UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Annual Financial Report

June 30, 2012

(With Independent Auditors' Report Thereon)

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Annual Financial Report

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From the Vice President/Chief Financial Officer, Comptroller

UNIVERSITY OF ILLINOIS
Urbana-Champaign ● Chicago ● Springfield

Office of Vice President/Chief Financial Officer, Comptroller
349 Henry Administration Building
506 South Wright Street
Urbana, IL 61801

December 17, 2012

Holders of University of Illinois
Health Services Facilities System Revenue Bonds
and The Board of Trustees of the University of Illinois:

I am pleased to transmit the Annual Financial Report of the University of Illinois Health Services Facilities System for the fiscal year ended June 30, 2012. This report supplements the financial statements of the University of Illinois presented in the Annual Financial Report.

The 2012 financial statements and accompanying notes appearing on pages 4 through 26 have been audited by KPMG LLP, Independent Certified Public Accountants, as special assistants to the Auditor General of the State of Illinois, whose report on the financial statements appears on pages 2 and 3.

KPMG LLP will also prepare a report for the year ended June 30, 2012, containing special data requested by the Auditor General and another report covering their audit of the compliance of the University with applicable state and federal laws and regulations for the year ended June 30, 2012. These reports, which include some data related to the Health Services Facilities System, are not contained herein and are primarily for the use of the Auditor General and State and Federal agencies.

Very truly yours,

Walter K. Knorr,
Vice President/Chief Financial Officer,
Comptroller

KPMG LLP
Aon Center
Suite 5500
200 East Randolph Drive
Chicago, IL 60601-6436

Independent Auditors' Report

The Honorable William G. Holland
Auditor General of the State of Illinois
and
The Board of Trustees
University of Illinois:

As Special Assistant Auditors for the Auditor General of the State of Illinois, we have audited the accompanying balance sheet of the University of Illinois Health Services Facilities System (System), a segment of the University of Illinois, as of June 30, 2012, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on the financial statements based on our audit. The 2011 comparative information has been derived from the System's 2011 financial statements and, in our report dated December 16, 2011, we expressed an unqualified opinion on those financial statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 the System'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 audit provides a reasonable basis for our opinion.

As discussed in note 1 to the financial statements, the financial statements of the System are intended to present the financial position, the changes in its financial position, and cash flows of only that portion of the business-type activities of the University of Illinois that are attributable to the transactions of the System relating to complying with the requirements of the indentures for the System's Revenue Bonds. The financial statements do not purport to, and do not, present fairly the financial position of the University of Illinois as of June 30, 2012 or the changes in its financial position or its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

As discussed in note (1) (o) to the financial statements, the System adopted the provisions of Governmental Accounting Standards Board Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53*, as of July 1, 2011.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Illinois Health Services Facilities System as of June 30, 2012, and the changes in its financial position and its cash flows for the year then ended, in conformity with U.S. generally accepted accounting principles.

Management of the System has omitted the Management's Discussion and Analysis that U.S. generally accepted accounting principles require to be presented to supplement the basic financial statements. Such missing information, although not a part of the basic financial statements, is required by U.S. generally accepted accounting principles 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. Our opinion on the basic financial statements is not affected by this missing information.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2012 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

KPMG LLP

Chicago, Illinois
December 17, 2012

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Balance Sheet

June 30, 2012
(with comparative totals for June 30, 2011)

Assets and Deferred Outflow of Resources	**2012**	**2011**
Current assets:		
Claim on cash and on pooled investments	$ 153,112,357	167,372,326
Restricted claim on cash and on pooled investments, required for current liabilities	89,190	108,849
Restricted cash and cash equivalents	11,625	9,640
Accrued investment income	360,584	241,279
Patient accounts receivable, net	85,595,933	76,325,203
Other receivables	9,726,658	10,245,843
Inventories	5,707,170	4,537,237
Prepaid expenses, deposits, and other assets	541,958	613,042
Total current assets	255,145,475	259,453,419
Noncurrent assets:		
Restricted claim on cash and pooled investments – less amount required for current liabilities disclosed above	7,065,752	5,356,021
Capital assets, net of accumulated depreciation	166,018,810	149,667,389
Prepaid expenses and other assets	305,697	328,854
Total noncurrent assets	173,390,259	155,352,264
Deferred outflow of resources related to swap	6,108,592	1,048,296
Total assets and deferred outflow of resources	$ 434,644,326	415,853,979
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	$ 33,837,414	25,597,982
Accrued payroll	16,683,801	14,398,030
Accrued interest payable	100,815	118,489
Estimated third-party settlements	34,184,641	44,522,957
Current maturities of long-term debt	5,120,237	3,490,356
Deferred revenue		18,788
Current portion of accrued compensated absences	2,302,861	1,933,009
Total current liabilities	92,229,769	90,079,611
Noncurrent liabilities:		
Long-term debt, net of current maturities	53,987,724	59,933,586
Accrued compensated absences, net of current portion	21,980,817	22,054,389
Derivative instrument – swap liability	7,224,261	1,048,296
Total noncurrent liabilities	83,192,802	83,036,271
Total liabilities	175,422,571	173,115,882
Invested in capital assets, net of related debt	106,910,849	86,243,448
Restricted:		
Expendable for capital projects	7,061,842	5,348,070
Expendable for debt service	3,910	7,951
Unrestricted	145,245,154	151,138,628
Total net assets	259,221,755	242,738,097
Total liabilities and net assets	$ 434,644,326	415,853,979

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Revenues, Expenses and Changes in Net Assets

Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)

	2012	2011
Operating revenues:		
Net patient service revenues	$ 534,410,907	494,322,938
Other revenues	50,756,522	39,558,160
Total operating revenues	585,167,429	533,881,098
Operating expenses:		
Salaries and wages	282,102,944	267,173,869
Fringe benefits	165,913,006	138,716,720
Supplies and general expenses	245,490,731	214,617,914
Administrative services	19,175,978	15,697,277
Depreciation and amortization	18,930,878	18,710,893
Total operating expenses	731,613,537	654,916,673
Operating loss	(146,446,108)	(121,035,575)
Nonoperating revenues (expenses):		
On-behalf payments for fringe benefits	159,135,224	131,963,682
State appropriations	45,000,000	45,000,000
Transfer of State appropriations to the Illinois DHFS Hospital Services Fund	(45,000,000)	(45,000,000)
Net increase in fair value of investments	1,254,233	2,665,883
Interest on capital asset related debt	(1,870,562)	(1,765,203)
Investment income	1,389,481	1,248,870
Loss on disposal of capital assets	(1,179,311)	(829,041)
Other nonoperating revenues, net	2,154,703	413,687
Net nonoperating revenue	160,883,768	133,697,878
Increase in net assets	14,437,660	12,662,303
Net assets, beginning of year	242,738,097	230,075,794
Cumulative effect of change in accounting principle	2,045,998	
Net assets, beginning of year, as adjusted	244,784,095	230,075,794
Net assets, end of year	$ 259,221,755	242,738,097

See accompanying notes to financial statements.

