



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

Financial Statements and Other Information

June 30, 2010 and 2009

(With Independent Auditors' Report Thereon)

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)
Fiscal year 2010 Official Roaster

Board of Directors

| | |
|---|---|
| Paul Roth, M.D. Albuquerque, New Mexico | Executive Vice President (Regent appointed) UNM Health Sciences Center Dean, UNM School of Medicine Chairman of the Board, UNMMG President and CEO, UNMMG |
| Carolyn Voss, M.D. Albuquerque, New Mexico | Senior Associate Dean of Clinical Affairs (Regent appointed) Chief Operating Officer, UNMMG |
| James H. Koch Albuquerque, New Mexico | UNM Regent (Regent appointed) |
| Chris Pacheco Albuquerque, New Mexico | Independent, non-UNM Faculty (Regent appointed) |
| Gerald Landgraf Albuquerque, New Mexico | Independent, non-UNM Faculty (Regent appointed) |
| John Wills, M.D. Albuquerque, New Mexico | Chair, Anesthesiology (Regent appointed) |
| Cheryl Willman, M.D. Albuquerque, New Mexico | Director, CRTIC (Regent appointed) |
| R. Steven Padilla, M.D. Albuquerque, New Mexico | Chair, Dermatology (Regent appointed) |
| Michael Richards, M.D. Albuquerque, New Mexico | Chair, Emergency Medicine (Regent appointed) |
| Martha McGrew, M.D. Albuquerque, New Mexico | Chair, Family & Community Medicine (Regent appointed) |
| Pope Moseley, M.D. Albuquerque, New Mexico | Chair, Internal Medicine (Regent appointed) |
| Gary Rosenberg, M.D. Albuquerque, New Mexico | Chair, Neurology (Regent appointed) |
| Howard Yonas, M.D. Albuquerque, New Mexico | Chair, Neurosurgery (Regent appointed) |
| William Rayburn, M.D. Albuquerque, New Mexico | Chair, OB/GYN (Regent appointed) |

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)
Fiscal year 2010 Official Roaster

Board of Directors

| | |
|---|--|
| Robert Schenk, M.D. Albuquerque, New Mexico | Chair, Orthopedics (Regent appointed) |
| Thomas Williams, M.D. Albuquerque, New Mexico | Chair, Pathology (Regent appointed) |
| Loretta Cordova de Ortega, M.D. Albuquerque, New Mexico | Chair, Pediatrics (Regent appointed) |
| Sam Keith, M.D. Albuquerque, New Mexico | Chair, Psychiatry (Regent appointed) |
| Philip Wiest, M.D. Albuquerque, New Mexico | Chair, Radiology (Regent appointed) |
| John Russell, M.D. Albuquerque, New Mexico | Chair, Surgery (Regent appointed) |
| <i>Nonvoting Directors</i> | |
| 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 |
| Robert Fritch, 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 |
| Ed Rose, M.D. Albuquerque, New Mexico | Executive Medical Director of Children Services |

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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 statements of net assets of the UNM Medical Group, Inc. (UNMMG), a component unit of the University of New Mexico as of June 30, 2010 and 2009, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of UNMMG's management. Our responsibility is to express opinions 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 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 audits provide a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of UNMMG as of June 30, 2010 and 2009, and the respective changes in net assets, and cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 4, 2010 on our consideration of UNMMG's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 9 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 opinions 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 basic financial statements. 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 and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

KPMG LLP

November 4, 2010

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

Management's Discussion and Analysis

June 30, 2010, 2009, and 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 years ended June 30, 2010, 2009, and 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. Over time, increases or decreases in net assets (the difference between assets and liabilities) are one indicator of the improvement or erosion of UNMMG's financial health when considered with nonfinancial facts such as patient statistics. This statement includes all assets and liabilities using the accrual basis of accounting, which is consistent with the accounting method used by private sector institutions.

The statement of revenues, expenses, and changes in net assets presents the revenues earned and expenses incurred during the years. 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 of 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 the UNM Regents, UNMMG is responsible for the practice oversight and management of the professional medical practice of the University of New Mexico.

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Management's Discussion and Analysis

June 30, 2010, 2009, and 2008

Condensed Summary of Net Assets

| | June 30 | | |
|----------------------------|----------------------|-------------------|-------------------|
| | 2010 | 2009 | 2008 |
| Assets: | | | |
| Current assets | \$ 42,653,069 | 32,297,312 | 34,053,524 |
| Capital assets | 1,476,151 | 1,211,830 | 505,316 |
| Other noncurrent assets | 12,756,125 | 7,410,400 | 4,487,900 |
| Total assets | <u>56,885,345</u> | <u>40,919,542</u> | <u>39,046,740</u> |
| Liabilities: | | | |
| Current liabilities | 30,869,329 | 20,778,373 | 23,531,434 |
| Total liabilities | <u>30,869,329</u> | <u>20,778,373</u> | <u>23,531,434</u> |
| Net assets: | | | |
| Invested in capital assets | 1,476,151 | 1,211,830 | 505,316 |
| Unrestricted | 24,539,865 | 18,929,339 | 15,009,990 |
| Total net assets | <u>\$ 26,016,016</u> | <u>20,141,169</u> | <u>15,515,306</u> |

Current assets include cash and other assets that were deemed to be consumed or convertible to cash within one year. As of June 30, 2010, total current assets of \$42.7 million consisted primarily of \$16.5 million of cash and cash equivalents compared to \$32.3 million in total current assets and \$14.1 million of cash and cash equivalents at June 30, 2009 compared to \$34.1 million in total current assets and \$16.1 million of cash and cash equivalents at June 30, 2008. Also, included in current assets are net patient receivables of \$18.0 million, \$16.8 million, and \$17.2 million in 2010, 2009, and 2008, respectively. Also, included in current assets are other receivables of \$8.2 million consisting primarily of a \$6.0 million due from UNM Sandoval County Regional Medical Center project and \$1.6 million due from UNM HSC and \$0.6 million due from UNMH compared to \$1.3 million and \$0.7 million in 2009 and 2008, respectively. Noncurrent assets represent capital assets in 2010 of \$1.5 million and other assets of \$12.8 million compared to \$1.2 million and other assets of \$7.4 million in 2009 and compared to \$0.5 million and other assets of \$4.5 million in 2008. Noncurrent assets primarily consist of board designated investments in cash and cash equivalents, certificates of deposit, money markets, U.S. government securities, and corporate debt securities.

