



**UNIVERSITY OF WISCONSIN  
HOSPITALS AND CLINICS AUTHORITY**

**Financial Statements**

**June 30, 2002, 2001, and 2000**

**(With Independent Auditors' Report Thereon)**

**UNIVERSITY OF WISCONSIN  
HOSPITALS AND CLINICS AUTHORITY**

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777 East Wisconsin Avenue  
Milwaukee, WI 53202

### **Independent Auditors' Report**

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

We have audited the accompanying balance sheets of University of Wisconsin Hospitals and Clinics Authority (Hospital) as of June 30, 2002, 2001 and 2000, and the related statements of operations, changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the Hospital's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of University of Wisconsin Hospitals and Clinics Authority as of June 30, 2002, 2001 and 2000, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

**KPMG LLP**

August 7, 2002



**UNIVERSITY OF WISCONSIN  
HOSPITALS AND CLINICS AUTHORITY**

Balance Sheets

June 30, 2002, 2001, and 2000

(In thousands)

Assets	<u>2002</u>	<u>2001</u>	<u>2000</u>
<b>Current assets:</b>			
Cash and cash equivalents	\$ 4,343	14,474	16,682
Patient accounts receivable, net of estimated uncollectible accounts of \$12,200 in 2002, \$11,800 in 2001, and \$14,490 in 2000	66,143	59,457	73,745
Other receivables	11,261	7,411	7,329
Inventories of supplies	7,524	7,111	7,923
Prepaid expenses	2,753	2,338	2,340
Total current assets	<u>92,024</u>	<u>90,791</u>	<u>108,019</u>
<b>Assets whose use is limited or restricted</b>			
Investments	139,743	157,190	137,466
Net property, plant, and equipment	34,118	37,920	44,152
Investment in affiliates	199,822	158,190	140,994
Other assets	878	855	842
	6,238	4,356	3,318
Total assets	<u>\$ 472,823</u>	<u>449,302</u>	<u>434,791</u>
<b>Liabilities and Net Assets</b>			
<b>Current liabilities:</b>			
Current installments of long-term debt	\$ 2,845	3,111	2,735
Accounts payable	19,359	14,974	14,803
Accrued expenses	32,999	33,925	35,879
Estimated payables to Medicare and Medicaid	1,544	1,212	269
Total current liabilities	<u>56,747</u>	<u>53,222</u>	<u>53,686</u>
Long-term debt, less current installments	129,427	131,986	135,097
Total liabilities	<u>186,174</u>	<u>185,208</u>	<u>188,783</u>
<b>Net assets:</b>			
Unrestricted	282,686	260,915	243,446
Temporarily restricted	3,168	2,415	1,848
Permanently restricted	795	764	714
Total net assets	<u>286,649</u>	<u>264,094</u>	<u>246,008</u>
Total liabilities and net assets	<u>\$ 472,823</u>	<u>449,302</u>	<u>434,791</u>

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN  
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Statements of Operations

Years ended June 30, 2002, 2001, and 2000

(In thousands)

	2002	2001	2000
Net patient service revenue	\$ 490,469	420,198	384,258
Other operating revenue	9,933	9,545	8,534
Total revenue	500,402	429,743	392,792
<b>Expenses:</b>			
Salaries, wages and agency costs	193,110	165,587	158,687
Employee benefits	64,160	54,878	50,818
Other expenses	36,502	30,139	29,806
Purchased services	51,613	47,252	44,178
Medical materials and supplies	100,683	84,001	79,971
Provision for bad debts	13,429	11,082	9,902
Depreciation and amortization	19,049	18,912	17,950
Interest	2,669	3,920	3,655
Total expenses	481,215	415,771	394,967
Income (loss) from operations	19,187	13,972	(2,175)
<b>Nonoperating gains (losses):</b>			
Investment income, includes \$1,850 in 2002 and \$1,041 in 2001 related to valuation of swap (note 5)	10,627	8,768	7,032
Equity interest in gain of affiliate	296	498	514
Loss on disposal of property, plant, and equipment	(843)	(194)	(410)
Other, net	70	62	28
Nonoperating gains, net	10,150	9,134	7,164
Revenue and gains in excess of expenses	29,337	23,106	4,989
<b>Other changes in unrestricted net assets:</b>			
Contributions of property, plant, and equipment	63	253	220
Net transfer to University of Wisconsin Medical School for capital expenditure support	(275)	(1,265)	(2,400)
Net assets released from restrictions used for purchase of property, plant and equipment	836	—	—
Net change in unrealized gains and losses on other than trading securities	(8,190)	(4,625)	6,406
Cumulative effect of a change in accounting principle to capitalize surgical supply inventory (note 1(e))	—	—	3,826
Other	—	—	1
Increase in unrestricted net assets	\$ 21,771	17,469	13,042

