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January 8, 2013

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, 2012, and 2011.

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



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

Financial Statements

June 30, 2012 and 2011

(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, 2012 and 2011, 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, 2012 and 2011, 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, 2012 and 2011, 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.



U.S. generally accepted accounting principles require that *management's discussion and analysis* on pages 3–8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

Des Moines, Iowa
November 16, 2012

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

Management's Discussion and Analysis

June 30, 2012 and 2011

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, 2012 and 2011. 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 2012, with an increase in net assets of \$54.9 million, or 5.0%, as compared to an increase in net assets in 2011 by \$85.9 million, or 8.4%. Operating income in 2012 was \$46.7 million, a decrease of \$13.6 million when compared to 2011. Nonoperating revenues and expenses decreased \$7.2 million. 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 in 2011 compared to 2010.

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 a 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 2012, net assets increased by \$54.9 million, or more than 5.0%, to \$1.2 billion. This is primarily due to net income from operations of \$46.7 million. 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.

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

Management's Discussion and Analysis

June 30, 2012 and 2011

Table 1 provides a summary of UIHC's assets, liabilities, and net assets as of June 30, 2012, 2011, and 2010.

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

Assets	2012	2011	2010
Current assets	\$ 343,791	303,528	275,824
Noncurrent cash and investments	607,919	606,578	494,312
Capital assets, net	566,046	507,357	506,927
Other assets	4,073	3,370	2,736
Total assets	<u>\$ 1,521,829</u>	<u>1,420,833</u>	<u>1,279,799</u>
Liabilities			
Current liabilities	\$ 157,574	125,438	109,289
Long-term debt	168,970	147,276	114,165
Other long-term liabilities	33,297	41,080	35,249
Total liabilities	<u>359,841</u>	<u>313,794</u>	<u>258,703</u>
Net assets:			
Invested in capital assets, net of related debt	405,962	368,302	398,504
Restricted	5,707	17,176	16,131
Unrestricted	750,319	721,561	606,461
Total net assets	<u>1,161,988</u>	<u>1,107,039</u>	<u>1,021,096</u>
Total liabilities and net assets	<u>\$ 1,521,829</u>	<u>1,420,833</u>	<u>1,279,799</u>

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

Management's Discussion and Analysis

June 30, 2012 and 2011

Table 2 shows the changes in net assets for 2012 compared to 2011 and 2010.

Table 2

UNIVERSITY OF IOWA HOSPITALS AND CLINICS

Condensed Revenues, Expenses, and Changes in Net Assets Information

(In thousands)

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating revenues:			
Net patient service revenue	\$ 1,041,179	988,234	899,706
Other revenue	57,114	45,214	43,752
Total operating revenues	<u>1,098,293</u>	<u>1,033,448</u>	<u>943,458</u>
Operating expenses:			
Salaries and benefits	546,771	488,546	465,583
Medical supplies and drugs	222,447	202,779	184,974
Other supplies and general expenses	212,655	211,714	191,999
Depreciation and amortization	69,724	70,062	74,812
Total operating expenses	<u>1,051,597</u>	<u>973,101</u>	<u>917,368</u>
Operating income	<u>46,696</u>	<u>60,347</u>	<u>26,090</u>
Nonoperating revenues (expenses):			
Gain (loss) on disposal of capital assets	851	(8,420)	(966)
Noncapital gifts	354	4,507	5,670
Investment income	24,243	37,472	28,608
Interest expense	(4,051)	(5,008)	(4,207)
Total nonoperating revenues, net	<u>21,397</u>	<u>28,551</u>	<u>29,105</u>
Excess of revenues over expenses before transfers	<u>68,093</u>	<u>88,898</u>	<u>55,195</u>
Capital gifts and grants	2,323	—	—
Net transfers out	(15,467)	(2,955)	(2,683)
Increase in net assets	54,949	85,943	52,512
Net assets, beginning of year	<u>1,107,039</u>	<u>1,021,096</u>	<u>968,584</u>
Net assets, end of year	<u>\$ 1,161,988</u>	<u>1,107,039</u>	<u>1,021,096</u>

