



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

Financial Statements

June 30, 2014 and 2013

(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 financial statements of the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC), which comprise the statements of net position as of June 30, 2014 and 2013, and the related statements of revenue, expenses, and changes in net position, and cash flows for the years then ended, and the related notes to the financial statements.

### **Management's Responsibility for the Financial Statements**

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

### **Auditors' Responsibility**

Our responsibility is to express an opinion on these 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 from material misstatement.

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

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

### **Opinion**

In our opinion, the 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, 2014 and 2013, and the results of its operations and its cash flows for the years then ended, in accordance with U.S. generally accepted accounting principles.



### **Emphasis of Matters**

As discussed in note 1 to the financial statements, 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, 2014 and 2013, the changes in its financial position and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles. Our opinion is not modified with respect to this matter.

As discussed in note 1 to the financial statements, UIHC has changed its method of accounting for certain items that were previously reported as assets and liabilities as deferred outflows or inflows of resources or recognize certain items that were previously reported as assets and liabilities as outflows of resources (expenses) or inflows of resources (revenue) due to the adoption of Government Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified to this matter.

### **Other Matters**

#### *Required Supplementary Information*

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3–8 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquires of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

**KPMG LLP**

November 5, 2014  
Des Moines, Iowa

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

June 30, 2014 and 2013

**Introduction**

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, 2014 and 2013. 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.

**Financial Highlights**

UIHC demonstrated financial success in 2014 with an increase in net position of \$57.9 million, or 5.0%, as compared to an increase in net position in 2013 by \$8.8 million, or 0.7%. Operating income in 2014 was \$54.6 million, an increase of \$17.0 million when compared to 2013. Nonoperating revenue and expenses increased \$27.3 million. Operating income in 2013 was \$37.5 million, a decrease of \$8.4 million when compared to 2012. Nonoperating revenue and expenses decreased \$3.4 million.

**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 consist of three statements – statements of net position; statements of revenue, expenses, and changes in net position; and statements of cash flows. These financial statements and related notes provide information about the activities of UIHC and have been prepared on an accrual basis in accordance with Governmental Accounting Standards Board (GASB) accounting principles.

As discussed in note 1 to the financial statements, UIHC adopted GASB 65, *Items Previously Reported as Assets and Liabilities*, which amends or superseded the accounting and financial reporting guidance for certain items previously required to be reported as assets or liabilities. The objective of this statement is to either properly classify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources or recognize certain items that were previously reported as assets and liabilities as outflows of resources (expense) or inflows of resources (revenue). The implementation of GASB 65 required UIHC to reclassify certain debt refunding gains and losses as deferred inflows and outflows and to expense bond issuances costs as incurred. GASB 65 required that upon implementation the standard to be applied retroactively by restating financial statements for all periods presented.

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**Statements of Net Position and Statements of Revenues, Expenses, and Changes in Net Position**

In 2014, net position increased by \$57.9 million, or approximately 5.0%, to \$1.23 billion. This is primarily due to net income from operations of \$54.6 million. In 2013, net position increased by \$8.8 million, or approximately 0.7%, to \$1.17 billion. This is primarily due to net income from operations of \$37.5 million. Table 1 provides a summary of UIHC's assets, deferred outflows, liabilities, deferred inflows, and net position as of June 30, 2014, 2013, and 2012.

**Table 1**

Condensed Statements of Net Position

(In thousands)

	<u>2014</u>	<u>2013 Restated</u>	<u>2012 Restated</u>
Current assets	\$ 429,990	349,550	343,216
Noncurrent cash and investments	720,379	781,560	607,920
Capital assets, net	699,136	634,785	566,046
Other assets	<u>1,020</u>	<u>936</u>	<u>974</u>
Total assets	1,850,525	1,766,831	1,518,156
Deferred outflows from debt refunding	<u>452</u>	<u>504</u>	<u>575</u>
Total assets and deferred outflows	<u>\$ 1,850,977</u>	<u>1,767,335</u>	<u>1,518,731</u>
<b>Liabilities, Deferred Inflows, and Net Position</b>			
Current liabilities	\$ 211,848	176,498	157,538
Long-term debt	370,579	384,896	168,929
Other long-term liabilities	<u>43,009</u>	<u>38,226</u>	<u>33,298</u>
Total liabilities	<u>625,436</u>	<u>599,620</u>	<u>359,765</u>
Deferred inflows from debt refunding	16	41	77
Net position:			
Net investment in capital assets	457,748	427,715	405,962
Restricted	7,571	8,410	5,707
Unrestricted	<u>760,206</u>	<u>731,549</u>	<u>747,220</u>
Total net position	<u>1,225,525</u>	<u>1,167,674</u>	<u>1,158,889</u>
Total liabilities, deferred outflows, and net position	<u>\$ 1,850,977</u>	<u>1,767,335</u>	<u>1,518,731</u>

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June 30, 2014 and 2013

Table 2 shows the changes in net position for 2014 compared to 2013 and 2012.

**Table 2**  
Statements of Revenue, Expenses, and Changes in Net Position  
(In thousands)

	<u>2014</u>	<u>2013 Restated</u>	<u>2012 Restated</u>
Operating revenue:			
Net patient service revenue	\$ 1,139,952	1,072,224	1,041,179
Other revenue	49,580	53,112	57,114
Total operating revenue	<u>1,189,532</u>	<u>1,125,336</u>	<u>1,098,293</u>
Operating expenses:			
Salaries and benefits	568,736	563,686	546,771
Medical supplies and drugs	247,318	222,992	222,447
Other supplies and general expenses	245,250	228,768	213,646
Depreciation and amortization	73,640	72,344	69,534
Total operating expenses	<u>1,134,944</u>	<u>1,087,790</u>	<u>1,052,398</u>
Operating income	<u>54,588</u>	<u>37,546</u>	<u>45,895</u>
Nonoperating revenue (expenses):			
Gain (loss) on disposal of capital assets	(2,986)	(614)	851
Noncapital gifts	50	2,529	354
Investment income	56,837	22,688	24,243
Interest expense	(8,607)	(6,635)	(4,051)
Total nonoperating revenue, net	<u>45,294</u>	<u>17,968</u>	<u>21,397</u>
Excess of revenue over expenses before transfers	99,882	55,514	67,292
Capital gifts and grants	300	20	2,323
Net transfers out	(42,331)	(46,749)	(15,467)
Increase in net position	57,851	8,785	54,148
Net position, beginning of year, as restated	<u>1,167,674</u>	<u>1,158,889</u>	<u>1,104,741</u>
Net position, end of year	<u>\$ 1,225,525</u>	<u>1,167,674</u>	<u>1,158,889</u>