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN  
HOSPITALS AND CLINICS AUTHORITY**

Statements of Changes in Net Assets

Years ended June 30, 2002, 2001, and 2000

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Balances at June 30, 1999	\$ 230,404	1,546	292	232,242
Increase (decrease) in net assets:				
Revenue and gains in excess of expenses	4,989	—	—	4,989
Investment income on restricted net assets	—	89	—	89
Grants, gifts, and donations	1	331	422	754
Net assets released from restrictions used for operations	—	(310)	—	(310)
Contributions of property, plant, and equipment	220	—	—	220
Net transfer to University of Wisconsin Medical School for capital expenditure support	(2,400)	—	—	(2,400)
Net change in unrealized gains and losses on other than trading securities	6,406	192	—	6,598
Cumulative effect of a change in accounting principle to capitalize surgical supply inventory	3,826	—	—	3,826
Increase in net assets	<u>13,042</u>	<u>302</u>	<u>422</u>	<u>13,766</u>
Balances at June 30, 2000	243,446	1,848	714	246,008
Increase (decrease) in net assets:				
Revenue and gains in excess of expenses	23,106	—	—	23,106
Investment income on restricted net assets	—	127	—	127
Grants, gifts, and donations	—	1,056	50	1,106
Net assets released from restrictions used for operations	—	(424)	—	(424)
Contributions of property, plant, and equipment	253	—	—	253
Net transfer to University of Wisconsin Medical School for capital expenditure support	(1,265)	—	—	(1,265)
Net change in unrealized gains and losses on other than trading securities	(4,625)	(192)	—	(4,817)
Increase in net assets	<u>17,469</u>	<u>567</u>	<u>50</u>	<u>18,086</u>
Balances at June 30, 2001	<u>260,915</u>	<u>2,415</u>	<u>764</u>	<u>264,094</u>

**UNIVERSITY OF WISCONSIN  
HOSPITALS AND CLINICS AUTHORITY**  
Statements of Changes in Net Assets, Continued  
Years ended June 30, 2002, 2001, and 2000  
(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Balances at June 30, 2001	260,915	2,415	764	264,094
Increase (decrease) in net assets:				
Revenue and gains in excess of expenses	29,337	—	—	29,337
Investment income on restricted net assets	—	182	—	182
Grants, gifts, and donations	—	2,249	31	2,280
Net assets released from restrictions used for operations	—	(477)	—	(477)
Net assets released from restrictions used for purchase of property, plant and equipment	836	(836)	—	—
Contributions of property, plant, and equipment	63	—	—	63
Net transfer to University of Wisconsin Medical School for capital expenditure support	(275)	—	—	(275)
Net change in unrealized gains and losses on other than trading securities	(8,190)	(365)	—	(8,555)
Increase in net assets	<u>21,771</u>	<u>753</u>	<u>31</u>	<u>22,555</u>
Balances at June 30, 2002	<u>\$ 282,686</u>	<u>3,168</u>	<u>795</u>	<u>286,649</u>

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN  
HOSPITALS AND CLINICS AUTHORITY**

Statements of Cash Flows

Years ended June 30, 2002, 2001, and 2000

(In thousands)

