



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

Financial Statements

June 30, 2003 and 2002

(With Independent Auditors' Report Thereon)



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

## Independent Auditors' Report

The Board of Regents,  
State of Iowa:

We have audited the accompanying balance sheets of the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) as of June 30, 2003 and 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of UIHC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of UIHC are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the business-type activities of the State University of Iowa that is attributable to the transactions of UIHC. UIHC is treated as a department of the State University of Iowa for financial reporting purposes. They do not purport to, and do not, present fairly the financial position of the State University of Iowa as of June 30, 2003 and 2002, and the changes in its financial position and its cash flows, where applicable, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State University of Iowa, University of Iowa Hospitals and Clinics as of June 30, 2003 and 2002, and the changes in its net assets and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis is not a required part of the basic financial statements of UIHC but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

**KPMG LLP**

December 19, 2003



KPMG LLP, a U.S. limited liability partnership, is the U.S. member firm of KPMG International, a Swiss cooperative.

## INTRODUCTION

This section of the University of Iowa Hospitals and Clinics' (UIHC) annual financial report presents management's discussion and analysis of the UIHC's financial performance during the years ended June 30, 2003 and 2002. The purpose is to provide an objective analysis of the financial activities of the UIHC based on currently known facts, decisions, and conditions. Please read it in conjunction with the UIHC's financial statements and the notes to the financial statements.

### **Overview of the Financial Statements**

This annual report consists of two parts – management's discussion and analysis and the financial statements.

The basic financial statements (balance sheets, statements of revenues, expenses and changes in net assets, and statements of cash flows) present, on a comparative basis, the financial position of UIHC at June 30, 2003 and 2002 (the end of the fiscal year) and the results of their operations and their financial activities for each of the years then ended. These statements report information about UIHC using accounting methods similar to those used by private-sector companies. The balance sheets include all of the UIHC's assets and liabilities. The statements of revenues, expenses and changes in net assets, and statements of cash flows reflect each year's activities on the accrual basis of accounting, i.e., when services are provided or obligations are incurred, not when cash is received or paid. These statements report UIHC's net assets and how they have changed. Net assets (the difference between assets and liabilities) is one way to measure financial health or position. The statements of cash flows provide relevant information about each year's cash receipts and cash payments and classify them as to operating, non-capital financing capital and related financing and investing activities. The financial statements include notes that explain information in the financial statements and provide more detailed data.

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Management's Discussion and Analysis

June 30, 2003 and 2002

**Overall Financial Position and Operations**

The UIHC's total net assets increased 3.5% to \$766.4 million. Table 1 provides a summary of the UIHC's net assets for 2003 compared to 2002:

**TABLE 1**

University of Iowa Hospitals and Clinics  
Condensed Net Assets Information (In thousands)

	<u>2003</u>	<u>2002</u>	<u>Change</u>
<b>Assets:</b>			
Current assets	\$ 213,148	160,388	52,760
Assets whose use is limited	303,657	319,931	(16,274)
Other assets	4,037	4,153	(116)
Capital assets	<u>366,290</u>	<u>351,739</u>	<u>14,551</u>
Total assets	<u>\$ 887,132</u>	<u>836,211</u>	<u>50,921</u>
<b>Liabilities:</b>			
Current liabilities	\$ 79,061	77,040	2,021
Long-term liabilities	<u>41,713</u>	<u>18,664</u>	<u>23,049</u>
Total liabilities	<u>\$ 120,774</u>	<u>95,704</u>	<u>25,070</u>
<b>Net assets:</b>			
Unrestricted	\$ 138,317	84,526	53,791
Invested in capital assets, net of related debt	326,057	336,225	(10,168)
Restricted	<u>301,983</u>	<u>319,756</u>	<u>(17,773)</u>
Total net assets	<u>\$ 766,357</u>	<u>740,507</u>	<u>25,850</u>

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**Management's Discussion and Analysis**

June 30, 2003 and 2002

**Financial Ratios**

Financial ratios relevant to the UIHC are as follows:

<u>Ratio</u>	<u>2003</u>	<u>2002</u>
Current ratio	2.70	2.08
Days cash on hand	228.51	247.08
Days revenue in A/R	101.33	67.30
Debt service coverage	16.25	16.56
Debt to capitalization	5.1%	2.1%

The first two ratios in the table above (current ratio and days cash on hand) are common liquidity indicators. Both ratios reflect the liquidity position of UIHC.

The days' revenue in patient accounts receivables (A/R) is an indicator of how quickly UIHC, on average, collects its patient receivables. The 2003 days revenue in A/R is much higher than 2002 primarily due to the implementation of a new patient accounting software on March 1, 2003 that delayed the processing of claims for several months.

Debt service coverage measures total debt service coverage (interest plus principal) from the UIHC cash flow. Higher values for debt service coverage indicate better debt payment ability. Long-term debt to capitalization is the proportion of long-term debt divided by net assets (excluding restricted by donors). Higher values for this ratio imply a greater reliance on debt financing and less ability to carry additional debt.

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Management's Discussion and Analysis

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**Revenues and Expenses**

Table 2 shows the changes in revenues and expenses for 2003 compared to 2002.

**TABLE 2**  
**UNIVERSITY OF IOWA HOSPITALS AND CLINICS**  
Condensed Revenues, Expenses, and Changes in Net Assets Information  
(In thousands)

	<u>2003</u>	<u>2002</u>	<u>Change</u>
Net patient service revenue	\$ 517,210	493,596	23,614
State grants	43,001	44,556	(1,555)
Other revenue	34,016	29,567	4,449
Total revenue	<u>594,227</u>	<u>567,719</u>	<u>26,508</u>
Expenses:			
Salaries and wages	225,767	207,278	18,489
Fringe benefits	72,282	71,533	749
Supplies and general expenses	248,286	238,991	9,295
Depreciation	36,233	37,166	(933)
Total expenses	<u>582,568</u>	<u>554,968</u>	<u>27,600</u>
Operating income	11,659	12,751	(1,092)
Nonoperating revenues, expenses, gains and losses:			
Loss on disposal of capital assets	(4,724)	(2,233)	(2,491)
Gifts and bequests	3,852	3,488	364
Investment income	16,317	13,734	2,583
Interest expense	(118)	(475)	357
Net transfers out	(1,136)	(1,737)	601
Increase in net assets	<u>25,850</u>	<u>25,528</u>	<u>322</u>
Net assets end of year	<u>\$ 766,357</u>	<u>740,507</u>	

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**Net Patient Service Revenues**

Net patient service revenues increased from 2002 to 2003 by \$23.6 million or 4.8%. Gross patient charges increased 12.2% during the same period. During fiscal year 2003, the UIHC implemented a price increase, which was an effective 8.0% increase for the fiscal year. The remaining increase resulted from inpatient volume decreases of 0.5% and outpatient volume increases of 3.2%.

