

**UNIVERSITY OF WISCONSIN HOSPITALS
AND CLINICS AUTHORITY**

Basic Financial Statements and
Required Supplementary Information

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

**UNIVERSITY OF WISCONSIN HOSPITALS
AND CLINICS AUTHORITY**

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Independent Auditors' Report

The Board of Directors
University of Wisconsin Hospitals
and Clinics Authority:

We have audited the accompanying basic financial statements of the University of Wisconsin Hospitals and Clinics Authority (the Hospital), a component unit of the State of Wisconsin, as of and for the years ended June 30, 2012 and 2011, which collectively comprise the Hospital's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Hospital'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 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 Hospital'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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of Wisconsin Hospitals and Clinics Authority as of June 30, 2012 and 2011, and the respective changes in financial position, and where applicable, cash flows thereof for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 27, 2012 on our consideration of the Hospital'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.

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 3 – 17 and the schedule of plan funding progress on page 52 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial



reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

September 27, 2012

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Management's Discussion and Analysis

June 30, 2012 and 2011

This section of the annual financial report for the University of Wisconsin Hospitals and Clinics Authority (the Hospital) presents management's analysis of the Hospital's performance during the fiscal years that ended on June 30, 2012 and 2011, and is designed to focus on the current fiscal year activity, resulting changes, and currently known facts; therefore, please read it in conjunction with the Hospital's financial statements.

Overview of the Financial Statements

This discussion and analysis is intended to serve as an introduction to the Hospital's financial statements, and the notes to the financial statements.

The balance sheets and the statements of revenues, expenses, and changes in net assets, and cash flows, reported on the accrual basis, provide an indication of the Hospital's financial health. The balance sheets include all of the Hospital's assets and liabilities, as well as an indication about which assets can be utilized for general purposes and which are restricted by external donors or for other purposes. The statements of revenues, expenses, and changes in net assets report all of the revenues and expenses during the period indicated. The statements of cash flows report the cash provided and used by operating activities, as well as other cash sources such as investment income and other cash uses, such as repayment of bonds and capital additions. The notes to financial statements provide additional information that is essential to a full understanding of the data provided in the financial statements.

Financial Highlights – Fiscal Year 2012

- The Hospital's net assets increased by approximately \$106.0 million.
- Net patient service revenues increased by \$122.1 million, or 11.5%. Total operating revenues increased by \$120.9 million, or 11.2%, and total operating expenses increased by \$66.2 million, or 6.6%.
- Operating income for the year was \$127.1 million.
- Total nonoperating revenue (expense) decreased by \$44.2 million or 238.7%. The majority of this decrease is due to an increase in interest expense, a net decrease in the fair value of investments, an increase in payments to the University of Wisconsin School of Medicine and Public Health for capital expenditure support, a net decrease in the equity interest in the income/loss of joint ventures and a net decrease in the fair value of interest rate swap agreements.
- The excess of revenues over expenses before capital grants, gifts and donations and additions to permanent endowments increased \$10.5 million or 11.5%.

Financial Highlights – Fiscal Year 2011

- The Hospital's net assets increased by approximately \$94.9 million.
- Net patient service revenues increased by \$57.3 million, or 5.7%. Total operating revenues increased by \$61.4 million, or 6.0%, and total operating expenses increased by \$54.1 million, or 5.7%.
- Operating income for the year was \$72.5 million.

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- Total nonoperating revenue (expense) increased by \$16.2 million or 710.2%. The majority of this increase is due to a net increase in the fair value of investments, net increase in the fair value of interest rate swap agreements and an increase in investment income.
- The excess of revenues over expenses before capital grants, gifts and donations, additions to permanent endowments, and change in method of accounting for derivative instruments (which occurred during the fiscal year ended June 30, 2010) increased \$23.6 million or 35.0%.

Hospital Highlights – Fiscal Year 2012

- The Hospital is ranked the top hospital in the state, is among the nation's top 50 hospitals in seven medical specialties and ranked as high-performing in five additional specialty areas in the U.S. News and World Report, "America's Best Hospitals 2012-2013."
- American Family Children's Hospital was ranked among the top 50 children's hospitals in seven medical and surgical specialties in the U.S. News and World Report, "2012-2013 Best Children's Hospitals Guide."
- The Hospital was named as one of only twelve organizations in the country on the list of "Best Companies for Hourly Workers" by Working Mother magazine in 2012. The Hospital has also been named to Working Mother's "100 Best Companies for Working Mothers" since 2007.
- Capital contributions paid to the University of Wisconsin School of Medicine and Public Health (UWSMPH) included \$2.5 million as the third installment of a \$7.5 million commitment to be paid over three years to acquire space in the Clinical Science Center vacated by occupants of the UWSMPH's Medical Foundation Centennial Building, \$2.8 million as the first installment of a \$5.7 million commitment to be paid over two years to acquire space in the Clinical Science Center vacated by UWSMPH and \$1.0 million as the first installment of a \$3.5 million commitment to be paid over five years for space in the UWSMPH's WIMR II building. In addition, the Hospital contributed \$2.3 million to the UW Health Simulation Center, which opened in 2012 to provide robust and realistic learning opportunities to prepare for actual patient care situations.

Hospital Highlights – Fiscal Year 2011

- Opened an Angiosuite in Surgical Services which combines state-of-the-art imaging technology with cutting edge minimally invasive surgical procedures.
- Installed Intraoperative Magnetic Resonance Imaging equipment (iMRI) which will allow neurosurgeons the ability to take real time images during surgery.
- Received CMS/Medicare Meaningful Use Incentive funds for achieving required measures in the electronic health record implementation.
- The Hospital refunded two outstanding debt issues in May 2011, converting from direct pay letter of credit backed variable rate bonds to direct bond purchase agreements with a commercial bank. The Hospital issued approximately \$56.7 million in Variable Rate Revenue Refunding Bonds Series 2011A. The Series 2011A bond proceeds and the Series 2009A Interest fund were used to refund \$57.1 million of Hospital Revenue Bonds consisting of Variable Rate Demand Revenue Refunding Bonds, Series 2009A. This transaction resulted in the recognition of a deferred loss of \$488,000 for other unamortized financing costs.

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Also in May 2011, the Hospital issued \$61.0 million of Variable Rate Revenue Refunding Bonds, Series 2011B. The bond proceeds were used to refund \$61.0 million of Variable Rate Demand Revenue Refunding Bonds, Series 2008B. This transaction resulted in the recognition of a deferred loss of \$474,000 for other unamortized financing costs.

- The Hospital is the top-ranked hospital in the Madison area, is among the top 50 hospitals in seven medical specialties, and ranked as high-performing in five additional specialty areas in the U.S. News and World Report, "America's Best Hospitals 2011."
- American Family Children's Hospital was ranked among the top 50 children's hospitals in the U.S. News and World Report, "2011-2012 Best Children's Hospitals Guide."
- The Hospital was named as one of only twelve organizations in the country on the list of "Best Companies for Hourly Workers" by Working Mother magazine in 2011. The Hospital has also been named to Working Mother's "100 Best Companies for Working Mothers" since 2007.
- Capital contributions to the University of Wisconsin School of Medicine and Public Health (UWSMPH) included \$2.5 million as the second installment of a \$7.5 million commitment to be paid over three years to acquire space in the Clinical Science Center vacated by occupants of the UWSMPH's Medical Foundation Centennial Building.

Financial Analysis and Results of Operations

At June 30, 2012, the Hospital's assets exceeded liabilities by \$774.8 million, which is an increase in total net assets of \$106.0 million, or 15.8%, from the prior fiscal year-end.

At June 30, 2011, the Hospital's assets exceeded liabilities by \$668.8 million, which is an increase in total net assets of \$94.9 million, or 16.5%, from the prior fiscal year-end.

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Table 1 summarizes assets, liabilities, and net assets at June 30 (in thousands):

	Table 1		Dollar change	Percentage change
	Net Assets			
	June 30,			
	<u>2012</u>	<u>2011</u>		
Current and other assets	\$ 878,128	734,226	143,902	19.6%
Capital assets	392,567	385,490	7,077	1.8
Total assets	<u>\$ 1,270,695</u>	<u>1,119,716</u>	<u>150,979</u>	13.5
Long-term debt	\$ 227,247	234,721	(7,474)	(3.2)
Other liabilities	268,653	216,174	52,479	24.3
Total liabilities	<u>495,900</u>	<u>450,895</u>	<u>45,005</u>	10.0
Net assets:				
Invested in capital assets, net of related debt	169,341	151,853	17,488	11.5
Restricted	13,771	10,847	2,924	27.0
Unrestricted	<u>591,683</u>	<u>506,121</u>	<u>85,562</u>	16.9
Total net assets	<u>774,795</u>	<u>668,821</u>	<u>105,974</u>	15.8
Total liabilities and net assets	<u>\$ 1,270,695</u>	<u>1,119,716</u>	<u>150,979</u>	13.5

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**Table 1
Net Assets**

	June 30,		Dollar change	Percentage change
	2011	2010		
Current and other assets	\$ 734,226	626,530	107,696	17.2%
Capital assets	385,490	392,004	(6,514)	(1.7)
Total assets	<u>\$ 1,119,716</u>	<u>1,018,534</u>	<u>101,182</u>	9.9
Long-term debt	\$ 234,721	243,158	(8,437)	(3.5)
Other liabilities	216,174	201,453	14,721	7.3
Total liabilities	<u>450,895</u>	<u>444,611</u>	<u>6,284</u>	1.4
Net assets:				
Invested in capital assets, net of related debt	151,853	150,496	1,357	0.9
Restricted	10,847	8,415	2,432	28.9
Unrestricted	<u>506,121</u>	<u>415,012</u>	<u>91,109</u>	22.0
Total net assets	<u>668,821</u>	<u>573,923</u>	<u>94,898</u>	16.5
Total liabilities and net assets	<u>\$ 1,119,716</u>	<u>1,018,534</u>	<u>101,182</u>	9.9

At June 30, 2012, the Hospital's cash and investments increased \$107.7 million or 20.5% compared to June 30, 2011. The majority of the increase in fiscal 2012 cash and investments is attributable to increases from operating activities, offset by purchases of property, plant, and equipment, repayments of long-term debt and interest paid.

At June 30, 2011, the Hospital's cash and investments increased \$101.2 million or 23.8% compared to June 30, 2010. The majority of the increase in fiscal 2011 cash and investments is attributable to increases from operating activities, offset by purchases of property, plant, and equipment, repayments of long-term debt and interest paid.

As of June 30, 2012, the Hospital reports the net present value of pledges receivable totaling \$2.7 million for the American Family Children's Hospital in accordance with Governmental Accounting Standards Board (GASB) Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. The net present value of pledges as of June 30, 2011, was \$1.7 million.

Pension-related liabilities include \$75.8 million and \$55.2 million at June 30, 2012 and 2011, respectively, of unfunded prior service pension liabilities which are recorded for the unfunded liabilities of participants in the Wisconsin Retirement System. In December 2003, the State issued annual appropriation bonds and used the proceeds to retire its unfunded past service pension obligation with the Wisconsin Retirement System, including the portion attributable to certain Hospital employees. The Hospital is required to annually reimburse the State for its share of ongoing debt service associated with the bonds, and in 2003 the Hospital recorded a liability for its estimated pro-rata share of the principal based on an understanding of the terms of repayment at that time. In 2012, based on the State's methodology for allocating responsibility for ongoing debt service to State entities, the

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Hospital recorded an adjustment of \$20.6 million to pension-related liabilities, \$14.3 million recorded to interest expense and \$6.3 million to other nonoperating expense.

Other liabilities also include \$20.7 million and \$16.2 million at June 30, 2012 and 2011, respectively, of the net other postemployment benefit obligation for retiree health insurance and \$16.9 million and \$10.3 million at June 30, 2012 and 2011, respectively, of the fair market value of the derivative instruments.

Table 2 compares 2012 revenues and expenses to 2011 and 2011 revenues and expenses to 2010, and shows the increase in net assets (in thousands).

