

# West Allis Memorial Hospital, Inc.

Financial Statements as of and for the  
Years Ended December 31, 2012 and 2011,  
and Independent Auditors' Report

# WEST ALLIS MEMORIAL HOSPITAL, INC.

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## INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying financial statements of West Allis Memorial Hospital, Inc. (the Hospital), an affiliate of Aurora Health Care, Inc. (Aurora), which comprise the balance sheets as of December 31, 2012 and 2011, and the related statements of operations and changes in net assets, and cash flows for the years then ended, and the related notes to the financial statements.

### Management's Responsibility for the Financial Statements

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

### Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

### Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of West Allis Memorial Hospital, Inc. as of December 31, 2012 and 2011, and the

results of its operations, changes in its net assets, and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

**Emphasis of Matter**

As discussed in Note 1 to the financial statements, the financial statements present the financial position, results of operations, and cash flows of the Hospital and are not necessarily indicative of what the financial position, results of operations, and cash flows would have been if the Hospital had been operated as an unaffiliated corporation during the periods presented. Certain expenses represent allocations from Aurora. Our opinion is not modified with respect to this matter.

*Deloitte & Touche LLP*

May 30, 2013

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## BALANCE SHEETS AS OF DECEMBER 31, 2012 AND 2011 (In thousands)

	2012	2011
<b>ASSETS</b>		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 84	\$ 107
Investments	-	4
Accounts receivable — net of allowance for doubtful accounts of \$17,923 and \$14,795, respectively	33,932	30,273
Other receivables	628	1,142
Inventory	3,036	3,141
Prepays and other current assets	589	614
Due from affiliates	256,463	214,732
Total current assets	<u>294,732</u>	<u>250,013</u>
PROPERTY, PLANT, AND EQUIPMENT — Net	<u>92,692</u>	<u>97,657</u>
OTHER ASSETS:		
Due from affiliates	85,725	79,659
Investments in unconsolidated entities	1,616	1,616
Other	3,254	2,757
Total other assets	<u>90,595</u>	<u>84,032</u>
<b>TOTAL</b>	<u><u>\$ 478,019</u></u>	<u><u>\$ 431,702</u></u>
<b>LIABILITIES AND NET ASSETS</b>		
CURRENT LIABILITIES:		
Current installments of long-term debt	\$ 1,029	\$ 1,072
Accounts payable	10,502	6,955
Accrued salaries and wages	7,832	7,011
Other accrued expenses	1,189	1,221
Due to affiliates	-	7,278
Estimated third-party payor settlements	3,002	3,935
Total current liabilities	23,554	27,472
LONG-TERM DEBT — Less current installments	25,432	26,460
OTHER LONG-TERM LIABILITIES	1,907	1,457
Total liabilities	<u>50,893</u>	<u>55,389</u>
NET ASSETS:		
Unrestricted	426,049	375,302
Temporarily restricted	1,077	1,011
Total net assets	<u>427,126</u>	<u>376,313</u>
<b>TOTAL</b>	<u><u>\$ 478,019</u></u>	<u><u>\$ 431,702</u></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, 2012 AND 2011 (In thousands)

