



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

Financial Statements

June 30, 2006 and 2005

(With Independent Auditors' Report Thereon)



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

Independent Auditors' Report

The Board of Regents
State of Iowa:

We have audited the accompanying balance sheets of the State University of Iowa, University of Iowa Hospitals and Clinics (UIHC) as of June 30, 2006 and 2005, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of UIHC's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of UIHC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in note 1, the financial statements of UIHC are intended to present the financial position and the changes in financial position and cash flows of only that portion of the business-type activities of the State University of Iowa that is attributable to the transactions of UIHC. UIHC is a department of the State University of Iowa for financial reporting purposes. They do not purport to, and do not, present fairly the financial position of the State University of Iowa as of June 30, 2006 and 2005, and the changes in its financial position and its cash flows, where applicable, for the years then ended, in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State University of Iowa, University of Iowa Hospitals and Clinics as of June 30, 2006 and 2005, and the changes in its net assets and its cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

The accompanying management's discussion and analysis on pages 3 through 8 is not a required part of the basic financial statements of UIHC, but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

Des Moines, Iowa
December 21, 2006

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

June 30, 2006 and 2005

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, 2006 and 2005. The purpose is to provide an objective analysis of the financial activities of UIHC based on currently known facts, decisions, and conditions. Please read it in conjunction with UIHC's financial statements and the accompanying notes to the financial statements.

Overview of the Financial Statements

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

The financial statements (balance sheets, statements of revenues, expenses, and changes in net assets, and statements of cash flows) present, on a comparative basis, the financial position of UIHC at June 30, 2006 and 2005 (the end of the fiscal year), and the results of its operations and its financial activities for each of the years then ended. These statements report information about UIHC using accounting methods similar to those used by private-sector companies. The balance sheets include all of UIHC's assets and liabilities. The statements of revenues, expenses, and changes in net assets reflect each year's activities on the accrual basis of accounting, i.e., when services are provided or obligations are incurred, not when cash is received or paid. These statements report UIHC's net assets and how they have changed. Net assets (the difference between assets and liabilities) is one way to measure financial health or position. The statements of cash flows provide relevant information about each year's cash receipts and cash payments and classify them as to operating, noncapital financing, capital, and related financing and investing activities. The financial statements include notes that explain information in the financial statements and provide more detailed data.

Overall Financial Position and Operations

UIHC's net assets increased in each of the past two years, with a \$50.1 million or 6.1% increase in 2006 and a \$35.7 million or 4.6% increase in 2005. UIHC reported an increase in operating income in both 2006 and 2005. Operating income in 2006 increased by \$9.4 million or 34.1% over the operating income reported in 2005. Operating income in 2005 increased by \$21.0 million or 323.9% over the operating income reported in 2004. Nonoperating revenues increased by \$3.9 million or 42.0% in 2006 compared to 2005. Nonoperating revenues decreased by \$2.3 million or 19.7% in 2005 compared to 2004. Table 1 provides a summary of UIHC's net assets as of June 30, 2006, 2005, and 2004.

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

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Assets:			
Current assets	\$ 221,068	198,480	208,087
Noncurrent cash and investments	357,618	336,364	323,782
Capital assets, net	462,034	433,365	403,954
Other assets	1,490	2,777	4,616
Total assets	<u>\$ 1,042,210</u>	<u>970,986</u>	<u>940,439</u>
Liabilities:			
Current liabilities	\$ 141,849	118,502	120,127
Long-term debt	29,956	31,218	33,298
Other long-term liabilities	1,248	2,191	3,686
Total liabilities	<u>173,053</u>	<u>151,911</u>	<u>157,111</u>
Net assets:			
Invested in capital assets, net of related debt	429,630	399,719	368,227
Restricted	13,869	12,437	14,763
Unrestricted:			
Designated by Board of Regents	343,764	323,917	308,807
Unrestricted	81,894	83,002	91,531
Total net assets	<u>869,157</u>	<u>819,075</u>	<u>783,328</u>
Total liabilities and net assets	<u>\$ 1,042,210</u>	<u>970,986</u>	<u>940,439</u>

A significant component of the change in UIHC's assets is the increase in capital assets. During 2006 and 2005, UIHC constructed or purchased \$85.4 million and \$80.7 million, respectively, of capital assets. The major capital asset additions included:

- Continuing construction of the Ambulatory Surgery Center and Procedure Suite
- Continuing construction of the Emergency Treatment Center expansion and renovation
- Old Capital Mall renovations
- Near completion of the new \$39.6 million Center of Excellence in Image-Guided Radiation Therapy
- Continuing construction of the Intermediate Pulmonary Care Unit
- Establishment of the Nursing Clinical Education Center
- MRI Suite Development

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- Continuing construction of the renovation of the Pediatric inpatient units, phase 2
- Development of Patient Registration Services Facilities
- Major equipment additions in 2006 and 2005 consisted of radiology digital imaging and picture archiving systems, Radiology Mobile Radiographic system, Radiology MRI system, anesthesia machines, replacement lithotripter, neonatal ventilators, equipment for the Intermediate Pulmonary Care unit and the Ambulatory Surgery Center, and healthcare information systems software for medication and intensive care services.

