

Contact: Andrea Anania

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES AUDIT REPORT

Action Requested: Receive the external audit report for the University of Iowa Health System and subsidiaries (UIHSS) for the years ended December 31, 2010, and December 31, 2009.

Executive Summary: KPMG LLP conducted the UIHSS audit for the fiscal years ended December 31, 2010, and December 31, 2009, in conformity with U.S. generally accepted accounting principles.

The audit indicated that the consolidated financial statements present fairly, in all material respects, the financial position of UIHSS as of December 31, 2010, and December 31, 2009, and the results of their operations and their cash flows for the years then ended.

A representative from KPMG LLP will be available via phone to present the report and answer questions at the Board meeting.

Background and Analysis: UIHS was formed to support the clinical, academic, and research programs of the University of Iowa College of Medicine and the University of Iowa Hospitals and Clinics. UIHS has the following wholly owned subsidiaries: (1) University of Iowa Affiliated Health Providers, L.C.; (2) University of Iowa Community Medical Services, Inc.; and (3) UI HealthWorks, L.L.C.

- ◆ As of December 31, 2010, assets totaled \$24.6 million, which represents an increase of \$4.3 million (21.2%) over the \$20.3 million from the prior year.
- ◆ As of December 31, 2010, revenues, gains, and other support totaled \$22.0 million and total expenses were \$21.6 million, for an operating income of \$325,193.
- ◆ UIHSS provides charity care to eligible patients at reduced or no cost based on the individual patient's financial situation. Charity care, determined at established rates, was \$13,760 and \$10,208 for 2010 and 2009, respectively.



UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2010 and 2009

(With Independent Auditors' Report Thereon)

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

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KPMG LLP
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Independent Auditors' Report

The Board of Directors
University of Iowa Health System:

We have audited the accompanying consolidated balance sheets of University of Iowa Health System and subsidiaries (the System) as of December 31, 2010 and 2009, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated 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 the System'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.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of University of Iowa Health System and subsidiaries as of December 31, 2010 and 2009, and the results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

KPMG LLP

August 1, 2011

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2010 and 2009

Assets	2010	2009
	<hr/>	<hr/>
Current assets:		
Cash and cash equivalents	\$ 12,669,374	9,826,081
Cash held in trust	6,581,754	2,863,438
Short-term investments	—	1,053,495
Patient accounts receivable, net of allowance of \$60,114 in 2010 and \$70,398 in 2009	1,256,937	1,569,502
Due from affiliates	1,282,864	1,467,369
Other receivables	264,639	1,294,788
Inventory	506,824	357,005
Prepaid expenses	159,233	138,938
Deferred tax asset	400,000	400,000
	<hr/>	<hr/>
Total current assets	23,121,625	18,970,616
Other long-term receivable	55,930	55,930
Investments in other healthcare joint ventures	1,071,413	880,313
Property, equipment, and leasehold improvements, net	379,662	418,961
	<hr/>	<hr/>
Total assets	\$ 24,628,630	20,325,820
	<hr/> <hr/>	<hr/> <hr/>
Liabilities and Net Assets		
Liabilities:		
Due to affiliates	\$ 70,845	392,899
Accounts payable	520,578	505,399
Other liabilities and accrued expenses	753,419	684,368
Cash held in trust	6,581,754	2,863,438
	<hr/>	<hr/>
Total liabilities	7,926,596	4,446,104
	<hr/>	<hr/>
Net assets – unrestricted	16,702,034	15,879,716
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Total liabilities and net assets	\$ 24,628,630	20,325,820
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See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Operations and Changes in Net Assets

Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Revenues, gains, and other support:		
Net patient service revenue	\$ 8,591,713	8,576,911
Management services	9,671,674	9,470,506
Management services fee	1,784,378	1,972,222
Other operating revenue	<u>1,919,058</u>	<u>1,732,153</u>
Total revenues, gains, and other support	<u>21,966,823</u>	<u>21,751,792</u>
Expenses:		
Patient services:		
Physicians' salaries and benefits	8,086	—
Nonphysicians' salaries and benefits	2,865,113	3,059,261
Supplies and expenses	7,941,495	7,291,863
Medical equipment	547,203	709,613
Depreciation and amortization	269,355	273,482
Interest	28,142	10,619
Provision for bad debt	310,562	268,139
Management services:		
Physicians' salaries and benefits	2,698,112	3,651,942
Nonphysicians' salaries and benefits	5,651,036	4,829,098
Supplies and expenses	1,313,976	974,232
Depreciation and amortization	<u>8,550</u>	<u>12,723</u>
Total expenses	<u>21,641,630</u>	<u>21,080,972</u>
Operating income from continuing operations	325,193	670,820
Other gains/(losses):		
Interest income	110,812	142,700
Equity in income (loss) of healthcare joint ventures	73,400	(150,279)
Loss on sale of healthcare joint venture	—	(853,838)
Other income	329,236	—
Loss on disposal of fixed assets	<u>(5,323)</u>	<u>—</u>
Increase (decrease) in net assets from continuing operations before income taxes	833,318	(190,597)
Income tax expense	<u>11,000</u>	<u>817</u>
Increase (decrease) in net assets from continuing operations	822,318	(191,414)
Discontinued operations:		
Loss from operations of disposed clinics	—	(268,925)
Income tax expense	<u>—</u>	<u>—</u>
Loss from discontinued operations	<u>—</u>	<u>(268,925)</u>
Increase (decrease) in net assets	822,318	(460,339)
Current year cash distribution	—	(200,000)
Net assets, beginning of year	<u>15,879,716</u>	<u>16,540,055</u>
Net assets, end of year	<u>\$ 16,702,034</u>	<u>15,879,716</u>

See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2010 and 2009

	<u>2010</u>	<u>2009</u>
Cash flows from operating activities:		
Increase (decrease) in net assets	\$ 822,318	(460,339)
Adjustments to reconcile increase in net assets to net cash provided by (used in) operating activities:		
Equity in (income) loss of healthcare joint ventures	(73,400)	150,279
Loss on sale of joint venture	—	853,838
Loss on disposal of fixed assets	5,323	—
Depreciation and amortization	277,905	286,205
Provision for bad debt	310,562	268,139
Change in:		
Receivables	964,409	(561,189)
Inventory	(149,819)	(72,630)
Prepaid expenses	(20,295)	80,402
Due to/from affiliates	(44,854)	71,111
Accounts payable and other liabilities and accrued expenses	59,278	(802,056)
Net cash provided by (used in) operating activities from continuing operations	<u>2,151,427</u>	<u>(186,240)</u>
Net cash provided by operating activities of discontinued operations	—	663,236
Net cash provided by operating activities	<u>2,151,427</u>	<u>476,996</u>
Cash flows from investing activities:		
Distributions from investments in healthcare joint ventures	—	25,000
Contributions to investments in health care joint ventures	(117,700)	(90,200)
Purchase of property and equipment	(243,929)	(365,350)
Decrease (increase) in short-term investments	1,053,495	(15,674)
Net cash provided by (used in) investing activities	<u>691,866</u>	<u>(446,224)</u>
Cash flows from financing activities:		
Distributions to UICOM and UIHC	—	(200,000)
Net cash used in financing activities	<u>—</u>	<u>(200,000)</u>
Net increase (decrease) in cash and cash equivalents	2,843,293	(169,228)
Cash and cash equivalents, beginning of year	<u>9,826,081</u>	<u>9,995,309</u>
Cash and cash equivalents, end of year	<u>\$ 12,669,374</u>	<u>9,826,081</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 28,142	10,619
Cash paid for income taxes	—	7,500

See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(1) Summary of Significant Accounting Policies and Related Matters

(a) Operations

University of Iowa Health System (UIHS) was incorporated under the provisions of the Iowa Nonprofit Corporation Act on December 2, 1994. UIHS was formed to support the clinical, academic, and research programs of the University of Iowa College of Medicine (UICOM) and the University of Iowa Hospitals and Clinics (UIHC).

