



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

Financial Statements

June 30, 2016 and 2015

(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, 2016 and 2015, 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, 2016 and 2015, 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, 2016 and 2015, 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.

### **Other Matters**

#### *Required Supplementary Information*

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 3–8 and the schedules of proportionate share in net pension liability and UIHC contributions on pages 43-46 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**

Des Moines, Iowa  
November 23, 2016

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

June 30, 2016 and 2015

**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, 2016 and 2015. 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 2016 with an increase in net position of \$75.9 million or 6.0%, as compared to an increase in net position in 2015 by \$37.4 million, or 3.0%. Operating income in 2016 was \$101.2 million, an increase of \$17.1 million when compared to 2015. Nonoperating revenue, net increased \$6.5 million driven mainly by investment performance. Operating income in 2015 was \$84.1 million, an increase of \$29.5 million when compared to 2014. Nonoperating revenue, net decreased \$45.0 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.

In July 2014, UIHC adopted GASB 68, *Accounting and Financial Reporting for Pensions – An Amendment of GASB Statement No. 27* and GASB Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date – An Amendment of GASB Statement No. 68*. The adoption of GASB 68 required UIHC to record its proportionate share of pension liability related to its employees' participation in Iowa Public Employee Retirement System (IPERS). As a result, beginning net position as of July 1, 2014 was restated by \$16.8 million.

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

In 2016, net position increased by \$75.9 million or approximately 6.0%, to \$1.34 billion. This is primarily due to net income from operations of \$101.2 million. In 2015, net position increased by \$37.4 million or approximately 3.0%, to \$1.26 billion. This is primarily due to net income from operations of \$84.1 million.

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Table 1 provides a summary of UIHC's assets, deferred outflows, liabilities, deferred inflows, and net position as of June 30, 2016, 2015, and 2014.

**Table 1**

Condensed Statements of Net Position

(In thousands)

<b>Assets and Deferred Outflows</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Current assets	\$ 349,817	343,237	369,641
Noncurrent cash and investments	658,584	737,817	780,728
Capital assets, net	973,850	820,650	699,136
Other assets	1,356	1,013	1,020
Total assets	1,983,607	1,902,717	1,850,525
Deferred outflows	13,748	6,105	452
Total assets and deferred outflows	\$ <u>1,997,355</u>	<u>1,908,822</u>	<u>1,850,977</u>
<b>Liabilities, Deferred Inflows, and Net Position</b>			
Current liabilities	\$ 223,513	213,955	211,848
Long-term debt	343,797	356,212	370,579
Other long-term liabilities	89,272	69,827	43,009
Total liabilities	656,582	639,994	625,436
Deferred inflows	1,959	5,928	16
Net position:			
Net investment in capital assets	620,211	486,161	457,748
Restricted	6,771	5,633	7,571
Unrestricted	711,832	771,106	760,206
Total net position	1,338,814	1,262,900	1,225,525
Total liabilities, deferred inflows, and net position	\$ <u>1,997,355</u>	<u>1,908,822</u>	<u>1,850,977</u>

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Table 2 shows the changes in net position for 2016 compared to 2015 and 2014.

**Table 2**

Statements of Revenue, Expenses, and Changes in Net Position

(In thousands)

	<u>2016</u>	<u>2015</u>	<u>2014</u>
Operating revenue:			
Net patient service revenue	\$ 1,410,009	1,261,432	1,139,952
Other revenue	46,656	52,835	49,580
Total operating revenue	<u>1,456,665</u>	<u>1,314,267</u>	<u>1,189,532</u>
Operating expenses:			
Salaries and benefits	655,019	600,713	568,736
Medical supplies and drugs	323,219	282,719	247,318
Other supplies and general expenses	298,277	272,038	245,250
Depreciation and amortization	78,993	74,712	73,640
Total operating expenses	<u>1,355,508</u>	<u>1,230,182</u>	<u>1,134,944</u>
Operating income	<u>101,157</u>	<u>84,085</u>	<u>54,588</u>
Nonoperating revenue (expenses):			
Gain (loss) on disposal of capital assets	(2,818)	212	(2,986)
Noncapital gifts	2	2	50
Investment income	15,669	7,563	56,837
Interest expense	(6,054)	(7,490)	(8,607)
Total nonoperating revenue, net	<u>6,799</u>	<u>287</u>	<u>45,294</u>
Excess of revenue over expenses before transfers	107,956	84,372	99,882
Capital gifts and grants	—	163	300
Net transfers out	(32,042)	(30,415)	(42,331)
Increase in net position	75,914	54,120	57,851
Net position, beginning of year	<u>1,262,900</u>	<u>1,208,780</u>	<u>1,167,674</u>
Net position, end of year	<u>\$ 1,338,814</u>	<u>1,262,900</u>	<u>1,225,525</u>

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June 30, 2016 and 2015

**Net Patient Service Revenue**

Net patient service revenue increased from 2015 to 2016 by \$148.6 million, or 11.8%, and \$121.5 million, or 10.7%, from 2014 to 2015. 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 2016 resulted from increases in both inpatient and outpatient areas. There was an increase in outpatient clinic visits from 2015 to 2016 by 49,792, or 5.6%, with a decrease in outpatient surgeries of (1,675) or (9.5%). On the inpatient side, acute admissions were up 1,369, or 4.3%, over 2015 and inpatient surgeries increased by 2,594, or 21.0%. The increase in 2015 resulted from increases in both inpatient and outpatient areas. There was an increase in outpatient clinic visits from 2014 to 2015 by 33,162, or 3.9%, and an increase in outpatient surgeries of 778, or 2.7%. On the inpatient side, acute admissions were up 1,118, or 3.6%, over 2014 and inpatient surgeries increased by 769, or 6.6%.

The provision for bad debts (a deduction from gross patient charges) increased \$16.6 million from \$15.8 million in 2015 to \$32.4 million in 2016. The provision for bad debts (a deduction from gross patient charges) decreased \$35.1 million from \$50.9 million in 2014 to \$15.8 million in 2015. The increase in the provision for bad debts in 2016 puts our bad debts in line with our historical annual amounts. The increase in 2016 compared to 2015 was due to the large decrease in the provision for bad debts in 2015. The large decrease in 2015 was caused by a significant shift in payor mix from self-pay to other insurers.

**Operating Expenses**

Total operating expenses increased 10.2% from \$1.23 billion in 2015 to \$1.36 billion in 2016. The largest dollar increase in expenses in 2016 was in medical supplies and drugs, which increased \$40.5 million, or 14.3%, when compared to 2015. In 2016, there was a continued effort to expand the outpatient pharmacy specialty drug program, which along with increased volumes and inflation, increased drug expense.

Total operating expenses increased 8.4% from \$1.13 billion in 2014 to \$1.23 billion in 2015. The largest dollar increase in expenses in 2015 was in medical supplies and drugs, which increased \$35.4 million, or 14.3%, when compared to 2014. In 2015, there was a continued effort to expand the outpatient pharmacy specialty drug program, which along with increased volumes and inflation, increased drug expense.

