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Iowa State University
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Iowa School for the Deaf
Iowa Braille and Sight Saving School
Lakeside Lab Regents Resource Center
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Southwest Iowa Regents Resource Center
Tri-State Graduate Center



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REGENTS**
STATE OF IOWA

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Robert Donley, *Executive Director*

January 12, 2012

Michael E. Marshall
Secretary of the Senate
State Capitol Building
Des Moines IA 50319

Charles Smithson
Chief Clerk of the House
State Capitol Building
Des Moines IA 50319

Re: University of Iowa Hospitals and Clinics – Audited Financial Report

Dear Members of the Iowa General Assembly:

Pursuant to Iowa Code 263A.13, enclosed is the UIHC audited financial report as of June 30, 2011, and 2010.

If there are any questions concerning this report, please do not hesitate to contact us.

Sincerely,

Robert Donley

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Enclosure

cc: Robin Madison, LSA
Andrea Anania
Legislative Liaisons
Legislative Log



KPMG LLP
2500 Ruan Center
666 Grand Avenue
Des Moines, IA 50309

November 8, 2011

The Board of Regents
State University of Iowa

Ladies and Gentlemen:

We have audited the financial statements of the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) as of and for the years ended June 30, 2011 and 2010, and have issued our report thereon under the date of November 8, 2011. Under our professional standards, we are providing you with the accompanying information related to the conduct of our audits.

Our Responsibility under Professional Standards

We are responsible for forming and expressing an opinion about whether the financial statements, that have been prepared by management with the oversight of the Board of Regents, are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. We have a responsibility to perform our audit of the financial statements in accordance with professional standards. In carrying out this responsibility, we planned and performed the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, we are to obtain reasonable, not absolute, assurance that material misstatements are detected. We have no responsibility to plan and perform the audit to obtain reasonable assurance that misstatements, whether caused by error or fraud, that are not material to the financial statements are detected. Our audit does not relieve management or the Board of Regents of their responsibilities.

In addition, in planning and performing our audit of the financial statements, we considered internal control over financial reporting (internal control) 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 UIHC's internal control. Accordingly, we do not express an opinion on the effectiveness of UIHC's internal control.

We also have a responsibility to communicate significant matters related to the financial statement audit that are, in our professional judgment, relevant to the responsibilities of the Board of Regents in overseeing the financial reporting process. We are not required to design procedures for the purpose of identifying other matters to communicate to you.

Other Information in Documents Containing Audited Financial Statements

Our responsibility for other information in documents containing UIHC's financial statements and our auditors' report thereon does not extend beyond the financial information identified in our auditors' report, and we have no obligation to perform any procedures to corroborate other information contained in these documents.



The Board of Regents
State University of Iowa
November 8, 2011
Page 2

Accounting Practices and Alternative Treatments

Significant Accounting Policies and Unusual Transactions

The significant accounting policies used by UIHC are described in note 1 to the financial statements. There were no new significant accounting policies adopted by UIHC during 2011 that materially affected the financial statements, nor were the application of existing policies changed during the current year.

Qualitative Aspects of Accounting Practices

We have discussed with the Board of Regents and management our judgments about the quality, not just the acceptability, of UIHC's accounting principles as applied in its financial reporting. The discussions generally included such matters as the consistency of UIHC's accounting policies and their application, and the understandability and completeness of UIHC's financial statements, which include related disclosures.

Management Judgments and Accounting Estimates

The preparation of the financial statements requires management of UIHC to make a number of estimates and assumptions relating to the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period.

Management's estimate of the allowance for doubtful accounts, reserves for contractual allowances on accounts receivable, and settlements with third-party payors are based primarily on historical trends and current reimbursement regulations. We evaluated key factors and assumptions used to develop these balances.

Uncorrected and Corrected Misstatements

In connection with our audit of UIHC's financial statements, we discussed with management a financial statement misstatement that has not been corrected in UIHC's books and records as of and for the year ended June 30, 2011. We have reported the misstatement to management on a Summary of Audit Differences and have received written representations from management that management believes that the effect of the uncorrected financial statement misstatement is immaterial to the financial statements taken as a whole. Attached is a copy of the summary that has been provided to, and discussed with, management. We did not propose any misstatements that were recorded in the financial statements.

Disagreements with Management

There were no disagreements with management on financial accounting and reporting matters that, if not satisfactorily resolved, would have caused a modification of our auditors' report on UIHC's financial statements.

Management's Consultation with Other Accountants

To the best of our knowledge, management has not consulted with or obtained opinions, written or oral, from other independent accountants during the year ended June 30, 2011.



The Board of Regents
State University of Iowa
November 8, 2011
Page 3

Significant Issues Discussed, or Subject to Correspondence, with Management

Major Issues Discussed with Management prior to Retention

We generally discuss a variety of matters with the Board of Regents and management each year prior to our retention by the Board of Regents as UIHC's auditors. During 2011, these discussions occurred in the normal course of our professional relationship, and our responses were not a condition to our retention.

Material Written Communications

The following material written communications between management and us were exchanged during the year:

1. Engagement letter
2. Management representation letter.

Significant Difficulties Encountered during the Audit

We encountered no significant difficulties in dealing with management in performing our audit.

Independence

Our professional standards and other regulatory requirements specify that we communicate to you in writing, at least annually, all independence-related relationships between our firm and the Company and provide confirmation that we are independent accountants with respect to the Company.

We hereby confirm that as of November 8, 2011 we are independent accountants with respect to UIHC under all relevant professional and regulatory standards.

* * * * *

This letter to the Board of Regents is intended solely for the information and use of the Board of Regents and management and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

KPMG LLP



University of Iowa Hospitals & Clines
Summary of Uncorrected Audit Differences
For year ended June 30, 2011
Amounts shown in thousands

Method used to quantify audit differences: **Rollover (Income Statement)**

#	Accounts and Description	Correcting Entry Required at Current Period End (Note - If there is an end-of-period balance sheet error, the correcting entry should be written irrespective of the period in which the error originated (i.e., there should not be any adjustments to opening retained earnings). If there was an uncorrected error in the prior end-of-period balance sheet, but there is not an error in the current end-of-period balance sheet, include only a description in this section.)		Impact of audit differences on financial statement captions														
		Debit	(Credit)	Type of Error Known Audit Difference (KD) or Most Likely Audit Difference (MLD)	Income Statement Effect Debit/(Credit)			Balance Sheet Effect Debit/(Credit)					Cash Flow Effect Increase/(Decrease)					
					Income effect of correcting the balance sheet in prior period (carried forward from prior period's column C)	Income effect of correcting the current period balance sheet	Income effect according to the Rollover (Income Statement) method	Net Assets at period end	Current Assets	Non-Current Assets	Current Liabilities	Non-Current Liabilities	Operating Activities	Investing Activities	Noncapital Financing activities	Financing Activities		
		----- A -----			B	C = A (Only Inc Stmt accounts)	C - B											
	Estimated Third-Party Payor Settlements Deduction from Revenue - Other Contractuals <To properly state Estimated Third-Party Payor Settlements>	1,336	(1,336)	MLD MLD	2,500	(1,336)	1,164	(1,336)	-	-	-	1,336	-	1,336	(1,336)	-	-	-
Aggregate of uncorrected audit differences (before tax)					2,500	(1,336)	1,164	(1,336)	-	-	-	1,336	-	-	-	-	-	-
Tax effect of uncorrected audit differences					-	-	-	-	-	-	-	-	-	-	-	-	-	-
Aggregate of uncorrected audit differences (after tax)							1,164	(1,336)	-	-	-	1,336	-	-	-	-	-	-
Financial statement amounts (per final financial statements)							(88,953)	(1,107,039)	303,528	1,117,305	(125,438)	(188,356)	142,300	(101,883)	1,552	(41,515)		
Uncorrected audit differences after tax effect as a percentage of financial statement amounts							-1.3%	0.1%	0.0%	0.0%	-1.1%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Communication of Uncorrected Audit Differences