	2002	2001	2000
Cash flows from operating activities:			
Increase in net assets	\$ 22,555	18,086	13,766
Adjustments to reconcile increase in net assets to net cash provided by operating activities:			
Cumulative effect of a change in accounting principle to capitalize surgical supply inventory	—	—	(3,826)
Net change in unrealized gains and losses on other than trading securities	8,555	4,817	(6,598)
Net transfer to University of Wisconsin Medical School for capital expenditure support	275	1,265	2,400
Depreciation and amortization	19,049	18,912	17,950
Provision for bad debts	13,429	11,082	9,902
Loss on disposal of property, plant, and equipment	843	194	410
Increase in fair value of swap agreement	(1,850)	(1,041)	—
(Increase) decrease in net patient accounts receivable	(20,115)	3,206	(20,936)
Increase (decrease) in estimated payables to Medicare and Medicaid	332	943	(2,454)
Equity interest in gain of affiliate	(296)	(498)	(514)
Decrease in accrued expenses	(926)	(1,954)	(931)
Contribution of property, plant, and equipment	(63)	(253)	(220)
Net change in other assets and liabilities and other adjustments	(419)	791	(1,399)
Net cash provided by operating activities	<u>41,369</u>	<u>55,550</u>	<u>7,550</u>
Cash flows from investing activities:			
Expenditures for property, plant, and equipment	(61,349)	(35,684)	(27,183)
Decrease (increase) in assets whose use is limited or restricted	17,447	(19,724)	(41,666)
(Increase) decrease in investments	(4,753)	1,415	(2,388)
Equity distributions from affiliate	318	485	1,000
Equity investment in affiliate	(45)	—	—
Net cash used in investing activities	<u>(48,382)</u>	<u>(53,508)</u>	<u>(70,237)</u>
Cash flows from financing activities:			
Proceeds from long-term debt	336	—	56,500
Repayment and refunding of long-term debt	(3,161)	(2,735)	(2,648)
Deferred financing costs	(18)	—	(2,130)
Transfer to University of Wisconsin Medical School for capital expenditure support	(275)	(1,515)	(2,400)
Net cash (used in) provided by financing activities	<u>(3,118)</u>	<u>(4,250)</u>	<u>49,322</u>
Net decrease in cash and cash equivalents	<u>(10,131)</u>	<u>(2,208)</u>	<u>(13,365)</u>
Cash and cash equivalents at beginning of year	<u>14,474</u>	<u>16,682</u>	<u>30,047</u>
Cash and cash equivalents at end of year	<u>\$ 4,343</u>	<u>14,474</u>	<u>16,682</u>
Supplemental disclosures of cash flow information:			
Cash paid for interest	<u>\$ 5,825</u>	<u>7,053</u>	<u>3,490</u>

See accompanying notes to financial statements.



**UNIVERSITY OF WISCONSIN  
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Notes to Financial Statements

June 30, 2002, 2001 and 2000

**(1) Summary of Organization and Significant Accounting Policies**

The University of Wisconsin Hospitals and Clinics Authority (Hospital) is a not-for-profit academic medical center. The Hospital operates an acute-care hospital with approximately 476 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. 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.

Under the terms of a Lease Agreement, the Hospital leases the facilities which 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 to the State of Wisconsin outstanding debt obligations on the leased facilities. The leased facilities are included with the Hospital's property, plant, and equipment (note 4) and the debt obligations on the leased facilities are included with the Hospital's long-term debt (note 5).

An Affiliation Agreement requires the Hospital to continue to support the educational, research, and clinical activities of the University of Wisconsin – Madison (University), including the University of Wisconsin Medical School (Medical School), which are administered by the Hospital. The Hospital will make an annual distribution of at least \$9.78 million, which shall be adjusted annually, for services and supplies provided by the Medical School and the University of Wisconsin Schools of Nursing and Pharmacy (note 3).

Subject to a Contractual Services Agreement and Operating and Service Agreement between the Board of Regents and the Hospital, the two parties have entered into contracts with each other for the continuation of the provision of services in support of programs and operations.

