



UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Financial Statements

December 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Table of Contents

| | Page(s) |
|---|----------------|
| Independent Auditors' Report | 1 – 2 |
| Financial Statements: | |
| Consolidated Balance Sheets | 3 |
| Consolidated Statements of Operations and Changes in Net Assets | 4 |
| Consolidated Statements of Cash Flows | 5 |
| Notes to Consolidated Financial Statements | 6 – 15 |



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

Independent Auditors' Report

The Board of Directors
University of Iowa Health System:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of the University of Iowa Health System and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2012 and 2011, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; these include the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

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 consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.



Opinion

In our opinion, the consolidated financial statements referred to above present fairly in all material respects, the financial position of the University of Iowa Health System and subsidiaries as of December 31, 2012 and 2011, and the results of their operations and their cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.

KPMG LLP

Des Moines, Iowa
July 31, 2013

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Balance Sheets

December 31, 2012 and 2011

| Assets | 2012 | 2011 |
|---|-------------------|-------------------|
| | <u> </u> | <u> </u> |
| Current assets: | | |
| Cash and cash equivalents | \$ 14,022,722 | 13,782,636 |
| Cash held in trust | 5,364,034 | 5,020,727 |
| Patient accounts receivable, net of allowance of \$63,079 in 2012 and \$63,945 in 2011 | 824,263 | 1,085,386 |
| Due from affiliates | 952,696 | 886,238 |
| Other receivables | 230,205 | 271,728 |
| Inventory | 494,326 | 551,033 |
| Prepaid expenses | 253,084 | 223,968 |
| Deferred tax assets | 400,000 | 400,000 |
| | <u> </u> | <u> </u> |
| Total current assets | 22,541,330 | 22,221,716 |
| Investments in healthcare joint ventures | 811,218 | 622,016 |
| Property, equipment, and leasehold improvements, net | 273,605 | 333,549 |
| | <u> </u> | <u> </u> |
| Total assets | \$ 23,626,153 | 23,177,281 |
| | <u> </u> | <u> </u> |
| Liabilities and Net Assets | | |
| Liabilities: | | |
| Due to affiliates | \$ 93,199 | 80,177 |
| Accounts payable | 361,180 | 312,184 |
| Other liabilities and accrued expenses | 789,993 | 699,670 |
| Cash held in trust | 5,364,034 | 5,020,727 |
| | <u> </u> | <u> </u> |
| Total liabilities | 6,608,406 | 6,112,758 |
| Net assets – unrestricted | 17,017,747 | 17,064,523 |
| | <u> </u> | <u> </u> |
| Total liabilities and net assets | \$ 23,626,153 | 23,177,281 |
| | <u> </u> | <u> </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, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|---|----------------------|----------------------|
| Revenues, gains, and other support: | | |
| Patient service revenue (net of contractual allowances and discounts) | \$ 7,735,662 | 8,166,874 |
| Provision for bad debts | <u>(351,106)</u> | <u>(330,535)</u> |
| Net patient service revenue less provision for bad debts | 7,384,556 | 7,836,339 |
| Management services | 10,454,644 | 9,755,079 |
| Management services fee | 1,405,636 | 1,787,640 |
| Other operating revenue | <u>2,178,345</u> | <u>2,104,052</u> |
| Total revenues, gains, and other support | <u>21,423,181</u> | <u>21,483,110</u> |
| Expenses: | | |
| Patient services: | | |
| Physicians' salaries and benefits | 1,122 | 11,879 |
| Nonphysicians' salaries and benefits | 3,398,721 | 3,244,190 |
| Supplies and expenses | 7,149,020 | 7,383,928 |
| Medical equipment | 697,922 | 645,562 |
| Depreciation and amortization | 174,768 | 226,719 |
| Interest | 20,049 | 32,501 |
| Management services: | | |
| Physicians' salaries and benefits | 1,762,969 | 2,245,804 |
| Nonphysicians' salaries and benefits | 7,295,295 | 6,163,857 |
| Supplies and expenses | 1,394,135 | 1,339,514 |
| Depreciation and amortization | <u>2,245</u> | <u>5,904</u> |
| Total expenses | <u>21,896,246</u> | <u>21,299,858</u> |
| Operating income (loss) | (473,065) | 183,252 |
| Other gains (losses): | | |
| Interest income | 68,676 | 137,657 |
| Equity in (loss) income of healthcare joint ventures | 107,383 | (213,947) |
| Gain on sale of healthcare joint venture | 32,962 | 1 |
| Other income | 235,721 | 268,598 |
| Loss on disposal of fixed assets | <u>(18,453)</u> | <u>(13,072)</u> |
| Increase (decrease) in net assets before income taxes | (46,776) | 362,489 |
| Income tax expense | <u>—</u> | <u>—</u> |
| Increase (decrease) in net assets | (46,776) | 362,489 |
| Net assets, beginning of year | <u>17,064,523</u> | <u>16,702,034</u> |
| Net assets, end of year | \$ <u>17,017,747</u> | \$ <u>17,064,523</u> |