Discussed with: Tom Netolicky Date: 10/31/2011

Discussed by: Don Kowalecki



**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Financial Statements

June 30, 2011 and 2010

(With Independent Auditors' Report Thereon)



KPMG LLP
2500 Ruan Center
666 Grand Avenue
Des Moines, IA 50309

Independent Auditors' Report

The Board of Regents
State of Iowa:

We have audited the accompanying balance sheets of the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) as of June 30, 2011 and 2010, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the years then ended. These financial statements are the responsibility of UIHC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. 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 UIHC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1 to the financial statements, the financial statements of UIHC are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business type activities of the State University of Iowa that is attributable to the transactions of UIHC. UIHC is a department of the State University of Iowa for financial reporting purposes. The financial statements of UIHC do not purport to, and do not, present fairly the financial position of the State University of Iowa as of June 30, 2011 and 2010, and the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State University of Iowa, University of Iowa Hospitals and Clinics as of June 30, 2011 and 2010, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying management's discussion and analysis on pages 3 through 8 is not a required part of the basic financial statements of UIHC, 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 supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Des Moines, Iowa
November 8, 2011

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Management's Discussion and Analysis

June 30, 2011 and 2010

Introduction

This section of the State University of Iowa, University of Iowa Hospitals and Clinics' (UIHC) annual financial report presents management's discussion and analysis of UIHC's financial performance during the years ended June 30, 2011 and 2010. The purpose is to provide an objective analysis of the financial activities of UIHC based on currently known facts, decisions, and conditions. Please read it in conjunction with UIHC's financial statements and the accompanying notes to the financial statements.

Financial Highlights

UIHC demonstrated financial success in 2011, with an increase in net assets of \$85.9 million, or 8.4%, as compared to an increase in net assets in 2010 by \$52.5 million, or 5.4%. Operating income in 2011 was \$60.3 million, an increase of \$34.3 million when compared to 2010. Nonoperating revenues and expenses decreased \$0.6 million. Operating income in 2010 was \$26.1 million, an increase of \$34.9 million when compared to 2009. Nonoperating revenues and expenses increased \$32.3 million, primarily due to investment income of \$28.6 million versus \$3.3 million in 2009.

Overview of the Financial Statements

This annual report consists of two parts – management's discussion and analysis and the basic financial statements.

The financial statements consist of three statements – a balance sheet; a statement of revenues, expenses, and changes in net assets; and statement of cash flows. These financial statements and related notes provide information about the activities of UIHC and have been prepared on an accrual basis in accordance with Governmental Accounting Standards Board (GASB) accounting principles.

Balance Sheet and Statement of Revenues, Expenses, and Changes in Net Assets

In 2011, net assets increased by \$85.9 million or more than 8.4% to \$1.1 billion. This is primarily due to net income from operations of \$60.3 million and investment income of \$37.5 million. In 2010, net assets increased by \$52.5 million or more than 5.4% to \$1.0 billion. This is primarily due to net income from operations of \$26.1 million and investment income of \$28.6 million.

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Management's Discussion and Analysis

June 30, 2011 and 2010

Table 1 provides a summary of UIHC's assets, liabilities, and net assets as of June 30, 2011, 2010, and 2009.

Table 1
UNIVERSITY OF IOWA HOSPITALS AND CLINICS
Condensed Balance Sheets Information
(In thousands)

Assets	2011	2010	2009
Current assets	\$ 303,528	275,824	243,815
Noncurrent cash and investments	606,578	494,312	440,088
Capital assets, net	507,357	506,927	528,100
Other assets	3,370	2,736	2,915
Total assets	<u>\$ 1,420,833</u>	<u>1,279,799</u>	<u>1,214,918</u>
Liabilities			
Current liabilities	\$ 125,438	109,289	114,326
Long-term debt	147,276	114,165	105,807
Other long-term liabilities	41,080	35,249	26,201
Total liabilities	<u>313,794</u>	<u>258,703</u>	<u>246,334</u>
Net assets:			
Invested in capital assets, net of related debt	368,302	398,504	427,073
Restricted	17,176	16,131	13,334
Unrestricted	721,561	606,461	528,177
Total net assets	<u>1,107,039</u>	<u>1,021,096</u>	<u>968,584</u>
Total liabilities and net assets	<u>\$ 1,420,833</u>	<u>1,279,799</u>	<u>1,214,918</u>

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Management's Discussion and Analysis

June 30, 2011 and 2010

Table 2 shows the changes in net assets for 2011 compared to 2010 and 2009.

Table 2

UNIVERSITY OF IOWA HOSPITALS AND CLINICS

Condensed Revenues, Expenses, and Changes in Net Assets Information

(In thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues:			
Net patient service revenue	\$ 988,234	899,706	883,417
Other revenue	45,214	43,752	44,777
Total operating revenues	<u>1,033,448</u>	<u>943,458</u>	<u>928,194</u>
Operating expenses:			
Salaries and benefits	488,546	465,583	494,519
Medical supplies and drugs	202,779	184,974	185,665
Other supplies and general expenses	211,714	191,999	183,795
Depreciation and amortization	70,062	74,812	72,975
Total operating expenses	<u>973,101</u>	<u>917,368</u>	<u>936,954</u>
Operating income (loss)	<u>60,347</u>	<u>26,090</u>	<u>(8,760)</u>
Nonoperating revenues (expenses):			
Loss on disposal of capital assets	(8,420)	(966)	(6,312)
Noncapital grants and contributions	4,507	5,670	3,189
Investment income	37,472	28,608	3,315
Interest expense	(5,008)	(4,207)	(3,392)
Total nonoperating revenues, (expenses), net	<u>28,551</u>	<u>29,105</u>	<u>(3,200)</u>
Excess (deficiency) of revenues over expenses before transfers	88,898	55,195	(11,960)
Net transfers (out) in	<u>(2,955)</u>	<u>(2,683)</u>	<u>788</u>
Increase (decrease) in net assets	85,943	52,512	(11,172)
Net assets, beginning of year	<u>1,021,096</u>	<u>968,584</u>	<u>979,756</u>
Net assets, end of year	<u>\$ 1,107,039</u>	<u>1,021,096</u>	<u>968,584</u>