Current liabilities are generally defined as amounts due within one year. As of June 30, 2010, total current liabilities of \$30.9 million include purchased services payable to UNM HSC of \$22.3 million compared to \$20.8 million and \$16.7 million in 2009 and \$23.5 million and \$19.7 million in 2008, respectively. Also included in current liabilities are amounts payable to UNM for operating expenses in the amount of \$1.1 million and other current liabilities of \$7.5 million compared to \$1.4 million and \$2.7 million in 2009 and \$2.0 million and \$1.8 million in 2008, respectively. Also included in current liabilities are amounts payable to UNM HSC, UNMH, and UNM Cancer Center of \$3.5 million compared to \$0.8 in 2009 and 2008, respectively.

At June 30, 2010, UNMMG's current ratio, the amount of current assets available to cover current liabilities, was 1.38 compared to 1.55 in 2009 and 1.45 in 2008. Payment of UNMMG's current liabilities is dependent on UNMMG's ability to collect patient and other receivables.

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Total net assets increased \$5.9 million to \$26.0 million at June 30, 2010 from \$20.1 million at June 30, 2009, due to the excess of revenue over expenses in 2010 of \$5.9 million. Total net assets increased \$4.6 million to \$20.1 million at June 30, 2009 from \$15.5 million at June 30, 2008, due to the excess of revenue over expenses in 2009 of \$4.6 million, which included operating income of \$4.5 million and interest income of \$0.1 million.

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

| | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|---|----------------------|-------------------|-------------------|
| Net operating revenues | \$ 112,784,434 | 102,761,627 | 87,867,917 |
| Operating expenses: | | | |
| Purchased clinical services | 79,757,863 | 74,471,673 | 65,992,167 |
| Salaries and benefits | 11,733,125 | 9,222,772 | 7,110,700 |
| Other | 15,436,254 | 14,573,359 | 10,151,348 |
| Total operating expenses | <u>106,927,242</u> | <u>98,267,804</u> | <u>83,254,215</u> |
| Operating income | <u>5,857,192</u> | <u>4,493,823</u> | <u>4,613,702</u> |
| Nonoperating revenues: | | | |
| Interest income | 17,655 | 132,040 | 445,683 |
| Forgiveness of liability due to UNM HSC | — | — | 10,455,921 |
| Total nonoperating revenues | <u>17,655</u> | <u>132,040</u> | <u>10,901,604</u> |
| Change in net assets | 5,874,847 | 4,625,863 | 15,515,306 |
| Net assets, beginning of year | <u>20,141,169</u> | <u>15,515,306</u> | — |
| Net assets, end of year | <u>\$ 26,016,016</u> | <u>20,141,169</u> | <u>15,515,306</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. Net operating service revenues for 2010 increased \$10.0 million from \$102.8 million in 2009 to \$112.8 million in 2010, reflecting an increase of 9.8%. Net operating revenues for 2009 increased \$14.9 million from \$87.9 million in 2008 to \$102.8 million in 2009, reflecting an increase of 17%. The increase in net operating revenues is due to two factors: (1) An increase in patient service volume. UNMMG measures patient service volume in work relative value units (WRVUs). Work relative value units represent an industry standard unit of measure of physician clinic effort to perform specific procedures. WRVUs were 2,194,449, which represent an increase of 146,635 or 7.2% from 2009. In 2009, WRVUs of 2,047,814 increased 156,317 or 8.3% from 2008. (2) For 2010, UNMMG negotiated rate increases among our commercial insurance payors resulting in overall weighted average increase of 3.5%.

These increases were offset by decrease in reimbursement for the State Coverage Initiative (SCI) Program. UNMMG receives reimbursement from the SCI program. This program is a Medicaid waiver program, funded in part by the State of New Mexico Human Services Department (HSD). Funding is modeled after a capitated payment program. UNMMG receives a pro rata portion of SCI reimbursement, net of costs based on claim experience. For the year ending June 30, 2010, UNMMG recognized \$5.5 million in revenues, which represents a

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\$0.9 million decrease from 2009. For the year ending June 30, 2009, UNMMG recognized \$6.4 million in revenues, which represented a \$2.8 million increase from 2008.

A condensed summary of the net operating revenue calculation follows:

| | <u>2010</u> | <u>2009</u> | <u>2008</u> |
|---|-----------------------|--------------------|-------------------|
| Patient service charges billed at established rates | \$ 305,496,676 | 276,745,462 | 239,464,023 |
| Adjustments to charges: | | | |
| Contractual adjustments | (119,567,289) | (107,974,791) | (92,313,513) |
| Charity care | (51,451,431) | (45,583,724) | (39,121,826) |
| Net patient billings | 134,477,956 | 123,186,947 | 108,028,684 |
| Provision for uncollectible accounts | (22,889,245) | (21,024,317) | (21,029,154) |
| Net patient service revenues | 111,588,711 | 102,162,630 | 86,999,530 |
| Other revenue | 1,195,723 | 598,997 | 868,387 |
| Total net operating revenues | <u>\$ 112,784,434</u> | <u>102,761,627</u> | <u>87,867,917</u> |

UNMMG encourages all patients to apply for financial assistance. UNMMG participates in the financial assistance program called UNM care. This program assigns patients primary care providers and allows them to receive care throughout UNM HSC locations. This program is available to Bernalillo County residents whose income is below 235% of the federal poverty level. As of June 30, 2010, 2009, and 2008, there were 27,411, 24,697, and 20,464 active enrollees, respectively. UNMMG does not pursue collection of amounts determined to qualify as charity care, they are deducted from gross revenue. For the year ending June 30, 2010, UNMMG provided \$51.5 million in charity care compared to \$45.6 million in 2009 and \$39.1 million in 2008.

UNMMG also provides services to patients who do not have any form of healthcare insurance or do not qualify under any other financial assistance program. UNMMG encourages patients to meet with a financial counselor to develop payment arrangements. Although UNMMG pursues collection of these accounts usually through an extended payment plan or a discounted rate, interest is not charged on these accounts, nor are liens placed on property or assets, or judgments filed against these patients. These accounts are fully reserved and recorded as provision for uncollectible accounts. As of June 30, 2010, UNMMG recorded \$22.9 million in provision for uncollectible accounts, which primarily represents the write-off of self-pay accounts compared to \$21.0 million as of June 30, 2009 and 2008.

UNMMG incurs costs associated with providing charity care and other services for which payment is not received. As of June 30, 2010, the estimated cost of care for providing these services was \$32.6 million compared to \$29.3 million in 2009 and \$25.3 million in 2008.

