

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

**Reports on State Financial Assistance in
Accordance with Chapter 10.550, State of Florida
*Rules of the Auditor General***

June 30, 2016

EIN: 59-1943502

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

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Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

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Introduction

This section of the Shands Teaching Hospital and Clinics, Inc. and Subsidiaries' ("Shands") annual financial report presents Shands' analysis of its financial performance as of and for the year ended June 30, 2016 with comparative information as of and for the years ended June 30, 2015 and 2014. This discussion has been prepared by management and should be read in conjunction with the consolidated basic financial statements and related note disclosures.

Organization

Shands is an affiliate of the University of Florida ("UF") where by statute the President of UF has the right to appoint and remove members of the Shands Board of Directors. Shands controls or owns various affiliated entities that operate facilities and provide services that are part of Shands.

Shands and certain of its affiliated entities, along with the UF Health Science Center, operate under d/b/a's beginning with "UF Health." The following identifies the significant component operating units and affiliates of Shands and their respective primary operations:

UF Health Shands Hospital is a major tertiary care teaching institution licensed to operate an 875-bed teaching hospital, which provides clinical settings for medical education programs at UF.

UF Health Shands Psychiatric Hospital is a psychiatric and substance abuse facility licensed to operate 81 beds, of which 61 are psychiatric and 20 are substance abuse.

UF Health Shands Rehabilitation Hospital is a 40-bed rehabilitation hospital located on the same campus as UF Health Shands Psychiatric Hospital.

UF Health Shands HomeCare is a hospital-based home care agency providing home care services to the citizens of north central Florida.

Shands Recovery, LLC (d/b/a "UF Health Florida Recovery Center") provides on-site leased housing in conjunction with intensive outpatient addiction treatment for alcohol and drug abuse. The entity was created and received separate outpatient licensure from the State of Florida in December 2014. Prior to incorporation, UF Health Florida Recovery Center was an outpatient department of UF Health Shands Psychiatric Hospital operating under the main hospital license.

Property Management leases properties in Gainesville, Florida.

ElderCare of Alachua County, Inc. provides social and health care support to the elderly in Alachua County.

Southeastern HealthCare Foundation, Inc. provides charitable aid to UF and to Shands and owns and leases various rental properties in Florida.

Joint Ventures: Shands has a 40% minority ownership interest in **Lake Shore HMA, LLC, Starke HMA, LLC, and Live Oak HMA, LLC** which owns or leases three rural community hospitals (Shands Lake Shore located in Lake City, Florida; Shands Starke located in Starke, Florida; and Shands Live Oak located in Live Oak, Florida). Community Health Systems, Inc. ("CHS") is the majority partner and manages the operations of the three facilities. Shands has a 5% minority interest in **Munroe HMA Holdings, LLC (d/b/a "Munroe Regional Medical Center")** which owns a regional medical center located in Ocala, Florida. CHS manages the operations of the facility and is the majority partner.

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Shands has an equal interest in Shands/Solantic Joint Venture, LLC (**d/b/a "CareSpot"**) which owns three walk-in urgent care centers located in Gainesville, Florida. Shands acquired its interest in the second location in February 2015 and the third location in July 2015. CareSpot manages the operations of all facilities. Shands and the University of Florida Development Corporation ("UFDC") are members in **Innovation Square, LLC ("Innovation Square")**. Situated between the UF campus and downtown Gainesville, Innovation Square is a planned mixed-use research neighborhood that advances the national and global profile of UF with Shands and the local biotech industry. Shands' financial interest results from assets transferred to Innovation Square, net of amounts received from UFDC representing their financial interest.

Overview of the Consolidated Basic Financial Statements

Along with management's discussion and analysis, the annual financial report includes the report of independent certified public accountants and the consolidated basic financial statements of Shands. The consolidated basic financial statements also include notes that explain in more detail some of the information in the consolidated basic financial statements. By referring to the accompanying notes to the financial statements, a broader understanding of issues impacting financial performance can be realized.

Required Financial Statements

The required statements are the consolidated basic statements of net position, the consolidated basic statements of revenues, expenses and changes in net position and the consolidated basic statements of cash flows. These statements offer short and long-term financial information about Shands' activities.

The consolidated basic statements of net position reflect all of Shands' assets, liabilities, deferred inflows and outflows and provide information about the nature and amounts of investments in resources (assets) and the obligations to creditors (liabilities). Assets, liabilities and deferred activity are presented in a classified format, which distinguishes between their current and long-term time frame. The difference between the assets plus deferred outflows and liabilities plus deferred inflows is reported as "net position."

The consolidated basic statements of revenues, expenses and changes in net position present the change in net position resulting from revenues earned and expenses incurred. All changes in net position are reported as revenues are earned and expenses are incurred, regardless of the timing of related cash flows.

The consolidated basic statements of cash flows report cash receipts, cash payments, and net changes in cash resulting from operating, financing (capital and non-capital), and investing activities. The purpose of the statements is to reflect the key sources and uses of cash during the reporting period.

Financial Analysis of Shands

Statements of Net Position

The condensed consolidated basic statements of net position included in this Management's Discussion and Analysis present the financial position of Shands as of June 30, 2016, 2015 and 2014 and include all assets, liabilities and deferred inflows and outflows. Net position is one indicator of the current financial condition of Shands. Changes in net position are an indicator of whether the overall financial condition of the organization has improved or worsened over a period of time. They also provide the basis for

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evaluating the capital structure, as well as assessing the liquidity and financial flexibility of Shands. However, the financial statement user should consider other nonfinancial factors, such as changes in economic conditions, population change, regulations, and government legislation affecting the health care industry.

The following table presents Shands' condensed consolidated basic statements of net position as of June 30, 2016, 2015 and 2014:

<i>(in thousands of dollars)</i>	2016	2015	2014
Cash and cash equivalents	\$ 52,930	\$ 33,657	\$ 14,494
Short-term investments	155,191	150,669	122,222
Other current assets	312,046	288,929	289,081
Capital assets, net	848,106	741,104	728,652
Other assets	681,653	807,227	420,436
Total assets	<u>2,049,926</u>	<u>2,021,586</u>	<u>1,574,885</u>
Deferred outflows of resources	<u>160,097</u>	<u>89,878</u>	<u>104,255</u>
Current liabilities	273,255	231,898	181,635
Long-term liabilities	<u>967,975</u>	<u>919,650</u>	<u>660,127</u>
Total liabilities	<u>1,241,230</u>	<u>1,151,548</u>	<u>841,762</u>
Deferred inflows of resources	<u>34,355</u>	<u>89,475</u>	<u>40,950</u>
Net position			
Net investment in capital assets	99,370	60,853	154,382
Restricted			
Nonexpendable	97	97	97
Expendable	9,959	7,646	7,848
Unrestricted	<u>825,012</u>	<u>801,845</u>	<u>634,101</u>
Total net position	<u>\$ 934,438</u>	<u>\$ 870,441</u>	<u>\$ 796,428</u>

Assets and Deferred Outflows of Resources

During 2016, cash and cash equivalents increased by \$19.3 million, or 57.3%. Cash provided by operating activities was \$204.7 million. In addition, cash increased by \$91.9 million due to reimbursement of construction requisitions from a trustee-held project fund. Cash uses included payments of \$63.4 million in support of UF and its medical programs, purchases of capital assets of \$137.8 million, principal and interest payments of \$56.0 million on outstanding debt, and posting of additional collateral of \$13.0 million for certain interest rate swaps. In addition, the Series 2016A Series Bonds were issued to advance refund the Series 2008D1 Bonds and Series 2008D2 Bonds (see "Advance Refunding" on page 10). Short-term investments increased by \$4.5 million, or 3.0%, as funds generated from operations were invested in anticipation of future working capital needs. During 2015, cash and cash equivalents increased by \$19.2 million, or 132.2%. Cash provided by operating activities was \$215.3 million. In addition, cash increased by \$124.1 million due to reimbursement of construction requisitions from a trustee-held project fund. Cash uses included payments of \$67.5 million in support of UF and its medical programs, purchases of capital assets of \$53.4 million, principal and interest payments of \$51.5 million on outstanding debt, and posting of additional collateral of \$7.8 million for certain interest rate swaps. Short-term investments increased by \$28.5 million, or 23.3%, as funds generated from operations were invested in anticipation of future working capital needs.

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Other current assets, including net patient accounts receivable, inventories, prepaid expenses and other current assets, and assets whose use is limited, current portion increased in 2016 by \$23.1 million, or 8.0%. Patient accounts receivable, net increased by \$22.7 million due to a variety of factors including volume growth, increased payment rates driven by higher case mix intensity and lower than expected collections on receivables which resulted in an increase in receivable days outstanding. Inventory balances increased by \$0.9 million. Prepaid expenses and other current assets decreased by \$0.5 million. In 2015, other current assets, including net patient accounts receivable, inventories, prepaid expenses and other current assets, and assets whose use is limited, current portion decreased by \$0.1 million, or 0.1%. Patient accounts receivable, net decreased by \$7.2 million due to improved collections on receivables and a reduction in receivable days outstanding. Inventory balances increased by \$1.3 million. Prepaid expenses and other current assets decreased by \$3.1 million primarily due to a decrease in prepaid service agreements and insurance. Assets whose use is limited, current portion increased by \$8.9 million.

Capital assets, net, increased in 2016 by \$107.0 million, or 14.4% reflecting purchases of \$137.8 million, which included \$104.1 million in construction costs for the new hospitals (see "New Hospitals Project" on page 11). Other capital activity included increases of \$17.0 million in retainage payable and \$9.8 million in capitalized interest, offset by depreciation and amortization expense of \$57.4 million, a net loss of \$0.1 million on disposal of assets, and proceeds of \$0.1 million received from sale of assets. In 2015, capital assets, net, increased by \$12.5 million, or 1.7% reflecting purchases of \$53.4 million, which included \$25.8 million in construction costs for the new hospitals. Other capital activity included assets acquired through installment debt financing of \$3.7 million, and increases of \$6.0 million in retainage payable and \$6.9 million in capitalized interest, offset by depreciation and amortization expense of \$56.6 million, and a net loss of \$0.9 million on disposal of assets.

Other assets decreased in 2016 by \$125.6 million, or 15.6%, primarily due to decreases of \$78.7 million in assets whose use is restricted and \$61.0 million in other assets, partially offset by an increase of \$14.3 million in assets whose use is limited, less current portion. The decrease in assets whose use is restricted is primarily due to a decrease of \$89.6 million in the trustee-held project fund and the application of \$4.3 million of debt service reserve funds towards the advance refunding of the Series 2008D1 Bonds and Series 2008D2 Bonds, partially offset by an increase of \$13.0 million in additional collateral requirements on certain interest rate swaps. The decrease in other assets is primarily due to a decrease of \$54.2 million in the pension asset associated with the defined benefit ("DB") pension plan and a \$17.7 million reduction in the note receivable due from Shands Jacksonville Medical Center, Inc. ("SJMC") (see additional discussion in "Other Changes in Net Position" on page 8), partially offset by an \$11.6 million increase in fair value for interest rate swaps in an asset position. The increase in assets whose use is limited, less current portion is due to increases in board designated funds for capital needs, post-retirement benefits, and other health programs. In 2015, other assets increased by \$386.8 million, or 92.0%, primarily due to an increase of \$205.8 million in assets whose use is restricted, an increase of \$125.2 million in assets whose use is limited, less current portion, and an increase of \$55.8 million in other assets. The increase in assets whose use is restricted, less current portion, is primarily due to bond proceeds of \$322.4 million, partially offset by issuance costs of \$2.7 million and reimbursements of \$124.1 million from the trustee-held portion of the proceeds, and an increase of \$7.8 million in additional collateral requirements related to certain interest rate swaps. The remaining increase in other assets is primarily due to an increase of \$54.2 million in the DB pension plan asset.