The UIHC obtains patient service payments from the federal government under the Medicare program, commercial insurance carriers, Wellmark BC/BS, the State of Iowa under the Medicaid program and from patients. Despite gross revenue changes of 12.2%, net patient service revenues increased only 4.8% reflecting the actual reimbursements from providers.

The following summary of patient service volume (as a percentage of gross UIHC revenues) was compiled from UIHC records:

	<u>2003</u>	<u>2002</u>
Medicare	30.0%	31.7%
Medicaid	13.7	12.7
Wellmark BCBS	23.8	22.7
Commercial and self-pay	25.7	26.2
Total before State indigent	93.2	93.3
State indigent care program	6.8	6.7
Total	<u>100.0%</u>	<u>100.0%</u>

The State of Iowa has made annual grants to the UIHC to care for certain uninsured or underinsured individuals as well as to provide psychiatric services and services to children with disabilities. This funding also helps to assure that a sufficient patient base exists at the UIHC to support health professions' education.

**Business Activity**

Some key business indicators are as follows:

	<u>2003</u>	<u>2002</u>	<u>Change</u>
Acute admissions	25,264	24,511	753
Acute inpatient days	177,252	179,992	(2,740)
Average length of stay (days)	7.02	7.34	(0.32)
Average daily census	486	493	(7)
Occupancy rate	76.2%	74.8%	1.4%
Births	1,450	1,439	11
Outpatient clinic visits	655,476	615,242	40,234
Inpatient major surgical procedures	9,603	9,128	475
Outpatient major surgical procedures	10,666	10,686	(20)

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Acute admissions increased 753 from 2002. Total patient days reflect a decrease of 2,740 days and a 4.4% decrease in the average length of stay. The overall case mix index, which is an overall measure of patient acuity, increased 2.6% from 1.5866 in 2002 to 1.6272 in 2003.

The UIHC's outpatient business recorded a 3.2% growth net of the overall price increase. Outpatient clinic visits were up 6.5% from 2002 and outpatient major surgical procedures decreased by 0.2%.

**Deductions from Revenue**

Contractual and other service adjustments, expressed as a percentage of gross revenues, were 36.7% for 2003 compared to 33.1% for 2002, an increase of 3.6 percentage points. The increase in contractual and other service adjustments is due partly to normal annual price increases offset in part by reduced reimbursement from Medicare and Medicaid and changes in negotiated payment rates from third-party insurers.

The State of Iowa requires UIHC to provide patient care to residents of Iowa under a state-supported indigent patient care program pursuant to Chapter 255 of the Code of Iowa. Services are provided to all eligible patients at reduced or no charges. Charity care is also provided to certain other patients in accordance with UIHC's charity care policy. Charity care to indigent patients under Chapter 255 increased from \$55.2 million in 2002 to \$64.1 million in 2003. Other indigent and charity patient care decreased from \$8.3 million in 2002 to \$7.6 million in 2003, as a result of a new patient access policy implemented in 2002 to limit the UIHC's exposure to patients without the ability to pay who reside outside the State of Iowa.

The provision for bad debts (a deduction from gross patient service revenue) increased \$4.4 million from \$24.3 million in 2002 to \$28.7 million in 2003.

**Other Revenue**

Other revenue increased \$4.4 million from \$29.6 million in 2002 to \$34.0 million in 2003. Included in other revenues are certain administrative services the UIHC provides to other units of the University, grants, and other miscellaneous revenues.

**Expenses**

Total expenses increased 5.0% from \$555.0 million in 2002 to \$582.6 million in 2003. The largest increases in expenses over 2002 levels are reflected in salaries and wages, fringe benefits, supplies and other general expenses.

**Salaries and Wages**

Total UIHC salaries and wages increased 8.9% over the prior year levels. In addition, included in the supplies and general expenses is an additional \$17.9 million in 2003 and \$17.5 million in 2002 for temporary agency staff. Temporary agency staff, primarily nurses, is being used because of the current shortages of professional nurses. UIHC has chosen to use temporary staff rather than close various inpatient units in order to maintain patient access to tertiary care. Initiatives to reduce the use and cost of temporary agencies include development of a master contract to better manage the cost, incentives for UIHC staff to work additional hours and several other recruitment initiatives to attract more hires.

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Full time equivalent employees (FTE's), including temporary staffing increased across the UIHC by 3.2% during 2003 (from 5,546 in 2002 to 5,721 in 2003).

**Employee Benefits**

Employee benefits, excluding the early retirement benefits, increased 8.5%. This increase was offset by a decrease in early retirement benefits due to the June 30, 2002 expiration date for eligible employees to elect to participate in the early retirement program. Overall, the UIHC benefits cost rose 1.0% in 2003 compared to 2002.

**Transactions with Related Parties**

The UIHC purchases certain administrative and supervisory services, utilities, and other general services from the University. These services are purchased at the approximate cost incurred by the servicing unit. For the years ended June 30, 2003 and 2002, UIHC expensed approximately \$69.7 million and \$68.3 million, respectively, for these administrative services, utilities, and other services and support requirements.

The UIHC also provides certain administrative services to units of the University particularly to the Roy J. and Lucille A. Carver College of Medicine (College of Medicine). These services include billing, collection, and other physician practice-related clinic overhead expenses. For the years ended June 30, 2003 and 2002, UIHC received revenue from these units of approximately \$22.9 million and \$20.0 million, respectively, for these services.

UIHC and the College of Medicine have formed a nonprofit corporation, University of Iowa Health System (UIHS), to enhance and support the educational missions of the UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multi-state network development activities. UIHC provided capitalization of UIHS through transfers of funds totaling \$0.7 million and \$0.8 million for the years ended June 30, 2003 and 2002, respectively. UIHC also transferred \$1.0 million per year to the University's College of Medicine in support of clinical programs for the years ended June 30, 2003 and 2002.

**Balance Sheets**

**Capital Assets**

Capital assets increased \$14.6 million in 2003 from \$351.7 million to \$366.3 million. This increase relates primarily to capital asset additions of \$57.5 million offset by \$41.0 million in depreciation, adjustments and loss on disposal of capital assets.

The major capital asset additions included:

- Implementation of the patient financing, admitting and scheduling information system, which was placed in service on March 1, 2003.
- Infrastructure improvements for data and voice networks, air handling systems and elevators.
- Office development for the Mental Health Clinical Research Center.
- Renovation of the Pharmacy drug storage and office support areas.