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

Management's Discussion and Analysis

June 30, 2012 and 2011

Net Patient Service Revenue

Net patient service revenue increased from 2011 to 2012 by \$52.9 million, or 5.4%, and \$88.5 million, or 9.8%, from 2010 to 2011. The increases in net patient service revenue were driven by both increases in patient volumes and pricing increases during the same periods. The increase in 2012 resulted from increases in both the inpatient and outpatient areas. On the inpatient side, acute admissions were up 588, or 2.0%, over 2011 and inpatient surgeries increased by 249, or 2.2%. There was also an increase in outpatient clinic visits from 2011 to 2012 by 39,389, or 5.1%, and increase in outpatient surgeries of 925, or 6.0%. The increase in 2011 is primarily due to an increase in acute admissions from 2010 to 2011 by 1,076, or 3.7%, an increase in inpatient surgeries of 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 an increase in outpatient surgeries of 1,208, or 8.5%.

The provision for bad debts (a deduction from gross patient charges) increased \$3.4 million from \$22.6 million in 2011 to \$26.0 million in 2012. Self-pay admissions increased 5.9% from prior year while self-pay clinic visits increased 14.0% from prior year. The provision for bad debts decreased \$0.4 million from \$23.0 million in 2010 to \$22.6 million in 2011.

Operating Expenses

Total operating expenses increased 8.1% from \$973.1 million in 2011 to \$1,051.6 million in 2012. The largest increase in expenses in 2012 was in salaries and wages, which increased \$30.0 million, or 8.3%, when compared to 2011. In addition, employee benefit expenses increased \$28.3 million. The increased personnel expenses were caused by increased employee counts to keep pace with increased volumes and additional liabilities for compensated absences. Drug expenses increased \$10.1 million, or 12.7%, in 2012 compared with 2011. Drug expenses increased with the addition of the Cancer Center and an increase in hemophilia drugs compared with 2011.

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, and minor equipment, which increased \$10.0 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.

Nonoperating Revenues and Expenses, Net

Nonoperating revenues consist primarily of gains (losses) on disposals of capital assets, investment income, interest expense, and noncapital contributions. Investment income decreased from 2011 to 2012 by \$13.3 million, or 35.3%, and increased from 2010 to 2011 by \$8.9 million, or 31.0%. During 2012, UIHC recorded overall earnings on the endowment and operating pools of \$13.7 million and a net unrealized gain on investments of \$10.5 million, which increased investment income accordingly. This compares to the overall earnings on the endowment and operating pools of \$18.0 million and a net unrealized gain on investments of \$19.5 million in the previous year.

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

Management's Discussion and Analysis

June 30, 2012 and 2011

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 2012, with a net increase in cash and cash equivalents of \$0.4 million. In 2012, net cash from operating activities provided cash inflows of \$120.5 million and net cash used in noncapital financing was \$15.1 million. 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 provided cash inflows of \$142.3 million and \$1.6 million, respectively. UIHC was able to purchase capital assets and 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 2012, UIHC had \$566.0 million invested in capital assets, net of accumulated depreciation. This is a \$58.6 million increase when compared to capital assets, net in 2011 of \$507.4 million. This increase is primarily due to spending on the Iowa River Landing project. Capital assets, net of accumulated depreciation increased \$0.5 million in 2011 when compared to capital assets, net in 2010 of \$506.9 million.

During 2012 and 2011, UIHC constructed or purchased \$174.1 million and \$85.0 million, respectively, of capital assets. The major capital asset additions in 2011 and 2012 included the following:

- North Liberty Land Purchase
- UIHC Children's Hospital
- Iowa River Landing
- Data Center
- Clinical Cancer Center
- EPIC Software Licenses

Debt

At June 30, 2012 and 2011, UIHC had \$174.8 million and \$151.9 million, respectively, in bonds outstanding. During 2012 and 2011, payments of long-term debt were \$24.4 million and \$4.5 million, respectively. During 2012, 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. UIHC also issued \$20.4 million of Series S.U.I. 2011A Hospital Revenue Refunding Bonds in 2012. The proceeds of the bonds were used to refund the Series 2002 Hospital Revenue Bonds.