**Nonoperating Revenue and Expenses, Net**

Nonoperating revenue consists primarily of gains (losses) on disposals of capital assets, investment income, interest expense, and noncapital gifts. Investment income increased from 2015 to 2016 by \$8.1 million, or 107.2%, and decreased from 2014 to 2015 by \$49.3 million, or 86.7%. During 2016, UIHC recorded overall earnings on the endowment and operating pools of \$9.3 million and a net unrealized gain on investments of \$6.3 million, which increased investment income accordingly. This compares to the overall earnings on the endowment and operating pools of \$27.4 million and a net unrealized loss on investments of \$19.9 million in the previous year. The increases in these investments follow overall 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 2016, with a net increase in cash and cash equivalents of \$2.7 million. In 2016, net cash from operating activities provided cash inflows of \$221.4 million and net cash used in noncapital financing was \$32.0 million. UIHC's overall liquidity decreased during 2015, with a net decrease in cash and cash equivalents of \$5.6 million. In 2015, net cash from operating activities provided cash inflows of \$102.4 million and net cash used in noncapital financing was \$30.4 million.

**Capital Assets and Debt Administration**

*Capital Assets*

At the end of 2016, UIHC had \$973.9 million invested in capital assets, net of accumulated depreciation. This is a \$153.2 million increase when compared to capital assets, net in 2015 of \$820.7 million. This increase is primarily due to the UIHC Children's Hospital. Capital assets, net of accumulated depreciation increased to \$820.7 million in 2015 compared to capital assets, net in 2014 of \$699.1 million. This increase is primarily due to the UIHC Children's Hospital.

The major capital asset additions in 2015 and 2016 included the following:

- Stead Family Children's Hospital
- Pediatric specialty clinic expansion and conference center development
- Main operating room expansion
- Pediatric cardiac catheterization laboratory relocation and expansion
- Ambulatory surgery center operating room expansion
- Emergency generators supporting John Pappajohn Pavilion, Children's Hospital and Hospital Ramp 2
- Levels 7 and 8 John Colloton Pavilion and John Pappajohn Pavilion rooftop infills
- University of Iowa Health Care Support Services Building interior construction and equipment
- Boyd Tower relocation of Pediatric and Psychiatry departmental offices

**Debt**

At June 30, 2016 and 2015, UIHC had \$353.6 million and \$369.6 million, respectively, in bonds and capital lease outstanding. During 2016 and 2015, payments of long-term debt were \$74.0 million and \$13.3 million, respectively. During 2016, UIHC issued \$29 million of Series S.U.I. 2016 Hospital Revenue Refunding Bonds and \$23.86 million of Series S.U.I. 2016A Hospital Revenue Refunding Bonds. The proceeds of the bonds were used by UIHC to refund the Series S.U.I. 2007 Hospital Revenue Bonds, Series S.U.I. 2007A Hospital Revenue Bonds, and Series S.U.I. 2009 Hospital Revenue Bonds.

During 2015, UIHC issued no Hospital Revenue Bonds.



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Management's Discussion and Analysis

June 30, 2016 and 2015

**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, 2016 and 2015

(In thousands)

<b>Assets and Deferred Outflows</b>	<b>2016</b>	<b>2015</b>
Current assets:		
Cash and cash equivalents	\$ 16,101	13,383
Short-term investments	75,435	51,886
Patient accounts receivable, net of estimated uncollectibles \$18,216 in 2016 and \$21,116 in 2015	210,724	236,775
Inventories	27,615	23,698
Current investments for debt service – restricted	1,230	1,296
Other current assets	18,712	16,199
Total current assets	349,817	343,237
Noncurrent cash and investments:		
Limited by bond resolutions	25,123	62,224
Designated by the Board of Regents	627,611	670,971
Restricted by donors	5,850	4,622
	658,584	737,817
Capital assets, net	973,850	820,650
Other assets	1,356	1,013
Total assets	1,983,607	1,902,717
Deferred outflow of resources:		
Deferred outflows	13,748	6,105
Total assets and deferred outflows	\$ 1,997,355	1,908,822
<b>Liabilities, Deferred Inflows, and Net Position</b>		
Current liabilities:		
Current maturities of long-term debt	\$ 9,842	13,416
Accounts payable and accrued expenses	141,776	128,878
Estimated third-party payor settlements	44,735	51,752
Due to related parties	16,900	9,740
Other current liabilities	6,457	5,393
Accrued interest	3,803	4,776
Total current liabilities	223,513	213,955
Long-term debt, net of current maturities	343,797	356,212
Other long-term liabilities	89,272	69,827
Total liabilities	656,582	639,994
Deferred inflow of resources:		
Deferred inflows	1,959	5,928
Net position:		
Net investment in capital assets	620,211	486,161
Restricted by donors for specific purposes	5,541	4,337
Restricted for debt service	1,230	1,296
Unrestricted	711,832	771,106
Total net position	1,338,814	1,262,900
Total liabilities, deferred inflows, and net position	\$ 1,997,355	1,908,822

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,  
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Statements of Revenue, Expenses, and Changes in Net Position

Years ended June 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Operating revenue:		
Net patient service revenue, net of provision for bad debts of \$32,399 in 2016 and \$15,831 in 2015	\$ 1,410,009	1,261,432
Other revenue	46,656	52,835
Total operating revenue	1,456,665	1,314,267
Operating expenses:		
Salaries and benefits	655,019	600,713
Medical supplies and drugs	323,219	282,719
Other supplies and general expenses	298,277	272,038
Depreciation and amortization	78,993	74,712
Total operating expenses	1,355,508	1,230,182
Operating income	101,157	84,085
Nonoperating revenue (expenses):		
Gain (loss) on disposal of capital assets	(2,818)	212
Noncapital gifts	2	2
Investment income	15,669	7,563
Interest expense	(6,054)	(7,490)
Total nonoperating revenue, net	6,799	287
Excess of revenue over expenses before transfers	107,956	84,372
Capital gifts and grants	—	163
Net transfers out	(32,042)	(30,415)
Increase in net position	75,914	54,120
Net position, beginning of year	1,262,900	1,208,780
Net position, end of year	\$ 1,338,814	1,262,900

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2016 and 2015

(In thousands)

	<b>2016</b>	<b>2015</b>
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 1,429,043	1,197,937
Other receipts	53,816	47,793
Payments to employees	(626,583)	(582,819)
Payments to suppliers and contractors	(634,845)	(560,505)
Net cash provided by operating activities	221,431	102,406
Cash flows from noncapital financing activities:		
Net transfers	(32,042)	(30,415)
Noncapital gifts	2	2
Net cash used in noncapital financing activities	(32,040)	(30,413)
Cash flows from capital and related financing activities:		
Purchase of capital assets	(232,202)	(197,200)
Proceeds from the sale of capital assets	9	974
Capital gifts and grants received	—	163
Proceeds from the issuance of long-term debt	52,860	—
Premium received on the issuance of long-term debt	6,495	—
Principal paid on long-term debt	(73,965)	(13,350)
Interest paid on long-term debt	(8,406)	(8,605)
Net cash used in capital and related financing activities	(255,209)	(218,018)
Cash flows from investing activities:		
Proceeds from sale of investments	246,242	424,542
Purchase of investments	(187,064)	(311,623)
Interest and dividends received on investments	9,358	27,493
Net cash provided by investing activities	68,536	140,412
Net (decrease) increase in cash and cash equivalents	2,718	(5,613)
Cash and cash equivalents at beginning of year	13,383	18,996
Cash and cash equivalents at end of year	\$ 16,101	13,383
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 101,157	84,085
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	78,993	74,712
Provision for bad debts	32,399	15,831
Changes in assets and liabilities:		
Accounts receivable	(6,348)	(75,911)
Inventories	(3,917)	(4,432)
Other assets	(10,434)	(10,069)
Accounts payable and accrued expenses	12,898	10,861
Other liabilities	16,540	15,786
Due to/from related parties	7,160	(5,042)
Estimated third-party payor settlements	(7,017)	(3,415)
Net cash provided by operating activities	\$ 221,431	102,406

Noncash investing activity:

    During 2016 and 2015, the net appreciation (depreciation) in fair value of investments was \$6,346 and \$(19,860), respectively.

