



**UNIVERSITY OF WISCONSIN
HOSPITALS AND CLINICS AUTHORITY**

Financial Statements

June 30, 2001, 2000 and 1999

(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, 2001, 2000 and 1999, 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, 2001, 2000 and 1999, 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 9, 2001



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**UNIVERSITY OF WISCONSIN
HOSPITALS AND CLINICS AUTHORITY**

Balance Sheets

June 30, 2001, 2000 and 1999

(In Thousands)

Assets	<u>2001</u>	<u>2000</u>	<u>1999</u>
Current assets:			
Cash and cash equivalents	\$ 14,474	16,682	30,047
Patient accounts receivable, net of estimated uncollectible accounts of \$11,800 in 2001, \$14,490 in 2000 and \$12,800 in 1999	59,457	73,745	62,710
Other receivables	7,411	7,329	3,926
Inventories of supplies	7,111	7,923	2,412
Prepaid expenses	<u>2,338</u>	<u>2,340</u>	<u>2,955</u>
Total current assets	<u>90,791</u>	<u>108,019</u>	<u>102,050</u>
Assets whose use is limited or restricted	157,190	137,466	95,801
Investments	37,920	44,152	35,175
Net property, plant and equipment	158,190	140,994	131,890
Investment in affiliate	855	842	1,328
Other assets	<u>4,356</u>	<u>3,318</u>	<u>1,285</u>
Total assets	<u>\$ 449,302</u>	<u>434,791</u>	<u>367,529</u>
Liabilities and Net Assets			
Current liabilities:			
Current installments of long-term debt	\$ 3,111	2,735	2,682
Accounts payable	14,974	14,803	11,773
Accrued expenses	33,925	35,879	36,810
Estimated payables to Medicare and Medicaid	<u>1,212</u>	<u>269</u>	<u>2,723</u>
Total current liabilities	<u>53,222</u>	<u>53,686</u>	<u>53,988</u>
Long-term debt, less current installments	<u>131,986</u>	<u>135,097</u>	<u>81,299</u>
Total liabilities	<u>185,208</u>	<u>188,783</u>	<u>135,287</u>
Net assets:			
Unrestricted	260,915	243,446	230,404
Temporarily restricted	2,415	1,848	1,546
Permanently restricted	<u>764</u>	<u>714</u>	<u>292</u>
Total net assets	<u>264,094</u>	<u>246,008</u>	<u>232,242</u>
Total liabilities and net assets	<u>\$ 449,302</u>	<u>434,791</u>	<u>367,529</u>

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN
HOSPITALS AND CLINICS AUTHORITY**

Statements of Operations

Years ended June 30, 2001, 2000 and 1999

(In Thousands)

	<u>2001</u>	<u>2000</u>	<u>1999</u>
Net patient service revenue	\$ 420,198	384,258	347,717
Other operating revenue	9,545	8,534	8,173
Total revenue	<u>429,743</u>	<u>392,792</u>	<u>355,890</u>
Expenses:			
Salaries, wages and agency costs	165,587	158,687	142,972
Employee benefits	54,878	50,818	46,353
Other expenses	30,139	29,806	27,869
Purchased services	47,252	44,178	40,321
Medical materials and supplies	84,001	79,971	69,424
Provision for bad debts	11,082	9,902	5,497
Depreciation and amortization	18,912	17,950	17,002
Interest	3,920	3,655	2,503
Total expenses	<u>415,771</u>	<u>394,967</u>	<u>351,941</u>
Income (loss) from operations	13,972	(2,175)	3,949
Nonoperating gains (losses):			
Investment income (includes \$1,041 related to valuation of swap in 2001 (note 5))	8,848	7,032	6,659
Equity interest in gain of affiliate	418	514	820
Loss on disposal of property, plant, and equipment	(194)	(410)	(148)
Other, net	62	28	(79)
Nonoperating gains, net	<u>9,134</u>	<u>7,164</u>	<u>7,252</u>
Revenue and gains in excess of expenses	<u>23,106</u>	<u>4,989</u>	<u>11,201</u>
Other changes in unrestricted net assets:			
Contributions of property, plant and equipment	253	220	24
Net transfer to University of Wisconsin Medical School for capital expenditure support	(1,265)	(2,400)	(2,400)
Net change in unrealized gains and losses on other than trading securities	(4,625)	6,406	2,631
Cumulative effect of a change in accounting principle to capitalize surgical supply inventory (note 1(e))	—	3,826	—
Other	—	1	67
Increase in unrestricted net assets	<u>\$ 17,469</u>	<u>13,042</u>	<u>11,523</u>