Deferred outflows of resources increased in 2016 by \$70.2 million, or 78.1%, primarily due to an increase of \$45.9 million in deferred outflows on pension along with an increase of \$24.4 million in the fair value of the hedged interest rate swaps. The increase in deferred outflows on pension resulted from the net impact of actuarial assumption changes of \$51.1 million (largely due to mortality assumptions) partially offset by actuarial experience of \$3.3 million and a net reduction of \$1.9 million in plan contribution levels.

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In 2015, deferred outflows of resources decreased by \$14.4 million, or 13.8%, primarily due to a decrease of \$20.0 million in deferred outflows on pension due to a reduction in contribution levels and amortization of actuarial losses partially offset by a decrease of \$5.8 million in the fair value of the hedged interest rate swaps.

Liabilities, Deferred Inflows of Resources and Net Position

Current liabilities increased in 2016 by \$41.4 million, or 17.8%, primarily due to increases of \$35.6 million in accounts payable and accrued expenses, \$5.2 million in accrued salaries and leave payable, and \$7.3 million in estimated third-party payor settlements, partially offset by a decrease of \$6.7 million in long-term debt, current portion. The increase in accounts payable and accrued expenses is primarily due to increases in patient volume, the timing of the regular payment cycle, as well as increases in retainage payable and other accrued expenses. The increase in estimated third-party payor settlements is primarily due to changes in estimates to prior year settlement amounts, resulting in increased liabilities. The decrease in long-term debt, current portion is due to the final maturity of the Series 2010B Bonds in December 2015. In 2015, current liabilities increased by \$50.3 million, or 27.7%, primarily due to increases of \$2.8 million in long-term debt, current portion, \$17.4 million in accounts payable and accrued expenses, \$4.1 million in accrued salaries and leave payable, and \$25.9 million in estimated third-party payor settlements. The increase in accounts payable and accrued expenses is primarily due to increases in vendor payables associated with patient volume increases, payroll deduction payables, retainage payable and interest accruals. The increase in estimated third-party payor settlements is primarily due to collection of prior year settlement receivable amounts, which offset settlement liabilities.

Long-term liabilities increased in 2016 by \$48.3 million, or 5.3%, due to an increase of \$26.3 million in fair value adjustments for interest rate swaps in a liability position, and an increase of \$36.0 million in the DB pension plan liability, partially offset by principal payments on debt of \$22.7 million including both current and long-term portions. In 2015, long-term liabilities increased by \$259.5 million, or 39.3%, primarily due to the issuance of \$300.0 million in debt, in addition to a bond premium of \$22.4 million, and an increase of \$5.6 million in the mark-to-market valuations of interest rate swaps. Partially offsetting the increase were principal payments on debt of \$21.5 million (including both current and long-term portions) and a decrease of \$45.4 million in the DB pension plan liability. At June 30, 2015, the position of the plan was an asset.

Deferred inflows of resources decreased in 2016 by \$55.1 million, or 61.6%, due to a decrease of \$47.3 million in deferred inflows on pension due to the net differences between projected and actual earnings on pension plan investments and a decrease of \$7.8 million in the deferred gain on debt refunding primarily due to the advance refunding of the Series 2008D1 Bonds and Series 2008D2 Bonds. In 2015, deferred inflows of resources increased by \$48.5 million, or 118.5%, due to an increase of \$49.4 million in deferred inflows on pension due to the net differences between projected and actual earnings on plan investments of \$70.9 million partially offset by amortization of plan asset gains of \$21.5 million, slightly offset by amortization of deferred gain on debt refunding of \$0.9 million.

Total net position increased in 2016 by \$64.0 million, or 7.4%, due to an excess margin of \$142.1 million, capital contributions of \$0.7 million, and other changes in net position of \$2.3 million, partially offset by transfers and expenditures in support of UF and its medical programs of \$63.4 million and the \$17.7 million reduction in the note due from SJMC. In 2015, total net position increased by \$74.0 million, or 9.3%, due to an excess margin of \$134.3 million and capital contributions of \$6.4 million, partially offset by transfers and expenditures in support of UF and its medical programs of \$66.5 million and other changes in net position of \$0.2 million.

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Statements of Revenues, Expenses and Changes in Net Position

The following table presents Shands' condensed consolidated basic statements of revenues, expenses and changes in net position for the years ended June 30, 2016, 2015 and 2014:

<i>(in thousands of dollars)</i>	2016	2015	2014
Net patient service revenue	\$ 1,337,704	\$ 1,262,058	\$ 1,177,446
Other operating revenue	<u>20,452</u>	<u>18,844</u>	<u>22,343</u>
Total operating revenues	1,358,156	1,280,902	1,199,789
Operating expenses	<u>1,219,170</u>	<u>1,147,499</u>	<u>1,114,346</u>
Operating income	138,986	133,403	85,443
Nonoperating revenues, net	<u>3,148</u>	<u>933</u>	<u>26,510</u>
Excess of revenues over expenses	142,134	134,336	111,953
Other changes in net position			
Transfers and expenditures in support of the University of Florida and its medical programs	(63,416)	(66,533)	(46,175)
Other transfers	(17,688)	-	-
Capital contributions	654	6,433	421
Other changes in net position	<u>2,313</u>	<u>(223)</u>	<u>492</u>
Increase in net position	63,997	74,013	66,691
Net position			
Beginning of year	<u>870,441</u>	<u>796,428</u>	<u>729,737</u>
End of year	<u>\$ 934,438</u>	<u>\$ 870,441</u>	<u>\$ 796,428</u>

In 2016, Shands changed the classification of an amount previously reported as an operating expense, which is more appropriately reported as a nonoperating expense. Accordingly, the 2015 and 2014 balances previously reported in the table above for operating expenses and nonoperating revenues, net, have been decreased by \$1.1 million and \$0.6 million, respectively, to conform with the 2016 presentation. The reclassifications had no impact on excess of revenues over expenses or increase in net position.

Operating Revenues

Total operating revenues increased in 2016 and 2015 by \$77.3 million, or 6.0%, and \$81.1 million, or 6.8%, respectively. The increase in both years was due to increased net patient service revenue.

During 2016, net patient service revenue increased by \$75.6 million, or 6.0%, reflecting increases in admissions of 1.7% and outpatient visits of 7.6%, and an increase of 4.1% in case mix intensity. In 2015, net patient service revenue increased by \$84.6 million, or 7.2%, reflecting increases in admissions of 3.2% and outpatient visits of 4.7%, and modest rate increases from non-governmental payors, partially offset by a decrease of 1.5% in case mix intensity.

Other operating revenue increased in 2016 by \$1.6 million, or 8.5% primarily from organ transplant related services. In 2015, other operating revenue decreased by \$3.5 million, or 15.7%, due in part to a decrease of \$1.7 million in contract pharmacy revenues, an arrangement in which Shands contracts with outside pharmacies to provide pharmacy services. In addition, funding from Medicare and Medicaid related to the electronic health record (EHR) incentive payment program decreased by \$0.9 million.

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The program provides for payments to eligible hospitals over a period of years with payments being phased down over time. Shands qualified for incentive payments for meeting "meaningful use" benchmarks associated with implementation of the EHR. In 2015, Shands received incentive payments of \$1.6 million.

Operating Expenses

Operating expenses increased in 2016 by \$71.7 million, or 6.2%. Salaries and benefits increased by \$42.6 million, or 7.8%. Salaries expense increased by \$15.5 million, or 3.6%, reflecting increases in staffing levels, due to the volume increases, and wage increases. Benefits costs increased by \$27.1 million, or 23.6%, primarily due to a \$25.4 million increase in DB pension expense. The increase in expense was largely due to the implementation of new mortality tables and a decrease in the investment return assumption. Supplies and services increased by \$28.3 million, or 5.2%, resulting from the increased patient volume and cost increases associated with certain drugs. Depreciation and amortization expense increased by \$0.8 million, or 1.3%. In 2015, operating expenses increased by \$33.2 million, or 3.0%. Salaries and benefits decreased by \$3.9 million, or 0.7%. Salaries expense increased by \$15.2 million, or 3.7%, reflecting increases in staffing levels, due to the volume increases, and wage increases. Benefits costs decreased by \$19.1 million, or 14.3%, primarily due to a \$24.1 million decrease in DB pension expense. The reduction in DB pension expense was largely due to better than expected returns on plan assets and the shorter amortization period to amortize those gains under GASB No. 68. Supplies and services increased by \$34.9 million, or 6.8%, resulting from the increased patient volume and cost increases associated with certain drugs. Depreciation and amortization expense increased by \$2.1 million, or 3.9%.

Nonoperating Revenues, net

Nonoperating revenues, net increased in 2016 by \$2.2 million, or 237.4%. Included in this category is investment performance and fair value changes of derivative instruments, which can vary significantly from year to year, and interest expense. Investment income, net increased by \$2.3 million due to increased interest and dividends. The change in fair value of investments increased by \$6.2 million and realized capital gains on investments decreased by \$3.2 million due to variability in the financial markets. The change in fair value of derivative instruments, which include nonhedging interest rate swaps, increased by \$9.5 million. Interest expense decreased by \$2.3 million, largely due to lower bond issuance costs incurred on the Series 2016A Bonds of \$0.2 million compared to the issuance costs incurred on the Series 2014A Bonds and Series 2014B Bonds of \$2.7 million issued in 2015 (see "Issuance of New Debt" on page 10). Loss on disposal of capital assets, net, decreased by \$0.8 million and other nonoperating revenues, net decreased by \$15.7 million. The decrease in other nonoperating revenues was due to lower joint venture results which included a non-cash adjustment of \$6.6 million to the investment balance. In 2015, nonoperating revenues, net decreased by \$25.6 million, or 96.5%. Investment income, net increased by \$3.5 million due to increased interest and dividends. The change in fair value of investments and realized capital gains on investments decreased by \$5.8 million and \$23.5 million, respectively, due to variability in the financial markets. The change in fair value of derivative instruments decreased by \$2.9 million. Interest expense increased by \$4.9 million, largely due to debt issuance costs and interest expense of \$2.7 million and \$2.8 million, respectively, associated with the addition of the Series 2014A Bonds and Series 2014B Bonds. Loss on disposal of capital assets, net, increased by \$0.6 million and other nonoperating revenues, net increased by \$8.6 million.