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2016 and 2015

(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 State University of Iowa (the University), which are generally referred to as the University Hospital, the Psychiatric Hospital, and the Center for Disabilities and Development. UIHC is part of the University, which is a component unit of the state of Iowa and operated under the supervision of the Board of Regents, state of Iowa (the Board). UIHC 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 is recorded when earned and expenses are recorded at the time liabilities are incurred without regard to receipt or disbursement of cash.

**(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.

For purposes of the Statement of Net Position and Statement of Cash Flows, cash and cash equivalents are reported in accordance with Board of Regents, State of Iowa policy Chapter 2., section 4.C.ix

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June 30, 2016 and 2015

(Dollars in tables in thousands)

(<http://www.iowaregents.edu/plans-and-policies/board-policy-manual/22-business-procedures/%23Investment%20Policy>), which states in part: to appropriately reflect the Board's overall investment strategy and as outlined in the GASB Statement No. 9 *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*, (paragraph 11), that all funds held by external investment managers, as defined in section 2.2.4.C.iv of the Board's investment policy, shall be reported on the audited financial statements of the Regent institutions as investments. Investments purchased by the institutions through Board authorized brokerage firms that meet the definition of cash equivalents, investment with original purchase dates to maturity of three months or less shall be reported on the audited financial statements of the Regent institutions as cash equivalents.

Investments are reported at fair value except for certain investments maintained in shorter term investments such as money market funds which are accounted for at amortized cost. Changes in unrealized gain (loss) on the carrying value of the investments are reported as a component of investment income in the Statements of Revenue, Expenses, and Changes in Net Position. Please see note 2 for further discussion.

Undesignated cash equivalents totaling \$16.1 million and \$13.4 million at June 30, 2016 and 2015, respectively, represent money market funds and other short-term investments not held by external investment managers 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 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. 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.

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June 30, 2016 and 2015

(Dollars in tables in thousands)

**(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. Interest costs capitalized for the years ended June 30, 2016 and 2015 were \$6.3 million and \$6.2 million, respectively.

**(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.

**(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 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.

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**(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.

**(p) Pension – Iowa Public Employees Retirement System**

For purposes of measuring the net pension liabilities, deferred outflows of resources and deferred inflows of resources, and pension expense, information about the fiduciary net position of the Iowa Public Employees Retirement System (IPERS) and additions to/deductions from IPERS' fiduciary net position have been determined on the same basis as they are reported by IPERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with benefit terms. Investments are reported at fair value.

**(q) 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.

**(r) Adoption of New Accounting Standard**

During 2016, the UIHC adopted GASB Statement No. 72, *Fair Value Measurement and Application*. This Statement addresses accounting and financial reporting issues related to fair value measurements. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investment and disclosures related to all fair value measurements. The adoption of this Statement had no effect on net position or on revenue or expenses.

**(s) Reclassifications**

Certain reclassifications were made to 2015 balances to conform to 2016 presentation. The reclassifications had no impact on net position or excess of revenue over expenses.



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**(2) Deposits and Investments**

Investments are made in accordance with Chapter 12B.10 of the Code of Iowa, and Board of Regents, State of Iowa policy (<http://www.iowaregents.edu/plans-and-policies/board-policy-manual/22-business-procedures/#Investment Policy>).

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.

Noncurrent cash and investments limited by bond resolutions or designated by the Board were held for the following purposes at June 30, 2016 and 2015:

	<u>2016</u>	<u>2015</u>
Limited by bond resolutions:		
Debt service reserve	\$ 25,123	27,080
Unspent bond proceeds	—	35,144
Designated by the Board of Regents:		
Capital projects and equipment and other needs	389,464	446,082
Surplus	579	1,096
Improvement, extension, repair, operation, and maintenance funds	237,568	223,793
Restricted by donors	<u>5,850</u>	<u>4,622</u>
	<u>\$ 658,584</u>	<u>737,817</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 \$91.5 million and \$65.3 million at June 30, 2016 and 2015, respectively. Cash equivalents designated by the Board totaled \$173.7 million and \$233.7 million at June 30, 2016 and 2015, respectively.

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UIHC's investments are recorded at fair value. As of June 30, 2016, UIHC had the following investments and quality credit ratings (in thousands):

Fixed income	Effective duration (years)	TSY/AGY	Quality credit ratings						Total market value
			AAA	AA	A	BBB	BB	B	
Corporate notes and bonds	148	\$ 698	321	1494	1245	75	29	—	3,862
U.S. government agencies	103	170	21,856	—	—	—	—	—	22,026
U.S. Treasury obligations	148	—	19,355	—	—	—	—	—	19,355
Mutual funds	3.98	—	96,806	13,832	52,583	38,561	41,845	—	243,627
		\$ 868	138,338	15,326	53,828	38,636	41,874	—	288,870
Other investments:									
Cash and cash equivalents									265,182
U.S. equity mutual funds									50,120
Non-U.S. equity mutual funds									419,118
Real assets									97,500
Private equity									7,760
Total cash and investments									\$ 751,350

UIHC's investments are recorded at fair value. As of June 30, 2015, UIHC had the following investments and quality credit ratings (in thousands):

Fixed income	Effective duration (years)	TSY/AGY	Quality credit ratings						Total market value
			AAA	AA	A	BBB	BB	B	
Corporate notes and bonds	163	\$ 1,021	290	2,087	1,194	29	—	—	4,621
U.S. government agencies	135	21,375	494	—	—	—	—	—	21,869
U.S. Treasury obligations	155	27,570	—	—	—	—	—	—	27,570
Mutual funds	4.14	—	78,680	14,659	33,174	21,174	64,254	—	211,941
		\$ 49,966	79,464	16,746	34,368	21,203	64,254	—	266,001
Other investments:									
Cash and cash equivalents									298,957
U.S. equity mutual funds									54,375
Non-U.S. equity mutual funds									49,772
Real assets									85,093
Private equity									5,380
Repurchase agreement									44,804
Total cash and investments									\$ 804,382

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**(a) 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.

**(b) 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 of Regents. As of June 30, 2016, the University's long-term bond funds benchmark is AA (Barclays Capital Aggregate Bond Index).

**(c) 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 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.

**(d) Fair Value Measurements**

Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Generally accepted accounting principles provide a hierarchy that prioritizes the inputs to fair value measurements based on the extent inputs to valuation techniques are observable in the marketplace. The hierarchy assigns a higher priority to observable inputs that would reflect UIHC's assumptions about how market participants would value an asset or liability based on the best information available. Fair value measurements should maximize the use of observable inputs and minimize the use of the unobservable inputs. The three levels of the fair value hierarchy are as follows:

- *Level 1* – Unadjusted quoted prices in active markets for identical assets or liabilities that are available at the measurement date.
- *Level 2* – Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly.
- *Level 3* – Unobservable inputs for the asset or liability that are used to measure fair value when observable inputs are not available. These inputs are developed based upon the best information available in such circumstances.

The categorization of fair value measurements by level of the hierarchy is based upon the lowest level input that is significant to the overall fair value measurement for a given asset or liability.

