

**Audit and Compliance Committee Memorandum**  
Board of Regents, State of Iowa

**Subject:** University of Iowa Hospitals and Clinics Audit Report

**Prepared by:** Andrea Anania

**Date Submitted:** January 19, 2005

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**Recommended Action:**

Discuss and receive the external audit report for the University of Iowa Hospitals and Clinics (UIHC) for the years ended June 30, 2004, and 2003.

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**Executive Summary:**

The UIHC report includes information regarding:

- The audit of the basic financial statements on an accrual basis of UIHC for the fiscal years ended June 30, 2004, and 2003, as conducted by KPMG LLP, an independent auditing firm.
- Management's discussion and analysis of the financial activities of the UIHC based on currently know facts, decision, and conditions. (This section is to be read in conjunction with the UIHC audited financial statements and notes to the financial statements.)

The Board Office had not received the auditor's management letter as of the date of mailing.

For reporting purposes, the UIHC includes the following health care units of the University of Iowa:

- University Hospital
- Psychiatric Hospital
- Center for Disabilities and Development (formerly the Hospital School)

The audit indicated that the financial statements present fairly, in all material respects, the financial position of UIHC as of June 30, 2004 and 2003 and the changes in its net assets and its cash flows for the years then ended.

No significant audit adjustments or findings were reported.

A representative from KPMG LLP will be available to answer questions at the committee meeting.

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**Background and Analysis:**

	<p>Annual audited financial statements of the UIHC are required by <u>Iowa Code §255.25</u>, Regent Policy Manual §7.08, and bond covenants.</p>
Audit	<p>KPMG LLP conducted the UIHC audit for the fiscal years ended June 30, 2004 and 2003, in accordance with generally accepted auditing standards.</p>
Reporting Entity	<p>UIHC includes substantially all of the health care provider activities for patient care associated with the University other than the physician and dentist services and research activities, which are provided by the faculties of the University's Colleges of Medicine and Dentistry.</p> <p>Student Health Services, Specialized Child Health Services outreach programs, and the University of Iowa Health System, a UIHC affiliate, are not included in this report.</p>
Basis of Presentation	<p>The financial statements were prepared in accordance with generally accepted governmental accounting principles accepted in the United States.</p> <p>UIHC recognizes revenue and expenses on the accrual basis of accounting using the economic resources measurement focus.</p>
Financials	<p>As of June 30, 2004, net assets totaled \$783.3 million, which represent an increase of \$16.9 million over the \$766.4 million from the prior year.</p> <p>For FY 2004, operating revenues were \$638.5 million and operating expenses were \$632.0 million, for an operating income of \$6.5 million.</p> <p>Non-operating revenues, expenses, gain, and losses totaled \$11.6 million, which included investment income of \$6.2 million.</p>
Bonds	<p>During the 2002 legislative session, the Board was authorized to sell up to \$100 million in hospital revenue bonds. In November 2002, the Board sold the first \$25 million of hospital revenue bonds to pay, in part, the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient facilities and patient care facilities, including facilities for image-guided radiation therapy services and mechanical and other supporting facilities at UIHC. These UIHC hospital revenue bonds were outstanding at June 30, 2004.</p>
Related Party Transactions	<p>The UIHC purchases certain administrative and supervisory services, utilities, and other general services from the University. These services are charged at the approximate cost incurred by the University. For the years ended June 30, 2004 and 2003, UIHC expensed approximately \$75.7 million and \$69.7 million, respectively for the services from the University.</p> <p>The UIHC also provides certain administrative services to units of the University. These services include billing, collection, and other physician practice-related clinic overhead expenses. For FY 2004 and 2003, the UIHC received revenue of approximately \$23.6 million and \$22.9 million, respectively, for these services.</p>

University of  
Iowa Health  
System

UIHC and the University's College of Medicine 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 provided capitalization of UIHS through transfers of funds totaling \$0.7 million for the year ended June 30, 2003. No funds were transferred during 2004.

UIHC has committed to additional funding of UIHS, as needed, of approximately \$6.8 million, to be used primarily for community practice development.

Additionally, UIHC paid UIHS for certain administrative and other general services in the amount of \$0.7 million and \$0.2 million for the years ended June 30, 2004, and 2003, respectively.

On March 1, 2003, a subsidiary of UIHS sold certain assets of six of its clinics to UIHC for \$946,128; \$121,900 was paid at the closing date, and the subsidiary and UIHC executed a promissory note for \$824,228. The note was payable monthly through June 2003 with interest at 4.25%. The subsidiary and UIHC also executed a management service and affiliation agreement on March 1, 2003, under which the subsidiary provides certain management, supervisory and administrative services to the clinics. In consideration for the costs and expenses in fulfilling the subsidiary's obligations under the agreement, UIHC pays the subsidiary a management fee equal to the amount necessary to operate the subsidiary and deliver services to the clinics. The term of the agreement is for one year, with the agreement automatically renewing for successive terms of one year unless either party gives notice to terminate.

UIHC supported clinical programs of the University's College of medicine through transfers of funds totaling \$0.9 million and \$1.0 million, for the years ended June 30, 2004, and June 30, 2003, respectively.

Faculty Practice  
Plan

The Faculty Practice Plan is a clinical component of the University's College of Medicine. The UIHC performs billing and collection services for this plan.

Outstanding accounts receivable were \$21.2 million and \$11.5 million at June 30, 2004, and June 30, 2003, respectively.

Net Patient  
Service Revenue

The UIHC has agreements with certain third-party payors that provide for payment of services at amounts different from established rates.

Revenue from Medicare and Medicaid programs accounted for approximately 26% and 13%, respectively, of UIHC's net patient revenue for the year ended 2004, and 28% and 9%, respectively, of UIHC's net patient revenue for the year ended 2003. A reasonable possibility exists that recorded estimates will change by a material amount in the near term due to interpretation of the complex laws and regulations governing the Medicare and Medicaid programs.

Medicaid UIHC receives supplemental disproportionate share and indirect medical education patient care reimbursement allowances from the State of Iowa Medicaid program. UIHC is obligated to transfer these supplemental receipts to the state to the extent of supplemental receipts. These transfers amounted to approximately \$46.1 million for FY 2004 and \$48.7 million for FY 2003 and have been excluded from revenues and expenses in the financial statements.

Charity Care The UIHC provided charity care at established hospital rates for the years ended June 30:

	<u>2004</u>	<u>2003</u>
Indigent patient care	\$80.6 million	\$66.6 million
Other charity care	\$1.8 million	\$5.1 million

Management Discussion and Analysis The UIHC annual financial report also includes a section on management's discussion and analysis, which provides an objective analysis of the financial activities of the UIHC based on currently known facts, decisions, and conditions. It is presented to be read in conjunction with the audited financial statements.

Other sections of the report include:

- Overview of the Financial Statements
- Overall Financial Position and Operations
- Debt
- Operating Results and Changes in Net Assets
- Net Patient Service Revenue
- Operating Expenses
- Transactions with Related Parties
- Non-operating Revenues and Expenses
- Contacting UIHC's Financial Management

UIHC's total net assets increased 2.2% to \$783.3 million.