Debt

At June 30, 2006 and 2005, UIHC had \$32.4 and \$33.6 million, respectively, in revenue bonds and capital lease obligations outstanding. During 2006 and 2005, principal payments on long-term debt were \$1.4 and \$2.3 million, respectively.

Operating Results and Changes in Net Assets

In 2006 and 2005, UIHC's net assets increased by \$50.1 million and \$35.7 million, respectively.

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Table 2 shows the changes in net assets for 2006 compared to 2005 and 2004.

Table 2

UNIVERSITY OF IOWA HOSPITALS AND CLINICS

Condensed Revenues, Expenses, and Changes in Net Assets Information

(In thousands)

	<u>2006</u>	<u>2005</u>	<u>2004</u>
Operating revenues:			
Net patient service revenue	\$ 737,336	637,737	603,530
Other revenue	36,505	36,381	34,985
Total operating revenues	<u>773,841</u>	<u>674,118</u>	<u>638,515</u>
Operating expenses:			
Salaries and benefits	370,511	348,638	329,695
Medical supplies and drugs	141,317	129,570	136,463
Other supplies and general expenses	171,432	119,879	123,209
Depreciation and amortization	53,707	48,542	42,663
Total operating expenses	<u>736,967</u>	<u>646,629</u>	<u>632,030</u>
Operating income	36,874	27,489	6,485
Nonoperating revenues (expenses):			
Gain (loss) on disposal of capital assets	(1,266)	(2,728)	1,483
Gifts and bequests	4,199	1,051	4,074
Investment income	10,327	11,170	6,207
Interest expense	(5)	(159)	(120)
Total nonoperating revenues, net	<u>13,255</u>	<u>9,334</u>	<u>11,644</u>
Excess of revenues over expenses before transfers	50,129	36,823	18,129
Net transfers out	<u>(47)</u>	<u>(1,076)</u>	<u>(1,159)</u>
Increase in net assets	50,082	35,747	16,970
Net assets, beginning of year	<u>819,075</u>	<u>783,328</u>	<u>766,358</u>
Net assets, end of year	<u>\$ 869,157</u>	<u>819,075</u>	<u>783,328</u>

Net Patient Service Revenue

Net patient service revenue increased from 2005 to 2006 by \$99.6 million or 15.6% and \$34.2 million or 5.7% from 2004 to 2005. The increases in net patient service revenue were driven by both increases in patient volumes and pricing increases during the same periods. During 2005, acute admissions decreased 321 or 1.3% from

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25,384 to 25,063 admissions. During 2006, acute admissions increased 967 or 3.9% from 25,063 to 26,030 admissions. The Hospital experienced increases in outpatient services during both years.

The State of Iowa (the State) has made annual appropriations to UIHC to care for certain uninsured or underinsured individuals, as well as to provide psychiatric services and services to children with disabilities. This funding also helps to assure that a sufficient patient base exists at UIHC to support health professionals' education. Effective July 1, 2005 the state-sponsored indigent care program ended and was replaced with a new Medicaid waiver demonstration program titled "IowaCare". The IowaCare program is approved by the Centers for Medicare and Medicaid Services for a 5-year period, from July 1, 2005 through June 30, 2010. Appropriations received for these programs in 2006 and 2005 were \$47,574,813 and \$40,690,905, respectively. Services provided by UIHC under its charity care programs, measured at established hospital rates, were \$106,503,606 and \$91,278,721 in 2006 and 2005, respectively.

The provision for bad debts (a deduction from gross patient charges) decreased \$29.4 million from \$57.4 million in 2005 to \$28.0 million in 2006. The provision for bad debts increased \$7.7 million from \$49.7 million in 2004 to \$57.4 million in 2005. The large decrease in the provision for bad debts from 2005 to 2006 was due to two factors. The first factor was that in 2004 and 2005 significant provisions were made for accounts receivables being carried from 2003 (resulting from the sunseting of the previous patient billing system). The second factor was due to improved collections.

Operating Expenses

Total operating expenses increased 14.0% from \$646.6 million in 2005 to \$737.0 million in 2006 and 2.3% from \$632.0 million in 2004 to \$646.6 million in 2005. The largest increases in expenses during these years are attributed to salaries and benefits, depreciation, and in 2006, other supplies and general expenses.

Transactions with Related Parties

UIHC purchases certain administrative and supervisory services, utilities, and other general services from the State University of Iowa (University). These services are purchased at the approximate cost incurred by the servicing unit. For the years ended June 30, 2006, 2005, and 2004, UIHC expensed approximately \$110.3 million, \$79.5 million, and \$75.7 million, respectively, for these administrative services, utilities, and other services and support requirements.