	2012	2011
REVENUE:		
Patient service revenue (net of contractual allowances and discounts)	\$ 252,745	\$ 255,481
Less: provision for bad debts	<u>16,216</u>	<u>12,631</u>
Net patient service revenue less provision for bad debts	236,529	242,850
Other revenue	<u>6,320</u>	<u>6,039</u>
Total revenue	<u>242,849</u>	<u>248,889</u>
EXPENSES:		
Salaries and wages	61,353	60,792
Fringe benefits	22,201	22,644
Professional fees	2,580	2,084
Supplies	32,223	35,579
Depreciation and amortization	9,344	9,252
Interest	1,615	1,665
Maintenance and service contracts	1,708	1,614
Building and equipment rental	1,893	2,255
Hospital tax assessment	9,392	9,879
Utilities	3,157	3,307
Purchased services	3,504	3,334
Management services and operational support	31,725	28,864
Other	<u>11,571</u>	<u>11,418</u>
Total expenses	<u>192,266</u>	<u>192,687</u>
OPERATING INCOME	50,583	56,202
Nonoperating loss - net	<u>(31)</u>	<u>(1)</u>
EXCESS OF REVENUE OVER EXPENSES	50,552	56,201
Transfers from Affiliates - net	169	433
Other	<u>26</u>	<u>152</u>
INCREASE IN UNRESTRICTED NET ASSETS	<u>50,747</u>	<u>56,786</u>
Change in beneficial interest in net assets of foundation	92	(206)
Contributions	-	28
Other	<u>(26)</u>	<u>-</u>
INCREASE (DECREASE) IN TEMPORARILY RESTRICTED NET ASSETS	<u>66</u>	<u>(178)</u>
Total increase in net assets	50,813	56,608
NET ASSETS:		
Beginning of year	<u>376,313</u>	<u>319,705</u>
End of year	<u>\$ 427,126</u>	<u>\$ 376,313</u>

See notes to financial statements.

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011 (In thousands)

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	2012	2011
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Increase in net assets	\$ 50,813	\$ 56,608
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Depreciation and amortization	9,344	9,252
Provision for bad debts	16,216	12,631
Change in beneficial interest in net assets of foundation	(92)	206
Increase in accounts receivable	(19,875)	(15,343)
(Decrease) increase in accounts payable and accrued expenses	4,336	(3,374)
(Decrease) increase in estimated third-party payor settlements	(933)	34
Other changes in assets and liabilities — net	689	(500)
Net cash provided by operating activities	<u>60,498</u>	<u>59,514</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Capital expenditures	(4,379)	(5,113)
Change in investments	4	-
Transfers and amounts due from affiliates — net	<u>(55,075)</u>	<u>(51,854)</u>
Net cash used in investing activities	<u>(59,450)</u>	<u>(56,967)</u>
<b>CASH USED IN FINANCING ACTIVITIES — Repayment of long-term debt</b>	<u>(1,071)</u>	<u>(2,484)</u>
<b>NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	(23)	63
<b>CASH AND CASH EQUIVALENTS:</b>		
Beginning of year	<u>107</u>	<u>44</u>
End of year	<u>\$ 84</u>	<u>\$ 107</u>
<b>SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION — Cash paid for interest</b>	<u>\$ 1,605</u>	<u>\$ 1,680</u>

See notes to financial statements.

# WEST ALLIS MEMORIAL HOSPITAL, INC.

## NOTES TO FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED DECEMBER 31, 2012 AND 2011

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### 1. DESCRIPTION OF ORGANIZATION

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

The Hospital is an affiliate of Aurora Health Care, Inc. (Aurora), a Wisconsin, not-for-profit corporation, which operates to provide a variety of health care related activities, education, philanthropic, medical research, and other benefits to the communities throughout eastern Wisconsin and northern Illinois. Health care services include primary and specialty care, pharmacies, behavioral health care, emergency care, rehabilitation, home care, and end-of-life care. The Aurora system comprises 14 acute-care hospital campuses, one psychiatric hospital, a network of 154 physician clinic facilities, home health services, 70 retail pharmacies, and other health care and related services. Aurora Health Care Metro, Inc. is an affiliate of Aurora and is the sole corporate member of the Hospital.

The accompanying financial statements present the financial position, results of operations, and cash flows of the Hospital and are not necessarily indicative of what the financial position, results of operations, and cash flows would have been if the Hospital had been operated as an unaffiliated corporation during the period presented.

### 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Use of Estimates** — 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, liabilities, revenues, and expenses as of the date and period of the financial statements. Actual results could differ from those estimates.

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

**Accounts Receivable** — 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 is as 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 and outpatient services, defined capital costs, medical education costs, select drugs, 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 reimbursed based on a discount from customary charges, prospectively determined rates per discharge or negotiated fee schedules.