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- Neuroimaging laboratory relocation
- Continuing construction of the new \$39.6 million Center of Excellence in Image-Guided Radiation Therapy.
- Major equipment additions in 2003 consisted of radiology digital imaging and picture archiving systems, magnetic resonance imager, ultrasound equipment, anesthesia machines, patient monitor upgrades, ergonomic assistive devices, pathology automated specimen processing modules and patient beds.

**Estimated Net Settlements Due to Third-Party Payors**

Estimated net settlements due to third-party payors decreased \$2.2 million from 2002. The decrease in the liability was primarily related to three items: 1) A \$1.5 million reduction in the anticipated amounts due to Wellmark BCBS. 2) A \$0.8 reduction in the amount due from Medicare for anticipated settlement of open cost reports and 3) A \$1.7 reduction for partial settlement of a Medicare residency program appeal.

**Other Long Term Liabilities**

Other long-term liabilities include \$6.0 million for costs associated with an employee early retirement program. UIHC has accrued an estimated benefit liability for all employees electing to participate in the plan. The plan was terminated in 2002 and all eligible employees who were interested in participating in the plan were required to elect participation in 2002 and begin their early retirement by the end of 2003.

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**Management's Discussion and Analysis**

June 30, 2003 and 2002

**Fiscal Year 2004 Outlook**

The Board of Regents, State of Iowa, approved the 2004 operating budget at their June 2003 meeting. This budget was developed after a review of key volume indicators and market trends. The budget incorporated the UIHC's current strategic business plan as well as state economic factors such as estimated population growth and unemployment rates.

The budget provides for income from operations of \$21.1 million, a 3.0% operating margin. The excess revenues over expenses budget for 2004 is \$34.6 million, a 4.8% excess margin.

The UIHC may be impacted by the following factors:

- Homeland Security and its impact on the economy
- the related impact on state finances and the level of state support for the UIHC, i.e. state appropriations for the indigent care program
- potential changes in federal, state and commercial payer reimbursement for patient services

The UIHC's 2004 capital budget projects spending of \$105.1 million, which includes continuing construction of the new perinatal and obstetrical patient care units, and of the new \$39.6 million Center of Excellence in Image-Guided Radiation Therapy which will utilize state-of-the-art technology and advanced radiation treatment.

**Contacting the Corporation's Financial Management**

This financial report provides the citizens of Iowa, our patients, bondholders, and creditors with a general overview of the UIHC's finances and operations. If you have questions about this report, please contact Mr. Anthony DeFurio, Associate Director and Chief Financial Officer, University of Iowa Hospitals and Clinics, 200 Hawkins Drive, E139 GH, Iowa City, Iowa 52242-1009.

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Balance Sheets

June 30, 2003 and 2002

Assets	<u>2003</u>	<u>2002</u>
<b>Current assets:</b>		
Cash and cash equivalents (note 2)	\$ 5,958,854	5,963,168
Short-term investments (note 2)	24,571,782	17,077,104
Patient accounts receivable, less allowance for uncollectibles		
\$45,728,476 in 2003 and \$17,562,121 in 2002 (notes 8 and 12)	143,583,988	91,006,293
Accounts receivable managed for the College of Medicine (note 7)	11,506,621	18,997,823
Inventories	15,381,751	16,167,707
Other current assets	4,303,889	3,625,106
Assets limited as to use – required for current liabilities (note 2):		
Externally restricted	<u>7,841,115</u>	<u>7,550,634</u>
Total current assets	213,148,000	160,387,835
<b>Assets limited as to use (note 2):</b>		
Externally restricted	301,747,020	319,669,844
Internally restricted	1,910,101	261,556
Capital assets, net (note 3)	366,289,701	351,738,888
Other assets	<u>4,036,965</u>	<u>4,153,307</u>
	<u>\$ 887,131,787</u>	<u>836,211,430</u>
<b>Liabilities and Net Assets</b>		
<b>Current liabilities:</b>		
Long-term liabilities, current portion (note 4)	\$ 6,054,005	4,830,341
Accounts payable	27,561,804	23,503,142
Construction, property, and equipment payables	2,585,839	3,739,592
Accrued expenses:		
Payroll and employee benefits (note 5)	22,899,638	20,320,637
Interest	692,678	392,244
Estimated net settlements due to third-party payors (note 8)	2,512,705	4,723,963
Due to related parties (note 7)	<u>16,754,242</u>	<u>19,529,755</u>
Total current liabilities	79,060,911	77,039,674
Long-term liabilities, excluding current installments (note 4)	<u>41,713,459</u>	<u>18,664,750</u>
Total liabilities	120,774,370	95,704,424
<b>Commitments and contingencies (notes 3, 6, 7, and 13)</b>		
<b>Net assets:</b>		
Unrestricted	138,317,032	84,525,650
Invested in capital assets, net of related debt	326,056,826	336,224,676
Restricted by bond indentures (note 2)	291,445,437	310,364,877
Restricted by donors	<u>10,538,122</u>	<u>9,391,806</u>
Total net assets	<u>766,357,417</u>	<u>740,507,009</u>
Total liabilities and net assets	<u>\$ 887,131,787</u>	<u>836,211,433</u>

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,  
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Statements of Revenue, Expenses, and Changes in Net Assets  
Years ended June 30, 2003 and 2002

	<u>2003</u>	<u>2002</u>
Operating revenue:		
Net patient service revenue (notes 8 and 9)	\$ 517,210,367	493,596,013
State grants (note 10)	43,000,911	44,556,608
Other revenue (note 7)	34,016,147	29,566,770
Total revenue	<u>594,227,425</u>	<u>567,719,391</u>
Operating expenses (note 7):		
Salaries and wages	225,767,349	207,278,200
Fringe benefits	72,282,320	71,533,959
Supplies and general expenses	248,285,664	238,990,623
Depreciation	36,233,348	37,166,142
Total expenses	<u>582,568,681</u>	<u>554,968,924</u>
Operating income	11,658,744	12,750,467
Nonoperating revenue, expenses, gains, and losses:		
Loss on disposal of capital assets	(4,723,937)	(2,233,081)
Gifts and bequests	3,852,558	3,488,285
Investment income	16,316,605	13,733,966
Interest expense (note 3)	(117,565)	(475,055)
Net transfers out	(1,135,994)	(1,736,106)
Increase in net assets	25,850,411	25,528,476
Total net assets, beginning of year	<u>740,507,006</u>	<u>714,978,530</u>
Total net assets, end of year	<u>\$ 766,357,417</u>	<u>740,507,006</u>