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN
HOSPITALS AND CLINICS AUTHORITY**

Statements of Changes in Net Assets

Years ended June 30, 2001, 2000 and 1999

(In Thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Balances at June 30, 1998	\$ 218,881	1,349	254	220,484
Increase (decrease) in net assets:				
Revenue and gains in excess of expenses	11,201	—	—	11,201
Investment income on restricted net assets	—	69	—	69
Grants, gifts and donations	63	353	38	454
Net assets released from restrictions used for operations	—	(293)	—	(293)
Transfers to unrestricted net assets for purchases of property, plant and equipment	4	(4)	—	—
Contributions of property, plant and equipment	24	—	—	24
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	2,631	72	—	2,703
Increase in net assets	11,523	197	38	11,758
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	13,042	302	422	13,766
Balances at June 30, 2000	\$ 243,446	1,848	714	246,008

(Continued)

**UNIVERSITY OF WISCONSIN
HOSPITALS AND CLINICS AUTHORITY**

Statements of Changes in Net Assets, Continued

Years ended June 30, 2001, 2000 and 1999

(In Thousands)

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</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>

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN
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Statements of Cash Flows

Years ended June 30, 2001, 2000 and 1999

(In Thousands)

	2001	2000	1999
Cash flows from operating activities:			
Increase in net assets	\$ 18,086	13,766	11,758
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	4,817	(6,598)	(2,703)
Net transfer to University of Wisconsin Medical School for capital expenditure support	1,265	2,400	2,400
Depreciation and amortization	18,912	17,950	17,002
Provision for bad debts	11,082	9,902	5,497
Loss on disposal of property, plant, and equipment	194	410	148
Increase in fair value of swap agreement	(1,041)	—	—
Decrease (increase) in net patient accounts receivable	3,206	(20,936)	(9,798)
Increase (decrease) in estimated payables to Medicare and Medicaid	943	(2,454)	(1,117)
Equity interest in gain of affiliate	(498)	(514)	(820)
(Decrease) increase in accrued expenses	(1,954)	(931)	298
Contributions of property, plant, and equipment	(253)	(220)	—
Net change in other assets and liabilities and other adjustments	791	(1,399)	4,149
Net cash provided by operating activities	55,550	7,550	26,814
Cash flows from investing activities:			
Expenditures for property, plant and equipment	(35,684)	(27,183)	(40,390)
(Increase) decrease in assets whose use is limited or restricted	(19,724)	(41,666)	19,153
Decrease (increase) in investments	1,415	(2,388)	(1,532)
Equity distributions from affiliate	485	1,000	175
Net cash used in investing activities	(53,508)	(70,237)	(22,594)
Cash flows from financing activities:			
Proceeds from long-term debt	—	56,500	—
Repayment and refunding of long-term debt	(2,735)	(2,648)	(2,670)
Deferred financing costs	—	(2,130)	—
Transfer to University of Wisconsin Medical School for capital expenditure support	(1,515)	(2,400)	(2,400)
Net cash provided by (used in) financing activities	(4,250)	49,322	(5,070)
Net decrease in cash and cash equivalents	(2,208)	(13,365)	(850)
Cash and cash equivalents at beginning of year	16,682	30,047	30,897
Cash and cash equivalents at end of year	\$ 14,474	16,682	30,047
Supplemental disclosures of cash flow information:			
Cash paid for interest	\$ 6,611	3,490	3,271

See accompanying notes to financial statements.

**UNIVERSITY OF WISCONSIN
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Notes to Financial Statements

June 30, 2001, 2000 and 1999

(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 470 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.