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Management's Discussion and Analysis

June 30, 2014 and 2013

**Net Patient Service Revenue**

Net patient service revenue increased from 2013 to 2014 by \$67.7 million, or 6.3%, and \$31.0 million, or 3.0%, from 2012 to 2013. The increases in net patient service revenue were driven by both increases in patient volumes and pricing increases during the same periods. The increase in 2014 resulted from increases in both inpatient and outpatient areas. There was an increase in outpatient clinic visits from 2013 to 2014 by 28,552, or 3.4%, and an increase in outpatient surgeries of 294, or 1.7%. On the inpatient side, acute admissions were up 418, or 1.4%, over 2013 and inpatient surgeries increased by 221, or 1.9%. The increase in 2013 resulted from increases in outpatient areas. There was an increase in outpatient clinic visits from 2012 to 2013 by 19,893, or 2.4%, and an increase in outpatient surgeries of 891, or 5.4%.

The provision for bad debts (a deduction from gross patient charges) increased \$26 million from \$24.9 million in 2013 to \$50.9 million in 2014. The provision for bad debts (a deduction from gross patient charges) decreased \$1.1 million from \$26 million in 2012 to \$24.9 million in 2013. The increase in the provision for bad debts in 2014 was caused by a shift in payor mix from Iowa Care to self-pay.

**Operating Expenses**

Total operating expenses increased 4.3% from \$1.09 billion in 2013 to \$1.13 billion in 2014. The largest dollar increase in expenses in 2014 was in medical supplies and drugs, which increased \$24.3 million, or 10.9%, when compared to 2013. In addition, other supplies and general expenses increased \$16.5 million, or 7.2%, in 2014 compared with 2013. In 2014, there was a concerted effort to expand the outpatient pharmacy specialty drug program, which along with increased volumes and inflation, increased drug expense.

Total operating expenses increased 3.4% from \$1.05 billion in 2012 to \$1.09 billion in 2013. The largest dollar increase in expenses in 2013 was in salaries and benefits, which increased \$16.9 million, or 3.1%, when compared to 2012. In addition, other supplies and general expenses increased \$15.1 million, or 7.0%, in 2013 compared with 2012. The increase in other supplies and general expenses was caused by an increase in medical services expense, which increased \$10.8 million, or 14.8%, compared with 2012.

**Nonoperating Revenue and Expenses, Net**

Nonoperating revenue consist primarily of gains (losses) on disposals of capital assets, investment income, interest expense, and noncapital gifts. Investment income increased from 2013 to 2014 by \$34.1 million, or 150.5%, and decreased from 2012 to 2013 by \$1.5 million, or 6.4%. During 2014, UIHC recorded overall earnings on the endowment and operating pools of \$20.4 million and a net unrealized gain on investments of \$36.4 million, which increased investment income accordingly. This compares to the overall earnings on the endowment and operating pools of \$19.4 million and a net unrealized gain on investments of \$3.3 million in the previous year. The increases in these investments follow overall increases in the investment markets.

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Management's Discussion and Analysis

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**Statements of Cash Flows**

The statements of cash flows reports cash receipts, cash payments, and net changes in cash resulting from operating, investing, and financing activities. UIHC's overall liquidity increased during 2014, with a net increase in cash and cash equivalents of \$.025 million. In 2014, net cash from operating activities provided cash inflows of \$150.0 million and net cash used in noncapital financing was \$42.3 million. UIHC's overall liquidity increased during 2013 with a net increase in cash and cash equivalents of \$0.3 million. In 2013, net cash from operating activities provided cash inflows of \$131.2 million and net cash used in noncapital financing was \$44.2 million. UIHC's overall liquidity increased during 2012 with a net increase in cash and cash equivalents of \$0.4 million.

**Capital Assets and Debt Administration**

*Capital Assets*

At the end of 2014, UIHC had \$699.1 million invested in capital assets, net of accumulated depreciation. This is a \$64.3 million increase when compared to capital assets, net in 2013 of \$634.8 million. This increase is primarily due to the UIHC Children's Hospital. Capital assets, net of accumulated depreciation increased \$68.8 million in 2013 when compared to capital assets, net in 2012 of \$566 million. This increase is primarily due to Iowa River Landing and UIHC Children's Hospital.

The major capital asset additions in 2013 and 2014 included the following:

- UIHC Children's Hospital
- Iowa River Landing
- Ambulatory Surgery Center and Operating Room Expansion
- Cardiovascular Intensive Care Unit Renovation
- MRI/CT Equipment Purchase
- Central Pharmacy Relocation
- Medical Alumni Auditorium Renovation

**Debt**

At June 30, 2014 and 2013, UIHC had \$383.9 million and \$393.0 million, respectively, in bonds and capital lease outstanding. During 2014 and 2013, payments of long-term debt were \$8.1 million and \$6.5 million, respectively.

During 2014, UIHC issued no Hospital Revenue Bonds.

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During 2013, UIHC issued \$190 million of Series S.U.I. 2012 Hospital Revenue Bonds. The proceeds of the Bonds will be used to construct, improve, remodel, repair, furnish, and equip a new children's hospital at the University of Iowa Hospitals and Clinics on the campus of The State University of Iowa, to fund a debt service reserve fund, and to pay the costs of issuing the Bonds. In addition, during 2013, UIHC entered into a capital lease arrangement relating to parking facilities at Iowa River Landing.

