Investment withhold	<u>2,207,771</u>
Total Board-designated assets	<u><u>\$ 4,270,923</u></u>

UNM MEDICAL GROUP, INC.
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Notes to Financial Statements

June 30, 2008

(5) Capital Assets

At June 30, 2008, capital assets consisted of:

Furniture and equipment	\$	2,862,132
Less accumulated depreciation		<u>(2,356,816)</u>
	\$	<u><u>505,316</u></u>

Activity in capital assets is summarized as follows:

		<u>Cost</u>	<u>Accumulated depreciation</u>	<u>Net</u>
Balance, July 1, 2007	\$	2,519,373	2,073,497	445,876
Additions		404,195	344,755	59,440
Deletions		<u>(61,436)</u>	<u>(61,436)</u>	—
Balance, June 30, 2008	\$	<u><u>2,862,132</u></u>	<u><u>2,356,816</u></u>	<u><u>505,316</u></u>

(6) Refunds Payable

Refunds payable are amounts received in error from third-party payors and/or payments on accounts receivable in excess of the patient account balance.

(7) Accrued Liabilities

At June 30, 2008, accrued liabilities consisted of:

Accrued operating expenses	\$	109,403
Due to UNMH		340,486
Indigent distribution due to UNM HSC		425,843
Accrued leave		226,889
Unclaimed property		160,250
Other		<u>85,067</u>
	\$	<u><u>1,347,938</u></u>

During the year ended June 30, 2008, the following changes occurred in accrued leave:

	<u>Balance July 1, 2007</u>	<u>Increase</u>	<u>Decrease</u>	<u>Balance June 30, 2008</u>
\$	240,682	436,284	(450,077)	226,889

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June 30, 2008

(8) Malpractice Insurance

As a New Mexico University Research Park and Economic Development Act corporation, the UNMMG enjoys sovereign immunity from suit for tort liability except as waived by the New Mexico legislature. In this connection, under the New Mexico Tort Claims Act, the New Mexico Legislature waived the State's and the UNMMG's sovereign immunity for claims arising out of negligence out of operation of the UNMMG. In addition, the New Mexico Tort Claims Act limits, as an integral part of this waiver of sovereign immunity, the amount of damages that can be assessed against the UNMMG on any tort. In this connection, the New Mexico Tort Claims Act allows damages to be awarded as follows: (a) up to \$300,000 for past and future reasonable economic or property losses incurred or to be incurred by the claimant; (b) up to \$400,000 for past and future noneconomic losses (such as pain and suffering) incurred or to be incurred by the claimant; and (c) up to \$350,000 for family members of the claimant (to the extent they qualify therefore) for loss of consortium. The New Mexico Tort Claims Act also prohibits the award of punitive or exemplary damages against the UNMMG. The New Mexico Tort Claims Act requires the Risk Management Division of the State of New Mexico General Services Department (State RMD) to provide coverage to the UNMMG through UNM HSC for those torts where the legislature has waived the State's sovereign immunity up to the damages limits of the New Mexico Tort Claims Act plus the cost incurred in defending any claims and/or lawsuits (including attorney's fees and expenses), with no deductible and with no self-insured retention by the UNMMG. As a result of the foregoing, the UNMMG is fully covered for claims and/or lawsuits and does not have any responsibility for claims beyond this premium. The UNMMG is allocated a portion of the premium assessed by the State to UNM HSC for this coverage which is reported as malpractice insurance expense on the statement of revenues, expenses, and changes in net assets.

(9) Patient Service Revenues

UNMMG generates net operating revenues through the billing and collection of professional services rendered. The majority of UNMMG revenue is generated through agreements with third-party payors who provide reimbursement at amounts different from established gross charges. Contractual adjustments resulting from these agreements to provide services for amounts that differ from billed charges, including services under Medicare, Medicaid, and certain managed care programs, are recorded as deductions from patient revenues. Accounts, when determined to be uncollectible, are charged against the allowance for uncollectible accounts.