**UNIVERSITY OF WISCONSIN
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Notes to Financial Statements

June 30, 2001, 2000 and 1999

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, 2001, 2000 and 1999

(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, 2001, 2000 and 1999. The pooled investment funds on deposit with the University of Wisconsin Foundation – Restricted Fund, the repurchase agreement and the guaranteed investment contract are recorded at cost plus accrued earnings to date, which approximate fair 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, 2001, 2000 and 1999.

(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 believes the Hospital's long-lived assets and intangibles are not impaired at June 30, 2001, 2000 and 1999.

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

**UNIVERSITY OF WISCONSIN
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Notes to Financial Statements

June 30, 2001, 2000 and 1999

(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) Reclassifications

Certain items in the 1999 and 2000 financial statements have been reclassified to conform with classifications used in 2001.

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

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

	2001	2000	1999
	(In thousands)		
Pooled investment funds on deposit with the University of Wisconsin Foundation – Restricted Fund	\$ 117,614	87,442	82,451
Funds held with trustee	39,527	49,971	13,303
Other	49	53	47
Total assets whose use is limited or restricted	\$ 157,190	137,466	95,801

The composition of the Hospital's interest in investments on deposit with the University of Wisconsin Foundation – Restricted Fund is as follows: domestic equities 23%, 30% and 28%, fixed income debt securities 69%, 64% and 68%, cash 4%, 0% and 0% and international equities 4%, 6% and 4%, at June 30, 2001, 2000 and 1999, respectively.

At June 30, 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%.

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Notes to Financial Statements

June 30, 2001, 2000 and 1999

At June 30, 1999, the funds held with trustee were invested in a guaranteed investment contract with a financial institution, maturing December 31, 2000, which provided a rate of return of 1.88% above the interest expense on the Series 1997 Bonds (note 5).

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

	2001	2000	1999
	(In thousands)		
Limited by:			
Board for capital replacement and debt retirement	\$ 114,500	84,939	80,677
Trustee under bond indenture agreement (note 5)	39,527	49,971	13,303
Restricted by donors	3,163	2,556	1,821
Total assets whose use is limited or restricted	\$ 157,190	137,466	95,801

Investments 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 57%, 50% and 54%, fixed income debt securities 0%, 8% and 15%, international equities 14%, 23% and 21%, cash 2%, 0% and 0% and other 27%, 19% and 10%, at June 30, 2001, 2000 and 1999, 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:

	2001	2000	1999
	(In thousands)		
Interest and dividend income	\$ 8,334	7,343	7,076
Net change in unrealized gains and losses	(4,817)	6,598	2,703
Total investment return	\$ 3,517	13,941	9,779

**UNIVERSITY OF WISCONSIN
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Notes to Financial Statements

June 30, 2001, 2000 and 1999

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

	2001	2000	1999
	(In thousands)		
Statement of Operations:			
Other operating revenue	\$ 400	222	348
Nonoperating gains – investment income	7,807	7,032	6,659
Other changes in unrestricted net assets – net change in unrealized gains and losses	(4,625)	6,406	2,631
Total investment return, unrestricted net assets	3,582	13,660	9,638
Statement of Changes in Net Assets:			
Investment income on restricted net assets	127	89	69
Net change in unrealized gains and losses on other than trading securities	(192)	192	72
Total investment return, restricted net assets	(65)	281	141
Total investment return	\$ 3,517	13,941	9,779

(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 \$31,383,000, \$30,478,000 and \$29,461,000 in 2001, 2000 and 1999, respectively. The Hospital committed to support certain Medical School capital expenditures as incurred, up to a maximum of \$6,315,000, of which \$1,515,000 was paid in fiscal 2001 and \$2,400,000 was paid in both fiscal years 2000 and 1999.

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 2001, 2000 and 1999, the Hospital received cash distributions of \$485,000, \$1,000,000 and \$175,000, respectively, from the partnership.