UIHS does not have members with voting rights. Upon dissolution, any remaining assets will be transferred to the University of Iowa, or its successor, if in existence. Otherwise the assets may be transferred by the board of directors to various entities exclusively for public purposes in accordance with the articles of incorporation for UIHS.

UIHS has a wholly owned subsidiary, University of Iowa Affiliated Health Providers, L.C. (UIAHP).

UIHS has a for-profit wholly owned subsidiary, University of Iowa Community Medical Services, Inc. (UICMS), which was formed in 1995 and began operations in 1996. UICMS has a for-profit wholly owned subsidiary, University of Iowa Community Homecare, Inc. (UICH), which was also formed in 1995 and began operations in 1996.

UIHS has a wholly owned subsidiary, UI HealthWorks, L.L.C. (UIHW), which was formed and began operations in 1998.

(b) Basis of Presentation

The consolidated financial statements are prepared in accordance with U.S. generally accepted accounting principles and include the accounts of UIHS and its subsidiaries (the System). All significant intercompany accounts and transactions have been eliminated in consolidation.

(c) Cash Equivalents

Cash equivalents consist of repurchase agreements in a cash management fund and government money market funds, which totaled \$12,274,271 and \$9,184,638 at December 31, 2010 and 2009, respectively.

(d) Investments

Investment securities at December 31, 2009 consist of certificates of deposit (see note 11).

Investments in healthcare joint ventures with 20% to 50% ownership are recorded using the equity method, and investments of less than 20% ownership recorded at cost, adjusted for impairment in value, if any.

(e) Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements are recorded at cost less accumulated depreciation and amortization. Depreciation and amortization are provided by primarily accelerated methods over the assets' estimated useful lives.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(f) Inventory

Inventory consists of supplies and pharmaceutical products, and is stated at the lower of cost or market.

(g) Cash Held in Trust

Cash held in trust consists of cash held by UIHS for the managed service organizations (MSO's) and is stated at fair value.

(h) System Funding

The Iowa State Board of Regents has authorized UIHC and UICOM to transfer \$30,945,000, one half from each entity, to UIHS to accomplish the purposes of UIHS. At December 31, 2010 and 2009, \$24,833,200 has been transferred to UIHS leaving \$6,111,800 of funding remaining.

(i) Net Patient Service Revenue

The System has agreements with third-party payors that provide for payments at amounts different from its established rates. 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 at adjusted in future periods as final settlements are determined.

(j) Charity Care

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

(k) Income Taxes

UIHS, UICMS, UICH, and UIHW are subject to federal and state income taxes and file their income tax returns on a consolidated basis. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and net operating loss carryforwards. Deferred taxes are measured using enacted rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effects of changes in tax rates are recognized in income in the period that includes the enactment date.

Income and losses of UIAHP are included in the income tax returns of their members.

The System's recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. There were no tax contingency accruals reflected in the System's financial statements at December 31, 2010 and 2009.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(l) Use of Estimates

The preparation of consolidated 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 disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(m) Fair Value Measurements

The Company utilizes valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs to the extent possible. The Company determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.

Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date.

See note 12 to the Consolidated Financial Statements.

(2) Investments in Other Healthcare Joint Ventures and Other Long-Term Receivable

At December 31, 2010, the System's investments in healthcare joint ventures consist primarily of investments in Deer Creek Health Center LLC (Deer Creek), CareResources, LLC (CareResources), and Cancer Care of Iowa City LLC for which the System has ownership percentages of 50%, 50%, and 40% respectively. On an aggregate basis, the healthcare joint ventures listed previously as of and for the year ended December 31, 2010 had total assets of \$3,144,109, total equity of \$2,355,372, and net loss of \$120,334.