The financial statements have been presented in conformity with accounting principles generally accepted in the United States of America as required in the Audit and Accounting Guide, Health Care Organizations, published by the American Institute of Certified Public Accountants.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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. Estimates also affect the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

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Notes to Financial Statements

June 30, 2002, 2001 and 2000

The significant accounting policies of the Hospital are as follows:

**(a) *Net Asset Accounting***

Restricted net assets are used to differentiate net assets whose use is limited or restricted by outside parties from unrestricted net assets on which outside parties place no restrictions or which arise as a result of the operations of the Hospital for its stated purposes. The restricted net assets are restricted for various operating purposes. The permanently restricted net assets have been restricted by donors and are to be maintained by the Hospital in perpetuity.

Temporarily restricted contributions received for specific operating purposes are recorded as additions to temporarily restricted net assets. To the extent that the donor restrictions have been met within the period, the net assets are reported as net assets released from restrictions and are recorded in other revenue.

Temporarily restricted contributions received for property, plant, and equipment are reported as additions to temporarily restricted net assets. To the extent that the donor restrictions have been met within the period, the net assets are reported as net assets released from restrictions and are recorded as additions to unrestricted net assets.

**(b) *Net Patient Service Revenue***

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

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

**(c) *Charity Care***

The Hospital has a policy of providing health care 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.

**UNIVERSITY OF WISCONSIN  
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Notes to Financial Statements

June 30, 2002, 2001 and 2000

**(d) Investments and Investment Income**

Investments in equity securities with readily determinable fair values, all investments in debt securities, and pooled investment funds on deposit with the University of Wisconsin Foundation – Endowment Fund are recorded at fair value based upon quoted market prices at June 30, 2002, 2001, and 2000. The pooled investment funds on deposit with the University of Wisconsin Foundation – Restricted Fund and the repurchase agreement are recorded at cost plus accrued earnings to date, which approximates fair value. Illiquid investments in private equity for which there is no ready market are recorded initially at cost. A valuation allowance is established when the estimated net realizable value of the investments is less than the cost or market value.

Investment income or loss (including interest, dividends, and realized gains and losses on investments) is included in revenue and gains in excess of expenses unless the income or loss is restricted by donor or law, in which case it is added directly to restricted net assets. Unrealized gains and losses on investments are excluded from revenue and gains in excess of expenses unless the investments are trading securities. The Hospital has no investments designated as trading securities at June 30, 2002, 2001, and 2000.

**(e) Inventories of Supplies**

The inventories of supplies are stated at cost (first-in, first-out) which is not in excess of market. Beginning in fiscal year 2000, the Hospital capitalized the cost of surgical supplies inventory, resulting in a cumulative effect of change in accounting principle of approximately \$3,826,000.

**(f) Property, Plant, and Equipment**

Property, plant, and equipment is stated at cost. Donated property, plant, and equipment is recorded at fair market value at the date of donation, which then is treated as cost. The cost of these assets is depreciated on the straight-line method over their estimated useful lives. Gains (losses) on sales of property, plant, and equipment are recorded as nonoperating gains (losses).

**(g) Long-Lived Assets**

The Hospital periodically assesses the recoverability of long-lived assets (including property, plant, and equipment and intangibles) when indications of potential impairment, based on estimated, undiscounted future cash flows, exist. Management considers such factors as current results, trends, and future prospects, in addition to other economic factors in determining the impairment of the asset. Management has determined that the Hospital's long-lived assets and intangibles are not impaired at June 30, 2002, 2001, and 2000.

**(h) Leases**

Leases that meet the criteria of capital leases are capitalized and assets and liabilities are recorded at amounts equal to the lesser of the present value of the minimum lease payments or the fair value of the leased properties at the beginning of the respective lease terms. Such assets are amortized on the straight-line method over the shorter of the related lease terms or their estimated useful lives.

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Notes to Financial Statements

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Amortization of the leased building and equipment is included in the financial statements with depreciation and amortization expense.

**(i) *Costs of Borrowing***

Costs incurred in connection with the issuance of long-term debt have been deferred and are being amortized over the term of the bonds.