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Other Changes in Net Position

Transfers and expenditures in support of UF and its medical programs decreased in 2016 by \$3.1 million, or 4.7%. Other transfers increased by \$17.7 million due to the net impact of the transactions with SJMC described below. Capital contributions decreased by \$5.8 million reflecting the release of restrictions in 2015 on \$6.0 million of capital donations previously reflected as temporarily restricted. Other changes in net position increased by \$2.5 million primarily due to temporarily restricted donations received as well as increased pledges. In 2015, transfers and expenditures in support of UF and its medical programs increased by \$20.4 million, or 44.1%. This increase includes \$12.5 million reflected as transfers to UF for the year ended June 30, 2015, which were previously reflected as operating expenses in the consolidated basic financial statements for the year ended June 30, 2014. The funding agreements for these amounts were modified to better reflect the nature of the support provided to UF and as such, have been accounted for as transfers. Capital contributions increased by \$6.0 million reflecting the release of restrictions on capital donations previously reflected as temporarily restricted.

At June 30, 2015, Shands had a note receivable of \$35.8 million due from SJMC. The original note amount was \$42.3 million to be paid in quarterly installments of \$0.8 million including interest of 4.5%, maturing on October 1, 2030. The current portion of the note receivable of \$1.6 million was included within prepaid expenses and other current assets and the long-term portion of the note receivable of \$34.2 million at June 30, 2015 was included within other assets in the accompanying consolidated basic statement of net position. The quarterly payment due July 1, 2015 was made, leaving a net receivable balance of \$35.4 million. On September 30, 2015, after assessment of each organization's financial position, Shands' Board of Directors agreed to reduce the note receivable due from SJMC by \$17.7 million, effective July 1, 2015. Beginning with the payment due on October 1, 2015, quarterly installments of principal and interest were revised to \$0.4 million, with the interest rate and maturity date remaining unchanged. At its meeting on September 28, 2015, the SJMC Board of Directors agreed to the same action.

Previously, SJMC was allowed to pay for its share of electronic medical record system implementation costs over time on an interest-free basis. The amount due from SJMC was \$6.1 million as of June 30, 2015 and was included in prepaid expenses and other current assets in the consolidated basic statement of net position. On September 25, 2015, SJMC offered, and Shands accepted, application of an interest rate of 3% to the monthly amounts outstanding back to July 2011 through June 2015. The impact of this action was to increase prepaid expenses and other current assets and increase net position for interest earned from inception of the arrangement through June 30, 2015 by \$1.6 million.

The net impact of the above actions decreased Shands' net position by \$16.1 million. At June 30, 2016, Shands has a remaining note receivable of \$17.1 million due from SJMC. The current portion of the note receivable of \$0.9 million is included within prepaid expenses and other current assets and the long-term portion of the note receivable of \$16.2 million is included within other assets in the accompanying consolidated basic statement of net position. Amounts related to the electronic medical record system implementation have been paid in full.

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Patient Volumes

The following tables present the associated volumes of each facility on a comparative basis for the years ended 2016, 2015 and 2014.

	2016	2015	Net Change	% Change	2014	Net Change	% Change
Inpatient Admissions (1)							
UF Health Shands Hospital	50,672	50,004	668	1.3%	48,381	1,623	3.4%
UF Health Shands Psychiatric Hospital	3,398	3,207	191	6.0%	3,195	12	0.4%
UF Health Shands Rehab Hospital	1,021	945	76	8.0%	904	41	4.5%
Total	55,091	54,156	935	1.7%	52,480	1,676	3.2%
Outpatient Visits (2)							
UF Health Shands Hospital	933,532	862,991	70,541	8.2%	824,953	38,038	4.6%
UF Health Shands Psychiatric Hospital	1,236	13,183	(11,947)	-90.6%	27,922	(14,739)	-52.8%
UF Health Shands Rehab Hospital	1,131	721	410	56.9%	349	372	106.6%
UF Health Florida Recovery Center (3)	25,381	16,308	9,073	N/A	-	16,308	N/A
Total	961,280	893,203	68,077	7.6%	853,224	39,979	4.7%

(1) Includes observation cases

(2) Includes emergency room and trauma visits

(3) Prior to December 2014, visits were previously reported in UF Health Shands Psychiatric Hospital activity. These amounts are: for the five month period July 1, 2014 - November 30, 2014 (11,324), and fiscal year 2014 (25,886).

During 2016, inpatient admissions increased by 1.7% and outpatient visits increased by 7.6%. During 2015, inpatient admissions increased by 3.2% and outpatient visits increased by 4.7%.

Statements of Cash Flows

The consolidated basic statements of cash flows provide additional information in regard to Shands' financial results by reporting the major sources and uses of cash. During 2016, cash and cash equivalents increased by \$19.3 million, or 57.3%. Cash inflows were primarily a result of cash provided by operating activities of \$204.7 million and reimbursements of \$91.9 million from a trustee-held project fund. Cash outflows include payments of \$63.4 million in support of UF and its medical programs, acquisition of capital assets of \$137.8 million, and principal and interest payments of \$56.0 million on outstanding debt. Shands also funded the DB pension plan by \$2.9 million in excess of pension expense as management proactively works toward improving the plan's funded status.

During 2015, cash and cash equivalents increased by \$19.2 million, or 132.2%. Cash inflows were primarily a result of cash provided by operating activities of \$215.3 million and reimbursements of \$124.1 million from a trustee-held project fund. Cash outflows include payments of \$67.5 million in support of UF and its medical programs, purchases of capital assets of \$53.4 million, and principal and interest payments of \$51.5 million on outstanding debt. Shands also funded the DB pension plan by \$30.2 million in excess of pension expense.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2016 and 2015

Defined Benefit Pension Plan Funded Status

As of June 30, 2016, the funded status (as measured under ERISA funding rules) was 65.7%, down from 75.1% as of June 30, 2015. The reduction in the funded status is largely due to a decrease in the discount rate, from 4.59% at June 30, 2015 to 3.74% at June 30, 2016. To help improve the funded status and lower the costs of plan administration, management offered a lump-sum payment option to terminated vested plan participants. In June 2016, 1,050 plan participants received lump-sum payments totaling \$51.8 million, eliminating \$75.2 million in actuarially determined plan obligations. As of June 30, 2015, the funded status was 75.1%, down slightly from 75.3% as of June 30, 2014.

Advance Refunding

In May 2016, the Alachua County Health Facilities Authority ("Authority") issued the Series 2016A Bonds in the amount of \$46.6 million on behalf of Shands, to advance refund the Series 2008D1 Bonds of \$21.7 million and Series 2008D2 Bonds of \$22.6 million. The proceeds of the Series 2016A Bonds and debt service reserve funds of \$4.4 million were used to purchase U.S. government securities, to be held in an irrevocable trust to meet the debt service on the refunded bonds through December 1, 2018, and to pay issuance costs of \$0.2 million. In connection with the transaction, a deferred outflow of \$7.0 million was recorded (to be amortized over the life of the new debt) which includes the unamortized bond discount of \$0.5 million related to the refunded debt. The interest rate on the Series 2016A Bonds is fixed at 2.15%. Shands advance refunded the Series 2008D1 Bonds and Series 2008D2 Bonds to reduce its total debt service payments over the next 14.5 years by \$10.9 million and to obtain an economic gain (difference between the present value of the debt service on the new debt and the refunded debt) of \$9.2 million.

Issuance of New Debt

In October 2014, the Authority, on behalf of Shands, issued Series 2014A Bonds (\$250.0 million) and Series 2014B Bonds (\$50.0 million) plus bond premium of \$22.4 million. The bond proceeds of \$322.4 million were placed in a trustee-held fund; \$2.7 million of the proceeds were used to pay issuance costs, with \$100.0 million used to reimburse Shands for amounts already expended for capital assets. The remaining proceeds in the trustee-held fund are being used exclusively for the construction of the UF Health Heart and Vascular Hospital and the UF Health Neuromedicine Hospital. The balance of the trustee-held fund was \$107.9 million as of June 30, 2016, reflecting the net impact of reimbursement requests (\$116.1 million) and interest income (\$4.3 million). The Series 2014A bonds are comprised of \$25.4 million in serial bonds maturing on dates in December 2025 through December 2036 at a fixed rate of 5% and \$224.6 million in term bonds with \$50.0 million at a fixed rate of 4% and \$174.6 million at a fixed rate of 5%, maturing in December 2044. The Series 2014B bonds are comprised of \$50.0 million in serial bonds maturing in December 2034 at a fixed rate of 5%. Both of the series are tax exempt and unenhanced.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

June 30, 2016 and 2015

Debt Outstanding

As of June 30, 2016, Shands had \$855.6 million in debt outstanding compared to \$876.6 million at June 30, 2015. Long-term debt is comprised of tax exempt bond issues, taxable notes, and installment debt. Shands utilizes interest rate swaps in order to synthetically convert certain variable rate bonds to fixed rate bonds. Including the effect of the interest rate swaps, 85% of Shands' bonds and notes outstanding are fixed while 15% are variable. The Series 1996A Bonds are fixed rate bonds insured by MBIA. The Series 2007A and Series 2007B Bonds, the Series 2008A Bonds, and the Series 2008C Bonds are variable rate bonds with fixed rate payor interest rate swaps which synthetically convert them to fixed rate bonds. The Series 2014A Bonds, Series 2014B Bonds, and 2016A Bonds are unenhanced fixed rate bonds. The Series 2010A Bonds and the Series 2012A and Series 2012B Bonds are variable rate bonds. The Series 2013A Taxable Notes and the 2012 Bank Note are taxable fixed rate notes.

As of June 30, 2015, Shands had \$876.6 million in debt outstanding compared to \$572.9 million at June 30, 2014. As previously noted, during 2015, Shands incurred an additional \$300.0 million in debt to finance a major construction project (see "New Hospitals Project" below).

New Hospitals Project

Construction is proceeding on the UF Health Heart and Vascular Hospital and the UF Health Neuromedicine Hospital. The new hospitals are being constructed on property adjacent to the UF Health Cancer Hospital on the campus of UF Health Shands Hospital in Gainesville, Florida. This project will include a new 9-floor building with 538,000 gross square feet of space. The building is expected to house the following facilities and services:

- 216 private patient beds, including 120 ICU/IMC beds and 96 acute care beds. Located on the patient floors will be a 6 bay inpatient dialysis suite, rehab therapy gym, CT scanner, satellite pharmacy, and a blood gas lab.
- an operating suite with 10 general ORs, 5 hybrid ORs, 1 intraoperative MRI, 5 Cath labs, 16 recovery bays, 38 pre/post-op rooms, blood dispensing station, and a gross pathology lab.
- ambulatory clinic space for Cardiovascular services and Neuromedicine services, a pre-operative clinic, a blood draw station, neurodiagnostic testing and heart and vascular ancillary services.
- a new radiology department with 3 CT scanners (1 located in neuro ICU), 2 MRIs, 2 general radiology rooms, 1 ultrasound room, and 1 fluoroscopy room.

The estimated cost of this project is \$440 million, excluding financing costs and capitalized interest. The project is expected to be completed and placed in service in the first quarter of calendar 2018. There is no certificate of need approval necessary for this project. Total project costs incurred as of June 30, 2016, excluding financing costs and capitalized interest was \$148.6 million.