UIHC also provides certain administrative services to units of the University, particularly to the Roy J. and Lucille A. Carver College of Medicine (College of Medicine). These services include billing, collection, and other physician practice-related clinic overhead expenses. For the years ended June 30, 2006, 2005, and 2004, UIHC received revenue from these units of approximately \$26.3 million, \$27.3 million, and \$23.6 million, respectively, for these services.

UIHC and the College of Medicine have formed a nonprofit corporation, University of Iowa Health System (UIHS), to enhance and support the educational missions of UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multi-state network development activities. No funds were transferred in 2006 and 2005. UIHC transferred \$0.9 million to the University's College of Medicine in support of clinical programs for the years ended June 30, 2006 and 2005.

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Nonoperating Revenues and Expenses

Nonoperating revenues consist primarily of gain (loss) on disposals of capital assets, investment income, and gifts and bequests. Investment income decreased from 2005 to 2006 by \$0.8 million or 7.5% and from 2004 to 2005 by \$4.9 million or 79.9%. During 2006, UIHC recorded a net unrealized loss on investments of \$1.6 million, which decreased investment income accordingly. This compares to the unrealized loss of \$1.6 million in the previous year.

Contacting UIHC's Financial Management

This financial report provides the citizens of Iowa, our patients, bondholders, and creditors with a general overview of UIHC's finances and operations. If you have questions about this report, please contact Mr. Dan Rieber, Interim Associate Director and Chief Financial Officer, University of Iowa Hospitals and Clinics, 200 Hawkins Drive, W139 GH, Iowa City, Iowa 52242-1009.

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Balance Sheets

June 30, 2006 and 2005

Assets	2006	2005
Current assets:		
Cash and cash equivalents	\$ 6,138,311	6,034,286
Short-term investments	67,090,836	58,277,395
Patient accounts receivable, net of estimated uncollectibles		
\$22,598,821 in 2006 and \$41,466,306 in 2005	102,860,830	93,964,050
Accounts receivable managed for the College of Medicine	18,552,970	19,029,004
Inventories	19,120,973	17,688,969
Other current assets	7,303,850	3,486,501
Total current assets	221,067,770	198,480,205
Noncurrent cash and investments:		
Designated by Board of Regents	343,763,717	323,916,868
Held by trustee for debt service	3,637,365	3,675,918
Restricted by contributors and grantors for capital acquisitions and research	10,217,344	8,770,941
	357,618,426	336,363,727
Capital assets, net	462,033,690	433,365,091
Other assets	1,490,027	2,777,360
Total assets	\$ 1,042,209,913	970,986,383
Liabilities and Net Assets		
Current liabilities:		
Current maturities of long-term debt	\$ 2,447,423	2,428,381
Accounts payable and accrued expenses	84,865,256	81,308,618
Estimated third-party payor settlements	7,773,514	8,504,509
Due to related parties	44,921,686	24,221,782
Other current liabilities	1,308,886	1,495,093
Current liabilities payable from restricted assets:		
Accrued interest	532,020	543,735
Total current liabilities	141,848,785	118,502,118
Long-term debt, net of current maturities	29,956,632	31,217,773
Other long-term liabilities	1,247,900	2,191,891
Total liabilities	173,053,317	151,911,782
Net assets:		
Invested in capital assets, net of related debt	429,629,635	399,718,937
Restricted:		
For debt service	3,105,345	3,132,183
By donors for specific purposes	10,763,214	9,304,927
Unrestricted	425,658,402	406,918,554
Total net assets	869,156,596	819,074,601
Total liabilities and net assets	\$ 1,042,209,913	970,986,383

See accompanying notes to financial statements.