See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Consolidated Statements of Cash Flows

Years ended December 31, 2012 and 2011

| | <u>2012</u> | <u>2011</u> |
|--|----------------------|----------------------|
| Cash flows from operating activities: | | |
| Increase (decrease) in net assets | \$ (46,776) | 362,489 |
| Adjustments to reconcile increase (decrease) in net assets to net cash provided by operating activities: | | |
| Equity in (income) loss of healthcare joint ventures | (107,383) | 213,947 |
| Gain on sale of joint venture | (32,962) | (1) |
| Loss on disposal of fixed assets | 18,453 | 13,072 |
| Depreciation and amortization | 177,013 | 232,623 |
| Provision for bad debts | 351,106 | 330,535 |
| Change in: | | |
| Receivables | (48,460) | (110,143) |
| Inventory | 56,707 | (44,209) |
| Prepaid expenses | (29,116) | (64,735) |
| Due to/from affiliates | (53,436) | 405,958 |
| Accounts payable and other liabilities and accrued expenses | 139,319 | (262,143) |
| Net cash provided by operating activities | <u>424,465</u> | <u>1,077,393</u> |
| Cash flows from investing activities: | | |
| Distributions from investments in healthcare joint ventures | — | 257,940 |
| Contributions to investments in healthcare joint ventures | (120,100) | (58,500) |
| Purchase of property and equipment | (135,522) | (199,582) |
| Proceeds from sale of investments in healthcare joint ventures | 71,243 | 36,011 |
| Net cash provided by (used in) investing activities | <u>(184,379)</u> | <u>35,869</u> |
| Net increase in cash and cash equivalents | 240,086 | 1,113,262 |
| Cash and cash equivalents, beginning of year | <u>13,782,636</u> | <u>12,669,374</u> |
| Cash and cash equivalents, end of year | \$ <u>14,022,722</u> | \$ <u>13,782,636</u> |
| Supplemental disclosure of cash flow information: | | |
| Cash paid for interest | \$ 20,049 | 32,501 |

See accompanying notes to consolidated financial statements.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(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 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.

(d) *Cash Equivalents*

Cash equivalents consist of repurchase agreements in a cash management fund and government money market funds, which totaled \$13,713,307 and \$13,409,064 at December 31, 2012 and 2011, respectively.

(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.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(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) *Impairment of Long Lived Assets*

Long lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, an impairment charge is recognized to the extent the carrying amount of the asset exceeds its fair value.

(h) *Inventory*

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

(i) *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.

(j) *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, 2012 and 2011, \$24,833,200 has been transferred to UIHS leaving \$6,111,800 of funding remaining.

(k) *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.

(l) *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.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(m) *Provision for Uncollectible Patient Accounts*

The provision for uncollectible patient accounts is based upon the UIHS' management's assessment of expected net collections considering the accounts receivable aging, historical collections experience, economic conditions, trends in healthcare coverage, and other collection indicators. Management periodically assesses the adequacy of the allowances for uncollectible accounts and contractual adjustments based upon historical write off experience. The results of these reviews are used to establish the net realizable value of patient accounts receivable. There are various factors that can impact collection trends, such as changes in the economy, which in turn may have an impact on unemployment rates and the number of uninsured and underinsured patients, the increased burden of copayments and deductibles to be made by patients with insurance, and business practices related to collection efforts. These factors continuously change and can have an impact on collection trends and our estimation process. Net patient accounts receivable have been adjusted to the estimated amounts expected to be collected and do not bear interest.

(n) *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. 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 \$1,991 and \$4,372 for 2012 and 2011, respectively.

(o) *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 University of Iowa Affiliated Health Providers, L.C. (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, 2012 and 2011.

(p) *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,

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

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.

At December 31, 2012 and 2011, UIHS had \$19,386,756 and \$18,803,363 of cash and cash equivalents and cash held in trust which utilized Level 1 inputs in the fair value determination.

(q) *Reclassification of prior Year Amounts*

Certain reclassifications were made to prior year financial statements to conform to the 2012 presentation.

(r) *New Accounting Standard*

Effective December 31, 2012, the UIHS adopted ASU 2011-07, *Health Care Entities (Topic 954): Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*, which requires health care entities to present the provision for bad debt relating to patient service revenue as a deduction from patient service revenue in the consolidated statements of operations rather than as operating expense. Additional disclosures relating to the sources of patient revenue and the allowance for doubtful accounts related to patient accounts receivable are also required. The adoption of this ASU had no impact on the financial condition, results of operations, or cash flows.

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

At December 31, 2012, 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 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, 2012 had total assets of \$2,222,161, total equity of \$1,689,423, and net income of \$262,906.

