

Contact: Patrice Sayre

AUDIT OF UIHC

Action Requested: Receive and discuss the external audit report for the University of Iowa Hospitals and Clinics (UIHC) for the years ended June 30, 2008, and June 30, 2007.

Executive Summary: The UIHC report (attached) includes the audit of the basic financial statements on an accrual basis for the fiscal years ended June 30, 2008, and June 30, 2007, as conducted by KPMG LLP, an independent auditing firm, and management's discussion and analysis of the financial activities of UIHC based on currently known facts, decisions, and conditions. (This section is to be read in conjunction with the UIHC audited financial statements and notes to the financial statements.)

For reporting purposes, UIHC includes the following University of Iowa health care units: (1) University Hospital; (2) Psychiatric Hospital; and (3) Center for Disabilities and Development.

The audit indicated that the financial statements present fairly, in all material respects, the financial position of UIHC as of June 30, 2008, and June 30, 2007, and the changes in its net assets and its cash flows for the years then ended. No significant audit adjustments were reported.

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

Additional Information: Annual audited financial statements of the UIHC are required by the Regent Policy Manual §7.09 and by bond covenants.

KPMG LLP conducted the UIHC audit for the fiscal years ended June 30, 2008, and June 30, 2007, in accordance with auditing standards generally accepted in the United States.

UIHC financial statements include substantially all of the health care provider activities for patient care associated with the University other than the physician and dentist services and research activities, which are provided by the faculties of the University's Colleges of Medicine and Dentistry. 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.

The financial statements were prepared in accordance with governmental accounting principles generally accepted in the United States. UIHC uses enterprise fund accounting and recognizes revenue and expenses on the accrual basis of accounting using the economic resources measurement focus.

- ◆ As of June 30, 2008, net assets totaled \$979.8 million, which represent an increase of \$31.6 million (3.3%) over the \$948.2 million from the prior year. A significant component of the change in UIHC's assets is due to the construction or purchase of capital assets totaling \$80.7 million and \$90.8 million during 2008 and 2007, respectively.
- ◆ For FY 2008, operating revenues were \$871.2 million and operating expenses were \$852.4 million, for an operating income of \$18.8 million (2.2% of operating revenues). The increases in net patient service revenue were driven by increased patient volumes and pricing. The largest increases in expenses are attributed to salaries and benefits; medical supplies and drugs; and depreciation.
- ◆ Non-operating revenues, expenses, gains, and losses netted \$12.9 million, which included investment income of \$13.8 million.
- ◆ The majority of long-term debt is from the issuance of hospital revenue bonds totaling \$78.9 million and \$29.9 million as of June 30, 2008, and 2007, respectively; UIHC issued \$50 million in revenue bonds during 2008. These bonds are payable solely out of UIHC income.

Related Part Transactions

- ◆ The UIHC purchases certain administrative services, utilities, and other general services from the University. These services are purchased at the approximate cost incurred by the University. For the years ended June 30, 2008, and June 30, 2007, UIHC expensed approximately \$105.2 million and \$98.8 million, respectively, for these services.
- ◆ The UIHC also provides certain administrative services to units of the University. These services include billing, collection, and other physician practice-related clinic overhead expenses. For FY 2008 and FY 2007, the UIHC received revenue of approximately \$28.9 million and \$27.7 million, respectively, for these services.

UIHC and the University's College of Medicine formed a nonprofit corporation, University of Iowa Health System (UIHS), to enhance and support the educational missions of the UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide / multi-state network development activities.

- ◆ UIHC supported clinical programs of the University's College of Medicine through transfers of funds of \$1.2 million and \$0.8 million for the years ended June 30, 2008 and June 30, 2007, respectively.

Revenue from Medicare and Medicaid programs accounted for approximately 23% and 13%, respectively, of UIHC's net patient revenue for the year ended 2008 as well as for the year ended 2007. A reasonable possibility exists that recorded estimates will change by a material amount in the near term due to interpretation of the complex laws and regulations governing the Medicare and Medicaid programs.

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

	2008	2007
Indigent patient care	\$177.2 million	\$148.7 million
Other charity care	\$10.9 million	\$16.3 million

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

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

Bonds Issued Subsequent to FY 2008

In December 2008, the Board approved \$33,750,000 of SUI Hospital Revenue Bonds for the purpose of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient facilities and patient care facilities, and mechanical and other supporting facilities at UIHC including, without limitation, the Ambulatory Surgery Center expansion and the Emergency Treatment Center expansion.



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

Financial Statements

June 30, 2008 and 2007

(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, 2008 and 2007, 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of UIHC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

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 a department of the State University of Iowa for financial reporting purposes. The financial statements of UIHC do not purport to, and do not, present fairly the financial position of the State University of Iowa as of June 30, 2008 and 2007, and the changes in its financial position and its cash flows, where applicable, for the years then ended, in conformity with U.S. generally accepted accounting principles.

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, 2008 and 2007, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

As described in note 1, in 2008 UIHC adopted the provisions of Governmental Accounting Standards Board Statement No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*, and Governmental Accounting Standards Board Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*.

The accompanying management's discussion and analysis on pages 3 through 8 is not a required part of the basic financial statements of UIHC, but is supplementary information required by the Governmental Accounting Standards Board. 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

Des Moines, Iowa
December 19, 2008

**STATE UNIVERSITY OF IOWA,
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Management's Discussion and Analysis

June 30, 2008 and 2007

This section of the State University of Iowa, University of Iowa Hospitals and Clinics' (UIHC) annual financial report presents management's discussion and analysis of UIHC's financial performance during the years ended June 30, 2008 and 2007. The purpose is to provide an objective analysis of the financial activities of UIHC based on currently known facts, decisions, and conditions. Please read it in conjunction with UIHC's financial statements and the accompanying notes to the financial statements.

Overview of the Financial Statements

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

The 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, 2008 and 2007 (the end of the fiscal year), and the results of its operations and its 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 UIHC's assets and liabilities. The statements of revenues, expenses, and changes in net assets 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 operating, noncapital 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.