Total operating expenses of \$106.9 million for the year ended June 30, 2010, \$98.3 million for the year ended June 30, 2009, and \$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 the School of Medicine (SOM),

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which totaled \$86.1 million in 2010 and \$79.5 million in 2009 and \$70.2 million in 2008. These two factors accounted for \$8.7 million and \$9.3 million in increased expense from 2009 to 2010 and from 2008 to 2009, respectively. Other expense increases were attributable to salaries and benefits expense primarily due to continued expansion of UNMMG's ambulatory clinic management and oversight function and growth in administrative functions to support continued growth of \$2.5 million from 2009 to 2010 and \$2.1 million from 2008 to 2009, respectively. These increases in expenses were offset by a decrease in other operating expenses of \$0.4 million. In 2009, the additional increase to expenses from 2008 was also due to the shift in medical malpractice expense of \$2.9 million from SOM, and patient registration and support costs of \$0.7 million.

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 dean's tax. The dean's tax is a fixed percentage assessment on clinical revenues assessed by the SOM equal to approximately \$5.5 million in 2010, \$5.1 million in 2009, and \$4.2 million in 2008 and is reported on the statement of revenues, expenses, and changes in net assets as an operating expense.

In 2010 and 2009, UNMH provided funding to UNMMG in the amount of \$1.0 million for the support of two UNMMG departments who provide direct operational support services to UNMH. The amount of funding provided is negotiated annually. This funding was not provided in 2008.

In 2010, UNMMG established a \$0.8 million rescission tax at a fixed percentage on clinical revenues to provide support to UNM HSC clinical, education, and research programs impacted by expected cuts from state and federal agencies and is reported as an operating expense on the statements of revenues, expenses, and changes in net assets.

Nonoperating revenues of \$18 thousand in 2010, \$132 thousand in 2009, and \$446 thousand in 2008 consisted principally of interest income on certificates of deposit, and a money market account in 2010 and interest income on certificates of deposit and repurchase agreements in 2009 and 2008.

Capital Assets

At June 30, 2010, UNMMG had \$1.5 million invested in capital assets, net of accumulated depreciation of approximately \$2.7 million compared to \$1.2 million and \$2.7 million at June 30, 2009 and \$0.5 million and \$2.4 million at June 30, 2008. 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.

Change in Net Assets

UNMMG's change in net assets reflected a net increase of \$5.9 million from 2009 to 2010 due to an increase in operating income compared to a net increase of \$4.6 million from 2008 to 2009 represented by an increase of operating income of \$4.5 million and interest income of \$0.1 million.

Other Matters

UNMMG continues to pursue initiatives to expand clinical services into Sandoval County. In August 2009, the Regents of the University of New Mexico approved the formation of the UNM Sandoval Regional Medical Center, Inc. (SRMC), a New Mexico nonprofit corporation organized under and pursuant to the New Mexico

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University Research Park and Economic Development Act. The creation of SRMC is largely a result of collaborative efforts between UNMMG and UNMH, and, accordingly, UNMMG and UNMH have representation on its board. SRMC is currently seeking financing to build the new acute care community teaching facility and the facilities in Sandoval County. In September 2010, SRMC received a HUD commitment letter allowing the FHA-Insured Mortgage Revenue Bonds to be issued to finance the construction of the facilities. In 2010, SRMC began to incur expenses related to the initial construction planning and design of the facilities. A memorandum of understanding was established between UNMMG and SRMC providing for UNMMG to fund the initial planning and construction costs until SRMC received its funding from HUD. SRMC will then reimburse UNMMG for all costs paid by UNMMG. UNMMG recorded those costs as a receivable due from SRMC, which represented \$6.0 million as of June 30, 2010.

Factors Impacting Future Periods

On March 23, 2010, President Obama signed into law the Patient Protection and Affordable Care Act (PPACA). This National Health Reform includes private insurance market reforms, expanded Medicaid eligibility provisions, Medicare and Medicaid funding reforms, value-based purchasing requirements, and amended time periods for filing Medicare fee-for-service (FFS) claims to one year from the date of service as one of many provisions aimed at curbing fraud, waste, and abuse in the Medicare program.

Health Plan reforms under PPACA include a set of required essential benefits including, but not limited to, emergency services, hospitalization, maternity and newborn care, mental health and substance use disorder services, preventative and wellness services, and pediatric services, including oral and vision care. Plans must also not require copayment or deductible on preventative services. Effective September 23, 2010, existing plans must provide coverage to dependent children until age 26 (unless eligible for other coverage), eliminate lifetime aggregate dollar limits and annual dollar limits on essential benefits, eliminate preexisting condition exclusions for children up to age 19, and prohibit rescinding of coverage except in cases of fraud, intentional misrepresentation, and nonpayment of premium.

Medicaid expansion under PPACA includes new eligibility criteria establishing a minimum floor for Medicaid coverage of 133% of the Federal Poverty Level (FPL), eliminating other nonincome based criteria (such as age, disability, or asset testing). This FPL criteria is mandatory for State implementation January 2014 and optional for years 2010 through 2013. The population most impacted by the new eligibility criteria is expected to be childless adults. States are also prohibited from reducing Medicaid or CHIP eligibility that was in place on the date of PPACA enactment. PPACA provides additional federal financing through the Federal Medical Assistance Percentage (FMAP) for newly eligible Medicaid patients.

The Human Services Division of the State of New Mexico (HSD) implemented cost containment measures on December 1, 2009, including a 3% reduction to the Medicaid physician fee schedule. HSD has identified a further budget shortfall for 2011 and 2012. Further cuts to the Medicaid physician fee scheduled are expected.

HSD eliminated the 30 day grace period for re-enrollment under the State Coverage Insurance (SCI) program effective July 1, 2010. The SCI Program is under consideration for possible elimination from the Medical Assistance Division Budget for subsequent years.

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On March 24, 2010, Governor Bill Richardson signed House Bill 2. This bill reduced general funding for higher education by an average of 3.5%. UNM HSC applied the decrease evenly across its programs, which resulted in an additional 2% reduction to the Center. The legislation also included language that if general fund revenues become insufficient to meet general fund appropriations for fiscal year 2011, the legislation authorized reductions in general fund allotments to all agencies, funds, programs, and other recipients that receive a general fund appropriation in Section 4 of the General Appropriation Act of 2010. On August 12, 2010, The State Board of Finance approved a further reduction of 3.2445% in General Fund appropriations. The Center's 2011 appropriations, after taking into consideration the two reductions above will be a reduction of \$618,054 from 2010.

