



UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2011 and 2010

(With Independent Auditors' Report Thereon)

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

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

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, 2011 and 2010, 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, 2011 and 2010, 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

July 13, 2012

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2011 and 2010

Assets	2011	2010
Current assets:		
Cash and cash equivalents	\$ 13,782,636	12,669,374
Cash held in trust	5,020,727	6,581,754
Patient accounts receivable, net of allowance of \$63,945 in 2011 and \$60,114 in 2010	1,085,386	1,256,937
Due from affiliates	886,238	1,282,864
Other receivables	271,728	264,639
Inventory	551,033	506,824
Prepaid expenses	223,968	159,233
Deferred tax assets	400,000	400,000
Total current assets	<u>22,221,716</u>	<u>23,121,625</u>
Other long-term receivable	—	55,930
Investments in healthcare joint ventures	622,016	1,071,413
Property, equipment, and leasehold improvements, net	333,549	379,662
Total assets	<u>\$ 23,177,281</u>	<u>24,628,630</u>
Liabilities and Net Assets		
Liabilities:		
Due to affiliates	\$ 80,177	70,845
Accounts payable	312,184	520,578
Other liabilities and accrued expenses	699,670	753,419
Cash held in trust	5,020,727	6,581,754
Total liabilities	<u>6,112,758</u>	<u>7,926,596</u>
Net assets – unrestricted	<u>17,064,523</u>	<u>16,702,034</u>
Total liabilities and net assets	<u>\$ 23,177,281</u>	<u>24,628,630</u>

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, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Revenues, gains, and other support:		
Net patient service revenue	\$ 8,166,874	8,591,713
Management services	9,755,079	9,671,674
Management services fee	1,787,640	1,784,378
Other operating revenue	<u>2,104,052</u>	<u>1,919,058</u>
Total revenues, gains, and other support	<u>21,813,645</u>	<u>21,966,823</u>
Expenses:		
Patient services:		
Physicians' salaries and benefits	11,879	8,086
Nonphysicians' salaries and benefits	3,244,190	2,865,113
Supplies and expenses	7,383,928	7,941,495
Medical equipment	645,562	547,203
Depreciation and amortization	226,719	269,355
Interest	32,501	28,142
Provision for bad debts	330,535	310,562
Management services:		
Physicians' salaries and benefits	2,245,804	2,698,112
Nonphysicians' salaries and benefits	6,163,857	5,651,036
Supplies and expenses	1,339,514	1,313,976
Depreciation and amortization	<u>5,904</u>	<u>8,550</u>
Total expenses	<u>21,630,393</u>	<u>21,641,630</u>
Operating income from continuing operations	183,252	325,193
Other gains/(losses):		
Interest income	137,657	110,812
Equity in (loss) income of healthcare joint ventures	(213,947)	73,400
Gain on sale of healthcare joint venture	1	—
Other income	268,598	329,236
Loss on disposal of fixed assets	<u>(13,072)</u>	<u>(5,323)</u>
Increase in net assets from continuing operations before income taxes	362,489	833,318
Income tax expense	<u>—</u>	<u>(11,000)</u>
Increase in net assets	362,489	822,318
Net assets, beginning of year	<u>16,702,034</u>	<u>15,879,716</u>
Net assets, end of year	\$ <u><u>17,064,523</u></u>	\$ <u><u>16,702,034</u></u>

See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2011 and 2010

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Increase in net assets	\$ 362,489	822,318
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Equity in loss (income) of healthcare joint ventures	213,947	(73,400)
Gain on sale of joint venture	(1)	—
Loss on disposal of fixed assets	13,072	5,323
Depreciation and amortization	232,623	277,905
Provision for bad debts	330,535	310,562
Change in:		
Receivables	(110,143)	964,409
Inventory	(44,209)	(149,819)
Prepaid expenses	(64,735)	(20,295)
Due to/from affiliates	405,958	(44,854)
Accounts payable and other liabilities and accrued expenses	(262,143)	59,278
Net cash provided by operating activities	<u>1,077,393</u>	<u>2,151,427</u>
Cash flows from investing activities:		
Distributions from investments in healthcare joint ventures	257,940	—
Contributions to investments in health care joint ventures	(58,500)	(117,700)
Purchase of property and equipment	(199,582)	(243,929)
Proceeds from sale of investments in healthcare joint ventures	36,011	—
Decrease in short-term investments	—	1,053,495
Net cash provided by investing activities	<u>35,869</u>	<u>691,866</u>
Net increase in cash and cash equivalents	1,113,262	2,843,293
Cash and cash equivalents, beginning of year	<u>12,669,374</u>	<u>9,826,081</u>
Cash and cash equivalents, end of year	\$ <u>13,782,636</u>	<u>12,669,374</u>
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$ 32,501	28,142

See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

(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) 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.

(c) Principles of Consolidation

The accompanying consolidated financial statements include the accounts of University of Iowa Health System and its subsidiaries (collectively, the System). All significant intercompany balances and transactions have been eliminated in consolidation. The System has no involvement with variable interest entities. The System accounts for investments over which it has significant influence but not a controlling financial interest using the equity method of accounting.