In the event that changes in the inputs used in the fair value measurement of an asset or liability result in a transfer into a different level, such transfers are recognized at the end of the reporting period.

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UIHC receives prices from custodians who use third-party pricing services to price portfolios. When available, quoted prices are used to determine fair value. When quoted prices in active markets are available, investments are classified within Level 1. For certain fixed income securities, pricing usually includes matrix pricing which includes modeling from observable market inputs in active markets. Typical inputs include benchmark yields, reported trades, broker-dealer quotes, issuer spreads, and benchmark securities, among others. These investments are classified as Level 2 within the fair value hierarchy.

Certain UIHC investments that do not have a readily determinable fair value are reported using Net Asset Value per share (NAV). Used as a practical expedient for the estimated fair value, NAV per share or its equivalent is provided by the fund manager and reviewed by UIHC. Investment holdings using the NAV as a practical expedient consist of UIHC interests in funds investing in nonmarketable private equity and real assets, as well as indirect holdings of publicly traded assets in fixed income and international equity commingled funds. These investments at NAV are not classified in the fair value hierarchy.

Due to the nature of the investments held by the funds, changes in market conditions, economic environment, regulatory environment, currency exchange rates, interest rates, and commodity price fluctuations may significantly impact the NAV of the funds, and consequently, the fair value of UIHC's interest in the funds and could materially affect the amounts reported in the consolidated financial statements. UIHC attempts to manage these risks through diversification, ongoing due diligence of fund managers, maintaining adequate liquidity, and continuously monitoring economic and market conditions.

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The following table reflects fair value measurements of investment assets at June 30, 2016 as categorized by level of the fair value hierarchy according to the lowest level of inputs significant to each measurement of NAV (in thousands):

	2016				
	Level 1	Level 2	Level 3	NAV	Total
Fixed income:					
Corporate notes and bonds	\$ —	3,862	—	—	3,862
U.S. government agencies	—	22,026	—	—	22,026
U.S. Treasury obligations	19,355	—	—	—	19,355
Mutual funds	174,932	—	—	68,695	243,627
U.S. equity	50,120	—	—	—	50,120
Non-U.S. equity	15,698	—	—	26,220	41,918
Real assets	86,692	—	—	10,808	97,500
Private equity	—	—	—	7,760	7,760
	<u>\$ 346,797</u>	<u>25,888</u>	<u>—</u>	<u>113,483</u>	486,168
Bank investments					88,758
Money market/cash equivalents					<u>176,424</u>
Total cash and investments					<u>\$ 751,350</u>

The following tables summarize UIHC's investments at June 30, 2016 for which NAV was used as a practical expedient to estimate fair value.

Asset class	Fair value determined using NAV 2016	Unfunded commitments at June 30, 2016	Redemption frequency	Redemption notice period
Fixed income mutual funds	\$ 68,695	—	daily-monthly	5-30 days
Non-U.S. equity	26,220	—	semimonthly-monthly	2-30 days
Real assets:				
Redeemable	4,615	—	quarterly	90 days
Nonredeemable	6,194	—	N/A	N/A
Private equity:				
Redeemable	—	—		
Nonredeemable	<u>7,759</u>	<u>—</u>	N/A	N/A
Investment measured at NAV	<u>\$ 113,483</u>	<u>—</u>		

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The following table reflects fair value measurements of investment assets at June 30, 2015 as categorized by level of the fair value hierarchy according to the lowest level of inputs significant to each measurement of NAV (in thousands):

	2015				
	Level 1	Level 2	Level 3	NAV	Total
Fixed income:					
Corporate notes and bonds	\$ —	4,481	—	—	4,481
U.S. government agencies	—	21,798	—	—	21,798
U.S. Treasury obligations	27,428	—	—	—	27,428
Mutual funds	176,137	—	—	72,836	248,973
U.S. equity	53,445	113	—	—	53,558
Non-U.S. equity	18,704	—	—	30,226	48,930
Real assets	77,288	—	—	7,515	84,803
Private equity	—	—	—	5,180	5,180
Repurchase agreement	—	44,804	—	—	44,804
	<u>\$ 353,002</u>	<u>71,196</u>	<u>—</u>	<u>115,757</u>	539,955
Bank investments					113,604
Money market/cash equivalents					<u>150,823</u>
Total cash and investments				<u>\$ 804,382</u>	

The following table summarizes the University's investments at June 30, 2015 for which NAV was used as a practical expedient to estimate fair value.

Asset class	Fair value determined using NAV 2015	Unfunded commitments at June 30, 2015	Redemption frequency	Redemption notice period
Fixed income mutual funds	\$ 72,836	—	daily-monthly	5-30 days
Non-U.S. equity	30,226	—	semimonthly-monthly	2-30 days
Real assets:				
Redeemable	3,845	—	quarterly	90 days
Nonredeemable	3,670	5,904	N/A	N/A
Private equity:				
Redeemable	—	—		
Nonredeemable	<u>5,180</u>	<u>6,329</u>	N/A	N/A
Investment measured at NAV	<u>\$ 115,757</u>	<u>12,233</u>		

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The following information is provided for investments that are valued using the NAV per share as a practical expedient:

*Fixed Income Mutual Funds* – This category includes investments in mutual funds holding assets that provide stability, generate income, and diversify market risk.

*Non-U.S. Equity Funds* – This category includes investments in international equities including both developed and emerging markets.

*Real Assets* – This category includes investments in private real estate and natural resource funds. Capital is committed during the course of the investment period, typically four years, of each fund, after which point capital commitments stop. UIHC’s interest in the nonredeemable funds is considered to be illiquid in that distributions from liquidation of the underlying asset of the fund are at the discretion of the general partner per the terms of the limited partnership agreement. Funds are typically liquidated over a period of five to ten years, and include a mechanism to extend the length of the partnership with approval from the limited partners.

*Private Equity* – This category includes funds that invest in strategies such as venture capital, leveraged buyouts and mezzanine debt. Capital is committed during the course of the investment period, typically four years, of each fund, after which point capital commitments stop. UIHC’s interest in the nonredeemable funds is considered to be illiquid in that distributions from liquidation of the underlying asset of the fund are at the discretion of the general partner per the terms of the limited partnership agreement. Funds are typically liquidated over a period of five to ten years, and include a mechanism to extend the length of the partnership with approval from the limited partners.

**(3) Capital Assets**

Capital assets at June 30, 2016 and 2015 are summarized as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Land	\$ 19,228	17,835
Land improvements	1,138	925
Infrastructure	55,123	54,686
Buildings and leasehold improvements	1,005,535	944,851
Equipment and software	486,661	448,450
Construction in progress (nondepreciable)	<u>360,998</u>	<u>244,329</u>
	1,928,683	1,711,076
Less accumulated depreciation	<u>954,833</u>	<u>890,426</u>
	<u>\$ 973,850</u>	<u>820,650</u>

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Capital asset additions, retirements, and balances as of and for the years ended June 30, 2016 and 2015 were as follows (in thousands):