During 2009, the System sold their 40% investment in Collaborative Laboratory Services, LLC (Collaborative Labs), which resulted in a loss on sale of \$853,838.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

UICH had an agreement with the Visiting Nurse Association of Johnson County (VNA) to provide private duty services through January 31, 2003. At December 31, 2010 and 2009, UICH had a receivable from VNA for services through January 31, 2003, in the amount of \$110,573 and \$158,573, respectively. The VNA receivable will be repaid under a revised agreement dated September 2010. The aggregate maturities of the receivable for the five years subsequent to December 31, 2010 are as follows:

2011	\$	24,000
2012		72,000
2013		14,573
2014		—
2015		—
		<hr/>
		110,573
Less discount on long-term receivables		<hr/> (30,643) <hr/>
Net receivables		79,930
Current portion		<hr/> (24,000) <hr/>
	\$	<hr/> <u>55,930</u> <hr/>

(3) Charity Care

The System provides charity care to eligible patients at reduced or no cost based on the individual patient's financial situation. Records are kept to identify, approve, and monitor those charges that are forgone under the charity care policy. Charity care, determined at established rates, was \$13,760 and \$10,208 for 2010 and 2009, respectively.

(4) Third-Party Reimbursement Programs

As a provider of healthcare services, the System generally grants credit to patients without requiring collateral or other securities; however, the System routinely obtains assignments of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies, which are considered third-party payors. A major portion of the revenues of the System is derived from these third-party payors. Significant changes have been made and may be made in certain of these programs that could have a material adverse impact on the financial condition of the System. These changes include federal and state laws and regulations, particularly those pertaining to Medicare and Medicaid.

The System has agreements with certain of these third-party payors that provide for payment of services at amounts different from established rates. These third-party payors include the Medicare and Medicaid programs, Blue Cross, various health maintenance and preferred provider organizations, commercial insurance companies, and other commercial enterprises. The basis for payment from these third-party payors varies by payor and includes established charges, contracted rates less than established charges, and periodic revenue at capitated rates per covered life. The System receives payment from these third-party payors for services at established rates less a usual, customary, and reasonable adjustment.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The percentage of patient service revenue at established rates by payor and patient accounts receivable by payor class at December 31, 2010 and 2009 were as follows:

	2010		2009	
	Patient revenue	Patient receivables	Patient revenue	Patient receivables
Medicare	12%	11%	28%	13%
Medicaid	21	15	16	14
Blue Cross	43	31	37	41
Commercial	22	31	18	25
Self-pay	2	12	1	7
	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

(5) Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements at December 31, 2010 and 2009 are summarized as follows:

	2010	2009
Moveable equipment	\$ 3,000,425	2,840,441
Leasehold improvements	273,153	273,153
Work in progress	—	20,331
Software	38,953	36,435
	<u>3,312,531</u>	<u>3,170,360</u>
Less accumulated depreciation and amortization	2,932,869	2,751,399
Net property, equipment, and leasehold improvements	<u>\$ 379,662</u>	<u>418,961</u>

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(6) Income Taxes

Income tax expense attributable to income from continuing operations at December 31, 2010 and 2009 consisted of the following components:

	<u>2010</u>	<u>2009</u>
Current tax (benefit) expense:		
Federal	\$ 8,000	785
State	3,000	32
Total current tax expense	<u>11,000</u>	<u>817</u>
Deferred tax expense:		
Federal	—	—
State	—	—
Total deferred tax expense	<u>—</u>	<u>—</u>
Total income tax expense	<u>\$ 11,000</u>	<u>817</u>

There was no income tax expense attributable to discontinued operations in 2009.