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

Management's Discussion and Analysis

June 30, 2012 and 2011

During 2011, UIHC issued \$37.6 million of Series S.U.I. 2010 Hospital Revenue Bonds and Series S.U.I. 2011 Telecommunications Facilities 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.

UIHC issued \$190 million of Series S.U.I. 2012 Hospital Revenue Bonds in September 2012. The proceeds of the bonds will be used to construct, improve, remodel, repair, furnish, and equip a new children's hospital at the University of Iowa Hospitals and Clinics on the campus of the State University of Iowa, to fund a debt service reserve fund, and to pay the costs of issuing 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, 2012 and 2011

(In thousands)

Assets	<u>2012</u>	<u>2011</u>
Current assets:		
Cash and cash equivalents	\$ 1,819	1,428
Short-term investments	144,012	122,062
Patient accounts receivable, net of estimated uncollectibles \$19,124 in 2012 and \$18,776 in 2011	153,061	135,676
Inventories	20,594	21,429
Current portion of debt service funds – restricted	1,496	1,273
Other current assets	22,809	21,660
Total current assets	<u>343,791</u>	<u>303,528</u>
Noncurrent cash and investments:		
Designated by the Board of Regents	588,719	577,877
Held by trustee restricted for debt service	14,704	12,798
Restricted by contributors and grantors for capital acquisitions and research	4,496	15,903
	<u>607,919</u>	<u>606,578</u>
Capital assets, net	566,046	507,357
Other assets	4,073	3,370
Total assets	<u>\$ 1,521,829</u>	<u>1,420,833</u>
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt	\$ 5,818	4,577
Accounts payable and accrued expenses	117,188	91,576
Estimated third-party payor settlements	22,146	15,847
Due to related parties	4,122	5,404
Other current liabilities	5,133	5,266
Accrued interest	3,167	2,768
Total current liabilities	<u>157,574</u>	<u>125,438</u>
Long-term debt, net of current maturities	168,970	147,276
Other long-term liabilities	33,297	41,080
Total liabilities	<u>359,841</u>	<u>313,794</u>
Net assets:		
Invested in capital assets, net of related debt	405,962	368,302
Restricted by donors for specific purposes	4,211	15,903
Restricted for debt service	1,496	1,273
Unrestricted	750,319	721,561
Total net assets	<u>1,161,988</u>	<u>1,107,039</u>
Total liabilities and net assets	<u>\$ 1,521,829</u>	<u>1,420,833</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, 2012 and 2011
(In thousands)

	<u>2012</u>	<u>2011</u>
Operating revenues:		
Net patient service revenue, net of provision for bad debts of \$25,990 in 2012 and \$22,589 in 2011	\$ 1,041,179	988,234
Other revenue	57,114	45,214
Total operating revenues	<u>1,098,293</u>	<u>1,033,448</u>
Operating expenses:		
Salaries and benefits	546,771	488,546
Medical supplies and drugs	222,447	202,779
Other supplies and general expenses	212,655	211,714
Depreciation and amortization	69,724	70,062
Total operating expenses	<u>1,051,597</u>	<u>973,101</u>
Operating income	<u>46,696</u>	<u>60,347</u>
Nonoperating revenues (expenses):		
Gain (loss) on disposal of capital assets	851	(8,420)
Noncapital gifts	354	4,507
Investment income	24,243	37,472
Interest expense	(4,051)	(5,008)
Total nonoperating revenues, net	<u>21,397</u>	<u>28,551</u>
Excess of revenues over expenses before transfers	68,093	88,898
Capital gifts and grants	2,323	—
Net transfers out	(15,467)	(2,955)
Increase in net assets	54,949	85,943
Net assets, beginning of year	<u>1,107,039</u>	<u>1,021,096</u>
Net assets, end of year	<u>\$ 1,161,988</u>	<u>1,107,039</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, 2012 and 2011

(In thousands)

