UNIVERSITY OF WISCONSIN HOSPITALS AND CLINICS AUTHORITY

Basic Financial Statements and
Required Supplementary Information

June 30, 2014 and 2013

(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:

Report on the Financial Statements

We have audited the accompanying 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, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the Hospital's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of Wisconsin Hospitals and Clinics Authority as of June 30, 2014 and

2013, and the changes in financial position and cash flows for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter

Required Supplementary Information

U.S. generally accepted accounting principles require that management's discussion and analysis on pages 3-16 and the schedule of plan funding progress on page 53 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 9, 2014 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Hospital's internal control over financial reporting and compliance.

KPMG LLP

St. Louis, Missouri
October 9, 2014

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, 2014 and 2013, 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 statements of net position and the statements of revenues, expenses, and changes in net position, and cash flows, reported on the accrual basis, provide an indication of the Hospital's financial health. The statements of net position include all of the Hospital's assets, deferred outflows of resources, 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 position 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 2014

- The Hospital's net position increased by approximately $108.1 million.
- Net patient service revenues increased by $94.4 million, or 7.7%. Total operating revenues increased by $96.1 million, or 7.6%, and total operating expenses increased by $111.2 million, or 9.7%.
- Operating income for the year was $93.6 million.
- Total nonoperating revenue (expense) increased by a net amount of $34.5 million or 142.3%. The more significant components of this net change are favorable investment experience and a decrease in payments to the University of Wisconsin School of Medicine and Public Health (UWSMPH).
- The excess of revenues over expenses before capital grants, gifts and donations and additions to permanent endowments increased $19.4 million or 23.0%.

Financial Highlights – Fiscal Year 2013

- The Hospital's net position increased by approximately $87.0 million.
- Net patient service revenues increased by $51.6 million, or 4.4%. Total operating revenues increased by $56.7 million, or 4.7%, and total operating expenses increased by $75.2 million, or 7.0%.
- Operating income for the year was $108.6 million.
- Total nonoperating revenue (expense) increased by a net amount of $1.4 million or 5.6%. The more significant components of this net change are a decrease in interest expense, favorable investment and

(Continued)

interest rate swap experience and an increase in payments to the University of Wisconsin School of Medicine and Public Health (UWSMPH).

- The excess of revenues over expenses before capital grants, gifts and donations and additions to permanent endowments decreased $17.1 million or 16.8%.

Hospital Highlights – Fiscal Year 2014

- The Hospital is ranked the top hospital in the state for the third consecutive year, is among the nation's top 50 hospitals in nine medical specialties for the second year in a row, and ranked as high-performing in three additional specialty areas in the U.S. News and World Report *America's Best Hospitals 2014-2015*. American Family Children's Hospital was again ranked among the nation's top 50 pediatric hospitals in four medical and surgical specialties.

- In January 2014, the AFCH became the first children's hospital in the world to offer new lower-dose radiation technology with the opening of an imaging pavilion and multi-specialty pediatric hybrid suite, including space for catheterization, angioplasty and operating rooms.

- In February 2014, the Hospital was redesignated as a Magnet Nursing organization. Magnet is the highest and most prestigious credential a health care organization can achieve for nursing excellence and quality patient care. Fewer than 7% of all registered hospitals in the United States receive Magnet designation or re-designation, including only 10 in Wisconsin.

- On April 29, 2014, the entities of UW Health and SwedishAmerican Health System in Rockford, IL approved a letter of intent by which SwedishAmerican will merge with UW Health system. The formal affiliation that UW Health has had with SwedishAmerican since 2010 led to the development of the new SwedishAmerican Regional Cancer Center that opened to patients in October 2013.

- In May 2014, the Hospital opened a 14-bed state-of-the-art Level IV Neonatal Intensive Care Unit (NICU) at the American Family Children's Hospital (AFCH), which is only one of two Level IV NICUs in the state. The unit provides services to premature and full-term neonatal infants requiring complex surgical interventions and/or subspecialty medical care.

- Also in May 2014, the Hospital opened a 12-bed Pediatric Universal Care Unit at AFCH, which includes rooms to serve children whose needs are higher than those of a general care unit, but not as acute as those in the Pediatric Intensive Care Unit (PICU).

- In June 2014, the Hospital opened a new autopsy suite and morgue, which will provide a modern space for pathology learning and autopsies.

Hospital Highlights – Fiscal Year 2013

- The Hospital is ranked the top hospital in the state for the second consecutive year, is among the nation's top 50 hospitals in nine medical specialties, and ranked as high-performing in four additional specialty areas in the U.S. News and World Report *America's Best Hospitals 2013-2014*. American Family

Children's Hospital was again ranked among the nation's top 50 pediatric hospitals, this time in six medical and surgical specialties.

- On December 28, 2012, the Hospital formed a new company, the Inntowner LLC, and purchased the Madison Best Western Inntowner Hotel. The hotel will provide a housing option for regional patients prior to and following their hospital stay, including those who need to remain in proximity to the Hospital for post-discharge care.

- In March 2013, the Hospital issued $272,595,000 of Hospital Revenue Bonds, Series 2013A. The bond proceeds are designated to finance qualified capital projects and to refund a portion of the outstanding Series 2008A Bonds and Series 2009B Bonds, the remainder of the Series 2009C Bonds and a partial termination of the Series 2009B interest rate swap agreement. The capital projects include a new comprehensive acute and ambulatory care facility on the east side of Madison, construction and equipment of a two-story addition to the American Family Children's Hospital and construction and equipping of a new autopsy and pathology suite. Those projects are under way and are scheduled for completion at various dates through 2015.

- In March 2013, Moody's Investor Services upgraded the hospital's rating on outstanding rated debt from A1 to Aa3 with a stable outlook.

- In April 2013, the Hospital opened the UW Health Digestive Health Center (DHC) on Madison's near west side. The opening of the DHC created the region's finest multi-disciplinary outpatient clinic serving patients with diseases of the digestive tract, liver and pancreas.

- The Hospital receives certain administrative and other general services from the University of Wisconsin and provides direct financial support for educational, research and clinical activities of the University through an Affiliation Agreement. In addition to the historic Affiliation Agreement transfers, the Hospital board of directors approved in fiscal year 2013 the provisions of an Annual Academic Advancement Agreement (AAA) to establish guidelines as to when the Hospital will provide additional financial support for the education/clinical programs and outcomes research associated with UWSMPH. Under the AAA, if the operating margin of the Hospital for any fiscal year exceeds a defined threshold, initially established as 5%, and days cash-on-hand exceeds a defined threshold, initially established as 180 days, the Hospital will make a distribution to UWSMPH. Included in nonoperating expense and accrued expenses is $35,639,000 representing the expected payment for the 2013 fiscal year.

- The Hospital was one of the first in the Upper Midwest and in the first group in the nation to receive the Comprehensive Stroke Center Certification from The Joint Commission and the American Heart Association/American Stroke Association in November 2012.

- In August 2012, the Hospital formed, along with the University of Wisconsin Medical Foundation, a new entity known as UW Health Accountable Care Organization, Inc. As of January 1, 2013, the organization became one of approximately 250 across the country awarded the opportunity to participate in the Medicare Shared Savings Program (MSSP). The ACO MSSP participant organizations coordinate care for assigned Medicare beneficiaries and have an opportunity to receive incentive payments for identifiable share cost savings.

Financial Analysis and Results of Operations

At June 30, 2014, the Hospital’s assets exceeded liabilities by $969.9 million, which is an increase in total net position of $108.1 million, or 12.5%, from the prior fiscal year-end.

At June 30, 2013, the Hospital’s assets exceeded liabilities by $861.8 million, which is an increase in total net position of $87.0 million, or 11.2%, from the prior fiscal year-end.