**Contacting UIHC's Financial Management**

This financial report provides the citizens of Iowa, UIHC 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, 318 CMAB, Iowa City, Iowa 52242.

**STATE UNIVERSITY OF IOWA,  
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Statements of Net Position

June 30, 2014 and 2013

(In thousands)

<b>Assets and Deferred Outflows</b>	<b>2014</b>	<b>2013 Restated</b>
Current assets:		
Cash and cash equivalents	\$ 2,154	2,129
Short-term investments	218,804	151,537
Patient accounts receivable, net of estimated uncollectibles \$32,426 in 2014 and \$19,709 in 2013	176,696	161,943
Inventories	19,266	19,119
Current portion of debt service funds – restricted	1,581	1,684
Other current assets	11,489	13,138
Total current assets	429,990	349,550
Noncurrent cash and investments:		
Designated by the Board of Regents	687,017	747,138
Held by trustee restricted for debt service	27,072	27,368
Restricted by contributors and grantors for capital acquisitions and research	6,290	7,054
	720,379	781,560
Capital assets, net	699,136	634,785
Other assets	1,020	936
Total assets	1,850,525	1,766,831
Deferred outflow of resources:		
Deferred outflow from debt refunding	452	504
Total assets and deferred outflows	\$ 1,850,977	1,767,335
<b>Liabilities, Deferred Inflows, and Net Position</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 13,350	8,108
Accounts payable and accrued expenses	118,017	116,327
Estimated third-party payor settlements	55,167	39,766
Due to related parties	14,783	2,021
Other current liabilities	5,592	5,246
Accrued interest	4,939	5,030
Total current liabilities	211,848	176,498
Long-term debt, net of current maturities	370,579	384,896
Other long-term liabilities	43,009	38,226
Total liabilities	625,436	599,620
Deferred inflow of resources:		
Deferred inflow from debt refunding	16	41
Net position:		
Net investment in capital assets	457,748	427,715
Restricted by donors for specific purposes	5,990	6,726
Restricted for debt service	1,581	1,684
Unrestricted	760,206	731,549
Total net position	1,225,525	1,167,674
Total liabilities, deferred inflows, and net position	\$ 1,850,977	1,767,335

See accompanying notes to financial statements.

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

Statements of Revenue, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

(In thousands)

	<b>2014</b>	<b>2013 Restated</b>
Operating revenue:		
Net patient service revenue, net of provision for bad debts of \$50,969 in 2014 and \$24,936 in 2013	\$ 1,139,952	1,072,224
Other revenue	49,580	53,112
Total operating revenue	1,189,532	1,125,336
Operating expenses:		
Salaries and benefits	568,736	563,686
Medical supplies and drugs	247,318	222,992
Other supplies and general expenses	245,250	228,768
Depreciation and amortization	73,640	72,344
Total operating expenses	1,134,944	1,087,790
Operating income	54,588	37,546
Nonoperating revenue (expenses):		
Loss on disposal of capital assets	(2,986)	(614)
Noncapital gifts	50	2,529
Investment income	56,837	22,688
Interest expense	(8,607)	(6,635)
Total nonoperating revenue, net	45,294	17,968
Excess of revenue over expenses before transfers	99,882	55,514
Capital gifts and grants	300	20
Net transfers out	(42,331)	(46,749)
Increase in net position	57,851	8,785
Net position, beginning of year, as restated	1,167,674	1,158,889
Net position, end of year	\$ 1,225,525	1,167,674

See accompanying notes to financial statements.

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

Statements of Cash Flows

Years ended June 30, 2014 and 2013

(In thousands)

	<b>2014</b>	<b>2013 Restated</b>
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 1,140,599	1,080,963
Other receipts	62,342	51,011
Payments to employees	(563,132)	(555,040)
Payments to suppliers and contractors	(489,807)	(445,771)
Net cash provided by operating activities	150,002	131,163
Cash flows from noncapital financing activities:		
Net transfers	(42,331)	(46,749)
Noncapital gifts	50	2,530
Net cash used in noncapital financing activities	(42,281)	(44,219)
Cash flows from capital and related financing activities:		
Purchase of capital assets	(138,715)	(121,595)
Proceeds from the sale of capital assets	727	2,511
Capital gifts and grants received	300	20
Proceeds from the issuance of long-term debt	—	190,000
Premium received on issuance of long-term debt	—	13,368
Principal paid on long-term debt	(8,108)	(6,540)
Interest paid on long-term debt	(9,665)	(5,307)
Net cash provided by (used in) capital and related financing activities	(155,461)	72,457
Cash flows from investing activities:		
Proceeds from sale of investments	408,337	100,192
Purchase of investments	(380,830)	(278,505)
Interest and dividends received on investments	20,258	19,222
Net cash provided by (used in) investing activities	47,765	(159,091)
Net increase in cash and cash equivalents	25	310
Cash and cash equivalents at beginning of year	2,129	1,819
Cash and cash equivalents at end of year	\$ 2,154	2,129
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 54,588	37,546
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	73,640	72,344
Provision for bad debts	50,969	24,936
Changes in assets and liabilities:		
Accounts receivable	(65,723)	(33,818)
Inventories	(147)	1,475
Other assets	1,719	9,016
Accounts payable and accrued expenses	1,690	(860)
Other liabilities	5,105	5,004
Due to related parties	12,761	(2,101)
Estimated third-party payor settlements	15,400	17,621
Net cash provided by operating activities	\$ 150,002	131,163

Noncash investing activities:

    During 2014 and 2013, the net appreciation in fair value of investments was \$36,526 and \$3,256, respectively.

    During 2014 and 2013, UIHC acquired \$0 and \$22,000 of property through capital lease obligations.

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,  
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Notes to Financial Statements

June 30, 2014 and 2013

(dollars in tables in thousands)

**(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 (UIHS), 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's financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenue are recorded when earned and expenses are recorded at the time liabilities are incurred without regard to receipt or disbursement of cash.