Approximately 77% of UNMMG's gross patient revenue for the year ended June 30, 2008 was derived from third-party payors. Medicare and Medicaid represented approximately 48%. A summary of the basis of reimbursement from major third-party payors follows:

Medicare and Medicaid – Professional services are reimbursed based on a published fee schedule that is determined by the related governing body of these programs. Continuation of these programs is dependent upon federal and state government policies and funding. There is a reasonable possibility that future revenue streams would be impacted as a result regulatory policy changes.

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June 30, 2008

Managed Care Contracts – UNMMG has also entered into contractual agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The reimbursement of professional services is determined primarily via a negotiated conversion factor and associated fee schedule with each payor. Managed care contract rates are negotiated annually.

A summary of the net patient service revenues for the year ended June 30, 2008 follows:

Patient service charges billed at established rates, including charity care	\$ 241,853,942
Adjustments to charges:	
Contractual adjustments	(94,703,432)
Charity care	<u>(39,121,826)</u>
Net patient billing	108,028,684
Provision for uncollectible accounts	<u>(21,029,154)</u>
Net patient service revenues	<u><u>\$ 86,999,530</u></u>

(10) Charity Care

UNMMG maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following information measures the level of charity care provided during the year ended June 30, 2008:

Changes foregone, based on established rates	\$ 39,121,826
Estimated costs and expenses incurred to provide charity care	16,431,167
Equivalent percentage of charity care to total gross revenue	16.18%

(11) Related-Party Transactions

UNMMG entered into a purchased services agreement with UNM HSC to purchase the clinical effort of various clinical providers primarily from the SOM. This clinical effort is the basis of the clinical services rendered and billed by the UNMMG. The cost of the clinical purchased services is negotiated by UNM HSC and the UNMMG Board. The cost is agreed upon annually and UNMMG is billed monthly by UNM HSC. In the event that additional clinical effort is required to support the clinical, educational, and research mission of the medical group, the executive committee of the UNMMG will determine and approve the purchase of any additional services. In addition, as part of the process in establishing the UNMMG, a liability of certain prior years distributions that were due to UNMMG on behalf of SOM will remain a distribution liability of UNMMG. For the year ended June 30, 2008, UNMMG purchased services in the amount of approximately \$66.0 million, which is recorded as an operating expense on the statement of revenues, expenses, and changes in net assets. The related unpaid amount of approximately \$19.7 million is reported as a current liability on the statement of net assets.

UNM processes payroll and various other expenses through its business office on behalf of UNMMG. UNMMG reimburses UNM for the expenses. For the year ended June 30, 2008, UNMMG's liabilities for

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June 30, 2008

these expenses were approximately \$2.0 million and are reported as a current liability on the statement of net assets. The related expenses are reported as operating expenses within the appropriate categories on the statement of revenues, expenses, and changes in net assets.

UNMH performs patient registration, Medicaid eligibility, and certain computer operation services on behalf of UNMMG. UNMMG reimburses UNMH for the cost of these services, which for the year ended June 30, 2008 was approximately \$0.5 million and is reported as patient registration and enrollment support expense on the statement of revenues, expenses, and changes in net assets. The related outstanding amount of approximately \$0.3 million is reported in accrued liabilities on the statement of net assets.

UNMH processes certain transactions using computer equipment and software owned by UNMMG. UNMH reimburses UNMMG for the estimated cost of the use of the computer and software. For the year ended June 30, 2008, UNMH reimbursed UNMMG approximately \$0.3 million, which is reported as an offset of data processing costs on the statement of revenues, expenses, and changes in net assets.

UNM HSC and the SOM allocate administrative support costs in exchange for administrative services provided to the clinical departments and the UNMMG via the assessment of a tax called gap tax and dean's tax, respectively. The dean's tax is a fixed percentage assessment on clinical revenues assessed by the SOM equal to approximately \$4.2 million reported on the statement of revenues, expenses, and changes in net assets. The gap tax is a fixed annual amount assessed by UNM HSC administration equal to approximately \$0.4 million reported on the statement of revenues, expenses, and changes in net assets.

