



# City of West Allis Matter Summary

7525 W. Greenfield Ave.  
West Allis, WI 53214

File Number	Title	Status
-------------	-------	--------

2007-0279 Report In Committee

West Allis Memorial Hospital, Inc.'s financial statements for the years ended December 31, 2006 and 2005, and Independent Auditors' report.

Introduced: 5/15/2007

Controlling Body: Administration & Finance Committee

## COMMITTEE RECOMMENDATION POF

ACTION DATE:	MOVER	SECONDER		AYE	NO	PRESENT	EXCUSED
<u>MAY 15 2007</u>			Barczak	✓			
			Czaplewski	✓			
			Dobrowski				
		✓	Kopplin				
			Lajsic	✓			
			Narlock				
			Reinke	✓			
			Sengstock				
			Vitale				
		Weigel		✓			
		TOTAL		5	0		

### SIGNATURE OF COMMITTEE MEMBER

Chair

Vice-Chair

Member

### COMMON COUNCIL ACTION

**PLACE ON FILE**

ACTION DATE:	MOVER	SECONDER		AYE	NO	PRESENT	EXCUSED
<u>MAY 15 2007</u>	✓		Barczak	✓			
			Czaplewski	✓			
			Dobrowski <i>exc</i>				✓
			Kopplin	✓			
			Lajsic	✓			
			Narlock <i>exc</i>				✓
			Reinke	✓			
			Sengstock	✓			
			Vitale	✓			
		Weigel	✓				
		TOTAL		8			2

***West Allis Memorial  
Hospital, Inc.***

*Financial Statements as of and for the  
Years Ended December 31, 2006 and  
2005, and Independent Auditors' Report*

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## TABLE OF CONTENTS

---

	<b>Page</b>
INDEPENDENT AUDITORS' REPORT	1
FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005:	
Balance Sheets	2
Statements of Operations and Changes in Net Assets	3
Statements of Cash Flows	4
Notes to Financial Statements	5-12

## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
Aurora Health Care, Inc.:

We have audited the accompanying balance sheets of West Allis Memorial Hospital, Inc. (the Hospital), an affiliate of Aurora Health Care, Inc., as of December 31, 2006 and 2005, and the related statements of operations and 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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Hospital's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the financial position of the Hospital as of December 31, 2006 and 2005, and the results of its operations, its changes in net assets, and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

*Deloitte & Touche LLP*

March 30, 2007

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## BALANCE SHEETS AS OF DECEMBER 31, 2006 AND 2005 (In thousands)

	2006	2005
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 79	\$ 87
Inventories and other current assets	970	831
Advances to and amounts due from affiliates	<u>95,581</u>	<u>84,788</u>
Total current assets	96,630	85,706
Assets Whose Use Is Limited	-	49
Advances to Affiliates	23,833	21,721
Property, Plant, and Equipment, Net	117,504	116,773
Other Assets, including Beneficial Interest in Net Assets of Foundation	<u>2,919</u>	<u>2,811</u>
<b>TOTAL ASSETS</b>	<u>\$ 240,886</u>	<u>\$ 227,060</u>
<b>LIABILITIES AND NET ASSETS</b>		
Current Liabilities:		
Current installments of long-term debt	\$ 2,050	\$ 2,735
Accounts payable	5,743	5,151
Estimated third-party payor settlements	8,006	6,221
Due to affiliates	2,982	5,449
Accrued expenses	<u>6,095</u>	<u>4,935</u>
Total current liabilities	24,876	24,491
Long-Term Debt, Less Current Installments	36,612	38,650
Other Long-Term Liabilities	<u>173</u>	<u>237</u>
Total liabilities	<u>61,661</u>	<u>63,378</u>
Net Assets:		
Unrestricted	178,459	163,014
Temporarily restricted	<u>766</u>	<u>668</u>
Total net assets	<u>179,225</u>	<u>163,682</u>
<b>TOTAL LIABILITIES AND NET ASSETS</b>	<u>\$ 240,886</u>	<u>\$ 227,060</u>

See notes to financial statements.