Net Patient Service Revenue

Net patient service revenue increased from 2010 to 2011 by \$88.5 million, or 9.8%, and \$16.3 million, or 1.8%, from 2009 to 2010. The increases in net patient service revenue were driven by both increases in patient volumes

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Management's Discussion and Analysis

June 30, 2011 and 2010

and pricing increases during the same periods. The increase in 2011 resulted from increases in both the inpatient and outpatient areas. On the inpatient side, acute admissions were up 1,076, or 3.7%, over 2010 and inpatient surgeries increased by 308, or 2.8%, and transplant surgeries increased by 5, or 1.7%. There was also an increase in outpatient clinic visits from 2010 to 2011 by 24,966, or 3.3%, and increase in outpatient surgeries of 1,208, or 8.5%. The increase in 2010 is primarily due to an increase in outpatient clinic visits from 2009 to 2010 by 11,511, or 1.6%, and increase in outpatient surgeries of 1,129, or 8.6%.

The provision for bad debts (a deduction from gross patient charges) decreased \$0.4 million from \$23.0 million in 2010 to \$22.6 million in 2011. Self-pay admissions decreased 16.4% from prior year while self-pay clinic visits increased 2.9% from prior year. The provision for bad debts decreased \$4.5 million from \$27.5 million in 2009 to \$23.0 million in 2010.

Operating Expenses

Total operating expenses increased 6.1% from \$917.4 million in 2010 to \$973.1 million in 2011. The largest increase in expenses in 2011 was in Repairs, Maintenance & Minor Equipment, which increased \$9.97 million, or 48.9%, when compared to 2010. The increased expenses consisted primarily of small equipment purchases. Supply expenses increased \$9.4 million, or 8.3%, in 2011 compared with 2010 and drug expenses increased \$8.3 million, or 11.8%. The increases in supply and drug expenses were primarily due to increases in volumes compared with 2010.

Total operating expenses decreased 2.1% from \$937.0 million in 2009 to \$917.4 million in 2010. The largest decrease in expenses in 2010 is attributable to salaries and benefits, which decreased \$28.9 million, or 5.9%, when compared to 2009. Total paid full-time equivalents (FTE's) decreased by 474, or 7.1%, from 6,685 in 2009 to 6,211 in 2010. In addition, during 2010, UIHC recorded a reduction to benefit expense in the amount of \$8.0 million related to medical resident FICA refund claims for periods ending before April 1, 2005 due to notification from the IRS of its intent to honor these claims. Medical supplies and drugs expense decreased \$0.7 million when compared to 2009. This is primarily due to a cost saving initiative to reduce expenses.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of loss on disposals of capital assets, investment income, interest expense, and noncapital grants and contributions. Investment income increased from 2010 to 2011 by \$8.9 million, or 31.0%, and from 2009 to 2010 by \$25.3 million, or 762.9%. During 2011, UIHC recorded overall earnings on the endowment and operating pools of \$18.0 million and a net unrealized gain on investments of \$19.5 million, which increased investment income accordingly. This compares to the overall earnings on the endowment and operating pools of \$4.7 million and a net unrealized gain on investments of \$20.0 million in the previous year. In addition, during 2010, UIHC recorded an interest accrual in the amount of \$3.9 million related to medical resident FICA refund claims for periods ending before April 1, 2005 due to notification from the IRS of their intent to honor these claims.

Statement of Cash Flows

The statement of cash flows reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. UIHC's overall liquidity increased during 2011, with a net increase in cash and cash equivalents of \$0.5 million. In 2011, net cash from operating and noncapital financing activities

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Management's Discussion and Analysis

June 30, 2011 and 2010

provided cash inflows of \$142.3 million and \$1.6 million, respectively. UIHC's overall liquidity increased during 2010, with a net increase in cash and cash equivalents of \$0.2 million. In 2010, net cash from operating and noncapital financing activities provided cash inflows of \$94.9 million and \$3.0 million, respectively. UIHC was able to purchase capital assets, investments, and pay down long-term debt with the net cash inflows mentioned above.

Capital Assets and Debt Administration

Capital Assets

At the end of 2011, UIHC had \$507.4 million invested in capital assets, net of accumulated depreciation. This is a \$0.5 million increase when compared to capital assets, net in 2010 of \$506.9 million. Capital assets, net of accumulated depreciation decreased \$21.1 million in 2010 when compared to capital assets, net in 2009 of \$528.1 million. This is primarily due to assets depreciating faster than capital assets were purchased.

During 2011 and 2010, UIHC constructed or purchased \$85.0 million and \$56.5 million, respectively, of capital assets. The major capital asset additions in 2011 included:

- North Liberty Land Purchase
- Iowa River Landing
- Data Center
- Clinical Cancer Center
- EPIC Software Licenses

The major capital additions in 2010 included:

- Institute for Clinical and Translational Science Facilities Development
- Sports Medicine Center
- Emergency Treatment Center Expansion and Renovation
- PIC Unit Expansion
- Medical Psych Inpatient Unit Relocation
- Additional major equipment additions in 2010 consisted of a Magnetom Avanto MRI for the Sports Medicine Center, a SOMATOM Definition Dual Source CT Scanner, a Single Axiom Artis DFC Single Plane Fluoroscopy, and a DataCaptor Software license to be used with EPIC

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Management's Discussion and Analysis

June 30, 2011 and 2010

Debt

At June 30, 2011 and 2010, UIHC had \$151.9 million and \$118.6 million, respectively, in revenue bonds and capital lease obligations outstanding. During 2011 and 2010, payments of long-term debt were \$4.5 million and \$4.6 million, respectively. During 2011, UIHC issued \$37.6 million of Series S.U.I. 2010 and Series S.U.I. 2011 Revenue Bonds, the proceeds of which will be used by UIHC for the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient care facilities, including construction of a new medical office building and related space, including finish materials, fixtures, furnishings, equipment, and appliances, funding a deposit to the Reserve Fund, and paying the costs of issuance of the Bonds.

In September 2011, UIHC issued \$26.8 million of Series S.U.I. 2011 Hospital Revenue Bonds. The proceeds of the Bonds will be used by the UIHC for the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient care facilities, including construction of a new medical office building and related space, including finish materials, fixtures, furnishings, equipment, and appliances, funding a deposit to the Reserve Fund, and paying the costs of issuance of the Bonds.

Contacting UIHC's Financial Management

This financial report provides the citizens of Iowa, our patients, bondholders, and creditors with a general overview of UIHC's finances and operations. If you have questions about this report, please contact Mr. Kenneth L. Fisher, Associate Vice President for Finance, UI Healthcare and CFO, University of Iowa Hospitals and Clinics, 300 CMAB, Iowa City, Iowa 52242.