**Table 2
Condensed Schedule of Revenues, Expenses, and Changes in Net Assets**

	<u>June 30</u>		<u>Dollar change</u>	<u>Percentage change</u>
	<u>2012</u>	<u>2011</u>		
Operating revenues:				
Net patient service revenues	\$ 1,181,671	1,059,550	122,121	11.5%
Other operating revenue	19,258	20,472	(1,214)	(5.9)
Total operating revenues – net	<u>1,200,929</u>	<u>1,080,022</u>	<u>120,907</u>	11.2
Operating expenses:				
Salaries and benefits	564,278	534,736	29,542	5.5
Medical materials and supplies	233,119	209,948	23,171	11.0
Purchased services and agency costs	135,298	120,339	14,959	12.4
Depreciation and amortization	43,606	45,839	(2,233)	(4.9)
Other	97,491	96,697	794	0.8
Total operating expenses	<u>1,073,792</u>	<u>1,007,559</u>	<u>66,233</u>	6.6
Operating income	<u>127,137</u>	<u>72,463</u>	<u>54,674</u>	75.5
Nonoperating revenues (expenses):				
Investment income and change in fair value	12,718	23,500	(10,782)	(45.9)
Interest expense	(25,668)	(7,915)	(17,753)	(224.3)

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**Table 2
Condensed Schedule of Revenues, Expenses, and Changes in Net Assets**

	<u>June 30</u>		<u>Dollar change</u>	<u>Percentage change</u>
	<u>2012</u>	<u>2011</u>		
Payments to the UWSMPH for capital expenditure support	\$ (11,600)	(2,500)	(9,100)	(364.0)%
Other	(1,114)	5,420	(6,534)	(120.6)
Total nonoperating revenues (expenses)	<u>(25,664)</u>	<u>18,505</u>	<u>(44,169)</u>	<u>(238.7)</u>
Excess of revenues over expenses before capital grants, gifts and donations and additions to permanent endowments	101,473	90,968	10,505	11.5
Capital grants, gifts and donations	3,987	3,286	701	21.3
Additions to permanent endowments	<u>514</u>	<u>644</u>	<u>(130)</u>	<u>(20.2)</u>
Increase in net assets	105,974	94,898	11,076	11.7
Net assets – beginning of year	<u>668,821</u>	<u>573,923</u>	<u>94,898</u>	16.5
Net assets – end of year	<u>\$ 774,795</u>	<u>668,821</u>	<u>105,974</u>	15.8

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**Table 2
Condensed Schedule of Revenues, Expenses, and Changes in Net Assets**

	<u>June 30</u>		<u>Dollar change</u>	<u>Percentage change</u>
	<u>2011</u>	<u>2010</u>		
Operating revenues:				
Net patient service revenues	\$ 1,059,550	1,002,272	57,278	5.7%
Other operating revenue	20,472	16,346	4,126	25.2
Total operating revenues – net	<u>1,080,022</u>	<u>1,018,618</u>	<u>61,404</u>	6.0
Operating expenses:				
Salaries and benefits	534,736	513,335	21,401	4.2
Medical materials and supplies	209,948	198,652	11,296	5.7
Purchased services and agency costs	120,339	103,122	17,217	16.7
Depreciation and amortization	45,839	48,874	(3,035)	(6.2)
Other	96,697	89,512	7,185	8.0
Total operating expenses	<u>1,007,559</u>	<u>953,495</u>	<u>54,064</u>	5.7
Operating income	<u>72,463</u>	<u>65,123</u>	<u>7,340</u>	11.3
Nonoperating revenues (expenses):				
Nonoperating revenues	23,500	8,151	15,349	188.3
Nonoperating expenses	(7,915)	(8,258)	343	(4.2)
Payments to the UWSMPH for capital expenditure support	(2,500)	(2,640)	140	(5.3)
Other	5,420	5,031	389	7.7
Total nonoperating revenues (expenses)	<u>18,505</u>	<u>2,284</u>	<u>16,221</u>	710.2
Excess of revenues over expenses before capital grants, gifts and donations, additions to permanent endowments, and change in method of accounting for derivative instruments	90,968	67,407	23,561	35.0

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**Table 2
Condensed Schedule of Revenues, Expenses, and Changes in Net Assets**

	<u>June 30</u>		<u>Dollar change</u>	<u>Percentage change</u>
	<u>2011</u>	<u>2010</u>		
Capital grants, gifts and donations	\$ 3,286	1,091	2,195	201.2
Additions to permanent endowments	644	111	533	480.2
Change in accounting for derivative instruments	—	(8,345)	8,345	100.0
Increase in net assets	94,898	60,264	34,634	57.5
Net assets – beginning of year	<u>573,923</u>	<u>513,659</u>	<u>60,264</u>	11.7
Net assets – end of year	<u><u>\$ 668,821</u></u>	<u><u>573,923</u></u>	<u><u>94,898</u></u>	16.5

Net Patient Service Revenue

Net patient service revenue in 2012 increased \$122.1 million, or 11.5% from the prior year. The primary reasons for the growth in revenue are the increases in the number of patients cared for and third-party payor reimbursement increases which averaged 3.4% during the year offset by an increase in the provision for charity care and bad debts. Inpatient volume, measured by admissions, increased approximately 500, or 2.0%, and outpatient volume, measured by visits, increased by approximately 25,000 visits, or 4.3%. Patient days stayed at approximately the same level as the prior year. The Hospital's case mix index (CMI), which is a measure of patient acuity, calculated on an MS-DRG basis was 1.94 in 2012 and 1.88 in 2011.

Sources of net patient service revenue by payor category for fiscal years 2012 and 2011 are depicted below:

**Table 3
Payor Mix**

	<u>Fiscal year</u>		<u>Percentage change</u>
	<u>2012</u>	<u>2011</u>	
Medicare	25.4%	24.9%	2.0%
Medicaid	7.7	7.9	(2.5)
Indemnity	4.6	3.7	24.3
Managed care – capitated	4.6	4.7	(2.1)
Managed care – noncapitated	48.4	49.4	(2.0)
Private pay and other	9.3	9.4	(1.1)
	<u><u>100.0%</u></u>	<u><u>100.0%</u></u>	

Net patient service revenue in 2011 increased \$57.3 million, or 5.7% from the prior year. The primary reasons for the growth in revenue are the increases in the number of patients cared for and third-party payor reimbursement increases which averaged 3.6% during the year and a decrease in the provision for charity care and bad debts.

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Inpatient volume, measured by admissions, increased approximately 900, or 3.5%, and outpatient volume, measured by visits, increased by approximately 2600 visits, or 0.5%. Patient days increased approximately 1900 or 1.4%. The Hospital's case mix index (CMI), which is a measure of patient acuity, calculated on an MS-DRG basis was 1.88 in 2011 and 2010, respectively.

Sources of net patient service revenue by payor category for fiscal years 2011 and 2010 are depicted below:

**Table 3
Payor Mix**

	Fiscal year		Percentage change
	2011	2010	
Medicare	24.9%	26.2%	(5.0)%
Medicaid	7.9	7.8	1.3
Indemnity	3.7	4.4	(15.9)
Managed care – capitated	4.7	4.7	—
Managed care – noncapitated	49.4	48.1	2.7
Private pay and other	9.4	8.8	6.8
	<u>100.0%</u>	<u>100.0%</u>	

Other operating revenue, which includes nonpatient revenue such as cafeteria sales and other auxiliary services, decreased approximately \$1.2 million to \$19.3 million in 2012, or 5.9%, and increased \$4.1 million to \$20.5 million in 2011, or 25.2% from \$16.3 million in 2010.

Operating Expenses

Operating expenses increased by \$66.2 million in 2012 or 6.6% over the prior year. The categories of expenses that caused the majority of the increase were salaries and wages, medical materials and supplies and purchased services. Salaries and wages expense increased 7.4% from 2011 due to wage rate increases. The increase in medical materials and supplies compared to the prior year was primarily in pharmaceuticals and medical/surgical supplies. The increase in purchased services is due to additional commitments to the UWSMPH and University of Wisconsin Medical Foundation (UWMF) pursuant to an affiliation agreement with the UWSMPH and UWMF and agency staff.

Operating expenses increased by \$54.1 million in 2011 or 5.7% over the prior year. The categories of expenses that caused the majority of the increase were salaries, wages and benefits, medical materials and supplies and purchased services. Salaries, wages, and benefits expense increased 4.2% from 2010 due to wage and fringe benefit rate increases. The increase in medical materials and supplies compared to the prior year was primarily in pharmaceuticals, stents and medical/surgical supplies. The increase in purchased services is due to additional commitments to the UWSMPH and UWMF pursuant to an affiliation agreement with the UWSMPH and UWMF, data processing fees for the buyout of the Siemens billing system and organ acquisition costs.

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Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of income from the Hospital's cash and long-term investments, loss on disposal of capital assets, interest expense on long-term debt, the change in fair market value of interest rate swaps, the equity interest in gain or loss from joint ventures and payments to UWSMPH. Investment income, including the change in fair value of investments, decreased to \$12.3 million in 2012 and increased to \$21.6 million in 2011 from \$12.1 million in 2010. The decrease in 2012 is due to the decrease in the fair value of investments.

The Hospital's investment income and net changes in fair value of investments for 2012, 2011, and 2010, are summarized in Table 4 (in thousands):

**Table 4
Investment Earnings by Asset Category**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Interest and dividend income:			
Equity investments	\$ 3,395	4,291	3,165
Fixed-income investments	11,584	6,872	4,447
Total investment income	<u>14,979</u>	<u>11,163</u>	<u>7,612</u>
Net (decrease) increase in fair value of investments	<u>(2,718)</u>	<u>10,390</u>	<u>4,442</u>
Total	<u>\$ 12,261</u>	<u>21,553</u>	<u>12,054</u>

The decrease in equity interest in income of joint ventures from \$5.4 million in 2011 to \$3.5 million in 2012 is due to the decrease in Unity's net income in 2012 in comparison to 2011, of which the Hospital records a 60% share. The fair value of the interest rate swap agreements resulted in \$.5 million nonoperating income in 2012 and \$1.9 million nonoperating income in 2011.

Interest expense in 2012 was \$25.7 million, \$7.9 million in 2011 and \$8.3 million in 2010. The increase in 2012 is due to additional interest expense due to the pension-related adjustments and higher effective interest rates on previous debt refinanced in 2011. The decrease in 2011 compared to 2010 is due to the decrease in variable bond interest rates.

Capital Assets

At June 30, 2012, the Hospital had \$392.6 million, net of accumulated depreciation and amortization, invested in capital assets. This amount represents a net increase, including additions and disposals, of \$7.1 million, or 1.8% from 2011. The net increase is due to purchase of new capital assets in 2012, offset by depreciation expense.

At June 30, 2011, the Hospital had \$385.5 million, net of accumulated depreciation and amortization, invested in capital assets. This amount represents a net decrease, including additions and disposals, of \$6.5 million, or 1.7% from 2010. The decrease is due to depreciation expense exceeding the purchase of new capital assets in 2011.

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Table 5 shows a summary of capital assets, net of accumulated depreciation and amortization, at June 30, 2012, 2011, and 2010 and major additions by year for the years ended June 30, 2012, 2011, and 2010 (in thousands).

**Table 5
Capital Assets at Year-End (Net of Accumulated Depreciation and Amortization)**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Land	\$ 17,064	14,785	14,385
Buildings and land improvements	285,413	291,255	297,894
Equipment	77,539	71,272	74,937
Construction in progress	12,551	8,178	4,788
Total	<u>\$ 392,567</u>	<u>385,490</u>	<u>392,004</u>

Major Additions by Year

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Land acquisition	\$ —	—	2,605
Buildings and improvements:			
Inpatient unit remodeling	2,031	3,198	3,246
Remodeled Outpatient Clinic	1,594	—	—
Receiving dock renovation and expansion	1,289	—	—
Reprocessing renovation	505	—	—
Remodeled Cancer clinic	—	1,932	—
Angiosuite in surgical services	—	883	—
Purchase off-campus facility	—	—	991
Radiation Oncology relocation and expansion to the Wisconsin Institutes for Medical Research Building	—	—	6,510
Data center improvements	—	—	552
Improvements to new leased facility	—	—	1,087
Equipment:			
Robotic Angiography Imaging in surgical services	—	1,720	—
Interventional Radiology Angiography system	—	1,600	—
Intraoperative MRI	—	2,648	—
Cardiac Catheterization Lab X-Ray system	—	1,247	—
Implementation costs for patient management system	—	—	3,539
DaVinci HD Robot Surgical System	1,698	—	—
Biplane Imaging System	1,562	—	—
Vital Sign Monitors	1,559	—	—

**UNIVERSITY OF WISCONSIN HOSPITALS
AND CLINICS AUTHORITY**

Management's Discussion and Analysis

June 30, 2012 and 2011

Construction in progress at June 30, 2012 consists principally of costs incurred for the build-out of an additional floor in the American Family Children's Hospital for a pediatric ICU and NICU, addition of three new operating rooms and seven prep and recovery rooms, and development costs for a proposed new eastside campus.