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## STATEMENTS OF OPERATIONS AND CHANGES IN NET ASSETS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 (In thousands)

	2006	2005
Revenue:		
Net Patient Service Revenue	\$ 191,756	\$ 172,443
Other Revenue	<u>7,343</u>	<u>6,730</u>
Total revenue	<u>199,099</u>	<u>179,173</u>
Expenses:		
Salaries	52,630	46,157
Fringe benefits	18,648	14,346
Professional fees	3,179	3,228
Supplies	24,593	22,314
Depreciation and amortization	9,074	8,820
Interest	2,157	2,256
Management services and operational support	43,285	40,674
Provision for bad debts	6,924	5,241
Other	<u>23,237</u>	<u>20,832</u>
Total expenses	<u>183,727</u>	<u>163,868</u>
Operating income	15,372	15,305
Nonoperating Gain	<u>5</u>	<u>9</u>
Excess of Revenue over Expenses	15,377	15,314
Transfers from affiliates, net	68	53
Cumulative effect of accounting change	<u>-</u>	<u>(207)</u>
Increase in unrestricted net assets	15,445	15,160
Temporarily Restricted Net Assets:		
Change in beneficial interest in net assets of foundation	<u>98</u>	<u>48</u>
Total increase in net assets	15,543	15,208
Net Assets:		
Beginning of year	<u>163,682</u>	<u>148,474</u>
End of year	<u>\$ 179,225</u>	<u>\$ 163,682</u>

See notes to financial statements.

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005 (In thousands)

	2006	2005
Cash Flows From Operating Activities:		
Increase in net assets	\$ 15,543	\$ 15,208
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	9,074	8,820
Provision for bad debts	6,924	5,241
Transfers from affiliates, net	(68)	(53)
Change in beneficial interest in net assets of foundation	(98)	(48)
Cumulative effect of accounting change	-	207
Increase (decrease) in estimated third-party payor settlements	1,785	(32)
Other, net	1,622	1,555
Net cash provided by operating activities	<u>34,782</u>	<u>30,898</u>
Cash Flows From Investing Activities:		
Capital expenditures	(9,805)	(2,654)
(Decrease) increase in assets whose use is limited, net	49	(2)
Advances, transfers and amounts due to (from) affiliates, net	<u>(22,299)</u>	<u>(25,581)</u>
Net cash used in investing activities	<u>(32,055)</u>	<u>(28,237)</u>
Cash Used In Financing Activities—Repayment of long-term debt	<u>(2,735)</u>	<u>(2,630)</u>
Net (Decrease) Increase in Cash and Cash Equivalents	(8)	31
Cash and Cash Equivalents:		
Beginning of year	<u>87</u>	<u>56</u>
End of year	<u>\$ 79</u>	<u>\$ 87</u>
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION—		
Cash paid for interest	<u>\$ 2,146</u>	<u>\$ 2,237</u>

See notes to financial statements.

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2006 AND 2005

---

### 1. DESCRIPTION OF ORGANIZATION

West Allis Memorial Hospital, Inc. (the Hospital) is a Wisconsin nonstock, not-for-profit corporation. The Hospital operates an acute-care hospital and serves primarily the greater Milwaukee area, providing inpatient, outpatient, and emergency care services. Aurora Health Care, Inc. (Aurora) is the sole corporate member of the Hospital.

Aurora is a Wisconsin nonstock, not-for-profit corporation which operates to provide and deliver a variety of health care services and activities in Eastern Wisconsin and the surrounding areas, and to carry on such educational, philanthropic, and medical research activities as may be part of an integrated health care delivery system. The Aurora system comprises 13 acute-care hospital campuses, one psychiatric hospital, a network of 106 physician clinic facilities, home health services, 126 retail pharmacies, and other health care and related services.

During 2006 and 2005, management and administrative expenses comprised of 23.3% and 24.2% of total expenses, respectively. Management and administrative expenses include information technology, finance, purchasing, patient billing, and human resources. The remaining expenses relate to the provision of health care services.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

Except as otherwise disclosed, the carrying value of all financial instruments of the Hospital (including cash and cash equivalents, advances to and amounts due from affiliates, assets whose use is limited, accounts payable, accrued expenses, and estimated third-party settlements) approximates their fair value, due to their short-term maturities. The fair value of the long-term debt is disclosed in Note 5.

Significant accounting policies of the Hospital are as follows:

**Cash and Cash Equivalents**—Cash and cash equivalents include highly liquid investments purchased with an original maturity of three months or less.

**Accounts Receivable**—The Hospital has an agreement to sell all of its receivables to Aurora, in connection with a system-wide, revolving period securitization transaction (see Note 7).