Table 1 summarizes assets, deferred outflows of resources, liabilities, and net position at June 30 (in thousands):

Table 1
Net Position

	June 30, 2014	June 30, 2013	Dollar change	Percentage change
Current and other assets	$ 1,145,159	1,191,636	(46,477)	(3.9)%
Capital assets	609,117	455,283	153,834	33.8
Total assets	1,754,276	1,646,919	107,357	6.5
Deferred outflows of resources	16,745	18,560	(1,815)	(9.8)
Total assets and deferred outflows of resources	$ 1,771,021	1,665,479	105,542	6.3
Long-term debt	$ 468,045	483,789	(15,744)	(3.3)
Other liabilities	333,105	319,871	13,234	4.1
Total liabilities	801,150	803,660	(2,510)	(0.3)
Net position:				
Net investment in capital assets	283,267	197,200	86,067	43.6
Restricted	10,760	15,998	(5,238)	(32.7)
Unrestricted	675,844	648,621	27,223	4.2
Total net position	969,871	861,819	108,052	12.5
Total liabilities and net position	$ 1,771,021	1,665,479	105,542	6.3

(Continued)

**Table 1
Net Position**

	June 30, 2013	June 30, 2012	Dollar change	Percentage change
Current and other assets	$ 1,191,636	871,067	320,569	36.8%
Capital assets	455,283	392,567	62,716	16.0
Total assets	1,646,919	1,263,634	383,285	30.3
Deferred outflows of resources	18,560	14,718	3,842	26.1
Total assets and deferred outflows of resources	$ 1,665,479	1,278,352	387,127	30.3
Long-term debt	$ 483,789	234,904	248,885	106.0
Other liabilities	319,871	268,653	51,218	19.1
Total liabilities	803,660	503,557	300,103	59.6
Net position:				
Net investment in capital assets	197,200	176,402	20,798	11.8
Restricted	15,998	13,771	2,227	16.2
Unrestricted	648,621	584,622	63,999	10.9
Total net position	861,819	774,795	87,024	11.2
Total liabilities and net position	$ 1,665,479	1,278,352	387,127	30.3

At June 30, 2014, the Hospital's cash and investments decreased $75.8 million or 8.1% compared to June 30, 2013. The majority of the decrease in fiscal 2014 cash and investments is attributable to purchases of property and equipment (including construction of a new comprehensive acute and ambulatory care facility on the east side of Madison), repayments of long-term debt, interest paid, payments to UWSMPH for the AAA agreement, increases in accounts receivable and in accounts payable.

At June 30, 2013, the Hospital's cash and investments increased $305.6 million or 48.3% compared to June 30, 2012. The majority of the increase in fiscal 2013 cash and investments is attributable to increases from operating activities and proceeds from long-term debt, offset by purchases of property, plant and equipment, repayments of long-term debt and interest paid.

As of June 30, 2014, the Hospital reports the net present value of pledges receivable totaling $1.5 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, 2013 was $2.3 million.

Pension-related liabilities include $64.7 million and $71.6 million at June 30, 2014 and 2013, respectively, of unfunded prior service liabilities for 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 2014, based on the State's methodology for allocating responsibility for ongoing debt service to State entities, the Hospital recorded an adjustment of $1.1 million to pension-related liabilities and other nonoperating expense.

Other liabilities also include $28.8 million and $24.5 million at June 30, 2014 and 2013, respectively, representing a postemployment benefit obligation for retiree health insurance and $8.7 million and $9.4 million at June 30, 2014 and 2013, respectively, for the fair market value of the derivative instruments.

Table 2 compares 2014 revenues and expenses to 2013 and 2013 revenues and expenses to 2012, and shows the increase in net position (in thousands).

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

	June 30		Dollar	Percentage
	2014	2013	change	change
Operating revenues:				
Net patient service revenues	$ 1,327,707	1,233,280	94,427	7.7%
Other operating revenue	26,077	24,367	1,710	7.0
Total operating revenues – net	1,353,784	1,257,647	96,137	7.6
Operating expenses:				
Salaries and benefits	639,992	588,190	51,802	8.8
Medical materials and supplies	295,188	253,118	42,070	16.6
Purchased services and agency costs	160,855	151,513	9,342	6.2
Depreciation and amortization	50,085	44,121	5,964	13.5
Other	114,061	112,073	1,988	1.8
Total operating expenses	1,260,181	1,149,015	111,166	9.7
Operating income	93,603	108,632	(15,029)	(13.8)
Nonoperating revenues (expenses):				
Investment income and change in fair value	30,307	20,245	10,062	49.7

(Continued)

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

	June 30 2014	June 30 2013	Dollar change	Percentage change
Interest expense	$ (10,669)	(10,110)	(559)	5.5%
Payments to the UWSMPH for capital expenditure support	(15,272)	(42,648)	27,376	(64.2)
Other	5,874	8,281	(2,407)	(29.1)
Total nonoperating revenues (expenses), net	10,240	(24,232)	34,472	(142.3)
Excess of revenues over expenses before capital grants, gifts and donations and additions to permanent endowments	$ 103,843	84,400	19,443	23.0
Capital grants, gifts and donations	4,195	2,678	1,517	56.6
Additions to permanent endowments	14	(54)	68	(125.9)
Increase in net position	108,052	87,024	21,028	24.2
Net assets-beginning of year	861,819	774,795	87,024	11.2
Net assets-end of year	$ 969,871	861,819	108,052	12.5

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

	June 30 2013	June 30 2012	Dollar change	Percentage change
Operating revenues:				
Net patient service revenues	$ 1,233,280	1,181,671	51,609	4.4%
Other operating revenue	24,367	19,258	5,109	26.5
Total operating revenues – net	1,257,647	1,200,929	56,718	4.7
Operating expenses:				
Salaries and benefits	588,190	564,278	23,912	4.2
Medical materials and supplies	253,118	233,119	19,999	8.6
Purchased services and agency costs	151,513	135,298	16,215	12.0

(Continued)

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

	June 30		Dollar	Percentage
	2013	2012	change	change
Depreciation and amortization	$ 44,121	43,606	515	1.2%
Other	112,073	97,491	14,582	15.0
Total operating expenses	1,149,015	1,073,792	75,223	7.0
Operating income	108,632	127,137	(18,505)	(14.6)
Nonoperating revenues (expenses):				
Investment income and change in fair value	20,245	12,718	7,527	59.2
Interest expense	(10,110)	(25,668)	15,558	(60.6)
Payments to the UWSMPH for capital expenditure support	(42,648)	(11,600)	(31,048)	267.7
Other	8,281	(1,114)	9,395	(843.4)
Total nonoperating revenues (expenses), net	(24,232)	(25,664)	1,432	(5.6)
Excess of revenues over expenses before capital grants, gifts and donations and additions to permanent endowments	84,400	101,473	(17,073)	(16.8)
Capital grants, gifts and donations	2,678	3,987	(1,309)	(32.8)
Additions to permanent endowments	(54)	514	(568)	(110.5)
Increase in net position	87,024	105,974	(18,950)	(17.9)
Net assets-beginning of year	774,795	668,821	105,974	15.8
Net assets-end of year	$ 861,819	774,795	87,024	11.2

Operating Revenues

Net patient service revenue in 2014 increased $94.4 million, or 7.7% 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 2.9% 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 1.7%, and outpatient volume, measured by visits, increased approximately 7,900 or 1.3%. Patient days increased approximately 2,700 or 1.9%. The Hospital's case-mix index (CMI), which is a measure of patient acuity, calculated on an MS-DRG basis was 2.02 in 2014 and 2.00 in 2013.

Sources of net patient service revenue by payor category for fiscal years 2014 and 2013 are depicted below:

Table 3
Payor Mix

	Fiscal year 2014	Fiscal year 2013	Percentage change
Medicare	25.1%	26.0%	(3.5)%
Medicaid	7.6	7.0	8.6
Indemnity	4.1	4.3	(4.7)
Managed care	52.8	52.6	0.4
Private pay and other	10.4	10.1	3.0
	100.0%	100.0%	

Net patient service revenue in 2013 increased $51.6 million, or 4.4% 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 2.9% during the year offset by an increase in the provision for charity care and bad debts. Inpatient volume, measured by admissions, increased approximately 800, or 2.9%, and outpatient volume, measured by visits, stayed at approximately the same level as the prior year. Patient days increased approximately 4,800 or 3.5%. The Hospital's case-mix index (CMI), which is a measure of patient acuity, calculated on an MS-DRG basis was 2.00 in 2013 and 1.94 in 2012.