Overall Financial Position and Operations

UIHC's net assets increased in each of the past two years, with a \$31.6 million or 3.3% increase in 2008 and a \$79.0 million or 9.1% increase in 2007. UIHC reported a decrease in operating income in 2008; however, reported an increase in operating income in 2007. Operating income in 2008 decreased by \$29.9 million or 61.4% over the operating income reported in 2007. Operating income in 2007 increased by \$11.9 million or 32.2% over the operating income reported in 2006. Nonoperating revenues decreased by \$17.4 million or 57.5% in 2008 compared to 2007. Nonoperating revenues increased by \$17.1 million or 129.0% in 2007 compared to 2006.

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Management's Discussion and Analysis

June 30, 2008 and 2007

Table 1 provides a summary of UIHC's net assets as of June 30, 2008, 2007, and 2006.

Table 1
UNIVERSITY OF IOWA HOSPITALS AND CLINICS
Condensed Balance Sheet Information

(In thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Assets:			
Current assets	\$ 248,547	226,332	221,068
Noncurrent cash and investments	432,981	389,667	357,618
Capital assets, net	508,652	497,645	462,034
Other assets	2,121	1,539	1,490
Total assets	<u>\$ 1,192,301</u>	<u>1,115,183</u>	<u>1,042,210</u>
Liabilities:			
Current liabilities	\$ 134,697	136,507	141,849
Long-term debt	76,230	28,620	29,956
Other long-term liabilities	1,618	1,877	1,248
Total liabilities	<u>212,545</u>	<u>167,004</u>	<u>173,053</u>
Net assets:			
Invested in capital assets, net of related debt	436,169	470,297	432,735
Restricted	13,292	14,322	10,764
Unrestricted	530,295	463,560	425,658
Total net assets	<u>979,756</u>	<u>948,179</u>	<u>869,157</u>
Total liabilities and net assets	<u>\$ 1,192,301</u>	<u>1,115,183</u>	<u>1,042,210</u>

A significant component of the change in UIHC's assets is the increase in capital assets. During 2008 and 2007, UIHC constructed or purchased \$80.7 million and \$90.8 million, respectively, of capital assets. The major capital asset additions included:

- Emergency Treatment Center expansion and renovation
- EPIC Clinical Information System
- Urology Clinic Renovation and Expansion
- Pneumatic Tube System Upgrade
- Autopsy Suite Relocation
- Burn Treatment Center Renovation
- Bariatric Surgery Inpatient Unit Development

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Management's Discussion and Analysis

June 30, 2008 and 2007

- Additional major equipment additions in 2008 and 2007 consisted of a Biplane Cardiac Angiography System, 64 Slice CT Scanner System, Magnetom Trio System, Gamma Camera, Cellavision Automated Digital Cell Morphology, Digital Mammography System, and Da Vinci Surgical System.

Debt

At June 30, 2008 and 2007, UIHC had \$79.1 and \$30.1 million, respectively, in revenue bonds and capital lease obligations outstanding. During 2008 and 2007, principal payments on long-term debt were \$1.5 million and \$2.7 million, respectively. During 2008, UIHC issued \$50 million in revenue bonds.

Operating Results and Changes in Net Assets

In 2008 and 2007, UIHC's net assets increased by \$31.6 million and \$79.0 million, respectively.

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Management's Discussion and Analysis

June 30, 2008 and 2007

Table 2 shows the changes in net assets for 2008 compared to 2007 and 2006.

Table 2

UNIVERSITY OF IOWA HOSPITALS AND CLINICS

Condensed Revenues, Expenses, and Changes in Net Assets Information

(In thousands)

	<u>2008</u>	<u>2007</u>	<u>2006</u>
Operating revenues:			
Net patient service revenue	\$ 826,362	776,023	737,336
Other revenue	44,810	38,670	36,505
Total operating revenues	<u>871,172</u>	<u>814,693</u>	<u>773,841</u>
Operating expenses:			
Salaries and benefits	451,927	403,955	370,511
Medical supplies and drugs	172,265	157,230	141,317
Other supplies and general expenses	160,032	147,603	171,432
Depreciation and amortization	68,140	57,168	53,707
Total operating expenses	<u>852,364</u>	<u>765,956</u>	<u>736,967</u>
Operating income	18,808	48,737	36,874
Nonoperating revenues (expenses):			
Loss on disposal of capital assets	(1,341)	(1,701)	(1,266)
Noncapital grants and contributions	1,942	4,969	4,199
Investment income	13,753	27,104	10,327
Interest expense	(1,440)	(12)	(5)
Total nonoperating revenues, net	<u>12,914</u>	<u>30,360</u>	<u>13,255</u>
Excess of revenues over expenses before transfers	31,722	79,097	50,129
Net transfers out	<u>(145)</u>	<u>(75)</u>	<u>(47)</u>
Increase in net assets	31,577	79,022	50,082
Net assets, beginning of year	<u>948,179</u>	<u>869,157</u>	<u>819,075</u>
Net assets, end of year	<u>\$ 979,756</u>	<u>948,179</u>	<u>869,157</u>

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Management's Discussion and Analysis

June 30, 2008 and 2007

Net Patient Service Revenue

Net patient service revenue increased from 2007 to 2008 by \$50.3 million or 6.5% and \$38.7 million or 5.2% from 2006 to 2007. The increases in net patient service revenue were driven by both increases in patient volumes and pricing increases during the same periods. During 2007, acute admissions increased 1,799 or 6.9% from 26,030 to 27,829 admissions. During 2008, acute admissions increased 1,520 or 5.5% from 27,829 to 29,349 admissions. UIHC experienced increases in outpatient services during both years.

The State of Iowa (the State) has made annual appropriations to 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 UIHC to support health professionals' education. Effective July 1, 2005, the state-sponsored indigent care program ended and was replaced with a new Medicaid waiver demonstration program titled "IowaCare." The IowaCare program is approved by the Centers for Medicare and Medicaid Services for a five-year period from July 1, 2005 through June 30, 2010. Appropriations received for these programs in 2008 and 2007 were \$59.7 million and \$54.4 million, respectively. Services provided by UIHC under its charity care programs, measured at established hospital rates, were \$177.2 million and \$148.7 million in 2008 and 2007, respectively.