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Balance Sheets

June 30, 2011 and 2010

(In thousands)

Assets	<u>2011</u>	<u>2010</u>
Current assets:		
Cash and cash equivalents	\$ 1,428	974
Short-term investments	122,062	103,394
Patient accounts receivable, net of estimated uncollectibles \$18,776 in 2011 and \$20,630 in 2010	135,676	129,962
Inventories	21,429	19,984
Current portion of debt service funds	1,273	1,213
Other current assets	21,660	20,297
Total current assets	<u>303,528</u>	<u>275,824</u>
Noncurrent cash and investments:		
Designated by the Board of Regents	577,877	469,203
Held by trustee for debt service	12,798	10,191
Restricted by contributors and grantors for capital acquisitions and research	15,903	14,918
	<u>606,578</u>	<u>494,312</u>
Capital assets, net	507,357	506,927
Other assets	3,370	2,736
Total assets	<u>\$ 1,420,833</u>	<u>1,279,799</u>
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt and capital lease obligation	\$ 4,577	4,449
Accounts payable and accrued expenses	91,576	79,642
Estimated third-party payor settlements	15,847	9,394
Due to related parties	5,404	8,374
Other current liabilities	5,266	5,408
Accrued interest	2,768	2,022
Total current liabilities	<u>125,438</u>	<u>109,289</u>
Long-term debt and capital lease obligation, net of current maturities	147,276	114,165
Other long-term liabilities	41,080	35,249
Total liabilities	<u>313,794</u>	<u>258,703</u>
Net assets:		
Invested in capital assets, net of related debt	368,302	398,504
Restricted by donors for specific purposes	15,903	14,918
Restricted for debt service	1,273	1,213
Unrestricted	721,561	606,461
Total net assets	<u>1,107,039</u>	<u>1,021,096</u>
Total liabilities and net assets	<u>\$ 1,420,833</u>	<u>1,279,799</u>

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**
Statements of Revenues, Expenses, and Changes in Net Assets
Years ended June 30, 2011 and 2010
(In thousands)

	<u>2011</u>	<u>2010</u>
Operating revenues:		
Net patient service revenue, net of provision for bad debts of \$22,589 in 2011 and \$22,964 in 2010	\$ 988,234	899,706
Other revenue	45,214	43,752
Total operating revenues	<u>1,033,448</u>	<u>943,458</u>
Operating expenses:		
Salaries and benefits	488,546	465,583
Medical supplies and drugs	202,779	184,974
Other supplies and general expenses	211,714	191,999
Depreciation and amortization	70,062	74,812
Total operating expenses	<u>973,101</u>	<u>917,368</u>
Operating income	<u>60,347</u>	<u>26,090</u>
Nonoperating revenues (expenses):		
Loss on disposal of capital assets	(8,420)	(966)
Noncapital grants and contributions	4,507	5,670
Investment income	37,472	28,608
Interest expense	(5,008)	(4,207)
Total nonoperating revenues, net	<u>28,551</u>	<u>29,105</u>
Excess of revenues over expenses before transfers	88,898	55,195
Net transfers out	<u>(2,955)</u>	<u>(2,683)</u>
Increase in net assets	85,943	52,512
Net assets, beginning of year	<u>1,021,096</u>	<u>968,584</u>
Net assets, end of year	<u>\$ 1,107,039</u>	<u>1,021,096</u>

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,
UNIVERSITY OF IOWA HOSPITALS AND CLINICS**

Statements of Cash Flows

Years ended June 30, 2011 and 2010

(In thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 988,973	892,058
Other receipts	42,244	48,550
Payments to employees	(478,690)	(456,172)
Payments to suppliers and contractors	(410,227)	(389,542)
Net cash provided by operating activities	142,300	94,894
Cash flows from noncapital financing activities:		
Net transfers	(2,955)	(2,683)
Noncapital grants and contributions	4,507	5,670
Net cash provided by noncapital financing activities	1,552	2,987
Cash flows from capital and related financing activities:		
Purchase of capital assets	(76,572)	(55,532)
Proceeds from the sale of capital assets	6,081	2,065
Proceeds from the issuance of long-term debt	37,571	12,825
Premium received on issuance of long-term debt	531	76
Principal paid on long-term debt	(4,538)	(4,530)
Interest paid on long-term debt	(4,588)	(4,415)
Net cash used in capital and related financing activities	(41,515)	(49,511)
Cash flows from investing activities:		
Proceeds from sale of investments	159,186	89,905
Purchase of investments	(279,588)	(147,163)
Interest and dividends received on investments	18,519	9,125
Net cash used in investing activities	(101,883)	(48,133)
Net increase in cash and cash equivalents	454	237
Cash and cash equivalents at beginning of year	974	737
Cash and cash equivalents at end of year	\$ 1,428	974
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 60,347	26,090
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	70,062	74,812
Provision for bad debts	22,589	22,964
Change in assets and liabilities:		
Accounts receivable	(28,303)	(22,013)
Inventories	(1,445)	590
Other assets	(2,057)	(11,754)
Accounts payable and accrued expenses	11,934	(2,534)
Other liabilities	5,690	10,540
Due to related parties	(2,970)	4,798
Estimated third-party payor settlements	6,453	(8,599)
Net cash provided by operating activities	\$ 142,300	94,894

Noncash investing activities:

UIHC held cash and investments at June 30, 2011 and 2010 with a fair value of \$730,068 and \$598,680, respectively. During 2011 and 2010, the net increase in fair value of these investments was \$19,492 and \$20,062, respectively.

See accompanying notes to financial statements.

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(1) Summary of Significant Accounting Policies and Related Matters

(a) Reporting Entity

For purposes of this report, the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) includes the healthcare units of the University of Iowa, which are generally referred to as the University Hospital, the Psychiatric Hospital, and the Center for Disabilities and Development. UIHC is part of the State University of Iowa (the University), which is owned and operated by the State of Iowa under the supervision of the Board of Regents, State of Iowa (the Board) and is a University department for financial reporting purposes.

UIHC includes substantially all of the healthcare provider activities for patient care associated with the University other than the physician and dentist services and research activities provided by the faculties of the University's Colleges of Medicine and Dentistry. Student Health Services, Specialized Child Health Services outreach programs, and the University of Iowa Health System, a UIHC affiliate, are not included in these financial statements.

UIHC is a comprehensive tertiary care referral center located in Iowa City, Iowa, offering a full range of clinical services in substantially all specialties and subspecialties of medicine and dentistry. UIHC serves as a resource for the state's primary and secondary healthcare providers. Patients are primarily from Iowa.

(b) Basis of Presentation

UIHC uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and other Governmental Entities that Use Proprietary Fund Accounting*, as amended, UIHC has the option to apply all Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, provided that such pronouncements do not conflict or contradict GASB pronouncements. UIHC has elected not to apply all FASB Statements and Interpretations issued after November 30, 1989.