**STATE UNIVERSITY OF IOWA,
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Statements of Revenue, Expenses, and Changes in Net Assets
Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Operating revenues:		
Net patient service revenue, net of provision for bad debts of \$27,993,309 in 2006 and \$57,377,570 in 2005	\$ 737,335,757	637,737,398
Other revenue	36,505,448	36,380,690
Total operating revenues	<u>773,841,205</u>	<u>674,118,088</u>
Operating expenses:		
Salaries and benefits	370,510,565	348,638,014
Medical supplies and drugs	141,317,570	129,569,919
Other supplies and general expenses	171,432,096	119,879,109
Depreciation and amortization	53,707,295	48,542,033
Total operating expenses	<u>736,967,526</u>	<u>646,629,075</u>
Operating income	36,873,679	27,489,013
Nonoperating revenues (expenses):		
Loss on disposal of capital assets	(1,266,298)	(2,728,568)
Noncapital grants and contributions	4,199,184	1,051,423
Investment income	10,327,681	11,169,791
Interest expense	(5,480)	(159,211)
Total nonoperating revenues, net	<u>13,255,087</u>	<u>9,333,435</u>
Excess of revenues over expenses before transfers	50,128,766	36,822,448
Net transfers out	<u>(46,771)</u>	<u>(1,075,664)</u>
Increase in net assets	50,081,995	35,746,784
Net assets, beginning of year	<u>819,074,601</u>	<u>783,327,817</u>
Net assets, end of year	<u>\$ 869,156,596</u>	<u>819,074,601</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Receipts from and on behalf of patients	\$ 714,301,660	613,862,106
Receipts from state grants	13,406,321	40,690,905
Other receipts and payments, net	57,338,044	35,762,885
Payments to employees	(366,977,453)	(348,515,563)
Payments to suppliers and contractors	(317,818,357)	(254,936,846)
Net cash provided by operating activities	<u>100,250,215</u>	<u>86,863,487</u>
Cash flow from noncapital financing activities:		
Transfers out	(543,683)	(1,858,383)
Transfers in	496,912	782,719
Noncapital grants and contributions	(4,199,184)	1,051,423
Net cash used in noncapital financing activities	<u>(4,245,955)</u>	<u>(24,241)</u>
Cash flows from capital and related financing activities:		
Purchase of capital assets	(79,429,381)	(78,682,497)
Proceeds from the sale of capital assets	233,702	62,441
Principal paid on long-term debt	(1,370,980)	(2,314,362)
Interest paid on long-term debt	(1,458,889)	(1,685,537)
Net cash used in capital and related financing activities	<u>(82,025,548)</u>	<u>(82,619,955)</u>
Cash flows from investing activities:		
Increase in noncurrent cash and investments	(14,471,008)	(11,978,847)
Purchase of short-term investments	(9,961,392)	(3,400,718)
Interest and dividends received on investments	10,557,713	11,318,679
Net cash used in investing activities	<u>(13,874,687)</u>	<u>(4,060,886)</u>
Net increase in cash and cash equivalents	104,025	158,405
Cash and cash equivalents at beginning of year	<u>6,034,286</u>	<u>5,875,881</u>
Cash and cash equivalents at end of year	<u>\$ 6,138,311</u>	<u>6,034,286</u>
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 36,873,679	27,489,013
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation and amortization	53,707,295	48,542,033
Provision for bad debts	27,993,309	57,377,570
Change in assets and liabilities:		
Accounts receivable	(36,414,055)	(38,827,075)
Inventories	(1,432,004)	(7,566,251)
Other current assets	(3,817,349)	1,429,863
Accounts payable and accrued expenses	3,556,638	757,489
Other current liabilities	(186,207)	(330,289)
Due to related parties	20,699,904	(2,444,191)
Estimated third-party payor settlements	(730,995)	435,325
Net cash provided by operating activities	<u>\$ 100,250,215</u>	<u>86,863,487</u>

Noncash investing activities:

UIHC held investments at June 30, 2006 with a fair value of \$430,847,573. During 2006, the net decrease in the fair value of these investments was \$1,553,234.

See accompanying notes to financial statements.

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Notes to Financial Statements

June 30, 2006 and 2005

(1) Summary of Significant Accounting Policies and Related Matters

(a) Reporting Entity

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

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

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

(b) Basis of Presentation

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

(c) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

(d) Cash and Investments

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

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Cash equivalents totaling \$6,138,311 and \$6,034,286 at June 30, 2006 and 2005, respectively, represent money market funds and other short-term investments that mature in three months or less from date of purchase.

(e) Inventories

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

(f) Capital Assets

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

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

(g) Costs of Borrowing

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

(h) Grants and Contributions

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

(i) Restricted Resources

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

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(j) Net Assets

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

(k) Operating Revenues and Expenses

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

(l) Net Patient Service Revenue

UIHC has agreements with third-party payors that provide for payments to UIHC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

(m) Charity Care

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

(n) Compensated Absences

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

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

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Notes to Financial Statements

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(o) Income Taxes

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

(2) Deposits and Investments

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

UIHC's cash and investments include specific investments and amounts pooled with cash and investments of the University and held in the University's name. UIHC's cash deposits at June 30, 2006 and 2005 were entirely covered by federal depository insurance or by the State Sinking Fund in accordance with Chapter 12C of the Code of Iowa. Chapter 12C provides for additional assessments against the depositories of the pool to ensure there will be no loss of public funds.

Noncurrent cash and investments limited by bond resolutions or designated by the Board were held for the following purposes at June 30, 2006 and 2005:

	2006	2005
Limited by bond resolutions:		
Debt service reserve	\$ 2,708,709	2,708,709
Debt retirement and interest sinking funds	928,656	967,209
Designated by Board of Regents:		
Capital projects and equipment and other needs	2,931,224	2,441,249
Surplus	247,417	321,767
Improvement, extension, and repair, operation, and maintenance funds	340,585,076	321,153,852
Restricted by donors	10,217,344	8,770,941
	\$ 357,618,426	336,363,727

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

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Cash and cash equivalents and short-term investments specifically identified or pooled with the cash and investments of the University totaled \$73,229,147 and \$64,311,681 at June 30, 2006 and June 30, 2005, respectively. Cash equivalents designated by the Board of Regents totaled \$64,981,589 and \$49,930,492 at June 30, 2006 and June 30, 2005, respectively.

