

**Audit and Compliance Committee Memorandum**  
Board of Regents, State of Iowa

**Subject:** University of Iowa Hospitals and Clinics Audit Report

**Prepared by:** Andrea Anania

**Date Submitted:** May 10, 2004

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**Recommended Action:**

Discuss and receive the external audit report for the University of Iowa Hospitals and Clinics (UIHC) for the years ended June 30, 2003, and 2002.

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**Executive Summary:**

The UIHC report includes information regarding:

- The audit of the basic financial statements on an accrual basis of UIHC for the fiscal years ended June 30, 2003, and 2002, as conducted by KPMG LLP, an independent auditing firm.
- The management letter from KPMG LLP.
- Management's discussion and analysis of the financial activities of the UIHC based on currently know facts, decision, 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, the UIHC includes the following health care units of the University of Iowa:

- University Hospital
- Psychiatric Hospital
- Center for Disabilities and Development (formerly the Hospital School)

The audit indicated that the financial statements present fairly, in all material respects, the financial position of UIHC as of June 30, 2003 and 2002 and the changes in its net assets and its cash flows for the years then ended.

No significant audit adjustments or findings were reported.

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

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**Background and Analysis:**

	<p>Annual audited financial statements of the UIHC are required by <u>Iowa Code §255.25</u>, Regent Policy Manual §7.08, and bond covenants.</p>
Audit	<p>KPMG LLP conducted the UIHC audit for the fiscal years ended June 30, 2003 and 2002 in accordance with generally accepted auditing standards.</p>
Reporting Entity	<p>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, which are provided by the faculties of the University's Colleges of Medicine and Dentistry.</p> <p>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.</p>
Basis of Presentation	<p>The financial statements were prepared:</p> <ul style="list-style-type: none"><li>• In accordance with generally accepted governmental accounting principles applicable to health care proprietary funds of a governmental entity.</li><li>• Using the economic resources measurement focus.</li></ul> <p>UIHC recognizes revenue and expenses on the accrual basis of accounting.</p>
Financials	<p>As of June 30, 2003, net assets totaled \$766.3 million, which represent an increase of \$25.8 million over the \$740.5 million from the prior year.</p> <p>For FY 2003, operating revenues were \$594.2 million and operating expenses were \$582.6 million, for an operating income of \$11.7 million or 1.96% operating margin.</p> <p>Non-operating revenues, expenses, gain, and losses totaled \$25.8 million, which included investment income of \$16.3 million.</p>
Bonds	<p>During the 2002 legislative session, the Board was authorized to sell up to \$100 million in hospital revenue bonds. In November 2002, the Board sold the first \$25 million of hospital revenue bonds to pay, in part, the costs of constructing, improving, remodeling, repairing, furnishing, and equipping inpatient and outpatient facilities and patient care facilities, including facilities for image-guided radiation therapy services and mechanical and other supporting facilities at UIHC.</p> <p>UIHC hospital revenue bonds outstanding at June 30, 2003, totaled \$27.9 million, of which \$2.9 million are payable within one year.</p>
Related Party Transactions	<p>The UIHC purchases certain administrative and supervisory services, utilities, and other general services from the University. These services include amounts due to the University's College of Medicine under an agreement for support for graduate medical education, specific clinical services, and other services. For the years ended June 30, 2003 and 2002, UIHC expensed approximately \$69.7 million and \$68.3 million, respectively for the services from the University. Charges for these services approximate cost.</p>

The UIHC also provides certain administrative services to units of the University. These include billing, collection, and other physician practice-related clinic overhead expenses. For FY 2003 and 2002, the UIHC received revenues of approximately \$22.9 million and \$20.0 million, respectively, for these services. Charges for these services approximate cost.

University of Iowa Health System

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 and multi-state network development activities.

The 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.

UIHC also transferred \$1.0 million per year to the College of Medicine in support of clinical programs for each of the two years.