The provision for bad debts (a deduction from gross patient charges) increased \$6.4 million from \$21.9 million in 2007 to \$28.3 million in 2008. This increase was primarily due to an increase in chargeoffs experienced during 2008. The provision for bad debts (a deduction from gross patient charges) decreased \$6.1 million from \$28.0 million in 2006 to \$21.9 million in 2007. The large decrease in the provision for bad debts from 2006 to 2007 was primarily due to improved collections in 2007, and in 2006, significant provisions were made for accounts receivable resulting from the termination of a previous patient billing system.

Operating Expenses

Total operating expenses increased 11.3% from \$766.0 million in 2007 to \$852.4 million in 2008 and 3.9% from \$737.0 million in 2006 to \$766.0 million in 2007. The largest increases in expenses during these years are attributed to salaries and benefits, medical supplies and drugs, and depreciation.

Transactions with Related Parties

UIHC purchases certain administrative and supervisory services, utilities, and other general services from the State University of Iowa (University). These services are purchased at the approximate cost incurred by the servicing unit. For the years ended June 30, 2008, 2007, and 2006, UIHC expensed approximately \$105.2 million, \$98.8 million, and \$110.3 million, respectively, for these administrative services, utilities, and other services and support requirements.

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, 2008, 2007, and 2006, UIHC received revenue from these units of approximately \$28.9 million, \$27.7 million, and \$26.3 million, respectively, for these services.

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Management's Discussion and Analysis

June 30, 2008 and 2007

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 UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multi-state network development activities. UIHC paid UIHS for certain administrative and other general services in the amount of \$1.2 million, \$0.8 million, and \$0.9 million for the years ended June 30, 2008, 2007, and 2006, respectively.

Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of loss on disposals of capital assets, investment income, and noncapital grants and contributions. Investment income decreased from 2007 to 2008 by \$13.4 million or 49.4% and increased from 2006 to 2007 by \$16.8 million or 162.4%. During 2008, UIHC recorded a net unrealized loss on investments of \$9.1 million, which decreased investment income accordingly. This compares to the unrealized gain of \$6.0 million in the previous year.

Contacting UIHC's Financial Management

This financial report provides the citizens of Iowa, our patients, bondholders, and creditors with a general overview of UIHC's finances and operations. If you have questions about this report, please contact Mr. Kenneth L. Fisher, Associate Vice President for Finance, UI Healthcare and CFO, University of Iowa Hospitals and Clinics, 300 CMAB, Iowa City, Iowa 52242.

**STATE UNIVERSITY OF IOWA,
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Balance Sheets

June 30, 2008 and 2007

Assets	2008	2007
Current assets:		
Cash and cash equivalents	\$ 610,197	518,850
Short-term investments	80,560,479	73,327,549
Patient accounts receivable, net of estimated uncollectibles \$19,069,133 in 2008 and \$19,172,518 in 2007	122,386,095	109,850,440
Accounts receivable managed for the College of Medicine	12,470,762	14,529,666
Inventories	20,443,440	18,828,463
Other current assets	12,075,962	9,277,187
Total current assets	248,546,935	226,332,155
Noncurrent cash and investments:		
Designated by the Board of Regents	413,037,098	372,636,805
Held by trustee for debt service	7,709,320	4,110,383
Restricted by contributors and grantors for capital acquisitions and research	12,234,919	12,920,168
	432,981,337	389,667,356
Capital assets, net	508,651,988	497,645,421
Other assets	2,120,662	1,538,650
Total assets	\$ 1,192,300,922	1,115,183,582
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt and capital lease obligation	\$ 2,906,453	1,437,566
Accounts payable and accrued expenses	99,706,257	88,186,442
Estimated third-party payor settlements	10,104,126	15,834,225
Due to related parties	15,784,049	26,405,900
Other current liabilities	4,940,818	4,134,125
Accrued interest	1,255,094	509,229
Total current liabilities	134,696,797	136,507,487
Long-term debt and capital lease obligation, net of current maturities	76,229,875	28,619,550
Other long-term liabilities	1,618,855	1,877,428
Total liabilities	212,545,527	167,004,465
Net assets:		
Invested in capital assets, net of related debt	436,168,891	470,297,013
Restricted by donors for specific purposes	12,234,919	12,920,168
Restricted for debt service	1,056,089	1,401,675
Unrestricted	530,295,496	463,560,261
Total net assets	979,755,395	948,179,117
Total liabilities and net assets	\$ 1,192,300,922	1,115,183,582

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2008 and 2007

	2008	2007
Operating revenues:		
Net patient service revenue, net of provision for bad debts of \$28,347,193 in 2008 and \$21,920,349 in 2007	\$ 826,362,577	776,022,956
Other revenue	44,810,153	38,670,286
Total operating revenues	871,172,730	814,693,242
Operating expenses:		
Salaries and benefits	451,926,998	403,954,652
Medical supplies and drugs	172,264,882	157,229,754
Other supplies and general expenses	160,032,622	147,603,279
Depreciation and amortization	68,140,792	57,168,102
Total operating expenses	852,365,294	765,955,787
Operating income	18,807,436	48,737,455
Nonoperating revenues (expenses):		
Loss on disposal of capital assets	(1,340,512)	(1,700,661)
Noncapital grants and contributions	1,941,363	4,969,220
Investment income	13,752,929	27,103,382
Interest expense	(1,439,768)	(12,016)
Total nonoperating revenues, net	12,914,012	30,359,925
Excess of revenues over expenses before transfers	31,721,448	79,097,380
Net transfers out	(145,170)	(74,859)
Increase in net assets	31,576,278	79,022,521
Net assets, beginning of year	948,179,117	869,156,596
Net assets, end of year	\$ 979,755,395	948,179,117