Total reported tax (benefit) expense applicable to the System's continuing operations varies from the tax that would have resulted from applying the statutory U.S. federal income tax rates to income before taxes at December 31, 2010 and 2009 as follows:

	<u>2010</u>	<u>2009</u>
Federal income taxes at statutory rates (34%)	\$ 283,328	(156,237)
State income tax, net of federal tax benefit	2,000	—
Change in federal valuation allowance	(221,800)	115,700
Other	(52,528)	41,354
	<u>\$ 11,000</u>	<u>817</u>

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

The tax effects of temporary differences between the consolidated financial statement and income tax bases of assets and liabilities that give rise to deferred tax assets and liabilities of the System at December 31, 2010 and 2009 are as follows:

	<u>2010</u>	<u>2009</u>
Deferred tax assets:		
Net operating loss carryforwards	\$ 4,841,700	5,494,800
Amortization	66,400	79,500
Allowance for uncollectible accounts receivable	—	3,100
Capital loss carryforward	341,500	—
Other	127,500	86,800
	<u>5,377,100</u>	<u>5,664,200</u>
Gross deferred tax assets		
Valuation allowance	<u>(4,977,100)</u>	<u>(5,264,200)</u>
Net deferred tax assets	<u>\$ 400,000</u>	<u>400,000</u>

For federal income tax purposes, UIHS has a net operating loss carryforward of approximately \$12,104,225 million at December 31, 2010, which is available to offset future taxable income of the consolidated group through 2022. UIHS also has federal and state alternative minimum tax credits available to offset future years' regular tax liabilities of approximately \$167,600. These credits have no expiration period. UIHS has capital loss carryforward of approximately \$854,000, which are available through 2014.

Management was unable to conclude it was more likely than not that UIHS would realize the benefits of the deferred tax assets beyond 2011. Accordingly, a valuation allowance has been recorded to offset the future benefit available from temporary differences for years beyond the year ended December 31, 2011. The current year valuation allowance is \$287,100 lower than prior year primarily due to a reduction in net operating losses. For the year ended December 31, 2010, management believes it is more likely than not that UIHS will realize \$400,000 of deferred tax assets related to net operating loss carryforwards.

The System files consolidated income tax returns in the U.S. federal and state jurisdictions. The System is currently not under income tax examination by the IRS nor any state. For federal and state tax purposes, the System's 2007 through 2009 tax years remain open for examination by the tax authorities. The System had no unrecognized tax benefits as of December 31, 2009 or 2010.

(7) Retirement Plans

The System has defined contribution employee benefit plans that cover substantially all full-time employees who meet certain eligibility requirements. The System makes a 100% matching contribution on the first 4% of the earnings that employees contribute. Employees must be employed by the System for one year to be eligible for matching contributions to the plans. For the years ended December 31, 2010 and 2009, the System had expenses of \$174,154 and \$184,524, respectively, related to the plans.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

(8) Transactions with Affiliates

UICMS provides general administrative services and supplies, including leasing of physicians, to Deer Creek. During 2010 and 2009, \$748,735 and \$854,964, respectively, was recognized in revenue from Deer Creek. At December 31, 2010 and 2009, UICMS had \$25,494 and \$30,716, respectively, due from Deer Creek. UICMS provided \$117,700 and \$90,200 of capital funding to Deer Creek during 2010 and 2009, respectively.

UICMS incurred expenses of \$547,272 in 2010 and \$411,123 in 2009 for contracted physicians and general services, equipment, and supplies provided by UIHC and other units of the University of Iowa. During 2010 and 2009, \$1,581,737 and \$1,472,813, respectively, was recognized by UICMS in revenue from UIHC and other departments of the University.

UICH incurred expenses of \$5,014 and \$4,881 in 2010 and 2009, respectively, for various services and supplies provided by UIHC and other departments of the University of Iowa. During 2010 and 2009, \$582,975 and \$448,734, respectively, were recognized in revenue from UIHC and other departments of the University. At December 31, 2010 and 2009, \$0 and \$421, respectively, was payable to UIHC and other departments of the University for various services and supplies.