	2012	2011
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 1,030,093	988,973
Other receipts	55,830	42,244
Payments to employees	(534,360)	(478,690)
Payments to suppliers and contractors	(431,055)	(410,227)
Net cash provided by operating activities	120,508	142,300
Cash flows from noncapital financing activities:		
Net transfers	(15,467)	(2,955)
Noncapital gifts	354	4,507
Net cash (used in) provided by noncapital financing activities	(15,113)	1,552
Cash flows from capital and related financing activities:		
Purchase of capital assets	(131,184)	(76,572)
Proceeds from the sale of capital assets	2,771	6,081
Capital gifts and grants received	2,323	—
Proceeds from the issuance of long-term debt	47,155	37,571
Premium received on issuance of long-term debt	819	531
Principal paid on long-term debt	(24,357)	(4,538)
Interest paid on long-term debt	(4,334)	(4,588)
Net cash used in capital and related financing activities	(106,807)	(41,515)
Cash flows from investing activities:		
Proceeds from sale of investments	51,780	159,186
Purchase of investments	(63,810)	(279,588)
Interest and dividends received on investments	13,833	18,519
Net cash provided by (used in) investing activities	1,803	(101,883)
Net increase in cash and cash equivalents	391	454
Cash and cash equivalents at beginning of year	1,428	974
Cash and cash equivalents at end of year	\$ 1,819	1,428
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 46,696	60,347
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	69,724	70,062
Provision for bad debts	25,990	22,589
Changes in assets and liabilities:		
Accounts receivable	(43,375)	(28,303)
Inventories	835	(1,445)
Other assets	(2,075)	(2,057)
Accounts payable and accrued expenses	25,612	11,934
Other liabilities	(7,916)	5,690
Due to related parties	(1,282)	(2,970)
Estimated third-party payor settlements	6,299	6,453
Net cash provided by operating activities	\$ 120,508	142,300
Noncash investing activities:		
UIHC held cash and investments at June 30, 2012 and 2011 with a fair value of \$755,246 and \$731,341, respectively.		
During 2012 and 2011, the net increase in fair value of these investments was \$10,456 and \$19,492, respectively.		

See accompanying notes to financial statements.

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

Notes to Financial Statements

June 30, 2012 and 2011

(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 (UIHS), 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.

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

Notes to Financial Statements

June 30, 2012 and 2011

Undesignated cash equivalents totaling \$1.8 million and \$1.4 million at June 30, 2012 and 2011, 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) Gifts and Grants

From time to time, UIHC receives grants, as well as gifts from individuals and private organizations. Gifts and grants 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 assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

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

Notes to Financial Statements

June 30, 2012 and 2011

(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 investment income and gifts 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 services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as 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.

(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'

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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, 2012 and 2011 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, 2012 and 2011 (in thousands):

	2012	2011
Limited by bond resolutions:		
Debt service reserve	\$ 14,704	12,798
Designated by the Board of Regents:		
Capital projects and equipment and other needs	1,989	882
Surplus	929	564
Improvement, extension, repair, operation, and maintenance funds	585,801	576,431
Restricted by donors	4,496	15,903
	\$ 607,919	606,578

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.

Cash and cash equivalents and short-term investments specifically identified or pooled with the cash and investments of the University totaled \$145.8 million and \$123.5 million at June 30, 2012 and 2011, respectively. Cash equivalents designated by the Board totaled \$140.9 million and \$171.2 million at June 30, 2012 and 2011, respectively.

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UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2012, UIHC had the following investments and quality credit ratings (in thousands):

Fixed income	Effective duration (years)	TSY/ AGY/NA	AAA	AA	A	BBB+	BB	B	Total market value
Corporate notes and bonds	3.88	\$ 17	1,286	344	1,836	1,301	89	—	4,873
U.S. government agencies	2.36	9,551	65	21,007	—	85	—	—	30,708
U.S. Treasury obligations	4.33	26,188	—	—	—	—	—	—	26,188
Mutual funds	5.68	—	61,048	166,694	14,496	—	2,232	29,335	273,805
		\$ 35,756	62,399	188,045	16,332	1,386	2,321	29,335	335,574
Equity:									
Cash and cash equivalents									\$ 286,671
U.S. equity mutual funds									61,697
Non-U.S. equity mutual funds									26,601
REIT mutual funds									28,066
Real assets									10,246
Private equity									1,538
Certificates of deposit									4,853
Total investments									\$ 755,246