Credit Ratings

In November 2015, both Moody's Investor Services ("Moody's") and Standard & Poor's ("S&P") affirmed their previous underlying credit ratings of A3 and A-, respectively. Both Moody's and S&P indicated a "Stable" outlook on all of Shands' rated debt.



Report of Independent Certified Public Accountants

To the Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Report on the Consolidated Basic Financial Statements

We have audited the accompanying consolidated basic financial statements of Shands Teaching Hospital and Clinics, Inc. and Subsidiaries (“Shands”), which comprise the consolidated basic statements of net position as of June 30, 2016 and 2015, and the related consolidated basic statements of revenues, expenses and changes in net position and the consolidated basic statements of cash flows for the years then ended, and the related notes to the consolidated basic financial statements.

Management’s Responsibility for the Consolidated Basic Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated basic 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 consolidated basic financial statements that are free from material misstatement, whether due to fraud or error.

Independent Certified Public Accountants’ Responsibility

Our responsibility is to express an opinion on the consolidated basic financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated basic financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated basic financial statements. The procedures selected depend on our judgment, including the assessment of the risks of material misstatement of the consolidated basic financial statements, whether due to fraud or error. In making those risk assessments, we consider internal control relevant to Shands’ preparation and fair presentation of the consolidated basic 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 Shands’ 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 consolidated basic 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 consolidated basic financial statements referred to above present fairly, in all material respects, the consolidated financial position of Shands Teaching Hospital and Clinics, Inc. and Subsidiaries as of June 30, 2016 and 2015, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

The accompanying Management's Discussion and Analysis ("MD&A") (Unaudited) for the years ended June 30, 2016 and 2015 on pages 1 through 11, the Schedule of Changes in the Net Pension Liability and Related Ratios (Unaudited), and the Schedule of Employer Contributions (Unaudited) on pages 54 and 55, respectively, are required by accounting principles generally accepted in the United States of America to supplement the consolidated basic financial statements. Such information, although not a part of the consolidated basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the consolidated basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the consolidated basic financial statements, and other knowledge we obtained during our audits of the consolidated basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audit was conducted for the purpose of forming an opinion on the consolidated basic financial statements. The consolidating information on pages 56 through 59 is presented for purposes of additional analysis and is not a required part of the consolidated basic financial statements. The information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated basic financial statements or to the consolidated basic financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the consolidating information is fairly stated, in all material respects, in relation to the consolidated basic financial statements taken as a whole.



Our audit was conducted for the purpose of forming an opinion on the consolidated basic financial statements as a whole. The accompanying Schedule of Expenditures of State Financial Assistance for the year ended June 30, 2016 is presented for purposes of additional analysis as required by Chapter 10.550, *Rules of the Auditor General*, and is not a required part of the consolidated basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated basic financial statements or to the consolidated basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of State Financial Assistance is fairly stated, in all material respects, in relation to the consolidated basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 20, 2016 on our consideration of Shands' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters for the year ended June 30, 2016. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Shands' internal control over financial reporting and compliance.

PricewaterhouseCoopers LLP

September 20, 2016

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Net Position
June 30, 2016 and 2015

(in thousands of dollars)

	2016	2015
Assets		
Current assets		
Cash and cash equivalents	\$ 52,930	\$ 33,657
Short-term investments	155,191	150,669
Patient accounts receivable, net of allowance for uncollectibles of \$70,521 and \$55,032, respectively	211,011	188,266
Inventories	15,153	14,217
Prepaid expenses and other current assets	50,680	51,211
Assets whose use is limited, current portion	35,202	35,235
Total current assets	<u>520,167</u>	<u>473,255</u>
Assets whose use is limited, less current portion	433,276	419,022
Assets whose use is restricted	159,135	237,843
Capital assets, net	848,106	741,104
Other assets	89,242	150,362
Total assets	<u>2,049,926</u>	<u>2,021,586</u>
Deferred outflows of resources		
Accumulated decrease in fair value of hedging derivatives	72,224	47,809
Deferred loss on debt refunding	416	496
Deferred outflows on pension	87,457	41,573
Total deferred outflows of resources	<u>160,097</u>	<u>89,878</u>
Liabilities		
Current liabilities		
Long-term debt, current portion	17,034	23,742
Capital lease obligations, current portion	214	199
Accounts payable and accrued expenses	122,330	86,808
Accrued salaries and leave payable	56,677	51,451
Estimated third-party payor settlements	77,000	69,698
Total current liabilities	<u>273,255</u>	<u>231,898</u>
Long-term liabilities		
Long-term debt, less current portion	838,652	852,884
Capital lease obligations, less current portion	756	975
Other liabilities	128,567	65,791
Total long-term liabilities	<u>967,975</u>	<u>919,650</u>
Total liabilities	<u>1,241,230</u>	<u>1,151,548</u>
Commitments and contingencies		
Deferred inflows of resources		
Deferred gain on debt refunding	2,936	10,758
Deferred inflows on pension	31,419	78,717
Total deferred inflows of resources	<u>34,355</u>	<u>89,475</u>
Net position		
Net investment in capital assets	99,370	60,853
Restricted		
Nonexpendable	97	97
Expendable	9,959	7,646
Unrestricted	825,012	801,845
Total net position	<u>\$ 934,438</u>	<u>\$ 870,441</u>

The accompanying notes are an integral part of these consolidated basic financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Revenues, Expenses and Changes in Net
Position
Years Ended June 30, 2016 and 2015

(in thousands of dollars)

	2016	2015
Operating revenues		
Net patient service revenue, net of provision for bad debts of \$135,847 and \$106,003, respectively	\$ 1,337,704	\$ 1,262,058
Other operating revenue	20,452	18,844
Total operating revenues	<u>1,358,156</u>	<u>1,280,902</u>
Operating expenses		
Salaries and benefits	587,434	544,817
Supplies and services	574,379	546,076
Depreciation and amortization	57,357	56,606
Total operating expenses	<u>1,219,170</u>	<u>1,147,499</u>
Operating income	<u>138,986</u>	<u>133,403</u>
Nonoperating revenues (expenses)		
State appropriations	7,050	7,050
Interest expense	(22,966)	(25,235)
Net investment income, including change in fair value	23,006	8,140
Loss on disposal of capital assets, net	(138)	(931)
Other nonoperating (expenses) revenues, net	(3,804)	11,909
Total nonoperating revenues, net	<u>3,148</u>	<u>933</u>
Excess of revenues over expenses before transfers, capital contributions, and other changes in net position	142,134	134,336
Transfers and expenditures in support of the University of Florida and its medical programs	(63,416)	(66,533)
Other transfers	(17,688)	-
Capital contributions	654	6,433
Other changes in net position	2,313	(223)
Increase in net position	<u>63,997</u>	<u>74,013</u>
Net position		
Beginning of year	870,441	796,428
End of year	<u>\$ 934,438</u>	<u>\$ 870,441</u>

The accompanying notes are an integral part of these consolidated basic financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Cash Flows
Years Ended June 30, 2016 and 2015

(in thousands of dollars)

	2016	2015
Cash flows from operating activities		
Cash received from patients and third-party payors	\$ 1,324,154	\$ 1,297,178
Other receipts from operations	16,727	24,016
Salaries and benefits paid to employees	(584,665)	(570,438)
Payments to suppliers and vendors	(551,526)	(535,445)
Net cash provided by operating activities	<u>204,690</u>	<u>215,311</u>
Cash flows from noncapital financing activities		
Payments received on notes receivable	3,049	8,278
Payments in support of the University of Florida and its medical programs	(63,416)	(67,548)
Other transfers, net	-	(2,000)
Donations and pledge receipts	13,059	5,906
Net cash used in noncapital financing activities	<u>(47,308)</u>	<u>(55,364)</u>
Cash flows from capital and related financing activities		
Purchase of capital assets	(137,813)	(53,379)
Proceeds from sale of capital assets	51	13
Proceeds from issuance of long-term debt	46,600	322,351
Debt proceeds deposited in trustee-held project fund	-	(319,691)
Advance refunding of debt	(52,085)	-
Payments of debt issuance costs	(218)	(2,660)
Payments of long-term debt	(22,747)	(21,503)
Interest payments	(33,263)	(29,967)
Posting of collateral on interest rate swaps	(13,029)	(7,792)
Capital contributions	654	6,433
Reimbursement from trustee-held project fund	91,901	124,146
Net cash (used in) provided by capital and related financing activities	<u>(119,949)</u>	<u>17,951</u>
Cash flows from investing activities		
Investment income received	11,444	8,225
Interest in joint venture	-	(1,141)
Purchase of short-term investments and assets whose use is limited	(162,000)	(72,799)
Purchase of assets whose use is restricted	(58,938)	(383,146)
Sale of short-term investments and assets whose use is limited	49,785	113,632
Sale of assets whose use is restricted	144,123	177,401
Other investing activity	(2,574)	(907)
Net cash used in investing activities	<u>(18,160)</u>	<u>(158,735)</u>
Net increase in cash and cash equivalents	19,273	19,163
Cash and cash equivalents		
Beginning of year	<u>33,657</u>	<u>14,494</u>
End of year	<u>\$ 52,930</u>	<u>\$ 33,657</u>

The accompanying notes are an integral part of these consolidated basic financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Cash Flows
Years Ended June 30, 2016 and 2015

(in thousands of dollars)

	2016	2015
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 138,986	\$ 133,403
Adjustments to operating income to net cash provided by operating activities		
Depreciation and amortization	57,357	56,606
Provision for bad debts	135,847	106,003
Changes in:		
Patient accounts receivable	(160,081)	(95,033)
Inventories	(937)	(1,279)
Prepaid expenses and other current assets	16,313	10,235
Other assets	3,008	(35,924)
Accounts payable and accrued expenses	30,008	9,461
Accrued salaries and leave payable	5,226	4,145
Estimated third-party payor settlements	7,302	25,913
Other liabilities	(28,339)	1,781
Total adjustments	<u>65,704</u>	<u>81,908</u>
Net cash provided by operating activities	<u>\$ 204,690</u>	<u>\$ 215,311</u>
Supplemental noncash investing, capital and financing activities		
Capital assets financed through capital lease and installment debt	\$ -	\$ 3,653

The accompanying notes are an integral part of these consolidated basic financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

1. Organization

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries (“Shands”) was incorporated on October 15, 1979 as a Florida not-for-profit corporation. The President of the University of Florida (“UF”), or his designee, serves as the President of Shands’ Board of Directors and retains appointment and termination rights over a majority of the members of Shands’ Board of Directors. The President of UF is deemed a state official as the position is appointed by a Board of Trustees that govern UF (the “UF Board”), and the members of the UF Board are appointed by the Governor and the Board of Governors of the State of Florida.

University of Florida Health or “UF Health” encompasses the UF Health Science Center and Shands. Shands and certain of its affiliated entities operate under d/b/a’s beginning with “UF Health.”