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,
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Statements of Cash Flows

Years ended June 30, 2008 and 2007

	2008	2007
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 801,370,595	763,687,736
Receipts from state grants	6,726,227	13,406,321
Other receipts and payments, net	36,247,205	24,177,804
Payments to employees	(444,402,454)	(400,363,880)
Payment to suppliers and contractors	(332,749,878)	(303,377,302)
	<u>67,191,695</u>	<u>97,530,679</u>
Cash flows from noncapital financing activities:		
Transfers out	(145,170)	(74,859)
Noncapital grants and contributions	1,941,363	4,969,220
	<u>1,796,193</u>	<u>4,894,361</u>
Cash flows from capital and related financing activities:		
Purchase of capital assets	(78,397,914)	(89,497,779)
Proceeds from the sale of capital assets	11,000	115,008
Proceeds from the issuance of long-term debt	50,000,000	—
Premium received on issuance of long-term debt	435,672	—
Principal paid on long-term debt	(1,535,350)	(2,660,100)
Interest paid on long-term debt	(2,626,969)	(1,418,047)
	<u>(32,113,561)</u>	<u>(93,460,918)</u>
Cash flows from investing activities:		
Proceeds from sale of investments	18,293,011	15,785,051
Purchase of short-term investments	(78,583,185)	(51,129,390)
Interest and dividends received on investments	23,507,194	20,760,756
	<u>(36,782,980)</u>	<u>(14,583,583)</u>
Net increase (decrease) in cash and cash equivalents	91,347	(5,619,461)
Cash and cash equivalents at beginning of year	518,850	6,138,311
Cash and cash equivalents at end of year	<u>\$ 610,197</u>	<u>518,850</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 18,807,436	48,737,455
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	68,140,792	57,168,102
Provision for bad debts	28,347,193	21,920,349
Change in assets and liabilities:		
Accounts receivable	(38,823,947)	(24,886,655)
Inventories	(1,614,977)	292,510
Other assets	(3,380,787)	(2,021,960)
Accounts payable and accrued expenses	11,519,815	3,321,186
Other liabilities	548,120	3,454,767
Due to related parties	(10,621,851)	(18,515,786)
Estimated third-party payor settlements	(5,730,099)	8,060,711
Net cash provided by operating activities	<u>\$ 67,191,695</u>	<u>97,530,679</u>

Noncash investing activities:

 UIHC held investments at June 30, 2008 and 2007 with a fair value of \$514,152,013 and \$463,513,755, respectively.

 During 2008 and 2007, the net (decrease) increase in fair value of these investments was \$(9,136,676) and \$5,989,840, respectively.

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,
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Notes to Financial Statements

June 30, 2008 and 2007

(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 healthcare 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 State 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 a University department for financial reporting purposes.

UIHC includes substantially all of the healthcare 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 these financial statements.

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 healthcare providers. Patients are primarily from Iowa.

(b) Basis of Presentation

UIHC uses enterprise fund accounting. Revenues and expenses are recognized on the accrual basis using the economic resources measurement focus. Based on Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, as amended, UIHC has elected to apply the provisions of all relevant pronouncements of the Financial Accounting Standards Board (FASB), including those issued after November 30, 1989, that do not conflict with or contradict GASB pronouncements.

(c) Use of Estimates

The preparation of 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 disclosures 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.

(d) 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 with the amounts for the overall University.

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Cash equivalents totaling \$610,197 and \$518,850 at June 30, 2008 and 2007, respectively, represent money market funds and other short-term investments that mature in three months or less from date of purchase.

(e) 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.

(f) Capital Assets

UIHC's capital assets are reported at historical cost. Contributed capital assets are reported at their estimated fair value at the time of their donation. All capital assets other than land are depreciated or amortized (in the case of capital leases) using the straight-line method of depreciation using the following asset lives:

Buildings and leasehold improvements	10 to 40 years
Infrastructure and land improvements	5 to 20 years
Equipment and software	3 to 10 years

(g) Costs of Borrowing

Except for capital assets acquired through gifts, contributions, or capital grants, interest cost on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets.

(h) Grants and Contributions

From time to time, UIHC receives grants from the University, as well as contributions from individuals and private organizations. Revenues from grants and contributions (including contributions of capital assets) are recognized when all eligibility requirements, including time requirements, are met. Grants and contributions may be restricted for either specific operating purposes or for capital purposes. Amounts that are unrestricted or that are restricted to a specific operating purpose are reported as nonoperating revenues. Amounts restricted to capital acquisitions are reported after nonoperating revenues and expenses.

(i) Restricted Resources

When UIHC has both restricted and unrestricted resources available to finance a particular program, it is UIHC's policy to use restricted resources before unrestricted resources.

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(j) Net Assets

Net assets of UIHC are classified in three components. Net assets invested in capital assets net of related debt consist of capital assets net of accumulated depreciation and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets. Restricted expendable net assets are noncapital net assets that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to UIHC, including amounts deposited with trustees as required by bond indentures. Unrestricted net assets are remaining net assets that do not meet the definition of invested in capital assets net of related debt or restricted.

(k) Operating Revenues and Expenses

UIHC's statements of revenues, expenses, and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing healthcare services – UIHC's principal activity. Nonexchange revenues, including taxes, grants, and contributions received for purposes other than capital asset acquisition, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than financing costs.

(l) Net Patient Service Revenue

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. 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 and adjusted in future periods as final settlements are determined.

(m) Charity Care

UIHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because UIHC does not pursue collection of amounts once determined to qualify as charity care, they are not reported as revenues in the accompanying statements of revenues, expenses, and changes in net assets (see note 10).

(n) Compensated Absences

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 sponsored by the University. UIHC funds its obligation to the retirement plan on a current basis, as earned by its employees.

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(o) 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.

(p) Adoption of New Accounting Pronouncements

Effective July 1, 2007, the UIHC adopted GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement establishes accounting and financial reporting standards for employers that participate in a defined benefit “other postemployment benefit” (OPEB) plan. See note 7 for additional information, including the impact of adoption.