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

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 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

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against benchmarks as established by the Board. As of June 30, 2012, 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 U.S. 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, 2012 and 2011 are summarized as follows (in thousands):

	<u>2012</u>	<u>2011</u>
Land	\$ 13,684	13,684
Land improvements	782	782
Infrastructure	42,104	41,591
Buildings and leasehold improvements	766,284	730,538
Equipment	307,219	299,726
Software	79,621	74,064
Construction in progress (nondepreciable)	98,255	48,544
	<u>1,307,949</u>	<u>1,208,929</u>
Less accumulated depreciation	741,903	701,572
	<u>\$ 566,046</u>	<u>507,357</u>

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Capital asset additions, retirements, and balances as of and for the years ended June 30, 2012 and 2011 were as follows (in thousands):

<u>Cost basis summary</u>	<u>June 30, 2011, balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2012, balances</u>
Land (nondepreciable)	\$ 13,684	—	—	13,684
Land improvements	782	—	—	782
Infrastructure	41,591	649	(136)	42,104
Buildings and leasehold improvements	730,538	35,746	—	766,284
Equipment and software	373,790	44,363	(31,313)	386,840
Construction in progress (nondepreciable)	48,544	93,365	(43,654)	98,255
Total at historical cost	<u>1,208,929</u>	<u>174,123</u>	<u>(75,103)</u>	<u>1,307,949</u>
Less accumulated depreciation for:				
Land improvements	743	3	—	746
Infrastructure	37,156	1,072	—	38,228
Buildings and leasehold improvements	441,619	29,651	—	471,270
Equipment and software	222,054	38,998	(29,393)	231,659
Total accumulated depreciation	<u>701,572</u>	<u>69,724</u>	<u>(29,393)</u>	<u>741,903</u>
Total capital assets, net	<u>\$ 507,357</u>	<u>104,399</u>	<u>(45,710)</u>	<u>566,046</u>

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<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>

At June 30, 2012, 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, 2012 is \$88.4 million. Other projects at June 30, 2012, with an estimated cost of \$314.6 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, 2012 and 2011 were \$2.9 million and \$1.3 million, respectively.

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(4) Long-Term Debt

Long-term debt outstanding at June 30, 2012 and 2011 was as follows (in thousands):

	2012	2011
Hospital Revenue Bonds:		
Series 2002 – 4.125% to 5.000%; maturing serially on September 1 through 2028	\$ —	20,535
Series S.U.I. 2007 – 4.375% to 5.500%; maturing serially on September 1 through 2027	21,750	22,675
Series S.U.I. 2007A – 4.000% to 5.500%; maturing serially on September 1 through 2027	21,725	22,600
Series S.U.I. 2009 – 5.500% to 6.125%; maturing serially on September 1 through 2028	30,250	31,375
Series S.U.I. 2010 – 3.000% to 4.500%; maturing serially on September 1 through 2036	30,000	30,000
Series S.U.I. 2011 – 2.000% to 4.000%; maturing serially on September 1 through 2032	26,800	—
Series S.U.I. 2011A – 2.000% to 4.125%; maturing serially on September 1 through 2028	20,355	—
Net unamortized premium on Hospital Revenue Bonds	1,326	1,189
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2003 – 3.150% to 3.800%; maturing serially on July 1 through 2013	220	595
Series S.U.I. 2008 – 2.375% to 3.375%; maturing serially on July 1 through 2015	1,966	2,488
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	7,571
Total long-term debt	174,788	151,853
Long-term debt, current portion	5,818	4,577
	\$ 168,970	147,276

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Activity in long-term debt for the years ended June 30, 2012 and 2011 was as follows (in thousands):