The Hospital has agreements with third-party payors that provide for payments to the Hospital at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows:

- *Medicare*—Inpatient acute, most hospital outpatient services, and inpatient rehabilitation services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Certain inpatient non-acute services, defined capital costs, medical education costs, certain drugs, certain outpatient services, and devices related to Medicare beneficiaries are paid based on cost-reimbursement methodologies. The Hospital is reimbursed for cost-reimbursable items at a tentative rate, with final settlement determined after submission of annual cost reports by the Hospital and audits thereof by the Medicare fiscal intermediary.
- *Medicaid*—Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed primarily based upon prospectively determined rates.
- *Other Third-Party Payors*—Services rendered to patients insured by other third-party payors are primarily reimbursed based on a discount from customary charges or prospectively determined rates per discharge. Other payment arrangements include negotiated fee schedules, per diems, and capitated payments.

*Inventories*—Medical supplies inventories are stated at the lower of cost (first-in, first-out) or market.

*Property, Plant, and Equipment*—Property, plant, and equipment acquisitions are recorded at cost. Donated property, plant, and equipment is recorded at fair market value at date of donation, which then is treated as cost. Property, plant, and equipment assets are depreciated on the straight-line method over their estimated useful lives, ranging from three to forty years. Plant and equipment are subject to the lease agreement between the Hospital and the City of West Allis (see Note 8).

The Hospital periodically assesses the impairment of long-lived assets (including property, plant, and equipment) whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. Management considers such factors as current results, trends, and future prospects, in addition to other economic factors, in determining the impairment of an asset. To date, no such impairment adjustments have been necessary.

*Deferred Financing Costs and Bond Discount*—Long-term debt discount and issuance costs are deferred and amortized over the term of the debt along with any original issue discount. Long-term debt issuance costs and original issue discounts are amortized using methods which approximate the interest yield method.

*Income Taxes*—The Hospital is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code (the Code) and has been recognized as tax exempt pursuant to Section 501(a) of the Code.

*Net Assets*—Unrestricted net assets arise as a result of the operations of the Hospital. Restricted net assets are used to differentiate resources whose use is limited by donors or grantors, which consist of temporarily restricted amounts. Temporarily restricted net assets are used to account for assets whose use has been limited by donors to later periods of time or to specific purposes. At December 31, 2006

and 2005, temporarily restricted net assets are comprised of assets held by an unconsolidated foundation for the benefit of the Hospital.

**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, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered, and adjusted in future periods as final settlements are determined. Laws and regulations governing government and other payment programs are complex and subject to interpretation. As a result, there is a reasonable possibility that recorded estimated third-party payor settlements could change by a material amount. Changes in estimates relating to prior years increased net patient service revenue by approximately \$600,000 in 2006 and \$3,300,000 in 2005. During 2005, the Hospital entered into a settlement agreement with a managed care provider to settle certain disputed patient claims relating to prior years. Settlement payment received by the Hospital increased net patient service revenue by \$342,000 in 2005.

**Other Revenue/Expense**—Other revenue primarily comprises revenues from cafeteria sales, rental of hospital space, investment income, and other miscellaneous services. Other expense primarily consists of occupancy, maintenance and repairs, and other administrative costs.

Investment income, resulting primarily from interest income on advances to affiliates (see Note 7), is reported as other revenue. Investment income totaled \$2,785,000 and \$2,465,000 in 2006 and 2005, respectively. Investment income on temporarily restricted net assets is recorded in the applicable category of restricted net assets, if such income is also donor restricted.

**Charity Care and Uninsured Care**—The Hospital provides care to patients who meet certain criteria under its *Helping Hands* program without charge or at amounts less than its established rates. Because the Hospital does not pursue collection of amounts determined to qualify under this program, they are not reported as revenue. Charges relating to charity care provided were \$4,441,000 and \$4,830,000 in 2006 and 2005, respectively.

**Excess of Revenue over Expenses**—The statement of operations includes excess of revenue over expenses. Changes in unrestricted net assets which are excluded from excess of revenue over expenses, include permanent transfers of assets to and from affiliates for other than goods and services, and other items (such as the cumulative effect of accounting changes).

**Pension Plan**—The Hospital participates in the Aurora Health Care, Inc. Pension Plan (the Aurora Pension Plan). The Aurora Pension Plan is a noncontributory defined benefit pension plan which is sponsored and administered by Aurora. The Aurora Pension Plan covers substantially all employees of Aurora and its participating affiliates. Periodic pension expense and the related liability for the Aurora Pension Plan are reported in Aurora's financial statements. Pension expense reported by the Hospital represents a portion of the total periodic pension costs and is allocated to the Hospital based on guidelines established by the plan administrator. The Hospital's expense for the Aurora Pension Plan was \$4,973,000 and \$2,508,000 in 2006 and 2005, respectively, representing 8.9% and 6.1%, of the total recorded pension expense for the Aurora Pension Plan, respectively. At December 31, 2006 and 2005, the projected benefit obligation of the Aurora Pension Plan totaled \$699,839,000 and \$649,771,000, respectively. The accumulated benefit obligation totaled \$601,229,000 and \$565,451,000, and the fair value of the related plan assets totaled \$516,847,000 and \$414,922,000, at December 31, 2006 and 2005, respectively.