UIHC's investments are recorded at fair value, as determined by quoted market price. As of June 30, 2006, UIHC had the following investments and quality credit ratings:

	<u>Market value</u>	<u>Effective duration</u>	<u>Quality rating</u>
University of Iowa Long-term Endowment Pool:			
Cash and cash equivalents	\$ 2,009,648	NA	NA
U.S. obligations	852,123	8.48	NA
Agency securities	1,188,290	3.21	NR
Corporate issuance	1,005,552	3.14	BBB+
Mortgage-backed securities	1,199,553	4.34	AAA
Mutual funds – fixed income	5,110,533	NA	NA
U.S. equity	23,572,753	NA	NA
International equity mutual fund	6,560,549	NA	NA
Real estate	2,160,700	NA	NA
Subtotal	<u>43,659,701</u>		
University of Iowa Intermediate (Quasi II) Endowment Pool:			
Cash and cash equivalents	7,187,668	NA	NA
U.S. obligations	4,498,260	8.69	NA
Agency securities	6,641,919	3.18	NR
Corporate issuance	5,662,714	3.12	BBB+
Mortgage-backed securities	6,854,975	4.30	AAA
Mutual funds – fixed income	29,230,592	NA	NA
Subtotal	<u>60,076,128</u>		
University of Iowa Operating Investment Pool:			
Cash and cash equivalents	136,326,485	NA	NA
U.S. obligations	49,571,037	1.09	NA
Agency securities	52,861,266	1.58	NR
Corporate issuance	64,087,785	1.57	AAA
Mortgage-backed securities	24,265,171	2.03	AAA
Subtotal	<u>327,111,744</u>		
Total investments	<u>\$ 430,847,573</u>		

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June 30, 2006 and 2005

As of June 30, 2005, UIHC had the following investments and quality credit ratings:

	<u>Market value</u>	<u>Effective duration</u>	<u>Quality rating</u>
University of Iowa Long-term Endowment Pool:			
Cash and cash equivalents	\$ 207,458	NA	NA
U.S. obligations	560,643	9.72	NA
Agency securities	14,504	11.70	NR
Corporate issuance	1,421,541	3.81	A+
Mortgage-backed securities	3,108,709	2.67	AAA
Mutual funds – fixed income	5,264,517	NA	NA
U.S. equity	23,358,070	NA	NA
International equity mutual fund	2,547,853	NA	NA
Subtotal	<u>36,483,295</u>		
University of Iowa Intermediate (Quasi II) Endowment Pool:			
Cash and cash equivalents	924,598	NA	NA
U.S. obligations	2,925,583	10.11	NA
Agency securities	87,107	11.70	NR
Corporate issuance	8,268,505	3.80	A+
Mortgage-backed securities	17,187,055	2.69	AAA
Mutual funds – fixed income	29,711,411	NA	NA
Subtotal	<u>59,104,259</u>		
University of Iowa Operating Investment Pool:			
Cash and cash equivalents	113,110,117	NA	NA
U.S. obligations	16,648,448	1.20	NA
Agency securities	45,342,976	1.10	NR
Corporate issuance	98,954,072	1.28	A+
Mortgage-backed securities	31,032,241	1.08	AAA
Subtotal	<u>305,087,854</u>		
Total investments	<u>\$ 400,675,408</u>		

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

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

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

(3) Capital Assets

Capital assets at June 30, 2006 and 2005 are summarized as follows:

	2006	2005
Infrastructure and land improvements	\$ 38,557,962	38,523,144
Buildings and leasehold improvements	577,315,440	498,388,803
Equipment and software	266,319,195	243,319,617
Construction in progress (nondepreciable)	53,518,981	76,727,165
	935,711,578	856,958,729
Less accumulated depreciation	473,677,888	423,593,638
	\$ 462,033,690	433,365,091

Capital asset additions, retirements, and balances for the years ended June 30, 2006 and 2005 were as follows:

Cost basis summary	Infrastructure and land improvements	Buildings and leasehold improvements	Equipment and software	Construction in progress (nondepreciable)	Total
June 30, 2004 balances	\$ 37,174,704	481,658,340	240,437,335	45,843,190	805,113,569
Acquisitions	1,348,440	16,730,463	31,780,850	30,883,975	80,743,728
Sales and retirements	—	—	(28,898,568)	—	(28,898,568)
June 30, 2005 balances	38,523,144	498,388,803	243,319,617	76,727,165	856,958,729
Acquisitions	34,818	78,926,637	29,689,887	(23,208,184)	85,443,158
Sales, retirements, and transfers	—	—	(6,690,309)	—	(6,690,309)
June 30, 2006 balances	\$ 38,557,962	577,315,440	266,319,195	53,518,981	935,711,578

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Related information on accumulated depreciation for the years ended June 30, 2006 and 2005 was as follows:

<u>Accumulated depreciation summary</u>	<u>Infrastructure and land improvements</u>	<u>Buildings and leasehold improvements</u>	<u>Equipment and software</u>	<u>Total</u>
June 30, 2004 balances	\$ 21,856,390	246,369,148	132,933,626	401,159,164
Depreciation expense	3,352,875	22,452,820	22,736,338	48,542,033
Sales and retirements	—	—	(26,107,559)	(26,107,559)
June 30, 2005 balances	25,209,265	268,821,968	129,562,405	423,593,638
Depreciation expense	2,268,690	26,660,529	24,778,076	53,707,295
Sales, retirements, and transfers	(11,930)	767,925	(4,379,040)	(3,623,045)
June 30, 2006 balances	<u>\$ 27,466,025</u>	<u>296,250,422</u>	<u>149,961,441</u>	<u>473,677,888</u>

At June 30, 2006, construction in progress related to various projects throughout the UIHC. The estimated cost to complete the current phase of equipment and projects under construction at June 30, 2006 is \$37.1 million. Other projects at June 30, 2006, with an estimated cost of \$189.4 million, have been committed to by the Board and/or UIHC; however, construction contracts had not been signed as of such date. These projects are anticipated to be funded through existing designated funds, cash provided by future operations, and/or the issuance of additional long-term debt.

Cost of capital assets includes interest during the construction period for qualifying projects. Interest costs capitalized for the years ended June 30, 2006 and 2005 were \$1,441,694 and \$1,484,638, respectively.

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(4) Long-term Debt

Long-term debt outstanding at June 30, 2006 and 2005 was as follows:

	<u>2006</u>	<u>2005</u>
Hospital Revenue Bonds:		
Series 1973 – matured September 1, 2003 but unredeemed	\$ 5,000	15,000
Series 1978 – matured September 1, 2003 but unredeemed	25,000	40,000
Series 1980 – matured September 1, 2000 but unredeemed	—	10,000
Series 1983 – matured September 1, 2003 but unredeemed	30,000	50,000
Series 2002 – 4.125% to 5.00%; maturing serially on September 1 through 2028	23,860,000	24,440,000
Telecommunications Facilities Revenue Bonds:		
Series S.U.I. 2000 – 4.80% to 5.40%; maturing serially on July 1 through 2015	5,004,855	5,382,660
Series S.U.I. 2003 – 2.00% to 3.80%; maturing serially on July 1 through 2013	<u>2,315,250</u>	<u>2,638,650</u>
Total long-term debt	31,240,105	32,576,310
Capital lease obligations (net book value of \$1,150,884)	<u>1,163,950</u>	<u>1,069,844</u>
	32,404,055	33,646,154
Long-term debt, current portion	<u>2,447,423</u>	<u>2,428,381</u>
	<u>\$ 29,956,632</u>	<u>31,217,773</u>

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Activity in long-term debt for the years ended June 30, 2006 and 2005 was as follows:

	June 30, 2005 balance	Additions	Reductions	June 30, 2006 balance	Amounts due within one year
Hospital Revenue Bonds, Series 1973	\$ 15,000	—	(10,000)	5,000	5,000
Hospital Revenue Bonds, Series 1978	40,000	—	(15,000)	25,000	25,000
Hospital Revenue Bonds, Series 1980	10,000	—	(10,000)	—	—
Hospital Revenue Bonds, Series 1983	50,000	—	(20,000)	30,000	30,000
Hospital Revenue Bonds, Series 2002	24,440,000	—	(580,000)	23,860,000	610,000
Telecommunications Facilities Revenue Bonds, 2000	5,382,660	—	(377,805)	5,004,855	394,785
Bonds, 2003	2,638,650	—	(323,400)	2,315,250	328,650
Total long-term debt	32,576,310	—	(1,336,205)	31,240,105	1,393,435
Capital lease obligations	1,069,844	128,881	(34,775)	1,163,950	1,053,988
	<u>\$ 33,646,154</u>	<u>128,881</u>	<u>(1,370,980)</u>	<u>32,404,055</u>	<u>2,447,423</u>

	June 30, 2004 balance	Additions	Reductions	June 30, 2005 balance	Amounts due within one year
Hospital Revenue Bonds, Series 1973	\$ 30,000	—	(15,000)	15,000	15,000
Hospital Revenue Bonds, Series 1978	70,000	—	(30,000)	40,000	40,000
Hospital Revenue Bonds, Series 1980	45,000	—	(35,000)	10,000	10,000
Hospital Revenue Bonds, Series 1983	50,000	—	—	50,000	50,000
Hospital Revenue Bonds, Series 2002	25,000,000	—	(560,000)	24,440,000	580,000
Telecommunications Facilities Revenue Bonds, 2000	5,743,072	—	(360,412)	5,382,660	377,805
Bonds, 2003	2,952,600	—	(313,950)	2,638,650	323,400
Net unamortized bond discount	(162,927)	—	162,927	—	—
Total long-term debt	33,727,745	—	(1,151,435)	32,576,310	1,396,205
Capital lease obligations	2,000,000	69,844	(1,000,000)	1,069,844	1,032,176
	<u>\$ 35,727,745</u>	<u>69,844</u>	<u>(2,151,435)</u>	<u>33,646,154</u>	<u>2,428,381</u>