The accompanying consolidated basic financial statements blend the accounts of Shands and its subsidiaries. The following identifies the significant affiliates of Shands and their respective primary operations:

- **UF Health Shands Hospital** is a major tertiary care teaching institution located in Gainesville, Florida, licensed to operate an 875-bed teaching hospital. UF Health Shands Hospital is a leading referral center in the State of Florida and provides clinical settings for medical education programs at UF.
- **UF Health Shands Psychiatric Hospital** is a psychiatric and substance abuse facility located in Gainesville, Florida, licensed to operate 81 beds, of which 61 are psychiatric and 20 are substance abuse.
- **UF Health Shands Rehabilitation Hospital** is a 40-bed rehabilitation hospital located on the same campus as UF Health Shands Psychiatric Hospital.
- **UF Health Shands HomeCare** is a hospital-based home care agency providing home care services to the citizens of north central Florida.
- **Shands Recovery, LLC (d/b/a “UF Health Florida Recovery Center”)** provides on-site leased housing in conjunction with intensive outpatient addiction treatment for alcohol and drug abuse. The entity was created and received separate outpatient licensure from the State of Florida in December 2014. Prior to incorporation, UF Health Florida Recovery Center was an outpatient department of UF Health Shands Psychiatric Hospital operating under the main hospital license.
- **Property Management** leases properties in Gainesville, Florida.
- **ElderCare of Alachua County, Inc. (“ElderCare”)**, a Florida not-for-profit corporation, provides social and health care support to the elderly in Alachua County, Florida, through the operations of a Senior Recreation Center and programs such as Meals on Wheels and an Alzheimer’s Day Care Center. Shands is the sole corporate member of ElderCare.
- **Southeastern HealthCare Foundation, Inc. (“Foundation”)**, a Florida not-for-profit corporation, provides charitable aid to UF and to Shands and owns and leases various rental properties in Florida. Shands is the sole corporate member of the Foundation.

Shands has interests in various joint ventures, fully described in Note 2.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

2. Summary of Significant Accounting Policies

The following is a summary of the significant accounting policies followed by Shands in the presentation of these consolidated basic financial statements:

Basis of Presentation

The accompanying consolidated basic financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America, including all applicable effective statements of the Governmental Accounting Standards Board ("GASB"), on the accrual basis of accounting and include the accounts of Shands and its subsidiaries. Significant intercompany accounts and transactions have been eliminated.

Use of Estimates

The preparation of these consolidated basic 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 amounts reported in the consolidated basic financial statements and accompanying notes. Actual results could differ from those estimates.

Tax Status

Shands and its subsidiaries are exempt from federal income taxes pursuant to Section 501(a) as organizations described in Section 501(c)(3) of the Internal Revenue Code and from state income taxes pursuant to Chapter 220 of the Florida Statutes.

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid instruments with original maturities of three months or less when purchased, except those classified as assets whose use is restricted in the accompanying consolidated basic statements of net position.

Investments

Investments primarily consist of domestic and global fixed income funds, global equity funds, high yield funds, hedge funds, Florida Treasury Investment Pool Special Purpose Investment Account ("SPIA"), and a private equity partnership.

Investments are carried at fair value. Interest, dividends, and gains and losses on investments, both realized and unrealized, are included in nonoperating revenues when earned.

Assets Whose Use is Limited

Assets whose use is limited is comprised of assets designated for specific purposes by the Board of Directors (the "Board"). The Board retains control of these assets and may, at its discretion, subsequently designate their use for other purposes. Amounts required to meet current liabilities are reported as current assets.

Assets Whose Use is Restricted

Assets whose use is restricted primarily include assets held by trustees under indenture agreements and collateral held by a swap counterparty.

Inventories

Inventories consist principally of medical, surgical, and pharmaceutical supplies that are stated at the lower of cost (average cost method) or market.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

Pledges Receivable

Pledges receivable represent donor commitments to provide future funding, primarily in association with various capital construction projects at Shands and are generally due over the next four years. Pledges receivable are recorded net of an estimated reserve for uncollectible pledges. The current portion of pledges receivable is reported in prepaid expenses and other current assets in the accompanying consolidated basic statements of net position. The long-term portion of pledges receivable is reported in other assets in the accompanying consolidated basic statements of net position. For the years ended June 30, 2016 and 2015, pledge discount rates range from 0.6% to 4.8%.

Capital Assets

Capital assets are recorded at historical cost at date of purchase or at the acquisition value at date of donation. Equipment under capital leases is stated at the present value of minimum lease payments at the inception of the lease. Routine maintenance and repairs are expensed when incurred. Expenditures that materially increase the value, change the capacity or extend the useful life of an asset are capitalized. Interest costs incurred on borrowed funds during the period of construction of capital assets are capitalized as a component of the cost of acquiring those assets. Depreciation is computed using the straight-line method over the estimated useful lives of the related depreciable assets as recommended by the American Hospital Association. Equipment under capital leases is amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the related assets. Such amortization is included in depreciation and amortization expense in the accompanying consolidated basic statements of revenues, expenses and changes in net position. Gains and losses on disposition are recorded in the year of disposal and are reported as nonoperating revenues (expenses) in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

Joint Ventures

Shands has a 40% minority interest in Lake Shore HMA, LLC, Starke HMA, LLC, and Live Oak HMA, LLC which owns or leases three rural community hospitals (Shands Lake Shore located in Lake City, Florida; Shands Starke located in Starke, Florida; and Shands Live Oak located in Live Oak, Florida). Community Health Systems, Inc. ("CHS") is the majority partner and manages the operations of the three facilities. Shands accounts for the investment under the equity method of accounting. At June 30, 2016 and 2015, an investment of approximately \$6,545,000 and \$14,304,000, respectively, was recorded in other assets in the accompanying consolidated basic statements of net position. For the years ended June 30, 2016 and 2015, an investment (loss) gain of approximately (\$7,759,000) and \$3,737,000, respectively, was recorded in other nonoperating revenues, net, in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

Shands has a 5% minority interest in Munroe HMA Holdings, LLC which owns a regional medical center (Munroe Regional Medical Center) located in Ocala, Florida. CHS manages the operations of the medical center and is the majority owner. Shands accounts for the investment under the equity method of accounting. At June 30, 2016 and 2015, an investment of approximately \$10,750,000 and \$10,626,000, respectively, was recorded in other assets in the accompanying consolidated basic statements of net position. For the years ended June 30, 2016 and 2015, an investment gain of approximately \$124,000 and \$603,000, respectively, was recorded in other nonoperating revenues, net in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

Shands has an equal interest in Shands/Solantic Joint Venture, LLC (d/b/a "CareSpot") which owns three walk-in urgent care centers located in Gainesville, Florida. Shands acquired its interest in the second location in February 2015 (\$1,141,000) and the third location in July 2015 (\$750,000). CareSpot manages the operations of the three facilities. Shands accounts for the investment under the equity method of accounting. At June 30, 2016 and 2015, an investment of approximately \$1,772,000 and \$1,605,000, respectively, was recorded in other assets in the accompanying consolidated basic statements of net position. For the years ended June 30, 2016 and 2015, an investment gain of approximately \$167,000 and \$122,000, respectively, was recorded in other nonoperating revenues, net in the accompanying consolidated basic statements of revenues, expenses and changes in net position. In addition, a cash distribution of \$750,000 was received for the year ended June 30, 2016.

Shands and the University of Florida Development Corporation ("UFDC") are members in Innovation Square, LLC ("Innovation Square"). Situated between the UF campus and downtown Gainesville, Innovation Square is a planned mixed-use research neighborhood that advances the national and global profile of UF with Shands and the local biotech industry. Shands' financial interest results from capital assets of approximately \$10,158,000 transferred to Innovation Square, net of \$2,000,000 of cash received from UFDC representing their financial interest. Shands accounts for the investment under the cost method of accounting. At June 30, 2016 and 2015, an investment of approximately \$8,158,000 was recorded in other assets in the accompanying consolidated basic statements of net position. For the years ended June 30, 2016 and 2015, no investment income or loss was recorded in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

Accrued Personal Leave

Shands provides accrued time off to eligible employees for vacations, holidays, and short-term illness dependent on their years of continuous service and their payroll classification. Shands accrues the estimated expense related to personal leave based on pay rates currently in effect. Upon termination of employment, employees will have their eligible accrued personal leave paid in varying amounts. Accrued personal leave was approximately \$35,430,000 and \$34,179,000 as of June 30, 2016 and 2015, respectively, and is included in accrued salaries and leave payable in the accompanying consolidated basic statements of net position.

Bond Issuance Costs

Bond issuance costs are expensed at time of issuance. Issuance costs of approximately \$218,000 and \$2,660,000 were expensed for the years ended June 30, 2016 and 2015, respectively.

Bond Premiums and Discounts

Bond premiums and discounts are amortized over the period the bonds are outstanding using the effective interest method.

Long-Term Debt

Long-term debt is comprised of tax exempt bond issues, taxable notes, and installment debt.

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Deferred Outflows and Inflows of Resources

Deferred outflows of resources represent a consumption of net assets that is applicable to a future reporting period. Deferred inflows of resources represent an acquisition of net assets that is applicable to a future reporting period. Deferred outflows of resources have a positive effect on net position, similar to assets, and deferred inflows of resources have a negative effect on net position, similar to liabilities. Notwithstanding those similarities, deferred outflows of resources are not assets and deferred inflows of resources are not liabilities and accordingly are not included in those sections of the accompanying consolidated basic statements of net position, but rather, separately reported.

Derivative Financial Instruments

Shands' derivative financial instruments consist of interest rate swaps, which are utilized by Shands to manage net exposure to interest rate changes associated with its variable rate debt and to lower its overall borrowing costs. Shands entered into the floating to fixed interest rate swap agreements to reduce the market risk associated with the changes in interest rates related to certain of Shands' variable rate revenue bonds. These derivative instruments are evaluated to determine if the derivative instrument is effective in reducing the identified financial risk. If the derivative instrument is determined to be an effective hedge, its fair value is an asset or liability with a corresponding deferred outflow or inflow in the accompanying consolidated basic statements of net position. Deferred outflows or inflows constitute changes in fair value of effectively hedged derivative instruments. If the derivative instrument is determined to be an ineffective hedge or when there is no hedgeable item, the derivative instrument is considered to be an investment derivative; its fair value is recorded in other assets or other liabilities within the consolidated basic statements of net position, and the change in fair value is recognized within net investment income in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

Defined Benefit Pension Plan

For purposes of measuring the net pension liability or asset, deferred outflows of resources and deferred inflows of resources related to the defined benefit plan, and defined benefit pension expense, information about the fiduciary net position of the Shands HealthCare Pension Plan (the "Plan") and additions to /deductions from the Plan's fiduciary net position have been determined on the same basis as they are reported to the Plan. For this purpose, benefit payments are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Net Position

Net position is categorized as "net investment in capital assets," "restricted-nonexpendable," "restricted-expendable," and "unrestricted." Net investment in capital assets is intended to reflect the portion of net position that is associated with capital assets, less outstanding balances due on borrowings used to finance the purchase or construction of those assets. Unspent debt proceeds are excluded from the calculation of net investment in capital assets and are included in unrestricted net position, unless the unspent amounts are externally restricted. Restricted net position has restrictions placed on the use of assets through external constraints imposed by contributors. Restricted-nonexpendable net position consists of assets that have been restricted by donors to be maintained by Shands in perpetuity. Restricted-expendable net position is assets whose use by Shands has been limited by donors to a specific time period or purpose. Unrestricted net position is net assets that do not meet the definition of net investment in capital assets and have no third-party restrictions on use.