For more information about the Hospital's capital asset activity, please see note 6 to the financial statements. Ongoing capital requirements will be funded primarily from operations and a tax-exempt bond financing. The Hospital's total capital budget for 2013 is \$131.8 million compared to \$77.9 million in 2012.

Long-Term Debt

At June 30, 2012, the Hospital had \$219.1 million in long-term debt, excluding current installments, compared to \$226.9 million at June 30, 2011 – a decrease of 3.4% due to principal payments on the State of Wisconsin general obligation and refunding bonds, Series 2002B, Series 2008A, Series 2009B, Series 2009C and the GE Loan.

Table 6 below provides the detail of outstanding long-term debt, excluding current installments, as of June 30, 2012, 2011, and 2010 (in thousands):

**Table 6
Outstanding Long-Term Debt – at Year-End**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
State of Wisconsin general obligation and refunding bonds	\$ 1,222	2,516	4,157
Authority Fixed Rate Revenue Bonds, Series 2002B	—	1,505	3,405
Authority Fixed Rate Revenue Bonds, Series 2008A	47,685	48,815	49,545
Authority Variable Rate Demand Revenue Bonds, Series 2008B	—	—	61,000
Authority Variable Rate Demand Revenue Bonds, Series 2009A	—	—	57,070
Authority Variable Rate Demand Revenue Bonds, Series 2009B	52,695	54,825	56,830
Authority Fixed Rate Adjustable Revenue Bonds, Series 2009C	4,394	4,668	4,931
Authority Fixed Rate Adjustable Revenue Bonds, Series 2011A	56,245	56,745	—
Authority Fixed Rate Adjustable Revenue Bonds, Series 2011B	61,000	61,000	—

**UNIVERSITY OF WISCONSIN HOSPITALS
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Management's Discussion and Analysis

June 30, 2012 and 2011

**Table 6
Outstanding Long-Term Debt – at Year-End**

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Equipment Loan	\$ 3,425	4,787	6,090
Premium on Series 2002B Bonds	48	113	176
Deferred Loss on Refunding of Series 1997 Bonds	(214)	(228)	(242)
Deferred Loss on Refunding of Series 2004 Bonds	(394)	(411)	(429)
Deferred Loss on Refunding of Series 2000 Bonds	(5,231)	(5,544)	(5,856)
Deferred Loss on Refunding of Series 2002A Bonds	(551)	(578)	(605)
Deferred Loss on Refunding of Series 2005 Bonds	(353)	(374)	(395)
Deferred Loss on Refunding of Series 2008B Bonds	(451)	(472)	—
Deferred Loss on Refunding of Series 2009A Bonds	(463)	(486)	—
Total	<u>\$ 219,057</u>	<u>226,881</u>	<u>235,677</u>

In 2011, the Hospital refunded Series 2008B and Series 2009A from direct pay letter of credit backed variable rate bonds to direct bond purchase agreements with a commercial bank at approximately the same outstanding principal amounts. Long-term debt, excluding current installments, at June 30, 2010, was \$235.7 million. The decrease from 2010 to 2011 resulted from the principal payments on the State of Wisconsin general obligation and refunding bonds, Series 2000, Series 2002B, Series 2008A, Series 2009B, Series 2009C bonds and the GE Loan.

Prior to the refunding in 2011, Series 2008B, Series 2009A and Series 2009B bonds were secured by an irrevocable transferable direct pay letter-of-credit agreements issued by US Bank. Series 2009B bonds continue to be secured by an irrevocable transferable direct pay letter-of-credit agreement issued by US Bank and these bonds carry an underlying A1 rating from Moody's and A+ from Standard & Poor's. They also carry a long-term rating of AAA from Moody's and Standard & Poor's based on the joint criteria with the letter-of-credit provider. Series 2011A bonds and Series 2011B bonds were refunded as direct bank purchase agreements with a commercial bank and, as such, are not rated.

Current legislation requires the Hospital to obtain approval of additional bond issuance from its board of directors, maintain an unenhanced bond rating in the category of "A" or better from Standard & Poor's Corporation and Moody's Investor Service, Inc., and notify the State Joint Committee on Finance and the Department of Administration. For more information about the Hospital's outstanding debt, please see note 7 to the financial statements.

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Management's Discussion and Analysis

June 30, 2012 and 2011

Economic Factors and Next Year's Budgets and Rates

The Hospital's senior leadership team considered many variables in developing the 2013 budget and rates. Key strategic goals of maintaining high quality, safety, and service standards, as well as achieving fiscal margins provide the primary objectives in preparing each year's budget. Fiscal 2013 budget assumptions were particularly difficult due to economic conditions and uncertain government reimbursement, including healthcare reform. This required a very disciplined approach in preparing the 2013 budget in an effort to manage the Hospital's costs within the revenue stream. The 2013 budget, as approved by the Hospital's board of directors, projects income from operations of \$77.5 million, resulting in an operating margin of 6.5%. Net income is budgeted at \$86.8 million representing a margin of 7.2%. Achieving a 7.2% margin is accomplished through increased volumes, average payment increases of 2.9% across all payor categories and by decreasing the cost per unit of service. The 2013 budget calls for volume increases of 3.0% for inpatient admissions, 2.1% for inpatient days, and 2.9% for outpatient clinic visits.

Requests for Information

This financial report is designed to provide a general overview of University of Wisconsin Hospitals and Clinics Authority's financial results for all those with an interest in the Hospital's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to Chief Financial Officer, 600 Highland Avenue, Mail Drop # 8370, Madison, Wisconsin 53792.

**UNIVERSITY OF WISCONSIN HOSPITALS
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Balance Sheets

June 30, 2012 and 2011

(In thousands)

Assets	2012	2011
Current assets:		
Cash and cash equivalents	\$ 53,387	52,804
Patient accounts receivable, net of estimated uncollectible accounts of \$36,000 in 2012 and \$38,000 in 2011	149,863	125,693
Other receivables	11,232	11,740
Inventories of supplies	8,475	8,483
Prepaid expenses	6,260	5,215
Total current assets	229,217	203,935
Noncurrent cash and investments:		
Designated by board for capital replacement and debt retirement	156,745	156,369
Held by trustee for professional liability and other purposes	4,021	1,085
Restricted by donors	8,628	7,214
Principal of permanent endowments	2,437	1,923
Other long-term investments	408,047	306,219
Total noncurrent cash and investments	579,878	472,810
Capital assets:		
Nondepreciable	31,892	25,220
Depreciable, net	360,675	360,270
Total capital assets, net	392,567	385,490
Investments in joint ventures	53,879	50,507
Pledges receivable	2,690	1,692
Other assets	5,403	5,282
Deferred outflows of resources	7,061	—
Total assets	\$ 1,270,695	1,119,716

See accompanying notes to financial statements.

Liabilities and Net Assets	2012	2011
	<u> </u>	<u> </u>
Current liabilities:		
Current installments of long-term debt	\$ 8,190	7,840
Accounts payable	36,487	27,614
Accrued expenses	86,623	87,761
Estimated payables to Medicare and Medicaid	32,081	19,117
	<u> </u>	<u> </u>
Total current liabilities	163,381	142,332
Long-term debt, less current installments	219,057	226,881
Other long-term liabilities	16,906	10,301
Other postemployment benefit obligation	20,718	16,221
Pension-related liabilities	75,838	55,160
	<u> </u>	<u> </u>
Total liabilities	495,900	450,895
Net assets:		
Invested in capital assets, net of related debt	169,341	151,853
Restricted – expendable for donor specified purposes	11,334	8,924
Restricted – nonexpendable	2,437	1,923
Unrestricted	591,683	506,121
	<u> </u>	<u> </u>
Total net assets	774,795	668,821
	<u> </u>	<u> </u>
Total liabilities and net assets	\$ <u>1,270,695</u>	<u>1,119,716</u>

**UNIVERSITY OF WISCONSIN HOSPITALS
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Statements of Revenues, Expenses, and Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

	2012	2011
Operating revenues:		
Net patient service revenue (net of provision for bad debts of \$20,078 in 2012 and \$18,372 in 2011)	\$ 1,181,671	1,059,550
Other operating revenue	19,258	20,472
Total operating revenues, net	1,200,929	1,080,022
Operating expenses:		
Salaries and wages	402,158	374,598
Employee benefits	162,120	160,138
Other expenses	71,504	70,527
Repairs, maintenance, and utilities	25,987	26,170
Purchased services and agency costs	135,298	120,339
Medical materials and supplies	233,119	209,948
Depreciation and amortization	43,606	45,839
Total operating expenses	1,073,792	1,007,559
Operating income	127,137	72,463
Nonoperating revenues (expenses):		
Investment income	14,979	11,163
Net increase (decrease) in fair value of investments	(2,718)	10,390
Interest expense	(25,668)	(7,915)
Equity interest in income/loss of joint ventures	3,497	5,420
Net increase in fair value of swaps	457	1,947
Other, net	(4,611)	—
Contribution to University of Wisconsin School of Medicine and Public Health for capital expenditure support	(11,600)	(2,500)
Total nonoperating revenues (expenses), net	(25,664)	18,505
Excess of revenues over expenses before capital grants, gifts, and donations and additions to permanent endowments	101,473	90,968
Capital grants, gifts and donations	3,987	3,286
Additions to permanent endowments	514	644
Increase in net assets	105,974	94,898
Net assets – beginning of the year	668,821	573,923
Net assets – end of the year	\$ 774,795	668,821

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN HOSPITALS
AND CLINICS AUTHORITY**

Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	2012	2011
Cash flows from operating activities:		
Cash received from and on behalf of patients	\$ 1,157,501	1,057,730
Payments to suppliers	(426,415)	(399,089)
Payments to employees	(555,786)	(523,812)
Net cash provided by operating activities	175,300	134,829
Cash flows from noncapital financing activities:		
Noncapital grants, contributions and other adjustments	(205)	(44)
Payments for pension-related liabilities	(7,838)	(7,692)
Additions to permanent endowment	514	644
Payment to University of Wisconsin School of Medicine and Public Health for capital expenditure support	(8,725)	(2,500)
Net cash used in noncapital financing activities	(16,254)	(9,592)
Cash flows from capital and related financing activities:		
Capital grants, gifts, and donations received	2,989	2,629
Proceeds from long-term debt	—	117,745
Repayment of principal on long-term debt	(7,845)	(125,552)
Interest paid on long-term debt	(8,563)	(7,606)
Deferred financing costs	(107)	(162)
Purchases of capital assets	(52,272)	(35,519)
Proceeds from sale of capital assets	46	188
Net cash used in capital and related financing activities	(65,752)	(48,277)
Cash flows from investing activities:		
Proceeds from sales of investments	5,734	3,492
Purchases of investments	(189,723)	(60,985)
Investment income received	14,975	11,172
Increase in investment in joint venture	125	2,814
Other, net	2,038	92
Net cash used in investing activities	(166,851)	(43,415)
Net (decrease) increase in cash and cash equivalents	(73,557)	33,545
Cash and cash equivalents:		
Beginning of year	135,718	102,173
End of year	\$ 62,161	135,718

**UNIVERSITY OF WISCONSIN HOSPITALS
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Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	2012	2011
Reconciliation of cash and cash equivalents to balance sheet:		
Cash and cash equivalents in current assets	\$ 53,387	52,804
Cash equivalents in noncurrent cash and investments	8,774	82,914
Total cash and cash equivalents	\$ 62,161	135,718
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	\$ 127,137	72,463
Adjustments to reconcile operating income to net cash provided by operating activities:		
Provision for bad debts	20,078	18,372
Depreciation and amortization	43,606	45,839
Amortization of bond premium and deferred loss of bond refinancing	372	334
Change in other postemployment benefit obligation	4,497	4,026
Adjustment to pension-related liabilities	3,604	3,480
Changes in assets and liabilities:		
Patient accounts receivable	(44,248)	(19,777)
Other receivables	534	(4,049)
Inventories of supplies	8	162
Prepaid expenses	(1,045)	1,346
Other assets	(98)	(240)
Accounts payable	10,375	1,329
Accrued expenses	(2,484)	3,418
Estimated payables to Medicare and Medicaid	12,964	8,126
Total adjustments	48,163	62,366
Net cash provided by operating activities	\$ 175,300	134,829

Noncash investing, capital and financing activities:

The Hospital held investments at June 30, 2012 and 2011 with fair values of \$571,104 and \$389,896, respectively.