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,  
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Statements of Cash Flows

Years ended June 30, 2003 and 2002

	2003	2002
<b>Cash flows from operating activities:</b>		
Cash received from patients and third-party payors	\$ 462,421,414	481,459,398
Cash from State grants	43,000,911	44,556,608
Other receipts	41,507,349	27,890,061
Cash paid to employees for salaries, wages, and fringe benefits	(295,916,958)	(273,506,890)
Cash paid to suppliers	(244,003,987)	(236,666,788)
Other cash receipts (payments)	(2,775,513)	1,908,641
Net cash provided by operating activities	4,233,216	45,641,030
<b>Cash flow from noncapital financing activities:</b>		
Transfers out	(2,897,679)	(1,866,369)
Transfers in	1,761,685	130,263
Net cash used in non-capital financing activities	(1,135,994)	(1,736,106)
<b>Cash flows from capital and related financing activities:</b>		
Capital expenditures	(50,843,701)	(41,561,930)
Proceeds from the sale of capital assets	306,355	64,600
Proceeds from the issuance of debt	25,000,000	—
Payments of debt	(5,185,168)	(3,144,852)
Interest paid on debt and capital lease	(1,037,805)	(957,861)
Gifts and bequests	3,852,558	3,488,285
Net cash used in capital and related financing activities	(27,907,761)	(42,111,758)
<b>Cash flows from investing activities:</b>		
Change in assets limited as to use	16,086,346	(15,747,296)
Change in short term investments	(7,728,077)	999,461
Interest on investments	16,447,956	15,315,334
Net cash provided by investing activities	24,806,225	567,499
Net increase (decrease) in cash and cash equivalents	(4,314)	2,360,665
Cash and cash equivalents at beginning of year	5,963,168	3,602,503
Cash and cash equivalents at end of year	\$ 5,958,854	5,963,168
<b>Reconciliation of operating income to net cash provided by operating activities:</b>		
Operating income	\$ 11,658,744	12,750,467
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation	36,233,348	37,166,142
Provision for bad debts	28,650,780	24,324,818
Change in assets and liabilities:		
Receivables	(73,737,273)	(27,736,702)
Inventories and other assets	223,515	(1,241,312)
Accounts payable	6,190,873	8,870,416
Due to related parties	(2,775,513)	1,908,641
Estimated net settlements due to third party payors	(2,211,258)	(10,401,440)
Net cash provided by operating activities	\$ 4,233,216	45,641,030
<b>Supplemental Disclosure of Cash Flow Information:</b>		
Capital lease obligation for equipment	\$ 5,000,000	—

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2003 and 2002

**(1) Summary of Significant Accounting Policies and Related Matters**

**(a) Reporting Entity**

For purposes of this report, the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) includes the health care units of the University of Iowa, which are generally referred to as the University Hospital, the Psychiatric Hospital, and the Center for Disabilities and Development. UIHC is part of the University of Iowa (the University), which is owned and operated by the State of Iowa under the supervision of the board of regents, State of Iowa (the Board) and is treated as a department for financial reporting purposes.

UIHC includes substantially all of the health care provider activities for patient care associated with the University other than the physician and dentist services and research activities provided by the faculties of the University's Colleges of Medicine and Dentistry. Student Health Services, Specialized Child Health Services outreach programs, and the University of Iowa Health System, a UIHC affiliate, are not included in this report.

UIHC is a comprehensive tertiary care referral center located in Iowa City, Iowa, offering a full range of clinical services in substantially all specialties and subspecialties of medicine and dentistry. UIHC serves as a resource for the state's primary and secondary health care providers. Patients are primarily from Iowa.

**(b) Basis of Presentation**

The financial statements of UIHC have been prepared in accordance with accounting principles generally accepted in the United States of America, which are applicable to health care proprietary funds of a governmental entity. Pursuant to Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that Use Proprietary Fund Accounting*, UIHC has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board, including those issued after November 30, 1989. Accordingly, the accounting policies of UIHC conform with the Audit and Accounting Guide, *Health Care Organizations*.

UIHC's financial statements are reported using the economic resources measurement focus and UIHC recognizes revenue and expenses on the accrual basis of accounting.

**(c) Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

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**(d) *Restricted Net Assets***

Restricted net assets are used to differentiate resources, the use of which is externally restricted by bond agreements and donors from resources of unrestricted net assets which are not restricted by external agreements or that arise as a result of the operations of UIHC.

**(e) *Cash and Investments***

Cash and investments of UIHC include specific investments and other cash and investments that are pooled with the cash and investments of the University and held in the name of the University. UIHC's share of pooled investments and income thereon are determined on a pro rata basis reflecting UIHC's amounts available for investment as compared to the amounts for the overall University.

Cash equivalents totaling \$5,958,854 and \$5,963,168 at June 30, 2003 and 2002, respectively, represent money market funds and other short-term investments which mature in three months or less from date of purchase.

Investments are recorded at fair value based on quoted market prices or dealer quotes. Unrestricted investment income and realized and unrealized gains and losses on investments are recorded as nonoperating income. Donor-restricted investment income is added to the appropriate restricted net assets balance.

**(f) *Assets Limited as to Use***

Externally restricted assets limited as to use include assets set aside in accordance with the requirements of bond resolutions and donors. Internally restricted assets limited as to use are assets set aside by the Board for future capital projects and equipment acquisitions, over which the Board retains control and, at its discretion, may use for other purposes within UIHC.

**(g) *Inventories***

Inventories consist primarily of medical and surgical, pharmaceutical, dietary, and other supplies. Inventories are stated at the lower of cost or market, with cost determined on the first-in, first-out or weighted average basis.

**(h) *Capital Assets***

Capital assets are stated at cost less accumulated depreciation. Donated capital assets are recorded at fair value at date of receipt. Capital assets transferred from other units of the University are transferred at cost less accumulated depreciation at date of transfer. Depreciation is provided on the straight-line method over the estimated useful lives of the assets in accordance with guidelines set forth by the American Hospital Association; generally 40 years for buildings; 5 to 25 years for renovations, remodeling, infrastructure, and land improvements; and 5 to 20 years for equipment.

**(i) *Statements of Revenues, Expenses, and Changes in Net Assets***

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as operating revenues and expenses. Peripheral or incidental transactions are reported as nonoperating revenues, expenses, gains, and losses.

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**(j) Net Patient Service Revenue**

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Retroactive adjustments under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

**(k) Charity Care**

Care is provided without charge or at amounts less than established rates to patients who meet certain criteria under UIHC's charity care policy. Due to the timing of the services rendered and the related determination of charity care, UIHC estimates charity care as part of its ongoing operations. Since UIHC does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue and patient accounts receivable in the accompanying financial statements.