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the costs of acquiring those assets.

**(j) *Cash Equivalents***

Cash equivalents are defined as highly liquid investments purchased with an original maturity of three months or less, excluding amounts reported as assets whose use is limited or restricted.

**(k) *Income Taxes***

The Hospital qualifies as a Section 501(c)(3) not-for-profit institution of the Internal Revenue Code (Code) and therefore is exempt from Federal and state 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.

**(l) *Derivative Instruments***

Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," establishes accounting and reporting standards requiring that every derivative instrument (including certain derivative instruments embedded in other contracts) be recorded on the balance sheet as either an asset or liability measured at its fair market value with changes in fair market value being included in the statement of operations, unless specific hedging criteria are met. The Hospital adopted the provisions of SFAS No. 133 effective July 1, 2000.

**(m) *Reclassifications***

Certain items in the 2001 and 2000 financial statements have been reclassified to conform with classifications used in 2002.

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Notes to Financial Statements

June 30, 2002, 2001 and 2000

**(2) Assets Whose Use is Limited or Restricted and Investments**

The following is a summary of assets whose use is limited or restricted:

	2002	2001 (In thousands)	2000
Pooled investment funds on deposit with the University of Wisconsin Foundation – Restricted Fund	\$ 128,458	117,614	87,442
Funds held with trustee	11,236	39,527	49,971
Other	49	49	53
Total assets whose use is limited or restricted	\$ 139,743	157,190	137,466

The composition of the Hospital's interest in investments on deposit with the University of Wisconsin Foundation – Restricted Fund is as follows: domestic equities 16%, 23%, and 30%, fixed income debt securities 79%, 69%, and 64%, cash 2%, 4%, and 0% and international equities 3%, 4%, and 6%, at June 30, 2002, 2001, and 2000, respectively.

At June 30, 2002, 2001, and 2000, the funds with trustee are invested in a repurchase agreement maintained with a financial institution in accordance with the provisions of the bond indenture agreement, mature on April 15, 2003 and provide a fixed rate of return of 6.635%.

Assets whose use is limited or restricted are classified as follows:

	2002	2001 (In thousands)	2000
Limited by:			
Board for capital replacement and debt retirement	\$ 124,522	114,500	84,939
Trustee under bond indenture agreement (note 5)	11,236	39,527	49,971
Restricted by donors	3,985	3,163	2,556
Total assets whose use is limited or restricted	\$ 139,743	157,190	137,466

Investments totaling approximately \$34,118,000, \$37,920,000 and \$44,152,000 at June 30, 2002, 2001, and 2000, respectively, primarily comprise pooled investment funds on deposit with the University of Wisconsin Foundation – Endowment Fund. The composition of the University of Wisconsin Foundation – Endowment Fund is as follows: domestic equities 55%, 57%, and 50%, fixed income debt securities 0%,

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Notes to Financial Statements

June 30, 2002, 2001 and 2000

0%, and 8%, international equities 15%, 14%, and 23%, cash 1%, 2%, and 0% and alternative investments (private equity and hedge funds) 24%, 27%, and 19%, at June 30, 2002, 2001, and 2000, respectively.

The composition of investment return on the Hospital's cash and cash equivalents, assets whose use is limited or restricted and investments is as follows:

	2002	2001 (In thousands)	2000
Interest and dividend income	\$ 9,056	8,254	7,343
Net change in unrealized gains and losses	(8,555)	(4,817)	6,598
Total investment return	\$ 501	3,437	13,941

Investment returns are included in the accompanying statements of operations and statements of changes in net assets as follows:

	2002	2001 (In thousands)	2000
<b>Statement of operations:</b>			
Other operating revenue	\$ 97	400	222
Nonoperating gains – investment income	8,777	7,727	7,032
Other changes in unrestricted net assets – net change in unrealized gains and losses	(8,190)	(4,625)	6,406
Total investment return, unrestricted net assets	684	3,502	13,660
<b>Statement of changes in net assets:</b>			
Investment income on restricted net assets	182	127	89
Net change in unrealized gains and losses on other than trading securities	(365)	(192)	192
Total investment return, restricted net assets	(183)	(65)	281
Total investment return	\$ 501	3,437	13,941