<u>Cost basis summary</u>	<u>June 30, 2015 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2016 balances</u>
Land (nondepreciable)	\$ 17,835	1,393	—	19,228
Land improvements	925	213	—	1,138
Infrastructure	54,686	437	—	55,123
Buildings and leasehold improvements	944,851	60,832	(148)	1,005,535
Equipment and software	448,450	53,575	(15,364)	486,661
Construction in progress (nondepreciable)	244,329	197,291	(80,622)	360,998
Total at historical cost	<u>1,711,076</u>	<u>313,741</u>	<u>(96,134)</u>	<u>1,928,683</u>
Less accumulated depreciation for:				
Land improvements	793	22	—	815
Infrastructure	42,751	1,640	—	44,391
Buildings and leasehold improvements	562,342	32,890	(114)	595,118
Equipment and software	284,540	44,441	(14,472)	314,509
Total accumulated depreciation	<u>890,426</u>	<u>78,993</u>	<u>(14,586)</u>	<u>954,833</u>
Total capital assets, net	<u>\$ 820,650</u>	<u>234,748</u>	<u>(81,548)</u>	<u>973,850</u>



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<u>Cost basis summary</u>	<u>June 30, 2014 balances</u>	<u>Acquisitions</u>	<u>Sales retirements and transfers</u>	<u>June 30, 2015 balances</u>
Land (nondepreciable)	\$ 15,609	2,226	—	17,835
Land improvements	925	—	—	925
Infrastructure	48,999	5,687	—	54,686
Buildings and leasehold improvements	888,365	56,586	(100)	944,851
Equipment and software	409,833	54,256	(15,639)	448,450
Construction in progress (nondepreciable)	166,096	160,696	(82,463)	244,329
Total at historical cost	<u>1,529,827</u>	<u>279,451</u>	<u>(98,202)</u>	<u>1,711,076</u>
Less accumulated depreciation for:				
Land improvements	776	17	—	793
Infrastructure	41,073	1,678	—	42,751
Buildings and leasehold improvements	532,075	30,367	(100)	562,342
Equipment and software	256,767	42,650	(14,877)	284,540
Total accumulated depreciation	<u>830,691</u>	<u>74,712</u>	<u>(14,977)</u>	<u>890,426</u>
Total capital assets, net	<u>\$ 699,136</u>	<u>204,739</u>	<u>(83,225)</u>	<u>820,650</u>

At June 30, 2016, 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, 2016 is \$129.6 million. Other projects at June 30, 2016, with an estimated cost of \$284.0 million, have been committed to by the Board and/or UIHC; however, construction contracts had not been signed as of June 30, 2016. 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.

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**(4) Long-Term Debt**

Long-term debt outstanding at June 30, 2016 and 2015 was as follows (in thousands):

	<b>2016</b>	<b>2015</b>
Hospital Revenue Bonds:		
Series S.U.I. 2007 – 4.375% to 5.500%; maturing serially on September 1 through 2027	\$ —	18,675
Series S.U.I. 2007A – 4.000% to 5.500%; maturing serially on September 1 through 2027	—	18,850
Series S.U.I. 2009 – 5.500% to 6.125%; maturing serially on September 1 through 2028	—	26,525
Series S.U.I. 2010 – 3.000% to 4.500%; maturing serially on September 1 through 2037	26,850	27,675
Series S.U.I. 2011 – 2.000% to 4.000%; maturing serially on September 1 through 2032	23,875	24,875
Series S.U.I. 2011A – 2.000% to 4.125%; maturing serially on September 1 through 2028	16,365	17,375
Series S.U.I. 2012 – 4.000% to 4.000%; maturing serially on September 1 through 2038	179,750	184,925
Series S.U.I. 2016 – 1.250% to 5.000%; maturing serially on September 1 through 2038	29,000	—
Series S.U.I. 2016A – 3.000% to 3.000%; maturing serially on September 1 through 2038	23,860	—
Net unamortized premium on Hospital Revenue Bonds	17,280	12,164
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2008 – 3.100% to 3.375%; maturing serially on July 1 through 2015	—	297
Series S.U.I. 2009 – 3.000% to 4.250%; maturing serially on July 1 through 2036	11,453	11,804
Series S.U.I. 2011 – 2.500% to 4.500%; maturing serially on July 1 through 2032	6,717	7,005
Total long-term bonds	335,150	350,170
Capital lease obligation	18,489	19,458
Total long-term debt	353,639	369,628
Long-term debt, current portion	9,842	13,416
	\$ 343,797	356,212

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Activity in long-term debt for the years ended June 30, 2016 and 2015 was as follows (in thousands):

	<u>June 30, 2015 balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2016 balance</u>	<u>Amounts due within one year</u>
Hospital Revenue Bonds, Series 2007	\$ 18,675	—	(18,675)	—	—
Hospital Revenue Bonds, Series 2007A	18,850	—	(18,850)	—	—
Hospital Revenue Bonds, Series 2009	26,525	—	(26,525)	—	—
Hospital Revenue Bonds, Series 2010	27,675	—	(825)	26,850	850
Hospital Revenue Bonds, Series 2011	24,875	—	(1,000)	23,875	1,025
Hospital Revenue Bonds, Series 2011A	17,375	—	(1,010)	16,365	1,040
Hospital Revenue Bonds, Series 2012	184,925	—	(5,175)	179,750	5,275
Hospital Revenue Bonds, Series 2016	—	29,000	—	29,000	—
Hospital Revenue Bonds, Series 2016A	—	23,860	—	23,860	—
Net unamortized bond premium	12,164	6,495	(1,379)	17,280	—
Telecommunications Facilities Revenue Bonds:					
Series 2008	297	—	(297)	—	—
Series 2009	11,804	—	(351)	11,453	359
Series 2011	7,005	—	(288)	6,717	295
Total long-term bonds	350,170	59,355	(74,375)	335,150	8,844
Capital lease obligations	19,458	—	(969)	18,489	998
Total long-term debt	\$ <u>369,628</u>	<u>59,355</u>	<u>(75,344)</u>	<u>353,639</u>	<u>9,842</u>

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	<u>June 30, 2014 balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>June 30, 2015 balance</u>	<u>Amounts due within one year</u>
Hospital Revenue Bonds, Series 2007	\$ 19,750	—	(1,075)	18,675	1,100
Hospital Revenue Bonds, Series 2007A	19,850	—	(1,000)	18,850	1,050
Hospital Revenue Bonds, Series 2009	27,825	—	(1,300)	26,525	1,350
Hospital Revenue Bonds, Series 2010	28,475	—	(800)	27,675	825
Hospital Revenue Bonds, Series 2011	25,850	—	(975)	24,875	1,000
Hospital Revenue Bonds, Series 2011A	18,355	—	(980)	17,375	1,010
Hospital Revenue Bonds, Series 2012	190,000	—	(5,075)	184,925	5,175
Net unamortized bond premium	13,116	—	(952)	12,164	—
Telecommunications Facilities Revenue Bonds:					
Series 2008	870	—	(573)	297	297
Series 2009	12,150	—	(346)	11,804	352
Series 2011	7,289	—	(284)	7,005	288
Total long-term bonds	363,530	—	(13,360)	350,170	12,447
Capital lease obligations	20,399	—	(941)	19,458	969
Total long-term debt	\$ 383,929	—	(14,301)	369,628	13,416

*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. 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 \$23.7 million. The maximum amount of Hospital Income pledged representing the undiscounted principal and interest on the bonds is \$460.6 million.

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In May 2016, the UIHC issued \$29 million of Hospital Revenue Refunding Bonds, Series S.U.I. 2016, with an average interest rate of 4.25% to advance refund \$35.4 million outstanding Hospital Revenue Refunding Bonds, Series S.U.I. 2007 and 2007A, with interest rates ranging between 4.00 and 5.50%. The University chose to early fund principal of \$2.3 million. As a result, the outstanding amount of the bonds at time of closing was \$33.1 million. Net bond proceeds of \$33.5 million were placed in an irrevocable escrow account with the UIHC as trustee. The escrow account is sufficient to fully service all remaining principal and interest due on the bonds. The Hospital Revenue Refunding Bonds, Series S.U.I. 2007 and 2007A will be called on September 1, 2017. The refunding permitted the University to realize an economic gain (difference between present values of the old and new debt service payments) of \$4.1 million; and reduced the aggregate debt service payments by \$4.4 million over the next eleven years.