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Notes to Financial Statements

June 30, 2014 and 2013

(dollars in tables in thousands)

UIHC adopted Governmental Accounting Standards Board (GASB) Statement No. 65, *Items Previously Reported as Assets and Liabilities*, which amends or superseded the accounting and financial reporting guidance for certain items previously required to be reported as assets or liabilities. The objective of this statement is to either properly classify certain items that were previously reported as assets and liabilities as deferred outflows of resources or deferred inflows of resources or recognize certain items that were previously reported as assets and liabilities as outflows of resources (expense) or inflows of resources (revenue). The implementation of GASB 65 required UIHC to reclassify certain debt refunding gains and losses as deferred inflows and outflows and to expense bond issuances costs as incurred. GASB 65 required that upon implementation the standard to be applied retroactively by restating financial statements for all periods presented.

	<u>As previously reported</u>	<u>Adjustments</u>	<u>2013 Restated balances</u>
Statements of net position:			
Other assets	\$ 5,948	4,508	1,440
Net position	1,172,182	4,508	1,167,674
Statement of revenue, expenses and changes in net position:			
Depreciation and amortization	\$ 72,671	327	72,344
Net position, beginning of year	1,161,988	3,099	1,158,889
Net position, end of year	1,172,182	4,508	1,167,674

**(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 revenue 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 is determined on a pro rata basis reflecting UIHC's amounts available for investment as compared with the amounts for the overall University.

Undesignated cash equivalents totaling \$2.2 million and \$2.1 million at June 30, 2014 and 2013, respectively, represent money market funds and other short-term investments that mature in three months or less from date of purchase.

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Notes to Financial Statements

June 30, 2014 and 2013

(dollars in tables in thousands)

**(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 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) Deferred Outflows and Inflows of Resources**

Deferred outflows of resources represent consumptions of net position that apply to future periods and will not be recognized as an outflow of resources (expense) until then. In the statements of net position as of June 30, 2014 and 2013, UIHC reported deferred outflow on debt refunding losses. This amount is deferred and amortized over the remaining life of the debt.

Deferred inflows of resources represent acquisitions of net position that apply to future periods and will not be recognized as an inflow of resources (revenue) until then. In the statements of net position as of June 30, 2014 and 2013, UIHC reported deferred inflow on debt refunding gains. This amount is deferred and amortized over the remaining life of the debt.

**(h) 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.

**(i) Gifts and Grants**

From time to time, UIHC receives grants, as well as gifts from individuals and private organizations. Gifts and grants may be restricted either for specific operating purposes or for capital purposes.

**(j) 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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**(k) Net Position**

Net position of UIHC is classified in four components. Net investment in capital assets consists of capital assets net of accumulated depreciation and reduced by the balances of any outstanding borrowings used to finance the purchase or construction of those assets. Net position restricted by donors for specific purposes is noncapital net position that must be used for a particular purpose, as specified by creditors, grantors, or contributors external to UIHC. Net position restricted for debt service is amounts deposited with trustees as required by bond indentures. Unrestricted net position is remaining net position that does not meet the definition of net investment in capital assets or restricted.

**(l) Operating Revenue and Expenses**

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

**(m) 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 and estimated uncollectible amounts. 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.

**(n) 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 revenue in the accompanying statements of revenue, expenses, and changes in net position.

**(o) 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.

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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.

**(p) *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.

**(q) *Reclassifications***

Certain reclassifications were made to 2013 balances to conform to 2014 presentation.

**(2) *Deposits and Investments***

Investments are made in accordance with Chapter 12B.10A, Section 5d of the Code of Iowa, and Board of Regents, State of Iowa policy. The University's portfolios may be invested in obligations of the U.S. government and its agencies, certificates of deposit, prime bankers' acceptances, commercial paper, repurchase agreements, investments authorized for the Iowa Public Employees' Retirement System in Section 97B.7A of the Code of Iowa, corporate debt, mortgage pass-through, and asset-backed securities, an open-end management investment company organized in trust form registered with the S.E.C. under the Investment Company Act of 1940, the Common Fund for nonprofit organizations, commingled vehicles/mutual funds/exchange-traded funds, and common stocks.

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, 2014 and 2013 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, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Limited by bond resolutions:		
Debt service reserve	\$ 27,072	27,368
Unspent bond proceeds	115,486	158,606
Designated by the Board of Regents:		
Capital projects and equipment and other needs	386,412	432,910
Surplus	476	459
Improvement, extension, repair, operation, and maintenance funds	184,643	155,163
Restricted by donors	<u>6,290</u>	<u>7,054</u>
	<u>\$ 720,379</u>	<u>781,560</u>

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 pools with allocations to equities, fixed income, real assets, and liquidity asset classes.

Cash and cash equivalents and short-term investments specifically identified or pooled with the cash and investments of the University totaled \$221.0 million and \$153.6 million at June 30, 2014 and 2013, respectively. Cash equivalents designated by the Board totaled \$82.0 million and \$237.5 million at June 30, 2014 and 2013, respectively.

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UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2014, UIHC had the following investments and quality credit ratings (in thousands):

<b>Fixed income</b>	<b>Effective duration (years)</b>	<b>TSY/AGY AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>BB</b>	<b>B</b>	<b>N/A</b>	<b>Total market value</b>
Corporate notes and bonds	1.74	\$ 3,109	304	2,231	1,425	—	—	—	7,069
U.S. government agencies	1.37	28,454	—	—	—	—	—	38	28,492
U.S. Treasury obligations	1.97	30,368	—	—	—	—	—	—	30,368
Mutual funds	3.98	—	119,798	13,679	2,393	23,783	73,341	—	232,994
		<u>\$ 61,931</u>	<u>120,102</u>	<u>15,910</u>	<u>3,818</u>	<u>23,783</u>	<u>73,341</u>	<u>38</u>	298,923
Other investments:									
Cash and cash equivalents									302,704
U.S. equity mutual funds									74,078
Non-U.S. equity mutual funds									55,048
Real assets									92,824
Private equity									3,838
Repurchase agreement									115,503
									<u>942,918</u>
Total cash and investments									<u>\$ 942,918</u>

UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2013, UIHC had the following investments and quality credit ratings (in thousands):

<b>Fixed income</b>	<b>Effective duration (years)</b>	<b>AAA</b>	<b>AA</b>	<b>A</b>	<b>BBB</b>	<b>BB</b>	<b>B</b>	<b>N/A</b>	<b>Total market value</b>
Corporate notes and bonds	3.28	\$ 1,183	383	1,312	826	—	—	—	3,704
U.S. government agencies	3.08	26,812	690	—	—	—	—	11	27,513
U.S. Treasury obligations	4.66	25,090	—	—	—	—	—	—	25,090
Mutual funds	6.68	55,759	172,605	15,188	—	2,270	29,955	—	275,777
		<u>\$ 108,844</u>	<u>173,678</u>	<u>16,500</u>	<u>826</u>	<u>2,270</u>	<u>29,955</u>	<u>11</u>	332,084
Other investments:									
Cash and cash equivalents									391,149
U.S. equity mutual funds									67,137
Non-U.S. equity mutual funds									28,687
REIT mutual funds									26,186
Real assets									10,997
Private equity									1,692
Repurchase agreement									74,191
Certificates of deposit									4,787
									<u>936,910</u>
Total cash and investments									<u>\$ 936,910</u>

*Interest Rate Risk* – Interest rate risk is the risk changes in interest rates will adversely affect the fair value of an investment. This risk is measured using effective duration. At time of purchase, the effective maturity of direct investment purchases by the University in the operating portfolio cannot exceed sixty-three months. There is no explicit limit on the average maturity of fixed income securities in the endowment portfolios. Each fixed income portfolio is managed to an appropriate benchmark.

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*Credit Risk* – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligation to the University. The University manages exposure to credit risk by measuring portfolios against benchmarks as established by the Board. As of June 30, 2014, the University’s long-term bond funds benchmark is AA (Barclays Capital Aggregate Bond Index).

*Concentration of Credit Risk* – Concentration of credit risk is the risk of loss attributed to the magnitude of investments in a single issuer. Except for U.S. Treasury or Agency debentures, pass-throughs, or REMICs, no more than 5% of University investment portfolios are invested in securities of a single issuer. All direct investment purchases by the University in the operating portfolio are U.S. Treasury and agency securities.

*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, 2014 and 2013 are summarized as follows (in thousands):

	<u>2014</u>	<u>2013</u>
Land	\$ 15,609	15,596
Land improvements	925	925
Infrastructure	48,999	47,890
Buildings and leasehold improvements	888,365	847,328
Equipment	325,283	321,275
Software	84,550	81,736
Construction in progress (nondepreciable)	166,096	102,904
	<u>1,529,827</u>	<u>1,417,654</u>
Less accumulated depreciation	830,691	782,869
	<u>\$ 699,136</u>	<u>634,785</u>

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Capital asset additions, retirements, and balances as of and for the years ended June 30, 2014 and 2013 were as follows (in thousands):

<u>Cost basis summary</u>	<u>June 30, 2013 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2014 balances</u>
Land (nondepreciable)	\$ 15,596	13	—	15,609
Land improvements	925	—	—	925
Infrastructure	47,890	1,109	—	48,999
Buildings and leasehold improvements	847,328	41,100	(63)	888,365
Equipment and software	403,011	36,289	(29,467)	409,833
Construction in progress (nondepreciable)	<u>102,904</u>	<u>107,300</u>	<u>(44,108)</u>	<u>166,096</u>
Total at historical cost	<u>1,417,654</u>	<u>185,811</u>	<u>(73,638)</u>	<u>1,529,827</u>
Less accumulated depreciation for:				
Land improvements	759	17	—	776
Infrastructure	39,660	1,413	—	41,073
Buildings and leasehold improvements	501,218	30,920	(63)	532,075
Equipment and software	<u>241,232</u>	<u>41,290</u>	<u>(25,755)</u>	<u>256,767</u>
Total accumulated depreciation	<u>782,869</u>	<u>73,640</u>	<u>(25,818)</u>	<u>830,691</u>
Total capital assets, net	<u>\$ 634,785</u>	<u>112,171</u>	<u>(47,820)</u>	<u>699,136</u>

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<u>Cost basis summary</u>	<u>June 30, 2012 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2013 balances</u>
Land (nondepreciable)	\$ 13,684	1,912	—	15,596
Land improvements	782	143	—	925
Infrastructure	42,104	5,786	—	47,890
Buildings and leasehold improvements	766,284	81,044	—	847,328
Equipment and software	386,840	50,674	(34,503)	403,011
Construction in progress (nondepreciable)	98,255	70,237	(65,588)	102,904
Total at historical cost	<u>1,307,949</u>	<u>209,796</u>	<u>(100,091)</u>	<u>1,417,654</u>
Less accumulated depreciation for:				
Land improvements	746	13	—	759
Infrastructure	38,228	1,432	—	39,660
Buildings and leasehold improvements	471,270	29,948	—	501,218
Equipment and software	231,659	41,278	(31,705)	241,232
Total accumulated depreciation	<u>741,903</u>	<u>72,671</u>	<u>(31,705)</u>	<u>782,869</u>
Total capital assets, net	<u>\$ 566,046</u>	<u>137,125</u>	<u>(68,386)</u>	<u>634,785</u>

At June 30, 2014, construction in progress is related to various projects throughout the UIHC. The estimated cost to complete the current phase of equipment and projects under construction at June 30, 2014 is \$186.7 million. Other projects at June 30, 2014, with an estimated cost of \$199.0 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, 2014 and 2013 were \$5.6 million and \$5.6 million, respectively.