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 933 Bradbury Street SE, Suite 2222 Albuquerque, NM 87106-410.

UNM MEDICAL GROUP, INC.
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Statements of Net Assets

June 30, 2010 and 2009

| Assets | <u>2010</u> | <u>2009</u> |
|--|----------------------|-------------------|
| Current assets: | | |
| Cash and cash equivalents | \$ 16,514,304 | 14,146,683 |
| Receivables: | | |
| Net patient receivables (net of allowance for uncollectible accounts of \$16,450,999 and contractual allowance of \$12,453,574 in 2010; \$14,795,725 and \$12,909,396 in 2009, respectively) | 17,964,079 | 16,811,341 |
| Due from SRMC (note 16) | 6,002,308 | — |
| Other | 2,172,378 | 1,339,288 |
| Total net receivables | <u>26,138,765</u> | <u>18,150,629</u> |
| Total current assets | <u>42,653,069</u> | <u>32,297,312</u> |
| Noncurrent assets: | | |
| Board designated assets: | | |
| Cash and cash equivalents (note 5) | 8,519,215 | 6,397,871 |
| Investments (note 5) | 4,108,607 | 966,538 |
| Total board designated assets | <u>12,627,822</u> | <u>7,364,409</u> |
| Capital assets, net (note 6) | 1,476,151 | 1,211,830 |
| Other assets | 128,303 | 45,991 |
| Total noncurrent assets | <u>14,232,276</u> | <u>8,622,230</u> |
| Total assets | <u>\$ 56,885,345</u> | <u>40,919,542</u> |
| Liabilities and Net Assets | | |
| Current liabilities: | | |
| Purchased services payable due to UNM HSC (note 12) | \$ 22,293,998 | 16,679,565 |
| Operating expenses due to UNM (note 12) | 1,094,800 | 1,434,391 |
| Accrued liabilities (note 8) | 6,698,173 | 2,090,487 |
| Refunds payable (note 7) | 782,358 | 573,930 |
| Total current liabilities | <u>30,869,329</u> | <u>20,778,373</u> |
| Commitments and contingencies (notes 14, 15, and 16) | | |
| Net assets: | | |
| Invested in capital assets | 1,476,151 | 1,211,830 |
| Unrestricted | 24,539,865 | 18,929,339 |
| Total unrestricted | <u>24,539,865</u> | <u>18,929,339</u> |
| Total net assets | <u>26,016,016</u> | <u>20,141,169</u> |
| Total liabilities and net assets | <u>\$ 56,885,345</u> | <u>40,919,542</u> |

See accompanying notes to financial statements

UNM MEDICAL GROUP, INC.

(A Component Unit of the University of New Mexico)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2010 and 2009

| | <u>2010</u> | <u>2009</u> |
|---|----------------------|--------------------|
| Operating revenues: | | |
| Patient service revenues, net (note 10) | \$ 111,588,711 | 102,162,630 |
| Other revenue | 1,195,723 | 598,997 |
| Total net operating revenues | <u>112,784,434</u> | <u>102,761,627</u> |
| Operating expenses: | | |
| Purchased clinical services from UNM HSC | 79,757,863 | 74,471,673 |
| Salaries and benefits | 11,733,125 | 9,222,772 |
| Dean's tax (note 12) | 5,470,733 | 5,051,438 |
| Malpractice insurance (note 9) | 4,692,359 | 4,720,045 |
| Other administrative | 1,455,164 | 1,677,090 |
| Patient registration and enrollment support | 1,152,837 | 1,194,691 |
| Rescission tax (note 12) | 821,914 | — |
| Data processing costs | 731,238 | 894,138 |
| Occupancy | 547,753 | 412,664 |
| Depreciation and amortization | 407,777 | 333,918 |
| Consulting | 156,479 | 289,375 |
| Total operating expenses | <u>106,927,242</u> | <u>98,267,804</u> |
| Operating income | <u>5,857,192</u> | <u>4,493,823</u> |
| Nonoperating revenues: | | |
| Interest income | 17,655 | 132,040 |
| Total nonoperating revenues | <u>17,655</u> | <u>132,040</u> |
| Change in net assets | 5,874,847 | 4,625,863 |
| Net assets, beginning of year | <u>20,141,169</u> | <u>15,515,306</u> |
| Net assets, end of year | <u>\$ 26,016,016</u> | <u>20,141,169</u> |

See accompanying notes to financial statements

UNM MEDICAL GROUP, INC.
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Statements of Cash Flows

Years ended June 30, 2010 and 2009

| | 2010 | 2009 |
|---|----------------|--------------|
| Cash flows from operating activities: | | |
| Payments from insurance and patients | \$ 109,811,312 | 102,685,293 |
| Payments to UNM | (86,523,058) | (86,521,387) |
| Payments to employees | (8,998,099) | (7,874,571) |
| Payments for employee benefits | (3,074,618) | (2,427,497) |
| Payments to suppliers | (4,043,471) | (3,975,679) |
| Other receipts (payments) | 1,113,410 | 170,986 |
| Net cash provided by operating activities | 8,285,476 | 2,057,145 |
| Cash flows from capital financing activities – purchase of capital assets | (672,097) | (1,040,432) |
| Cash flows from investing activities: | | |
| Investment income | 17,655 | 132,040 |
| Proceeds from maturity of investments | 966,538 | 957,755 |
| Purchases of investments | (4,108,607) | (966,538) |
| Net cash provided by (used in) investing activities | (3,124,414) | 123,257 |
| Net increase in cash and cash equivalents | 4,488,965 | 1,139,970 |
| Cash and cash equivalents, beginning of year | 20,544,554 | 19,404,584 |
| Cash and cash equivalents, end of year | \$ 25,033,519 | 20,544,554 |
| Reconciliation of operating income to net cash provided by operating activities: | | |
| Operating income | \$ 5,857,192 | 4,493,823 |
| Adjustments to reconcile operating income to net cash provided by operating activities: | | |
| Depreciation and amortization | 407,777 | 333,918 |
| Provision for doubtful accounts | 22,889,245 | 21,024,316 |
| Changes in assets and liabilities: | | |
| Patient receivables | (24,041,984) | (20,592,163) |
| Due from SRMC | (6,002,308) | — |
| Other receivables | (833,090) | (620,674) |
| Other assets | (82,312) | 170,986 |
| Purchase services due to UNM HSC | 5,614,433 | (3,020,780) |
| Operating expense due to UNM | (339,591) | (587,016) |
| Accrued liabilities | 4,607,686 | 742,549 |
| Refunds payable | 208,428 | 112,186 |
| Net cash provided by operating activities | \$ 8,285,476 | 2,057,146 |

See accompanying notes to financial statements

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

Notes to Financial Statements

June 30, 2010 and 2009

(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 of 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 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 and distributions payable to UNM HSC in the amount of \$10,455,921 were forgiven. 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.