Faculty Practice Plan

The Faculty Practice Plan is a clinical component of the University's College of Medicine. The UIHC performs billing and collection services for this plan. Outstanding accounts receivable of the Faculty Practice Plan are recorded as accounts receivables and due to related parties (accounts payable) on the UIHC financial statements.

Net Patient Service Revenue

The UIHC has agreements with certain third-party payors that provide for payment of services at amounts different from established rates. The UIHC received approximately 56% and 60%, respectively, for fiscal years 2002 and 2003, of its gross patient revenue from established rates.

As a result of Medicare reimbursement issues related primarily to medical education, the UIHC has not finalized settlement for these specific issues with Medicare and Medicaid for the years ended June 30, 1985 through 2003. If successful, the UIHC could realize approximately \$2.5 million in additional revenue. The final outcome is not determinable, so the revenues have not been recorded.

Charity Care

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

	<u>2003</u>	<u>2002</u>
Indigent patient care	\$66.6 million	\$58.6 million
Other charity care	\$5.1 million	\$4.9 million

Medicaid

UIHC receives supplemental disproportionate share and indirect medical education patient care reimbursement allowances from the State of Iowa Medicaid program. UIHC is obligated to transfer these supplemental receipts to the state to the extent of supplemental receipts. These transfers amounted to approximately \$48.7 million for FY 2003 and \$46.5 million for FY 2002 and have been excluded from revenues and expenses.

Auditor's  
Management  
Letter

KPMG LLP reported that they did not note transactions entered into by the UIHC that were both significant and unusual in relation to proper accounting treatment that the auditors would be required to inform the committee.

The auditors evaluated the key factors and assumptions used in determining the allowance for estimated uncollectible accounts and contractual adjustments and estimated settlements with third-party payors and determined them reasonable in relation to the financial statements taken as a whole.

The auditors discussed certain financial statement misstatements, which are not adjusted on the financial statements, because management believes the effects of the uncorrected financial statement misstatements are immaterial, both individually and in the aggregate, to the financial statements.

The auditors reported:

- There were no disagreements with management that would have caused a modification to the report on the financial statements.
- To the best of their knowledge, management did not consult with other independent accountants during the past year.
- Discussions of major issues with management.
- No significant difficulties in dealing with management in performing the audit.

Management  
Discussion and  
Analysis

The UIHC annual financial report also includes a section on management's discussion and analysis, which provides an 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.

The UIHC's total net assets increased 3.5% to \$766.4 million.

Financial Ratios

Liquidity Indicators:	<u>2003</u>	<u>2002</u>
Current ratio (current assets divided by current liabilities)	2.70	2.08
Days cash on hand	228.51	247.08
An indicator of how quickly UIHC, on average, collects its patient receivables:		
Days revenue to A/R	101.33	67.30
Debt service coverage	16.25	16.56
Debt to capitalization	5.1%	2.1%

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Patient Related Data	<p>Net patient service revenues increased from 2002 to 2003 by \$23.6 million, or 4.8%.</p> <p>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%.</p> <p>The UIHC 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%.</p>
Expenses	<p>Total expenses increased 5.0% from \$555.0 million in 2002 to \$582.6 million in 2003.</p> <p>Salaries and wages at UIHC increased 8.9% over the prior year levels.</p> <p>Full time equivalent employees, including temporary staffing increased across the UIHC by 3.2% during 2003.</p> <p>Employee benefits, excluding early retirement benefits, increased 8.5%.</p>
Capital Assets	<p>Capital assets increased \$14.6 million in 2003, from \$351.7 million to \$366.3 million.</p>
Fiscal Year 2004 Outlook	<p>The 2004 operating budget, approved by the Board, provides for income from operation 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.</p> <p>The UIHC may be impacted by:</p> <ul style="list-style-type: none"><li>• Homeland security</li><li>• State finances</li><li>• Changes in federal, state, and payer reimbursements</li></ul>

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