Accounts receivable are stated at net realizable value. Accounts receivable are reduced by a contractual allowance and by an allowance for doubtful accounts. In evaluating the collectibility of accounts receivable, the Hospital analyzes its past history and identifies trends for each of its major payor sources of revenue to estimate the appropriate contractual allowance and allowance for doubtful accounts. Management regularly reviews data about these major payor sources in evaluating the sufficiency of the contractual allowance and allowance for doubtful accounts.

For receivables associated with services provided to patients who have third-party coverage, the Hospital analyzes contractually due amounts and provides a contractual allowance, as well as an allowance for doubtful accounts, if necessary. For receivables associated with self-pay patients, the Hospital records a significant provision for bad debt and charity care in the period of service on the basis of its past experience, which indicates that many patients are unable or unwilling to pay the portion of their bill for which they are financially responsible. The difference between the standard rates (or the discounted rates, if negotiated) and the amounts actually collected after all reasonable collection efforts have been exhausted is recorded as a reduction to the allowance for doubtful accounts.

The Hospital's allowance for doubtful accounts increased from 32.8% of gross accounts receivable less contractual allowances at December 31, 2011, to 34.6% of gross accounts receivable less contractual allowances at December 31, 2012. The Hospital's allowance for doubtful accounts increased \$3,128,000 from \$14,795,000 at December 31, 2011, to \$17,923,000 at December 31, 2012. The increase in the allowance for doubtful accounts was the result of negative trends experienced in the collection of amounts from self-pay patients and rate increases in 2012. The Hospital did not change its charity care or uninsured discount policies during 2012 and 2011. The Hospital does not maintain a material allowance for doubtful accounts from third-party payors and did not have significant write-offs from third-party payors.

The composition of patient accounts receivable, net of contractual allowances (before the allowance for doubtful accounts) is summarized as follows as of December 31:

	2012	2011
Managed care and all other	41 %	42 %
Medicare	12 %	12 %
Medicaid	4 %	3 %
Self-pay	<u>43 %</u>	<u>43 %</u>
	<u>100 %</u>	<u>100 %</u>

**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 are recorded at fair value at date of donation, which is then treated as cost. Interest expense incurred during the period of construction of significant capital projects is capitalized as a component of the cost of the asset. There was no interest capitalized in 2012 and 2011.

Property, plant, and equipment assets are depreciated on the straight-line method over their estimated useful lives, ranging from three to 40 years. Plant and equipment are subject to the lease agreement between the Hospital and the City of West Allis (see Note 7).

The Hospital periodically assesses the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount of an asset or group of assets may not be recoverable. Recoverability of an asset or group 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, a quoted market price, or prices for similar assets. Management considers such factors as current results, trends, and future prospects, in addition to other economic factors, in determining the impairment of an asset. No such impairment adjustments were recorded in 2012 and 2011.

**Investments in Unconsolidated Entities** — Investments in unconsolidated entities are accounted for using the cost or equity method. The Hospital applies the equity method of accounting for joint ventures and for investments with ownership interests of 50% or less, if the Hospital has the ability to exercise significant influence over the operating and financial policies of the investee. All other investees are accounted for using the cost method. Income (loss) on unconsolidated entities is included in nonoperating income (loss), net.

**Fair Value of Financial Instruments** - Except as otherwise disclosed, the carrying value of all financial instruments of the Hospital (including cash and cash equivalents, accounts receivable, advances to and amounts due from affiliates, accounts payable, accrued expenses, and estimated third-party settlements) approximates their fair value due to their short-term maturities at December 31, 2012 and 2011. The fair value of the long-term debt is disclosed in Note 4.

**Deferred Financing Costs and Amortization of Bond Discount** — Long-term debt 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 that approximate the effective interest rate 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.

The Hospital evaluates its uncertain tax positions on an annual basis. A tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. There have been no uncertain tax positions recorded in 2012 or 2011.

**Net Assets** — Restricted net assets are used to differentiate resources, the use of which is limited by the donor or grantor, from unrestricted net assets that arise as a result of the operations of the Hospital. Temporarily restricted net assets consist of donations restricted to various specific purposes by donors. At December 31, 2012 and 2011, temporarily restricted net assets comprise assets held by an unconsolidated foundation for the benefit of the Hospital (see Note 6). Investment income on temporarily restricted net assets is recorded in the applicable category of restricted net assets, if such income is also donor restricted.