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**(4) Long-Term Debt**

Long-term debt outstanding at June 30, 2014 and 2013 was as follows (in thousands):

	<b>2014</b>	<b>2013</b>
Hospital Revenue Bonds:		
Series S.U.I. 2007 – 4.375% to 5.500%; maturing serially on September 1 through 2027	\$ 19,750	20,775
Series S.U.I. 2007A – 4.000% to 5.500%; maturing serially on September 1 through 2027	19,850	20,800
Series S.U.I. 2009 – 5.500% to 6.125%; maturing serially on September 1 through 2028	27,825	29,075
Series S.U.I. 2010 – 3.000% to 4.500%; maturing serially on September 1 through 2037	28,475	29,250
Series S.U.I. 2011 – 2.000% to 4.000%; maturing serially on September 1 through 2032	25,850	26,800
Series S.U.I. 2011A – 2.000% to 4.125%; maturing serially on September 1 through 2028	18,355	19,310
Series S.U.I. 2012 – 4.000% to 4.000%; maturing serially on September 1 through 2038	190,000	190,000
Net unamortized premium on Hospital Revenue Bonds	13,116	14,083
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2003 – 3.650% to 3.650%; maturing serially on July 1 through 2013	—	112
Series S.U.I. 2008 – 3.100% to 3.375%; maturing serially on July 1 through 2015	870	1,426
Series S.U.I. 2009 – 3.000% to 4.250%; maturing serially on July 1 through 2036	12,150	12,489
Series S.U.I. 2011 – 2.000% to 4.500%; maturing serially on July 1 through 2032	7,289	7,571
Total long-term bonds	363,530	371,691
Capital lease obligation	20,399	21,313
Total long-term debt	383,929	393,004
Long-term debt, current portion	13,350	8,108
	\$ 370,579	384,896

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Activity in long-term debt for the years ended June 30, 2014 and 2013 was as follows (in thousands):

	<b>June 30, 2013 balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>June 30, 2014 balance</b>	<b>Amounts due within one year</b>
Hospital Revenue Bonds, Series 2007	\$ 20,775	—	(1,025)	19,750	1,075
Hospital Revenue Bonds, Series 2007A	20,800	—	(950)	19,850	1,000
Hospital Revenue Bonds, Series 2009	29,075	—	(1,250)	27,825	1,300
Hospital Revenue Bonds, Series 2010	29,250	—	(775)	28,475	800
Hospital Revenue Bonds, Series 2011	26,800	—	(950)	25,850	975
Hospital Revenue Bonds, Series 2011A	19,310	—	(955)	18,355	980
Hospital Revenue Bonds, Series 2012	190,000	—	—	190,000	5,075
Net unamortized bond premium	14,083	—	(967)	13,116	—
Telecommunications Facilities Revenue Bonds:					
Series 2003	112	—	(112)	—	—
Series 2008	1,426	—	(556)	870	573
Series 2009	12,489	—	(339)	12,150	346
Series 2011	7,571	—	(282)	7,289	285
Total long-term bonds	371,691	—	(8,161)	363,530	12,409
Capital lease obligations	21,313	—	(914)	20,399	941
Total long-term debt \$	<u>393,004</u>	<u>—</u>	<u>(9,075)</u>	<u>383,929</u>	<u>13,350</u>

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	<u>June 30, 2012</u> <u>balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2013</u> <u>balance</u>	<u>Amounts due</u> <u>within</u> <u>one year</u>
Hospital Revenue Bonds, Series 2007	\$ 21,750	—	(975)	20,775	1,025
Hospital Revenue Bonds, Series 2007A	21,725	—	(925)	20,800	950
Hospital Revenue Bonds, Series 2009	30,250	—	(1,175)	29,075	1,250
Hospital Revenue Bonds, Series 2010	30,000	—	(750)	29,250	775
Hospital Revenue Bonds, Series 2011	26,800	—	—	26,800	950
Hospital Revenue Bonds, Series 2011A	20,355	—	(1,045)	19,310	955
Hospital Revenue Bonds, Series 2012	—	190,000	—	190,000	—
Net unamortized bond premium	1,249	13,368	(534)	14,083	—
Telecommunications Facilities					
Revenue Bonds:					
Series 2003	220	—	(108)	112	112
Series 2008	1,966	—	(540)	1,426	556
Series 2009	12,825	—	(336)	12,489	339
Series 2011	7,571	—	—	7,571	282
Total long-term bonds	<u>174,711</u>	<u>203,368</u>	<u>(6,388)</u>	<u>371,691</u>	<u>7,194</u>
Capital lease obligations	<u>—</u>	<u>22,000</u>	<u>(687)</u>	<u>21,313</u>	<u>914</u>
Total long-term debt	<u>\$ 174,711</u>	<u>225,368</u>	<u>(7,075)</u>	<u>393,004</u>	<u>8,108</u>

***Long-term bonds***

The Hospital Revenue Bonds are special obligations of the Board 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 at the University, 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, less current expenses (as defined in the resolution authorizing the issuance of the bonds, the Bond Resolution). Hospital Income does not include state appropriations to the University or IowaCare appropriations to the Hospital System. So long as the bonds or parity bonds remain outstanding, the entire Hospital Income 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 at least equal to the maximum annual amount of the principal and interest coming due on the bonds and any parity bonds, or \$25.3 million. The maximum amount of Hospital Income pledged representing the undiscounted principal and interest on the bonds is \$529.1 million.

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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 (in thousands):

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year(s) ending June 30:			
2015	\$ 12,409	14,205	26,614
2016	12,447	13,728	26,175
2017	12,544	13,235	25,779
2018	12,915	12,723	25,638
2019	13,374	12,205	25,579
2020 through 2024	74,426	52,385	126,811
2025 through 2029	86,604	34,943	121,547
2030 through 2034	63,472	19,095	82,567
2035 through 2039	62,223	6,187	68,410
	<u>\$ 350,414</u>	<u>178,706</u>	<u>529,120</u>

***Capital Lease Obligations***

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

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year(s) ending June 30:			
2015	\$ 941	602	1,543
2016	969	574	1,543
2017	998	545	1,543
2018	1,027	516	1,543
2019	1,057	486	1,543
2020 through 2024	5,775	2,411	8,186
2025 through 2029	6,677	1,760	8,437
2030 through 2031	2,955	222	3,177
	<u>\$ 20,399</u>	<u>7,116</u>	<u>27,515</u>

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**(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 remaining 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.