In June 2016, the UIHC issued \$23.9 million of Hospital Revenue Refunding Bonds, Series S.U.I. 2016A, with an average interest rate of 3.03% to advance refund \$25.2 million of outstanding Hospital Revenue Refunding Bonds, Series S.U.I. 2009, with interest rates ranging between 5.50 and 6.125%. The University chose to early fund principal of \$1.4 million. As a result, the outstanding amount of the bonds at time of closing was \$23.8 million. Net bond proceeds of \$25.7 million were placed in an irrevocable escrow account with the UIHC as trustee. The escrow account is sufficient to fully service all remaining principal and interest due on the bonds. The Hospital Revenue Refunding Bonds, Series S.U.I. 2009 will be called on September 1, 2018. The refunding permitted the University to realize an economic gain (difference between present values of the old and new debt service payments) of \$4 million; and reduced the aggregate debt service payments by \$4.3 million over the next twelve years.

During 2015, UIHC issued no Hospital Revenue Bonds.

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.

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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:			
2017	\$ 8,844	11,608	20,452
2018	12,660	11,613	24,273
2019	13,499	11,217	24,716
2020	13,822	10,799	24,621
2021	14,255	10,357	24,612
2022 through 2026	78,217	43,595	121,812
2027 through 2031	75,606	27,453	103,059
2032 through 2036	63,986	13,906	77,892
2037 through 2039	36,981	2,160	39,141
	<u>\$ 317,870</u>	<u>142,708</u>	<u>460,578</u>

The following are deferred outflows of resources and deferred inflows of resources related to debt refundings as of June 30, 2016 and 2015:

	<u>2016 Deferred outflows of resources</u>	<u>2016 Deferred inflows of resources</u>
Deferred outflows and inflows from debt refunding:		
Revenue Bonds 2011A Series refunding loss	\$ 354	—
Revenue Bonds 2016 Series refunding loss	1,878	—
Revenue Bonds 2016A Series refunding loss	2,766	—
	<u>\$ 4,998</u>	<u>—</u>

	<u>2015 Deferred outflows of resources</u>	<u>2015 Deferred inflows of resources</u>
Deferred outflows and inflows from debt refunding:		
Revenue Bonds 2011A Series refunding loss	\$ 402	—
Revenue Bonds 2008 Series refunding gain	—	3
	<u>\$ 402</u>	<u>3</u>

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*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:			
2017	\$ 998	545	1,543
2018	1,027	516	1,543
2019	1,057	486	1,543
2020	1,089	455	1,544
2021	1,121	422	1,543
2022 through 2026	6,120	2,434	8,554
2027 through 2031	7,077	1,082	8,159
	<u>\$ 18,489</u>	<u>5,940</u>	<u>24,429</u>

**(5) Retirement Benefit Plans**

*Teachers Insurance and Annuity Association*

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.

*Iowa Public Employees Retirement System*

*Plan Description* – Eligible employees not electing to participate in the Plan are required to participate in the Iowa Public Employees' Retirement System (IPERS), which is a cost-sharing multiple-employer defined-benefit pension plan administered by the State of Iowa (the State). IPERS issues a stand-alone financial report, which is available to the public by mail at 7401 Register Drive P.O. Box 9117, Des Moines, Iowa 50306-9117 or at [www.ipers.org](http://www.ipers.org). IPERS benefits are established under Iowa Code Chapter 97B and the administrative rules thereunder. Chapter 97B and the administrative rules are the official plan documents. The following brief description is provided for general informational purposes only. Refer to the plan documents for more information.

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*Pension Benefits* – A regular member may retire at normal retirement age and receive monthly benefits without an early retirement reduction. Normal retirement age is age 65, any time after reaching age 62 with 20 or more years of covered employment, or when the member's years of service plus the member's age at the last birthday equals or exceeds 88, whichever comes first. (These qualifications must be met on the member's first month of entitlement to benefits.) Members cannot begin receiving retirement benefits before age 55. The formula used to calculate a Regular member's monthly IPERS benefit includes:

- A multiplier (based on years of service)
- The member's highest five-year average salary (for members with service before June 30, 2012, the highest three-year average salary as of that date will be used if it is greater than the highest five-year average salary.)

If a member retires before normal retirement age, the member's monthly retirement benefit will be permanently reduced by an early retirement reduction. The early retirement reduction is calculated differently for service earned before and after July 1, 2012. For service earned before July 1, 2012, the reduction is 0.25% for each month that the member receives benefits before the member's earliest normal retirement age. For service earned starting July 1, 2012, the reduction is 0.50% for each month that the member receives benefits before age 65.

Generally, once a member selects a benefit option, a monthly benefit is calculated and remains the same for the rest of the member's lifetime. However, to combat the effects of inflation, retirees who began receiving benefits prior to July 1990 receive a guaranteed dividend with their regular November benefit payments.

*Disability and Death Benefits* – A vested member who is awarded federal Social Security disability or Railroad Retirement disability benefits is eligible to claim IPERS benefits regardless of age. Disability benefits are not reduced for early retirement. If a member dies before retirement, the member's beneficiary will receive a lifetime annuity or a lump-sum payment equal to the present actuarial value of the member's accrued benefit or calculated with a set formula, whichever is greater. When a member dies after retirement, death benefits depend on the benefit option the member selected at retirement.

*Contributions* – Effective July 1, 2012, as a result of a 2010 law change, the contribution rates are established by IPERS following the annual actuarial valuation, which applies IPERS' Contribution Rate Funding Policy and Actuarial Amortization Method. Statute limits the amount rates can increase or decrease each year to 1 percentage point. IPERS Contribution Rate Funding Policy requires that the actuarial contribution rate be determined using the "entry age normal" actuarial cost method and the actuarial assumptions and methods approved by the IPERS Investment Board. The actuarial contribution rate covers normal cost plus the unfunded actuarial liability payment based on a 30-year amortization period. The payment to amortize the unfunded actuarial liability is determined as a level percentage of payroll, based on the Actuarial Amortization Method adopted by the Investment Board.

In fiscal years 2016 and 2015, pursuant to the required rate, regular members contributed 5.95% of pay and UIHC contributed 8.93% for a total rate of 14.8%.



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UIHC's contributions to IPERS for the years ended June 30, 2016 and 2015 were \$3.6 million and \$2.7 million, respectively.

*Net Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions* – At June 30, 2016 and 2015, UIHC reported a liability in other long-term liabilities on the statements of net position of \$23.5 million and \$15.5 million, respectively, for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015 and 2014, respectively, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. UIHC's proportion of the net pension liability was based on UIHC's share of contributions to the pension plan relative to the contributions of all IPERS participating employers. At June 30, 2015, UIHC's proportion was 0.4734892%, which was an increase of 0.0896114% from its proportion measured as of June 30, 2014 of 0.3838778%.