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Operating Revenues and Expenses

Shands' consolidated basic statements of revenues, expenses and changes in net position distinguish between operating and nonoperating revenues and expenses. Operating revenues result from exchange transactions associated with providing health care services, Shands' principal activity. Operating expenses are all expenses incurred to provide health care services. State appropriations, interest expense, net investment income, and gain (loss) on disposal of capital assets are reported as nonoperating revenues (expenses). Donations received for the purpose of acquiring or constructing capital assets are recorded below nonoperating revenues as capital contributions.

Net Patient Service Revenue and Patient Accounts Receivable

Shands has agreements with Medicare, Medicaid, and other third-party payors that provide for payments to Shands at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, discounted charges, and per diem payments. Net patient service revenue and patient accounts receivable are reported at estimated net realizable amounts from patients, third-party payors, and others for services rendered and include estimated retroactive revenue adjustments due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered, and such amounts are adjusted in future periods as adjustments become known or as years are no longer subject to such audits, reviews, and investigations. For the years ended June 30, 2016 and 2015, net patient service revenue (decreased) increased by approximately (\$8,385,000) and \$1,500,000, respectively, due to such adjustments.

Laws and regulations governing the Medicare and Medicaid programs are complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

Medicare

Shands participates in the federal Medicare program. Approximately 33% of Shands' net patient service revenue for the years ended June 30, 2016 and 2015 was derived from services to Medicare beneficiaries. Inpatient acute care services rendered to Medicare beneficiaries are reimbursed 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, and defined capital costs related to Medicare beneficiaries are reimbursed based upon a prospective reimbursement methodology. Shands is paid for reimbursable services at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits by the Medicare fiscal intermediary. Shands' classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review. As of June 30, 2016, the Medicare cost reports were final settled by Shands' Medicare fiscal intermediary through June 30, 2006.

It is management's opinion that settlements of outstanding Medicare cost reports, when received, will not vary materially from the estimated amounts, which are recorded as current liabilities in the accompanying consolidated basic statements of net position.

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Medicaid

Approximately 19% of Shands' net patient service revenue for the years ended June 30, 2016 and 2015 was derived under the Medicaid program. Inpatient services rendered to Medicaid program beneficiaries are reimbursed at prospectively determined rates per discharge and outpatient services are reimbursed based upon a cost reimbursement methodology subject to certain ceilings. Shands is reimbursed for outpatient services at a tentative rate with final settlement determined after submission of annual cost reports by Shands, and audits by the Medicaid fiscal intermediary. As of June 30, 2016, the Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 2009. In addition to the prospectively determined rates per discharge and tentative payments received by Shands for the provision of health care services to Medicaid beneficiaries, the State of Florida provides supplemental Medicaid and disproportionate share payments to reflect the additional costs associated with treating the Medicaid population in Florida. These amounts are reflected in net patient service revenue in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

The Agency for Health Care Administration ("AHCA") is the administrator of the Statewide Medicaid Managed Care ("SMMC") Managed Medical Assistance ("MMA") Program in the State of Florida. The MMA program is comprised of several types of managed care plans including Health Maintenance Organizations, Provider Service Networks, and Children's Medical Services Network. The majority of Medicaid recipients are required to enroll in the MMA program.

Shands' Medicaid outpatient interim rates are based on the most recent "as filed" Medicaid cost report. The outpatient rates used for 2016 and 2015 were based on the unaudited cost reports for 2014 and 2013, respectively.

It is management's opinion that settlements of outstanding Medicaid cost reports, when received, will not vary materially from the estimated amounts, which are recorded as current liabilities in the accompanying consolidated basic statements of net position.

Other Third-Party Payors

Shands has also entered into reimbursement agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for reimbursement under these agreements includes prospectively determined rates per discharge, discounts from established charges and prospectively determined per diem rates.

Provision for Bad Debts and Allowance for Uncollectible Accounts

The provision for bad debts is based on management's assessment of historical and expected net collections, considering business and economic conditions, trends in federal and state governmental health care coverage, and other collection indicators. Throughout the year, management assesses the adequacy of the allowance for uncollectible accounts based upon these trends. The results of this review are then used to make any modification to the provision for bad debts to establish an appropriate allowance for uncollectible accounts. Patient accounts receivable are written off after collection efforts have been followed under Shands' policies.

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Electronic Medical Records Incentive Program

Shands received approximately \$593,000 and \$1,574,000 in incentives under the Medicare Electronic Medical Record incentive program as authorized by the Health Information Technology for Clinical Health Act (“HITEC”) for the years ended June 30, 2016 and 2015, respectively. Shands adopted the gain contingency revenue recognition model for HITEC, and recognizes revenue when it demonstrates meaningful use of certified electronic health record technology for the applicable period. Payments received were earned and recognized as other operating revenue in the accompanying consolidated basic statements of revenues, expenses and changes in net position.

Accounting Pronouncements

In June 2015, the GASB issued GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* (“GASB No. 75”). GASB No. 75 addresses accounting and financial reporting for other postemployment plans that are provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. GASB No. 75 is effective for fiscal years beginning after June 15, 2017. Shands is currently evaluating the impact GASB No. 75 will have on its consolidated basic financial statements.

In March 2016, the GASB issued GASB Statement No. 81, *Irrevocable Split-Interest Agreements* (“GASB No. 81”). GASB No. 81 improves accounting and financial reporting by establishing recognition and measurement requirements for irrevocable split-interest agreements which are a specific type of giving arrangement used by donors to provide resources to two or more beneficiaries, including governments. GASB No. 81 is effective for fiscal years beginning after December 15, 2016. Shands is currently evaluating the impact GASB No. 81 will have on its consolidated basic financial statements.

In March 2016, the GASB issued GASB Statement No. 82, *Pension Issues – an Amendment of GASB Statements No. 67, No. 68, and No. 73* (“GASB No. 82”). This Statement addresses specific issues including presentation of payroll related measures in required supplementary information, selection of assumptions, and classification of employer paid member contributions. GASB No. 82 is effective for fiscal years beginning after June 15, 2016. Shands is currently evaluating the impact GASB No. 82 will have on its consolidated basic financial statements.

Reclassifications

Certain amounts in the 2015 consolidated basic financial statements have been reclassified to conform with the 2016 presentation. A reclassification of approximately \$419,022,000 from assets whose use is restricted to assets whose use is limited, less current portion is reflected in the accompanying consolidated basic statements of net position at June 30, 2015 and a reclassification of approximately \$1,093,000 from operating expenses to nonoperating revenues (expenses) is reflected in the accompanying consolidated basic statements of revenues, expenses and changes in net position for the year ended June 30, 2015. The reclassifications did not have an impact on the previously reported net position or increase in net position. Additionally, these reclassifications impacted certain amounts in the accompanying consolidated basic statements of cash flows for the year ended June 30, 2015. However, the reclassifications did not have an impact on the net increase in cash and cash equivalents.

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3. Unsponsored Community Benefit

Community benefit is a planned, managed, organized, and measured approach to a health care organization's participation in meeting identified community health needs. It implies collaboration with a "community" to "benefit" its residents, particularly the poor and other underserved groups, by improving health status and quality of life. Community benefit projects and services are identified by health care organizations in response to findings of a community health assessment, strategic and/or clinical priorities, and partnership areas of attention.

Community benefit categories include financial assistance, community health services, health professions education, research, and donations. Shands has a long history of providing community benefits and has quantified these benefits using national guidelines developed by the Catholic Health Association in collaboration with the Voluntary Hospital Association.

Shands has policies for providing financial assistance for patients requiring care but who have limited or no means to pay for that care. These policies provide free or discounted health and health-related services to persons who qualify under certain income and asset criteria. Because Shands does not pursue collection of amounts determined to qualify for financial assistance, they are not reported as net patient service revenue. Shands maintains records to identify and monitor the level of financial assistance it provides. Charges foregone for services provided under Shands' financial assistance policy as a percentage of total charges for the years ended June 30, 2016 and 2015 were approximately 4.1% and 5.3%, respectively.

In addition to financial assistance, Shands provides benefits for the broader community. The cost of providing these community benefits can exceed the revenue sources available. Examples of the benefits provided by Shands and general definitions regarding those benefits are described below:

- Community health services include activities carried out to improve community health. They extend beyond patient care activities and are usually subsidized by the health care organization. Examples include community health education, counseling and support services, and health care screenings.
- Health professions education includes education provided in clinical settings such as internships and programs for physicians, nurses, and allied health professionals. It also includes scholarships for health professional education related to providing community health improvement services and specialty in-service programs to professionals in the community.
- Research includes studies on health care delivery, unreimbursed studies on therapeutic protocols, evaluation of innovative treatments, and research papers prepared for professional journals.
- Donations include funds and in-kind services benefiting the community-at-large.

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Shands' valuation of unsponsored community benefits at cost for the years ended June 30, 2016 and 2015 is as follows:

<i>(in thousands of dollars)</i>	2016	2015
Financial assistance provided	\$ 50,548	\$ 62,439
Government support applied to charity care	(3,656)	(5,856)
Net unreimbursed financial assistance	<u>46,892</u>	<u>56,583</u>
Benefits for the broader community		
Community health services	6,464	7,436
Health professions education	21,267	28,954
Research	15,702	16,336
Donations	<u>2,724</u>	<u>1,927</u>
Total quantifiable benefits for the broader community	<u>46,157</u>	<u>54,653</u>
Total unsponsored community benefits	<u>\$ 93,049</u>	<u>\$ 111,236</u>

The cost of financial assistance provided was determined by applying Shands' overall cost to charge ratio to total charges foregone. Cost of benefits for the broader community represents actual expenses incurred.

Shands also plays a leadership role in the communities it serves by providing additional community benefits that have not been quantified. This role includes serving as a state designated Level I trauma center in Gainesville, Florida. Shands also maintains air ambulance services at its trauma center, as well as a regional burn intensive care unit to help meet the emergency needs of citizens. Other specialty services provided at Shands' facilities include a transplant center of excellence for adult and pediatric patients in several disciplines including: heart, lung, liver, kidney, pancreas, and bone marrow. In addition, Shands provides specialized pediatric services including neonatal intensive care, pediatric intensive care, pediatric open heart and cardiac catheterization.

In addition to the community benefits described above, Shands provides benefits to the community through advocacy of community service by employees. Shands employees serve numerous organizations through board representation, in-kind and direct donations, fund-raising, youth sponsorship, and other related activities.