The Hospital Revenue Bonds are special obligations of the Board of Regents payable solely out of Hospital Income. "Hospital Income" is defined as the gross income and funds received by the Hospital System, including the proceeds of rates, fees, charges, and payments for healthcare provider activities for patient care services rendered by the University's hospitals, clinics, laboratories, and ancillary facilities, after deduction of Current Expenses. Hospital Income does not include State appropriations to the University or Hospital System. So long as the Bonds or Parity Bonds remain outstanding, the entire Hospital System income and revenues shall be deposited to the Revenue Fund and shall be disbursed to the following funds in the following order: (1) the operation and maintenance fund, (2) the sinking fund, (3) the reserve fund, and (4) the system fund. The reserve fund requirement is equal to the maximum annual amount of the principal and interest coming due on the bonds and any parity bonds, or \$1,753,500.

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

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

	Principal	Interest
Year ending June 30:		
2007	\$ 1,393,435	1,404,388
2008	1,385,960	1,352,072
2009	1,442,413	1,296,164
2010	1,500,210	1,236,436
2011	1,569,058	1,172,819
2012 through 2016	7,534,030	4,853,679
2017 through 2021	5,135,000	3,434,785
2022 through 2026	6,515,000	2,036,150
2027 through 2029	4,765,000	365,375
	\$ 31,240,105	17,151,870

Capital Lease Obligations

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

Year ending June 30:	
2007	\$ 1,062,037
2008	34,844
2009	31,009
2010	30,179
2011	25,327
Total minimum payments required	1,183,396
Less amounts representing interest	19,446
	\$ 1,163,950

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

UIHC participates in the University's early retirement program. Subject to the approval of the director and chief executive officer of UIHC, an eligible employee may elect to receive early retirement incentives. The early retirement program generally provides certain life insurance and healthcare benefits until the employee reaches age 65. Retirees may continue participation after age 65 at their own cost. Eligible employees include faculty, professional – scientific employees, and merit system employees who have been employed by the Board for at least 15 years and are between 57 and 63 years old. Benefits under the early retirement plan are internally accounted for in the University's benefits pool and are paid by UIHC through the annual assessment paid to the pool. The plan was terminated in 2002 and all eligible employees who were interested in participating in the plan were required to elect participation in 2003. UIHC accrues an estimated benefit liability when an employee elects to participate in the plan and, at June 30, 2006 and 2005, UIHC has accrued \$2,556,785 and \$3,686,984, respectively, for these benefits in other current liabilities and other long-term liabilities.

(6) Retirement Benefit Plans

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

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

The University internally accounts for employee benefits using a benefits pool. Each department, including UIHC, is assessed a total amount to be paid into the pool covering all employee benefits, which approximated \$23.3 million and \$22.0 million for contributions to TIAA-CREF and IPERS in 2006 and 2005, respectively.

(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, professional, and general liability. UIHC pays the employer portion of the costs related to workers' compensation, unemployment, and medical and dental benefits. The provision for estimated medical malpractice claims includes estimates of the ultimate costs for both reported claims and claims incurred but not reported. UIHC purchases commercial property insurance for its facilities including business interruption insurance. UIHC also purchases commercial life and disability insurance for eligible employees as part of the University's benefit program.

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UIHC's portion of the health insurance liability, which is included in accounts payable and accrued expenses, is \$2,449,858 and \$2,211,066 as of June 30, 2006 and 2005, respectively, as follows:

	2006	2005
Liability for unpaid healthcare claims at beginning of year	\$ 2,211,066	2,121,020
Healthcare expenses incurred during the year	30,437,486	27,003,631
Healthcare payments to the University during the year	(30,198,694)	(26,913,585)
Liability for unpaid healthcare claims at end of year	\$ 2,449,858	2,211,066

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

The State Appeals Board, subject to the advice and approval of the Attorney General, is authorized to settle tort claims against the State of Iowa as set forth in Chapter 669 of the Code of Iowa. Tort liability claims settled in excess of \$5,000 must have the unanimous approval of all the members of the Appeals Board, the State Attorney General, and the District Court of the State of Iowa for Polk County. By interagency agreement, tort liability claims (including professional liability) under \$5,000 may be administered by the University, subject to a maximum expenditure of \$100,000 per year. All other tort claims are paid from the State of Iowa's general fund and are not an obligation of UIHC.