Sources of net patient service revenue by payor category for fiscal years 2013 and 2012 are depicted below:

Table 3
Payor Mix

	Fiscal year 2013	Fiscal year 2012	Percentage change
Medicare	26.0%	25.4%	2.4%
Medicaid	7.0	7.7	(9.1)
Indemnity	4.3	4.6	(6.5)
Managed care	52.6	53.0	(0.8)
Private pay and other	10.1	9.3	8.6
	100.0%	100.0%	

Other operating revenue, which includes nonpatient revenue such as cafeteria sales, other auxiliary services and, commencing in 2014, revenues from Inntowner LLC, increased approximately $1.7 million to $26.1 million in 2014 or 7.0% and increased approximately $5.1 million to $24.4 million, or 26.5% in 2013.

Operating Expenses

Operating expenses increased by $111.2 million, or 9.7%, in 2014 compared to the prior year. The categories of expenses that caused the majority of the increase were salaries and wages, employee benefits and medical materials and supplies. Salaries and wages expense increased 6.1% from 2013 due to wage rate increases and increases in FTEs. Employee benefits increased 15.9% from 2013 due to increases in FTE's, rates, payment received in 2013 for a FICA resident reimbursement and change in the workers compensation reserve. The increase in medical materials and supplies compared to the prior year was primarily in pharmaceuticals due to the increase in high cost specialty drugs. 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.

Operating expenses increased by $75.2 million, or 7.0%, in 2013 compared to the prior year. The categories of expenses that caused the majority of the increase were salaries and wages, medical materials and supplies, purchased services and agency costs and other expenses. Salaries and wages expense increased 6.3% from 2012 due to wage rate increases and increases in FTEs. 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; debt issuance costs for the Series 2013A bonds that as of 2013, with the early adoption of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, now classifies debt issuance costs as an expense when incurred; and organ acquisition fees. Other expenses increased $10.3 million or 14.4% primarily in purchases of minor equipment and building rental due to the opening of DHC.

Nonoperating Revenues and Expenses

Nonoperating revenues and expenses consist primarily of income from the Hospital's cash and long-term investments, 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, noncapital grants and contributions, other, net and payments to UWSMPH. Investment income, including the change in fair value of investments, increased from $17.4 million in 2013 to $30.5 million in 2014, and increased from $12.3 million in 2012 to $17.4 million in 2013, as depicted in the following chart (amounts are in thousands):

Table 4
Investment Earnings by Asset Category

		2014	2013	2012
Interest and dividend income:				
Equity investments	$	3,663	3,427	3,395
Fixed-income investments		8,982	13,286	11,584
Total investment income		12,645	16,713	14,979
Net increase (decrease) in fair value of investments		17,862	663	(2,718)
Total	$	30,507	17,376	12,261

Equity interest in income of joint ventures remained relatively stable at $3.3 million in 2013 and 2014. The change in fair value of the interest rate swap agreements resulted in $(0.2) million expense in 2014 and $2.9 million income in 2013.

Interest expense was $10.7 million in 2014, $10.1 million in 2013 and $25.7 million in 2012. The increase in 2014 is due to a slight increase in rates from bonds that were moved from variable to fixed rates in 2013. Interest expense in 2013 includes interest on the Series 2013A bond financing. The decrease from 2012 to 2013 is primarily due to a nonrecurring financial statement adjustment in 2012 to retroactively record additional interest expense for several prior years associated with pension-related obligations.

Capital Assets

At June 30, 2014, the Hospital had $609.1 million, net of accumulated depreciation and amortization, invested in capital assets. This represents a net increase of $153.8 million, or 33.8%, over 2013. The net change is due to completion of the buildout of American Family Children's Hospital (AFCH), buildout of the NICU and Pediatric Universal Care Unit, Autopsy and Pathology Suite, shell space for additional AFCH expansion and ongoing construction of a new facility on the east side of Madison, offset by depreciation expense.

At June 30, 2013, the Hospital had $455.3 million, net of accumulated depreciation and amortization, invested in capital assets. This represents a net increase of $62.7 million, or 16.0%, over 2012. The net change is due to purchase of new capital assets in 2013, including the Inntowner LLC's land, buildings and equipment, offset by depreciation expense.

Table 5 shows a summary of capital assets, net of accumulated depreciation and amortization, at June 30, 2014, 2013, and 2012 and major additions by year for the years ended June 30, 2014, 2013, and 2012 (in thousands).

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

		2014	2013	2012
Land	$	24,405	21,564	17,064
Buildings and land improvements		328,846	295,004	285,413
Equipment		129,020	103,700	77,539
Construction in progress		126,846	35,015	12,551
Total	$	609,117	455,283	392,567

Major Additions by Year

	2014	2013	2012
Land acquisition	$ 2,841	4,500	—
Buildings and improvements:			
Buildout of AFCH NICU and Pediatric Universal Care Unit	9,442	—	—
Autopsy and Pathology Suite	13,085	—	—
Shell space for expansion of additional AFCH floors	15,379	—	—
AFCH Diagnostic and Therapy unit	6,415	—	—
Operating room expansion	632	12,960	—
Inntowner building/remodeling	648	7,804	—
Additional fire alarm strobes and system upgrade	2,950	—	—
Plumbing and water treatment	607	—	—
Improvements to new leased facility (Digestive Health Center)	—	2,356	—
Inpatient unit remodeling	—	1,128	2,031
Remodeled pediatric space in ED	—	767	—
Remodeled outpatient clinic	725	—	1,594
Receiving dock renovation and expansion	—	—	1,289
Reprocessing renovation	—	—	505
Equipment:			
Nurse call upgrade	1,190	—	—
Enterprise licensing	1,509	—	—
Patient telemonitoring system	1,541	—	—
Monoplane x-ray systems	3,988	—	—
Air handling unit	1,977	—	—
Tomotherapy systems	4,591	—	—
Inntowner room remodeling equipment	1,123	—	—
Linear accelerator	—	3,920	—
IV Infusion pumps and pump system	—	3,717	—
Magnetic Resonance Imaging (MRI) machine	—	2,873	—
Biplane imaging system	1,825	2,724	1,562
Inntowner equipment	—	2,200	—
Computer-assisted Tomography (CT) machine	—	2,139	—
Microsoft licensing	—	1,336	—
DaVinci HD Robot surgical system	—	—	1,698
Vital sign monitors	—	—	1,559

Construction in progress at June 30, 2014 consists principally of costs incurred for the construction of a new comprehensive acute and ambulatory care facility on the east side of Madison, expansion of an operating room, isolation fan upgrade and room remodeling.

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 the remaining proceeds of a 2013 tax-exempt bond financing. The Hospital's total capital budget for 2015 is $211.2 million compared to $202.5 million in 2014. The 2015 budget includes $62.0 million that was deferred from 2014 to 2015.

Long-Term Debt

At June 30, 2014, the Hospital had $451.6 million in long-term debt, excluding current installments, compared to $468.6 million at June 30, 2013 – a decrease of 3.6% due to principal payments on the State of Wisconsin general obligation and refunding bonds, Series 2008A, Series 2009B, Series 2011A, Series 2013A, GE Equipment Loan, Equipment Financing agreement and capital leases.

Table 6 below provides the detail of outstanding long-term debt, excluding current installments, as of June 30, 2014, 2013, and 2012 (in thousands):

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

		2014	2013	2012
State of Wisconsin general obligation and refunding bonds	$	267	559	1,222
Authority Fixed Rate Revenue Bonds, Series 2008A		13,130	14,905	47,685
Authority Variable Rate Demand Revenue Bonds, Series 2009B		30,820	30,875	52,695
Authority Fixed Rate Adjustable Revenue Bonds, Series 2009C		—	—	4,394
Authority Fixed Rate Adjustable Revenue Bonds, Series 2011A		51,945	54,145	56,245
Authority Fixed Rate Adjustable Revenue Bonds, Series 2011B		61,000	61,000	61,000
Authority Fixed Rate Adjustable Revenue Bonds, Series 2013A		266,525	269,765	—
Equipment Loan		511	2,002	3,425
Equipment Financing Agreement		4,466	8,932	—
Capital Leases		4,120	6,247	—
Premium on Series 2013A Bonds		18,857	20,216	—
Premium on Series 2002B Bonds		—	—	48
Total	$	451,641	468,646	226,714

The Series 2013A and Series 2008A bonds carry ratings of Aa3 by Moody's and A+ from Standard & Poor's. The Series 2009B bonds are secured by an irrevocable transferable direct pay letter-of-credit agreement issued by US Bank and these bonds carry an underlying Aa3 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 are supported by 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, notify the State Joint Committee on Finance and the Department of Administration about its debt issuance plans and maintain an unenhanced bond rating in the category of "A" or better from Standard & Poor's Corporation and Moody's Investor Service, Inc. For more information about the Hospital's outstanding debt, please see note 7 to the financial statements.