During 2012 and 2011, the net (decrease)/increase in the fair value of these investments was \$(2,718) and \$10,390, respectively.

The Hospital has recorded pledges of \$2,690 in 2012 and \$1,692 in 2011 related to the American Family Children's Hospital Campaign.

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN HOSPITALS
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Notes to Basic Financial Statements

June 30, 2012 and 2011

(1) Summary of Organization and Significant Accounting Policies

The University of Wisconsin Hospitals and Clinics Authority (the Hospital) is an academic medical center operating an acute care hospital with 530 available beds, numerous specialty clinics, and four ambulatory facilities providing comprehensive health care to patients, education programs, research, and community service primarily to residents of southern Wisconsin.

Prior to fiscal year 1997, the Hospital was a unit of the University of Wisconsin – Madison (the University). Beginning in fiscal year 1997, in accordance with legislation passed by the Wisconsin State Legislature, the Hospital restructured as a Public Authority, a public body corporate and politic created by Wisconsin Statutes. This legislation provided, among other things, for the Board of Regents of the University of Wisconsin System (Board of Regents) to execute various agreements with the Hospital. The State of Wisconsin (the State) appoints the majority of the board of directors of the Hospital. Based on statutorily mandated relationships with State governmental units, the Hospital is included as a discretely presented component unit in the State's basic financial statements.

Under the terms of a Lease Agreement, the Hospital leases the facilities that were occupied by the Hospital as of June 29, 1996, for a nominal annual amount for an initial term of 30 years to be renewed annually with automatic extensions of one additional year on each July 1 until action is taken to stop the extensions. In addition, the Hospital is required to repay the State's outstanding debt obligations on the leased facilities. The leased facilities are included with the Hospital's capital assets (note 6), and the debt obligations on the leased facilities are included with the Hospital's long-term debt (note 7).

An Affiliation Agreement (the Agreement) requires the Hospital to continue to support the educational, research, and clinical activities of the University, including the University of Wisconsin School of Medicine and Public Health (UWSMPH) and the University of Wisconsin Schools of Nursing and Pharmacy (note 4). Subject to a Contractual Services Agreement and Operating and Service Agreement between the Board of Regents and the Hospital, the two parties have entered into contracts with each other for the continuation of the provision of services in support of programs and operations.

The significant accounting policies of the Hospital are as follows:

(a) Basis of Accounting

The accounting policies of the Hospital conform to accounting principles generally accepted in the United States of America as applicable to governmental entities. The accounts of the Hospital, which are reported similar to an enterprise fund, are used to account for the Hospital's activities that are financed and operated in a manner similar to a private business enterprise. Accordingly, the Hospital maintains its records on the accrual basis of accounting. Revenues from operations, investments, and other sources are recorded when earned. Expenses, including depreciation and amortization, are recorded when incurred.

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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, the Hospital has elected not to apply Financial Accounting Standards Board (FASB) or Accounting Principles Board Opinions (APB), issued on or after November 30, 1989, to the Hospital's financial statements.

Nonexchange transactions, in which the Hospital receives value without directly giving equal value in return, include grants and contributions. Revenues from grants and contributions are recognized in the fiscal year in which all eligibility requirements have been satisfied. Eligibility requirements include timing requirements, which specify the year the resources are required to be used or the fiscal year in which use is first permitted, and expenditure requirements, in cases where the resources are provided to the Hospital on a reimbursement basis.

(b) Cash and Cash Equivalents

Cash and cash equivalents are defined as highly liquid investments purchased with an original maturity of three months or less.

(c) Inventories of Supplies

The inventories of supplies are valued at the lower of cost (first-in, first-out) or market.

(d) Investments and Investment Income

Investments in equity securities with readily determinable fair values and all investments in debt securities are recorded at fair value based upon quoted market prices. The pooled investment funds on deposit with the University of Wisconsin Foundation – Expendable Fund are recorded at cost, plus accrued earnings to date. The University of Wisconsin Foundation assumes the market risk for the Hospital's investment in the University of Wisconsin Foundation – Expendable Fund. The pooled investment funds on deposit with the University of Wisconsin Foundation – Endowment Fund are recorded using net asset value as a practical expedient in estimating fair value, based on information provided by the University of Wisconsin Foundation. The estimated values are reviewed and evaluated by the Hospital. Interest, dividends, and changes in the fair value of investments are included in nonoperating revenue.

Investments in joint ventures, in which the Hospital has the ability to exercise significant but not a controlling influence over the ventures' operating and financial policies, are recorded using the equity method of accounting.

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(e) Capital Assets

Capital assets are stated at cost. Capital assets under capital leases are stated at the present value of minimum lease payments. Donated capital assets are recorded at fair market value at the date of donation, which then becomes the asset's historical cost. Individual capital expenditures greater than \$3,000 are capitalized. Depreciation or amortization on capital assets is calculated on the straight-line method over the shorter of the estimated useful life or the period of the lease term. Gains (losses) on sales of capital assets are recorded as nonoperating revenues (expenses). Additions, replacements, major repairs, and renovations are capitalized. Costs of repairs and maintenance are expensed as incurred. The estimated useful life of capital assets is as follows:

Buildings and improvements	20 – 40 years
Equipment	5 – 10 years

(f) Costs of Borrowing

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized on the straight-line basis over the term of the bonds, which approximates the interest-yield method.

(g) Contributions

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

Endowments are provided to the Hospital on a voluntary basis by individuals and private organizations. Permanent endowments require that the principal or corpus of the endowment be retained in perpetuity. If a donor has not provided specific instructions, the net appreciation of the investments of endowment funds are recorded with investment income in nonoperating revenue.

(h) Net Assets

Net assets of the Hospital are classified in four components:

Invested in Capital Assets – Net of Related Debt – which consists of capital assets, net of accumulated depreciation and amortization, and reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets.

Restricted, Expendable – which are noncapital net assets that must be used for a particular purpose, as specified by creditors or contributors external to the Hospital.

Restricted, Nonexpendable – which equal the principal portion of permanent endowments.

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June 30, 2012 and 2011

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

Unrestricted Net Assets – which are remaining net assets that do not meet the definitions of invested in capital assets, net of related debt, or restricted net assets.

(i) Operating Revenues and Expenses

The Hospital's statements of revenues, expenses, and changes in net assets distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing healthcare services – the Hospital's principal activity. Nonexchange revenues, including contributions received for purposes other than capital asset acquisition support payments to related organizations, are reported as nonoperating revenues. Operating expenses are all expenses incurred to provide healthcare services, other than interest expense.

(j) Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered. Reimbursable amounts from third-party payors are estimated in the period the related services are rendered and adjusted in future periods, as final settlements are determined.

Net patient service revenue includes revenue derived from agreements with various managed care organizations to provide medical services to subscribing participants. Under certain of these agreements, the Hospital receives fixed monthly capitation payments (generally, adjusted annually) based on the number of each managed care organizations' participants, regardless of services actually performed by the Hospital. The Hospital recognizes, in the year of contractual commitment, any losses on these contracts when it is probable that expected medical and maintenance expense under a group of existing contracts would exceed anticipated premiums and recoveries on these contracts. In other agreements, the managed care organizations make fee for service payments to the Hospital for certain covered services based primarily upon discounted fee schedules.

(k) Charity Care

The Hospital has a policy of providing healthcare services, without charge or at amounts less than established rates, to those unable to pay all or a portion of their charges and who meet certain eligibility criteria established in the Hospital's charity care policy. Because the Hospital does not pursue collection of amounts determined to qualify as charity care, they are not reported as patient service revenue.

(l) Risk Management

The Hospital is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; and employee health, dental, and accident benefits. The Hospital is self-insured for workers'

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compensation (note 13). The estimated provision for self-insured workers' compensation includes the ultimate cost for both reported losses and losses incurred but not reported as of the respective balance sheet dates. Commercial insurance coverage is purchased for other claims arising from such matters. The primary commercial insurance for professional liability is a full deductible policy (note 12). Settled claims have not exceeded this commercial coverage in any of the three preceding years.

(m) *Compensated Absences*

The Hospital's employees earn vacation days at varying rates depending on years of service. Employees may accumulate vacation time up to a specified maximum. Employees are paid for accumulated vacation time if they terminate employment. Consistent with the compensated absences reporting standards of GASB Statement No. 16, *Accounting for Compensated Absences*, an accrual for certain salary-related payments associated with compensated absences is included in the accrued expenses at June 30, 2012 and 2011.

(n) *Income Taxes*

The Hospital qualifies as a Section 501(c)(3) not-for-profit institution of the Internal Revenue Code (the Code) and, therefore, is exempt from federal income taxes pursuant to Section 501(a) of the Code. The Hospital is, however, subject to federal income taxes on any unrelated business income under the provisions of Section 511 of the Code. The Hospital is exempt from state income taxes under Section 71.26(b)(e) of Wisconsin Statutes.

(o) *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.

(p) *Derivative Instruments*

The Hospital's derivative instruments represent interest rate swaps that are used as part of its risk management strategy to manage exposure to fluctuations in interest rates and to manage the overall cost of its debt. Interest rate swaps are used to hedge identified and approved exposures and are not used for speculative purposes.

Effective July 1, 2009, the Hospital records derivative instruments on the balance sheet as either an asset or liability measured at their fair market value with changes in fair market value being included in the statements of revenues, expenses and changes in net assets.

(q) *Pension-related Liabilities*

In December 2003, the State issued Annual Appropriation Bonds and used the proceeds to retire the State's unfunded pension liability with the Wisconsin Retirement System, including a portion attributable to certain Hospital employees. The Hospital is responsible for reimbursing the State for

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its portion of the annual debt service related to the bonds. That liability is reported as a component of pension-related liabilities on the Hospital's balance sheet.

Since 2003, the State has refinanced and entered into swap arrangements for various portions of the Annual Appropriation Bonds. As a result, the debt service associated with those bonds varies over time. In addition, the percentage of the debt service allocable to the Hospital varies over time based on the State's methodology for allocating that liability to its various agencies. The Hospital adjusts its records, as necessary, whenever its allocated share of the outstanding debt service changes. The adjustment representing additional interest is reported as interest expense and the portion attributable to principal is reported as other nonoperating expense.

(2) Restricted Net Assets and Endowments

Restricted expendable net assets as of June 30, 2012 and 2011 are available for the following purposes (in thousands):

	2012	2011
Capital purposes	\$ 8,343	4,407
Research and general	2,991	4,517
Total expendable restricted net assets	\$ 11,334	8,924

Restricted nonexpendable net assets as of June 30, 2012 and 2011 represent the principal amounts of permanent endowments restricted to investment in perpetuity. Investment earnings for the Hospital's permanent endowments are expendable for purposes restricted by the donors primarily for patient assistance purposes.

(3) Designated Assets

Included in the \$591,683,000 and \$506,121,000 of unrestricted net assets reported as of June 30, 2012 and 2011, respectively, are \$156,745,000 and \$156,369,000, respectively, that have been designated by the Hospital's board of directors for capital replacement and debt retirement. Designated funds remain under the control of the board of directors, which may, at its discretion, later designate the funds for other purposes.