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)

	2012	2011
Cash flows from operating activities:		
Patient services	$ 514,801,861	496,964,413
Payments to suppliers	(232,794,726)	(204,416,620)
Payments for administrative services	(19,175,978)	(15,697,277)
Payments to employees	(271,563,173)	(258,944,928)
Payments for benefits	(6,481,502)	(6,900,258)
Other receipts	37,447,497	25,648,991
Net cash provided by operating activities	22,233,979	36,654,321
Cash flows from noncapital financing activities:		
Other receipts	758,244	146,038
Net cash provided by noncapital financing activities	758,244	146,038
Cash flows from capital and related financing activities:		
Purchases of capital assets	(30,526,841)	(17,469,798)
Principal paid on capital debt and leases	(5,841,899)	(4,733,687)
Interest paid on capital debt and leases	(1,715,804)	(1,734,696)
Net cash used in capital and related financing activities	(38,084,544)	(23,938,181)
Cash flows from investing activities:		
Interest on investments	1,270,176	1,267,721
Pooled cash allocated from University related to unrealized gains	1,254,233	2,665,883
Net cash provided by investing activities	2,524,409	3,933,604
Net (decrease) increase in cash and cash equivalents	(12,567,912)	16,795,782
Cash and cash equivalents, beginning of year	172,846,836	156,051,054
Cash and cash equivalents, end of year	$ 160,278,924	172,846,836

(Continued)

UNIVERSITY OF ILLINOIS
HEALTH SERVICES FACILITIES SYSTEM

Statement of Cash Flows

Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)

	2012	2011
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$ (146,446,108)	(121,035,575)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation and amortization expense	18,930,878	18,710,893
Provision for uncollectible accounts	35,117,875	25,847,621
On-behalf payments for fringe benefits	159,135,224	131,963,682
Changes in assets and liabilities:		
Patient receivables	(44,388,605)	(19,050,495)
Other receivables	519,185	(1,367,567)
Inventories	(1,169,933)	(112,704)
Prepaid expenses, deposits, and other assets	71,084	(301,340)
Accounts payable and accrued expenses	10,525,203	6,283,889
Estimated third-party settlements	(10,338,316)	(4,155,651)
Accrued compensated absences	296,280	(147,220)
Deferred income	(18,788)	18,788
Net cash provided by operating activities	$ 22,233,979	36,654,321
Noncash investing, capital, and financing activities:		
On-behalf payments for fringe benefits	$ 159,135,224	131,963,682
State appropriation	45,000,000	45,000,000
Transfers to Illinois DHFS Hospital Services Fund	(45,000,000)	(45,000,000)
Capital assets transferred to the System from other sources	1,624,705	135,846
Capital assets transferred to the University	(228,246)	
Capital assets acquired through capital leases	4,515,153	
Loss on disposal of capital assets	(1,179,311)	(829,041)

See accompanying notes to financial statements.

(1) Summary of Significant Accounting Policies

Organizational Background and Basis of Presentation

The University of Illinois Health Services Facilities System (System) comprises the University of Illinois Hospital (Hospital) and associated clinical facilities providing patient care at, but not limited to, the University of Illinois at Chicago Medical Center. The System is a tertiary care facility located primarily in Chicago, Illinois offering a full range of clinical services. The System does not include the operations of the University of Illinois' Medical Service Plans or Colleges of Medicine. Management of the System is the responsibility of the University of Illinois (University).

The System was established by a Bond Resolution (Resolution) of the Board of Trustees (Board) of the University of Illinois adopted on January 22, 1997. These financial statements have been prepared to satisfy the requirements of the 1997B and 2008 bond indentures. The financial balances and activities of the System, included in these financial statements, are included in the University's financial statements. The financial statements of the System are prepared in accordance with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The System is not a separate legal entity and has not presented management's discussion and analysis.

The financial statements include certain prior year comparative information that has been derived from the System's 2011 financial statements. Such information does not include all of the information required to constitute a presentation in conformity with U.S. generally accepted accounting principles. Accordingly, such information should be read in conjunction with the System's financial statements for the year ended June 30, 2011.

Significant Accounting Policies

(a) Financial Statement Presentation and Basis of Accounting

The System prepared its financial statements as a Business Type Activity, as defined by GASB Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*, using the economic resources measurement focus and the accrual basis of accounting. Business Type Activities are those financed in whole or in part by fees charged to external parties for goods and services.

Under the accrual basis, revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of the related cash flows. Advances are classified as deferred revenue.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System follows all applicable GASB pronouncements. In addition, the System follows all applicable Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions and Accounting Research Bulletins of the Committee on Accounting Procedures issued on or before November 30, 1989 unless those pronouncements conflict with or contradict GASB pronouncements. The System has elected not to apply FASB pronouncements issued after November 30, 1989.

(b) ***Cash and Cash Equivalents***

The Statement of Cash Flows details the change in the cash and cash equivalents balance for the fiscal year. Cash and all liquid investments with original maturities of ninety days or less are defined as cash and cash equivalents.

(c) ***Investments***

Investments are recorded at fair value. Fair value is determined by quoted market prices for most of the System's investments. Fair value for investments in limited partnerships and certain mutual funds is determined using net asset values as provided by external investment managers.

(d) ***Inventories***

Inventories of pharmaceutical and other supplies are stated at the lower of cost, determined using the first-in, first-out method, or market.

(e) ***Capital Assets***

Capital assets are recorded at cost or, if donated, at fair value at the date of a gift. Depreciation of the capital assets is calculated on a straight-line basis over the estimated useful lives (see below) of the respective assets. The University's policy requires the capitalization of all land and collection purchases regardless of cost, equipment over $5,000, software, easements, buildings and improvements over $100,000 and infrastructure over $1,000,000. The System does not capitalize collections of works of art or historical treasures held for public exhibition, education or research in furtherance of public service rather than capital gain, unless they were previously capitalized as of June 30, 1999. Proceeds from the sale, exchange or other disposal of any item belonging to a collection of works of art or historical treasures must be applied to the acquisition of additional items for the same collection.