**Patient Service Revenue** — Patient service revenue includes amounts from patients, third-party payors, and others for services rendered. The Hospital recognizes patient service revenue associated with services provided to patients who have third-party coverage on the basis of contractual rates for the services provided. In addition, patient service revenue includes 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 patient service revenue by approximately \$2,588,000 in 2012 and \$500,000 in 2011.

The Hospital has filed formal appeals relating to the settlement of certain prior year Medicare cost reports. The ultimate outcome of such appeals cannot be determined at this time. Any resulting gains will be recognized in the statements of operations and changes in net assets when realized.

The Company's payor mix, based upon patient service revenue, net of contractual allowances and discounts (before the provision for bad debts), is as follows for the years ended December 31:

	2012	2011
Managed care	51 %	52 %
Medicare	25 %	25 %
Medicaid	8 %	7 %
Self-pay and other	<u>15 %</u>	<u>16 %</u>
	<u>100 %</u>	<u>100 %</u>

The Hospital historically reported other payors with managed care. During 2012, the Hospital reclassified other payors and included it with self-pay. As a result, the 2011 percentages have been changed to conform with the 2012 presentation.

Due to the nature of the Hospital's patient base, the majority of patients who do not have commercial insurance qualify for Medicare or Medicaid programs, resulting in a very limited amount of self-pay revenue.

Wisconsin legislation assesses a fee or tax on the gross patient revenue. The revenues from this assessment are used to increase payments made to hospitals for services provided to Medicaid and other medically indigent patients. The Hospital's net patient service revenues reflect this increase in payment for services to Medicaid and other medically indigent patients, and hospital tax assessment expense reflects the fee assessed by the State. Patient service revenue during 2012 and 2011 includes \$11,981,000 and \$12,240,000, respectively, related to this program, and expenses include \$9,392,000 and \$9,879,000, respectively, of tax assessment fees.

**Provision for Bad Debt** — For uninsured patients that do not qualify for charity care, the Hospital recognizes revenue on the basis of its standard rates for services provided (or on the basis of discounted rates, if negotiated or provided by policy). On the basis of its historical experience, a significant portion of the Hospital's uninsured will be unwilling or unable to pay for the services provided. In addition, a portion of the Hospital's insured patients will be unwilling or unable to pay the portion of their bill for which they are financially responsible in the period services were provided. The Hospital records a provision for bad debts related to uninsured patients, and related to insured patients for the portion of their bill for which they are financially responsible, in the period services were provided.

**Other Revenue/Expense** — Other revenue primarily comprises revenues from cafeteria sales, rental of hospital space, certain interest income, and other miscellaneous services. Other expense primarily consists of taxes, insurance, and other administrative costs.

**Functional Expenses** – The Hospital provides health care services to residents within its geographic areas. Expenses related to providing these services for the years ended December 31, 2012 and 2011 are as follows (in thousands):

	2012	2011
Health care services	\$ 179,296	\$ 180,489
General and administrative	<u>12,970</u>	<u>12,198</u>
Total	<u>\$ 192,266</u>	<u>\$ 192,687</u>

General and administrative expenses primarily include information technology, legal, finance, purchasing, patient billing, and human resources.

**Nonoperating Income (Losses) — Net** — Revenues and expenses from delivering health care services and other activities that arise from the Hospital’s ongoing major or central operations are reported in operations. Income and losses that arise from transactions that are peripheral or incidental to the Hospital’s main activities, such as income and losses attributable to sales of property, plant, and equipment, are included in nonoperating income (loss), net.

**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. The cost of charity care, estimated based on the Hospital’s specific cost-to-charge ratio, was \$2,246,000 in 2012 and \$1,772,000 in 2011.

**Excess of Revenue over Expenses** — The statements of operations and changes in net assets includes excess of revenue over expenses. Changes in unrestricted net assets that are excluded from excess of revenue over expenses, consistent with industry practice, include permanent transfers of assets to and from affiliates for other than goods and services.