4. Investments

Investments are reported in the accompanying consolidated basic statements of net position as follows at June 30, 2016 and 2015:

<i>(in thousands of dollars)</i>	2016	2015
Current assets		
Short-term investments	\$ 155,191	\$ 150,669
Assets whose use is limited, current portion	<u>35,202</u>	<u>35,235</u>
	190,393	185,904
Long-term assets		
Assets whose use is limited, less current portion	433,276	419,022
Assets whose use is restricted	<u>159,135</u>	<u>237,843</u>
	<u>\$ 782,804</u>	<u>\$ 842,769</u>

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Assets whose use is limited include investments internally designated by the Board of Directors and are comprised of the following at June 30, 2016 and 2015:

<i>(in thousands of dollars)</i>	2016	2015
Internally designated by the Board of Directors for:		
Capital improvements and debt service	\$ 459,268	\$ 444,671
Other health programs	6,190	6,537
Other postemployment benefits	3,020	3,049
	<u>468,478</u>	<u>454,257</u>
Less: Current portion	<u>(35,202)</u>	<u>(35,235)</u>
Long-term portion	<u>\$ 433,276</u>	<u>\$ 419,022</u>

Assets whose use is restricted include investments held by trustees, a swap counterparty, and an insurance company with external restrictions and are comprised of the following at June 30, 2016 and 2015:

<i>(in thousands of dollars)</i>	2016	2015
Held by trustees under indenture agreements	\$ 124,094	\$ 215,830
Held by counterparty under swap agreements	34,991	21,963
Held by insurance company under escrow agreement	50	50
	<u>\$ 159,135</u>	<u>\$ 237,843</u>

Shands has an investment management agreement with the University of Florida Investment Corporation (“UFICO”) to manage a portion of its investments. UFICO was created by the UF Trustees for the purpose of managing assets held by UF and its related corporations. Shands’ investments managed by UFICO are invested in the Florida Global Equity Fund, LLC, Florida Global Fixed Income Fund, LLC, Florida Hedged Strategies Fund, LLC, and Florida Short-Term Fund, LP.

The Florida State Treasury operates a special investment program for public entities and is called the Special Purpose Investment Account (“SPIA”). The SPIA funds are combined with State Funds and are invested as part of the Florida Treasury Investment Pool.

Pantheon USA Fund V, L.P. is a private equity fund whose investments include limited partnerships which invest in diversified buyout, growth equity and venture capital portfolios.

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The maturity of investments at June 30, 2016 is as follows:

(in thousands of dollars)

	Investment Maturities					
	Fair Value	Less Than 1 Year	1-5 Years	6-10 Years	More Than 10 Years	N/A
Fixed income mutual funds	\$ 45,747	\$ 8,199	\$ -	\$ 37,548	\$ -	\$ -
Fixed income high yield fund	41,434	-	-	-	-	41,434
Florida Short-Term Fund, LP	82,230	-	-	-	-	82,230
Florida Global Fixed Income Fund, LLC	185,826	-	-	-	-	185,826
Florida Global Equity Fund, LLC	135,455	-	-	-	-	135,455
Florida Hedged Strategies Fund, LLC	23,573	-	-	-	-	23,573
SPIA	230,607	-	230,607	-	-	-
Pantheon USA Fund V, L.P.	1,463	-	-	-	-	1,463
Commercial paper and money market funds	1,478	1,478	-	-	-	-
Collateral on deposit with swap counterparty	34,991	34,991	-	-	-	-
	<u>\$ 782,804</u>	<u>\$ 44,668</u>	<u>\$ 230,607</u>	<u>\$ 37,548</u>	<u>\$ -</u>	<u>\$ 469,981</u>

The maturity of investments at June 30, 2015 is as follows:

(in thousands of dollars)

	Investment Maturities					
	Fair Value	Less Than 1 Year	1-5 Years	6-10 Years	More Than 10 Years	N/A
Fixed income mutual funds	\$ 43,978	\$ 8,137	\$ -	\$ 35,841	\$ -	\$ -
Fixed income high yield fund	42,029	-	-	-	-	42,029
Florida Short-Term Fund, LP	80,562	-	-	-	-	80,562
Florida Global Fixed Income Fund, LLC	180,122	-	-	-	-	180,122
Florida Global Equity Fund, LLC	126,547	-	-	-	-	126,547
Florida Hedged Strategies Fund, LLC	25,036	-	-	-	-	25,036
SPIA	318,815	-	318,815	-	-	-
Pantheon USA Fund V, L.P.	2,313	-	-	-	-	2,313
Commercial paper and money market funds	1,404	1,404	-	-	-	-
Collateral on deposit with swap counterparty	21,963	21,963	-	-	-	-
	<u>\$ 842,769</u>	<u>\$ 31,504</u>	<u>\$ 318,815</u>	<u>\$ 35,841</u>	<u>\$ -</u>	<u>\$ 456,609</u>

Investment Risk Factors

There are many factors that can affect the value of investments. Some, such as concentration of credit risk, custodial credit risk, interest rate risk and foreign currency risk may affect both equity and fixed income securities. Equity securities respond to such factors as economic conditions, individual company earnings performance and market liquidity, while fixed income securities may be sensitive to credit risk and changes in interest rates.

Credit Risk

This is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Shands' investment policy provides guidelines for its fund managers and lists specific allowable investments. The policy provides for the utilization of varying styles of managers so that portfolio diversification is maximized and total portfolio efficiency is enhanced.

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The credit risk profile of Shands' investments as of June 30, 2016 is as follows:

(in thousands of dollars)

	Fair Value	Ratings			
		AAA	AA	Af	N/A
Fixed income mutual funds	\$ 45,747	\$ -	\$ -	\$ -	\$ 45,747
Fixed income high yield fund	41,434	-	-	-	41,434
Florida Short-Term Fund, LP	82,230	-	-	-	82,230
Florida Global Fixed Income Fund, LLC	185,826	-	-	-	185,826
Florida Global Equity Fund, LLC	135,455	-	-	-	135,455
Florida Hedged Strategies Fund, LLC	23,573	-	-	-	23,573
SPIA	230,607	-	-	230,607	-
Pantheon USA Fund V, L.P.	1,463	-	-	-	1,463
Commercial paper and money market funds	1,478	-	-	-	1,478
Collateral on deposit with swap counterparty	34,991	-	-	-	34,991
	<u>\$ 782,804</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 230,607</u>	<u>\$ 552,197</u>

The credit risk profile of Shands' investments as of June 30, 2015 is as follows:

(in thousands of dollars)

	Fair Value	Ratings			
		AAA	AA	Af	N/A
Fixed income mutual funds	\$ 43,978	\$ -	\$ -	\$ -	\$ 43,978
Fixed income high yield fund	42,029	-	-	-	42,029
Florida Short-Term Fund, LP	80,562	-	-	-	80,562
Florida Global Fixed Income Fund, LLC	180,122	-	-	-	180,122
Florida Global Equity Fund, LLC	126,547	-	-	-	126,547
Florida Hedged Strategies Fund, LLC	25,036	-	-	-	25,036
SPIA	318,815	-	-	318,815	-
Pantheon USA Fund V, L.P.	2,313	-	-	-	2,313
Commercial paper and money market funds	1,404	-	-	-	1,404
Collateral on deposit with swap counterparty	21,963	-	-	-	21,963
	<u>\$ 842,769</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 318,815</u>	<u>\$ 523,954</u>

Concentration of Credit Risk

Investments in any one issuer that represent 5% or more of Shands' investment portfolio are required to be disclosed. Investments issued or explicitly guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from this requirement. As of June 30, 2016 and 2015, Shands did not have any investments that equaled or exceeded this threshold.

Custodial Credit Risk

As of June 30, 2016 and 2015, Shands' investments were not exposed to custodial credit risk since the full amount of investments were insured, collateralized, or registered in Shands' name.

Interest Rate Risk

Shands does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates. Refer to the distribution of Shands' investment in fixed income securities by maturity as of June 30, 2016 and 2015.

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Investment income, net for the years ended June 30, 2016 and 2015 is as follows:

<i>(in thousands of dollars)</i>	2016	2015
Dividends, interest and other income	\$ 12,227	\$ 9,862
Realized gains, net	302	3,522
Net increase (decrease) in fair value of investments	768	(5,438)
Net increase in fair value of non-hedging interest rate swaps	9,709	194
Net investment income	<u>\$ 23,006</u>	<u>\$ 8,140</u>

5. Fair Value

Shands categorizes its fair value measurements within the fair value hierarchy established by GASB Statement No. 72, *Fair Value Measurement and Application* ("GASB No. 72") in the three broad levels listed below.

- Level 1 – quoted prices in active markets for identical securities.
- Level 2 – other significant observable inputs (including quoted prices for similar investments, interest rates, credit risks, etc.).
- Level 3 – significant unobservable inputs (including Shands' own assumptions in determining the fair value of investments).

The recurring fair value measurement of investments at June 30, 2016 is as follows:

<i>(in thousands of dollars)</i>	Fair Value	Quoted Prices in Active Markets for Identical Securities (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level				
Fixed income mutual funds	\$ 45,747	\$ 45,747	\$ -	\$ -
Fixed income high yield fund	41,434	-	41,434	-
Total Investments by fair value level	<u>87,181</u>	<u>\$ 45,747</u>	<u>\$ 41,434</u>	<u>\$ -</u>
Investments measured at the net asset value (NAV)				
Florida Short-Term Fund, LP	82,230			
Florida Global Fixed Income Fund, LLC	185,826			
Florida Global Equity Fund, LLC	135,455			
Florida Hedged Strategies Fund, LLC	23,573			
SPIA	230,607			
Pantheon USA Fund V, L.P.	1,463			
Total Investments measured at the NAV	<u>659,154</u>			
Total Investments measured at fair value	746,335			
Other				
Commercial paper and money market funds	1,478			
Cash collateral on deposit with swap counterparty	34,991			
	<u>\$ 782,804</u>			

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The recurring fair value measurement of investments at June 30, 2015 is as follows:

(in thousands of dollars)

	Fair Value	Quoted Prices in Active Markets for Identical Securities (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level				
Fixed income mutual funds	\$ 43,978	\$ 43,978	\$ -	\$ -
Fixed income high yield fund	42,029	-	42,029	-
Total Investments by fair value level	<u>86,007</u>	<u>\$ 43,978</u>	<u>\$ 42,029</u>	<u>\$ -</u>
Investments measured at the NAV				
Florida Short-Term Fund, LP	80,562			
Florida Global Fixed Income Fund, LLC	180,122			
Florida Global Equity Fund, LLC	126,547			
Florida Hedged Strategies Fund, LLC	25,036			
SPIA	318,815			
Pantheon USA Fund V, L.P.	2,313			
Total Investments measured at the NAV	<u>733,395</u>			
Total Investments measured at fair value	<u>819,402</u>			
Other				
Commercial paper and money market funds	1,404			
Cash collateral on deposit with swap counterparty	21,963			
	<u>\$ 842,769</u>			

Fixed income mutual funds classified in Level 1 of the fair value hierarchy are valued at quoted market prices for identical securities in active markets. The fixed income high yield fund classified in Level 2 of the fair value hierarchy is valued at market prices for similar securities in active markets.

Shands' investments in the Florida Global Equity Fund, LLC, Florida Global Fixed Income Fund, LLC, Florida Hedged Strategies Fund, LLC, and Florida Short-Term Fund, LP are measured at the net asset value ("NAV") per share or its equivalent. Florida Global Equity Fund, LLC includes investments in domestic and international securities, and domestic, international, and emerging markets stock funds. Florida Global Fixed Income Fund, LLC includes investments in an intermediate-term Government Bond index fund and corporate bonds. Florida Hedged Strategies Funds, LLC includes investments in domestic and international hedge funds and exchange traded funds. Florida Short-Term Fund, LP includes investments in corporate bonds, U.S. treasuries and U.S. government agencies, and cash and cash equivalents. Shands can redeem its investment in the Florida Short-Term Fund, LP and 90% of the limited liability company investments with 45 days' notice, and under certain conditions, including liquidity needs, can redeem all of its investments with three business days' notice.