(d) Cash Equivalents

Cash equivalents consist of repurchase agreements in a cash management fund and government money market funds, which totaled \$13,409,064 and \$12,274,271 at December 31, 2011 and 2010, respectively.

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December 31, 2011 and 2010

(e) Investments

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.

(f) 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.

(g) Inventory

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

(h) 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.

(i) 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, 2011 and 2010, \$24,833,200 has been transferred to UIHS leaving \$6,111,800 of funding remaining.

(j) 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.

(k) Management Services and Management Services Fee Revenue

The System performs certain management, supervisory, and administrative services for various clinics. Management services revenue consists of operating and staffing costs for the respective clinics and is recorded as incurred and earned. Management services fees is the consideration for the management services provided to the various clinics. Management services fee revenue is recorded based on the agreement in place with each clinic. The terms of the agreement are for one year, with automatically renewing unless either party gives notice to terminate.

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(l) 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.

(m) 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 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, 2011 and 2010.

(n) Fair Value Measurements

The System utilizes valuation techniques that maximize the use of observable inputs and minimizes the use of unobservable inputs to the extent possible. The System 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 Healthcare Joint Ventures and Other Long-Term Receivable

At December 31, 2011, the System's investments in healthcare joint ventures consist primarily of investments in CareResources, LLC (CareResources), and Cancer Care of Iowa City LLC for which the

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System has ownership percentages of 50% and 40%, respectively. On an aggregate basis, the healthcare joint ventures listed previously as of and for the year ended December 31, 2011 had total assets of \$2,016,057 total equity of \$1,343,382, and net loss of \$335,266.

During 2011, the System sold their 50% investment in Deer Creek Health Center, LLC, which resulted in a gain on sale of \$1.

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, 2011 and 2010, UICH had a receivable from VNA for services through January 31, 2003, in the amount of \$20,573 and \$110,573, respectively. The VNA receivable will be repaid in full during 2012.

(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. The System incurred expense for charity care of \$4,372 and \$5,367 for 2011 and 2010, 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.

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The percentage of patient service revenue at established rates by payor and patient accounts receivable by payor class at December 31, 2011 and 2010 were as follows:

	2011		2010	
	Patient revenue	Patient receivables	Patient revenue	Patient receivables
Medicare	14%	9%	12%	11%
Medicaid	23	10	21	15
Blue Cross	39	49	43	31
Commercial	23	21	22	31
Self-pay	1	11	2	12
	<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, 2011 and 2010 are summarized as follows:

	2011	2010
Moveable equipment	\$ 2,840,084	3,000,425
Leasehold improvements	272,461	273,153
Software	38,953	38,953
	<u>3,151,498</u>	<u>3,312,531</u>
Less accumulated depreciation and amortization	<u>2,817,949</u>	<u>2,932,869</u>
Net property, equipment, and leasehold improvements	<u>\$ 333,549</u>	<u>379,662</u>

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December 31, 2011 and 2010

(11) Fair Value Measurements

The following table presents the carrying amounts and estimated fair values of the System's financial instruments at December 31, 2011 and 2010. 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.

	2011		2010	
	Carrying amount	Fair value	Carrying amount	Fair value
Current assets:				
Cash and cash equivalents	\$ 13,782,636	13,782,636	12,669,374	12,669,374
Cash held in trust	5,020,727	5,020,727	6,581,754	6,581,754
Patient accounts receivable	1,085,386	1,085,386	1,256,937	1,256,937
Due from affiliates	886,238	886,238	1,282,864	1,282,864
Other receivables	271,728	271,728	264,639	264,639
Liabilities:				
Due to affiliates	\$ 80,177	80,177	70,845	70,845
Accounts payable	312,184	312,184	520,578	520,578
Other liabilities and accrued expenses	699,670	699,670	753,419	753,419
Cash held in trust	5,020,727	5,020,727	6,581,754	6,581,754

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, 2011 and 2010 represent the amounts that would be received to sell those assets in an orderly transaction between market 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, patient accounts receivable, due from affiliates, other receivables, 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.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2011 and 2010

(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, 2011 and 2010:

		December 31, 2011			
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Assets:					
Cash and cash equivalents	\$	13,782,636	—	—	13,782,636
Cash held in trust		<u>5,020,727</u>	<u>—</u>	<u>—</u>	<u>5,020,727</u>
Total	\$	<u><u>18,803,363</u></u>	<u><u>—</u></u>	<u><u>—</u></u>	<u><u>18,803,363</u></u>
		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		<u>6,581,754</u>	<u>—</u>	<u>—</u>	<u>6,581,754</u>
Total	\$	<u><u>19,251,128</u></u>	<u><u>—</u></u>	<u><u>—</u></u>	<u><u>19,251,128</u></u>

(13) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through July 13, 2012, the date the consolidated financial statements were available to be issued, and determined there are no other items to disclose.