(4) Transactions with Related Parties

The Hospital receives certain administrative and other general services from the University and provides direct support for the educational, research, and clinical activities of the University through the Agreement. Direct costs associated with these services and support approximated \$57,671,000 and \$56,875,000 in 2012 and 2011, respectively. The Hospital committed to support certain UWSMPH and University of Wisconsin School of Nursing capital expenditures as incurred, with the remaining \$6,014,000 as of June 30, 2012, of the commitment to be paid as the capital projects commence in agreed-upon installments. At June 30, 2012 and 2011, the Hospital had \$1,898,000 and \$3,586,000 in receivables, respectively, and \$5,511,000 and \$5,900,000 in payables, respectively, with the University.

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University Health Care, Inc. (UHC) is a Wisconsin nonstock, not-for-profit corporation. UHC primarily is engaged in furthering the teaching, research, and service functions of the Hospital, UWSMPH, and the University of Wisconsin Medical Foundation (UWMF), each of which are members of UHC. UHC acquired 100% of the equity interest of Unity Health Plans effective January 1, 2005. This acquisition was funded 60% by the Hospital and 40% by UWMF. By resolution of UHC and agreement by its members, the Hospital and UWMF shall indirectly hold 60% and 40%, respectively, of the equity and ownership rights of Unity Health Plans. The UWSMPH shall have no ownership rights or funding obligations in and to Unity Health Plans. The super majority rights for governance of Unity Health Plans do not grant control to either the Hospital or UWMF. As such, the Hospital's investment in Unity Health Plans through UHC is accounted for by the equity method. At June 30, 2012 and 2011, the Hospital had \$906,000 and \$1,139,000 in receivables, respectively, with Unity Health Plans and UHC. The Hospital received payments of \$51,520,000 and \$46,834,000 for the years ended June 30, 2012 and 2011, respectively, from UHC under a capitation agreement with Unity Health Plans. Unity Health Plans assumes the risk in the event of hospital utilization in excess of capitation payments.

e-Care of Wisconsin, LLC, was formed in May 2008 as a limited liability company. UHC is the sole member of the LLC. The board of managers of e-Care of Wisconsin, LLC consists of three appointees from the Hospital and two appointees each from UWMF and UHC; as such, the Hospital's investment is accounted for on the equity basis. Capital contributions to the LLC are funded 70% by the Hospital and 30% by UWMF as per resolution of the board of directors of UHC.

UHC was audited by other auditors as of December 31, 2011 and 2010, and for the years then ended. A summary of certain financial data for UHC as of and for the years ended December 31, 2011 and 2010 is as follows (in thousands):

	2011	2010
Total assets	\$ 136,443	134,024
Unrestricted net assets	59,084	56,271
Total revenue	408,757	382,390
Excess of revenues over expenses	565	4,354

Wisconsin Therapies, Inc., a not-for-profit corporation controlled by the Hospital, was organized for the purpose of forming a limited liability company with Chartwell Midwest. Wisconsin Therapies, Inc. is a holding company that has no assets, liabilities, or operations. The limited liability company is called Chartwell Wisconsin Enterprises, LLC, and is the sole member in Chartwell Midwest Wisconsin, LLC, and a single-member limited liability company providing tertiary home care, infusion therapy and other home health services to acutely and chronically ill patients primarily in Wisconsin. The Hospital's investment in the company is adjusted for equity in undistributed earnings of Chartwell Wisconsin Enterprises, LLC.

Wisconsin Dialysis, Inc. is a not-for-profit corporation, which is owned 45%, 45%, and 10% among the Hospital, Meriter Hospital Inc., and UWMF, respectively. The investment is being accounted for by the equity method. At June 30, 2012 and 2011, the Hospital had \$381,000 and \$269,000 in receivables, respectively, from Wisconsin Dialysis, Inc.

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The Hospital has a one-third membership interest in Madison Surgery Center Inc. The other members include Meriter Hospital, Inc. and UWMF. The investment is being accounted for by the equity method.

Madison United Healthcare Linen, Ltd. provides laundry services to hospitals, long-term care facilities and clinics. The Hospital is a 46.1% member, along with two other hospitals. The investment is being accounted for by the equity method.

Madison Environmental Resourcing, Inc. was established in 1986 to provide waste treatment and disposal of solid waste material for member organizations operating in the healthcare industry. The Hospital is a 40.9% member, together with Meriter Hospital, Inc. and St. Mary's Hospital. The investment is being accounted for by the equity method.

Generations Fertility Care, Inc. opened in September 2010. The Hospital is a one-third member, along with UWMF and Meriter Hospital, Inc. The investment is being accounted for by the equity method.

Investments in joint ventures as of June 30, 2012 and 2011 comprise of the following (in thousands):

	<u>2012</u>	<u>2011</u>
University Health Care, Inc.	\$ 35,679	34,556
e-Care of Wisconsin, LLC	1,010	790
Wisconsin Therapies, Inc.	1,662	1,451
Wisconsin Dialysis, Inc.	2,933	2,135
Madison Surgery Center, Inc.	7,443	6,928
Madison United Healthcare Linen, Ltd.	4,123	3,952
Madison Environmental Resourcing, Inc.	662	641
Generations Fertility Care, Inc.	367	54
Total	<u>\$ 53,879</u>	<u>50,507</u>

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(5) Deposits and Investments

(a) Deposits

Custodial credit risk for deposits is the risk that in the event of a financial institution failure, the Hospital's deposits will not be returned. Deposits included in current cash and cash equivalents as of June 30, 2012 and 2011 are presented in the table below (in thousands):

	2012	2011
Bank balances:		
FDIC – Insured	\$ 312	141
Uninsured, collateralized, or collateralized by securities held by the pledging institution or by its trust department or agent in other than the Hospital's name	60,767	60,965
Petty cash	68	75
Total bank balances	\$ 61,147	61,181
Carrying amount	\$ 53,387	52,804

Additional amounts on deposit with the Hospital's investment advisor for investment in fixed-income securities included in noncurrent cash and investments are \$7,651,000 and \$81,780,000 as of June 30, 2012 and 2011, respectively. These amounts are uninsured and uncollateralized. Other restricted deposits held with a trustee and included in noncurrent cash and investments are \$1,072,000 and \$1,134,000 as of June 30, 2012 and 2011, respectively.

(b) Investments

The board of directors has authorized management to invest in debt and equity securities through the following:

Fixed-income securities – investments in U.S. Treasury bonds and notes, corporate bonds and other government bonds managed by an investment advisor. Amounts are recorded at fair value based on quoted market prices.

University of Wisconsin Foundation – Expendable Fund – pooled investments recorded at cost, plus accrued earnings to date. The Foundation assumes the market risk for investments in this fund.

University of Wisconsin Foundation – Endowment Fund – pooled investments recorded using net asset value as a practical expedient in estimating fair value.

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Noncurrent cash and investments comprise at June 30, 2012 and 2011, as follows (in thousands):

	2012	2011
Cash equivalents:		
Money market – investment advisor	\$ 7,651	81,780
Funds held with trustee money market fund	4,020	1,085
Other	51	49
Fixed income mutual fund	90,091	—
Fixed income securities	212,686	124,884
Pooled investment funds on deposit with the University of Wisconsin Foundation:		
Pooled Expendable Fund	164,129	161,689
Pooled Endowment Fund	101,250	103,323
Total	\$ 579,878	472,810

Investments held in the pooled endowment at the Foundation comprise of the following as of June 30, 2012:

	2012	2011
Cash	2%	2%
Fixed income	17	11
Hedge funds	4	17
Equity	49	43
Private equity	24	18
Real estate assets	4	9
	100%	100%

The Hospital may redeem its investments held with the Foundation with a 30 day notice, subject to certain fund availability restrictions.

(c) Investment Risk Factors

There are many factors that can affect the value of investments. Some, such as custodial risk, concentration of credit risk, and foreign currency risk may affect both equity and fixed-income securities. Equity securities respond to factors such as economic conditions, individual company earnings performance, and market liquidity, while fixed-income securities are particularly sensitive to credit risks and changes in interest rates.

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(d) Credit Risk

Credit risk is the risk that the Hospital will not recover its investments due to the failure of the counterparty to fulfill its obligation. The Hospital does not have an investment policy over credit risk. Investments in fixed-income securities are subject to credit risk as of June 30, 2012 and 2011 as determined through a nationally recognized rating agency, Moody's, are presented in the table below (in thousands):

	<u>2012</u>	<u>2011</u>
Aaa	\$ 76,152	62,028
Aa1	3,206	1,805
Aa2	5,396	4,193
Aa3	7,967	2,186
A1	9,299	5,331
A2	18,589	4,921
A3	16,634	6,847
Baa1	18,279	9,374
Baa2	31,454	15,119
Baa3	10,476	5,662
Ba1	1,317	1,577
Ba2	320	—
Not rated	13,597	5,841
Total	<u>\$ 212,686</u>	<u>124,884</u>

Investments in the pooled expendable fund and the pooled endowment fund are not subject to credit risk as the Foundation is not rated.

(e) Interest Rate Risk

Interest rate risk is the risk that the fair value of the Hospital's investments will decrease as a result of an increase in interest rates. Concentration of credit risk is the risk of loss attributed to the magnitude of the Hospital's investment in a single issuer or investment. The Hospital does not have an investment policy over interest rate risk. Maturities related to the Hospital's fixed-income investments as of June 30, 2012 and 2011 are presented in the tables below (in thousands):

		<u>2012</u>		
		<u>Total</u>	<u>< 1 year</u>	<u>2 – 5 years</u>
U.S. Treasury bonds and notes	\$ 50,766	—	—	50,766
Corporate bonds	133,992	12,064	22,967	98,961
Other government bonds	27,928	306	15,625	11,997
Total	<u>\$ 212,686</u>	<u>12,370</u>	<u>38,592</u>	<u>161,724</u>

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		2011			
		<u>Total</u>	<u>< 1 year</u>	<u>2 – 5 years</u>	<u>> 5 years</u>
U.S. Treasury bonds and notes	\$	46,050	—	23,937	22,113
Corporate bonds		66,456	5,963	38,292	22,201
Other government bonds		12,378	402	7,934	4,042
Total	\$	<u>124,884</u>	<u>6,365</u>	<u>70,163</u>	<u>48,356</u>

(6) Capital Assets

Capital asset additions, retirements, and balances for the year ended June 30, 2012 are as follows (in thousands):

		<u>Balance, June 30, 2011</u>	<u>Additions and transfers</u>	<u>Retirements</u>	<u>Balance, June 30, 2012</u>
Capital assets not being depreciated:					
Land	\$	14,785	2,279	—	17,064
Land improvements		2,257	20	—	2,277
Construction in progress		8,178	4,373	—	12,551
Total		<u>25,220</u>	<u>6,672</u>	<u>—</u>	<u>31,892</u>
Capital assets being depreciated:					
Buildings and improvements		510,416	13,844	(858)	523,402
Equipment		254,214	30,355	(3,851)	280,718
Total		<u>764,630</u>	<u>44,199</u>	<u>(4,709)</u>	<u>804,120</u>
Less accumulated depreciation and amortization for:					
Buildings and improvements		221,418	19,706	(858)	240,266
Equipment		182,942	23,817	(3,580)	203,179
Total		<u>404,360</u>	<u>43,523</u>	<u>(4,438)</u>	<u>443,445</u>
Total capital assets being depreciated – net		<u>360,270</u>	<u>676</u>	<u>(271)</u>	<u>360,675</u>
Total capital assets	\$	<u>385,490</u>	<u>7,348</u>	<u>(271)</u>	<u>392,567</u>

Construction in progress at June 30, 2012 consists principally of costs incurred for the build-out of an additional floor in the American Family Children’s Hospital for a pediatric ICU and NICU, addition of three new operating rooms and seven prep and recovery rooms and development costs for a proposed new eastside campus. The construction projects are being financed with cash from operations.