Economic Factors and Next Year's Budgets and Rates

The Hospital's senior leadership team considered many variables in developing the 2015 budget and rates. Among those were: the expected payments from the Federal Medicare and State Medicaid Programs, which represent a substantial portion of the Hospital's business, and whose rate increases have historically not kept pace with cost inflation; the increase in the percentage of the Hospital's patients now covered under capitation-based contracts; anticipated salary increases and staff additions; expected cost increases for medical supplies and pharmaceuticals; and other expected cost increases affecting key contracted services. The 2015 budget, as approved by the Hospital's board of directors, projects income from operations of $69.8 million, resulting in an operating margin of 5.0%. Net income is budgeted at $87.4 million representing a total margin of 6.2%. The 2015 budget calls for volume increases of 1.5% for inpatient admissions, 3.0% for inpatient days, and 1.3% 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 AND CLINICS AUTHORITY

Statements of Net Position

June 30, 2014 and 2013

(In thousands)

Assets		**2014**	**2013**
Current assets:			
Cash and cash equivalents	$	60,260	66,270
Patient accounts receivable, net of estimated uncollectible accounts of $39,000 in 2014 and $34,000 in 2013		163,776	142,671
Other receivables		16,963	14,336
Inventories of supplies		15,754	9,083
Prepaid expenses		7,242	6,794
Total current assets		263,995	239,154
Noncurrent cash and investments:			
Designated by board for capital replacement and debt retirement		157,337	157,078
Held by trustee for capital projects and other purposes		125,452	207,148
Restricted by donors		6,865	11,281
Principal of permanent endowments		2,397	2,383
Other long-term investments		510,727	494,674
Total noncurrent cash and investments		802,778	872,564
Capital assets:			
Nondepreciable, including construction-in-progress		154,555	59,431
Depreciable, net		454,562	395,852
Total capital assets, net		609,117	455,283
Investments in joint ventures		62,874	56,908
Pledges receivable		1,489	2,317
Other assets		14,023	20,693
Total assets		1,754,276	1,646,919
Deferred Outflows of Resources			
Accumulated decrease in fair value of derivative instruments		4,160	5,048
Deferred loss on debt refunding		12,585	13,512
Total deferred outflows of resources		16,745	18,560
Total assets and deferred outflows of resources	$	1,771,021	1,665,479

See accompanying notes to basic financial statements.

Liabilities and Net Position		2014	2013
Current liabilities:			
Current installments of long-term debt	$	16,404	15,143
Accounts payable		67,629	35,371
Accrued expenses		112,195	127,639
Estimated payables to Medicare and Medicaid		51,088	51,416
Total current liabilities		247,316	229,569
Long-term debt, less current installments		451,641	468,646
Other long-term liabilities		8,706	9,394
Other postemployment benefit obligation		28,791	24,460
Pension-related liabilities		64,696	71,591
Total liabilities		801,150	803,660
Net position:			
Net investment in capital assets		283,267	197,200
Restricted – expendable for donor specified purposes		8,363	13,615
Restricted – nonexpendable		2,397	2,383
Unrestricted		675,844	648,621
Total net position		969,871	861,819
Total liabilities and net position	$	1,771,021	1,665,479

UNIVERSITY OF WISCONSIN HOSPITALS AND CLINICS AUTHORITY

Statements of Revenues, Expenses, and Changes in Net Position

Years ended June 30, 2014 and 2013

(In thousands)

		2014	2013
Operating revenues:			
Net patient service revenue (net of provision for bad debts of $34,563 in 2014 and $27,399 in 2013)	$	1,327,707	1,233,280
Other operating revenues		26,077	24,367
Total operating revenues, net		1,353,784	1,257,647
Operating expenses:			
Salaries and wages		453,924	427,686
Employee benefits		186,068	160,504
Other expenses		84,377	81,805
Repairs, maintenance, and utilities		29,684	30,268
Purchased services and agency costs		160,855	151,513
Medical materials and supplies		295,188	253,118
Depreciation and amortization		50,085	44,121
Total operating expenses		1,260,181	1,149,015
Operating income		93,603	108,632
Nonoperating revenues (expenses):			
Investment income		12,645	16,713
Net increase (decrease) in fair value of investments		17,862	663
Interest expense		(10,669)	(10,110)
Equity interest in income/loss of joint ventures		3,257	3,268
Net increase (decrease) in fair value of derivative instruments		(200)	2,869
Other, net		2,617	5,013
Contributions to University of Wisconsin School of Medicine and Public Health		(15,272)	(42,648)
Total nonoperating revenues (expenses), net		10,240	(24,232)
Excess of revenues over expenses before capital grants, gifts, and donations and additions to permanent endowments		103,843	84,400
Capital grants, gifts and donations		4,195	2,678
Additions (deductions) to permanent endowments		14	(54)
Increase in net position		108,052	87,024
Net position – beginning of the year		861,819	774,795
Net position – end of the year	$	969,871	861,819

See accompanying notes to basic financial statements.

UNIVERSITY OF WISCONSIN HOSPITALS AND CLINICS AUTHORITY

Statements of Cash Flows

Years ended June 30, 2014 and 2013

(In thousands)

	2014	2013
Cash flows from operating activities:		
Cash received from and on behalf of patients	$ 1,306,602	1,240,472
Payments to suppliers	(531,628)	(482,646)
Payments to employees	(633,888)	(581,024)
Net cash provided by operating activities	141,086	176,802
Cash flows from noncapital financing activities:		
Noncapital grants, contributions and other adjustments	1,064	1,447
Payments for pension-related liabilities	(4,439)	(4,021)
Additions (deductions) to permanent endowment	14	(54)
Payment to University of Wisconsin School of Medicine and Public Health	(36,306)	(7,009)
Net cash used in noncapital financing activities	(39,667)	(9,637)
Cash flows from capital and related financing activities:		
Capital grants, gifts, and donations received	5,018	3,051
Proceeds from long-term debt	—	293,010
Repayment of principal on long-term debt	(15,065)	(71,275)
Interest paid on long-term debt	(17,932)	(10,639)
Financing costs	—	1,130
Loss on bond refinancing	—	(6,434)
Purchases of capital assets	(178,224)	(90,831)
Proceeds from sale of capital assets	173	18
Net cash provided by (used in) capital and related financing activities	(206,030)	118,030
Cash flows from investing activities:		
Proceeds from sales of investments	107,658	23,983
Purchases of investments	(10,258)	(209,345)
Investment income received/fees paid	996	(31)
Increase in investment in joint venture	(2,709)	239
Other, net	61	3,724
Net cash provided by (used in) in investing activities	95,748	(181,430)
Net increase (decrease) in cash and cash equivalents	(8,863)	103,765
Cash and cash equivalents:		
Beginning of year	165,926	62,161
End of year	$ 157,063	165,926

(Continued)

UNIVERSITY OF WISCONSIN HOSPITALS
AND CLINICS AUTHORITY

Statements of Cash Flows

Years ended June 30, 2014 and 2013

(In thousands)

		2014	2013
Reconciliation of cash and cash equivalents to statement of net position:			
Cash and cash equivalents in current assets	$	60,260	66,270
Cash equivalents in noncurrent cash and investments		96,803	99,656
Total cash and cash equivalents	$	157,063	165,926
Reconciliation of operating income to net cash provided by operating activities:			
Operating income	$	93,603	108,632
Adjustments to reconcile operating income to net cash provided by operating activities:			
Provision for bad debts		34,563	27,399
Depreciation and amortization		50,085	44,121
Amortization on bond premium and deferred loss on bond refinancing		248	341
Change in other postemployment benefit obligation		4,331	3,742
Changes in assets and liabilities:			
Patient accounts receivable		(55,668)	(20,207)
Other receivables		(2,628)	(2,884)
Inventories of supplies		(6,671)	(608)
Prepaid expenses		(448)	(534)
Other assets		(268)	(423)
Accounts payable		21,587	(5,230)
Accrued expenses		2,680	3,118
Estimated payables to Medicare and Medicaid		(328)	19,335
Total adjustments		47,483	68,170
Net cash provided by operating activities	$	141,086	176,802

Noncash investing, capital and financing activities:

The Hospital held investments at June 30, 2014 and 2013 with fair values of $705,975 and $772,908, respectively. During 2014 and 2013, the net increase in the fair value of these investments was $17,862 and $663, respectively.