Estimated useful lives for capital assets are as follows:

	Useful life (in years)		**Useful life (in years)**
Buildings:		Improvements other than buildings:	
Shell	50	Site improvements	20
Service systems	25	Infrastructure	25
Fixed equipment	15	Moveable equipment:	
Remodeling	25	Equipment	3 – 15
Intangibles:			
Software	5 – 10		

(f) ***Deferred Outflow of Resources***

Under hedge accounting, the University has determined that the interest rate swap agreements on bonds payable, as hedging derivative instruments, are an effective hedge and, accordingly, changes in the fair values of the interest rate swaps, since being associated with the related outstanding bonds, are reported as deferred outflow of resources on the accompanying balance sheet. Additionally, interest rate swaps reassigned to new debt, after a refunding of debt that the swap was previously hedging, normally have an other than zero fair value upon the reassociation. For swaps with a fair value of other than zero upon reassociation with a hedgeable item, the fair value is amortized as an adjustment to interest expense in a systematic manner.

(g) Compensated Absences

Accrued compensated absences for System personnel are charged as an operating expense, using the vested method, based on earned but unused vacation and sick leave days including the System's share of Social Security and Medicare taxes. The estimated outstanding liability at June 30, 2012 was $24,283,678.

(h) Premiums, Issuance Costs, and Deferred Loss on Refundings

Premiums, issuance costs and losses on refundings for the System's bonds are deferred and amortized over the life of the debt issue using the straight-line method.

(i) Net Assets

The System's resources are classified into net asset categories and reported in the Balance Sheet. These categories are defined as (a) Invested in capital assets, net of related debt – capital assets net of accumulated depreciation and related outstanding debt balances attributable to the acquisition, construction, or improvement of those assets, (b) Restricted expendable – net assets subject to externally imposed restrictions that can be fulfilled by actions of the System pursuant to those stipulations or that expire by the passage of time, and (c) Unrestricted – net assets not subject to externally imposed stipulations but may be designated for specific purposes by action of management or the Board. The System first applies restricted net assets when an expense or outlay is incurred for purposes for which both restricted and unrestricted net assets are available.

(j) Classification of Revenues

The Statement of Revenues, Expenses and Changes in Net Assets classifies the System's fiscal year activity as operating and nonoperating. Operating revenues generally result from exchange transactions such as payments received for providing goods and services.

Certain revenue sources that the System relies on for operations including on-behalf payments for fringe benefits and investment income are defined by GASB Statement No. 35 as nonoperating. In addition, transactions related to capital and financing activities are components of net nonoperating revenue.

In fiscal year 2012, $45,000,000 of State appropriations were transferred to the Illinois Hospital Services Fund, which is a special fund established in the State of Illinois Treasury pursuant to the State Finance Act, 30 ILCS 105/6z-30. This fund is owned and operated by the Illinois Department of Healthcare and Family Services (DHFS). It is not part of or a related organization of the University.

Other operating revenues of the System include reimbursement from the University for System services/facilities utilized in connection with University programs, revenues from laboratory services provided to external organizations, cafeteria/gift shop sales and other sources.

(k) Patient Services Revenue

Net patient service revenue is reported at the estimated net realizable amounts due 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. The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Approximately 96% of the Hospital's net patient service revenues were derived from Medicare, Medicaid, Blue Cross and managed care programs for the year ended June 30, 2012.

(Continued)

Accruals for settlements with third-party payors are made based on estimates of amounts to be received or paid under the terms of the respective contracts and related settlement principles and regulations of the federal Medicare program, the Illinois Medicaid program, and the Blue Cross Plan of Illinois. For the year ended June 30, 2012, the Statement of Revenues, Expenses and Changes in Net Assets included increases in net patient service revenue of approximately $3,670,000 related to retroactive settlements and changes in prior year third-party settlement estimates.

Retroactive Medicaid reimbursements that were included in net patient revenues in fiscal year 2012 for services provided in fiscal year 2011 was approximately $5,838,000. The reimbursements received from the State Medicaid Program related to retroactive per diem rates for Medicaid inpatients and increased rates for Medicaid outpatients.

The System provides care without charge or at amounts at less than its established rates to patients who meet the criteria of its charity care policy. Because the System does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue. Consideration for eligibility of charity care is based on the application of the System's charity care policy and includes patient qualification criteria, financial resource criteria and service criteria. The System does not include the unreimbursed cost of providing care to Medicaid and Medicare patients as charity care.

The net cost of charity care provided in 2012 was approximately $17,806,000, an increase of 10% from the prior year. The net cost of charity care is determined by the total charity care cost less any patient related revenue due to the sliding scale payments or other patient specific resources. Most of the patient specific resources came from the Center for Medicare & Medicaid Services 1011 program reimbursement.

The System has agreements with various Health Maintenance Organizations (HMOs) to provide medical services to subscribing participants. Under these agreements, the System receives monthly capitation payments based on the number of each HMO's participants, regardless of services actually performed by the System. In addition, the HMOs make fee-for-service payments to the System for certain covered services based upon discounted fee schedules.

The System grants credit without collateral to its patients, most of who are local residents and are insured under third-party payor agreements. The mix of receivables from patients and third-party payors at June 30, 2012 was as follows:

Medicare	14%
Medicaid	34
HMO/PPO	38
Commercial	10
Self-pay and other	4
	100%

The System provides allowances for uncollectible accounts receivable based upon management's best estimate of uncollectible accounts, considering type, age, collection history, and any other factors as considered appropriate.

(l) ***Classification of Expenses***

The majority of the System's expenses are exchange transactions which GASB defines as operating expenses for financial statement presentation. Nonoperating expenses include transfers of State appropriations and capital financing costs.

(m) On-Behalf Payments for Fringe Benefits

In accordance with GASB Statement No. 24, *Accounting and Financial Reporting for Certain Grants and Other Financial Assistance*, the System reported payments made by the State of Illinois on behalf of the System for contributions to State group insurance and retirement programs, including postemployment benefits, for System employees and its retirees of $159,135,224 for the year ended June 30, 2012. On-behalf payments are classified as nonoperating revenues and the corresponding expenses are reported in fringe benefits of the System as operating expenses.

(n) 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 disclosure 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.