**UNIVERSITY OF WISCONSIN  
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Notes to Financial Statements

June 30, 2002, 2001 and 2000

**(3) Transactions with Related Parties**

The Hospital receives certain administrative and other general services from the University, including the Medical School. Direct costs associated with these services approximated \$33,164,000, \$31,383,000, and \$30,478,000 in 2002, 2001, and 2000, respectively. The Hospital committed to support certain Medical School capital expenditures as incurred, up to a maximum of \$6,890,000, of which \$6,590,000 was paid through June 30, 2002 and the remaining \$300,000 is to be paid by June 2005.

Wisconsin Therapies, Inc., a not-for-profit corporation controlled by the Hospital, was organized for the purpose of entering into a general partnership with Chartwell Midwest. The partnership is called Chartwell Wisconsin Enterprises, LLC, and is the sole member in Chartwell Midwest Wisconsin, LLC, a single member limited liability company. The investment in affiliate is adjusted for equity in undistributed earnings of Chartwell Wisconsin Enterprises, LLC. During 2002, 2001, and 2000, the Hospital received cash distributions of \$318,000, \$485,000, and \$1,000,000, respectively, from the partnership.

Wisconsin Dialysis, Inc. was organized in April 2002 as a not-for-profit corporation for the purpose of entering into a 45/45/10 general partnership between the Hospital, Meriter Hospital Inc. and the University of Wisconsin Medical Foundation, respectively. During fiscal year 2002, an initial total contribution of \$100,000 was split according to each partner's pro-rated ownership. The investment is being accounted for by the equity method.

**(4) Property, Plant, and Equipment**

A summary of property, plant, and equipment follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
		(In thousands)	
Land and land improvements	\$ 3,934	3,934	3,934
Buildings, leasehold improvements, and fixed equipment	213,287	173,819	169,652
Moveable equipment	138,258	138,901	128,825
Construction in progress	<u>28,601</u>	<u>26,358</u>	<u>6,809</u>
Total property, plant, and equipment	384,080	343,012	309,220
Less accumulated depreciation and amortization	<u>184,258</u>	<u>184,822</u>	<u>168,226</u>
Net property, plant, and equipment	<u>\$ 199,822</u>	<u>158,190</u>	<u>140,994</u>

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Total property, plant, and equipment approximating \$29,741,000, \$33,968,000, and \$38,573,000 is held under the Lease Agreement (note 1) at June 30, 2002, 2001, and 2000. In addition, approximately \$824,000 of property, plant, and equipment is held under other capital lease agreements at June 30, 2000.

Construction in progress at June 30, 2002 consists principally of costs incurred for the expansion of ambulatory services and remodeling of inpatient rooms at 600 Highland Avenue. The construction project is being financed with debt proceeds (note 5). During 2002, 2001, and 2000 interest expense of approximately \$1,713,000, \$2,634,000, and \$836,000, and interest income of approximately \$1,713,000, \$2,477,000, and \$836,000, was capitalized, respectively.

Total remaining commitments on property, plant, and equipment purchases and the renovation and construction projects approximate \$5,289,000 at June 30, 2002.

**(5) Long-term Debt**

Long-term debt is summarized as follows:

	2002	2001	2000
		(In thousands)	
Amounts payable to the State of Wisconsin for:			
General Obligation Bonds	\$ 1,719	3,058	3,860
Refunding Bonds	24,053	25,539	27,126
Total amounts payable to the State of Wisconsin	25,772	28,597	30,986
Obligations under capital leases	—	—	346
Variable Rate Demand Hospital Revenue Bonds, Series 1997	50,000	50,000	50,000
Hospital Revenue Bonds, Series 2000	56,500	56,500	56,500
Total long-term debt	132,272	135,097	137,832
Less current installments	2,845	3,111	2,735
Long-term debt, less current installments	\$ 129,427	131,986	135,097

The amounts payable to the State of Wisconsin represent portions of the respective obligations for which repayment has been assigned to the Hospital in connection with the financing of Hospital facilities and equipment (note 1). In March 2002, the Hospital was notified that the State included the cost of the CSC Heat Recovery Chiller project in a new general obligation bond series and assigned \$336,000 of the series to the Hospital which is included with amounts payable to the State of Wisconsin. Interest rates range from



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3.5% to 7.0%, with final maturities due in April 2022. Annual principal and semiannual interest payments are required on all amounts payable to the State of Wisconsin.