Effective July 1, 2007, the UIHC adopted GASB Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues*. This statement establishes criteria for governments to use to account for the exchange of an interest in their expected receivables or specific future revenues for immediate cash payments. This statement also requires disclosures pertaining to future revenues that have been pledged or sold. Adoption of this statement had no impact on the financial statements.

(2) Deposits 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, 2008 and 2007 were 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 that there will be no loss of public funds.

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Noncurrent cash and investments limited by bond resolutions or designated by the Board were held for the following purposes at June 30, 2008 and 2007:

	2008	2007
Limited by bond resolutions:		
Debt service reserve	\$ 6,653,231	2,708,708
Debt retirement and interest sinking funds	1,056,089	1,401,675
Designated by the Board of Regents:		
Capital projects and equipment and other needs	4,308,635	3,833,753
Surplus	610,619	374,304
Improvement, extension, repair, operation, and maintenance funds	408,117,844	368,428,748
Restricted by donors	12,234,919	12,920,168
	\$ 432,981,337	389,667,356

Funds for improvement, extension, repair, 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. Noncurrent cash and investments 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 through the University's pooled investment funds.

Cash and cash equivalents and short-term investments specifically identified or pooled with the cash and investments of the University totaled \$81,170,676 and \$73,846,399 at June 30, 2008 and 2007, respectively. Cash equivalents designated by the Board totaled \$138,263,607 and \$93,106,458 at June 30, 2008 and 2007, respectively.

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UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2008, UIHC had the following investments and quality credit ratings:

	<u>Fair market value</u>	<u>Effective duration</u>	<u>Quality rating</u>
University of Iowa Long-Term Endowment Pool:			
Cash and cash equivalents	\$ 1,796,354	NA	NA
U.S. obligations	6,879	15.88	NA
Agency securities	422,951	2.41	NR
Corporate issuance	2,608,413	3.84	AA
Mortgage-backed securities	2,055,889	5.22	NR
Mutual funds – fixed income	7,621,116	3.71	BBB+
U.S. equity	18,477,804	NA	NA
International equity mutual fund	6,745,568	NA	NA
Real estate	2,620,755	NA	NA
Subtotal	<u>42,355,729</u>		
University of Iowa Intermediate (Quasi II) Endowment Pool:			
Cash and cash equivalents	9,712,975	NA	NA
U.S. obligations	30,564	15.88	NA
Agency securities	1,779,247	2.41	NR
Corporate issuance	10,861,050	3.81	AA
Mortgage-backed securities	8,570,951	5.22	NR
Mutual funds – fixed income	30,196,524	4.16	A+
Subtotal	<u>61,151,311</u>		
University of Iowa Operating Investment Pool:			
Cash and cash equivalents	206,147,323	NA	NA
U.S. obligations	8,067,879	3.96	NA
Agency securities	41,212,193	1.85	NR
Corporate issuance	110,085,067	1.96	AA+
Mortgage-backed securities	18,389,175	2.17	NR
Mutual funds – fixed income	26,743,336	1.90	AA+
Subtotal	<u>410,644,973</u>		
Total investments	<u>\$ 514,152,013</u>		

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As of June 30, 2007, UIHC had the following investments and quality credit ratings:

	<u>Fair market value</u>	<u>Effective duration</u>	<u>Quality rating</u>
University of Iowa Long-Term Endowment Pool:			
Cash and cash equivalents	\$ 893,576	NA	NA
U.S. obligations	850,146	7.24	NA
Agency securities	1,528,064	2.19	NR
Corporate issuance	1,853,864	2.59	AAA
Mortgage-backed securities	2,191,055	4.52	NR
Mutual funds – fixed income	5,554,629	4.16	AA
U.S. equity	25,565,205	NA	NA
International equity mutual fund	8,132,908	NA	NA
Real estate	2,542,057	NA	NA
Subtotal	<u>49,111,504</u>		
University of Iowa Intermediate (Quasi II) Endowment Pool:			
Cash and cash equivalents	4,587,689	NA	NA
U.S. obligations	3,540,005	7.21	NA
Agency securities	6,267,557	2.15	NR
Corporate issuance	6,603,811	2.56	AAA
Mortgage-backed securities	9,147,503	4.51	NR
Mutual funds – fixed income	30,668,215	4.16	AA
Subtotal	<u>60,814,780</u>		
University of Iowa Operating Investment Pool:			
Cash and cash equivalents	161,471,592	NA	NA
U.S. obligations	42,317,184	1.99	NA
Agency securities	25,124,186	1.65	NR
Corporate issuance	93,367,481	1.56	AAA
Mortgage-backed securities	7,826,524	1.76	NR
Mutual funds – fixed income	23,480,504	1.50	AA+
Subtotal	<u>353,587,471</u>		
Total investments	<u>\$ 463,513,755</u>		

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Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The maximum duration of the University’s operating portfolio may not exceed the duration of the Merrill 1 – 3 year Government/Corporate Index by more than 20%. At time of purchase, the effective maturity of securities in the operating portfolio cannot exceed 63 months. There is no explicit limit on the average maturity of fixed income securities in the endowment portfolios. The effective duration of each fixed income portfolio shall be within a range of plus or minus 25% of the duration for that portfolio’s established benchmark.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the University. To reduce the University’s exposure to credit risk, the weighted-average credit quality of the University’s operating and endowment portfolios as rated by Standard & Poor’s, Fitch, or Moody’s should be consistent with the average credit quality of the established benchmark, which is AA or Aa.

Concentration of Credit Risk – Concentration of credit risk is the risk of loss attributable to the magnitude of a government’s investment in a single issuer. Except for Treasury or Agency debentures, pass-throughs, or REIMICs, no more than 5% of the operating and fixed income endowment portfolios are invested in securities of a single issuer.

Foreign Currency Risk – Foreign currency risk is the risk of an investment’s value changing due to changes in currency exchange rates. The University’s investment policy does not allow direct investment in foreign currencies. Also, no more than 30% of the long-term endowment portfolio can be invested in non-U.S. securities.