(o) New Accounting Pronouncements

The System adopted the provisions of GASB Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions, an amendment of GASB Statement No. 53*, (GASB 64) which was effective July 1, 2011. This statement clarifies whether an effective hedging relationship continues after the replacement of a swap counterparty. In September 2008, Lehman Brothers Holdings Inc. (LBHI), the parent of Lehman Brothers Commercial Bank (LBCB) filed for protection under Chapter 11 of the bankruptcy code. This caused an event of default under the interest rate swap agreement dated April 2, 2007 by and between LBCB and the University. The University entered into a novation agreement, which terminated the swap with LBCB and entered into a new interest rate swap agreement with a different counterparty with the same terms and conditions that were present in the April 2, 2007 agreement. As of July 1, 2011, implementation of GASB 64 required the System to eliminate the accounting treatment previously applied for the swap transaction through a retroactive adjustment to beginning net assets. In implementing this pronouncement the System recorded an effect of a change in accounting principle to beginning of year net assets by $2,045,998 as follows:

- A retroactive adjustment of ($1,193,969) represents the re-establishment of the difference between the deferred outflow of resources and derivative instrument-swap liability due to the interest rate swap agreement being disassociated with the Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2007, due to its refunding.

- A retroactive adjustment of $3,239,967 representing the elimination of the unamortized financing payable that was recognized when the interest rate swap agreement novated from LBHI to the current counterparty, Loop Financial Products, in fiscal year 2009.

Net assets, beginning of year, as previously reported	$ 242,738,097
Cumulative effect of change in accounting principle	2,045,998
Net assets, beginning of year, as adjusted	$ 244,784,095

(2) Cash, Cash Equivalents and Investments

The System has cash and certain investments which are pooled with other University funds for the purpose of securing a greater return on investment and providing an equitable distribution of investment return. Income is distributed based upon average quarterly balances invested in the investment pool.

Illinois Statutes govern the investment policies of the University. Allowable investments under these policies include the following:

- Obligations of the U.S. Treasury, other federal agencies and instrumentalities
- Interest-bearing savings accounts and time deposits of any bank as defined by the Illinois Banking Act
- Corporate bonds, stocks and equities
- Asset-backed securities
- Commercial paper
- Repurchase agreements
- Mutual funds

Nearly all of the University's investments are managed by external professional investment managers, who have full discretion to manage their portfolios subject to investment policy and manager guidelines established by the University, and in the case of mutual funds and other commingled vehicles, in accordance with the applicable prospectus.

The Board develops University policy on investments and delegates the execution of those policies to its administrative agents. The University follows the State of Illinois Uniform Prudent Management of Institutional Funds Act and the State of Illinois Public Funds Investment Act when investing its funds.

The following details the carrying value of the System's cash, cash equivalents, and investments as of June 30, 2012:

Mutual funds – money market	$	11,625
Claim on cash and pooled investments		160,267,299
Total cash, cash equivalents and investments	$	160,278,924

(a) Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. In accordance with its investment policy, the University employs multiple investment managers, of which each has specific maturity assignments related to the operating funds. The funds are structured with different layers of liquidity. Funds expected to be used within one year are invested in money market instruments. Core operating funds are invested in longer maturity investments. Core operating funds investment manager's performance benchmarks are the Barclays one-year to three-year Government Credit Bond Index and the Barclays Capital Intermediate Aggregate Bond Index. The University's manager guidelines provide that the average weighted duration of the portfolio, including option positions, not vary from that of their respective performance benchmarks by more than +/-20%. At June 30, 2012, all of the System's nonpooled cash and cash equivalents had maturities less than one year. Claim on cash and on pooled investments represents the System's share of participation in the University's operating internal investment pool. At June 30, 2012, the University's operating internal investment portfolio had an effective duration of 1.5 years. The operating internal investment pool consists of money market funds and other short-term investments (40%), stocks (6%) and long-term investments such as corporate bonds and government securities (54%).

(b) Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The University's investment policy requires that operating funds be invested in fixed income securities and money market instruments. Fixed income securities shall be rated investment grade or better by one or more nationally recognized statistical rating organizations. Securities not covered by the investment grade standard are allowed if, in the manager's judgment, those instruments are of comparable credit quality. Securities which fall below the stated minimum credit requirements subsequent to initial purchase may be held at the manager's discretion. It is expected that the average credit quality of the operating funds will not fall below Standard & Poor's AA- or equivalent. At June 30, 2012, the System's nonpooled cash and cash equivalents carried an AAA quality rating. At June 30, 2012, the University's operating internal investment pool primarily consisted of securities with quality ratings of AA or better.

(c) Custodial Credit Risk

Custodial credit risk is the risk that in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. Exposure to custodial credit risk relates to investment securities that are held by someone other than the University and are not registered in the University's name. The University investment policy does not limit the value of investments that may be held by an outside party. At June 30, 2012, the University's investments and deposits had no custodial credit risk exposure.

(d) Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the University's investment in a single issuer. The University's policy provides that the total operating funds portfolio will be broadly diversified across securities in a manner that is consistent with fiduciary standards of diversification. This diversification is achieved by employing multiple investment managers and imposing maximum position limits for each manager. Within the University investment policy, the University's manager guidelines for operating investments provide that non-U.S. government obligations (other national governments) may not exceed 10% per issuer and private mortgage-backed and asset-backed securities may not exceed 10% per issuer (unless collateral is credit independent of the issuer and the security's credit enhancement is generated internally, in which case the limit is 25% per issuer). Obligations with other issuers, other than the U.S. government, U.S. agencies, or U.S. government sponsored corporations and agencies, may not exceed 5%. As of June 30, 2012, not more than 5% of the University's total investments were invested in securities of any one issuer, excluding securities issued or guaranteed by the U.S. government, mutual funds, and external investment pools or other pooled investments.

(e) Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The University does not have an overarching policy related to foreign currency risk; however, under the investment manager's guidelines, the portfolio's foreign currency exposure may be unhedged or hedged back into U.S. dollars. Cross hedging is not permitted. The University's operating fund investments generally are not exposed to foreign currency risk.