For the year ended June 30, 2016 and 2015, UIHC recognized pension expense of \$4.6 million and \$1.7 million, respectively. At June 30, 2016 and 2015, UIHC reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	<b>2016 Deferred outflows of resources</b>	<b>2016 Deferred inflows of resources</b>
Difference between expected and actual experience	\$ 356	—
Changes of assumptions	648	—
Net difference between projected and actual earnings on pension plan investments	—	1,959
Changes in proportion and differences between contributions and proportionate share of contributions	4,143	—
Contributions subsequent to the measurement date	3,603	—
Total	<u>\$ 8,750</u>	<u>1,959</u>

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	<b>2015 Deferred outflows of resources</b>	<b>2015 Deferred inflows of resources</b>
Difference between expected and actual experience	\$ 169	—
Changes of assumptions	685	—
Net difference between projected and actual earnings on pension plan investments	—	5,925
Changes in proportion and differences between contributions and proportionate share of contributions	2,188	—
Contributions subsequent to the measurement date	2,660	—
Total	\$ 5,702	5,925

\$3.6 million reported as deferred outflows of resources related to pensions resulting from UIHC's contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ending June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows (in thousands):

Year ending June 30:	
2017	\$ 447
2018	447
2019	447
2020	1,693
2021	154
	\$ 3,188

There are no nonemployer contributing entities at IPERS.

*Actuarial Assumptions* – The total pension liability in the June 30, 2015 and 2014 actuarial valuations were determined using the following actuarial assumptions, applied to all periods included in the measurement:

Rate of inflation (effective June 30, 2014)	3.00%
Salary increase (effective June 30, 2014)	4.00% average, including inflation
Investment rate of return (effective June 30, 1996)	7.50% per annum, compounded annually, net of pension plan investment expense, including inflation

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The actuarial assumptions used in the June 30, 2015 and 2014 valuations were based on the results of actuarial experience studies with dates corresponding to those listed above.

Mortality rates were based on the RP-2000 Generational Mortality Tables, as appropriate, with adjustments for mortality improvements based on Scale AA.

The long-term expected rate of return on pension plan investments was determined using a building-block method in which best-estimate ranges of expected future real rates (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset Class are summarized in the following table:

<u>Asset class</u>	<u>Asset allocation</u>	<u>Long-term expected real rate of return</u>
Core plus fixed income	28%	2.04%
U.S. equity	24	6.29
Non-U.S. equity	16	6.75
Private equity	11	11.32
Real estate	8	3.48
Credit opportunities	5	3.63
TIPS	5	1.91
Other real assets	2	6.24
Cash	1	(0.71)
Total	<u>100%</u>	

*Discount Rate* – The discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the contractually required rate and that contributions from UIHC will be made at contractually required rates, actuarially determined. Based on those assumptions, the pension plan’s fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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*Sensitivity of UIHC's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate* – The following presents UIHC's proportionate share of the net pension liability calculated using the discount rate of 7.50%, as well as what UIHC's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5%) or 1-percentage-point higher (8.5%) than the current rate (in thousands).

	<b>1% Decrease (6.5)%</b>	<b>Discount rate (7.5)%</b>	<b>1% Increase (8.5)%</b>
UIHC's proportionate share of the net pension liability	\$ 41,212	23,539	8,621

*Pension Plan Fiduciary Net Position* – Detailed information about the pension plan's fiduciary net position is available in the separately issued IPERS financial report, which is available on IPERS' Web site at [www.ipers.org](http://www.ipers.org).

*Payables to the Pension Plan* – At June 30, 2016 and 2015, respectively, UIHC reported payables to the defined-benefit pension plan of \$321 and \$256, for legally required employer contributions and \$214 and \$171, for legally required employee contributions, which had been withheld from employee wages but not yet remitted to IPERS.

**(6) Postemployment Benefits**

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.

**(a) Annual OPEB Cost and Net OPEB Obligation for Professional and Scientific and Faculty**

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.

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 2016 and 2015, UIHC's allocated annual OPEB cost was \$10.6 million and \$9.2 million, respectively, of which \$2.4 million was contributed to the plan in 2016 and \$2.6 million in 2015. The net allocated OPEB obligation at June 30, 2016 and 2015 was \$34.1 million and \$25.2 million, respectively. There is no requirement to fund 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 77% and 72% of the premium costs in fiscal years

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2016 and 2015, respectively. In fiscal years 2016 and 2015, total member contributions were \$5.8 million and \$4.0 million, respectively.

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, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. For fiscal years 2016 and 2015, UIHC's allocated annual OPEB cost was \$2.5 million and \$2.3 million, respectively, of which \$1.1 million was contributed to the plan in 2016 and \$1.0 million in 2015. UIHC recognized a net OPEB liability of \$14.7 million and \$13.3 million, at June 30, 2016 and 2015, respectively, 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.

**(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 \$6.3 million and \$5.2 million as of June 30, 2016 and 2015, respectively, as follows (in thousands):

	<u>2016</u>	<u>2015</u>
Liability for unpaid healthcare claims at beginning of year	\$ 5,150	4,733
Healthcare expenses incurred during the year	84,822	74,123
Healthcare payments to the University during the year	<u>(83,695)</u>	<u>(73,706)</u>
Liability for unpaid healthcare claims at end of year	<u>\$ 6,277</u>	<u>5,150</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 interagency 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 \$150,000 in losses is the responsibility of UIHC. Under the State coverage, losses in excess of the \$150,000 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 crime policy 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, 2016 and 2015, UIHC expensed approximately \$173.7 million and \$165.0 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2016 and 2015, approximately \$10.2 million and \$6.1 million, respectively, were due to the Carver College of Medicine. At June 30, 2016 and 2015, \$3.6 million and \$3.7 million, respectively, were 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, 2016 and 2015, UIHC received revenue from these units of approximately \$9.2 million and \$16.0 million, respectively, for these services, which is recorded in other revenue in the statements of revenue, expense, and changes in net position.

UIHC transfers to and receives transfers from Non-UIHC University of Iowa units. Net transfers to these units totaled \$32.0 million and \$30.4 million for the years ended June 30, 2016 and 2015, respectively.

University of Iowa Health System and Subsidiaries (UIHS) was incorporated under the provisions of the Iowa Nonprofit Corporations Act on December 2, 1994. UIHS was formed 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 certain

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administrative and other general services in the amount of \$1.9 million and \$1.9 million for the years ended June 30, 2016 and 2015, respectively. For the years ended June 30, 2016 and 2015, UIHC transferred \$11.7 million and \$12.1 million, respectively, which is recorded in net transfers in the statements of revenue, expenses, and changes in net position.

**(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):

	<u>2016</u>	<u>2015</u>
Gross patient charges:		
Inpatient charges	\$ 1,978,323	1,716,806
Outpatient charges	<u>1,924,724</u>	<u>1,635,429</u>
Total gross patient charges	3,903,047	3,352,235
Less deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	2,460,639	2,074,972
Provision for bad debt	<u>32,399</u>	<u>15,831</u>
Net patient service revenue	<u>\$ 1,410,009</u>	<u>1,261,432</u>

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 2016 and 2015 from these major payor sources, is as follows:

	<u>2016</u>	<u>2015</u>
Patient (self-pay)	\$ 40,114	23,971
Less provision for bad debt	<u>32,399</u>	<u>15,831</u>
Self-pay (net of contractual allowance, discounts, and provision for bad debts)	7,715	8,140
Medicaid	206,524	185,151
Medicare	356,603	304,133
Commercial insurance and other third-party payors	<u>839,167</u>	<u>764,008</u>
Patient service revenue (net of contractual allowance, discounts, and provision for bad debts)	\$ <u><u>1,410,009</u></u>	<u><u>1,261,432</u></u>

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. 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 2016 and 2015 net patient service revenue from third-party payors increased approximately \$20.8 million and \$3.5 million, respectively, due to prior year retroactive adjustments in excess of amounts previously estimated.