**Incentive Savings Plan**—The Hospital participates in the Aurora Health Care, Inc. Incentive Savings Plan (the Aurora Savings Plan). The Aurora Savings Plan is a contributory defined contribution plan sponsored and administered by Aurora. The Aurora Savings Plan covers regular full or part-time employees of Aurora and its participating affiliates. Employee contributions of up to 4% of compensation are matched 50% by the Hospital. The Hospital's expense for the Aurora Savings Plan was \$694,000 and \$620,000 in 2006 and 2005, respectively.

**New Accounting Pronouncements**—In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Post-Retirement Plans – an amendment of FASB Statements No. 87, 88, 106 and 132(R)*, which requires that employers recognize the funded status of a defined benefit pension and other postretirement plan as a net asset or liability. Under SFAS No. 158, companies are required to measure plan assets and benefit obligations as of their fiscal year end. Aurora presently uses a measurement date of September 30. The recognition provisions of SFAS No. 158 are effective at the end of 2007, while the measurement date provision becomes effective in 2008. The Hospital may receive an allocation of any adjustment required as a result of the adoption of SFAS No. 158. The ultimate amounts recorded are highly dependent on various estimates and assumptions, including the discount rate selected, future compensation levels, and performance of plan assets. Changes in these assumptions could increase or decrease the estimated impact of implementing SFAS No. 158.

### 3. ASSETS WHOSE USE IS LIMITED

Assets whose use is limited or restricted is comprised of a certificate of deposit valued at \$49,000 at December 31, 2005, and is stated at fair market value. The funds were designated for continuing education for the board of directors and were classified in the balance sheet as a long-term asset at December 31, 2005. These funds were spent during 2006 and therefore are not reflected on the balance sheet at December 31, 2006.

### 4. PROPERTY, PLANT, AND EQUIPMENT

The following is a summary of the components of property, plant and equipment (see Note 8) at December 31, 2006 and 2005 (in thousands):

	2006	2005
Land and improvements	\$ 1,940	\$ 1,794
Buildings and fixed equipment	180,928	174,508
Movable equipment	48,484	45,030
Construction in progress	<u>1,254</u>	<u>1,484</u>
	232,606	222,816
Accumulated depreciation	<u>(115,102)</u>	<u>(106,043)</u>
Property, plant and equipment, net	<u>\$ 117,504</u>	<u>\$ 116,773</u>

The Hospital records all known asset retirement obligations for which the fair value of the liability can be reasonably estimated, including certain obligations relating to asbestos abatement and storage tank removal. At December 31, 2006 and 2005, the Corporation recognized asset retirement obligations of \$173,000 and \$237,000, respectively, (including cumulative accretion) and asset retirement costs of \$15,000 and \$30,000, respectively (net of accumulated depreciation).

At December 31, 2006, construction in progress consisted of various improvement projects. There was no capitalized interest recorded in 2006 or 2005.

## 5. LONG-TERM DEBT AND LEASE COMMITMENTS

Long-term debt at December 31, 2006 and 2005 is summarized as follows (in thousands):

	2006	2005
Wisconsin Health and Educational Facilities Authority bonds	\$26,093	\$26,093
City of West Allis (City) general obligation bonds and promissory notes, net of unamortized discount of \$76 and \$88, respectively (see Note 8)	<u>12,569</u>	<u>15,292</u>
	38,662	41,385
Less current installments	<u>(2,050)</u>	<u>(2,735)</u>
Long-term debt, less current installments	<u>\$36,612</u>	<u>\$38,650</u>

Aurora has issued revenue bonds through the Wisconsin Health and Educational Facilities Authority (WHEFA). Such bonds are subject to a Master Trust Indenture (the Aurora Indenture). All outstanding debt under the Aurora Indenture is the general, unsecured, joint, and several obligations of the members of the Aurora Obligated Group, which comprises various affiliates of the Aurora system. The Hospital is not a member of the Obligated Group. However, it is the intent of Aurora and the Hospital that each system affiliate with allocated WHEFA debt will be responsible for its respective share of principal and interest as reflected in its financial statements.