(f) Securities Lending

To enhance the return on investments, the Board has authorized participation in a securities lending program. Through its custodian bank, Northern Trust, the University loans securities to independent third parties. Such loans are secured by collateral consisting of cash, cash equivalents or U.S. government securities and irrevocable bank letters of credit in an amount not less than 102% of the fair value of the securities loaned. Noncash collateral cannot be pledged or sold by the University unless the borrower defaults. Cash collateral is invested by Northern Trust in a short-term investment pool. As of June 30, 2012, the short-term investment pool has a weighted average maturity of one hundred and eight days. The University receives interest and dividends during the loan period as well as a fee from the custodian. Marking to market is performed every business day and the borrower is required to deliver additional collateral when necessary so that the total collateral held by the custodian will equal at least the fair value plus accrued interest of the borrowed securities. All security loans can be terminated on demand by either the University or the borrowers. The University's pro rata share of cash received as securities lending collateral was approximately $90,732,000 at June 30, 2012, and is recorded as an asset and corresponding liability on the University's Balance Sheet. As of June 30, 2012, approximately $89,659,000 of the investments reported on the University's Balance Sheet was on loan, secured by collateral with a fair value of approximately $91,319,000. At June 30, 2012, the University has no credit risk exposure to borrowers because the amounts the University owes the borrowers exceed the amounts the borrowers owe the University. The System does not directly participate in this securities lending program, and hence, no amounts have been recorded in the accompanying financial statements related to securities lending transactions.

(3) Capital Assets

Capital asset activity for the year ended June 30, 2012 is summarized as follows:

Capital assets
(In thousands)

	Beginning balance	Additions	Retirements	Transfers	Ending balance
Nondepreciable capital assets:					
Land	$ 770,917				770,917
Construction in process	2,984,039	16,311,203		(5,022,517)	14,272,725
Total nondepreciable capital assets	3,754,956	16,311,203	—	(5,022,517)	15,043,642
Depreciable capital assets:					
Buildings	184,891,371			2,520,205	187,411,576
Leasehold improvements	2,177,211				2,177,211
Equipment	169,671,431	18,503,228	(25,534,651)		162,640,008
Software	22,908,314	1,852,268		2,502,312	27,262,894
Total depreciable capital assets	379,648,327	20,355,496	(25,534,651)	5,022,517	379,491,689
Less accumulated depreciation:					
Buildings	81,668,640	4,914,172			86,582,812
Leasehold improvements	1,488,267	235,909			1,724,176
Equipment	131,364,087	11,561,494	(24,127,094)		118,798,487
Software	19,214,900	2,196,146			21,411,046
Total accumulated depreciation	233,735,894	18,907,721	(24,127,094)	—	228,516,521
Total net depreciable capital assets	145,912,433	1,447,775	(1,407,557)	5,022,517	150,975,168
Total capital assets	$ 149,667,389	17,758,978	(1,407,557)	—	166,018,810

(4) Long-Term Obligations

During fiscal year 1997, Health Services Facilities System Bonds Series 1997B were issued for $25,000,000. Series 1997B Bonds are variable rate bonds, which bear interest at a rate determined weekly and paid monthly.

During fiscal year 2008, the University issued $41,215,000 Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2008. Proceeds from the bonds funded the redemption of the Variable Rate Demand Health Services Facilities System Revenue Bonds, Series 2007 on July 28, 2008 and paid costs incidental to the issuance of the bonds. The difference between the reacquisition price and net carrying amount of the old debt, loss on refunding, was $4,485,000. This loss is deferred and amortized as a component of interest expense over the remaining life of the old debt or the life of the new debt, whichever is shorter.

Costs associated with the issuance of the bonds have been recorded as prepaid expense and are being amortized over the life of the bonds. Amortization was $23,157 for the year ended June 30, 2012.

Long-term obligations activity for the year ended June 30, 2012 was as follows:

			Long–term obligations				
Series	**Rate on June 30 outstanding debt**	**Fiscal year maturity dates**	**Beginning balance**	**Additions**	**Deductions**	**Ending balance**	**Current portion**
Bonds payable:							
1997B	Variable	2013 – 2027	$ 17,800,000		800,000	17,000,000	800,000
2008	Variable	2013 – 2027	41,215,000		1,135,000	40,080,000	2,090,000
			59,015,000	—	1,935,000	57,080,000	2,890,000
Unamortized deferred loss on refunding			(3,823,565)		(250,732)	(3,572,833)	(250,732)
Financing payable under swap			3,239,967		3,239,967	—	—
Total bonds payable			58,431,402	—	4,924,235	53,507,167	2,639,268
Other obligations			4,992,540	4,515,153	3,906,899	5,600,794	2,480,969
Total long–term debt			63,423,942	4,515,153	8,831,134	59,107,961	5,120,237
Compensated absences			23,987,398	3,202,331	2,906,051	24,283,678	2,302,861
Total long–term obligations			$ 87,411,340	7,717,484	11,737,185	83,391,639	7,423,098

The bonds do not constitute obligations of the State of Illinois. Bond principal and interest payments are funded from revenues pledged from (a) System net revenues, principally consisting of all charges, income and revenues received from the continued use and operation of the System, excluding depreciation charges and transfers, (b) Medical Service Plan (MSP) revenues net of bad debt expense and (c) College of Medicine tuition revenue. These revenues for the year ended June 30, 2012 are as follows:

System net revenues	$ 7,713,284
Adjusted MSP revenues	197,612,155
College of Medicine student tuition	47,605,720
Total	$ 252,931,159

The table below shows the amount of revenues pledged for future principal and interest payments on the bonds:

Pledged revenues					
Bond issue(s)	Purpose	Source of revenue pledged	Future revenues pledged[1]	Term of commitment	Debt service to pledged revenues (current year)
Health Services Facilities System (HSFS)	Additions to System and Refunding	Net HSFS, Medical Service Plan revenue net of bad debt expense, College of Medicine net tuition revenue	$ 68,578,227	2027	1.34%

[1] Total future principal and interest payments on debt

The resolution authorizing the University of Illinois Health Services Facilities System Revenue Bonds provides for the establishment of separate funds as follows: Revenue Fund, Project Fund, Repair and Replacement Reserve, Equipment Reserve, Bond and Interest Sinking Fund and Development Reserve. All income and revenues received from the continued use and operation of the System, as provided for by the Bond Resolution, are to be deposited in the Revenue Fund and used to pay necessary operation and maintenance expenses of the System. The Bond Resolution also requires transfers to funds as follows:

Project Fund – at the discretion of the University Comptroller, amounts not needed to complete construction and renovation projects specified in the Bond Resolution are required to be transferred either to the Repair and Replacement Reserve or to the Bond and Interest Sinking Fund.

Repair and Replacement Reserve – an amount calculated as specified in the Bond Resolution to provide for the cost of unusual maintenance and repairs.

Equipment Reserve – an amount approved by the Board for the acquisition of movable equipment to be installed in the facilities constituting the System. The reserve may not exceed 20% of the book value of the movable equipment of the System.

Bond and Interest Sinking Fund – amounts transferred into the Bond and Interest Sinking Fund sufficient to pay principal and interest as it becomes due on the outstanding bonds.