In April 1997, the Hospital issued \$50,000,000 of Variable Rate Demand Hospital Revenue Bonds, Series 1997 (Series 1997 Bonds). The bond proceeds are designated to finance qualified capital projects. Principal payments on the Series 1997 Bonds are due annually commencing in April 2010 through April 2026. Interest is payable monthly. The effective annual interest rate was 1.8% in 2002 and 3.8% in 2001 and 2000.

In March 2000, the Hospital issued \$56,500,000 of Hospital Revenue Bonds, Series 2000 (Series 2000 Bonds). The bond proceeds are designated to finance qualified capital projects. Principal payments on the Series 2000 Bonds are due annually commencing in April 2007 through April 2029. Interest rates range from 5.35% to 6.20% and interest is payable semiannually on April 1 and October 1 of each year beginning October 1, 2000. The effective annual interest rate was 6.1% in 2002 and 2001.

In September 2000, the Hospital entered into an interest rate swap in order to effectively change a portion of the Series 2000 Bonds fixed rate interest cash flows to variable rate interest cash flows. The notional amount of this swap agreement is \$46,460,000. The terms of the swap agreement are for the Hospital to pay to the counterparty a variable rate (Bond Market Association Swap Index BMA), which averaged 1.68% in fiscal 2002 and 3.71% in fiscal 2001, and to receive a fixed interest payment from the counterparty of 4.57% through October 1, 2005 and 4.765% thereafter based on the same notional amount. The interest rate swap is recorded in other assets at its approximate fair value of \$2,891,000 at June 30, 2002 and \$1,041,000 at June 30, 2001. The change in fair value is reflected in investment income in the statement of operation. The Hospital is subject to counterparty credit risk with regard to the payment due under and the fair value of the interest rate swap. The Hospital is still obligated for all interest and principal under the terms of the Series 2000 bonds.

The Series 1997 Bonds and Series 2000 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 the Lease Agreement (note 1) and provisions limiting the amount of additional indebtedness which may be incurred. The borrowing agreements also require the establishment and maintenance of certain funds under the control of a trustee (note 2).

Current legislation (note 1) limits the Hospital's total borrowings, exclusive of amounts payable to the State of Wisconsin, to \$175,000,000, with limited exceptions.

The estimated fair value of long-term debt, based on discounted cash flows at management's estimated current borrowing rates is \$136,388,000 at June 30, 2002 and approximates cost at June 30, 2001, and 2000.

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Aggregate scheduled principal maturities of long-term debt during the next five fiscal years and thereafter are as follows:

	(In thousands)
Year:	
2003	\$ 2,845
2004	2,967
2005	2,792
2006	2,927
2007	2,909
Thereafter	117,832
	\$ 132,272

**(6) Net Patient Service Revenue and Third-Party Payors Reimbursement**

A summary of gross and net patient service revenue follows:

	2002	2001	2000
	(In thousands)		
Gross patient service revenue:			
Inpatient:			
Routine services	\$ 116,109	94,426	79,339
Ancillary services	317,093	280,543	258,318
Outpatient	315,231	262,157	203,859
Total gross patient service revenue	748,433	637,126	541,516
Less provision for contractual adjustments under:			
Government programs	130,674	105,771	68,921
Managed care and other	127,290	111,157	88,336
Net patient service revenue	\$ 490,469	420,198	384,259

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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 follows:

- **Medicare** – Inpatient acute care services rendered to Medicare program 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. Inpatient nonacute services, outpatient services provided before August 2000, 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, 1999. Effective August 1, 2000, the outpatient reimbursement system was changed to prospective rates.