UICH has a subcontractor agreement with UIHC to obtain home infusion therapy staffing and products from UIHC. Expenses incurred under this agreement were \$315,517 and \$288,357 in 2010 and 2009, respectively. At December 31, 2010 and 2009, \$24,839 and \$49,776, respectively, was payable to UIHC under this agreement.

UICH provides services to the South East Iowa City (SEIC) clinics under a contract with UICMS. UICMS provides management, operating, and certain physician services for these clinics under an annually renewable contract with UICH. Net, patient service revenue for these services was \$607,832 and \$510,630 in 2010 and 2009, respectively. At December 31, 2010 and 2009, UICH had a receivable of \$154,512 and \$86,769, respectively, related to these services.

UICH purchases management services from a related party, CareResources. Expenses incurred for these services in 2010 and 2009 were \$297,887 and \$267,958, respectively. At December 31, 2010 and 2009, UICH owed \$29,185 and \$28,779, respectively, to CareResources related to these services. UICH incurred expenses of \$15,566 and \$22,234 in 2010 and 2009, respectively, for various services and supplies provided to UICH by CareResources. UICH received \$11,688 and \$12,606 in credit from CareResources in 2010 and 2009, respectively, due to purchases by UICH for CareResources where UICH could secure a greater discount.

UICMS and UIHC executed a management service and affiliation agreement under which UICMS will provide certain management, supervisory, and administrative services to formerly owned clinics. In consideration for the costs and expenses in fulfilling UICMS's obligations under the agreement, UIHC will pay UICMS, on a monthly basis, a management fee equal to the amount necessary to 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. For 2010 and 2009, the service fee revenue amounted to \$1,552,540 and \$1,143,566, respectively. UICMS incurred operating and staffing expenses for the clinics, which will be reimbursed by UIHC. At December 31, 2010 and 2009, UICMS had a receivable of \$714,360 and \$504,839 related to these services.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2010 and 2009

UICMS provides management, operating, and certain physician services for the Lone Tree, North Liberty, and South East Iowa clinics under an annually renewable contract with the Department of Family Medicine (a department of UIHC). For 2010 and 2009, the service fee revenue amounted to \$0 and \$463,202, respectively. In addition, UICMS incurred operating and staffing expenses for the clinics, which will be reimbursed by the Department of Family Medicine.

At December 31, 2010 and 2009, UICMS maintained in a restricted account cash and a corresponding liability in the amount of \$6,565,469 and \$2,834,271, respectively, related to these clinics.

Receivables from other affiliates were \$388,498 and \$845,045 at December 31, 2010 and 2009, respectively. Payables to other affiliates were \$16,821 and \$313,923 at December 31, 2010 and 2009, respectively.

At December 31, 2010 and 2009, UIHW maintained cash and corresponding liability in the amount of \$16,285 and \$29,167, respectively, for the University of Iowa behavioral health.

(9) Liability Insurance

Professional liability insurance coverage is maintained on a claims-made basis of \$5,000,000 per occurrence, \$5,000,000 per year, with a \$25,000 retention. The amount of loss for claims that may be asserted and not covered by insurance is estimated at \$0 at December 31, 2010. The accompanying consolidated financial statements do not include any accrued liabilities for possible losses due to unasserted claims.

Should the claims-made policy not be renewed or replaced with equivalent insurance, claims based on occurrences during the policy term, but reported subsequently, would be uninsured.

(10) Commitments

Certain property, equipment, and office space is being leased under long-term noncancelable operating leases. Rent expense under operating leases was \$1,552,073 for 2010 and \$1,117,198 for 2009. Future minimum rental payments required under noncancelable operating leases that have initial or remaining noncancelable lease terms of one year or more as of December 31, 2010 are as follows:

Year ending December 31:		
2011	\$	1,676,784
2012		1,488,413
2013		1,455,880
2014		1,430,972
2015		1,095,279
Thereafter		<u>2,754,454</u>
Total minimum lease payments		\$ <u>9,901,782</u>

The System has an agreement to sublease a portion of its clinical space to the Joint Office of Clinical Outreach Services of UIHC/University of Iowa College of Medicine. Future minimum rental income

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through 2011 under this noncancelable sublease is \$35,960 and \$97,606 at December 31, 2010 and 2009, respectively.