**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 that 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 unfunded status of the Aurora Pension Plan are reported in Aurora’s financial statements. The Hospital’s portion of the pension liability for the unfunded status of the Aurora Pension Plan has not been recorded in the Hospital’s financial statements.

Pension expense reported by the Hospital represented a portion of the total periodic pension costs and was allocated to the Hospital based on guidelines established by the plan administrator. The Hospital’s contribution to the Aurora Pension Plan was \$4,953,000 and \$5,189,000 in 2012 and 2011, respectively, representing 5.2% and 7.6%, respectively, of the total recorded pension expense for the Aurora Pension Plan. At December 31, 2011, the Hospital’s portion of the periodic pension cost is included in due to affiliates on the accompanying balance sheet. There were no amounts due to Aurora at December 31, 2012. At December 31, 2012 and 2011, the projected benefit obligation of the Aurora Pension Plan totaled \$1,450,932,000 and \$1,300,402,000, respectively, and the fair value of the related plan assets totaled \$960,682,000 and \$803,911,000, 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 defined contribution plan sponsored and

administered by Aurora, whereby the Hospital contributes a percentage of participants' qualifying compensation up to certain limits as outlined in the Aurora Savings Plans. The Aurora Savings Plan covers regular full or part-time employees of Aurora and its participating affiliates. The Hospital's expense for the Aurora Savings Plan was \$1,324,000 and \$1,301,000 in 2012 and 2011, respectively.

**Subsequent Events** — For the year ended December 31, 2010, the Hospital has evaluated subsequent events for potential recognition and disclosure through May 30, 2013, the date of financial statement issuance.

**New Accounting Pronouncements** — In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*, which expands existing disclosure requirements for fair value measurements and makes other amendments in order to develop a single, converged fair value framework. The Hospital adopted the provisions of this standard effective December 31, 2012. Adoption of this guidance had no impact on the Hospital's financial statements and minimal impact on the disclosures thereto.

In December 2011, the FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210), Disclosures about Offsetting Assets and Liabilities*. The amendments in ASU 2011-11 require entities to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The disclosure requirements of ASU 2011-11, which are to be applied retrospectively, are effective for the Hospital as of January 1, 2013. The adoption of ASU 2011-11 is not expected to have a material impact on the financial statements of the Hospital.

**Reclassification** — In 2012, the Hospital separately presented other receivables and inventory from other current assets and reclassified the 2011 amounts to conform to the 2012 presentation.

In 2012, the Hospital separately presented investment in unconsolidated entities from other noncurrent assets and reclassified the 2011 amounts to conform to the 2012 presentation.

Certain reclassifications were made to the amounts presented in the consolidated statement of cash flows within net cash provided by operating activities to conform to the 2012 presentation as a result of the balance sheet reclassifications.

In addition, the Hospital revised certain 2011 disclosures from what was previously reported. These revisions include the 2011 disclosure of the allowance for doubtful accounts as a percentage of gross accounts receivable less contractual allowances disclosed in Note 2 and the fixed interest rate range disclosed in Note 4.

### 3. PROPERTY, PLANT, AND EQUIPMENT

The summary of the components of property, plant, and equipment (see Note 7) at December 31, 2012 and 2011 is as follows (in thousands):

	2012	2011
Land and improvements	\$ 2,073	\$ 2,073
Buildings and fixed equipment	195,208	193,450
Movable equipment	50,078	47,562
Construction in progress	<u>-</u>	<u>894</u>
Total property, plant, and equipment	247,359	243,979
Accumulated depreciation	<u>(154,667)</u>	<u>(146,322)</u>
Property, plant, and equipment — net	<u>\$ 92,692</u>	<u>\$ 97,657</u>

### 4. LONG-TERM DEBT

Long-term debt at December 31, 2012 and 2011 is summarized as follows (in thousands):