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(d) Cash and Investments

Cash and investments of UIHC include specific investments and other cash and investments that are pooled with the cash and investments of the University and held in the name of the University. UIHC's share of pooled investments and income thereon is determined on a pro rata basis reflecting UIHC's amounts available for investment as compared with the amounts for the overall University.

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Undesignated cash equivalents totaling \$1.4 million and \$1.0 million at June 30, 2011 and 2010, respectively, represent money market funds and other short-term investments that mature in three months or less from date of purchase.

(e) Inventories

Inventories consist primarily of medical and surgical, pharmaceutical, dietary, and other supplies. Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out or weighted average basis.

(f) Capital Assets

UIHC's capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using the following asset lives:

Buildings and leasehold improvements	10 to 40 years
Infrastructure and land improvements	5 to 20 years
Equipment and software	3 to 10 years

(g) Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(h) Grants and Contributions

From time to time, UIHC receives grants, as well as contributions from individuals and private organizations. Grants and contributions may be restricted either for specific operating purposes or for capital purposes.

(i) Restricted Resources

When UIHC has both restricted and unrestricted resources available to finance a particular program, it is UIHC's policy to use restricted resources before unrestricted resources.

(j) Net Assets

Net assets of UIHC are classified in four components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Net assets restricted by donors for specific purposes are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to UIHC. Net assets restricted for debt service are amounts deposited with trustees as required by bond indentures. Unrestricted net

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assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

(k) *Operating Revenues and Expenses*

UIHC's statements of revenues, expenses, and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing healthcare services – UIHC's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

(l) *Net Patient Service Revenue*

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

(m) *Charity Care*

UIHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UIHC does not pursue collection of amounts once determined to qualify as charity care, they are not reported as revenues in the accompanying statements of revenues, expenses, and changes in net assets.

(n) *Compensated Absences*

UIHC employees accumulate vacation and sick leave under the provisions of the Code of Iowa. Under the State's policy, accrued vacation benefits are paid at an employee's regular hourly rate when used or are paid upon retirement, death, or termination with certain exceptions. Sick leave is paid in a similar manner when used or to a maximum of \$2,000 upon retirement. These benefits are accrued in the financial statements as earned by UIHC employees.

Retirement benefits are provided to employees primarily through a defined contribution retirement plan sponsored by the University. UIHC funds its obligation to the retirement plan on a current basis, as earned by its employees.

(o) *Income Taxes*

UIHC, as part of the University, is exempt from federal income taxes, pursuant to Section 115 of the Internal Revenue Code. As such, UIHC is subject to income taxes only on unrelated business income under the provisions of Section 511 of the Internal Revenue Code.

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(p) Reclassification of Prior Year Amounts

Certain reclassifications were made to the prior year financial statements to conform to the presentation of 2011.

(2) Deposits and Investments

In accordance with Chapter 12B.10A, section 5d of the Code of Iowa, the University's portfolios may be invested in obligations of the U.S. government and its agencies, certificates of deposit, prime bankers' acceptances, investment grade commercial paper, repurchase agreements, investments authorized by the Iowa Public Employees' Retirement System (IPERS) in Section 97B.7 of the Code of Iowa, investment grade corporate debt, mortgage pass through and asset backed securities with an A rating at time of purchase, an open-end management investment company organized in trust form registered with the S.E.C. under the Investment Company Act of 1940, the Common Fund for nonprofit organizations, and common stocks.

UIHC's cash and investments include specific investments and amounts pooled with cash and investments of the University and held in the University's name. UIHC's cash deposits at June 30, 2011 and 2010 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. Chapter 12C provides for additional assessments against the depositories of the pool to ensure that there will be no loss of public funds.

Noncurrent cash and investments limited by bond resolutions or designated by the Board were held for the following purposes at June 30, 2011 and 2010 (in thousands):

	2011	2010
Limited by bond resolutions:		
Debt service reserve	\$ 12,798	10,191
Designated by the Board of Regents:		
Capital projects and equipment and other needs	882	5,538
Surplus	564	466
Improvement, extension, repair, operation, and maintenance funds	576,431	463,199
Restricted by donors	15,903	14,918
	\$ 606,578	494,312

Funds for improvement, extension, repair, operation, and maintenance shall be used to pay costs of operating and maintaining the hospital system whenever other funds are not sufficient and for improvements, extensions, and repairs. Noncurrent cash and investments include designated assets set aside by the Board for future facility infrastructure improvements, equipment, and technological needs, over which UIHC retains control and may, at its discretion, subsequently authorize its use for other purposes. The funds are invested in investment-grade, long-term fixed income and in certain high-quality equities through the University's pooled investment funds.

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Cash and cash equivalents and short-term investments specifically identified or pooled with the cash and investments of the University totaled \$123.5 million and \$104.4 million at June 30, 2011 and 2010, respectively. Cash equivalents designated by the Board totaled \$166.3 million and \$166.2 million at June 30, 2011 and 2010, respectively.

UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2011, UIHC had the following investments and quality credit ratings (in thousands):

Fixed income	Effective duration (years)	TSY/ AGY/NA	AAA	AA	A	BBB	B	Total market value
Corporate notes and bonds	4.22	\$ —	857	225	1,423	635	—	3,140
U.S. government agencies	3.58	23,616	—	—	—	—	—	23,616
U.S. Treasury obligations	3.54	28,146	—	—	—	—	—	28,146
Mutual funds	5.69	—	54,011	152,258	14,142	—	28,729	249,140
		\$ 51,762	54,868	152,483	15,565	635	28,729	304,042
Equity:								
Cash and cash equivalents								\$ 294,582
U.S. equity mutual funds								56,070
Non-U.S. equity mutual funds								28,050
REIT mutual funds								31,036
Real assets								2,230
Private equity								1,198
Certificates of deposit								14,133
Total investments								\$ 731,341

As of June 30, 2010, UIHC had the following investments and quality credit ratings (in thousands):

Fixed income	Effective duration (years)	TSY/ AGY/NA	AAA	AA	A	BBB	B	Total market value
Corporate notes and bonds	2.74	\$ —	—	—	54,145	—	—	54,145
U.S. government agencies	1.00	22,430	—	—	—	—	—	22,430
U.S. Treasury obligations	3.61	26,289	—	—	—	—	—	26,289
Mutual funds	3.81	128,890	—	—	23,036	10,089	—	162,015
		\$ 177,609	—	—	77,181	10,089	—	264,879
Equity:								
Cash and cash equivalents								\$ 270,253
U.S. equity mutual funds								33,176
Non-U.S. equity mutual funds								17,039
REIT mutual funds								14,546
Total investments								\$ 599,893

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. This risk is measured using effective duration. At time of purchase, the effective maturity of direct investment purchases by the University in the operating portfolio cannot exceed

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sixty-three months. There is no explicit limit on the average maturity of fixed income securities in the endowment portfolios. Each fixed income portfolio is managed to an appropriate benchmark.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the University. The University manages exposure to credit risk by measuring portfolios against benchmarks as established by the Board of Regents. As of June 30, 2011, the operating portfolio benchmark and the long-term bond portfolio benchmark is AA1 (Barclays Capital Aggregate Bond Index).