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.

Revenue from Medicare accounted for approximately 25.3% and 24.1% of UIHC's net patient revenue for the years ended 2016 and 2015, respectively.

**(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 Medicaid programs accounted for approximately 14.6% and 14.7% of UIHC's net patient revenue for the years ended 2016 and 2015, respectively.



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**(c) 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, 2016 and 2015 are as follows:

	<u>2016</u>	<u>2015</u>
Charity care	\$ 27,079	25,502
Charity care for state institution patients	<u>7,320</u>	<u>7,232</u>
Charity care charges forgone	<u>\$ 34,399</u>	<u>32,734</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, 2016 and 2015, approximate the following:

	<u>2016</u>	<u>2015</u>
Medicare	\$ 62,858	30,646
Medicaid	38,667	21,783
Medicaid out of state	<u>3,172</u>	<u>2,069</u>
Uncompensated costs of services	<u>\$ 104,697</u>	<u>54,498</u>

**STATE UNIVERSITY OF IOWA,  
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Notes to Financial Statements

June 30, 2016 and 2015

(Dollars in tables in thousands)

**(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, 2016 and 2015 was as follows:

	<u>2016</u>	<u>2015</u>
Blue Cross/Blue Shield	25%	29%
Commercial pay	32	28
Medicare	25	25
Medicaid	15	15
Self-pay	1	1
Other	<u>2</u>	<u>2</u>
	<u>100%</u>	<u>100%</u>

**(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, 2016 and 2015 was \$9.8 million and \$5.6 million, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2016 (in thousands):

Year ending June 30:	
2017	\$ 8,007
2018	6,785
2019	5,190
2020	5,054
2021	4,654
2022–2026	23,272
2027–2031	20,946
2032–2036	<u>5,538</u>
Total	<u>\$ 79,446</u>

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(Dollars in tables in thousands)

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

Accounts payable and accrued expenses reported as current liabilities at June 30, 2016 and 2015 consisted of the following amounts (in thousands):

	<u>2016</u>	<u>2015</u>
Payable to employees (including payroll taxes)	\$ 92,016	82,546
Payable to suppliers	45,875	38,491
Other	<u>3,885</u>	<u>7,841</u>
Total accounts payable and accrued expenses	<u>\$ 141,776</u>	<u>128,878</u>

**(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.

**(15) Subsequent Events**

UIHC has reviewed subsequent events through November 23, 2016 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.

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

Schedule of Proportionate Share of the Net Pension Liability

Iowa Public Employees' Retirement System

Last Fiscal Year \*

(In thousands)

Required Supplementary Information

June 30, 2016

(Unaudited)

	<u>2016</u>	<u>2015</u>
UIHC's proportion of the net pension liability	0.47349%	0.38388%
UIHC's proportionate share of the net pension liability	\$ 23,539	15,536
UIHC's covered-employee payroll	32,763	29,902
UIHC's proportionate share of the net pension liability as a percentage of its covered-employee payroll	71.8%	52.0%
Plan fiduciary net position as a percentage of the total pension liability	85.2%	87.6%

The amounts presented for each fiscal year were determined as of June 30.

\* Note:

GASB Statement No. 68 requires ten years of information to be presented in this table.

However, until a full 10-year trend is compiled, UIHC will present information for those years for which information is available.

See accompanying independent auditors' report.

**STATE UNIVERSITY OF IOWA,  
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Schedule of UIHC Contributions  
Iowa Public Employees' Retirement System  
Last 10 Fiscal Years

(In thousands)

Required Supplementary Information

June 30, 2016

(Unaudited)

	<u>2016</u>	<u>2015</u>	<u>2014</u>	<u>2013</u>	<u>2012</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Statutorily required contribution	\$ 3,603	2,660	2,299	1,896	1,528	976	665	587	470	423
Contributions in relation to the statutorily required contribution	<u>(3,603)</u>	<u>(2,660)</u>	<u>(2,299)</u>	<u>(1,896)</u>	<u>(1,528)</u>	<u>(976)</u>	<u>(665)</u>	<u>(587)</u>	<u>(470)</u>	<u>(423)</u>
Contribution deficiency (excess)	<u>\$ —</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
UIHC's covered-employee payroll	\$ 32,763	29,902	25,706	21,965	18,748	13,521	9,854	9,159	7,740	6,775
Contributions as a percentage of the covered-employee payroll	11.0%	8.9%	8.9%	8.6%	8.1%	7.2%	6.7%	6.4%	6.1%	5.8%

See accompanying independent auditors' report.

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

Notes to Required Supplementary Information

June 30, 2016

(Unaudited)

*Changes of Benefit Terms*

Legislation passed in 2010 modified benefit terms for current Regular members. The definition of final average salary changed from the highest three to the highest five years of covered wages. The vesting requirement changed from four years of service to seven years. The early retirement reduction increased from 3% per year measured from the member's first unreduced retirement age to a 6% reduction for each year of retirement before age 65.

In 2008, legislative action transferred four groups – emergency medical service providers, county jailers, county attorney investigators, and National Guard installation security officers – from Regular membership to the protection occupation group for future service only.

Benefit provisions for sheriffs and deputies were changed in the 2004 legislative session. The eligibility for unreduced retirement benefits was lowered from age 55 by one year each July 1 (beginning in 2004) until it reached age 50 on July 1, 2008. The years of service requirement remained at 22 or more. Their contribution rates were also changed to be shared 50-50 by the employee and employer, instead of the previous 40–60 split.

*Changes of Assumptions*

The 2014 valuation implemented the following refinements as a result of a quadrennial experience study:

- Decreased the inflation assumption from 3.25% to 3.00%.
- Decreased the assumed rate of interest on member accounts from 4.00% to 3.75% per year.
- Adjusted male mortality rates for retirees in the Regular membership group.
- Reduced retirement rates for sheriffs and deputies between the ages of 55 and 64.

Moved from an open 30-year amortization period to a closed 30-year amortization period for the unfunded actuarial liability (UAL) beginning June 30, 2014. Each year thereafter, changes in the UAL from plan experience will be amortized on a separate closed 20-year period.

The 2010 valuation implemented the following refinements as a result of a quadrennial experience study:

- Adjusted retiree mortality assumptions.
- Modified retirement rates to reflect fewer retirements.
- Lowered disability rates at most ages.
- Lowered employment termination rates
- Generally increased the probability of terminating members receiving a deferred retirement benefit.
- Modified salary increase assumptions based on various service duration.

**STATE UNIVERSITY OF IOWA,  
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Notes to Required Supplementary Information

June 30, 2016

(Unaudited)

The 2007 valuation adjusted the application of the entry age normal cost method to better match projected contributions to the projected salary stream in the future years. It also included in the calculation of the UAL amortization payments the one-year lag between the valuation date and the effective date of the annual actuarial contribution rate.

The 2006 valuation implemented the following refinements as a result of a quadrennial experience study:

- Adjusted salary increase assumptions to service-based assumptions.
- Decreased the assumed interest rate credited on employee contributions from 4.25% to 4.00%.
- Lowered the inflation assumption from 3.50% to 3.25%.

Lowered disability rates for sheriffs and deputies and protection occupation members.