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Capital asset additions, retirements, and balances for the year ended June 30, 2011 are as follows (in thousands):

	<u>Balance, June 30, 2010</u>	<u>Additions and transfers</u>	<u>Retirements</u>	<u>Balance, June 30, 2011</u>
Capital assets not being depreciated:				
Land	\$ 14,385	400	—	14,785
Land improvements	1,961	296	—	2,257
Construction in progress	4,788	3,390	—	8,178
Total	<u>21,134</u>	<u>4,086</u>	<u>—</u>	<u>25,220</u>
Capital assets being depreciated:				
Buildings and improvements	498,511	12,151	(246)	510,416
Equipment	240,544	23,441	(9,771)	254,214
Total	<u>739,055</u>	<u>35,592</u>	<u>(10,017)</u>	<u>764,630</u>
Less accumulated depreciation and amortization for:				
Buildings and improvements	202,579	19,071	(232)	221,418
Equipment	165,606	26,637	(9,301)	182,942
Total	<u>368,185</u>	<u>45,708</u>	<u>(9,533)</u>	<u>404,360</u>
Total capital assets being depreciated – net	<u>370,870</u>	<u>(10,116)</u>	<u>(484)</u>	<u>360,270</u>
Total capital assets	<u>\$ 392,004</u>	<u>(6,030)</u>	<u>(484)</u>	<u>385,490</u>

Construction in progress at June 30, 2011 consisted principally of costs incurred for inpatient unit and clinic remodeling. The construction projects were financed with cash from operations.

Total remaining commitments on capital asset purchases and the renovation and construction projects approximated \$1.5 million at June 30, 2012.

The creation of the American Family Children's Hospital represented the Hospital's first major facility funded in partnership with private donors. Building on a \$10 million founding gift from American Family Insurance Corp., a \$41 million campaign for the construction of the new Children's Hospital, began in 2003. As of June 30, 2012 and 2011, \$38.1 million has been received and \$2.7 million and \$1.7 million, respectively, of net present value pledges receivable have been recorded in the financial statements as capital donations.

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(7) Long-Term Debt

Changes in long-term debt for the years ended June 30, 2012 and 2011 are as follows (in thousands):

	<u>Balance, June 30, 2011</u>	<u>Additions</u>	<u>Payments and amortization</u>	<u>Balance, June 30, 2012</u>	<u>Amounts due within one year</u>
Amounts payable to the State under capital lease agreements for:					
General Obligation Bonds \$	269	—	77	192	24
Refunding Bonds	3,888	—	1,570	2,318	1,264
Total payable to the state	4,157	—	1,647	2,510	1,288
Hospital Revenue Bonds:					
Series 2002B	3,405	—	1,900	1,505	1,505
Series 2008A	49,545	—	730	48,815	1,130
Series 2009B	56,830	—	2,005	54,825	2,130
Series 2009C	4,930	—	261	4,669	275
Series 2011A	56,745	—	—	56,745	500
Series 2011B	61,000	—	—	61,000	—
Hospital Equipment Loan	6,089	—	1,302	4,787	1,362
Total long-term debt	242,701	—	7,845	234,856	8,190
Series 2000 Refunding deferred loss	(5,544)	—	(313)	(5,231)	—
Series 1997 Refunding deferred loss	(228)	—	(14)	(214)	—
Series 2004 Refunding deferred loss	(411)	—	(17)	(394)	—
Series 2002A Refunding deferred loss	(578)	—	(27)	(551)	—
Series 2005 Refunding deferred loss	(374)	—	(21)	(353)	—
Series 2008B Refunding deferred loss	(472)	—	(21)	(451)	—
Series 2009A Refunding deferred loss	(486)	—	(23)	(463)	—
Premium on long-term debt	113	—	65	48	—
Long-term debt including premium	\$ 234,721	—	7,474	227,247	8,190

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	<u>Balance, June 30, 2010</u>	<u>Additions</u>	<u>Payments and amortization</u>	<u>Balance, June 30, 2011</u>	<u>Amounts due within one year</u>
Amounts payable to the state under capital lease agreements for:					
General Obligation Bonds	\$ 275	—	6	269	7
Refunding Bonds	5,593	—	1,705	3,888	1,634
Total payable to the state	5,868	—	1,711	4,157	1,641
Hospital Revenue Bonds:					
Series 2002B	5,205	—	1,800	3,405	1,900
Series 2008A	50,060	—	515	49,545	730
Series 2008B	61,000	—	61,000	—	—
Series 2009A	57,070	—	57,070	—	—
Series 2009B	58,790	—	1,960	56,830	2,005
Series 2009C	5,180	—	250	4,930	262
Series 2011A	—	56,745	—	56,745	—
Series 2011B	—	61,000	—	61,000	—
Hospital Equipment Loan	7,335	—	1,246	6,089	1,302
Total long-term debt	250,508	117,745	125,552	242,701	7,840
Series 2000 Refunding deferred loss	(5,856)	—	(312)	(5,544)	—
Series 1997 Refunding deferred loss	(242)	—	(14)	(228)	—
Series 2004 Refunding deferred loss	(429)	—	(18)	(411)	—
Series 2002A Refunding deferred loss	(605)	—	(27)	(578)	—
Series 2005 Refunding deferred loss	(395)	—	(21)	(374)	—
Series 2009A Refunding deferred loss	—	(475)	(3)	(472)	—
Series 2008B Refunding deferred loss	—	(490)	(4)	(486)	—
Premium on long-term debt	177	—	64	113	—
Long-term debt including premium	\$ 243,158	116,780	125,217	234,721	7,840

The amounts payable to the State under capital lease agreements represent portions of the respective obligations for which repayment has been assigned to the Hospital in connection with the financing of the Hospital's facilities and equipment (note 1).

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In October 2002, the Hospital issued \$68,500,000 of Hospital Revenue Bonds, Series 2002 (Series 2002 Bonds) consisting of \$55,600,000 Series 2002A Short-term Adjustable Securities and \$12,900,000 Series 2002B Fixed Interest Rate Bonds. The bond proceeds were designated to finance-qualified capital projects. In March 2009, the Hospital refunded \$55,600,000 of the outstanding Series 2002A bonds with Variable Rate Demand Revenue Bonds, Series 2009A. The refunding of the Series 2002A bonds resulted in the recognition of a deferred loss of \$641,000. Principal payments on the remaining Series 2002B Bonds are \$1,505,000 due in April 2013. Interest rates for the Series 2002B Bonds range from 5.25% to 5.50% and payable semiannually on April 1 and October 1 of each year. The effective annual interest rate of the Series 2002B Bonds was 6.60% in 2012 and 6.10% in 2011.

In September 2005, the Hospital issued \$59,770,000 of Variable Rate Demand Hospital Revenue Bonds, Series 2005 (Series 2005 Bonds). The bond proceeds were designated to refund a portion of the then outstanding Series 2000 Bonds. As a result of advanced refunding, the Hospital recognized a deferred loss of \$7,339,000, which is being amortized to interest expense over the term of the debt. There are no amounts outstanding on the defeased bonds at June 30, 2012 and 2011. In March 2009, the Hospital refunded \$58,095,000 of the outstanding Series 2005 bonds with Variable Rate Demand Hospital Revenue Bonds, Series 2009B and transferred the April 2009 principal payment of \$495,000 into escrow. The refunding of the Series 2005 Bonds resulted in the recognition of a deferred loss of \$423,000.

In May 2008, the Hospital issued \$50,375,000 of Fixed Rate Bonds, Series 2008A (Series 2008A Bonds) through a private placement. The bond proceeds were used to refund \$50,000,000 of Variable Rate Demand Hospital Revenue Bonds, Series 1997. Principal payments on the remaining Series 2008A Bonds, ranging from \$1,130,000 to \$5,245,000, are due annually from April 2012 through April 2026. Interest is payable semiannually. In 2012 and 2011, the effective interest rate was 5.30%.

In June 2008, the Hospital issued \$61,000,000 of Variable Rate Demand Revenue Refunding Bonds, Series 2008B Bonds, secured by an irrevocable transferable direct pay letter of credit issued by a commercial bank. The bonds proceeds were used to refund \$60,000,000 of Hospital Revenue Bonds consisting of Short-term Adjustable Rate Securities, Series 2004. In 2011, the effective interest rate was 0.20%. In May 2011, the Hospital refunded \$61,000,000 of the outstanding Series 2008B bonds with Revenue Refunding Bonds, Series 2011B. The refunding of the Series 2008B bonds resulted in the recognition of a deferred loss of \$474,198.

In September 2008, the Hospital entered into an equipment financing agreement with GE Government Finance, Inc in the amount of \$9,283,424. Principal and interest payments are made monthly commencing on November 1, 2008, for seven years. In 2012 and 2011, the effective interest rate was 4.50%.

In March 2009, the Hospital issued \$57,070,000 of Variable Rate Demand Revenue Refunding Bonds, Series 2009A (Series 2009A Bonds), secured by an irrevocable transferable direct pay letter of credit issued by a commercial bank. The bond proceeds were used to refund \$55,600,000 of the outstanding Hospital Revenue Bonds consisting of Short-Term Adjustable Rate Securities, Series 2002A. In 2011, the effective interest rate was 0.20%. In May 2011, the Hospital refunded the outstanding \$57,070,000 of the Series 2009A bonds with Revenue Refunding Bonds, Series 2011A and the balance of the Series 2009A Interest Fund. The refunding of the Series 2009A bonds resulted in the recognition of a deferred loss of \$487,933.

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In March 2009, the Hospital also issued \$59,345,000 of Variable Rate Demand Revenue Refunding Bonds, Series 2009B (Series 2009B Bonds). The bond proceeds were used to refund \$58,095,000 of Variable Rate Demand Revenue Refunding Bonds, Series 2005. Principal payments on the remaining Series 2009B Bonds, ranging from \$2,130,000 to \$8,195,000, are due annually from April 2012 through April 2029. Series 2009B Bonds bear interest at a weekly rate determined by a remarketing agent. Interest is payable monthly. The effective annual interest rate was 0.10% in 2012 and 0.20% in 2011.

The Series 2009B Bonds are secured by an irrevocable transferable direct pay letter of credit issued by a commercial bank. The initial letter of credit agreement has a stated expiration date of five years. It does not require any principal payments within the first year of the draw; interest payments are due monthly. Outstanding principal payments under the letter of credit would revert to a term out loan after the first year. Any obligations under the term out loans are repayable in equal quarterly installments based on a four-year straight-line amortization commencing on the 367th day after the draw with final payments of the outstanding balances on the earliest to occur of: (a) the date on which the letter of credit is replaced or substituted; (b) five (5) years following the date of the draw preceding such Term Out Loan; (c) the date the bonds are successfully remarketed; or (d) the date on which all amounts due have been accelerated pursuant to the letters-of-credit. The letter-of-credit agreements include a material adverse effect clause. The agreements provide specific details as to what constitutes a material adverse effect and that a material adverse effect could constitute an event of default under the letter of credit. At June 30, 2012 and 2011, there were no amounts outstanding under the letter of credit.

In June 2009, the Hospital issued \$5,300,000 of Fixed Rate Hospital Revenue Bonds, Series 2009C (Series 2009C Bonds) through a private placement. The bond proceeds were designated to finance qualified capital projects. Principal payments on the remaining Series 2009C Bonds, ranging from \$248,000 to \$478,000, are due bi-annually commencing from April 2012 through October 2024. Series 2009C Bonds bear interest from June 30, 2009 through October 1, 2012, at the initial fixed rate of 5.07% per annum. The interest rate will be reset every three years and is payable biannually. In 2012 and 2011, the effective interest rate was 5.10%.

In May 2011, the Hospital issued \$56,745,000 of Revenue Refunding Bonds, Series 2011A to a commercial bank in the form of a direct bond purchase agreement. The bond proceeds were used to refund \$57,070,000 of Variable Rate Demand Revenue Bonds, Series 2009A. Principal payments on the remaining Series 2011A Bonds, ranging from \$500,000 to \$3,900,000, are due annually from April 2013 through April 2032. Series 2011A bonds bear interest at 74% of LIBOR, plus 1.04%, payable monthly. In 2012 and 2011, the effective interest rate was 1.20%.

In May 2011, the Hospital also issued \$61,000,000 of Revenue Refunding Bonds, Series 2011B to a commercial bank in the form of a direct bond purchase agreement. The bond proceeds were used to refund \$61,000,000 of Variable Rate Demand Revenue Bonds, Series 2008B. Principal payments on the remaining Series 2011B Bonds, ranging from \$9,950,000 to \$15,275,000, are due annually in April 2030 through April 2034. Series 2011B bonds bear interest at 74% of LIBOR, plus 1.04%, payable monthly. The effective interest rate was 1.30% in 2012 and 1.10 in 2011. The 2011B bond documents include a material adverse effect clause. The bond documents provide specific details as to what constitutes a material adverse effect and that a material adverse effect could constitute an event of default.