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributed to the magnitude of investments in a single issuer. Except for Treasury or Agency debentures, pass-throughs or REMICs, no more than 5% of University investment portfolios are invested in securities of a single issuer. All direct investment purchases by the University in the operating portfolio are US Treasury and Agency securities.

Foreign Currency Risk – Foreign currency risk is the risk of an investment's value changing due to changes in currency exchange rates. The University's investment policy does not allow direct investment in foreign currencies. Also, no more than 30% of the long-term endowment portfolio can be invested in non-U.S. securities.

(3) Capital Assets

Capital assets at June 30, 2011 and 2010 are summarized as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Land	\$ 13,684	—
Land improvements	782	782
Infrastructure	41,591	41,211
Buildings and leasehold improvements	730,538	724,425
Equipment	299,726	310,585
Software	74,064	71,170
Construction in progress (nondepreciable)	48,544	25,674
	<u>1,208,929</u>	<u>1,173,847</u>
Less accumulated depreciation	701,572	666,920
	<u>\$ 507,357</u>	<u>506,927</u>

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Capital asset additions, retirements, and balances as of and for the years ended June 30, 2011 and 2010 were as follows (in thousands):

<u>Cost basis summary</u>	<u>June 30, 2010 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2011 balances</u>
Land (nondepreciable)	\$ —	13,684	—	13,684
Land improvements	782	—	—	782
Infrastructure	41,211	482	(102)	41,591
Buildings and leasehold improvements	724,425	6,113	—	730,538
Equipment and software	381,755	30,344	(38,309)	373,790
Construction in progress (nondepreciable)	25,674	34,370	(11,500)	48,544
Total at historical cost	<u>1,173,847</u>	<u>84,993</u>	<u>(49,911)</u>	<u>1,208,929</u>
Less accumulated depreciation for:				
Land improvements	740	3	—	743
Infrastructure	35,543	1,712	(99)	37,156
Buildings and leasehold improvements	411,853	29,766	—	441,619
Equipment and software	218,784	38,581	(35,311)	222,054
Total accumulated depreciation	<u>666,920</u>	<u>70,062</u>	<u>(35,410)</u>	<u>701,572</u>
Total capital assets, net	<u>\$ 506,927</u>	<u>14,931</u>	<u>(14,501)</u>	<u>507,357</u>

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<u>Cost basis summary</u>	<u>June 30, 2009 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2010 balances</u>
Land improvements	\$ 782	—	—	782
Infrastructure	40,539	672	—	41,211
Buildings and leasehold improvements	693,912	30,513	—	724,425
Equipment and software	379,854	29,385	(27,484)	381,755
Construction in progress (nondepreciable)	29,746	(4,072)	—	25,674
Total at historical cost	<u>1,144,833</u>	<u>56,498</u>	<u>(27,484)</u>	<u>1,173,847</u>
Less accumulated depreciation for:				
Land improvements	737	3	—	740
Infrastructure	33,565	1,978	—	35,543
Buildings and leasehold improvements	381,956	29,897	—	411,853
Equipment and software	200,476	42,761	(24,453)	218,784
Total accumulated depreciation	<u>616,734</u>	<u>74,639</u>	<u>(24,453)</u>	<u>666,920</u>
Total capital assets, net	<u>\$ 528,099</u>	<u>(18,141)</u>	<u>(3,031)</u>	<u>506,927</u>

At June 30, 2011, construction in progress is related to various projects throughout the UIHC. The estimated cost to complete the current phase of equipment and projects under construction at June 30, 2011 is \$40.2 million. Other projects at June 30, 2011, with an estimated cost of \$315.9 million, have been committed to by the Board and/or UIHC; however, construction contracts had not been signed as of such date. These projects are anticipated to be funded through existing designated funds, cash provided by future operations, and/or the issuance of additional long-term debt.

Cost of capital assets includes interest during the construction period for qualifying projects. Interest costs capitalized for the years ended June 30, 2011 and 2010 were \$1.3 million and \$1.4 million, respectively.

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(4) Long-Term Debt

Long-term debt outstanding at June 30, 2011 and 2010 was as follows (in thousands):

	2011	2010
Hospital Revenue Bonds:		
Series 2002 – 4.125% to 5.000%; maturing serially on September 1 through 2028	\$ 20,535	21,260
Series S.U.I. 2007 – 4.375% to 5.500%; maturing serially on September 1 through 2027	22,675	23,550
Series S.U.I. 2007A – 4.000% to 5.500%; maturing serially on September 1 through 2027	22,600	23,425
Series S.U.I. 2009 – 5.500% to 6.125%; maturing serially on September 1 through 2028	31,375	32,450
Series S.U.I. 2010 – 3.000% to 4.500%; maturing serially on September 1 through 2036	30,000	—
Net unamortized premium on Hospital Revenue Bonds	1,189	983
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2003 – 3.150% to 3.800%; maturing serially on July 1 through 2013	595	958
Series S.U.I. 2008 – 2.375% to 3.375%; maturing serially on July 1 through 2015	2,488	2,997
Series S.U.I. 2009 – 3.000% to 4.250%; maturing serially on July 1 through 2036	12,825	12,825
Series S.U.I. 2011 – 2.000% to 4.500%; maturing serially on July 1 through 2032	7,571	—
Total long-term debt	151,853	118,448
Capital lease obligations	—	166
	151,853	118,614
Long-term debt, current portion	4,577	4,449
	\$ 147,276	114,165

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Activity in long-term debt for the years ended June 30, 2011 and 2010 was as follows (in thousands):

	<u>June 30, 2010 balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2011 balance</u>	<u>Amounts due within one year</u>
Hospital Revenue Bonds, Series 2002	S 21,260	—	(725)	20,535	755
Hospital Revenue Bonds, Series 2007	23,550	—	(875)	22,675	925
Hospital Revenue Bonds, Series 2007A	23,425	—	(825)	22,600	875
Hospital Revenue Bonds, Series 2009	32,450	—	(1,075)	31,375	1,125
Hospital Revenue Bonds, Series 2010	—	30,000	—	30,000	—
Net unamortized bond premium	983	531	(325)	1,189	—
Telecommunications Facilities Revenue Bonds:					
Series, 2000	958	—	(363)	595	375
Series, 2008	2,997	—	(509)	2,488	522
Series, 2009	12,825	—	—	12,825	—
Series, 2011	—	7,571	—	7,571	—
Total long-term debt	<u>118,448</u>	<u>38,102</u>	<u>(4,697)</u>	<u>151,853</u>	<u>4,577</u>
Capital lease obligations	<u>166</u>	<u>—</u>	<u>(166)</u>	<u>—</u>	<u>—</u>
	<u>S 118,614</u>	<u>38,102</u>	<u>(4,863)</u>	<u>151,853</u>	<u>4,577</u>
	<u>June 30, 2009 balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2010 balance</u>	<u>Amounts due within one year</u>
Hospital Revenue Bonds, Series 2002	S 21,950	—	(690)	21,260	725
Hospital Revenue Bonds, Series 2007	24,375	—	(825)	23,550	875
Hospital Revenue Bonds, Series 2007A	24,225	—	(800)	23,425	825
Hospital Revenue Bonds, Series 2009	33,750	—	(1,300)	32,450	1,075
Net unamortized bond premium	1,002	76	(95)	983	—
Telecommunications Facilities Revenue Bonds:					
Series, 2003	1,310	—	(352)	958	362
Series, 2008	3,485	—	(488)	2,997	509
Series, 2009	—	12,825	—	12,825	—
Total long-term debt	<u>110,097</u>	<u>12,901</u>	<u>(4,550)</u>	<u>118,448</u>	<u>4,371</u>
Capital lease obligations	<u>241</u>	<u>—</u>	<u>(75)</u>	<u>166</u>	<u>77</u>
	<u>S 110,338</u>	<u>12,901</u>	<u>(4,625)</u>	<u>118,614</u>	<u>4,448</u>