Under terms of its borrowing agreements with Aurora, the Hospital's allocated WHEFA debt is due annually in varying amounts commencing in 2012 and extending through 2029, and bears interest at a rate of 6%.

The City general obligation bonds and promissory notes represent obligations for which repayment has been assigned to the Hospital for the financing of Hospital facilities and equipment. The bonds and notes are due in varying installments through 2013. Interest rates are fixed and ranged from 2.75% to 4.25% at December 31, 2006 and 2.0% to 4.25% at December 31, 2005 (see Note 8).

Certain borrowing agreements require sinking fund deposits with a trustee sufficient to pay principle and interest when due and the establishment and maintenance of certain special funds under the control of trustees. Further, certain borrowing agreements contain various covenants regarding maintenance of property, continuation of operations, issuance of additional debt, and maintenance of debt to total capitalization and other financial ratios and indicators. To the extent such funds or covenants are required under current WHEFA borrowing agreements, these are being maintained and monitored by Aurora. To the extent such funds or covenants are required under current City borrowing agreements, they are being maintained and monitored by the Hospital. At December 31, 2006, management believes the Hospital and Aurora were in compliance with the covenants contained in the debt agreements.

Scheduled maturities on all long-term debt (excluding amortization of unamortized bond discounts of \$76,000) at December 31, 2006 are as follows (in thousands):

2007	\$ 2,050
2008	2,125
2009	2,225
2010	2,305
2011	2,430
Thereafter	<u>27,603</u>
Total	<u>\$ 38,738</u>

The estimated fair market value of long-term debt, based on discounted cash flows at estimated current borrowing rates, approximated \$39,514,000 and \$42,093,000 at December 31, 2006 and 2005, respectively.

Cash payments for interest totaled \$2,146,000 and \$2,237,000 in 2006 and 2005, respectively.

#### **6. SELF-FUNDED HEALTH, DENTAL, AND OTHER BENEFITS**

Substantially all of the Hospital's employees and their eligible dependents participate in a self-funded health and dental insurance plan sponsored and administered by Aurora. The Hospital's allocated costs under the plan, which totaled \$6,912,000 and \$6,161,000 in 2006 and 2005, respectively, are based upon actual claims paid, administration fees, and provisions for unpaid and unreported claims at year end. Such costs are included with fringe benefits in the accompanying financial statements.

The Hospital also provides salary continuation payments to current and inactive employees who are eligible to receive long-term disability and workers' compensation, under self-funded arrangements. The Hospital costs under the Plan, which totaled \$974,000 and \$788,000 in 2006 and 2005, respectively, were based on actual claims paid. Aurora measures the cost of its unfunded obligations under such programs based upon actuarial calculations, however does not allocate any of the unfunded liabilities to the Hospital.

#### **7. ADVANCES TO AND TRANSACTIONS WITH AFFILIATES**

Aurora has entered into a series of agreements under which it sold and will continue to sell certain patient accounts receivable to a qualifying special purpose entity, in a revolving period securitization transaction expected to span a long-term period. In connection with this securitization, the Hospital sells, without recourse and on an ongoing basis, its patient accounts receivable to Aurora. As consideration for such sales, the Hospital records an intercompany receivable equal to the net value of the patient receivables sold. At December 31, 2006 and 2005, the net patient accounts receivable sold totaled \$19,075,000 and \$16,595,000, respectively, net of allowance for doubtful accounts of \$13,171,000 and \$10,096,000, respectively. The intercompany receivable is included in current advances to affiliate in the accompanying financial statements.

Aurora has a centralized cash depository and disbursement arrangement, as a means of improving investment returns and facilitating the settlement of intercompany balances. Affiliates, which, on a net basis, have advanced funds, earn interest on such advances. Similarly, affiliates, which, on a net basis, have borrowed funds, incur interest expense on those borrowings. Interest rates credited or charged approximate those earned by Aurora on its centralized depository accounts. At December 31, 2006 and 2005, the Hospital's portion of Aurora's cash concentration accounts totaled \$100,339,000 and

\$89,914,000, respectively. Such amounts are classified as current and noncurrent advances to affiliates in the accompanying financial statements in the same proportion as Aurora's consolidated current and noncurrent cash and investments. Interest income credited to the Hospital on its portion of Aurora's cash concentration accounts totaled \$2,767,000 and \$2,445,000 in 2006 and 2005, respectively, and is included in other revenue in the accompanying financial statements.