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The Series 2002 Bonds, Series 2008A Bonds, Series 2009B Bonds, Series 2011A Bonds and Series 2011B are collateralized by a security interest in substantially all of the Hospital's revenue. The borrowing agreements contain various covenants and restrictions, including compliance with the terms and conditions of a Lease Agreement (note 1) and provisions limiting the amount of additional indebtedness that may be incurred. Management believes that the Hospital is in compliance with all debt covenants and has not incurred a material adverse effect as defined at June 30, 2012 and 2011.

Legislation (note 1) which had limited the Hospital's total borrowings to a defined amount was amended in April 2008. The statute now requires the Hospital to obtain approval of additional bond issuance from its Board of Directors, maintain an unenhanced bond rating in the category of "A" or better from Standard & Poor's Corporation (S&P) and Moody's Investor Service, Inc. (Moody's), and notify the State Joint Committee on Finance. The Hospital's current rating from S&P and Moody's is A+ and A1, respectively.

In October 2002, the Hospital entered into an interest rate swap in order to convert a portion of the Series 2002A Short-term Adjustable Rate Securities to fixed rates. The notional amount of this swap agreement was \$21,350,000 at June 30, 2012 and 2011, and matures on April 1, 2022. This swap had been applied to the Series 2009A with the refunding of the Series 2002A bonds and is now applied to the Series 2011A bonds with the refunding of the Series 2009A bonds. The terms of the swap agreement are for the Hospital to pay the counterparty a fixed rate of 3.85% per annum, payable semiannually, and the Hospital to receive a floating rate of 70% of one-month London InterBank Offered Rate (LIBOR) per annum, payable monthly. In 2012 and 2011, the effective interest rate received by the Hospital was 0.20%. The fair value of the swap agreement was \$(3,527,775) and \$(2,624,539) at June 30, 2012 and 2011, respectively.

In November 2004, the Hospital entered into an interest rate swap in order to convert a portion of the Series 1997 Variable Rate Demand Bonds to fixed rates. This swap had been applied to the 2008B bonds with the refunding of Series 1997 bonds and is now applied to the Series 2011B bonds with the refunding of Series 2008B bonds. The notional amount of this swap agreement was \$25,250,000 and \$25,950,000 at June 30, 2012 and 2011, respectively, and matures on April 1, 2021. The terms of the swap agreement are for the Hospital to pay the counterparty a fixed rate of 3.45% per annum, payable semiannually, and the Hospital to receive a floating rate of 70% of one-month LIBOR per annum, payable monthly. In 2012 and 2011, the effective interest rate received by the Hospital was 0.20%. The fair value of the swap agreement was \$(3,533,355) and \$(2,500,265) at June 30, 2012 and 2011, respectively.

In September 2005, the Hospital entered into an interest rate swap in order to convert the Series 2005 Variable Rate Demand Hospital Revenue Bonds to fixed rate. This swap has been applied to the Series 2009B with the refunding of the Series 2005 Bonds. The notional amount of the swap agreement was \$54,825,000 and \$56,830,000 at June 30, 2012 and 2011, respectively, and matures on April 1, 2029. The terms of the swap agreement are for the Hospital to pay the counterparty a fixed rate of 3.31% per annum, payable monthly, and the Hospital to receive a floating rate of 58.3% of one-month LIBOR per annum plus 0.36%, payable monthly. In 2012 and 2011, the effective interest rate received by the Hospital was 0.50%. The fair value of the swap agreement was \$(9,844,450) and \$(5,176,455) at June 30, 2012 and 2011, respectively.

The fair values of the swap agreements were estimated considering the project cash flows associated with the swaps, and the fair values are reflected in other long-term liabilities on the financial statements.

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Prior to 2012, all of the Hospital's swap agreements were reported as ineffective under the guidelines of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments* (Statement No. 53). Accordingly, the changes in fair market value were reflected as nonoperating income or expense in the statement of revenues, expenses and changes in net assets. In 2012, the Hospital determined that the derivative instruments associated with the Series 2011A and Series 2011B bonds have been effective since inception, the year the Hospital adopted Statement No. 53. Accordingly, an immaterial adjustment of \$5,125,805 is reflected in the 2012 net increase in fair value of swaps in the statement of revenues, expenses and changes in net assets to record the cumulative change in fair market values associated with those effective swaps through June 30, 2011 within deferred outflows of resources on the balance sheet. The change in fair market value of the effective swaps in 2012 of \$1,936,326 is also reflected in deferred outflows of resources.

There are collateral posting provisions on the swap agreement. The collateral amount required is determined based on the fair value of the swap, less the applicable threshold of \$7,000,000 at the Hospital's current rating. Collateral valuations are performed daily, based on the official market closing curve. While the counterparty holds the collateral, the funds will earn the overnight Federal Funds interest rate, payable monthly. Collateral of \$3,000,000 was required as of June 30, 2012. No collateral was required as of June 30, 2011.

The Hospital will be exposed to variable rates if the counterparty to the swap defaults or if the swaps are terminated. The swap agreements include bilateral additional termination event provisions. Under the provisions, either party has the option, but not the obligation, to terminate the swap transaction if the other party gets downgraded below certain thresholds. The Hospital nor the counterparties have been downgraded below these thresholds at June 30, 2012 and 2011. The Hospital does not intend to terminate these agreements. The swaps expose the Hospital to basis risk should the relationship between LIBOR and variable rate converge, changing the synthetic rate on the bonds. As of June 30, 2012 and 2011, the Hospital was not exposed to credit risk because each of the swaps had a negative fair value. However, should interest rates change and any one of the fair value of the swaps become positive, the Hospital would be exposed to credit risk in the amount of the swap's fair value.

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Aggregate scheduled principal and interest repayments on long-term debt as stated under the actual debt terms, including the effect of the swaps based on the effective interest rate at June 30, 2012 are as follows (in thousands):

<u>Year ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Interest rate swap – net</u>	<u>Total</u>
2013	\$ 8,190	4,701	3,121	16,012
2014	8,562	4,416	3,008	15,986
2015	8,931	4,187	2,810	15,928
2016	8,158	3,950	2,589	14,697
2017	7,975	3,752	2,356	14,083
2018 – 2022	44,773	15,413	7,898	68,084
2023 – 2027	52,632	8,424	3,898	64,954
2028 – 2032	65,410	4,075	676	70,161
2033 – 2035	30,225	556	—	30,781
Subtotal	<u>234,856</u>	<u>49,474</u>	<u>26,356</u>	<u>310,686</u>
Deferred loss on refunding of Series 2000 Bonds	(5,231)	—	—	(5,231)
Deferred loss on refunding of Series 1997 Bonds	(214)	—	—	(214)
Deferred loss on refunding of Series 2004 Bonds	(394)	—	—	(394)
Deferred loss on refunding of Series 2002A Bonds	(551)	—	—	(551)
Deferred loss on refunding of Series 2005 Bonds	(353)	—	—	(353)
Deferred loss on refunding of Series 2008B Bonds	(451)	—	—	(451)
Deferred loss on refunding of Series 2009A Bonds	(463)	—	—	(463)
Premium on long-term debt	48	—	—	48
Total	<u>\$ 227,247</u>	<u>49,474</u>	<u>26,356</u>	<u>303,077</u>

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Aggregate scheduled principal payments on long-term debt based on the 2009B Bonds being put back to the Hospital and a corresponding draw being made on letters of credit (in thousands).

2013	\$	8,190
2014		19,581
2015		19,875
2016		19,132
2017		18,963
2018 – 2022		33,414
2023 – 2027		36,171
2027 – 2032		49,305
2033 – 2035		30,225
Total	\$	234,856

(8) Net Patient Service Revenue

The Hospital has agreements with third-party payors that provide for reimbursement at amounts different from the Hospital's established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospital's established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursements with major third-party payors is as follows:

(a) Medicare

Inpatient acute care services rendered to Medicare beneficiaries and defined capital costs 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. Outpatient services are reimbursed based on prospectively determined rates with separate payment classifications established for each distinct service rendered within the encounter. Inpatient nonacute services, medical education, and certain organ acquisition costs related to Medicare beneficiaries are paid based upon cost-reimbursement methods, established fee screens, or a combination thereof. The Hospital is reimbursed for cost-reimbursement items at a tentative rate with final settlement determined after submission of annual cost reports by the Hospital and audits by the Medicare fiscal intermediary. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2006. The estimated receivables and payables to Medicare included in the financial statements include those cost reports that have not been audited by the Medicare fiscal intermediary.

Net patient service revenue for the years ended June 30, 2012 and 2011 included approximately \$3,279,000 and \$1,232,000, respectively, of retrospectively determined settlements from third-party payors and changes in estimates. Also, during 2012, the Hospital and approximately 2,200 other hospitals, reached a settlement with the Centers for Medicare and Medicaid Services (CMS) in a class action lawsuit related to an alleged error in a prior year's reimbursement rates. The hospitals' suit alleged that CMS committed a mathematical error in 1998 when it adjusted certain factors impacting payments for inpatient hospital services. As a result of the settlement, the Hospital received a payment in June 2012 of approximately \$6.0 million. The amount is reflected in the

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accompanying 2012 statement of revenues, expenses and changes in net assets as an adjustment to net patient service revenue.

(b) Medicaid

Inpatient services rendered to Medicaid beneficiaries are reimbursed similar to the method for Medicare inpatient acute care services. Differences from the Medicare method pertain to reimbursements for organ transplants, capital costs, and medical education costs. Medicaid outpatient services are paid on a predetermined rate per visit.

Laws and regulations governing 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 impact of any change in estimates is recorded in the year the change is determined. In management's opinion, the ultimate disposition of these uncertainties will not have a material adverse effect on the financial position of the Hospital or results of operations.

(c) Other

The Hospital has also entered into reimbursement agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursements under these agreements includes capitation, prospectively determined rates per discharge, discounts from established rates, and prospectively determined per diem rates.

Capitation revenue with third-party payors comprised approximately 5.0% of net patient service revenue for both years ended June 30, 2012 and 2011.

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The Hospital grants credit without collateral to its patients, most of whom are local residents and are insured under third-party payor agreements. The mix of net patient service revenue and net patient accounts receivable at June 30, 2012 and 2011 is summarized as follows:

	2012	2011
Net patient service revenue:		
Medicare	25.4%	24.9%
Medicaid	7.7	7.9
Managed care	53.0	54.1
Indemnity	4.6	3.7
Other	9.3	9.4
	100.0%	100.0%
Net patient accounts receivable:		
Medicare	24.5%	27.2%
Medicaid	10.1	9.0
Managed care	44.8	50.6
Indemnity	7.5	4.7
Other	13.1	8.5
	100.0%	100.0%

(9) Charity Care

The Hospital maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The approximate level of charity care provided (based on charges) during the years ended June 30, 2012 and 2011 was \$53,065,000 and \$45,674,000, respectively.

(10) Pension Plan

Virtually all Hospital employees participate in the Wisconsin Retirement System (WRS), a cost sharing, multiple employer, defined-benefit public employee retirement system governed by Chapter 40 of the Wisconsin Statutes. All permanent employees expected to work over 600 hours per year are eligible to participate in the WRS. The 2011 Wisconsin Act 10, which was implemented in August 2011, contained provisions that affected the retirement program. The WRS employee contribution rate for general employees was changed from 5.0% to 5.8% of their salary and it prohibited employers from paying the WRS employee required contribution for all WRS employees who did not have a collective bargaining agreement in place prior to the effective date of Act 10. The WRS employee contribution rate was changed to 5.9% effective January 2012. Prior to Act 10, The Hospital employees participating in WRS were categorized as either Hospital Board or Hospital Authority employees. Covered general employees were required by statute to contribute 5.0% of their salary to the plan; however, the Hospital funded these contributions to the plan on behalf of the employees. The Hospital was required to contribute the remaining amounts necessary to pay the projected cost of defined future benefits related to current service on a pay-as-you-go basis, as determined from the State of Wisconsin Department of Employee Trust Funds.

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Act-10 also eliminated the separate category of Board employees and all are now Hospital Authority employees.