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The Hospital Revenue Bonds are special obligations of the Board of Regents payable solely out of Hospital Income, the general purpose of which is to expand and improve UIHC facilities. "Hospital Income" is defined as the gross income and funds received by the Hospital System, including the proceeds of rates, fees, charges, and payments for healthcare provider activities for patient care services rendered by the University's hospitals, clinics, laboratories, and ancillary facilities after deduction of current expenses. Hospital Income does not include State appropriations to the University or Hospital System. So long as the bonds or parity bonds remain outstanding, the entire Hospital System income and revenues shall be deposited to the revenue fund and shall be disbursed to the following funds in the following order: (1) the operation and maintenance fund, (2) the sinking fund, (3) the reserve fund, and (4) the system fund. The reserve fund requirement is at least equal to the maximum annual amount of the principal and interest coming due on the bonds and any parity bonds, or \$10.7 million. The maximum amount of Hospital Income pledged representing the undiscounted principal and interest on the bonds is \$231.8 million.

The Telecommunications Facilities Revenue Bonds (Telecommunications Bonds) represent UIHC's share of the remaining outstanding bonds that were issued by the University to pay costs of constructing and installing communications facilities and equipment on the University's campus. No specific revenue stream of UIHC has been pledged to service the Telecommunications Bonds. Monthly payments are required to be made to various sinking funds for payment of principal and interest. A portion of the monthly payments is supported by UIHC.

Scheduled principal and interest payments on the bonds for the next five years and five-year increments thereafter are as follows (in thousands):

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2012	\$ 4,577	7,127
2013	5,598	6,584
2014	6,109	6,343
2015	6,239	6,084
2016	6,157	5,817
2017 through 2021	33,459	24,729
2022 through 2026	41,582	16,200
2027 through 2031	31,101	6,147
2032 through 2036	13,061	2,036
2037	2,781	62
	<u>\$ 150,664</u>	<u>81,129</u>

(5) Retirement Benefit Plans

Substantially all UIHC employees meeting eligibility requirements participate in the University of Iowa Retirement Plan (the Plan). The Plan is a defined contribution retirement plan providing benefits through the Teachers Insurance and Annuity Association and the College Retirement Equity Fund (TIAA-CREF). UIHC contributions to the Plan are 10% of employee compensation after the first five years of employment. During the first five years of employment, UIHC's contribution is 6.67% of the first \$4,800

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of compensation and 10% of the balance of employee compensation. Employees are required to contribute an amount equal to 50% of UIHC's contribution. All contributions to the Plan are immediately 100% vested.

Eligible employees not electing to participate in the Plan are required to participate in the Iowa Public Employees' Retirement System (IPERS), a multiple employer, cost-sharing public employees' retirement system.

The University internally accounts for employee benefits using a benefits pool. Each department, including UIHC, is assessed a total amount to be paid into the pool covering all employee benefits, which approximated \$29.9 million and \$28.6 million for contributions to TIAA-CREF and IPERS in 2011 and 2010, respectively.

(6) Health Insurance Benefits for Retirees

Other postemployment benefits (OPEB) are recorded in the financial statements as noncurrent accrued payroll on the balance sheets and are included as an operating expense in salaries, wages, and employee benefits on the statements of revenues, expenses, and changes in net assets.

All UIHC employees meeting eligibility requirements participate in the University of Iowa Health Insurance Benefits for Retirees. The University of Iowa's defined benefit postemployment healthcare plan provides medical and dental benefits to eligible retired employees, which include employees who retire from the University after attaining age 55 and before reaching age 62, or who retire after attaining age 62 with ten or more years of service.

The contribution requirements of plan members and the University are established and may be amended by the Board of Regents. The terms and conditions governing the postemployment benefits to which employees are entitled are in the sole authority and discretion of the University's Board of Regents. For fiscal years 2011 and 2010, UIHC's allocated annual OPEB cost was \$8.8 million and \$8.5 million, respectively, of which \$4.3 million was contributed to the plan in 2011 and \$3.7 million in 2010. The net allocated OPEB obligation at June 30, 2011 and 2010 was \$15.6 million and \$12.3 million, respectively. Although there is no requirement to fund the OPEB liability, the University has chosen to fund it on a "pay as you go" basis. University policy dictates the payment of retiree claims as they become due. Plan members receiving benefits contributed 50% and 56% of the premium costs in fiscal years 2011 and 2010, respectively. In fiscal years 2011 and 2010, total member contributions were \$4.4 million and \$4.8 million, respectively.

The University's defined benefit postemployment healthcare plan does not issue a separate financial report, but is included in the University's annual report, which can be obtained at the University of Iowa, 4 Jessup Hall, Iowa City, Iowa 52242.

(7) Risk Management

The University, or the State of Iowa on behalf of UIHC, self-insures workers' compensation, unemployment, medical, and dental benefits for eligible employees, automobile, professional, and general liability. UIHC pays the employer portion of the costs related to workers' compensation, unemployment,

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and medical and dental benefits. UIHC purchases commercial property insurance for its facilities, including business interruption insurance. UIHC also purchases commercial life and disability insurance for eligible employees as part of the University's benefit program.

UIHC's portion of the health insurance liability, which is included in accounts payable and accrued expenses, is \$4.1 million and \$4.7 million as of June 30, 2011 and 2010, respectively, as follows (in thousands):

	2011	2010
Liability for unpaid healthcare claims at beginning of year	\$ 4,678	3,632
Healthcare expenses incurred during the year	49,874	53,759
Healthcare payments to the University during the year	(50,404)	(52,713)
Liability for unpaid healthcare claims at end of year	\$ 4,148	4,678

Board institutions cooperatively self-insure for automobile liability up to \$250,000. Losses in excess of \$250,000 are self-insured by the State of Iowa.