	2012	2011
Allocated Wisconsin Health and Educational Facilities Authority bonds	\$ 25,975	\$ 26,031
City of West Allis (City) general obligation bonds and promissory notes — net of unamortized discount of \$4 in 2011 (see Note 7)	486	1,001
Notes payable	<u>-</u>	<u>500</u>
Total long-term debt	26,461	27,532
Less current installments	<u>(1,029)</u>	<u>(1,072)</u>
Long-term debt — less current installments	<u>\$ 25,432</u>	<u>\$ 26,460</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, 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 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 2039, 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 and are due in

varying installments through 2013. The rate on these fixed-rate bonds was 3.875% at December 31, 2012, and ranged from 3.7% to 3.875% at December 31, 2011 (see Note 7).

Scheduled maturities on long-term debt at December 31, 2012 are as follows (in thousands):

2013	\$ 1,029
2014	525
2015	547
2016	614
Thereafter	<u>23,746</u>
Total	<u>\$ 26,461</u>

The estimated fair value of long-term debt, based on discounted cash flows at estimated current borrowing rates, approximated \$27,912,000 and \$27,652,000 at December 31, 2012 and 2011, respectively. The fair value of debt is classified as Level 2 within the fair value hierarchy as the fair value was determined based upon inputs other than quoted market prices that are observable either directly or indirectly.

#### **5. 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 \$9,313,000 and \$9,097,000 in 2012 and 2011, 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 \$1,225,000 and \$1,235,000 in 2012 and 2011, respectively, were based on actual claims paid. Such costs are included with fringe benefits in the accompanying financial statements. 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.

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

Aurora has a centralized cash depository and disbursement arrangement as a means of improving investment returns and facilitating the settlement of intercompany balances. The interest on advances to Aurora or expenses on borrowings from Aurora are recorded as an adjustment to the expenses for management services and operational support provided by Aurora to the Hospital. At December 31, 2012 and 2011, the Hospital's portion of Aurora's cash concentration accounts totaled \$342,188,000 and \$294,391,000, respectively. Such amounts are classified as current and noncurrent due from affiliates in the accompanying financial statements in the same proportion as Aurora's consolidated current and noncurrent cash and investments. Amounts advanced by the Hospital to Aurora have been primarily used to fund advances to or investments in the various operating members of the Aurora system. Management of the Hospital believes Aurora and its 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 \$31,725,000 and \$28,864,000 in 2012 and 2011, respectively.

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 \$7,181,000 and \$6,793,000 in 2012 and 2011, 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 an increase in unrestricted net assets of \$169,000 and \$433,000 in 2012 and 2011, respectively.

The Aurora Foundation, Inc. (the Foundation) holds unrestricted assets of \$1,076,000 and \$983,000 at December 31, 2012 and 2011, respectively, that 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 2012 and 2011.

## 7. COMMITMENTS AND CONTINGENCIES

**Lease Agreement** — The Hospital has a non-cancelable 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 \$1,726,000 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 3) and the general obligation bonds related to the leased facilities are included with the Hospital's long-term debt (see Note 4). The agreement provides for annual payments of \$350,000 in lieu of annual lease payments. The lease expires in 2063.

The Hospital also has various non-cancelable operating lease agreements for medical support buildings and equipment, which have remaining fixed terms ranging from one to fourteen years at December 31, 2012. Future minimum lease payments related to these operating leases that have initial or remaining lease terms in excess of one year at December 31, 2012 are as follows (in thousands):

	<b>Future Minimum Lease Payments</b>
2013	\$ 1,983
2014	1,518
2015	848
2016	739
2017	746
Thereafter	<u>3,409</u>
Total	<u>\$ 9,243</u>



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

The Hospital believes it has made adequate provision for potential exposures relating to its legal 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. (ALA), a wholly owned subsidiary of Aurora, assumes the primary medical professional liability and general liability risks of Aurora and its affiliates, including the Hospital. Insurance companies have issued policies covering these liabilities and ceded the risks back to ALA through reinsurance agreements. 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; directors' and officers' liability and other customary business liabilities. There are no assurances that the Hospital will be able to renew existing policies or procure coverage on similar terms in the future.

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