Development Reserve – an amount approved by the Board for System development. No transfers were authorized by the Board during the year ended June 30, 2012, and there were no balances in the reserve at June 30, 2012.

The System made all required transfers for the year ended June 30, 2012.

After fulfillment of the provisions described above, the surplus, if any, remaining in the Revenue Fund may be used at the Board's option (a) to redeem bonds of the System which are subject to early redemption, (b) to improve or add facilities to the System, or (c) for any other lawful purpose.

Assets restricted by Bond Resolution were held for the following purposes at June 30, 2012:

Restricted assets:		
Cash and investments	$	7,166,567
Purpose:		
Repair and replacement reserve	$	7,061,842
Bond and interest sinking fund		104,725
Total assets limited as to use		7,166,567
Less amounts required for current liabilities		(100,815)
Total for long-term use	$	7,065,752

(a) Health Services Facilities System Variable Rate Debt and Interest Rate Swap Agreement

Demand Provisions

The System's bonds mature serially through October 2026. These bonds have variable interest rates that are adjusted periodically (i.e., daily, weekly, or monthly), generally with interest paid at the beginning of each month. The bonds are subject to purchase on the demand of the holder at a price equal to principal plus accrued interest on seven days notice and delivery to the University's several remarketing agents. The University pays the remarketing agent fees on the outstanding bond balance. If the remarketing agent is unable to resell any bonds that are "put" to the agent, the University has a standby bond purchase agreement with a liquidity facility entity. The University has several such agreements, with the fees on the Bond Purchase Commitment (formula based on outstanding bonds plus pro forma interest). The University, in the event a liquidity facility is utilized, has reimbursement agreements with different financial entities. Generally, the payback period is five to seven years, at an interest rate initially set at slightly above prime or the federal funds rate. The required future interest payments for these variable rate bonds have been calculated using the current interest rate, based upon short-term tax-exempt rates, or the synthetic fixed rate, as illustrated in the table below:

Variable rate bonds at June 30, 2012

Bond issues	Interest rate at June 30, 2012	Remarketing agent	Remarketing fee	Liquidity facility: Bank	Liquidity facility: Expiration	Liquidity facility: Insurer	Liquidity facility: Fee
HSFS, Series 1997B	0.18%	JPMorgan Securities	0.070%	JPMorgan Chase LOC	April 1, 2014	JPMorgan Chase LOC	0.55%
HSFS, Series 2008	0.18	Goldman Sachs	0.070	JPMorgan Chase LOC	June 3, 2014	JPMorgan Chase LOC	0.55

Interest Rate Swap Agreement

In April 2007, the University entered into a variable-to-fixed interest rate swap agreement with LBCB. The purpose of this interest rate swap was to hedge variable rate demand Health Services Facility System revenue refunding bonds issued in July 2007. The objective of this swap was to effectively change the System's variable interest rate on the bonds to a synthetic fixed rate. The notional amount of the interest rate swap was $40,875,000. No cash was paid or received when the original swap agreements were entered into. In accordance with the swap agreement, the University makes monthly payments to the counterparty equal to 3.534% times the notional amount and receives monthly payments from the counterparty equal to 68% of one-month London Interbank Offered Rate (LIBOR), which commenced October 1, 2007. This interest rate swap agreement with LBCB transferred to the Series 2008 bonds in July 2008. $330,000 of the HSFS Series 2008 bond is not covered by this agreement.

In December 2008, the University entered into a novation agreement, which terminated the swap with LBCB and entered into a new interest rate swap agreement with Loop Financial Products I LLC (Loop) with the same terms and conditions that were present in the April 2007 agreement. In December 2008, Loop officially became the new counterparty on the interest rate swap agreement.

The University engaged a third-party consultant to calculate the “mark to market” or “market value” of the swap transaction. On June 30, 2012, the mark to market value of the swap was ($7,224,261).

Credit Risk – As of June 30, 2012, the University was not exposed to credit risk because the swaps had a negative fair value. If interest rates change and the fair value of the swap became positive, the University would be exposed to credit risk in the amount of the derivative’s fair value. The counterparty may have to post collateral in the University’s favor in certain conditions, and the University would never be required to post collateral in the counterparty’s favor.

Interest Rate Risk – During fiscal year 2012, low interest rates exposed the University to interest rate risk, which adversely affected the fair values of the swap agreements.

Termination Risk – The swap is scheduled to terminate in October 2026. The University has the option to terminate the swap early. The University or the counterparties may terminate a swap if the other party fails to perform under the terms of the contract. The University may terminate a swap if both credit ratings of the counterparties fall below BBB+ as issued by Standard & Poor’s and Baa1 as issued by Moody’s Investors Service. As of June 30, 2012, the counterparty (Loop) credit rating by Standard & Poor’s was A+ and by Moody’s Investors Service was A2.

If a swap is terminated, the variable-rate bonds would no longer carry a synthetic fixed interest rate. In addition, if at the time of termination, a swap has a negative fair value, the University would be liable to the counterparties for a payment equal to the swap’s fair value.

Basis Risk – The swap exposes the University to basis risk should the relationship between LIBOR or Securities Industry Financial Markets Association and the variable weekly rate determined by remarketing agents change, changing the synthetic rate on the bonds. If a change occurs that results in the difference in rates widening, the expected cost savings may not be realized.

Other Risks – Since the swap agreement extends to the maturity of the related bond, it does not expose the University to rollover risk. In addition, the University is not exposed to foreign currency risk associated with this swap agreement. The University is not exposed to market access risk as of June 30, 2012. However, if the University decides to issue refunding bonds and credit is more costly at that time, it could be exposed to market access risk.

(b) Debt Service Requirements

Future debt service requirements for the Series 1997B and 2008 Bonds at June 30, 2012 are as follows:

		Principal		Interest
2013	$	2,890,000		1,386,094
2014		3,005,000		1,310,935
2015		3,120,000		1,232,886
2016		3,240,000		1,152,890
2017		3,365,000		1,069,655
2018 - 2022		18,805,000		3,977,535
2023 - 2027		22,655,000		1,368,232
Total debt service		57,080,000	$	11,498,227
Unamortized deferred loss on refunding		(3,572,833)		
Total bonds payable	$	53,507,167		

The required debt service for the variable rate Series 1997B and 2008 Bonds has been calculated using the current interest rate of 0.18% and 0.18%, respectively, over the remaining life of the bonds.

Using the actual rate in effect as of June 30, 2012 (0.18% for Series 2008), debt service requirements of the variable rate debt and net swap payments, assuming current interest rates remain the same for their term, were as follows. As rates vary, variable-rate bond interest payments and net swap payments will also vary.