**UNIVERSITY OF WISCONSIN
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Notes to Financial Statements

June 30, 2001, 2000 and 1999

(4) Property, Plant and Equipment

A summary of property, plant and equipment follows:

	2001	2000	1999
	(In thousands)		
Land and land improvements	\$ 3,934	3,934	3,934
Buildings, leasehold improvements and fixed equipment	173,819	169,652	152,165
Moveable equipment	138,901	128,825	125,247
Construction in progress	26,358	6,809	8,702
Total property, plant and equipment	343,012	309,220	290,048
Less accumulated depreciation and amortization	184,822	168,226	158,158
Net property, plant and equipment	\$ 158,190	140,994	131,890

Total property, plant and equipment approximating \$33,968,000, \$38,573,000 and \$43,211,000 is held under the Lease Agreement (note 1) at June 30, 2001, 2000 and 1999. In addition, approximately \$824,000 and \$1,060,000 of property, plant and equipment is held under other capital lease agreements at June 30, 2000 and 1999.

Construction in progress at June 30, 2001 consists principally of costs incurred for the renovation of the pediatric intensive care unit, the addition of new operating room suites and the expansion of ambulatory services at 600 Highland Avenue. The construction project is being financed with debt proceeds (note 5). During 2001, 2000 and 1999 interest expense of approximately \$2,634,000, \$836,000 and \$778,000, and interest income of approximately \$2,477,000, \$836,000 and \$607,000, was capitalized, respectively.

Total remaining commitments on property, plant and equipment purchases and the renovation and construction projects approximate \$22,242,000 at June 30, 2001.

**UNIVERSITY OF WISCONSIN
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Notes to Financial Statements

June 30, 2001, 2000 and 1999

(5) Long-term Debt

Long-term debt is summarized as follows:

	2001	2000	1999
	(In thousands)		
Amounts payable to the State of Wisconsin for:			
General Obligation Bonds	\$ 3,058	3,860	4,686
Refunding Bonds	25,539	27,126	28,621
Total amounts payable to the State of Wisconsin	28,597	30,986	33,307
Obligations under capital leases	—	346	674
Variable Rate Demand Hospital Revenue Bonds, Series 1997	50,000	50,000	50,000
Hospital Revenue Bonds, Series 2000	56,500	56,500	—
Total long-term debt	135,097	137,832	83,981
Less current installments	3,111	2,735	2,682
Long-term debt, less current installments	\$ 131,986	135,097	81,299

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). Interest rates range from 4.0% to 7.75%, with final maturities due in April 2016. 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 3.8% in 2001 and 2000 and 3.2% in 1999.

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 each year beginning October 1, 2000. The effective annual interest rate was 6.1% in 2001.

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In September 2000, the Hospital entered into an interest rate swap in order to convert a portion of the Series 2000 Bonds fixed rate debt to variable rate. The notional amount of this swap agreement was \$46,460,000 effective September 15, 2000. The terms of the swap agreement are for the Hospital to pay a variable rate (Bond Market Association Swap Index "BMA"), which averaged 3.71% in fiscal 2001, and to receive a fixed interest payment of 4.57% through October 1, 2005 and 4.765% thereafter based on the same notional amount. The mark to market fair value gain of the swap agreement of approximately \$1,041,000 is included in nonoperating gains and investment income in the statement of operations in 2001. The Hospital is still obligated on 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 \$106,500,000, with limited exceptions. The Hospital is currently pursuing an increase in the limit of additional borrowings.

The estimated fair value of long-term debt, based on discounted cash flows at management's estimated current borrowing rates, approximates cost at June 30, 2001, 2000 and 1999.

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

<u>Year</u>	(In thousands)
2002	\$ 3,111
2003	2,841
2004	2,963
2005	2,788
2006	2,922
Thereafter	<u>120,472</u>
Total	<u>\$ 135,097</u>

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

A summary of gross and net patient service revenue follows:

	2001	2000	1999
	(In thousands)		
Gross patient service revenue:			
Inpatient:			
Routine services	\$ 94,426	79,339	74,617
Ancillary services	280,543	258,318	224,663
Outpatient	262,157	203,859	164,113
Total gross patient service revenue	637,126	541,516	463,393
Less provision for contractual adjustments under:			
Government programs	105,771	68,921	47,140
Managed care and other	111,157	88,336	68,536
Net patient service revenue	\$ 420,198	384,258	347,717

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 non-acute 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. Effective August 1, 2000, the outpatient reimbursement system was changed to prospective rates. The Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 1998.
- **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 29%, 32% and 34% in 2001, 2000 and 1999, respectively.