The Hospital has recorded pledges of $1,489 in 2014 and $2,317 in 2013 related to the American Family Children's Hospital Campaign.

See accompanying notes to basic financial statements.

(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 545 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.

On December 28, 2012, the Hospital formed a new company, The Inntowner LLC, and purchased the Madison Best Western Inntowner Hotel. The hotel provides a short-term housing option for regional patients prior to and following their hospital stay, including those who need to remain in proximity to the Hospital for post-discharge care.

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.

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 in its “Pooled 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 in its “Pooled 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.

(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. 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	3 – 10 years

(f) Costs of Borrowing

Prior to 2013, costs incurred in connection with the issuance of long-term debt were deferred and amortized on a straight-line basis over the term of the bonds, which approximated the interest-yield method. In 2013, the Hospital elected to early adopt GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Under the new provisions, long-term debt issuance costs are recognized as an expense in the period incurred. Although accounting changes adopted to conform to Statement No. 65 should generally be applied retroactively by restating prior years' financial statements, it has been determined that the effects of such restatement would be immaterial. An adjustment of $979,000 is reflected in operating expense in the statement of revenues, expenses and changes in net position for the year ended June 30, 2013 to reflect the prior years' impact.

(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 Position

Net position of the Hospital is classified into four components:

Net Investment in Capital Assets – which consists of capital assets, net of accumulated depreciation and amortization, reduced by the current balances of any outstanding borrowings used to finance the purchase or construction of those assets and deferred outflows or inflows of resources that are attributable to the acquisition, construction, or improvement of those assets or related debt.

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

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

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 Position – which are remaining net position, deferred outflows of resources, liabilities, and deferred inflows of resources that do not meet the definitions of net investment in capital assets or restricted net position.

(Continued)

(i) Operating and Nonoperating Revenues and Expenses

The Hospital's statements of revenues, expenses, and changes in net position 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. Nonexchange expenses, including interest expense and other expenses incidental to the Hospital's principal activity, are reported as nonoperating expenses.

(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 organization's 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' 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 statement of net position 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 two preceding years.

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(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 accrued expenses.

(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.

The Hospital records derivative instruments on the statement of net position as either an asset or liability measured at their fair market values. The Hospital records the changes in fair market value of ineffective derivative instruments on the statements of revenues, expenses and changes in net position. The Hospital records the changes in fair market value of effective derivative instruments on the statements of net position as deferred outflows of resources

(q) Pension-Related Liabilities

The Hospital has certain post-retirement obligations for its current and former employees that are reflected as pension-related liabilities in its financial statements. The first such obligation relates to pension plan enhancements that occurred between 1982 and 1990 that created a prior service pension obligation for all State of Wisconsin agencies covered under the Wisconsin Retirement System. The second component relates to a sick leave conversion program that allows retiring State agency employees to convert unused sick leave at the time of their retirement to pay for post-retirement health insurance. The State legislature adopted provisions in 1984 which mandated advance funding of this sick leave conversion program and gave rise to a second unfunded obligation. Each State agency was assigned a portion of these obligations reflecting the actuarially computed share associated with its employees. At the time these events occurred, the Hospital was deemed an agency of the State and was assigned a portion of these obligations. The Hospital has been funding these obligations following an amortization period that runs through 2030.

In December 2003, the State of Wisconsin Department of Administration issued Annual Appropriation Bonds to allow it to accelerate the funding of a substantial portion of these obligations for many of its agencies, including a portion attributable to a subset of Hospital employees that at the time were still deemed to be State employees. The Hospital is responsible for reimbursing the State for its portion of the annual debt service related to the bonds. That liability is also included as a component of pension-related liabilities on the Hospital's statement of net position.

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. Any adjustment representing additional interest is reported as interest expense and any portion attributable to principal is reported as other nonoperating expense.

(r) Reclassification

Certain prior year financial statement amounts have been reclassified to conform to the current year presentation.

(2) Restricted Net Position and Endowments

Restricted expendable net position as of June 30, 2014 and 2013 are available for the following purposes (in thousands):

	2014	2013
Capital purposes	$ 3,774	9,977
Research and general	4,589	3,638
Total expendable restricted net position	$ 8,363	13,615

Restricted nonexpendable net position as of June 30, 2014 and 2013 represents 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 Unrestricted Net Position

Included in the $675,844,000 and $648,621,000 of unrestricted net position reported as of June 30, 2014 and 2013, respectively, are $157,337,000 and $157,078,000, 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 $61,490,000 and $61,338,000 in 2014 and 2013, respectively. The Hospital committed to support certain UWSMPH and University of Wisconsin School of Nursing capital expenditures as incurred, with the remaining $1,899,000 as of June 30, 2014, of the commitment to be paid as the capital projects commence in agreed-upon installments. At June 30, 2014 and 2013, the Hospital had $2,645,000 and $2,658,000 in receivables, respectively, and $6,092,000 and $4,504,000 in payables, respectively, with the University.

In addition to the historic Affiliation Agreement transfers, the Hospital's board of directors approved, in fiscal year 2013, the provisions of an Annual Academic Advancement Agreement (AAA) to establish guidelines as to when the Hospital will provide additional financial support to UWSMPH for education/clinical programs and outcomes research. Under the original AAA provisions, if the operating margin of the Hospital for any fiscal year exceeded a defined threshold, initially established as 5%, and days cash-on-hand exceeds a defined threshold, initially established as 180 days, the Hospital would make a distribution to UWSMPH. During fiscal year 2014, the AAA was amended such that the operating income representing the operating margin between 5% and 6% is distributed entirely to UWSMPH. Amounts in excess of 6% are partially distributed to UWSMPH. Included in nonoperating expense and accrued expenses is an estimated payment due to UWSMPH of $14,605,000 and $35,639,000, respectively, representing the expected payment for the 2014 and 2013 fiscal year.

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 owns 100% of the equity interest of Unity Health Plans and its 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, 2014 and 2013, the Hospital had $1,186,000 and $1,648,000 in receivables, respectively, with Unity Health Plans and UHC. The Hospital received payments of $78,809,000 and $64,218,000 for the years ended June 30, 2014 and 2013, respectively, from UHC under a capitation agreement with Unity Health Plans. Through February 1, 2013, Unity Health Plans assumed the risk in the event of hospital utilization in excess of capitation payments. Under the terms of a risk-sharing contract amendment effective February 1, 2013, UHC has assumed the benefits and risks for any excess or deficiency of premiums compared to health care expenses of Unity. The first measurement period under the new provisions is February 1, 2013 to December 31, 2013. Based on results through June 30, 2014 and 2013, the Hospital recorded an estimated receivable amount of $3,726,000 and $1,500,000, respectively.

(Continued)

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, 2013 and 2012, and for the years then ended. A summary of certain financial data for UHC as of and for the years ended December 31, 201 and 2012 is as follows (in thousands):

		2013	2012
Total assets	$	199,943	164,877
Unrestricted net assets		72,738	68,544
Total revenue		651,197	497,363
Revenues over/(under) expenses		1,634	(517)

Wisconsin Therapies, Inc., a not-for-profit corporation in which the Hospital has a 50% interest, 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, 2014 and 2013, the Hospital had $200,000 and $56,000 in receivables, respectively, from Wisconsin Dialysis, Inc.

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. provides 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. is a joint venture fertility business owned equally by the Hospital, UWMF and Meriter Hospital, Inc. The investment is being accounted for by the equity method.