Health Services Facilities System Revenue Bonds, Series 2008
Variable-Rate Debt Service Requirements

		Variable rate bonds		Interest rate	
		Principal	Interest	swaps, net	Total
2013	$	2,090,000	72,144	1,284,310	3,446,454
2014		2,105,000	68,382	1,214,473	3,387,855
2015		2,220,000	64,593	1,141,833	3,426,426
2016		2,240,000	60,597	1,067,573	3,368,170
2017		2,365,000	56,565	990,170	3,411,735
2018 - 2022		13,205,000	215,622	3,676,293	17,096,915
2023 - 2027		15,855,000	87,750	1,251,022	17,193,772
Total	$	40,080,000	625,653	10,625,674	51,331,327

(5) Leases and Other Obligations

The System leases various buildings and equipment under operating lease agreements, including leases renewed on an annual basis. Total rental expense under these agreements was $746,590 for the year ended June 30, 2012. There are no future minimum lease payments under operating leases, except those leases renewed on an annual basis.

Other obligations consist of third-party financing arrangements for equipment, which have maturity dates from 2013 through 2016 and interest rates ranging from 0.16% to 5.0%. As of June 30, 2012, future minimum payments under other obligations are as follows:

		Principal	**Interest**
2013	$	2,480,969	224,186
2014		2,529,461	117,386
2015		412,869	23,473
2016		177,495	5,581
Total minimum payments – other obligations	$	5,600,794	370,626

(6) Patient Accounts Receivable and Accounts Payable and Other Current Liabilities

Patient accounts receivable and accounts payable and other current liabilities, reported as current assets and liabilities, consisted of the following amounts:

Patient accounts receivable:		
Patients and their insurance carriers	$	187,783,156
Medicare		52,252,015
Medicaid		123,517,655
Total		363,552,826
Less allowance for uncollectible accounts		(277,956,893)
Total patient accounts receivable, net	$	85,595,933
Accounts payable and other current liabilities:		
Payable to employees	$	16,683,801
Payable to suppliers and service providers		29,652,440
Payable to health plans and for workers' compensation claims		4,184,974
Estimated third-party settlements		34,184,641
Total accounts payable and other current liabilities	$	84,705,856

(7) Net Patient Service Revenues

The Hospital has agreements with third-party payors that provide for payments to the Hospital at established program rates or costs, as defined, for rendering services to program beneficiaries. The Hospital provides contractual allowances on a current basis for the differences between charges for services rendered and the expected payments under these programs. The patient revenues from third-party payor programs, less the contractual allowances and provision for uncollectible accounts for fiscal year 2012, were as follows:

Medicaid	$	522,385,218
Medicare		477,958,371
HMO/PPO		589,099,477
Commercial		37,416,445
Self-pay and other		111,731,155
Total gross revenue		1,738,590,666
Less:		
Contractual allowances		(1,169,061,884)
Provision for uncollectible accounts		(35,117,875)
Net patient revenue	$	534,410,907

A summary of the payment arrangements with major third-party payors follows:

Medicare – Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient skilled nursing services are paid at prospectively determined rates that are based on the patients' acuity. Other inpatient nonacute services, and defined medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. The Hospital is reimbursed for certain services at tentative rates with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary. Substantially all outpatient services are subject to a prospective payment system. Under this system, payments to the Hospital are based on a predetermined package rate based on services provided to patients. The System is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits by the Medicare fiscal intermediary. At June 30, 2012, all Medicare settlements for 2012, 2011, and 2010 are subject to audit and retroactive adjustment.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates-per-discharge. Outpatient services rendered to program beneficiaries are reimbursed at prospectively determined rates. Medicaid payment methodologies and rates for services are subject to change based on the amount of funding available to the State of Illinois Medicaid Program, and any such changes could have a significant effect on the Hospital's revenues.

Blue Cross – Inpatient and outpatient services rendered to Blue Cross subscribers are reimbursed under a cost reimbursement methodology. The System is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the System and audits by Blue Cross. At June 30, 2012, the Blue Cross settlements for 2012 and 2011 are subject to audit and retroactive adjustment.

The System also has payment agreements with certain commercial insurance carriers, HMOs and preferred provider organizations (PPOs). The basis for payment under these agreements includes prospectively

(Continued)

determined rates-per-discharge, discounts from established charges, prospectively determined daily rates and captivated per-member per-month rates.

(8) Retirement and Postemployment Benefits

(a) Retirement Benefits

Substantially all employees of the System participate in the State Universities Retirement System of Illinois (SURS), a cost-sharing multiple-employer defined-benefit pension plan. The University contributes to the plan with a special funding situation whereby the State of Illinois makes substantially all actuarially determined required contributions on behalf of the participating employers. The University contributions include payments for System employees covered under the plan.

SURS was established July 21, 1941 to provide retirement annuities and other benefits for staff members and employees of the State universities, certain affiliated organizations, and certain other State educational and scientific agencies and for survivors, dependents and other beneficiaries of such employees. SURS is considered a component unit of the State of Illinois' financial reporting entity and is included in the State's financial reports as a pension trust fund. SURS is governed by Section 5/15, Chapter 40, of the *Illinois Compiled Statutes*. SURS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by accessing the Web site at www.surs.org, or by calling 1-800-275-7877.

Eligible employees must participate upon initial employment. Employees are ineligible to participate if (a) employed after having attained age 68; (b) employed less than 50% of full time; or (c) employed less than full time and attending classes with an employer. Of those University employees ineligible to participate, the majority are students at the University.

Plan members are required to contribute 8.0% of their annual covered salary and substantially all employer contributions are made by the State of Illinois on behalf of the individual employers at an actuarially determined rate. The current rate is 34.51% of annual covered payroll. The contribution requirements of plan members and employers are established and may be amended by the Illinois General Assembly. The University's contributions to SURS for the years ended June 30, 2012, 2011 and 2010 were $439,316,000, $350,480,000, and $319,047,000, respectively, equal to the required contributions for each year. The calculated allocation of these contributions that relate to the System was approximately $79,206,000 for the year ended June 30, 2012, and is reflected within the accompanying financial statements as fringe benefits expense.