During 2012, the System sold their 9% investment in the Trinity Physician Hospital Organization, which resulted in a gain on sale of \$32,962.

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, UICH had a receivable from VNA for

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

services through January 31, 2003, in the amount of \$20,573. As of December 31, 2012, the receivable had been paid in full.

On June 30, 2012, UIHS sold a 50% interest in its wholly owned subsidiary, UIAHP, to Mercy Hospital in Cedar Rapids, Iowa (Mercy). UIAHP was repurposed as a joint venture between UIHS and Mercy for the purpose of establishing an Accountable Care Organization (ACO) as defined by the Affordable Care Act. UIAHP had total assets of \$240,514, total equity of \$240,514, and net income of \$414 as of and for the year ended December 31, 2012.

(3) 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.

The percentage of patient service revenue at established rates by payor and patient accounts receivable by payor class at December 31, 2012 and 2011 were as follows:

| | 2012 | | 2011 | |
|------------|-----------------|---------------------|-----------------|---------------------|
| | Patient revenue | Patient receivables | Patient revenue | Patient receivables |
| Medicare | 14% | 11% | 14% | 9% |
| Medicaid | 31 | 16 | 23 | 10 |
| Blue Cross | 34 | 34 | 39 | 49 |
| Commercial | 20 | 29 | 23 | 21 |
| Self-pay | 1 | 10 | 1 | 11 |
| | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

Patient service revenue (net of contractual allowances, discounts and provision for bad debts), recognized in 2012 from these major payor sources, is as follows:

| | | |
|---|----|-------------------------|
| Medicare | \$ | 1,005,075 |
| Medicaid | | 2,243,542 |
| Commercial insurance and others | | <u>4,487,045</u> |
| Patient service revenue (net of contractual allowances and discounts) | | 7,735,662 |
| Provision for bad debts | | <u>(351,106)</u> |
| Net patient service revenue less provision for bad debts | \$ | <u><u>7,384,556</u></u> |

(4) Property, Equipment, and Leasehold Improvements

Property, equipment, and leasehold improvements at December 31, 2012 and 2011 are summarized as follows:

| | <u>2012</u> | <u>2011</u> |
|---|--------------------------|-----------------------|
| Movable equipment | \$ 2,228,190 | 2,840,084 |
| Leasehold improvements | 266,206 | 272,461 |
| Work in process | — | 38,953 |
| Software | <u>40,523</u> | <u>—</u> |
| | 2,534,919 | 3,151,498 |
| Less accumulated depreciation and amortization | <u>2,261,314</u> | <u>2,817,949</u> |
| Net property, equipment, and leasehold improvements | \$ <u><u>273,605</u></u> | <u><u>333,549</u></u> |

(5) Income Taxes

Total reported income 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, 2012 and 2011 as follows:

| | <u>2012</u> | <u>2011</u> |
|---|--------------------|-----------------|
| Federal income taxes at statutory rates (34%) | \$ (15,904) | 123,000 |
| State income tax, net of federal tax benefit | — | — |
| Change in federal valuation allowance | 53,800 | (119,000) |
| Other | <u>(37,896)</u> | <u>(4,000)</u> |
| | \$ <u><u>—</u></u> | <u><u>—</u></u> |

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

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, 2012 and 2011 are as follows:

| | <u>2012</u> | <u>2011</u> |
|---|--------------------|--------------------|
| Deferred tax assets: | | |
| Net operating loss carryforwards | \$ 4,744,900 | 4,669,900 |
| Amortization | 40,300 | 53,400 |
| Allowance for uncollectible accounts receivable | 12,000 | 12,000 |
| Capital loss carryforward | 341,500 | 341,500 |
| Other | <u>89,400</u> | <u>81,600</u> |
| Gross deferred tax assets | 5,228,100 | 5,158,400 |
| Valuation allowance | <u>(4,828,100)</u> | <u>(4,758,400)</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 \$1.9 million at December 31, 2012, which is available to offset future taxable income of the consolidated group through 2024. UIHS also has federal and state alternative minimum tax credits available to offset future years' regular tax liabilities of approximately \$132,000. These credits have no expiration period. UIHS has capital loss carryforwards 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 2012. Accordingly, a valuation allowance has been recorded to offset the future benefit available from temporary differences for years beyond the year ended December 31, 2012. The current year valuation allowance is \$69,700 higher than prior year primarily due to an increase in net operating losses. For the year ended December 31, 2012, 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 Internal Revenue Service (IRS) nor any state. For federal and state tax purposes, the System's 2008 through 2010 tax years remain open for examination by the tax authorities. The System had no unrecognized tax benefits as of December 31, 2011 or 2012.