UNMMG reimburses UNM HSC for the collections from third parties related to the indigent care services provided by UNMMG during the fiscal year. For the year ended June 30, 2008, amounts owed to UNM HSC were approximately \$0.4 million and are reported in accrued liabilities on the statement of net assets.

UNMMG leases office space under an operating lease agreement with UNMH. See note 12 for further discussion.

(12) Operating Leases

UNMMG leases office space under an operating lease agreement with UNMH that expires on September 30, 2009.

Future minimum lease payments are as follows:

Year ending June 30:		
2009	\$	290,096
2010		<u>76,409</u>
Total minimum lease payments	\$	<u><u>366,505</u></u>

Rent expense for the year ended June 30, 2008 was \$236,159.

UNM MEDICAL GROUP, INC.
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June 30, 2008

(13) Contingencies

UNMMG is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; and errors and omissions and natural disasters. UNMMG is insured through the State for all insurable risks and employee benefits. There have been no significant reductions in coverage from the prior year, and settlements have not exceeded coverage in the past three years. UNMMG is allocated a portion of the premium assessed by the State to UNM HSC, which was \$48,122 for the year ended June 30, 2008 and is reported as an operating expense on the statement of revenues, expenses, and changes in net assets.

(14) Other Matters

In 2008, UNMMG signed a letter of intent to negotiate exclusively with Legacy Hospital Partners, Inc. to build a new acute care teaching facility in Sandoval County. The letter of intent establishes milestones to be accomplished by both parties in order to move forward in the construction of the facilities. Construction is expected to commence in the first quarter of calendar year 2009 with expected completion in the winter of 2010. UNMMG has not entered into any arrangements for funding at this time.

UNM MEDICAL GROUP, INC.
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Pledged Collateral by Banks

June 30, 2008

Deposits and repurchase agreements per bank (Wells Fargo)	\$	21,000,938
Less:		
Repurchase agreements, at cost – commercial paper varying interest rates ranging from 0.7750% – 1.025% overnight sweeps to fund		(9,781,841)
FDIC coverage		(100,000)
		11,119,097
Total uninsured public funds		5,559,549
State of New Mexico – collateral requirement – 50%		
Pledged collateral:		
FNMA, 31409 VDH3, 03/01/2036, 6.0%		6,196,787
FNMA, 31410 EN46, 06/01/2036, 6.0%		5,459,908
GNMA, 36202 DPS4, 09/20/2031, 6.5%		130,153
GNMA, 36202 DT68, 08/20/2032, 6.0%		234,387
		12,021,235
Total pledged collateral		12,021,235
Overcollateralized	\$	6,461,686

All pledged collateral is held by Wells Fargo's trust departments or their agent in UNMMG's name.

See accompanying independent auditors' report.

UNM MEDICAL GROUP, INC.
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Deposit and Investment Account Balances

June 30, 2008

<u>Account</u>	<u>Type of account</u>	<u>Bank balance</u>	<u>Reconciling items</u>	<u>Book balance</u>
Wells Fargo	Checking	\$ 20,043,183	638,599	19,404,584
Total cash		<u>\$ 20,043,183</u>	<u>638,599</u>	<u>19,404,584</u>
Investments:				
Wells Fargo	Certificate of deposit	\$ 21,021	—	21,021
Wells Fargo	Certificate of deposit	215,160	—	215,160
Wells Fargo	Certificate of deposit	21,030	—	21,030
Wells Fargo	Certificate of deposit	20,996	—	20,996
Wells Fargo	Certificate of deposit	20,977	—	20,977
Wells Fargo	Certificate of deposit	21,881	—	21,881
Wells Fargo	Certificate of deposit	219,665	—	219,665
Wells Fargo	Certificate of deposit	21,944	—	21,944
Wells Fargo	Certificate of deposit	21,962	—	21,962
Wells Fargo	Certificate of deposit	22,044	—	22,044
Wells Fargo	Certificate of deposit	222,480	—	222,480
Wells Fargo	Certificate of deposit	22,024	—	22,024
Wells Fargo	Certificate of deposit	84,523	—	84,523
Wells Fargo	Certificate of deposit	22,048	—	22,048
Total investments		<u>\$ 957,755</u>	<u>—</u>	<u>957,755</u>

See accompanying independent auditors' report.