Investments in joint ventures as of June 30, 2014 and 2013 comprise of the following (in thousands):

		2014	2013
University Health Care, Inc.	$	43,080	38,463
e-Care of Wisconsin, LLC		800	998
Wisconsin Therapies, Inc.		1,840	1,429
Wisconsin Dialysis, Inc.		4,483	3,490
Madison Surgery Center, Inc.		7,641	7,441
Madison United Healthcare Linen, Ltd.		4,112	4,137
Madison Environmental Resourcing, Inc.		745	692
Generations Fertility Care, Inc.		115	258
Madison Rehabilitation Hospital		58	—
	$	62,874	56,908

(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, 2014 and 2013 are presented in the table below (in thousands):

		2014	2013
Bank balances:			
FDIC – Insured	$	559	559
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		65,970	76,667
Petty cash		44	47
Total bank balances	$	66,573	77,273
Carrying amount	$	60,260	66,270

Additional amounts on deposit with the Hospital's investment advisor for investment in fixed-income securities included in noncurrent cash and investments are $8,966,000 and $16,901,000 as of June 30, 2014 and 2013, respectively. These amounts are uninsured and uncollateralized. Other restricted deposits held with a trustee and included in noncurrent cash and investments are $2,141,000 and $1,366,000 as of June 30, 2014 and 2013, 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.

Noncurrent cash and investments comprise at June 30, 2014 and 2013, as follows (in thousands):

		2014	2013
Cash equivalents:			
Money market – investment advisor	$	8,966	16,901
Funds held with trustee money market fund		900	900
Funds held with trustee commercial paper		86,885	81,812
Other		52	43
Fixed income mutual fund		151,027	149,826
Fixed income securities		224,689	218,771
Fixed income securities held with trustee		37,667	124,436
Pooled investment funds on deposit with the University of Wisconsin Foundation:			
Pooled Expendable Fund		162,614	167,114
Pooled Endowment Fund		129,978	112,761
Total	$	802,778	872,564

Investments held in the Pooled Endowment Fund at the Foundation consist of the following as of June 30, 2014 and 2013:

	2014	2013
Cash	3%	3%
Fixed income	16	17
Equity	58	54
Private equity	21	23
Real estate assets	2	3
	100%	100%

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

(Continued)

(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.

(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, 2014 and 2013 as determined through a nationally recognized rating agency, Moody's, are presented in the table below (in thousands):

	2014	2013
Aaa	$ 108,393	110,713
Aa1	4,890	9,246
Aa2	6,446	24,134
Aa3	10,936	44,949
A1	19,167	21,904
A2	11,091	27,580
A3	14,986	18,111
Baa1	20,422	23,000
Baa2	30,421	29,794
Baa3	12,900	11,375
Ba1	3,317	2,935
Ba3	345	326
Not rated	19,042	19,140
Total	$ 262,356	343,207

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, 2014 and 2013 are presented in the tables below (in thousands):

		2014			
		Total	**< 1 year**	**2 – 5 years**	**> 5 years**
U.S. Treasury bonds and notes	$	115,420	20,459	66,208	28,753
Corporate bonds		145,217	35,184	72,911	37,122
Other government bonds		1,719	—	320	1,399
Total	$	262,356	55,643	139,439	67,274

		2013			
		Total	**< 1 year**	**2 – 5 years**	**> 5 years**
U.S. Treasury bonds and notes	$	55,568	—	5,797	49,771
Corporate bonds		234,633	98,237	100,793	35,603
Other government bonds		53,006	10,823	31,092	11,091
Total	$	343,207	109,060	137,682	96,465

(6) Capital Assets

Capital asset additions, retirements, and balances for the year ended June 30, 2014 are as follows (in thousands):

		Balance, June 30, 2013	**Additions and transfers**	**Retirements**	**Balance, June 30, 2014**
Capital assets not being depreciated:					
Land	$	21,564	2,841	—	24,405
Land improvements		2,852	452	—	3,304
Construction in progress		35,015	91,831	—	126,846
Total		59,431	95,124	—	154,555

		Balance, June 30, 2013	Additions and transfers	Retirements	Balance, June 30, 2014
Capital assets being depreciated:					
Buildings and improvements	$	553,267	55,469	—	608,736
Equipment		317,204	53,592	(9,812)	360,984
Total		870,471	109,061	(9,812)	969,720
Less accumulated depreciation and amortization for:					
Buildings and improvements		261,115	22,079	—	283,194
Equipment		213,504	28,006	(9,546)	231,964
Total		474,619	50,085	(9,546)	515,158
Total capital assets being depreciated – net		395,852	58,976	(266)	454,562
Total capital assets	$	455,283	154,100	(266)	609,117

Construction in progress at June 30, 2014 consists principally of costs incurred for construction of a new comprehensive acute and ambulatory care facility on the east side of Madison, operating room expansion, and isolation fan upgrade. The construction projects are being financed through a combination of operating funds, philanthropy and the 2013 bond financing (see note 7). During 2014, interest expense of approximately $8,770,000, net of interest income of approximately $956,000, was capitalized.

Capital asset additions, retirements, and balances for the year ended June 30, 2013 are as follows (in thousands):

		Balance, June 30, 2012	Additions and transfers	Retirements	Balance, June 30, 2013
Capital assets not being depreciated:					
Land	$	17,064	4,500	—	21,564
Land improvements		2,277	575	—	2,852
Construction in progress		12,551	22,464	—	35,015
Total		31,892	27,539	—	59,431

(Continued)

		Balance, June 30, 2012	Additions and transfers	Retirements	Balance, June 30, 2013
Capital assets being depreciated:					
Buildings and improvements	$	523,402	29,988	(123)	553,267
Equipment		280,718	49,828	(13,342)	317,204
Total		804,120	79,816	(13,465)	870,471
Less accumulated depreciation and amortization for:					
Buildings and improvements		240,266	20,972	(123)	261,115
Equipment		203,179	23,149	(12,824)	213,504
Total		443,445	44,121	(12,947)	474,619
Total capital assets being depreciated – net		360,675	35,695	(518)	395,852
Total capital assets	$	392,567	63,234	(518)	455,283

Construction in progress at June 30, 2013 consists principally of costs incurred for construction of a new comprehensive acute and ambulatory care facility on the east side of Madison, construction and equipping of a two story addition to American Family Children's Hospital for a pediatric ICU and NICU, build-out and equipping of the Diagnostic and Therapy unit in American Family Children's Hospital, equipping of a new Autopsy and Pathology suite and fire alarm system upgrade. The construction projects are being financed through a combination of operating funds, philanthropy and the 2013 bond financing (see note 7). During 2013, interest expense of approximately $2,586,000, net of interest income of approximately $(713,000), respectively, was capitalized.

Total remaining commitments on capital asset purchases and the renovation and construction projects approximated $55,239,000 million at June 30, 2014.

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. Additional campaigns totaling $14.9 million have been subsequently initiated. As of June 30, 2014, $51.9 million has been received and $1.5 million and $2.3 million, respectively, of net present value pledges receivable were reflected in the financial statements as of June 30, 2014 and 2013, respectively.

(7) Long-Term Debt

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

	Balance, June 30, 2013	Additions	Payments and amortization	Balance, June 30, 2014	Amounts due within one year
Amounts payable to the State under capital lease agreements for:					
General Obligation Bonds	$ 168	—	161	7	—
Refunding Bonds	1,054	—	512	542	282
Total payable to the state	1,222	—	673	549	282
Hospital Revenue Bonds:					
Series 2002B	—	—	—	—	—
Series 2008A	16,430	—	1,525	14,905	1,775
Series 2009B	30,925	—	50	30,875	55
Series 2009C	—	—	—	—	—
Series 2011A	56,245	—	2,100	54,145	2,200
Series 2011B	61,000	—	—	61,000	—
Series 2013A	272,595	—	2,830	269,765	3,240
Capital Leases	8,332	—	1,996	6,336	2,216
Premium on long-term debt	20,216	—	679	19,537	680
Hospital Equipment Loan	16,824	—	5,891	10,933	5,956
Total long-term debt including premium	483,789	—	15,744	468,045	16,404
Series 2000 Refunding deferred outflows of resources	$ (4,919)	—	(312)	(4,607)	—
Series 1997 Refunding deferred outflows of resources	(200)	—	(14)	(186)	—
Series 2004 Refunding deferred outflows of resources	(376)	—	(17)	(359)	—
Series 2002A Refunding deferred outflows of resources	(524)	—	(27)	(497)	—
Series 2005 Refunding deferred outflows of resources	(331)	—	(21)	(310)	—
Series 2008B Refunding deferred outflows of resources	(431)	—	(21)	(410)	—
Series 2009A Refunding deferred outflows of resources	(439)	—	(23)	(416)	—