The payroll for employees covered by WRS and the total required contributions were as follows:

The payroll for employees covered by WRS for the year ended June 30, 2012, was \$387,110,000; the employer's total payroll was \$402,158,000. The total required contributions, paid by both the employer and the employees, for the year ended June 30, 2012 were \$54,658,000. The payroll for employees covered by WRS for the year ended June 30, 2011 was \$373,955,000; the employer's total payroll was \$374,598,000. The total required contributions, paid entirely by the employer, for the year ended June 30, 2011 were \$50,746,000.

Employees who retire at or after age 65 are entitled to receive a retirement benefit. Employees may retire at age 55 and receive reduced benefits. Retirement benefits are calculated as 1.6% of final average earnings for each year of creditable service. Final average earnings is the average of the employee's three highest years' earnings. Employees terminating covered employment before becoming eligible for a retirement benefit may withdraw their contributions and, by doing so, forfeit all rights to any subsequent benefit. For employees beginning participation on or after January 1, 1990, and no longer actively employed on or after April 24, 1998, creditable service in each of five years is required for eligibility for a retirement annuity. Participants employed prior to 1990 and on or after April 24, 1998 are immediately vested.

Although projected benefits for current service are funded on a pay-as-you go basis, the Hospital has recorded liabilities related to the unfunded prior service costs and sick leave conversion credits.

The Hospital is required to make periodic payments to the WRS in respect of the employer's share of the unfunded prior service liability and sick leave conversion credit of the WRS related to prior service costs. The statutorily required payments are based upon a percentage of covered wages. This percentage was designed to amortize the unfunded liability over 40 years, with 20 years remaining in 2012. The Hospital's total obligation is increased each year by an amount of interest, currently equal to 7.8% of the amount of the unfunded liability. The Hospital's liability for unfunded prior service liability and sick leave conversion credit, payable to WRS, was \$25,467,000 and \$28,238,000, as of June 30, 2012 and 2011, respectively.

For employees that were classified as Hospital Board employees prior to the enactment of Act 10, the Hospital's liability for unfunded prior service and sick leave is payable to the State. In December 2003, the State issued annual appropriation bonds and used the proceeds to retire the State's portion (including the then Hospital Board employees) of the unfunded pension liability with WRS. The Hospital is required to reimburse the State for the Hospital's pro rata share of the associated debt service. The Hospital has recognized a liability of \$51,128,000 as of June 30, 2012, of which \$757,000 is payable in 2013 and is recorded in accrued expenses and \$50,371,000 is recorded in pension-related liabilities, payable in annual principal and interest payments to the State over approximately 19 years. Included in the June 30, 2012 liability is \$20.6 million representing an adjustment recorded in 2012 based on updated information provided by the State based on its methodology for allocating responsibility for ongoing debt service to State entities.

The Hospital recognized a liability of \$31,982,000 as of June 30, 2011, of which \$5,060,000 was payable in 2012 and recorded in accrued expenses and \$26,922,000 is recorded in pension-related liabilities,

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payable in annual principal and interest payments to the State over approximately 20 years. Amounts payable to the State for the years 2011 through 2016 range from approximately \$2,800,000 to \$3,400,000.

The total pension related liabilities for the Hospital as of June 30, 2012 and 2011 total \$75,595,000 and \$60,220,000, respectively, including current portion. The liability is made up of the amounts payable to both the State and the WRS, as discussed above. Copies of the separately issued WRS financial report, that includes financial statements and required supplementary information, may be obtained by writing to Department of Employee Trust Funds, 801 West Badger Road, P.O. Box 7931, Madison, Wisconsin 53707-7931

(11) Retiree Health Insurance Plan

(a) Plan Description

The Hospital is a part of the State's Health Insurance Program, which is an employer-sponsored program offering group medical coverage to eligible employees and retirees of the State and participating local government employers. Created under Chapter 40 of the Wisconsin State Statutes, the State Department of Employee Trust Funds and the Group Insurance Board have program administration and oversight responsibilities under Wis. Stat. Sections 15.165(2) and 40.03(6).

Under this agent multiple-employer plan, retired employees of the Hospital are allowed to pay the same healthcare premium as active employees, creating an implicit rate subsidy for retirees. This implicit rate subsidy, which is calculated to cover preage 65 retirees (since at age 65, retirees are required to enroll in Medicare when eligible), is treated as an other postemployment benefit (OPEB). Retirees over age 65 may purchase Medicare supplemental and prescription benefit coverage through the plan.

The Department of Employee Trust funds issues a publicly available financial report that includes financial statements and required supplementary information for the plan. That report may be obtained by writing to Department of Employee Trust Funds, 801 West Badger Road, PO Box 7931, Madison, Wisconsin 53707-7931.

(b) Funding Policy

The health insurance plan is currently on a "pay-as-you-go-basis." GASB Statement No. 45 does not address funding of the OPEB obligation and the Hospital does not intend to fund it. Current employees are not required to contribute to the retiree healthcare plan. Retirees electing to participate in the plan pay 100% of premiums directly to the plan either out-of-pocket or with their accumulated sick leave conversion credits.

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(c) Annual OPEB Cost

The Hospital's 2012 and 2011 OPEB cost (expense), dollar amount of contributions, and components of OPEB cost were as follows (in thousands):

	<u>2012</u>	<u>2011</u>
Annual Required Contribution (ARC)	\$ 5,571	5,948
Interest on the net OPEB obligation	689	670
ARC adjustment with interest	<u>(753)</u>	<u>(617)</u>
Annual OPEB cost	5,507	6,001
Employer contribution implicit rate adjustment	<u>(1,010)</u>	<u>(1,975)</u>
Change in the net OPEB obligation	4,497	4,026
Net OPEB obligation beginning balance	<u>16,221</u>	<u>12,195</u>
Net OPEB obligation ending balance	<u>\$ 20,718</u>	<u>16,221</u>

The Hospital's annual OPEB cost, percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation are as follows:

<u>Fiscal year ended</u>		<u>Annual OPEB cost</u>	<u>Percent of annual OPEB contributed</u>		<u>Net OPEB obligation</u>
6/30/2012	\$	5,507	18.3%	\$	20,718
6/30/2011		6,001	32.9		16,221
6/30/2010		6,088	25.4		12,195

(d) Funded Status and Funding Progress

As permitted by GASB 45, the Hospital obtains biannual actuarial valuations of its plan.

The Hospital does not fund the plan, and consequently the funded status was zero as of July 1, 2011 (the most recent actuarial valuation).

	<u>2012</u>	<u>2011</u>
Actuarial accrued liability (AAL)	\$ 35,639	39,246
Actuarial value of plan assets	<u>—</u>	<u>—</u>
Unfunded actuarial accrued liability (UAAL)	<u>\$ 35,639</u>	<u>39,246</u>
Funded ratio (actuarial value of plan assets/AAL)	—%	—%
Covered payroll (active plan members)	\$ 387,110	346,287

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The actuarial accrued liability calculation considers the retiree drug subsidy (RDS) provisions of Medicare Part D as a separate transaction. Therefore, the actuarial accrued liability, the annual required contribution of the employer (ARC), and the annual OPEB costs are determined without reduction of RDS payments. At June 30, 2012, the Medicare Part D portion included in the actuarial accrued liability is \$.1 million.

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents the transition year trend information that shows whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

(e) Actuarial Methods and Assumptions

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and plan members) and include the types of benefits provided at the time of the valuation and the historical pattern of sharing the benefit costs between employer and plan members to that point. In the actuarial valuation for fiscal year 2012-2013, the projected unit credit method was used. Actuarial calculations reflect a long-term perspective. The actuarial assumptions included a 4.25% discount rate and an annual healthcare cost trend rate of 0.5% for 2011, 1.8% for 2012 and 8.0% for 2013-2014, reduced by decrements to an ultimate rate of 5.5% after 13 years. The unfunded actuarial accrued liability is being amortized as a 30-year level percentage of pay amortization periods on a closed basis for the initial UAAL. The remaining amortization period was 26 years at June 30, 2012.

(12) Malpractice Insurance

The Hospital has occurrence-based coverage for claims incurred July 1, 2002 through June 30, 2003, and has claims-made or tail coverage under various policies for claims made before and after that period. Losses in excess of the professional liability insurance are fully covered through the Hospital's mandatory participation in the Injured Patient and Families Compensation Fund of the State of Wisconsin. The Injured Patient and Families Compensation Fund has coverage limits of \$1,000,000 per claim and \$3,000,000 in aggregate per year and pays that portion of a medical malpractice claim, which is in excess of the legal primary insurance limit prescribed under law, or the maximum liability limit for which the health provider is insured, whichever limit is greater. Most qualified health care providers permanently practicing or operating in the State of Wisconsin are required to pay Injured Patient and Families Compensation Fund operating fees. Risk of loss is retained by the fund. Noneconomic damages are capped in the State of Wisconsin. The Hospital has recorded in the financial statements its best estimate for the ultimate cost discounted at 3% of professional liability claims, including incurred but not reported claims.

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(13) Liabilities for Workers' Compensation Claims

A reconciliation of changes in the aggregate liabilities for workers' compensation claims for the years ended June 30, 2012 and 2011 is as follows (in thousands):

		Amount of claims liabilities beginning of year	Incurred claims and changes in estimates	Payments on claims	Amount of claims liabilities end of year
	\$				
2012		7,136	4,774	(2,245)	9,665
2011		7,006	2,221	(2,091)	7,136

Workers' compensation claim expense is included with employee benefits expense in the statements of revenues, expenses, and changes in net assets and accrued expenses in the balance sheets.

(14) Commitments and Contingencies

(a) Leases

The Hospital leases buildings, equipment, and helicopter transport services under operating leases. Rental expense for cancelable and noncancelable operating leases was approximately \$14,931,000 and \$16,233,000 for 2012 and 2011, respectively, and is included in other expenses.

Future minimum payments for the next five years under operating leases that have initial or remaining noncancelable lease terms in excess of one year and under license agreements that have remaining noncancelable terms in excess of one year as of June 30, 2012, are as follows (in thousands):

2013	\$	10,003
2014		5,711
2015		3,986
2016		3,029
2017		1,893
2018 – 2021		3,275
Total	\$	27,897

(b) Regulatory Investigations

The U.S. Department of Justice and other federal agencies are increasing resources dedicated to regulatory investigation and compliance audits of health care providers. The Hospital is subject to these regulatory efforts. Management is currently unaware of any regulatory matters, which will have a material adverse effect on the Hospital's financial position or results of operations.

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(c) **Other**

The Hospital is subject to various legal proceedings and claims, which are incidental to its normal business activities. In the opinion of management, the amount of ultimate liability with respect to these actions will not have a material adverse effect on the Hospital's financial position or results of operations.

(15) Noncurrent Liabilities

The activity in the Hospital's noncurrent liabilities for the years ended June 30, 2012 and 2011 is set forth below (amounts in thousands):

	<u>Balance at June 30, 2011</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2012</u>
Long-term debt, less current installments	\$ 226,881	—	7,824	219,057
Net OPEB obligation	16,221	4,497	—	20,718
Pension-related liabilities	55,160	28,516	7,838	75,838
Other long-term liabilities (interest rate swaps)	10,301	6,605	—	16,906
	<u>Balance at June 30, 2010</u>	<u>Increases</u>	<u>Decreases</u>	<u>Balance at June 30, 2011</u>
Long-term debt, less current installments	\$ 235,677	116,780	125,576	226,881
Net OPEB obligation	12,195	6,001	1,975	16,221
Pension-related liabilities	59,627	3,225	7,692	55,160
Other long-term liabilities (interest rate swaps)	12,249	—	1,948	10,301

REQUIRED SUPPLEMENTARY INFORMATION

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Schedule of Plan Funding Progress

As of June 30, 2012

(In thousands)

Actuarial valuation date	Actuarial value of assets	Actuarial accrued liability (AAL)	Unfunded actuarial accrued liability (UAAL)	Funded ratio	Covered payroll	UAAL as a percentage of covered payroll
7/1/2007	\$ —	30,508	30,508	—%	\$ 320,162	9.5%
7/1/2009	—	39,246	39,246	—	346,287	11.3
7/1/2011	—	35,639	35,639	—	387,110	9.2

See accompanying independent auditors' report.