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

(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 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, 2006 and 2005, UIHC expensed approximately \$110.3 million and \$79.5 million, respectively, for these administrative services, utilities, and other services and support requirements. At June 30, 2006 and 2005, approximately \$21.9 million and \$801,000, respectively, were due to the University 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, 2006 and 2005, UIHC received revenue from these units of approximately \$26.3 million and \$27.3 million, respectively, for these services.

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UIHC and the College of Medicine have formed a nonprofit corporation, University of Iowa Health System (UIHS), to enhance and support the educational missions of the UIHC and the College of Medicine, particularly as these missions apply to clinical activities and statewide and multi-state network development activities. UIHC paid UIHS for certain administrative and other general services in the amount of \$0.9 million and \$0.7 million for the years ended June 30, 2006 and 2005, respectively.

The Faculty Practice Plan (the Practice Plan) is a clinical component of the University's College of Medicine. The UIHC performs billing and collection services for the Practice Plan. At June 30, 2006 and 2005, accounts receivables outstanding for the Practice Plan were \$18,552,970 and \$19,029,004, respectively. These amounts are also included in due to related parties at June 30, 2006 and 2005.

(9) Net Patient Service Revenue

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

Medicare

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

Iowa Medicaid

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

Revenue from Medicare and Medicaid programs accounted for approximately 22% and 13%, respectively, of UIHC's net patient revenue for the year ended 2006, and 26% and 16%, respectively, of UIHC's net patient revenue for the year ended 2005. 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 2006 net patient service revenue increased approximately \$2,757,000 due to the removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, review, and investigations. The 2005 net patient service revenue increased approximately \$442,000 due to the removal of allowances previously estimated that are no longer necessary as a result of final settlements and years that are no longer subject to audits, review, and investigations.

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

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

	2006	2005
Gross patient charges:		
Inpatient charges	\$ 774,803,188	748,118,368
Outpatient charges	616,266,703	554,153,048
Total gross patient charges	1,391,069,891	1,302,271,416
Less:		
Deductions from gross patient charges:		
Contractual adjustments – Medicare, Medicaid, and other	653,734,134	664,534,018
Net patient service revenue	\$ 737,335,757	637,737,398

Included in net patient service revenue are certain amounts received from the State of Iowa in support of indigent care. State reimbursements are received annually to provide acute patient care, psychiatric, and developmental patient care services to patients. Patients are referred from a variety of sources, such as their home county, state institutions, and school districts. For the years ended June 30, 2006 and 2005, amounts received from the State of Iowa were \$47.6 million and \$40.7 million, respectively.

(10) Charity Care

The State of Iowa has made annual appropriations to UIHC to care for certain uninsured or underinsured individuals, as well as to provide psychiatric services and services to children with disabilities. This funding also helps to assure that a sufficient patient base exists at UIHC to support health professionals' education and provides partial funding of charges foregone related to these services. The amount of charges foregone for services and supplies furnished under UIHC's charity policy aggregated \$118.9 million and \$95.7 million for 2006 and 2005, respectively.

(11) Disclosures about the Fair Value of Financial Instruments

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

Investments are recorded at fair value. The estimated fair value of the long-term debt was calculated by discounting future cash flows using borrowing rates currently available for debt of similar maturity. Carrying amount and estimated fair value of long-term debt at June 30, 2006 were \$31,240,105 and \$32,864,171, respectively, and at June 30, 2005 were \$32,576,310 and \$35,496,147, respectively. Other assets and obligations are insignificant, and carrying amounts are assumed to approximate fair value.

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

(12) Concentrations of Credit Risk

UIHC grants credit without collateral to its patients, most of who are Iowa residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2006 and 2005 was as follows:

	2006	2005
Commercial pay	37%	31%
Medicare	17	20
Self-pay	7	5
Medicaid	14	17
Blue Cross/Blue Shield	22	24
Other	3	3
	100%	100%

(13) Operating Leases

UIHC uses certain capital assets under noncancelable operating leases. In most cases, management expects that, in the normal course of operations, the leases will be renewed or replaced by other leases. Total rent expense under operating leases for the years ended June 30, 2006 and 2005 was \$4,490,616 and \$4,610,838, respectively.

The following is a schedule by year of future minimum rental payments required under noncancelable operating leases as of June 30, 2006:

	Year ending June 30:	
	2007	\$ 2,356,716
	2008	2,230,346
	2009	2,119,188
	2010	2,124,024
	2011	421,932
	Total minimum payments required	\$ 9,252,206

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

Notes to Financial Statements

June 30, 2006 and 2005

(14) Accounts Payable and Accrued Expenses

Accounts payable and accrued expenses reported as current liabilities at June 30, 2006 and 2005 consisted of the following amounts:

<u>Accounts payable and accrued expenses</u>	<u>2006</u>	<u>2005</u>
Payable to employees (including payroll taxes)	\$ 58,035,302	53,367,935
Payable to suppliers	18,281,690	18,406,053
Other	8,548,264	9,534,630
Total accounts payable and accrued expenses	<u>\$ 84,865,256</u>	<u>81,308,618</u>

(15) 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 which 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.