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 faculty and staff physicians and other professional healthcare providers under the patient care management, supervision, and quality control of the SOM 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.

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 on Financial Accounting Standards issued by the Financial Accounting Standards Board (FASB) after November 1989.

UNM MEDICAL GROUP, INC.
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Notes to Financial Statements

June 30, 2010 and 2009

(b) Net Assets

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

- *Invested in capital assets* – capital assets, net of accumulated depreciation.
- *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. Deposits are in demand accounts with a local financial institution. State statute requires financial institutions to pledge qualifying collateral to UNMMG to cover at least 50% of the uninsured deposits.

One hundred percent (100%) of the cash balance at June 30, 2010 was collateralized with securities held in the name of UNMMG. One hundred percent (100%) of the deposit balance at June 30, 2009 was guaranteed under the FDIC Temporary Liquidity Guarantee Program. The Dodd-Frank Wall Street Reform and Consumer Protection Act signed into law on July 21, 2010 by President Barack Obama permanently raised the maximum deposit insurance amount to \$250,000.

(e) Marketable Securities

Investments are recorded at fair market value. At June 30, 2010, investments consisted primarily of corporate debt securities, U.S. government and government agency securities, and certificates of deposit. At June 30, 2009, investments consisted primarily of certificates of deposit and repurchase agreements. Investment income includes interest and realized and unrealized gains and losses. Investment income is reported as nonoperating revenue when earned.

UNMMG follows GASB Statement No. 40, *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. This statement addresses common deposit and investment risks related to credit risk, concentration of risk, investment rate risk, and foreign currency risk, and also requires certain disclosures of investments at fair values that are highly sensitive to changes in interest rates, as well as deposit and investment policies related to the risks identified in the statement.

UNM MEDICAL GROUP, INC.
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June 30, 2010 and 2009

(f) 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 and a provision for doubtful accounts.

Self-pay patients are referred to and reclassified under financial assistance programs when applicable. Other discounts exist based on income earning levels if no other financial assistance programs are available. UNMMG utilizes an extended business office vendor to manage the collection of self-pay accounts using various payment arrangements. All self pay accounts regardless of days outstanding are fully reserved.

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 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.

UNMMG as part of UNM HSC participates in the SCI Program. This program is a Medicaid waiver program, funded in part by the State of New Mexico Human Services Department (HSD). Funding is modeled after a capitated payment program. UNMMG receives a pro rata portion of SCI reimbursement, net of costs based on claim experience.

(g) 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 not reported as revenue in the statement of revenues, expenses, and change in net assets.

(h) Capital Assets

Capital assets consist primarily of furniture and equipment and are stated at cost at the date of acquisition. 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.

UNM MEDICAL GROUP, INC.
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Notes to Financial Statements

June 30, 2010 and 2009

(i) 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.

(j) 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. The agreement allows for renegotiation of the annual cost in the event of material changes in clinical effort during the course of the year. Furthermore, if additional funding is required to support the clinical, educational, and research mission of the SOM, the executive committee of the UNMMG will determine and approve the purchase of any additional services.

(k) Salaries & Benefits

In 2009, UNMMG established its own payroll system allowing for the transition of employees from UNM and the hiring of employees directly into UNMMG. Employees working at UNMMG at June 30, 2008, were given the option to convert to a UNMMG employee or remain a UNM employee. Any new employees hired after July 1, 2008 are hired as UNMMG employees only. On July 1, 2008, 32 of the 162 UNM employees transitioned to UNMMG. At June 30, 2010, there were 127 UNMMG and 112 UNM employees. For those employees who remained with 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. For UNMMG employees, substantially all of the same benefits offered to UNM employees were made available to UNMMG employees except for retirement benefits. A defined contribution plan was established for UNMMG employees effective July 1, 2009. See note 13 for further discussion.

(l) Income Taxes

UNMMG is a governmental not-for-profit organization and is exempt from federal and state income taxes as an organization described in Section 501(c)(3) of the Internal Revenue Code; however, income generated from activities unrelated to the UNMMG's exempt purpose is subject to income taxes. For the years ended 2010 and 2009, there was no income generated unrelated to the UNMMG's exempt purpose.

UNM MEDICAL GROUP, INC.
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Notes to Financial Statements

June 30, 2010 and 2009

(3) Cash, Cash Equivalents, and Investments

(a) Cash and Cash Equivalents

UNMMG's cash and cash equivalents are held in demand accounts 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.

Bank balances are categorized as follows:

| | 2010 | 2009 |
|---|---------------|-------------|
| Operating accounts | \$ 18,909,000 | 20,953,630 |
| Savings account | 496,777 | 22,544 |
| Total bank balances | \$ 19,405,777 | 20,976,174 |
| Amount insured by FDIC | \$ 524,421 | 20,976,174 |
| Amount collateralized with securities held in UNMMG's name | 24,896,839 | 10,071,256 |

Also included in cash and cash equivalents at June 30, 2010 is a money market account in the amount of \$5,918,255. This account is subject to interest rate risk in less than one year. The money market fund is invested in short-term high quality municipal securities.

(b) Marketable Securities

Interest Rate Risk – Debt Investments – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. Currently, UNMMG does not have a specific policy to limit its exposure to interest rate risk.

In 2010, UNMMG established an investment policy directing the investment activities of UNMMG. A summary of the marketable securities and their respective maturities and their exposure to interest rate risk as follows:

Custodial Credit Risk – Debt Investments – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, UNMMG will not be able to recover the value of its investments or collateral that is in the possession of an outside party at June 30, 2010. Marketable securities of \$4,108,607 at June 30, 2010 are insured, registered, and held by the counterparty's agent in UNMMG's name.