		Balance, June 30, 2013	Additions	Payments and amortization	Balance, June 30, 2014	Amounts due within one year
Series 2008A Refunding deferred outflows of resources	$	(6,120)	—	(477)	(5,643)	—
Series 2009C Refunding deferred outflows of resources		(172)	—	(15)	(157)	—
Total deferred loss on debt refunding in deferred outflows of resources	$	(13,512)	—	(927)	(12,585)	—

		Balance, June 30, 2012	Additions	Payments and amortization	Balance, June 30, 2013	Amounts due within one year
Amounts payable to the State under capital lease agreements for:						
General Obligation Bonds	$	192	—	24	168	25
Refunding Bonds		2,318	—	1,264	1,054	638
Total payable to the state		2,510	—	1,288	1,222	663
Hospital Revenue Bonds:						
Series 2002B		1,505	—	1,505	—	—
Series 2008A		48,815	—	32,385	16,430	1,525
Series 2009B		54,825	—	23,900	30,925	50
Series 2009C		4,669	—	4,669	—	—
Series 2011A		56,745	—	500	56,245	2,100
Series 2011B		61,000	—	—	61,000	—
Series 2013A		—	272,595	—	272,595	2,830
Capital Leases		—	8,767	435	8,332	2,085
Premium on long-term debt		48	20,415	247	20,216	—
Hospital Equipment Loan		4,787	15,999	3,962	16,824	5,890
Total long-term debt including premium	$	234,904	317,776	68,891	483,789	15,143
Series 2000 Refunding deferred outflows of resources	$	(5,231)	—	(312)	(4,919)	—
Series 1997 Refunding deferred outflows of resources		(214)	—	(14)	(200)	—
Series 2004 Refunding deferred outflows of resources		(394)	—	(18)	(376)	—
Series 2002A Refunding deferred outflows of resources		(551)	—	(27)	(524)	—

(Continued)

	Balance, June 30, 2012	Additions	Payments and amortization	Balance, June 30, 2013	Amounts due within one year
Series 2005 Refunding deferred outflows of resources	$ (353)	—	(22)	(331)	—
Series 2008B Refunding deferred outflows of resources	(451)	—	(20)	(431)	—
Series 2009A Refunding deferred outflows of resources	(463)	—	(24)	(439)	—
Series 2008A Refunding deferred outflows of resources	—	(6,259)	(139)	(6,120)	—
Series 2009C Refunding deferred outflows of resources	—	(175)	(3)	(172)	—
Total deferred loss on debt refunding in deferred outflows of resources	$ (7,657)	(6,434)	(579)	(13,512)	—

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).

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 outflow of resources of $641,000. Prior to the adoption of GASB Statement No. 63 and No. 65, the deferred outflow of resources was classified as a deferred loss. With the early adoption of GASB Statement No. 63 and 65, the deferred loss, which was an offset to long-term debt, has been reclassified to deferred outflows of resources on the statement of net position. Principal payments on the remaining Series 2002B Bonds was $1,505,000 paid 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 5.50% in 2013.

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, 2014 and 2013. 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 outflow of resources 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, resulting in the recognition of a deferred outflow of resources of $271,000, which is being amortized to interest expense over the term of the debt. Principal payments on the remaining Series 2008A Bonds, ranging from $1,010,000 to $2,020,000, are due annually from April 2015 through April 2023. Interest is payable semiannually. The effective interest rate of the Series 2008A Bonds was 5.00% in 2014 and 2013. In March 2013, the Hospital refunded $31,760,000 of the outstanding Series 2008A Bonds with Fixed Rate Demand Hospital Revenue Bonds, Series 2013A. The refunding of the Series 2008A Bonds resulted in the recognition of a deferred outflow of resources of $6,259,000.

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, resulting in the recognition of a deferred outflow of resources of $465,000, which is being amortized to interest expense over the term of the debt. 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 outflow of resources of $474,000.

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. The effective annual interest rate was 4.40% in 2014 and 2013.

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 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 outflow of resources of $488,000.

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 $50,000 to $8,195,000, are due annually from April 2015 through April 2029. Series 2009B Bonds bear interest at a weekly rate determined by a remarketing agent. Interest is payable monthly. In 2014 and 2013, the effective annual interest rate was 0.10%. In March 2013, the Hospital refunded $21,770,000 of the outstanding Series 2009B Bonds with Fixed Rate Demand Hospital Revenue Bonds, Series 2013A.

The Series 2009B Bonds are secured by an irrevocable transferable direct pay letter of credit issued by a commercial bank. The letter-of-credit-agreement had a stated expiration date of March 2014. On July 31, 2013, it was extended through March 2019. In the event of a draw under the letter of credit, it does not require any principal payments within the first year; 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, 2014 and 2013, 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. The effective annual interest rate on the Series 2009C Bonds was 1.20% in 2014 and 4.30% in 2013. In March 2013, the Hospital refunded all of the outstanding Series 2009C Bonds with Fixed Rate Demand Hospital Revenue Bonds, Series 2013A. The refunding of the Series 2009C Bonds resulted in the recognition of a deferred outflow of resources of $192,000.

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 $2,200,000 to $3,900,000, are due annually from April 2015 through April 2032. Series 2011A bonds bear interest at 74% of LIBOR, plus 1.04%, payable monthly. In 2014 and 2013, 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 1.20% in 2014 and 1.30% in 2013. 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.

In March 2013, the Hospital issued $272,595,000 of Fixed Rate Hospital Revenue Bonds, Series 2013A. The bond proceeds are designated to finance qualified capital projects and to refund a portion of the outstanding Series 2008A Bonds and Series 2009B Bonds, the remainder of the outstanding Series 2009C Bonds, and a partial termination of the Series 2009B interest swap agreement. The Series 2013A Bonds were sold at a premium totaling $20,415,000. The premium will be amortized to interest expense on a straight-line basis over the life of the bonds which approximates the interest yield. Principal payments on the Series 2013A Bonds, ranging from $1,240,000 to $24,955,000 are due annually beginning in April 2014 and continuing through April 2043. Interest is payable semi-annually at rates ranging from 3.00% to 5.00%. The effective interest rate was 4.00% in 2014 and 3.90% in 2013.

In March 2013, the Hospital entered into an interest-free equipment financing agreement with GE Capital Corporation in the amount of $15,998,641. Principal payments are due annually commencing in April 2013 for 3 years.

The Hospital is obligated under capital leases covering equipment that expire at various dates during the next five years. At June 30, 2014, the Hospital had $8,707,000 of gross amount of equipment recorded and related accumulated depreciation of $2,384,000, recorded under capital leases.

The Series 2008A Bonds, Series 2009B Bonds, Series 2011A Bonds, Series 2011B Bonds, and Series 2013A Bonds 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, 2014 and 2013.

State of Wisconsin statutes require 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. The Hospital's current ratings from Standard &Poor's and Moody's are A+ and Aa3, 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 $18,750,000 and $20,850,000 at June 30, 2014 and 2013, respectively, 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. The effective interest rate received by the Hospital was .10% in 2014 and .20% in 2013. The fair value of the swap agreement was $(2,096,005) and $(2,539,626) at June 30, 2014 and 2013, 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 $22,250,000 and $24,150,000 at June 30, 2014 and 2013, 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. The effective interest rate received by the Hospital was 0.10% in 2014 and 0.20% in 2013. The fair value of the swap agreement was $(2,064,000) and $(2,508,391) at June 30, 2014 and 2013, 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. In March 2013, a portion of the swap in the amount of $21,770,000 was unwound in connection with the Series 2013A financing. The notional amount of the swap agreement was $29,860,000 at June 30, 2014 and 2013, and matures on April 1, 2029. The Hospital paid $2,629,336 in connection with the partial termination. 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 2014 and 2013, the effective interest rate received by the Hospital was .50%. The fair value of the swap agreement was $(4,546,389) and $(4,346,418) at June 30, 2014 and 2013, respectively.