	<u>June 30, 2011, balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2012, balance</u>	<u>Amounts due within one year</u>
Hospital Revenue Bonds, Series 2002	\$ 20,535	—	(20,535)	—	—
Hospital Revenue Bonds, Series 2007	22,675	—	(925)	21,750	975
Hospital Revenue Bonds, Series 2007A	22,600	—	(875)	21,725	925
Hospital Revenue Bonds, Series 2009	31,375	—	(1,125)	30,250	1,175
Hospital Revenue Bonds, Series 2010	30,000	—	—	30,000	750
Hospital Revenue Bonds, Series 2011	—	26,800	—	26,800	—
Hospital Revenue Bonds, Series 2011A	—	20,355	—	20,355	1,045
Net unamortized bond premium	1,189	819	(682)	1,326	(35)
Telecommunications Facilities Revenue Bonds:					
Series 2000	595	—	(375)	220	108
Series 2008	2,488	—	(522)	1,966	539
Series 2009	12,825	—	—	12,825	336
Series 2011	7,571	—	—	7,571	—
Total long-term debt	\$ <u>151,853</u>	<u>47,974</u>	<u>(25,039)</u>	<u>174,788</u>	<u>5,818</u>

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	<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	\$ 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	—
	<u>118,448</u>	<u>38,102</u>	<u>(4,697)</u>	<u>151,853</u>	<u>4,577</u>
Total long-term debt					
Capital lease obligations	<u>166</u>	<u>—</u>	<u>(166)</u>	<u>—</u>	<u>—</u>
	<u>\$ 118,614</u>	<u>38,102</u>	<u>(4,863)</u>	<u>151,853</u>	<u>4,577</u>

The Hospital Revenue Bonds are special obligations of the Board 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 at the University, 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, less current expenses (as defined in the resolution authorizing the issuance of the bonds, the Bond Resolution). Hospital Income does not include state appropriations to the University or IowaCare appropriations to the Hospital System. So long as the bonds or parity bonds remain outstanding, the entire Hospital Income 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 \$12.6 million. The maximum amount of Hospital Income pledged representing the undiscounted principal and interest on the bonds is \$257.6 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.

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

	Principal	Interest
Year(s) ending June 30:		
2013	\$ 5,818	7,798
2014	7,194	6,969
2015	7,334	6,706
2016	7,272	6,434
2017	7,269	6,151
2018 through 2022	40,850	26,108
2023 through 2027	50,181	16,427
2028 through 2032	32,447	6,027
2033 through 2037	15,097	1,499
	\$ 173,462	84,119

(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 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 \$33.0 million and \$29.9 million for contributions to TIAA-CREF and IPERS in 2012 and 2011, 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 and 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

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from the University after attaining age 55 and before reaching age 62, or who retire after attaining age 62 with 10 or more years of service.

The contribution requirements of plan members and the University are established and may be amended by the Board. 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. For fiscal years 2012 and 2011, UIHC's allocated annual OPEB cost was \$9.3 million and \$8.8 million, respectively, of which \$4.7 million was contributed to the plan in 2012 and \$4.3 million in 2011. The net allocated OPEB obligation at June 30, 2012 and 2011 was \$20.3 million and \$15.6 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 49% and 50% of the premium costs in fiscal years 2012 and 2011, respectively. In fiscal years 2012 and 2011, total member contributions were \$4.6 million and \$4.4 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, 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 \$4.0 million and \$4.1 million as of June 30, 2012 and 2011, respectively, as follows (in thousands):

	<u>2012</u>	<u>2011</u>
Liability for unpaid healthcare claims at beginning of year	\$ 4,148	4,678
Healthcare expenses incurred during the year	54,538	49,874
Healthcare payments to the University during the year	<u>(54,658)</u>	<u>(50,404)</u>
Liability for unpaid healthcare claims at end of year	<u>\$ 4,028</u>	<u>4,148</u>

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

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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, 2012 and 2011, UIHC expensed approximately \$135.6 million and \$133.0 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2012 and 2011, approximately \$0.9 million and \$2.7 million, respectively, was due to the Carver College of Medicine, and \$3.2 million and \$2.7 million, respectively, 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 ended June 30, 2012 and 2011, UIHC received revenue from these units of approximately \$31.3 million and \$30.5 million, respectively, for these services.