Amounts advanced to Aurora have been primarily used to fund advances to or investments in the various operating members of the Aurora system. Management of Aurora believes the affiliates have the ability and intent to repay these advances. Should some or all of these advances not be repaid by Aurora, the Hospital's net assets would be reduced and its debt to equity ratio would be increased. The fair value of the Hospital's advances to affiliates is estimated to approximate their carrying value.

Transactions with affiliates are recorded at amounts which approximate cost and are allocated based upon volume, usage and budgeted financial operations. Aurora provides certain administrative and support services to the Hospital. Additionally, the Hospital provides operational support to certain affiliated clinics closely associated with the Hospital. Expenses for management services totaled \$43,285,000 and \$40,674,000 (including operational support of \$5,184,000 and \$3,256,000) in 2006 and 2005, respectively. At December 31, 2006 and 2005, the Hospital owed \$2,982,000 and \$5,449,000, respectively, to affiliated organizations for such activities, included in due to affiliates in the accompanying financial statements.

The Hospital, along with certain other Aurora affiliates, participates in the Aurora Consolidated Laboratories Co-Tenancy (the Co-Tenancy). The primary purpose of the Co-Tenancy is to operate an integrated, full-service diagnostic laboratory. Other expenses include \$6,820,000 and \$6,451,000 in 2006 and 2005, respectively, related to laboratory services provided by the Co-Tenancy.

Permanent transfers of assets and liabilities to and from affiliates for other than goods and services are reported as changes in unrestricted net assets. Net transfers of assets and liabilities from affiliates amounted to \$68,000 in 2006 and \$53,000 in 2005.

The Aurora Foundation, Inc. (the Foundation) holds unrestricted assets of \$766,000 and \$668,000 at December 31, 2006 and 2005, respectively, which are expected to be used for the benefit and support of the Hospital and its activities and are included in other assets in the accompanying balance sheet. Amounts received from the Foundation for educational and operating purposes were not significant in 2006 and 2005.

## 8. COMMITMENTS AND CONTINGENCIES

*Lease Agreement*—The Hospital has a noncancelable lease agreement with the City for the right to operate the Hospital. The City has title to all assets and any subsequent additions, with the exception of certain equipment with a net book value of \$1,685,000 used by the Hospital for laboratory services. The Hospital has exclusive right to the use of the assets and the obligation to maintain and replace them over the term of the lease agreement. The historical cost of the leased facilities is included with the Hospital's property, plant, and equipment (see Note 4) and the general obligation bonds related to the leased facilities are included with the Hospital's long-term debt (see Note 5). The lease agreement does not provide for lease payments; however, a determination is made annually as to the amount of Hospital funds which can, consistent with sound financial management, be turned over to the City. Historically, these payments have not been material to the Hospital's financial statements. The lease agreement expires in 2063 .

Total rent expense on operating leases for property and equipment approximated \$2,424,000 and \$2,118,000 in 2006 and 2005, respectively.

***Litigation and Potential Risks***—The Hospital is subject to various regulatory investigations, legal proceedings, and claims which are incidental to its normal business activities.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. Compliance with such laws and regulations can be subject to future government review and interpretation as well as significant regulatory action, including fines, penalties and potential exclusion from the Medicare and Medicaid programs. As a result, there is a reasonable possibility that recorded estimated third-party settlements and related reserves could change by a material amount.

The Hospital believes it has made adequate provision for potential exposures relating to its legal and regulatory matters. In the opinion of the management, the amount of ultimate liability with respect to these actions will not materially affect the financial position or results of operations of the Hospital.

***Insurance Coverage***—The Hospital is a qualified healthcare provider as defined by Wisconsin state statute and has professional liability insurance with limits of \$1,000,000 per incident and \$3,000,000 in aggregate for claims incurred during a policy year, regardless of when the claim is reported (occurrence coverage). Losses in excess of these amounts are fully covered through mandatory participation in the State of Wisconsin Injured Patients and Families Compensation Fund.

Aurora Liability Assurance, Ltd., a wholly owned subsidiary of Aurora, assumes the primary medical professional liability and general liability risks of Aurora and its affiliates, including the Hospital, through a reinsurance agreement with insurance companies. The Hospital is allocated premium expense based on loss experience and estimated total exposure.

The Hospital is commercially insured for workers' compensation stop-loss; auto; property, boiler and machinery; and directors and officers liability. There are no assurances that the Hospital will be able to renew existing policies or procure coverage on similar terms in the future.

\* \* \* \* \*