During fiscal year 2002, the Hospital received settlements due to the reopening of prior year cost reports that resulted in an increase net patient service revenue of approximately \$1,600,000.

- **Medicaid** – Inpatient services rendered to Medicaid program 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 pre-determined rate per visit.

The percentage of net patient service revenue applicable to services provided to Medicare and Medicaid patients was approximately 30%, 29%, and 32% in 2002, 2001, and 2000, respectively.

- **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.

Capitated agreements with third-party payors comprise approximately 8%, 9%, and 9% of net patient service revenue for each of the years ended June 30, 2002, 2001, and 2000, respectively.

The mix of net receivables from patients and third-party payors is summarized as follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Medicare	24%	22%	21%
Medicaid	5	6	4
Managed care	34	36	34
Other	37	36	41
Total	<u>100%</u>	<u>100%</u>	<u>100%</u>

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**(7) Unreimbursed and Partially Reimbursed 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 during the years ended June 30, 2002, 2001, and 2000 is as follows:

	2002	2001	2000
	(In thousands)		
Charges foregone, based on established rates	\$ 8,345	8,257	7,280

**(8) Pension Plan**

Virtually all Hospital employees participate in the Wisconsin Retirement System (System), a cost-sharing multiple-employer public employee retirement system. All permanent employees expected to work over 600 hours a year are eligible to participate in the System. Covered employees are required by statute to contribute 5% of their salary to the plan. However, the Hospital makes these contributions to the plan on behalf of the employees. The Hospital is required to contribute the remaining amounts necessary to pay the projected cost of defined future benefits. Total contributions made by the Hospital for the years ended June 30, 2002, 2001, and 2000, approximating \$21,814,000, \$19,603,000, and \$19,052,000, respectively, are included in employee benefit expense.

During 2001, the Hospital received notice from the Wisconsin Department of Employee Trust Funds that it would be entitled to a \$2,800,000 employer pension credit as a result of 1999 Wisconsin Act 11. The State of Wisconsin Controllers Office has requested that these credits be repaid to the State of Wisconsin. The Hospital is contesting this request, however due to the uncertainty until the matter is resolved, the amount has been recorded as a liability rather than a reduction of pension expense.

**(9) Malpractice Insurance**

The Hospital has professional liability insurance with a private insurance carrier for its employees that covers Hospital liability for claims arising on or after July 1, 2002 (occurrence-based coverage). The Hospital also carries a separate tail coverage policy on Hospital and resident liability for claims arising from activities prior to July 1, 2002. Losses in excess of the professional liability insurance are fully covered through the Hospital's mandatory participation in the Patients' Compensation Fund of the State of Wisconsin.

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**(10) Commitments and Contingencies**

*Leases*

The Hospital leases buildings, equipment, and helicopter transport services under operating leases. Rental expense for cancelable and noncancelable operating leases was approximately \$6,248,000, \$5,446,000, and \$5,002,000 for 2002, 2001, and 2000, respectively, and is included in other expenses. Future minimum lease payments for the next five years under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of June 30, 2002 are as follows:

Year:		
2003	\$	4,209
2004		4,124
2005		4,052
2006		3,832
2007		3,362
Thereafter		6,928
	\$	<u>26,507</u>

*Regulatory Investigation*

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 may have a material adverse effect on the Hospital's financial position or results of operations.

*Other*

The Hospital is subject to various legal proceedings and claims which are incidental to its normal business activities. In the opinion of the Hospital, the amount of ultimately liability with respect to these actions will not materially affect the operations or net assets of the Hospital.

**(11) Subsequent Event**

In September 2002, the Hospital cancelled the interest rate swap agreement with a counterparty under which the difference between the fixed- and floating- rate interest amounts calculated on an agreed-upon notional principal amount (\$46,460,000) were exchanged. The cancellation resulted in a gain to the Hospital of \$1,144,000 reflecting additional market value appreciation subsequent to June 30, 2002.