The State Appeals Board, subject to the advice and approval of the Attorney General, is authorized to settle tort claims against the State of Iowa as set forth in Chapter 669 of the Code of Iowa. Tort liability claims settled in excess of \$5,000 must have the unanimous approval of all the members of the State Appeals Board, the State Attorney General, and the District Court of the State of Iowa for Polk County. By interagency agreement, tort liability claims (including professional liability) under \$5,000 may be administered by the University, subject to a maximum expenditure of \$100,000 per year. All other tort claims are paid from the State of Iowa's general fund and are not an obligation of UIHC.

The State maintains an employee fidelity bond where the first \$100,000 in losses is the responsibility of UIHC. Losses in excess of the \$100,000 deductible are insured up to \$10 million. Coverage extends to all UIHC employees.

(8) Transactions with Related Parties

UIHC receives certain administrative services, utilities, and other general services from the University. The services and support costs include amounts due to the University's Carver College of Medicine for support of graduate medical education, specific clinical services, and other services. These services are charged to UIHC at the approximate cost incurred by the servicing unit. For the years ended June 30, 2011 and 2010, UIHC expensed approximately \$133.0 million and \$127.4 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2011 and 2010, approximately \$2.7 million and \$5.7 million, respectively, was due to the Carver College of Medicine and \$2.7 million was due to the University of Iowa for services and support.

UIHC also provides certain administrative services to units of the University. These services include billing, collection, and other physician practice-related clinic overhead expenses. These services are charged to units of the University at the approximate cost incurred by the servicing unit. For the years

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ended June 30, 2011 and 2010, UIHC received revenue from these units of approximately \$30.5 million and \$30.0 million, respectively, for these services.

UIHC and the College of Medicine have formed a nonprofit corporation, University of Iowa Health System (UIHS), to enhance and support the educational missions of the UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multi-state network development activities. UIHC paid UIHS for certain administrative and other general services in the amount of \$1.6 million and \$1.5 million for the years ended June 30, 2011 and 2010, respectively.

(9) Net Patient Service Revenue

Net patient service revenue, as reflected in the accompanying statements of revenues, expenses, and changes in net assets, consists of the following (in thousands):

	2011	2010
Gross patient charges:		
Inpatient charges	\$ 1,286,234	1,124,983
Outpatient charges	1,108,451	978,345
Total gross patient charges	2,394,685	2,103,328
Less:		
Deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	1,406,451	1,203,622
Net patient service revenue	\$ 988,234	899,706

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. A summary of the payment arrangements with major third-party payors is as follows:

(a) Medicare

Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

(b) Iowa Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are primarily paid at prospectively determined rates per discharge. Physician clinical services are paid based on fee schedule amounts.

Revenue from Medicare and Medicaid programs accounted for approximately 24% and 14%, respectively, of UIHC's net patient revenue for the year ended 2011, and 25% and 13%, respectively, of UIHC's net patient revenue for the year ended 2010. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result,

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there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2011 and 2010 net patient service revenue increased approximately \$7.2 million and \$1.6 million, respectively, due to prior year retroactive adjustments in excess of amounts previously estimated.

(c) IowaCare

The IowaCare program serves people between the ages of 19 and 64 with income up to 200% of the federal poverty level who do not have other sources of healthcare coverage. This program was initially approved by the Centers for Medicare and Medicaid Services (CMS) as a Section 1115 Medicaid demonstration program to operate from July 1, 2005 through June 30, 2010. CMS has subsequently reauthorized the IowaCare program through December 31, 2013. Inpatient and outpatient services rendered to IowaCare program beneficiaries are primarily paid at prospectively determined rates per discharge. Physician clinical services were not reimbursed until 2011 and are now paid based on fee schedule amounts, although the dollars available for physicians are capped while the obligation to provide services is not. Hospital appropriations received for this program in 2011 and 2010 were \$76.3 million and \$74.3 million, respectively.

(d) Commercial

UIHC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to UIHC under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

(10) Charity Care and Uncompensated Cost of Services

UIHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Certain accounts are classified as charity care and, therefore, are not reported as revenue. Charges forgone for services and supplies furnished under UIHC's charity policy for the years ended June 30, 2011 and 2010 are as follows (in thousands):

	<u>2011</u>	<u>2010</u>
Charity care	\$ 27,057	24,339
Charity care for state institution patients	<u>5,315</u>	<u>7,168</u>
Charity care charges forgone	<u>\$ 32,372</u>	<u>31,507</u>

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UIHC also provides reduced price services and free programs throughout the year. The total uncompensated costs of services other than charity care, for the years ended June 30, 2011 and 2010, approximates the following (in thousands):

	(unaudited)	
	2011	2010
Medicare	\$ 22,858	25,515
Medicaid	8,943	13,714
Medicaid out of state	805	910
IowaCare	23,012	17,226
Uncompensated costs of services	\$ 55,618	57,365

(11) Concentrations of Credit Risk

UIHC grants credit without collateral to its patients, most of whom are Iowa residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2011 and 2010 was as follows:

	2011	2010
Blue Cross/Blue Shield	27%	23%
Commercial pay	26	26
Medicare	19	21
Medicaid	13	13
IowaCare	7	10
Self-pay	5	5
Other	3	2
	100%	100%

(12) Operating Leases

UIHC uses certain capital assets under noncancelable operating leases. In most cases, management expects that, in the normal course of operations, the leases will be renewed or replaced by other leases. Total rent expense under operating leases for the years ended June 30, 2011 and 2010 was \$6.6 million and \$4.9 million, respectively.

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The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2011 (in thousands):

Year ending June 30:		
2012	\$	573
2013		265
2014		64
2015		64
2016		64
Total minimum payments required	\$	1,030

(13) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses reported as current liabilities at June 30, 2011 and 2010 consisted of the following amounts (in thousands):

Accounts payable and accrued expenses	2011	2010
Payable to employees (including payroll taxes)	\$ 54,855	51,054
Payable to suppliers	32,795	26,622
Other	3,926	1,966
Total accounts payable and accrued expenses	\$ 91,576	79,642

(14) Law and Regulations

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that UIHC is in compliance with government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made that are expected to have a material effect on UIHC's financial statements, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory action unknown or unasserted at this time.

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(15) Subsequent Events

UIHC issued \$26.8 million of Series S.U.I. 2011 Hospital Revenue Bonds in September 2011. The proceeds of the Bonds will be used by the UIHC for the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient care facilities, including construction of a new medical office building and related space, including finish materials, fixtures, furnishings, equipment, and appliances, funding a deposit to the Reserve Fund, and paying the costs of issuance of the bonds.

UIHC will issue \$20.4 million of Series S.U.I. 2011A Hospital Revenue Refunding Bonds in November 2011. The proceeds of the Bonds will be used to refund the Series 2002 Hospital Revenue Bonds.

UIHC has reviewed subsequent events through November 8, 2011, the date the financial statements were available to be issued, and concluded that there were no events or transactions during this period that would require recognition or disclosure in the financial statements other than those already disclosed.