(3) Capital Assets

Capital assets at June 30, 2008 and 2007 are summarized as follows:

	2008	2007
Land improvements	\$ 741,775	733,795
Infrastructure	40,487,990	38,742,122
Buildings and leasehold improvements	638,562,709	618,748,088
Equipment	287,801,234	273,450,802
Software	34,733,843	25,164,456
Construction in progress (nondepreciable)	63,211,532	46,605,771
	1,065,539,083	1,003,445,034
Less accumulated depreciation	556,887,095	505,799,613
	\$ 508,651,988	497,645,421

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Capital asset additions, retirements, and balances for the years ended June 30, 2008 and 2007 were as follows:

<u>Cost basis summary</u>	<u>June 30, 2007 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2008 balances</u>
Land improvements	\$ 733,795	7,980	—	741,775
Infrastructure	38,742,122	1,745,868	—	40,487,990
Buildings and leasehold improvements	618,748,088	19,814,621	—	638,562,709
Equipment and software	298,615,258	42,539,851	(18,620,032)	322,535,077
Construction in progress (nondepreciable)	46,605,771	16,605,761	—	63,211,532
Total at historical cost	<u>1,003,445,034</u>	<u>80,714,081</u>	<u>(18,620,032)</u>	<u>1,065,539,083</u>
	<u>June 30, 2007 balances</u>	<u>Depreciation expense</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2008 balances</u>
Less accumulated depreciation for:				
Land improvements	733,794	133	—	733,927
Infrastructure	29,077,203	2,246,173	—	31,323,376
Buildings and leasehold improvements	323,254,485	29,467,366	(1,383)	352,720,468
Equipment and software	152,734,131	36,427,120	(17,051,927)	172,109,324
Total accumulated depreciation	<u>505,799,613</u>	<u>68,140,792</u>	<u>(17,053,310)</u>	<u>556,887,095</u>
Total capital assets, net	<u>\$ 497,645,421</u>	<u>12,573,289</u>	<u>(1,566,722)</u>	<u>508,651,988</u>

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Cost basis summary	June 30, 2006 balances	Acquisitions	Sales retirements and transfers	June 30, 2007 balances
Land improvements	\$ 733,795	—	—	733,795
Infrastructure	37,824,167	917,955	—	38,742,122
Buildings and leasehold improvements	577,315,440	41,432,648	—	618,748,088
Equipment and software	266,319,195	55,406,250	(23,110,187)	298,615,258
Construction in progress (nondepreciable)	53,518,981	(6,913,210)	—	46,605,771
Total at historical cost	<u>935,711,578</u>	<u>90,843,643</u>	<u>(23,110,187)</u>	<u>1,003,445,034</u>
	June 30, 2006 balances	Depreciation expense	Sales retirements and transfers	June 30, 2007 balances
Less accumulated depreciation for:				
Land improvements	733,794	—	—	733,794
Infrastructure	26,732,231	2,344,972	—	29,077,203
Buildings and leasehold improvements	296,250,422	26,978,956	25,107	323,254,485
Equipment and software	149,961,441	27,844,174	(25,071,484)	152,734,131
Total accumulated depreciation	<u>473,677,888</u>	<u>57,168,102</u>	<u>(25,046,377)</u>	<u>505,799,613</u>
Total capital assets, net	<u>\$ 462,033,690</u>	<u>33,675,541</u>	<u>1,936,190</u>	<u>497,645,421</u>

At June 30, 2008, 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, 2008 is \$30.4 million. Other projects at June 30, 2008, with an estimated cost of \$259.8 million, have been committed to by the Board and/or UIHC; however, construction contracts had not been signed as of such date. These projects are anticipated to be funded through existing designated funds, cash provided by future operations, and/or the issuance of additional long-term debt.

Cost of capital assets includes interest during the construction period for qualifying projects. Interest costs capitalized for the years ended June 30, 2008 and 2007 were \$1,913,355 and \$1,383,240, respectively.

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(4) Long-Term Debt

Long-term debt outstanding at June 30, 2008 and 2007 was as follows:

	<u>2008</u>	<u>2007</u>
Hospital Revenue Bonds:		
Series 1983 – matured September 1, 2003	\$ —	5,000
Series 2002 – 4.125% to 5.000%; maturing serially on September 1 through 2028	22,615,000	23,250,000
Series S.U.I. 2007 – 4.375% to 5.500%; maturing serially on September 1 through 2027	25,000,000	—
Series S.U.I. 2007A – 4.000% to 5.500%; maturing serially on September 1 through 2027	25,000,000	—
Net unamortized premium on Hospital Revenue Bonds	415,962	—
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2000 – 4.900% to 5.400%; maturing serially on July 1 through 2015	4,194,060	4,610,070
Series S.U.I. 2003 – 2.200% to 3.800%; maturing serially on July 1 through 2013	1,651,650	1,986,600
	<u>78,876,672</u>	<u>29,851,670</u>
Total long-term debt	78,876,672	29,851,670
Capital lease obligations (net book value of \$245,591)	259,656	205,446
	<u>79,136,328</u>	<u>30,057,116</u>
Long-term debt, current portion	2,906,453	1,437,566
	<u>2,906,453</u>	<u>1,437,566</u>
	<u>\$ 76,229,875</u>	<u>28,619,550</u>

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Activity in long-term debt for the years ended June 30, 2008 and 2007 was as follows:

	June 30, 2007 balance	Additions	Reductions	June 30, 2008 balance	Amounts due within one year
Hospital Revenue Bonds, Series 1983	\$ 5,000	—	(5,000)	—	—
Hospital Revenue Bonds, Series 2002	23,250,000	—	(635,000)	22,615,000	665,000
Hospital Revenue Bonds, Series 2007	—	25,000,000	—	25,000,000	625,000
Hospital Revenue Bonds, Series 2007A	—	25,000,000	—	25,000,000	775,000
Net unamortized bond premium	—	435,672	(19,710)	415,962	—
Telecommunications Facilities Revenue:					
Bonds, 2000	4,610,070	—	(416,010)	4,194,060	435,113
Bonds, 2003	1,986,600	—	(334,950)	1,651,650	342,300
Total long-term debt	29,851,670	50,435,672	(1,410,670)	78,876,672	2,842,413
Capital lease obligations	205,446	198,600	(144,390)	259,656	64,040
	<u>\$ 30,057,116</u>	<u>50,634,272</u>	<u>(1,555,060)</u>	<u>79,136,328</u>	<u>2,906,453</u>
	June 30, 2006 balance	Additions	Reductions	June 30, 2007 balance	Amounts due within one year
Hospital Revenue Bonds, Series 1973	\$ 5,000	—	(5,000)	—	—
Hospital Revenue Bonds, Series 1978	25,000	—	(25,000)	—	—
Hospital Revenue Bonds, Series 1983	30,000	—	(25,000)	5,000	5,000
Hospital Revenue Bonds, Series 2002	23,860,000	—	(610,000)	23,250,000	635,000
Telecommunications Facilities Revenue:					
Bonds, 2000	5,004,855	—	(394,785)	4,610,070	416,010
Bonds, 2003	2,315,250	—	(328,650)	1,986,600	334,950
Total long-term debt	31,240,105	—	(1,388,435)	29,851,670	1,390,960
Capital lease obligations	1,163,950	313,161	(1,271,665)	205,446	46,606
	<u>\$ 32,404,055</u>	<u>313,161</u>	<u>(2,660,100)</u>	<u>30,057,116</u>	<u>1,437,566</u>

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The Hospital Revenue Bonds are special obligations of the Board of Regents payable solely out of Hospital Income, the general purpose of which is to expand and improve UIHC facilities. "Hospital Income" is defined as the gross income and funds received by the Hospital System, including the proceeds of rates, fees, charges, and payments for healthcare provider activities for patient care services rendered by the University's hospitals, clinics, laboratories, and ancillary facilities after deduction of current expenses. Hospital Income does not include State appropriations to the University or Hospital System. So long as the bonds or parity bonds remain outstanding, the entire Hospital System income and revenues shall be deposited to the revenue fund and shall be disbursed to the following funds in the following order: (1) the operation and maintenance fund, (2) the sinking fund, (3) the reserve fund, and (4) the system fund. 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, or \$5,694,438. The maximum amount of Hospital Income pledged representing the undiscounted principal and interest on the bonds is \$112,320,877. The annual debt service is expected to require approximately .7% of annual Hospital Income as defined.

The Telecommunications Facilities Revenue Bonds (Telecommunications Bonds) represent UIHC's share of the remaining outstanding bonds that were issued by the University to pay costs of constructing and installing communications facilities and equipment on the University's campus. No specific revenue stream of UIHC has been pledged to service the Telecommunications Bonds. Monthly payments are required to be made to various sinking funds for payment of principal and interest. A portion of the monthly payments is 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:		
2009	\$ 2,842,413	3,040,360
2010	3,125,210	2,922,348
2011	3,269,057	2,794,087
2012	3,435,005	2,660,358
2013	3,330,898	2,526,644
2014 through 2018	17,233,127	10,464,533
2019 through 2023	19,310,000	6,838,634
2024 through 2028	24,245,000	2,617,613
2029	1,670,000	—
	<u>\$ 78,460,710</u>	<u>33,864,577</u>

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Capital Lease Obligations

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

Year ending June 30:			
2009	\$	80,253	
2010		80,898	
2011		77,505	
2012		46,158	
2013		16,400	
Total minimum payments required		301,214	
Less amounts representing interest		41,558	
	\$	259,656	

(5) Other Long-Term Liabilities – Early Retirement Benefits Payable

UIHC participates in the University’s early retirement program. 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 healthcare benefits until the employee reaches age 65. Retirees may continue participation after age 65 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 15 years and are between 57 and 63 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 2003. UIHC accrues an estimated benefit liability when an employee elects to participate in the plan and, at June 30, 2008 and 2007, UIHC has accrued \$226,093 and \$1,356,761, respectively, for these benefits in other current and long-term liabilities.

(6) 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 10.00% of the balance of employee compensation. Employees are required to contribute an amount equal to 50.00% of UIHC’s contribution. All contributions to the Plan are immediately 100% vested.

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.

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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, which approximated \$27.4 million and \$24.9 million for contributions to TIAA-CREF and IPERS in 2008 and 2007, respectively.

(7) Health Insurance Benefits for Retirees

As described in note 1, in 2008 UIHC adopted the provisions of Governmental Accounting Standards Board Statement (GASB) No. 45, *Accounting and Financial Reporting by Employers for Postretirement Benefits Other Than Pensions*. In accordance with GASB Statement No. 45, other postemployment benefits (OPEB) are recorded in the financial statements as noncurrent accrued payroll on the statements of net assets and are included as an operating expense in salaries, wages and employee benefits on the statements of revenues, expenses and changes in net assets.

All UIHC employees meeting eligibility requirements participate in the University of Iowa Health Insurance Benefits for Retirees. The University of Iowa's defined benefit postemployment healthcare plan provides medical and dental benefits to eligible retired employees, which includes employees who retire from the University after attaining age 55 and before reaching age 62, or who retire after attaining age 62 with ten or more years of service.

The contribution requirements of plan members and the University are established and may be amended by the Board of Regents. The terms and conditions governing the postemployment benefits to which employees are entitled are in the sole authority and discretion of the University's Board of Regents. For fiscal year 2008, UIHC's allocated annual OPEB cost was \$3.8 million of which \$2.2 million was contributed to the plan. The net allocated OPEB obligation at June 30, 2008 was 1.6 million. GASB 45 does not require funding of the OPEB liability, and the University has chosen to fund it on a "pay as you go" basis. University Policy dictates the payment of retiree claims as they become due. Plan members receiving benefits contributed 55% of the premium costs. In fiscal year 2008, total member contributions were \$2.0 million.