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, which approximated \$34.9 million and \$33.6 million for contributions to TIAA-CREF and IPERS in 2014 and 2013, respectively.

**(6) Health Insurance Benefits for Retirees**

Other postemployment benefits (OPEB) are recorded in the financial statements as noncurrent accrued payroll on the statements of net position and are included as an operating expense in salaries and benefits on the statements of revenue, expenses, and changes in net position.

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 include employees who retire from the University after attaining age 55 and before reaching age 62, or who retire after attaining age 62 with 10 or more years of service.

**(a) Annual OPEB cost and net OPEB obligation for Professional & Scientific and Faculty**

The contribution requirements of plan members and the University are established and may be amended by the Board. 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. For fiscal years 2014 and 2013, UIHC's allocated annual OPEB cost was \$6.3 million and \$5.3 million, respectively, of which \$2.3 million was contributed to the plan in 2014 and \$2.8 million in 2013. The net allocated OPEB obligation at June 30, 2014 and 2013 was \$17.3 million and \$13.0 million, respectively. Although there is no requirement to fund the OPEB liability, 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 64% and 46% of the premium costs in fiscal years 2014 and 2013, respectively. In fiscal years 2014 and 2013, total member contributions were \$4.0 million and \$2.4 million, respectively.

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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, Iowa 52242

**(b) Other postemployment benefits**

UIHC's merit employees are participants in the State of Iowa postretirement medical plan (OPEB Plan). The State of Iowa recognized the implicit rate subsidy for the OPEB Plan as required by GASB Statement No. 45. UIHC recognized a net OPEB liability of \$11.8M for other postemployment benefits, which represents UIHC's portion of the State's net OPEB liability. UIHC's portion of the net OPEB liability was calculated using the ratio of full time equivalent UIHC merit employees compared to all full time equivalent employees of the State of Iowa.

Details of the OPEB Plan are provided on a statewide basis and are available in the State of Iowa's Comprehensive Annual Financial Report. The report may be obtained by writing to the Iowa Department of Administrative Services, Hoover State Office Building, Des Moines, Iowa 50319.

UIHC recognized a net OPEB liability of \$17.3 million for the University retiree benefit plan and a liability of \$11.8 million for its allocation portion of the State's net OPEB liability, for a total net OPEB liability of \$29.1 million.

**(7) 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 liability, professional liability, and general (tort) 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.

UIHC's portion of the health insurance liability, which is included in accounts payable and accrued expenses, is \$4.7 million and \$4.2 million as of June 30, 2014 and 2013, respectively, as follows (in thousands):

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Liability for unpaid healthcare claims at beginning of year	\$ 4,244	4,028	4,148
Healthcare expenses incurred during the year	69,866	59,997	54,538
Healthcare payments to the University during the year	<u>(69,377)</u>	<u>(59,781)</u>	<u>(54,658)</u>
Liability for unpaid healthcare claims at end of year	<u>\$ 4,733</u>	<u>4,244</u>	<u>4,028</u>

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The University of Iowa and other Board of Regents institutions are self-insured for automobile liability up to \$250,000. Losses in excess of \$250,000 are paid by the State of Iowa, as provided in Chapter 669 of the Code of Iowa.

UIHC is an agency of the State of Iowa and is covered by the State's self-insurance for tort liability. Tort claims against the State of Iowa are handled as provided in the Iowa Tort Claims Act (Iowa Code, Chapter 669) which also sets forth the procedures by which tort claims may be brought. Claims under Chapter 669 may be filed against the State on account of wrongful death, personal injury or property damage incurred by reason of the negligence of the UIHC or its employees while acting within the scope of employment. By inter-agency agreement, tort liability claims under \$5,000 may be administered by the UIHC subject to a maximum expenditure of \$100,000 per year. All other tort claims may be paid from the State's general fund.

The State maintains an employee fidelity bond where the first \$100,000 in losses is the responsibility of UIHC. Under the State coverage, losses in excess of the \$100,000 deductible are insured up to \$2,000,000. The University maintains separate fidelity and crime coverage, which extends to all employees, and includes coverage for robbery and theft. The University's bond provides an additional \$8,000,000 in coverage over the state bond.

**(8) 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, 2014 and 2013, UIHC expensed approximately \$148.7 million and \$146.3 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2014, approximately \$11.8 million was due to the Carver College of Medicine, and at June 30, 2013, \$1.3 million was due from the Carver College of Medicine. At June 30, 2014 and 2013, \$3.0 million and \$3.3 million, respectively, was due to the University of Iowa 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, 2014 and 2013, UIHC received revenue from these units of approximately \$16.1 million and \$17.2 million, respectively, for these services.

UIHC transfers to and receives transfers from Non-UIHC University of Iowa units. Net transfers to these units totaled \$42.3 million and \$46.7 million for the years ended June 30, 2014 and 2013, respectively.

UIHC and the College of Medicine have formed a nonprofit corporation, 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 multistate network development activities. UIHC paid UIHS for

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certain administrative and other general services in the amount of \$1.6 million and \$1.4 million for the years ended June 30, 2014 and 2013, respectively.

**(9) Net Patient Service Revenue**

Net patient service revenue, as reflected in the accompanying statements of revenue, expenses, and changes in net position, consists of the following (in thousands):

	<b>2014</b>	<b>2013</b>
Gross patient charges:		
Inpatient charges	\$ 1,530,196	1,441,485
Outpatient charges	1,547,944	1,404,324
Total gross patient charges	3,078,140	2,845,809
Less deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	1,887,219	1,748,649
Provision for bad debt	50,969	24,936
Net patient service revenue	\$ 1,139,952	1,072,224

The provision for uncollectible patient accounts is based upon UIHC’s management’s assessment of expected net collections considering the accounts receivable aging, historical collections experience, economic conditions, trends in healthcare coverage, and other collection indicators. Management periodically assesses the adequacy of the allowances for uncollectible accounts and contractual adjustments based upon historical write-off experience. The results of these reviews are used to establish the net realizable value of patient accounts receivable. UIHC follows established guidelines for placing certain patient balances with collection agencies. Self-pay accounts are written off as bad debt at the time of transfer to the collection agency. Deductibles and coinsurance are classified as either third-party or self-pay receivables on the basis of which party has the primary remaining financial responsibility, while the total gross revenue remains classified based on the primary payor at the time of service. Net patient accounts receivable have been adjusted to the estimated amounts expected to be collected.