**(l) Employee Benefits**

UIHC employees accumulate vacation and sick leave under the provisions of the Code of Iowa. Under the state's policy, accrued vacation benefits are paid at an employee's regular hourly rate when used or are paid upon retirement, death, or termination with certain exceptions. Sick leave is paid in a similar manner when used or to a maximum of \$2,000 upon retirement. These benefits are accrued in the financial statements as earned by UIHC employees.

Retirement benefits are provided to employees primarily through a defined contribution retirement plan. UIHC funds its obligation to the retirement plan on a current basis, as earned by its employees.

**(m) Income Taxes**

UIHC, as part of the University, is exempt from federal income taxes, pursuant to Section 115 of the Internal Revenue Code. As such, UIHC is subject to income taxes only on unrelated business income under the provisions of Section 511 of the Internal Revenue Code.

**(n) Reclassifications**

Certain amounts included in the 2002 financial statements have been reclassified to conform to the 2003 presentation.

**(2) Cash and Investments**

In accordance with the Code of Iowa, investments may consist of obligations of the following: U.S. government and its agencies; certificates of deposit; prime bankers' acceptances; commercial paper; repurchase agreements; investments authorized by the Iowa Public Employees' Retirement System (IPERS) in Section 97B.7 of the Code of Iowa; an open-end management investment company organized in trust form registered with the Securities and Exchange Commission under the Investment Company Act of 1940; and the Common Fund for Nonprofit Corporations.

UIHC's cash and investments include specific investments and amounts pooled with cash and investments of the University and held in the University's name. UIHC's cash deposits at June 30, 2003 and 2002 were

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entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. Chapter 12C provides for additional assessments against the depositories of the pool to ensure there will be no loss of public funds.

The fair value of UIHC's cash and investments at June 30, 2003 and 2002 are included in the accompanying balance sheets as follows:

	<u>2003</u>	<u>2002</u>
Cash and cash equivalents	\$ 5,958,854	5,963,168
Short-term investments	24,571,782	17,077,104
Assets limited as to use – required for current liabilities	7,841,115	7,550,634
Assets limited as to use	<u>303,657,121</u>	<u>319,931,400</u>
	<u>\$ 342,028,872</u>	<u>350,522,306</u>

Assets limited as to use by bond resolutions or by the Board were held for the following purposes at June 30, 2003 and 2002:

	<u>2003</u>	<u>2002</u>
Limited by bond resolutions:		
Debt service reserve	\$ 5,749,995	14,124,175
Debt retirement and interest sinking funds	1,142,413	3,868,016
Surplus	89,864	174,405
Improvement, extension, and repair and operation and maintenance funds	292,304,280	299,748,915
Limited by Board of Regents:		
Capital projects and equipment and other needs	1,910,101	261,556
Restricted by donors	<u>10,301,583</u>	<u>9,304,967</u>
	311,498,236	327,482,034
Less amounts required for current liabilities	<u>7,841,115</u>	<u>7,550,634</u>
	<u>\$ 303,657,121</u>	<u>319,931,400</u>

Funds for improvement, extension, and repair and operation and maintenance shall be used to pay costs of operating and maintaining the hospital system whenever other funds are not sufficient and for improvements, extensions, and repairs. Assets limited as to use include designated assets set aside by the Board for future facility infrastructure improvements, equipment, and technological needs, over which UIHC retains control and may at its discretion subsequently authorize its use for other purposes. The funds are invested in investment-grade long-term fixed income and in certain high quality equities.

The University's investments are categorized to give an indication of the risk. The categories are: (1) insured or registered in the University's name or securities held by the University or its agent in the University's name; (2) uninsured and unregistered securities held by the counterparty's trust department or

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agent in the University's name; and (3) uninsured and unregistered securities held by the counterparty or by its trust department or agent but not in the University's name.

Fair values of UIHC's portion of the University's cash and investments at June 30, 2003 and 2002 were as follows:

	<b>2003</b>			<b>Total fair value</b>
	<b>Category 1</b>	<b>Category 2</b>	<b>Category 3</b>	
U.S. government securities	\$ 124,864	130,964,118	—	131,088,982
Corporate bonds	—	4,420,183	—	4,420,183
Equity securities	—	23,155,101	—	23,155,101
Mutual funds				95,885,712
Money market funds				86,730,121
Cash				35,000
Interest receivable				713,773
				<u>\$ 342,028,872</u>

	<b>2002</b>			<b>Total fair value</b>
	<b>Category 1</b>	<b>Category 2</b>	<b>Category 3</b>	
U.S. government securities	\$ 220,532	176,284,954	—	176,505,486
Corporate bonds	—	20,782,313	—	20,782,313
Equity securities	—	20,797,024	—	20,797,024
Mutual fund				54,876,430
Money market funds				76,184,463
Cash				35,000
Interest receivable				1,341,590
				<u>\$ 350,522,306</u>

**(3) Capital Assets**

Capital assets at June 30, 2003 and 2002 are summarized as follows:

	<b>2003</b>	<b>2002</b>
Land improvements	\$ 7,089,207	7,089,207
Buildings	484,675,281	468,824,315
Equipment	220,033,694	203,440,483
Construction in progress	25,161,261	22,426,374
	<u>736,959,443</u>	<u>701,780,379</u>
Less accumulated depreciation	<u>370,669,742</u>	<u>350,041,491</u>
	<u>\$ 366,289,701</u>	<u>351,738,888</u>

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Capital assets activity for the years ended June 30, 2003 and 2002 was as follows:

<u>Cost basis summary</u>	<u>Land improvements</u>	<u>Buildings and leasehold improvements</u>	<u>Equipment</u>	<u>Construction in progress</u>	<u>Total</u>
June 30, 2001 balance	\$ 7,089,207	463,696,701	194,998,866	9,194,903	674,979,677
Acquisitions	—	10,481,499	18,668,807	13,231,471	42,381,777
Sales and retirements	—	(5,353,885)	(10,227,190)	—	(15,581,075)
June 30, 2002 balances	7,089,207	468,824,315	203,440,483	22,426,374	701,780,379
Acquisitions	—	15,850,966	38,949,937	2,734,887	57,535,790
Sales and retirements	—	—	(22,356,726)	—	(22,356,726)
June 30, 2003 balances	<u>\$ 7,089,207</u>	<u>484,675,281</u>	<u>220,033,694</u>	<u>25,161,261</u>	<u>736,959,443</u>

Related information on accumulated depreciation for the years ended June 30, 2003 and 2002 was as follows:

<u>Accumulated depreciation summary</u>	<u>Land improvements</u>	<u>Buildings and leasehold improvements</u>	<u>Equipment</u>	<u>Total</u>
June 30, 2001 balance	\$ 4,368,723	204,617,700	116,570,864	325,557,287
Depreciation expense	246,035	19,479,139	17,440,968	37,166,142
Sales and retirements	—	(4,093,502)	(8,588,436)	(12,681,938)
June 30, 2002 balances	4,614,758	220,003,337	125,423,396	350,041,491
Depreciation expense	256,896	20,043,889	15,932,563	36,233,348
Sales and retirements	—	—	(15,605,097)	(15,605,097)
June 30, 2003 balances	<u>\$ 4,871,654</u>	<u>240,047,226</u>	<u>125,750,862</u>	<u>370,669,742</u>

At June 30, 2003, construction in progress related to various projects throughout the UIHC. The estimated cost to complete the current phase of equipment and projects under construction at June 30, 2003 is \$55.2 million. Other projects at June 30, 2003, with an estimated cost of \$233.4 million, have been committed to by the Board and/or UIHC; however, construction contracts had not been signed as of such date.

Cost of capital assets includes interest during the construction period for qualifying projects. Interest costs capitalized for the years ended June 30, 2003 and 2002 were \$1,124,505 and \$401,675, respectively.

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**(4) Long-term Liabilities**

Long-term liabilities outstanding at June 30, 2003 and 2002 was as follows:

	<u>2003</u>	<u>2002</u>
Hospital Revenue Bonds:		
Series 1973 – 4.50% to 5.90%; maturing serially on September 1 through 2003	\$ 715,000	1,350,000
Series 1978 – 6.10% to 6.20%; maturing serially on September 1 through 2003	1,070,000	2,000,000
Series 1980 – 8.00% to 9.00%; matured September 1, 2000 but unredeemed	75,000	100,000
Series 1983 – 7.20%, maturing serially on September 1 through 2003	1,050,000	2,020,000
Series 2002 - 4.125% to 5.00%; maturing serially on September 1, 2004 through 2028	25,000,000	—
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 1995 – 4.35% to 5.10%; maturing serially on July 1 through 2011	3,408,630	3,702,688
Series S.U.I. 2000 – 4.40% to 5.40%; maturing serially on July 1 through 2015	6,089,040	6,420,150
Net unamortized discount on Telecommunications Facilities Revenue Bonds and Hospital Revenue Bonds	(174,795)	(78,626)
Capital lease obligation	3,000,000	—
Other long-term liabilities:		
Early retirement benefits payable	7,534,589	7,980,879
	<u>47,767,464</u>	<u>23,495,091</u>
Long-term liabilities - current portion	<u>6,054,005</u>	<u>4,830,341</u>
	<u>\$ 41,713,459</u>	<u>18,664,750</u>

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Activity in long-term liabilities for the years ended June 30, 2003 and 2002 were as follows:

	June 30, 2002			June 30, 2003	Amounts due within 1 year
	balance	Additions	Reductions	balance	
Hospital Revenue Bonds, Series 1973	\$ 1,350,000		(635,000)	715,000	715,000
Hospital Revenue Bonds, Series 1978	2,000,000		(930,000)	1,070,000	1,070,000
Hospital Revenue Bonds, Series 1980	100,000		(25,000)	75,000	75,000
Hospital Revenue Bonds, Series 1983	2,020,000		(970,000)	1,050,000	1,050,000
Hospital Revenue Bonds, Series 2002	—	25,000,000	—	25,000,000	—
Telecommunications Facilities Revenue Bonds, 1995	3,702,688		(294,058)	3,408,630	306,630
Telecommunications Facilities Revenue Bonds, 2000	6,420,150		(331,110)	6,089,040	345,968
Net unamortized bond discount	(78,626)	(109,901)	13,732	(174,795)	—
Total long-term debt	15,514,212	24,890,099	(3,171,436)	37,232,875	3,562,598
Capital lease obligation	—	5,000,000	(2,000,000)	3,000,000	1,000,000
Other long-term liabilities:					
Early retirement benefits payable	7,980,879	1,218,641	(1,664,931)	7,534,589	1,491,407
\$	<u>23,495,091</u>	<u>31,108,740</u>	<u>(6,836,367)</u>	<u>47,767,464</u>	<u>6,054,005</u>
	June 30, 2001			June 30, 2002	Amounts due within 1 year
	balance	Additions	Reductions	balance	
Hospital Revenue Bonds, Series 1973	\$ 1,945,000	—	(595,000)	1,350,000	675,000
Hospital Revenue Bonds, Series 1978	2,915,000	—	(915,000)	2,000,000	1,000,000
Hospital Revenue Bonds, Series 1980	135,000	—	(35,000)	100,000	100,000
Hospital Revenue Bonds, Series 1983	3,020,000	—	(1,000,000)	2,020,000	1,020,000
Telecommunications Facilities Revenue Bonds, 1995	3,984,165	—	(281,477)	3,702,688	292,688
Telecommunications Facilities Revenue Bonds, 2000	6,738,525	—	(318,375)	6,420,150	331,110
Net unamortized bond discount	(90,784)	—	12,158	(78,626)	—
Total long-term debt	18,646,906	—	(3,132,694)	15,514,212	3,418,798
Other long-term liabilities:					
Early retirement benefits payable	2,003,633	7,459,057	(1,481,811)	7,980,879	1,411,543
\$	<u>20,650,539</u>	<u>7,459,057</u>	<u>(4,614,505)</u>	<u>23,495,091</u>	<u>4,830,341</u>

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The Hospital Revenue Bonds resolutions relate solely to University Hospital. University Hospital is required to maintain certain special trust funds into which revenues (excluding state grants) are deposited to first secure the payments of the bonds and then, in respective order: payment of bond sinking fund, reserve fund, and improvement fund requirements, as well as operating fund expense, capital expense, and other needs of the University Hospital. Any remaining funds are required to be retained for future support of University Hospital. Monthly payments are required to be made to various sinking funds for payment of principal, interest, and bond reserve and improvement funds. The reserve fund requirement for the Hospital Revenue Bonds issued in December 2002 is \$1,753,500. The reserve fund requirement for Hospital Revenue Bonds issued prior to December 2002 is \$2,849,000. The reserve fund requirement is equal to the maximum annual amount of the principal and interest coming due on the bonds and any parity bonds.

The Telecommunications Facilities Revenue Bonds (Telecommunications Bonds) represent UIHC's share of the remaining outstanding bonds that were issued by the State University of Iowa to pay costs of constructing and installing communications facilities and equipment on the University campus. Monthly payments are required to be made to various sinking funds for payment of principal and interest. A portion of the monthly payments are supported by UIHC.