The University's defined benefit postemployment healthcare plan does not issue a separate financial report, but is included in the University's annual report, which can be obtained at the University of Iowa, 4 Jessup Hall, Iowa City, IA 52242.

(8) 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 as part of the University's benefit program.

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UIHC's portion of the health insurance liability, which is included in accounts payable and accrued expenses, is \$3,761,143 and \$3,313,891 as of June 30, 2008 and 2007, respectively, as follows:

	<u>2008</u>	<u>2007</u>
Liability for unpaid healthcare claims at beginning of year	\$ 3,313,891	2,449,858
Healthcare expenses incurred during the year	38,432,936	34,788,689
Healthcare payments to the University during the year	<u>(37,985,684)</u>	<u>(33,924,656)</u>
Liability for unpaid healthcare claims at end of year	<u>\$ 3,761,143</u>	<u>3,313,891</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 State 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 \$5,000 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 and are not an obligation of UIHC.

The State maintains an employee fidelity bond where the first \$100,000 in losses is 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.

(9) Transactions with Related Parties

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 Carver 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, 2008 and 2007, UIHC expensed approximately \$105.2 million and \$98.8 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2008 and 2007, approximately \$0.9 million and \$9.0 million, respectively, were due to the Carver College of Medicine for services and support.

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, 2008 and 2007, UIHC received revenue from these units of approximately \$28.9 million and \$27.7 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

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development activities. UIHC paid UIHS for certain administrative and other general services in the amount of \$1.2 million and \$0.8 million for the years ended June 30, 2008 and 2007, respectively.

The Faculty Practice Plan (the Practice Plan) is a clinical component of the University's College of Medicine. The UIHC performs billing and collection services for the Practice Plan. At June 30, 2008 and 2007, accounts receivable outstanding for the Practice Plan was \$12,470,762 and \$14,529,666, respectively. These amounts are also included in due to related parties at June 30, 2008 and 2007.

(10) Net Patient Service Revenue

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

Medicare

Inpatient acute care services and outpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors.

Iowa Medicaid

Inpatient and outpatient services rendered to Medicaid program beneficiaries are primarily paid at prospectively determined rates per discharge. Physician clinical services are paid based on fee schedule amounts.

Revenue from Medicare and Medicaid programs accounted for approximately 23% and 13%, respectively, of UIHC's net patient revenue for the year ended 2008, and 22% and 13%, respectively, of UIHC's net patient revenue for the year ended 2007. Laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term. The 2008 and 2007 net patient service revenue decreased approximately \$6.4 million and \$9.7 million, respectively, due to prior year retroactive adjustments in excess of amounts previously estimated.

UIHC has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to UIHC under these agreements includes prospectively determined rates per discharge, discounts from established charges, and prospectively determined daily rates.

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Net patient service revenue, as reflected in the accompanying statements of revenues, expenses, and changes in net assets, consists of the following:

	2008	2007
Gross patient charges:		
Inpatient charges	\$ 991,691,988	888,982,256
Outpatient charges	753,173,887	713,579,696
Total gross patient charges	1,744,865,875	1,602,561,952
Less:		
Deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	918,503,298	826,538,996
Net patient service revenue	\$ 826,362,577	776,022,956

Included in net patient service revenue are certain amounts received from the State of Iowa in support of indigent care. State reimbursements 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, 2008 and 2007, amounts received from the State of Iowa were \$59.7 million and \$54.4 million, respectively.

(11) Charity Care

The State of Iowa has made annual appropriations to 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 UIHC to support health professionals' education and provides partial funding of charges foregone related to these services. The amount of charges foregone for services and supplies furnished under UIHC's charity policy aggregated \$188.1 million and \$165.0 million for 2008 and 2007, respectively.

(12) 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 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, 2008 were \$78,876,672 and \$83,137,092, respectively, and at June 30, 2007 were \$29,851,670 and \$30,426,912, respectively. Other assets and obligations are insignificant, and carrying amounts are assumed to approximate fair value.

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,

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therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(13) 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, 2008 and 2007 was as follows:

	2008	2007
Commercial pay	34%	36%
Medicare	18	18
Self-pay	5	6
Medicaid	13	12
Blue Cross/Blue Shield	28	26
Other	2	2
	100%	100%

(14) 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, 2008 and 2007 was \$4,811,709 and \$4,555,313, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2008:

Year ending June 30:		
2009	\$	2,746,120
2010		2,572,185
2011		2,521,705
2012		691,381
2013		587,629
Total minimum payments required	\$	9,119,020

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(15) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses reported as current liabilities at June 30, 2008 and 2007 consisted of the following amounts:

<u>Accounts payable and accrued expenses</u>	<u>2008</u>	<u>2007</u>
Payable to employees (including payroll taxes)	\$ 69,894,357	62,770,843
Payable to suppliers	28,204,340	23,257,121
Other	1,607,560	2,158,478
Total accounts payable and accrued expenses	<u>\$ 99,706,257</u>	<u>88,186,442</u>

(16) Law and Regulations

The healthcare industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed. Management believes that UIHC is in compliance with government laws and regulations as they apply to the areas of fraud and abuse. While no regulatory inquiries have been made that are expected to have a material effect on UIHC's financial statements, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory action unknown or unasserted at this time.

(17) Subsequent Events

UIHC issued \$33,700,000 of Hospital Revenue Bonds in December 2008. The proceeds of the Bonds will be used to reimburse the UIHC for the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient care facilities. These facilities include, without limitation, the Ambulatory Surgery Center and Procedure Suites and Replacement Ambulatory Care Clinics Development, the Emergency Treatment Center expansion and renovation, the Inpatient Nursing/Ambulatory Clinic/Other Patient Care Units and Support Services/Functions, the Cancer Clinic expansion and renovation, and funding a deposit to the Reserve Fund and paying the costs of issuance of the Bonds.

As of October 31, 2008, UIHC's investments have declined in market value by approximately \$30.9 million.