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Patient service revenue (net of contractual allowances and discounts but before the provision for bad debts), recognized in 2014 and 2013 from these major payor sources, is as follows:

	<u>2014</u>	<u>2013</u>
Patient (self-pay)	\$ 57,928	31,541
Less provision for bad debt	<u>50,969</u>	<u>24,936</u>
Self-pay (net of contractual allowance, discounts, and provision for bad debts)	6,959	6,605
Medicaid	200,341	172,508
Medicare	302,110	286,719
Commercial insurance and other third-party payors	<u>630,542</u>	<u>606,392</u>
Patient service revenue (net of contractual allowance, discounts, and provision for bad debts)	<u>\$ 1,139,952</u>	<u>1,072,224</u>

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 is as follows:

**(a) 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.

**(b) 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 27% and 18%, respectively, of UIHC's net patient revenue for the year ended 2014, and 27% and 16%, respectively, of UIHC's net patient revenue for the year ended 2013. 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 2014 net patient service revenue increased approximately \$1.0 million due to prior year retroactive adjustments in excess of amounts previously estimated. The 2013 net patient service revenue decreased approximately \$2.2 million due to prior year retroactive adjustments in excess of amounts previously estimated.

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**(c) IowaCare**

The IowaCare program serves people between the ages of 19 and 64 with income up to 200% of the federal poverty level who do not have other sources of healthcare coverage. This program was initially approved by the Centers for Medicare and Medicaid Services (CMS) as a Section 1115 Medicaid demonstration program to operate from July 1, 2005 through June 30, 2010. CMS has subsequently reauthorized the IowaCare program through December 31, 2013. Inpatient and outpatient services rendered to IowaCare program beneficiaries are primarily paid at prospectively determined rates per discharge. The amount of revenue UIHC received for this program in 2014 and 2013 was \$39.9 million and \$79.9 million, respectively, which is included in commercial and other third-party payors in the table above which describes patient service revenue by major payor sources.

**(d) Commercial**

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.

**(10) Charity Care and Uncompensated Cost of Services**

UIHC provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than established rates. Certain accounts are classified as charity care and, therefore, are not reported as revenue. Charges forgone for services and supplies furnished under UIHC's charity policy for the years ended June 30, 2014 and 2013 are as follows:

	<u>2014</u>	<u>2013</u>
Charity care	\$ 32,680	26,938
Charity care for state institution patients	11,302	6,003
Charity care charges forgone	<u>\$ 43,982</u>	<u>32,941</u>

UIHC also provides reduced price services and free programs throughout the year. The total uncompensated costs of services other than charity care, for the years ended June 30, 2014 and 2013, approximate the following:

	<u>2014</u>	<u>2013</u>
Medicare	\$ 28,200	22,266
Medicaid	21,103	12,608
Medicaid out of state	960	691
IowaCare	<u>16,276</u>	<u>36,249</u>
Uncompensated costs of services	<u>\$ 66,539</u>	<u>71,814</u>

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**(11) 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, 2014 and 2013 was as follows:

	<b>2014</b>	<b>2013</b>
Blue Cross/Blue Shield	26%	27%
Commercial pay	32	27
Medicare	22	22
Medicaid	15	12
IowaCare	—	6
Self-pay	3	4
Other	2	2
	100%	100%

**(12) 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, 2014 and 2013 was \$4.7 million and \$6.1 million, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2014 (in thousands):

Year ending June 30:		
2015	\$	1,903
2016		672
2017		579
2018		479
2019		283
Thereafter		471
Total minimum payments required	\$	4,387

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**(13) Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses reported as current liabilities at June 30, 2014 and 2013 consisted of the following amounts (in thousands):

	<b>2014</b>	<b>2013</b>
Payable to employees (including payroll taxes)	\$ 80,014	79,059
Payable to suppliers	32,799	32,981
Other	5,204	4,287
Total accounts payable and accrued expenses	\$ 118,017	116,327

**(14) 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.

The American Recovery and Reinvestment Act of 2009 provides for Medicare and Medicaid incentive payments beginning in 2011 to certain hospitals and professionals that implement and achieve meaningful use of certified electronic health record (EHR) technology in ways that demonstrate improved quality and effectiveness of care. Eligibility for annual Medicare incentive payments is dependent on providers demonstrating meaningful use of EHR technology in each period over a four-year period. An initial Medicaid incentive payment is available to providers that adopt, implement, or upgrade certified EHR technology. However, in order to receive additional Medicaid incentive payments in subsequent years, providers must demonstrate continued meaningful use of EHR technology.

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The UIHC accounts for meaningful use incentive payments as a nonexchange transaction. Medicare EHR incentive payments are recognized as revenue when eligible providers demonstrate meaningful use of certified EHR technology and the cost report information for the full cost report year that will determine the full calculation of the incentive payment is available. Medicaid EHR incentive payments are recognized as revenue when an eligible provider demonstrates meaningful use of certified EHR technology. During the years ended June 30, 2014 and 2013, UIHC recognized \$2.0 million and \$2.6 million, respectively, of Medicare meaningful use revenue and \$2.6 million and \$3.6 million, respectively, of Medicaid meaningful use revenue in its statements of revenue, expenses, and changes in net position.

**(15) Subsequent Events**

UIHC has reviewed subsequent events through November 5, 2014, the date the financial statements were issued, and concluded that there were no events or transactions during this period that would require recognition or disclosure in the financial statements other than those already disclosed.