The System has agreements to lease physicians and/or physician assistants to Deer Creek and nine clinics, which UICMS manages under contract. UICMS signed several noncancelable employment contracts with physicians and will be reimbursed by Deer Creek and the clinics. Future commitments as of December 31, 2010 under these noncancelable leases are as follows:

Year ending December 31:		
2011	\$	2,067,806
2012		1,533,584
2013		1,115,224
2014		143,524
		4,860,138
Total noncancelable leases	\$	4,860,138

(11) Fair Value Measurements

The following table presents the carrying amounts and estimated fair values of the System's financial instruments at December 31, 2010 and 2009. Fair value is defined as the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

	2010		2009	
	Carrying amount	Fair value	Carrying amount	Fair value
Current assets:				
Cash and cash equivalents	\$ 12,669,374	12,669,374	9,826,081	9,826,081
Cash held in trust	6,581,754	6,581,754	2,863,438	2,863,438
Short-term investments	—	—	1,053,495	1,053,495
Patient accounts receivable	1,256,937	1,256,937	1,569,502	1,569,502
Due from affiliates	1,282,864	1,282,864	1,467,369	1,467,369
Other receivables	264,639	264,639	1,294,788	1,294,788
Liabilities:				
Due to affiliates	\$ 70,845	70,845	392,899	392,899
Accounts payable	520,578	520,578	505,399	505,399
Other liabilities and accrued expenses	753,419	753,419	684,368	684,368
Cash held in trust	6,581,754	6,581,754	2,863,438	2,863,438

The carrying amounts shown in the table are included in the consolidated balance sheets under the indicated captions.

The fair values of the financial instruments shown in the above table as of December 31, 2010 and 2009 represent the amounts that would be received to sell those assets in an orderly transaction between market

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participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the System's own judgments about the assumptions that market participants would use in pricing the asset or liability. Those judgments are developed by the System based on the best information available in the circumstances, including expected cash flows and appropriately risk-adjusted discount rates, available observable and unobservable inputs.

Cash and cash equivalents, cash held in trust, short-term investments, patient accounts receivable, due from affiliates, other receivables, prepaid expenses, due to affiliates, accounts payable, other liabilities and accrued expenses, and cash held in trust: The carrying amounts, at face value or cost plus accrued interest, approximate fair value because of the short maturity of these instruments.

(12) Fair Value Hierarchy

The following table presents the placement in the fair value hierarchy of assets and liabilities that are measured at fair value on a recurring basis (including items that are required to be measured at fair value and items for which the fair value option has been elected) at December 31, 2010 and 2009:

		December 31, 2010			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:					
Cash and cash equivalents	\$	12,669,374	—	—	12,669,374
Cash held in trust		6,581,754	—	—	6,581,754
Total	\$	<u>19,251,128</u>	<u>—</u>	<u>—</u>	<u>19,251,128</u>
		December 31, 2009			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:					
Cash and cash equivalents	\$	9,826,081	—	—	9,826,081
Cash held in trust		2,863,438	—	—	2,863,438
Short-term investments		—	1,053,495	—	1,053,495
Total	\$	<u>12,689,519</u>	<u>1,053,495</u>	<u>—</u>	<u>13,743,014</u>

(13) Discontinued Operations

On December 31, 2009, UICMS sold their Oncology and Wapello clinics to UIHC for \$611,789, which approximated fair value. The assets of these clinics consisted of inventory and accounts receivable.

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(14) Subsequent Events

The System sold its investment in Deer Creek Health Center LLC on May 31, 2011 at a gain of \$1.

The System has evaluated subsequent events from the balance sheet date through August 1, 2011, the date the financial statements were available to be issued, and determined there are no other items to disclose.