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**Independent Auditors' Report on Internal Control over Financial Reporting and
on Compliance and Other Matters Based on an Audit of Basic Financial Statements
Performed in Accordance with *Government Auditing Standards***

The Board of Directors
UNM Medical Group, Inc.
and
Mr. Hector Balderas, State Auditor:

We have audited the financial statements of the University of New Mexico Medical Group, Inc. (UNMMG) as of and for the year ended June 30, 2008, and have issued our report thereon dated December 18, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered UNMMG's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of UNMMG's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of UNMMG's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the UNMMG's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the UNMMG's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether UNMMG's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the

determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted a matter that is required to be reported under *Government Auditing Standards* paragraph 5.14 and 5.16, and Section 12-6.5 NMSA 1978 that is described in the accompanying schedule of findings and responses as finding 2008-1. UNMMG's response to the finding identified in our audit is described in the accompanying schedule of findings and responses. We did not audit UNMMG's response, and, accordingly, we express no opinion on it.

This report is intended solely for the information and the use of the board of directors, management, and the New Mexico State Auditor, and is not intended to be and should not be used by anyone other than those specified parties.

KPMG LLP

December 18, 2008

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)

Schedule of Findings and Responses

Year ended June 30, 2008

2008-01 – Timely Reconciliation of Accounts

Condition

During fiscal year 2008, UNM Medical Group (UNMMG) did not perform reconciliations throughout the year or at year-end on the cash transfer account and did not perform a timely review of reconciliations of other account balances such as other accounts receivable, deferred revenue, and miscellaneous income. In addition, the forgiveness of liability reconciliation related to the merger of University Physicians Associates into UNMMG was not completed in a timely manner.

Criteria

Timely and accurate financial reporting is an integral component of an effective financial management system. The lack of proper and timely performance and/or review of account reconciliations is a violation of good accounting practices.

Cause

UNMMG did not perform and/or review account reconciliations for key accounts in a timely manner.

Effect

The lack of proper and timely reconciliations resulted in several audit adjustments being recorded.

Recommendation

We recommend that UNMMG perform and review all key account reconciliations in a timely manner (i.e., monthly) in order to ensure the accuracy of interim as well as year-end financial information.

UNMMG Response

Management agrees that reconciliations for the accounts noted above should be performed accurately and corrections posted in a timely manner. While reconciliations were performed and reviewed, management concurs that final reconciliations and follow-up on account corrections were not completed. Management will implement procedures in fiscal year 2009 to review reconciliations and ensure corrections are posted to accounts in a timely manner.

The transition and merger of UPA into UNMMG in fiscal year 2008 and the accounting treatment of the surviving entity were still being finalized through the end of the fiscal year. This resulted in a delay of the final forgiveness determination. The forgiveness of liability was a one-time nonrecurring event; therefore, no further action is required.

* * * * *

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)

Exit Conference

Year ended June 30, 2008

Exit Conference

An exit conference was conducted on October 8, 2008 with a member of the board of directors and members of UNMMG management. During this meeting, the contents of this report were discussed with the following:

Paul Roth, M.D.	Chief Executive Officer and Board Chairman
Robert Katz, M.D.	Chief Operating Officer
Mel Eaves	Audit Committee Chair
Gerald Landgraf	Audit Committee
Fredrick Rupp, M.D.	Audit Committee
Anthony R. Masciotra, Jr.	Executive Director and CFO
Rodney W. Martinez	Financial Controller
Rosella Clifford	Accounting Manager
Christine Chavez	Director of Internal Audit, UNM
Cynthia C. Reinhart	Partner, KPMG LLP
Suzette Longfellow	Senior Manager, KPMG LLP