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

	<u>Principal</u>	<u>Interest</u>
Year ending June 30:		
2004	\$ 3,562,598	1,711,153
2005	1,242,824	1,570,326
2006	1,295,805	1,514,442
2007	1,359,785	1,455,244
2008	1,425,010	1,392,289
2009 through 2013	7,751,283	5,894,937
2014 through 2018	6,270,365	4,226,298
2019 through 2023	5,635,000	2,924,475
2024 through 2028	7,195,000	1,352,625
2029	1,670,000	41,750
	<u>\$ 37,407,670</u>	<u>22,083,539</u>

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***Capital Lease Obligation:***

Capital lease outstanding at June 30, 2003 is as follows:

<u>Capital Lease</u>	<u>Amount Payable</u>
PET/CT Scanner and Conventional PET Scanner.	\$3,000,000

The following is a schedule by year of future minimum payments required:

Year ending June 30:	
2004	\$ 1,000,000
2005	1,000,000
2006	<u>1,000,000</u>
Total minimum payments required	<u><u>\$ 3,000,000</u></u>

***Other long-term liabilities – early retirement benefits payable***

Subject to the approval of the director and chief executive officer of UIHC, an eligible employee may elect to receive early retirement incentives. The early retirement program generally provides certain life insurance and health care benefits until the employee reaches age sixty-five. Retirees may continue participation after age sixty-five at their own cost. Eligible employees include faculty, professional – scientific employees and merit system employees who have been employed by the Board for at least fifteen years and are between fifty-seven and sixty-three years old. Benefits under the early retirement plan are internally accounted for in the University’s benefits pool and are paid by UIHC through the annual assessment paid to the pool. The plan was terminated in 2002 and all eligible employees who were interested in participating in the plan were required to elect participation in 2002. UIHC accrues an estimated benefit liability when an employee elects to participate in the Plan, and at June 30, 2003 and 2002, UIHC has accrued \$7,534,589 and \$7,980,879 for these benefits.

**(5) Retirement Benefit Plans**

Substantially all UIHC employees meeting eligibility requirements participate in the University of Iowa Retirement Plan (the Plan). The Plan is a defined contribution retirement plan providing benefits through the Teachers Insurance and Annuity Association and the College Retirement Equity Fund (TIAA-CREF). UIHC contributions to the Plan are 10% of employee compensation after the first five years of employment. During the first five years of employment, UIHC’s contribution is 6.67% of the first \$4,800 of compensation and 10% of the balance of employee compensation. Employees are required to contribute an amount equal to 50% of UIHC’s contribution. All contributions to the Plan are immediately 100% vested.

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Eligible employees not electing to participate in the Plan are required to participate in the Iowa Public Employees' Retirement System (IPERS), a multiple employer, cost-sharing public employees' retirement system.

The University internally accounts for employee benefits using a benefits pool. Each department, including UIHC, is assessed a total amount to be paid into the pool covering all employee benefits, of which management estimates approximately \$19.0 and \$17.4 million was for contributions to TIAA-CREF and IPERS in 2003 and 2002 respectively.

**(6) Risk Management**

The University, or the State of Iowa on behalf of UIHC, self-insures workers' compensation, unemployment, medical, and dental benefits for eligible employees, automobile, professional and general liability. UIHC pays the employer portion of the costs related to workers' compensation, unemployment, and medical and dental benefits. UIHC purchases commercial property insurance for its facilities including business interruption insurance. UIHC also purchases commercial life and disability insurance for eligible employees.

The health insurance liability, which is included in accrued payroll and employee benefits, is approximately \$3,422,000 and \$4,453,000 as of June 30, 2003 and 2002 respectively.

	<u>2003</u>	<u>2002</u>
Liability for unpaid health care claims at beginning of year	\$ 4,453,000	3,243,000
Health care expenses incurred during the year	17,641,730	20,575,522
Health care payments to the University during the year	<u>(18,672,730)</u>	<u>(19,365,522)</u>
Liability for unpaid health care claims at end of year	<u>\$ 3,422,000</u>	<u>4,453,000</u>

Board institutions cooperatively self-insure for automobile liability up to \$250,000. Losses in excess of \$250,000 are self-insured by the State of Iowa.

The State Appeals Board, subject to the advice and approval of the Attorney General, is authorized to settle tort claims against the State of Iowa as set forth in Chapter 669 of the Code of Iowa. Tort liability claims settled in excess of \$5,000 must have the unanimous approval of all the members of the Appeals Board, the State Attorney General, and the District Court of the State of Iowa for Polk County. By interagency agreement, tort liability claims (including professional liability) under \$4,000 may be administered by the University, subject to a maximum expenditure of \$100,000 per year. All other tort claims are paid from the State of Iowa's general fund.

The State maintains an employee fidelity bond where the first \$100,000 in losses are the responsibility of UIHC. Losses in excess of the \$100,000 deductible are insured up to \$10,000,000. Coverage extends to all UIHC employees.

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**(7) Transactions With Related Parties**

The UIHC receives certain administrative services, utilities, and other general services from the University. The services and support costs include amounts due to the University's College of Medicine for support of graduate medical education, specific clinical services, and other services. These services are charged to UIHC at the approximate cost incurred by the servicing unit. For the years ended June 30, 2003 and 2002, UIHC expensed approximately \$69.7 million and \$68.3 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2003 and 2002, approximately \$5,247,621 and \$531,932, respectively, were due to the University for services and support.

The UIHC also provides certain administrative services to units of the University. These services include billing, collection, and other physician practice-related clinic overhead expenses. These services are charged to units of the University at the approximate cost incurred by the servicing unit. For the years ended June 30, 2003 and 2002, UIHC received revenue from these units of approximately \$22.9 million and \$20.0 million, respectively, for these services.

UIHC and the College of Medicine have formed a nonprofit corporation, University of Iowa Health System (UIHS), to enhance and support the educational missions of the UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multi-state network development activities. UIHC provided capitalization of UIHS through transfers of funds totaling \$0.7 million and \$0.8 million for the years ended June 30, 2003 and 2002, respectively. The UIHC has committed to additional funding of UIHS, as needed, of approximately \$6.8 million, to be used primarily for community practice development. Additionally, UIHC paid UIHS for certain administrative and other general services in the amount of \$0.2 million for the year ended June 30, 2003. UIHC also transferred \$1.0 million per year to the University's College of Medicine in support of clinical programs for the years ended June 30, 2003 and June 30, 2002, respectively.