UIHC transfers to and receives transfers from non-UIHC University of Iowa units. Net transfers to these units totaled \$15.5 million and \$3.0 million for the years ended June 30, 2012 and 2011, respectively.

UIHC and the College of Medicine have formed a nonprofit corporation, 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 multistate network development activities. UIHC paid UIHS for certain administrative and other general services in the amount of \$1.6 million for the years ended June 30, 2012 and 2011.

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(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):

	2012	2011
Gross patient charges:		
Inpatient charges	\$ 1,373,372	1,286,234
Outpatient charges	1,264,562	1,108,451
Total gross patient charges	2,637,934	2,394,685
Less:		
Deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	1,596,755	1,406,451
Net patient service revenue	\$ 1,041,179	988,234

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 12%, respectively, of UIHC's net patient revenue for the year ended 2012, and 24% and 14%, respectively, of UIHC's net patient revenue for the year ended 2011. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2012 and 2011 net patient service revenue increased approximately \$3.3 million and \$7.2 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

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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. The amount of revenue the Hospital received for this program in 2012 and 2011 were \$71.5 million and \$76.3 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, 2012 and 2011 are as follows (in thousands):

	<u>2012</u>	<u>2011</u>
Charity care	\$ 23,774	27,057
Charity care for state institution patients	4,876	5,315
Charity care charges forgone	<u>\$ 28,650</u>	<u>32,372</u>

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, 2012 and 2011, approximate the following (in thousands):

	<u>2012</u>	<u>2011</u>
Medicare	\$ 23,432	22,858
Medicaid	10,467	8,943
Medicaid out of state	1,606	805
IowaCare	25,279	23,012
Uncompensated costs of services	<u>\$ 60,784</u>	<u>55,618</u>

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(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, 2012 and 2011 was as follows:

	2012	2011
Blue Cross/Blue Shield	27%	27%
Commercial pay	27	26
Medicare	19	19
Medicaid	13	13
IowaCare	7	7
Self-pay	4	5
Other	3	3
	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, 2012 and 2011 was \$4.6 million and \$6.6 million, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2012 (in thousands):

Year ending June 30:	
2013	\$ 763
2014	417
2015	390
2016	257
Total minimum payments required	\$ 1,827

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(13) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses reported as current liabilities at June 30, 2012 and 2011 consisted of the following amounts (in thousands):

	2012	2011
Payable to employees (including payroll taxes)	\$ 75,010	54,855
Payable to suppliers	37,121	32,795
Other	5,057	3,926
Total accounts payable and accrued expenses	\$ 117,188	91,576

(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.

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 to certain hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. An initial Medicaid incentive payment is available to providers that adopt, implement, or upgrade certified EHR technology. However, in order to receive additional Medicaid incentive payments in subsequent years, providers must demonstrate continued meaningful use of EHR technology.

The University of Iowa Hospitals and Clinics accounts for meaningful use incentive payments as a nonexchange transaction. Medicare EHR incentive payments are recognized as revenues when eligible providers demonstrate meaningful use of certified EHR technology and the cost report information for the full cost report year that will determine the full calculation of the incentive payment is available. Medicaid EHR incentive payments are recognized as revenues when an eligible provider demonstrates meaningful use of certified EHR technology. For fiscal year 2012, The University of Iowa Hospitals and Clinics recognized \$3.4 million of Medicare meaningful use revenues and \$6.0 million of Medicaid meaningful use revenues in its statements of revenues, expenses, and changes in net assets.

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(15) Subsequent Events

UIHC issued \$190 million of Series S.U.I. 2012 Hospital Revenue Bonds in September 2012. The proceeds of the bonds will be used to construct, improve, remodel, repair, furnish, and equip a new children's hospital at the University of Iowa Hospitals and Clinics on the campus of the University, to fund a debt service reserve fund, and to pay the costs of issuing the bonds.

UIHC has reviewed subsequent events through November 16, 2012, 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.