UNM MEDICAL GROUP, INC.
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Notes to Financial Statements

June 30, 2010 and 2009

Credit Risk – Debt Investments – Credit risk is the risk that an issuer or other counterparty to the investment will not fulfill their obligations. UNMMG is required to disclose credit ratings of its debt investments in order to assess credit risk. U.S. obligations, investments explicitly guaranteed by the U.S. government, and nondebt investments are excluded from this requirement. Currently, UNMMG’s policy restricts debt investments to specific investment ratings issued by nationally recognized statistical rating organizations. A summary of the marketable securities and their respective maturities and their exposure to interest rate risk follows:

| <u>Description</u> | <u>Rating</u> | <u>Fair value</u> | <u>June 30, 2010</u> | |
|--|---------------|---------------------|-----------------------------|--------------------|
| | | | <u>Less than 1 year</u> | <u>1 – 5 years</u> |
| Securities not subject to interest rate risk: | | | | |
| Certificates of deposits | | \$ 22,579 | 22,579 | — |
| Securities subject to investment risk: | | | | |
| Corporate Bonds | A1/A+ | 592,116 | 183,919 | 408,197 |
| Corporate Bonds | A2/A | 1,569,634 | 959,824 | 609,810 |
| Corporate Bonds | A1/AA | 202,700 | 202,700 | — |
| Corporate Bonds | AA2/AA | 306,823 | 102,603 | 204,220 |
| Corporate Bonds | AA3/AA- | 203,186 | — | 203,186 |
| Corporate Bonds | BAA1/A | 202,428 | — | 202,428 |
| Total Corporate Bonds | | <u>3,076,887</u> | <u>1,449,046</u> | <u>1,627,841</u> |
| US Treasury notes – SER Z-2013 | | 757,429 | — | 757,429 |
| U.S. government: | | | | |
| Federal Farm Credit Bank | | <u>251,712</u> | <u>—</u> | <u>251,712</u> |
| Total marketable securities | | <u>\$ 4,108,607</u> | <u>1,471,625</u> | <u>2,636,982</u> |

Concentration of Credit Risk – Investments – Concentration of credit risk is the risk of loss attributed to investments in a single issuer. Investments in any one issuer that represents 5% or more of all total investments are considered to be exposed to concentrated credit risk and are required to be disclosed. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. UNMMG has a policy to limit its exposure to concentrated risk. The policy states the portfolio will be constructed and maintained to provide prudent diversification with regard to concentration of holdings in individual issues, corporations, or industries.

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Notes to Financial Statements

June 30, 2010 and 2009

As of June 30, 2010, UNMMG's investment portfolio had no investments exposed to concentration of credit risk.

(4) Concentration of Risk

UNMMG receives payment for professional medical services to patients in healthcare facilities of the UNM HSC and other locations contracted with UNM. These payor sources include Medicare, Medicaid, and other third party payors. The following table summarizes the percent of gross accounts receivable from all payors as of June 30, excluding self-pay, which UNMMG fully reserves.

| | 2010 | 2009 |
|-----------------------|-------------|-------------|
| Medicare and Medicaid | 53% | 53% |
| Commercial insurance | 37 | 35 |
| Other | 10 | 12 |
| | 100% | 100% |

(5) Board Designated Assets

Board designated assets are classified in the accompanying statements 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, 2010, and 2009, these assets comprise investments in money market funds, debt securities, U.S. government securities, certificates of deposit recorded at cost, which approximated fair value, and cash and cash equivalents.

In 2009, the Board also voted to designate additional assets to fund future clinical initiatives and improvement in quality measurements and outcomes for the medical group (i.e., quality and investment funding).

Assets are designated for the following purposes:

| | 2010 | 2009 |
|-------------------------------|---------------|-------------|
| Investment reserve | \$ 7,707,771 | 5,707,771 |
| Department reserve | 3,025,416 | — |
| Quality reserve | 1,200,000 | 900,000 |
| Hardware and technology | 694,635 | 756,638 |
| Total board designated assets | \$ 12,627,822 | 7,364,409 |

Investment reserve – Represents funds designated for future initiatives UNMMG wishes to fund such as, new ambulatory clinics, new lines of clinic services, or expansion of existing initiatives.

Department reserve – Represents funds designated on behalf of SOM departments for funding of future department initiatives.

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Quality reserve – Represents funds designated to support established incentive programs to improve quality of care measurements and initiatives.

Hardware and technology – Represents funds designated to fund future purchases of capital equipment and software.

(6) Capital Assets

Activity in capital assets that consist of furniture and equipment is summarized as follows:

| | <u>Cost</u> | <u>Accumulated depreciation</u> | <u>Net</u> |
|------------------------|---------------------|-------------------------------------|------------------|
| Balance, July 1, 2008 | \$ 2,862,132 | 2,356,816 | 505,316 |
| Additions | 1,040,432 | 333,918 | 706,514 |
| Balance, June 30, 2009 | 3,902,564 | 2,690,734 | 1,211,830 |
| Additions | 672,098 | 407,777 | 264,321 |
| Deletions | 432,254 | 432,254 | — |
| Balance, June 30, 2010 | \$ <u>4,142,408</u> | <u>2,666,257</u> | <u>1,476,151</u> |

(7) 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. At June 30, 2010 and 2009, refunds payable were \$782,358 and \$573,930, respectively.

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Notes to Financial Statements

June 30, 2010 and 2009

(8) Accrued Liabilities

Accrued liabilities consisted of the following at June 30:

| | 2010 | 2009 |
|--------------------------------------|--------------|-------------|
| Due to UNMH | \$ 1,242,698 | 259,173 |
| Settlement liability | 1,042,373 | — |
| Accrued operating expenses | 1,009,088 | 692,066 |
| Malpractice liability | 1,002,758 | — |
| Rescission assessment | 821,913 | — |
| Accrued leave | 614,536 | 388,907 |
| Indigent distribution due to UNM HSC | 355,660 | 360,909 |
| Payroll and benefits liability | 193,208 | — |
| Unclaimed property | 164,759 | 162,890 |
| Other | 146,674 | 49,165 |
| Due to UNM Cancer Center | 104,506 | 177,377 |
| | \$ 6,698,173 | 2,090,487 |

During the years ended June 30, 2010 and 2009, the following changes occurred in accrued leave:

| | Balance July 1, 2008 | Increase | Decrease | Balance June 30, 2009 |
|----|---------------------------------|-----------------|-----------------|----------------------------------|
| \$ | 226,889 | 601,416 | (439,398) | 388,907 |

| | Balance June 30, 2009 | Increase | Decrease | Balance June 30, 2010 |
|----|----------------------------------|-----------------|-----------------|----------------------------------|
| \$ | 388,907 | 688,662 | (463,033) | 614,536 |

(9) 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. 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. 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

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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 medical malpractice insurance expense on the statement of revenues, expenses, and changes in net assets. For both years ended June 30, 2010 and 2009, malpractice expense was \$4.7 million and was recorded as an operating expense on the statements of revenues, expenses, and change in net assets. As of June 30, 2010, a liability of \$1.0 million was recorded as an accrued liability on the statement of net assets.