On March 1, 2003, a subsidiary of UIHS sold certain assets of 6 of its clinics to UIHC for \$946,128. \$121,900 was paid at the closing date, and the subsidiary and UIHC executed a promissory note for \$824,228. The note is payable monthly through June 2003 with interest at 4.25%. The subsidiary and UIHC also executed a management service and affiliation agreement on March 1, 2003, under which the subsidiary will provide certain management, supervisory and administrative services to the clinics after the sale. In consideration for the costs and expenses in fulfilling the subsidiary's obligations under the agreement, UIHC will pay the subsidiary on a monthly basis a management fee equal to the amount necessary to operate the subsidiary and deliver services to the clinics. The term of the agreement is for one year, with the agreement automatically renewing for successive terms of one year unless either party gives notice to terminate.

The Faculty Practice Plan (the Plan) is a clinical component of the University's College of Medicine. The UIHC performs billing and collection services for the Plan. At June 30, 2003 and 2002, accounts receivable outstanding for the Plan was \$11,506,621 and \$18,997,823, respectively. These amounts are also included in due to related parties at June 30, 2003 and 2002.

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**(8) Net Patient Service Revenue**

UIHC provides health care services through its inpatient and outpatient care facilities. UIHC payment terms are cash at the time of service; however, if necessary, it will make periodic payment arrangements with patients generally without requiring collateral or other securities. UIHC 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 (i.e., Medicare, Medicaid, Wellmark Blue Cross, health maintenance organizations, and commercial insurance policies). A significant portion of net patient service revenue relates to patients covered by these third-party payors. Significant changes have been made and may be made in certain of these programs which could have a material adverse impact on the financial condition of UIHC. These changes include federal and state laws and regulations, particularly those pertaining to Medicare and Medicaid.

UIHC has agreements with certain of these third-party payors that provide for payment of services at amounts different from established rates. The basis for payment from third-party payors varies by payor and includes established charges, prospectively determined rates per discharge, contracted rates less than established charges, and retroactively determined cost-based rates. Approximately 56% and 60% of gross patient revenue determined at established rates for the years ended June 30, 2003 and 2002, respectively, resulted from patients covered by Medicare, Medicaid, Wellmark Blue Cross, other commercial payors and self-pay.

The following summarizes the differences between gross patient service revenue determined at established rates and net patient service revenue for the years ended June 30, 2003 and 2002:

	2003		2002	
	Amount	Percent	Amount	Percent
Patient service revenue at established rates	\$ 975,875,094	100%	\$ 869,612,477	100%
Less:				
Charity care revenue foregone (note 9)	71,672,820	7%	63,448,555	7%
Contractual and bad debt allowances	386,991,907	40%	312,567,909	36%
Net patient service revenue	<u>\$ 517,210,367</u>	<u>53%</u>	<u>\$ 493,596,013</u>	<u>57%</u>

Amounts due from and to third-party payors represent settlement amounts due from and to Medicare, Medicaid, Wellmark Blue Cross, and other programs based upon the application of reimbursement formulas, applicable law, regulations, and program instructions. UIHC has not finalized settlement with certain of these payors for the years ended June 30, 2000 through 2003 and therefore, has recorded estimated settlements as of June 30, 2003. Additionally, as a result of Medicare reimbursement issues related primarily to medical education, UIHC has not finalized settlements for these specific issues with

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Medicare and Medicaid for the years ended June 30, 1985 through 2003. UIHC has appealed certain issues which could provide approximately \$2.5 million additional revenue to UIHC if the appeals are successful. Management intends to vigorously contest the issues; however, the final outcome is not currently determinable. Therefore, the additional revenues have not been recorded.

**(9) Charity Care**

The State of Iowa requires UIHC to provide patient care to residents of Iowa under a state-supported indigent patient care program. Services are provided to all eligible patients at reduced or no costs. Charity care is also provided to certain other patients in accordance with UIHC's charity care policy.

Charity care for the years ended June 30, 2003 and 2002 at established hospital rates is summarized as follows:

	2003	2002
Indigent patient care	\$ 66,594,847	\$ 58,562,548
Other charity patient care	5,077,973	4,886,007
Total gross revenue foregone	\$ 71,672,820	\$ 63,448,555

**(10) State Grants**

State grants are received annually to provide acute patient care, psychiatric, and developmental patient care services to patients. Patients are referred from a variety of sources such as their home county, state institutions, and school districts. For the years ended June 30, 2003 and 2002, grants received from the State of Iowa were \$43,000,911 and \$44,556,608, respectively.

UIHC also receives supplemental disproportionate share and indirect medical education patient care reimbursement allowances from the State of Iowa's Medicaid program. UIHC is obligated to transfer funds to the State of Iowa to the extent of these supplemental receipts. For the years ended June 30, 2003 and 2002, UIHC received \$48,652,792 and \$46,483,562, respectively, in supplemental receipts and paid the same amount to the State of Iowa. These amounts have been excluded from revenues and expenses in the accompanying financial statements.

**(11) Disclosures About the Fair Value of Financial Instruments**

Financial instruments are described as cash, contractual obligations, or rights to pay or receive cash. The fair value for certain financial instruments approximates the carrying value because of the short-term maturity of those instruments, which include receivables, accounts payable, accrued liabilities, estimated net settlements to third-party payors, and other current liabilities.

Investments are recorded at fair value. The estimated fair value of the long-term debt was calculated by discounting future cash flows using borrowing rates currently available for debt of similar maturity. Carrying amount and estimated fair value of long-term debt at June 30, 2003 were \$37,232,875 and \$44,393,604, respectively, and at June 30, 2002 were \$15,514,212 and \$16,505,159, respectively. Other assets and obligations are insignificant, and carrying amounts are assumed to approximate fair value.

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Fair value estimates are made at a specific point in time based on relevant market information. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

**(12) Concentrations of Credit Risk**

UIHC grants credit without collateral to its patients, most of whom are Iowa residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2003 and 2002 was as follows:

	2003	2002
Commercial pay	16%	22%
Medicare	32	28
Self-Pay and other	12	16
Medicaid	13	12
Blue Cross/Blue Shield	19	17
Other	8	5
	100%	100%

**(13) Operating Leases**

UIHC uses certain capital assets under noncancelable operating leases. In most cases, management expects that, in the normal course of operations, the leases will be renewed or replaced by other leases. Total rent expense under operating leases for the years ended June 30, 2003 and 2002 was \$4,328,751 and \$3,923,864, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2003:

	Year ending June 30:	
	2004	\$ 1,383,177
	2005	1,353,072
	2006	1,353,072
	Total minimum payments required	\$ 4,089,321