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

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. The changes in fair market value of the effective swaps of $(888,000) and $(2,013,000) for the years ended June 30, 2014 and 2013, respectively, are reflected as adjustments to 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. No collateral was required as of June 30, 2014 and 2013.

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. Neither the Hospital nor the counterparties have been downgraded below these thresholds at June 30, 2014 and 2013. 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, 2014 and 2013, 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.

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, 2014 are as follows (in thousands):

Year ending June 30		Principal	Interest	Interest rate swap – net	Total
2015	$	15,724	14,328	2,299	32,351
2016		14,459	13,983	2,136	30,578
2017		9,747	13,692	1,960	25,399
2018		10,007	13,378	1,771	25,156
2019		9,267	13,022	1,575	23,864
2020 – 2024		52,903	59,446	5,151	117,500
2025 – 2029		65,950	50,439	2,885	119,274
2030 – 2034		79,815	45,415	—	125,230
2035 – 2039		96,655	32,702	—	129,357
2040 – 2044		93,981	9,504	—	103,485
Subtotal		448,508	265,909	17,777	732,194
Premium on long-term debt		19,537	—	—	19,537
Total debt	$	468,045	265,909	17,777	751,731

Should a situation arise in which the Series 2009B variable rate bonds were put back to the Hospital and the Hospital made a draw on the commercial bank letter of credit, the timing of scheduled principal payments on long-term debt would change as depicted below (in thousands):

2015	$	15,724
2016		22,114
2017		17,392
2018		17,652
2019		16,912
2020 – 2024		50,408
2025 – 2029		37,855
2030 – 2034		79,815
2035 – 2039		96,655
2040 – 2044		93,981
Total	$	448,508

(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, 2010. The estimated receivables and payables to Medicare included in the financial statements include those cost reports that are subject to audit by the Medicare fiscal intermediary.

Net patient service revenue for the years ended June 30, 2014 and 2013 included approximately $7,422,000 and $4,704,000, respectively, of retrospectively determined settlements from third-party payors and changes in estimates.

(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 11.5% and 10.0% of net patient service revenue during the years ended June 30, 2014 and 2013, respectively.

(Continued)

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, 2014 and 2013 is summarized as follows:

	2014	2013
Net patient service revenue:		
Medicare	25.1%	26.0%
Medicaid	7.6	7.0
Managed care	52.8	52.6
Indemnity	4.1	4.3
Private pay and other	10.4	10.1
	100.0%	100.0%
Net patient accounts receivable:		
Medicare	24.0%	25.4%
Medicaid	9.2	9.1
Managed care	39.6	41.7
Indemnity	12.2	8.7
Other	15.0	15.1
	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, 2014 and 2013 was $61,919,000 and $60,866,000, 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 6.65% effective January 2013 and 7.00% in January 2014. 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. Act 10 also eliminated the separate category of Board employees and all are now Hospital Authority employees.

The payroll for employees covered by WRS for the year ended June 30, 2014 was $433,253,000; the employer's total payroll was $452,395,000. The total required contributions, paid by both the employer and the employees, for the year ended June 30, 2014 were $70,866,000. The payroll for employees covered by WRS for the year ended June 30, 2013, was $408,353,000; the employer's total payroll was $426,967,000. The total required contributions, paid by both the employer and the employees, for the year ended June 30, 2013 were $61,289,000.

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 19 years remaining in 2014. The Hospital's total obligation is increased each year by an amount of interest, currently equal to 7.2% 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 $17,764,000 and $22,204,000, as of June 30, 2014 and 2013, 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 Department of Administration. In December 2003, the State Department of Administration 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 $49,319,000 as of June 30, 2014, of which $2,387,000 is payable in 2014 and is recorded in accrued expenses and $46,932,000 is recorded in pension-related liabilities, payable in annual principal and interest payments to the State over approximately 18 years. In 2014, the liability was decreased by $1.1 million based on updated information provided by the State based on its methodology for allocating responsibility for ongoing debt service to State entities and is recorded as miscellaneous nonoperating expense.

The Hospital's liability was $50,371,000 as of June 30, 2013, of which $983,000 was payable in 2014 and is recorded in accrued expenses and $49,388,000 was recorded in pension-related liabilities.

The total pension-related liabilities for the Hospital as of June 30, 2014 and 2013 total $67,083,000 and $72,575,000, 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 pre-age 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.

(c) Annual OPEB Cost

The Hospital's 2014 and 2013 OPEB cost (expense), dollar amount of contributions, and components of OPEB cost were as follows (in thousands):

		2014	2013
Annual Required Contribution (ARC)	$	5,903	5,298
Interest on the net OPEB obligation		1,039	881
ARC adjustment with interest		(1,231)	(995)
Annual OPEB cost		5,711	5,184
Employer contribution implicit rate adjustment		(1,380)	(1,442)
Change in the net OPEB obligation		4,331	3,742
Net OPEB obligation beginning balance		24,460	20,718
Net OPEB obligation ending balance	$	28,791	24,460

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

Fiscal year ended		Annual OPEB cost	Percent of annual OPEB contributed		Net OPEB obligation
6/30/2014	$	5,711	24.1%	$	28,791
6/30/2013		5,184	27.8		24,460
6/30/2012		5,507	18.3		20,718

(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 $0 as of July 1, 2013 (the most recent actuarial valuation).

		2014
Actuarial accrued liability (AAL)	$	37,332
Actuarial value of plan assets		—
Unfunded actuarial accrued liability (UAAL)	$	37,332
Funded ratio (actuarial value of plan assets/AAL)		—%
Covered payroll (active plan members)	$	433,253

(Continued)

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 2013-2014, 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 7.5% for 2014-2015, 7.0% for 2016-2017 and 6.5% for 2018-2019, reduced by decrements to an ultimate rate of 5.5% after 8 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 24 years at June 30, 2014.

(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. The Fund may pay claims in excess of the primary limits if the Fund is named in legal action. Most qualified health care providers permanently practicing or operating in the State of Wisconsin are required to pay, unless exempt, 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.

(13) Liabilities for Workers' Compensation Claims

A reconciliation of changes in the aggregate liabilities for workers' compensation claims for the years ended June 30, 2014 and 2013 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
2014	$	8,900	4,247	(3,514)	9,633
2013		9,665	1,757	(2,522)	8,900

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

(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 $17,784,000 and $15,938,000 for 2014 and 2013, respectively, and is included in other expenses.

Future minimum payments under noncancelable operating leases and license agreements (with initial or remaining lease terms in excess of one year) and future minimum capital lease payments as of June 30, 2014, are as follows (in thousands):

		Operating leases	Capital leases
2015	$	14,300	2,739
2016		12,020	2,280
2017		9,023	1,673
2018		7,132	1,532
2019		6,665	—
2020–2024		13,455	—
2025–2029		8,506	—
Total future minimum lease payments	$	71,101	8,224

		Operating leases	Capital leases
Less amount representing interest	$	—	1,888
Present value of future minimum lease payments		71,101	6,336
Less current portion of obligations under capital leases		—	2,216
Obligations under capital leases, excluding current portion	$	71,101	4,120

(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.

(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, 2014 and 2013 is set forth below (amounts in thousands):

		Balance at June 30, 2013	Increases	Decreases	Balance at June 30, 2014
Long-term debt, less current installments	$	468,646	—	17,005	451,641
Net OPEB obligation		24,460	4,331	—	28,791
Pension-related liabilities		71,591	—	6,895	64,696
Other long-term liabilities (interest rate swaps)		9,394	—	688	8,706

		Balance at June 30, 2012	Increases	Decreases	Balance at June 30, 2013
Long-term debt, less current installments	$	226,714	317,776	75,844	468,646
Net OPEB obligation		20,718	3,742	—	24,460
Pension-related liabilities		75,838	—	4,247	71,591
Other long-term liabilities (interest rate swaps)		16,906	—	7,512	9,394

REQUIRED SUPPLEMENTARY INFORMATION

UNIVERSITY OF WISCONSIN HOSPITALS
AND CLINICS AUTHORITY

Schedule of Plan Funding Progress

June 30, 2014

(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
7/1/2009	$	—	39,246	39,246	—%	$	346,287	11.3%
7/1/2011		—	35,639	35,639	—		387,110	9.2
7/1/2013		—	37,332	37,332	—		433,253	8.6

See accompanying independent auditors’ report.