(10) 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 75% and 76% of UNMMG's gross patient revenue was derived from third party payors in 2010 and 2009, respectively. Of this, Medicare and Medicaid represented approximately 51% and 49% in 2010 and 2009, respectively. 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, which 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 of regulatory policy changes.

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.

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A summary of the net patient service revenues follows for the years ended June 30, 2010 and 2009:

| | 2010 | 2009 |
|---|----------------|---------------|
| Patient service charges billed at established rates | \$ 305,496,676 | 276,745,462 |
| Adjustments to charges: | | |
| Contractual adjustments | (119,567,289) | (107,974,791) |
| Charity care | (51,451,431) | (45,583,724) |
| Net patient billing | 134,477,956 | 123,186,947 |
| Provision for uncollectible accounts | (22,889,245) | (21,024,317) |
| Net patient service revenues | \$ 111,588,711 | 102,162,630 |

(11) 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 years ended June 30, 2010, 2009, and 2008:

| | 2010 | 2009 |
|---|---------------|-------------|
| Charges forgone, based on established rates | \$ 51,451,431 | 45,583,724 |
| Estimated costs and expenses incurred to provide charity care | 23,513,304 | 20,031,517 |
| Equivalent percentage of charity care to total gross revenue | 17.00% | 16.30% |

(12) 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 pays UNM HSC on a monthly basis. In the event that additional funding is required to support the clinical, educational, and research mission of the SOM, the executive committee of the UNMMG will determine and approve the purchase of any additional services. For the years ended June 30, 2010 and 2009, UNMMG purchased services in the amounts of approximately \$79.8 million and \$74.5 million, respectively, which is recorded as an operating expense on the statements of revenues, expenses, and changes in net assets. The related unpaid amounts of approximately \$22.3 million and \$16.7 million at June 30, 2010 and 2009, respectively are reported as a current liability on the statements of net assets.

UNM processes payroll and various other expenses through its business office on behalf of UNMMG. UNMMG reimburses UNM for the expenses. At June 30, 2010 and 2009, UNMMG's liabilities for these expenses were approximately \$1.1 million and \$1.4 million, respectively, and are reported as a current liability on the statements of net assets. The related expenses are reported as operating expenses within the appropriate categories on the statements of revenues, expenses, and changes in net assets.

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June 30, 2010 and 2009

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 years ended June 30, 2010 and 2009 were approximately \$1.2 million and is reported as patient registration and enrollment support expense on the statements of revenues, expenses, and changes in net assets. At June 30, 2010 and 2009, approximately \$1.2 million and \$0.3 million, respectively, is reported in accrued liabilities on the statements of net assets.

UNMH processes certain transactions using a computer and software resources owned by UNMMG. UNMH reimburses UNMMG for the estimated cost of the use of the computer and software. UNMH reimbursed UNMMG approximately \$0.3 million for both the years ended June 30, 2010 and 2009, which is reported as an offset of data processing costs on the statements of revenues, expenses, and changes in net assets.

In 2010 and 2009, UNMH provided funding to UNMMG in the amount of \$1.0 million for the support of two UNMMG departments who provide direct operational support services to UNMH. The amount of funding provided is negotiated annually and is reported as an offset of salary and benefit costs on the statements of revenues, expenses, and changes in net assets.

UNM HSC and SOM allocate administrative support costs in exchange for administrative services provided to the clinical departments and the UNMMG via the assessment of a tax dean's tax. The dean's tax is a fixed percentage assessment on clinical revenues assessed by the SOM equal to approximately \$5.5 million and \$5.1 million for the years ended June 30, 2010 and 2009, respectively, and is reported as an operating expense on the statements of revenues, expenses, and changes in net assets. In 2010, UNMMG established a \$0.8 million rescission tax at a fixed percentage on clinical revenues to provide support to UNM HSC clinical, education, and research programs impacted by expected cuts from state and federal agencies and is reported as an operating expense on the statements 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. The related outstanding amount of approximately \$0.4 million for both 2010 and 2009 is reported in current liabilities on the statements of net assets.

In 2010, UNMMG was party to a service agreement settlement with UNM HSC's Cancer Center for \$0.8 million. UNMMG was required to fund the settlement and UNM HSC's Cancer Center would reimburse UNMMG. UNMMG recorded settlement payable in other accrued liabilities and recorded the associated receivable from Cancer Center in other receivables in the statement of net assets.

UNMMG leases office space under an operating lease agreement with UNMH. See note 14 for further discussion.

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

Notes to Financial Statements

June 30, 2010 and 2009

(13) Benefit Plans

UNMMG has a defined contribution plan covering eligible UNMMG paid employees. UNMMG provides a dollar for dollar match up to 6% of employee's elective deferral. In addition, UNMMG may make a discretionary contribution to the employee's plan based on a percentage of the employee salary. The discretionary contribution percentages were 4% in 2010 and 2009. The plan was established on July 1, 2008 by the Board of Directors of UNMMG and can be amended at its discretion. Total contributions were \$416,148 and \$265,620 for the years ended June 30, 2010 and 2009, respectively. Employees paid under UNM participate in the defined benefit retirement plan under the Educational Retirement Act of the State of New Mexico.

(14) Operating Leases

UNMMG subleases office space under an operating lease agreement with UNMH. The lease expired on September, 2009 and the current arrangement is on a month to month basis. UNMMG is also committed under facility lease arrangements related to the clinics established under UNMMG. Rent expense for the years ended June 30, 2010 and 2009 were \$547,753 and \$412,664, respectively.

(15) 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 of New Mexico (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 \$39,339 and \$52,933 in 2010 and 2009, respectively, and is reported as an operating expense on the statements of revenues, expenses, and changes in net assets.