(b) Postemployment Benefits

The State Employees Group Insurance Act of 1971 (Act), as amended, authorizes the State to provide health, dental, vision and life insurance benefits for certain retirees and their dependents. Substantially all State and university component unit employees become eligible for these other postemployment benefits (OPEB) if they eventually become annuitants of one of the State sponsored pension plans. The Department of Healthcare and Family Services and the Department of Central Management Services administer these benefits for annuitants with the assistance of the State's sponsored pension plans. The portions of the Act related to OPEB establish a cost-sharing multiple-employer defined-benefit OPEB plan (plan) with a special funding situation in which the State funds substantially all nonparticipant contributions. The plan does not issue a stand-alone financial report but is included as a part of the State's financial statements. A copy of the financial statements of the State can be obtained at www.ioc.state.il.us.

The health, dental and vision benefits provided to and contribution amounts required from annuitants are the result of collective bargaining between the State and various unions that represent the State's and the university employees in accordance with limitations established in the Act. Therefore, the benefits provided and contribution amounts are subject to periodic change. The Act requires the State to provide life insurance benefits for annuitants equal to their annual salary as of the last day of employment until age 60, at which time the benefit amount becomes $5,000.

The State makes substantially all of the contributions for OPEB on-behalf of the State universities. Since the State contributes substantially all of the employer contributions, the single-employer provisions of GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, have been followed for reporting the plan. The State is not required to and does not fund the plan other than the pay-as-you-go amount necessary to provide the current benefits.

Annuitants may be required to contribute toward health, dental, and vision benefits with the amounts based on factors such as date of retirement, years of credited service with the State or a university, whether the annuitant is covered by Medicare, and whether the annuitant has chosen a managed healthcare plan. Annuitants who retired prior to January 1, 1998, and who are vested in one of the State's sponsored pension plans, do not contribute toward health, dental, and vision benefits. For annuitants who retired on or after January 1, 1998, the annuitant's contribution amount is reduced 5% for each year of credited service with the State allowing those annuitants with 20 or more years of credited service to not have to contribute toward health, dental, and vision benefits. For fiscal year 2012, the annual cost of health, dental, and vision benefits before the State's contribution was $7,538 ($3,949 if Medicare eligible) if the annuitant chose benefits provided by a HMO and $10,697 ($4,483 if Medicare eligible) if the annuitant chose other benefits. Additional contributions by annuitants for dependents ranging from $960 to $2,814 ($900 to $2,538 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

For current employees, contributions are dependent upon annual salary and whether or not the employee chooses to receive benefits through an HMO. Current employee contribution amounts to the plan for fiscal year 2012 are shown as follows:

Annual Employee Health, Dental, and Vision Contribution Requirements

		Benefits provided through	
		HMO	**Others**
Employee annual salary:			
$30,200 and below	$	696	996
$30,201 – $45,600		756	1,056
$45,601 – $60,700		786	1,086
$60,701 – $75,900		816	1,116
$75,901 and above		846	1,146

Additional contributions by employees for dependents ranging from $960 to $2,814 ($900 to $2,538 if Medicare eligible) are also required depending on the benefits selected and whether there is one or multiple dependents.

(9) Related-Party Transactions

The University charged the System for administrative and other services totaling $19,175,978 in fiscal year 2012, primarily based upon the gross expenditures and debt service transfers of various operations of the System. These charges represent a portion of the estimated administrative and other service costs incurred by the University in support of the System. An additional $13,809,422 was paid by the University on behalf of the System for salaries and utility costs for the year ended June 30, 2012, in exchange for System services and facilities provided, and are recognized as operating expenses (salaries and general) and other operating revenues.

Most healthcare services rendered by physicians at the University are charged, billed and collected through the MSP. For ambulatory care services, there is a charge for both a professional and technical component. The System bills and collects on behalf of the MSP for the professional component of ambulatory care services. Based on the underlying agreements between the MSP and the University, the System remits funds collected to the MSP. Total MSP remittances from the System for the year ended June 30, 2012 relating to the billing and collection of physician fees and the delivery of ambulatory care were $23,510,851.

During 2012, various departments within the College of Medicine agreed to reimburse the System for a portion of the expenses related to the resident and fellowship training program. This reimbursement, which totaled $3,579,691, has been reflected in the financial statements as a reduction of the related expenses.

(10) Commitments and Contingencies

(a) Commitments

At June 30, 2012, the System had commitments on various construction projects and contracts for repairs and renovation of health services facilities of $2,062,558.

(b) Contingencies

The University (including the System) is involved in regulatory audits arising in the normal course of business. On June 8, 2007, a notice was received from the Office of Inspector General (OIG) on behalf of the Illinois Department of Healthcare and Family Services (IDHFS) indicating that the University received an overpayment of $14.8 million covering the period May 1, 2004 through April 30, 2006 on behalf of Medicaid patients, of which $10 million and $4.8 million related to the University's College of Pharmacy and the System, respectively. University management is in the process of contesting this overpayment and estimates the System's portion of the probable liability related to this overpayment is approximately $3.8 million. During fiscal year 2010, the University submitted additional documentation and evidence of its positions. As of September 29, 2011, the OIG on behalf of the IDHFS contacted the University to request its settlement offer to resolve the audit. The University intends to pursue settlement discussion with OIG and IDHFS with a view toward resolution of the matter. It is estimated that the System's established liability including a provision for subsequent audits totaling $8.5 million remains sufficient to cover the probable outcome of the audits and has been included in estimated third-party settlements payable within the accompanying Balance Sheet as of June 30, 2012.

In 2012 and 2011, the System received notices from the Medicare program requiring that they provide Medicare with documentation for claims to carry out the Recovery Audit Contract (RAC) program. The System is responding to these requests. Review of claims through the RAC program may result in a liability to the Medicare program and could have a material impact on the System's net patient service revenues.

The University (including the System) is a defendant in a number of legal actions primarily related to medical malpractice. These legal actions have been considered in estimating the University's accrued self-insurance liability, which covers hospital and clinical patient liability; hospital and medical professional liability; estimated general and contract liability; and workers' compensation liability. At June 30, 2012, the University's total accrued self-insurance liability was $245,709,090.

The University’s accrued self-insurance includes $167,923,909 at June 30, 2012, for the most probable and reasonably estimable ultimate cost of uninsured medical malpractice liabilities. Ultimate cost consists of amounts estimated by the University’s risk management division and actuaries for asserted claims, unasserted claims arising from reported incidents, expected litigation expenses and amounts determined by actuaries using relevant industry data and Hospital specific data to cover projected losses for claims incurred but not yet reported. The System contributes to the University’s self-insurance reserve through annual assessments for claim exposure. Therefore, no liability related to medical malpractice claims is included in the System’s financial statements, but the entire self-insurance liability is reflected in the University’s financial statements.