(6) 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, 2012 and 2011, the System had expenses of \$243,152 and \$195,739, respectively, related to the plans.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(7) Transactions with Affiliates

UICMS provides general administrative services and supplies, including leasing of physicians, to Deer Creek. During 2011, \$327,646 was recognized in revenue from Deer Creek and \$58,500 of capital funding was provided to Deer Creek. Deer Creek was sold in May 2011.

UICMS incurred expenses of \$387,944 in 2012 and \$531,215 in 2011 for contracted physicians and general services, equipment, and supplies provided by UIHC and other units of the University of Iowa. At December 31, 2012, \$5,903 was outstanding related to these expenses. There was no corresponding liability outstanding relating to these expenses at December 31, 2011.

UICMS and UIHC executed a management service and affiliation agreement under which UICMS will provide certain management, supervisory, and administrative services to clinics owned by UIHC. During 2012 and 2011, \$10,103,774 and \$9,164,517, respectively, was recognized by UICMS in revenue from UIHC and other departments of the University related to operating and staffing expenses for the clinics, which will be reimbursed by UIHC. 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 2012 and 2011, the service fee revenue amounted to \$1,405,636 and \$1,732,540 respectively. At December 31, 2012 and 2011, UICMS had a receivable of \$851,201 and \$779,923 related to management fees earned under the management service and affiliation agreement.

UICH incurred expenses of \$8,592 and \$4,096 in 2012 and 2011, respectively, for various services and supplies provided by UIHC and other departments of the University of Iowa. At December 31, 2012 and 2011, there were no outstanding payables to UIHC and other departments of the University related to these expenses. During 2012 and 2011, \$493,207 and \$597,209, respectively, were recognized in revenue from UIHC and other departments of the University for infusion therapy services provided by UICH. At December 31, 2012 and 2011, UICH had a receivable of \$63,040 and \$83,959, respectively, related to these services.

UICH has a subcontractor agreement with UIHC to obtain home infusion therapy staffing and products from UIHC. Expenses incurred under this agreement were \$312,602 and \$306,786 in 2012 and 2011, respectively. At December 31, 2012 and 2011, \$52,966 and \$52,832, respectively, was payable to UIHC under this agreement.

UICH purchases management services from a related party, CareResources. Expenses incurred for these services in 2012 and 2011 were \$40,209 and \$241,425, respectively. At December 31, 2012 and 2011, UICH owed \$9,743 and \$4,730, respectively, to CareResources related to these services. UICH incurred expenses of \$16,385 and \$25,181 in 2012 and 2011, respectively, for various services and supplies provided to UICH by CareResources. UICH received \$1,068 and \$1,788 in credit from CareResources in 2012 and 2011, respectively, due to purchases by UICH for CareResources where UICH could secure a greater discount.

At December 31, 2012 and 2011, UICMS maintained a restricted cash account and a corresponding liability in the amount of \$5,340,135 and \$4,997,732, respectively, related to these clinics.

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

Receivables from other affiliates were \$38,455 and \$22,356 at December 31, 2012 and 2011, respectively. Payables to other affiliates were \$24,587 and \$22,615 at December 31, 2012 and 2011, respectively.

At December 31, 2012 and 2011, UIHW maintained cash and corresponding liability in the amount of \$23,899 and \$22,995, respectively, for the University of Iowa behavioral health.

(8) 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. There is no estimated loss for claims that may be asserted and not covered by insurance at December 31, 2012. 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.

(9) Commitments

Certain property, equipment, and office space is being leased under long-term noncancelable operating leases. Rent expense under operating leases was \$1,678,919 for 2012 and \$1,647,440 for 2011. 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, 2012 are as follows:

| | |
|------------------------------|---------------------|
| Year ending December 31: | |
| 2013 | \$ 1,555,116 |
| 2014 | 1,393,621 |
| 2015 | 1,046,462 |
| 2016 | 703,557 |
| 2017 | 661,420 |
| Thereafter | <u>1,464,814</u> |
| Total minimum lease payments | <u>\$ 6,824,990</u> |

The System has agreements to lease physicians and/or physician assistants to clinics, which UICMS manages under contract. UICMS signed several noncancelable employment contracts with physicians and will be reimbursed by the clinics. Future commitments as of December 31, 2012 under these noncancelable leases are as follows:

| | |
|----------------------------|---------------------|
| Year ending December 31: | |
| 2013 | \$ 1,902,092 |
| 2014 | 656,960 |
| 2015 | <u>270,751</u> |
| Total noncancelable leases | <u>\$ 2,829,803</u> |

UNIVERSITY OF IOWA HEALTH SYSTEM AND SUBSIDIARIES

Notes to Consolidated Financial Statements

December 31, 2012 and 2011

(10) Subsequent Events

The System has evaluated subsequent events from the consolidated balance sheet date through July 31, 2013, the date the consolidated financial statements were available to be issued, and determined there are no other items to disclose.