(16) Other Matters

UNMMG continues to pursue initiatives to expand clinical services into Sandoval County. In August 2009, the Regents of the University of New Mexico approved the formation of the UNM Sandoval Regional Medical Center, Inc. (SRMC), a New Mexico nonprofit corporation organized under and pursuant to the New Mexico University Research Park and Economic Development Act. The creation of SRMC is largely a result of collaborative efforts between UNMMG and UNMH, and, accordingly, UNMMG and UNMH shall have representation on its board. A memorandum of understanding was established between UNMMG and SRMC providing for UNMMG to fund the initial planning and construction costs until SRMC received its funding from HUD. SRMC will then reimburse UNMMG for all costs paid by UNMMG. UNMMG recorded those costs as a receivable due from SRMC, which represented \$6.0 million as of June 30, 2010. SRMC closed on its financing November 3, 2010 to build the new acute care community teaching facility and Medical Office Building in Sandoval County. At closing the majority of the \$6 million of costs incurred to date were paid to UNMMG with the remainder expected to be funded by SRMC before the end of the second quarter of fiscal year 2011.

UNM MEDICAL GROUP, INC.
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Notes to Financial Statements

June 30, 2010 and 2009

As a requirement of the SRMC bond issuance by the bond rating agencies, the Board of UNMMG approved, for the benefit of SRMC, the issuance of a Quick Draw letter of credit to the benefit of the bond trustee (Wells Fargo Bank N.A.) covering any shortfall occasioned by the negative arbitrage associated with the bond financing. UNMMG secured \$10,125,000 to be held by the bond trustee through the SRMC construction period. It is anticipated that the SRMC construction will be completed by June 30, 2012. The amount of the quick draw cash requirement will be recalculated upon each semi-annual bond debt service payment, at which, the funds in excess of the requirement will revert back to UNMMG.

UNM MEDICAL GROUP, INC.
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Pledged Collateral by Banks

June 30, 2010

| | | |
|--|----|--------------------------|
| Deposits per bank (Wells Fargo) | \$ | 19,405,777 |
| Less: | | |
| FDIC Coverage | | (524,421) |
| Total uninsured public funds | | <u>18,881,356</u> |
| State of New Mexico Collateral Requirement – 50% | | <u>9,440,678</u> |
| Pledged collateral: | | |
| FNMA, 31409 VDH3, 03/01/2036, 6.0% | | 3,616,525 |
| FNMA, 31410 EN46, 06/01/2036, 6.0% | | 3,844,063 |
| FNMA, 31411 VT25, 04/01/2037, 5.0% | | 6,682,409 |
| FNMA, 31414 EMS0, 06/01/2038, 6.0% | | 6,444,366 |
| FNMA, 31415 RGN8, 07/01/2038, 5.5% | | 4,054,286 |
| GNMA, 36202 DPS4, 09/20/2031, 6.5% | | 91,375 |
| GNMA, 36202 DT68, 08/20/2032, 6.0% | | 163,815 |
| Total pledged collateral | | <u>24,896,839</u> |
| Overcollateralized | | <u><u>15,456,161</u></u> |

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.
(A Component Unit of the University of New Mexico)

Deposit and Investment Account Balances

June 30, 2010

| Account | Type of account name of asset | Bank balance | Reconciling items | Book balance |
|---------------------------------|---|-----------------|----------------------|-----------------|
| Wells Fargo | Checking | \$ 18,909,000 | (290,513) | 18,618,487 |
| | Savings | 496,777 | — | 496,777 |
| Morgan Stanley: Smith Barney | Money market: | — | — | — |
| | Western asset institutional Tax-free reserve | 5,918,255 | — | 5,918,255 |
| | Total cash | 25,324,032 | (290,513) | 25,033,519 |
| Investments: | | | | |
| Wells Fargo | Certificate of deposit | 22,579 | — | 22,579 |
| Morgan Stanley: Smith Barney | Corporate bonds: | | | |
| | Paccar Financial Corp | 203,182 | — | 203,182 |
| | Cisco Systems Inc | 183,919 | — | 183,919 |
| | Ibm Corp | 205,015 | — | 205,015 |
| | Boeing Capital Corp | 207,928 | — | 207,928 |
| | SBC Communications Inc | 126,112 | — | 126,112 |
| | Cellco Part/Veri Wireless | 206,055 | — | 206,055 |
| | Hewlett Packard Co | 203,963 | — | 203,963 |
| | Praxair Inc Notes | 203,840 | — | 203,840 |
| | Catepillar Financial SE | 203,697 | — | 203,697 |
| | John Deere Capital Corp | 202,271 | — | 202,271 |
| | Oracle/ozark Hldg Global NTS | 215,767 | — | 215,767 |
| | Medtronic Inc | 202,701 | — | 202,701 |
| | Wal Mart Stores Inc Notes | 102,603 | — | 102,603 |
| | Novartis Capital Global | 204,220 | — | 204,220 |
| | Proctor & Gamble Co | 203,186 | — | 203,186 |
| | Covidian Intl Finance SA | 202,428 | — | 202,428 |
| | Total corporate bonds | 3,076,887 | — | 3,076,887 |
| | U.S. Treasury notes: | | | |
| | SER Z-2013 | 757,429 | — | 757,429 |
| | U.S. government bonds: | | | |
| | Federal Farm Credit Bank | 251,712 | — | 251,712 |
| | Total investments | \$ 4,108,607 | — | 4,108,607 |

See accompanying independent auditor's report.



KPMG LLP
Suite 700
Two Park Square
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PO Box 3990
Albuquerque, NM 87190

**Independent Auditors' Report on Internal Control over Financial Reporting
and on Compliance and Other Matters Based on an Audit of 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 UNM Medical Group, Inc. (UNMMG) as of and for the year ended June 30, 2010, and have issued our report thereon dated November 4, 2010. 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 deficiency in internal control over financial reporting 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 and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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*.

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

KPMG LLP

November 4, 2010

UNM MEDICAL GROUP, INC.
(A Component Unit of the University of New Mexico)
Schedule of Findings and Responses
Fiscal year ended June 30, 2010

Section IV – Other Findings, as Required by State Statute, Section 12-6-5, NMSA 1978

There are no current year state compliance or operational findings to report.

There were no state compliance or operational findings to report in 2009.

UNM MEDICAL GROUP, INC.
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Exit Conference

Fiscal year ended June 30, 2010

An exit conference was conducted on October 19, 2010, 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:

| | |
|---------------------------|--|
| Carolyn Voss, MD | Sr. VP, Medical Director, Executive VP, and COO |
| Phil Wiest, MD | Audit Committee Member |
| Anthony R. Masciotra, Jr. | Executive Director, SVP Operations, and CFO |
| Rodney W. Martinez | AVP – Finance and Financial Controller |
| Mary Swanson | Accounting Director |
| Cynthia C. Reinhart | Partner, KPMG LLP |
| Greg Monk | Manager, KPMG LLP |