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Shands' investment in SPIA is measured at the NAV per share or its equivalent. SPIA invests in a combination of short-term liquid instruments and intermediate fixed income securities. A maximum of 40% can be redeemed with 5 day notice including \$20,000,000 with same day notice. The remaining 60% can be redeemed with 6 month notice. The 6 month notice can be waived by SPIA administration upon request.

Shands' investment in Pantheon USA Fund V, L.P. is measured at the NAV per share or its equivalent. Redemptions are allowable only to the extent of distributions received from the fund's underlying fund investments. It is expected that the underlying assets of the fund will be liquidated over the next 1 to 3 years. The remaining unfunded commitment as of June 30, 2016 is approximately \$330,000.

Shands' interest rate swaps are classified in Level 2 of the fair value hierarchy. The fair values of the fixed rate payer and fixed rate receiver interest rate swaps are estimated using the zero-coupon discounting method. This method calculates the future payments required by the swap, assuming that the current forward rates implied by the yield curve are the market's best estimate of future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for a hypothetical zero-coupon rate bond due on the date of each future net settlement payment on the swaps. The fair values of the 2007A and 2007B total return swaps are estimated by multiplying each swap's notional amount by the difference between the base price and the current fair value of the underlying bonds. As the Series 2007A Bonds and Series 2007B Bonds are not actively trading, to replicate the fair value of these bonds, the prices were implied by applying a credit spread adjustment based on bonds with similar terms and similar issuers that are trading in active markets. Fair value of the interest rate swaps are included in Note 8.

Shands long-term debt is classified in Level 2 of the fair value hierarchy. The fair value of fixed rate debt is estimated based on dealer quotes for hospital taxable and tax-exempt debt with similar terms and maturities and using discounted cash flow analyses based on current interest rates for similar types of borrowing arrangements. The fair value of variable rate debt approximates its carrying value. The carrying value of Shands' long-term debt was approximately \$855,686,000 and \$876,626,000 at June 30, 2016 and 2015, respectively. The fair value was approximately \$879,053,000 and \$857,963,000 at June 30, 2016 and 2015, respectively.

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6. Capital Assets

A summary of changes in capital assets during fiscal years 2016 and 2015 is as follows:

<i>(in thousands of dollars)</i>	Balance at June 30, 2015	Additions	Disposals and Transfers	Balance at June 30, 2016
Land	\$ 49,595	\$ -	\$ (2)	\$ 49,593
Buildings and leasehold improvements	848,684	5,799	-	854,483
Equipment	446,963	17,513	(15,855)	448,621
Totals at historical cost	<u>1,345,242</u>	<u>23,312</u>	<u>(15,857)</u>	<u>1,352,697</u>
Less: Accumulated depreciation for				
Buildings and leasehold improvements	(311,798)	(25,375)	-	(337,173)
Equipment	<u>(346,996)</u>	<u>(31,982)</u>	<u>15,667</u>	<u>(363,311)</u>
	<u>(658,794)</u>	<u>(57,357)</u>	<u>15,667</u>	<u>(700,484)</u>
Construction-in-progress	<u>54,656</u>	<u>156,538</u>	<u>(15,301)</u>	<u>195,893</u>
Capital assets, net	<u>\$ 741,104</u>	<u>\$ 122,493</u>	<u>\$ (15,491)</u>	<u>\$ 848,106</u>

<i>(in thousands of dollars)</i>	Balance at June 30, 2014	Additions	Disposals and Transfers	Balance at June 30, 2015
Land	\$ 47,595	\$ 2,000	\$ -	\$ 49,595
Buildings and leasehold improvements	832,155	18,365	(1,836)	848,684
Equipment	431,119	33,560	(17,716)	446,963
Totals at historical cost	<u>1,310,869</u>	<u>53,925</u>	<u>(19,552)</u>	<u>1,345,242</u>
Less: Accumulated depreciation for				
Buildings and leasehold improvements	(288,044)	(24,872)	1,118	(311,798)
Equipment	<u>(332,752)</u>	<u>(31,734)</u>	<u>17,490</u>	<u>(346,996)</u>
	<u>(620,796)</u>	<u>(56,606)</u>	<u>18,608</u>	<u>(658,794)</u>
Construction-in-progress	<u>38,579</u>	<u>56,466</u>	<u>(40,389)</u>	<u>54,656</u>
Capital assets, net	<u>\$ 728,652</u>	<u>\$ 53,785</u>	<u>\$ (41,333)</u>	<u>\$ 741,104</u>

Depreciation and amortization expense was approximately \$57,357,000 and \$56,606,000 for the years ended June 30, 2016 and 2015, respectively. Amortization expense on equipment under capital leases was approximately \$193,000 for the years ended June 30, 2016 and 2015. Interest costs capitalized were approximately \$9,811,000 and \$6,948,000 for the years ended June 30, 2016 and 2015, respectively. For the years ended June 30, 2016 and 2015, fully depreciated equipment with an original cost of approximately \$14,744,000 and \$16,635,000, respectively, was written-off.

Construction-in-progress at June 30, 2016 consists primarily of costs incurred for the new hospitals located on the main campus of Shands. Retainage and construction payables were approximately \$26,836,000 and \$9,912,000 at June 30, 2016 and 2015, respectively.

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Shands has contracts for the construction and renovation of facilities and equipment purchases. As of June 30, 2016, the remaining commitments related to these contracts were approximately \$155,644,000.

7. Long-Term Debt

Long-term debt is comprised of the following at June 30:

<i>(in thousands of dollars)</i>	2016	2015
Health Facilities Tax Exempt Revenue Bonds		
Series 1996A, final maturity December 2016	\$ 2,855	\$ 5,545
Series 2007A, final maturity December 2037	100,395	100,395
Series 2007B, final maturity December 2037	35,000	35,000
Series 2008A, final maturity December 2037	49,990	49,990
Series 2008C, final maturity October 2028	46,875	50,625
Series 2008D1, final maturity December 2023	-	21,715
Series 2008D2, final maturity December 2030	-	22,625
Series 2010A, final maturity July 2025	51,705	54,886
Series 2010B, final maturity December 2015	-	9,395
Series 2012A, final maturity December 2037	34,320	34,320
Series 2012B, final maturity December 2037	37,500	37,500
Series 2014A, final maturity December 2044	250,000	250,000
Series 2014B, final maturity December 2044	50,000	50,000
Series 2016A, final maturity December 2030	46,600	-
	<u>705,240</u>	<u>721,996</u>
Taxable Notes		
Series 2013A, final maturity December 2042	125,000	125,000
Bank Note Payable, final maturity March 2019	4,100	5,540
	<u>129,100</u>	<u>130,540</u>
Installment debt, final maturity February 2017	<u>681</u>	<u>2,972</u>
	835,021	855,508
Net unamortized bond premium	<u>20,665</u>	<u>21,118</u>
Total long-term debt	855,686	876,626
Less: Current portion	<u>(17,034)</u>	<u>(23,742)</u>
Long-term portion	<u>\$ 838,652</u>	<u>\$ 852,884</u>

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Changes in Shands' long-term debt, excluding unamortized discounts or premiums were as follows:

<i>(in thousands of dollars)</i>	Balance at June 30, 2015	Additions	Reductions	Balance at June 30, 2016	Amounts Due Within One Year
Health Facilities Tax Exempt Revenue Bonds					
Series 1996A, final maturity December 2016	\$ 5,545	\$ -	\$ (2,690)	\$ 2,855	\$ 2,855
Series 2007A, final maturity December 2037	100,395	-	-	100,395	-
Series 2007B, final maturity December 2037	35,000	-	-	35,000	-
Series 2008A, final maturity December 2037	49,990	-	-	49,990	-
Series 2008C, final maturity October 2028	50,625	-	(3,750)	46,875	3,750
Series 2008D1, final maturity December 2023	21,715	-	(21,715)	-	-
Series 2008D2, final maturity December 2030	22,625	-	(22,625)	-	-
Series 2010A, final maturity July 2025	54,886	-	(3,181)	51,705	3,182
Series 2010B, final maturity December 2015	9,395	-	(9,395)	-	-
Series 2012A, final maturity December 2037	34,320	-	-	34,320	1,955
Series 2012B, final maturity December 2037	37,500	-	-	37,500	2,140
Series 2014A, final maturity December 2044	250,000	-	-	250,000	-
Series 2014B, final maturity December 2044	50,000	-	-	50,000	-
Series 2016A, final maturity December 2030	-	46,600	-	46,600	-
Taxable Notes					
Series 2013A, final maturity December 2042	125,000	-	-	125,000	-
Bank Note Payable, final maturity March 2019	5,540	-	(1,440)	4,100	1,460
Installment debt, final maturity February 2017	2,972	-	(2,291)	681	681
Total long-term debt	<u>\$ 855,508</u>	<u>\$ 46,600</u>	<u>\$ (67,087)</u>	<u>\$ 835,021</u>	<u>\$ 16,023</u>

<i>(in thousands of dollars)</i>	Balance at June 30, 2014	Additions	Reductions	Balance at June 30, 2015	Amounts Due Within One Year
Health Facilities Tax Exempt Revenue Bonds					
Series 1996A, final maturity December 2016	\$ 8,075	\$ -	\$ (2,530)	\$ 5,545	\$ 2,690
Series 2007A, final maturity December 2037	100,395	-	-	100,395	-
Series 2007B, final maturity December 2037	35,000	-	-	35,000	-
Series 2008A, final maturity December 2037	49,990	-	-	49,990	-
Series 2008C, final maturity October 2028	54,375	-	(3,750)	50,625	3,750
Series 2008D1, final maturity December 2023	21,715	-	-	21,715	-
Series 2008D2, final maturity December 2030	22,625	-	-	22,625	-
Series 2010A, final maturity July 2025	58,068	-	(3,182)	54,886	3,182
Series 2010B, final maturity December 2015	18,355	-	(8,960)	9,395	9,395
Series 2012A, final maturity December 2037	34,320	-	-	34,320	-
Series 2012B, final maturity December 2037	37,500	-	-	37,500	-
Series 2014A, final maturity December 2044	-	250,000	-	250,000	-
Series 2014B, final maturity December 2044	-	50,000	-	50,000	-
Taxable Notes					
Series 2013A, final maturity December 2042	125,000	-	-	125,000	-
Bank Note Payable, final maturity March 2019	6,940	-	(1,400)	5,540	1,440
Installment debt, final maturity February 2017	1,000	3,653	(1,681)	2,972	2,290
Total long-term debt	<u>\$ 573,358</u>	<u>\$ 303,653</u>	<u>\$ (21,503)</u>	<u>\$ 855,508</u>	<u>\$ 22,747</u>

The current portion of net unamortized bond premium was approximately \$1,011,000 and \$995,000 as of June 30, 2016 and 2015, respectively.

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Maturities of long-term debt including corresponding interest, over the next five years and in five-year increments thereafter are as follows:

(in thousands of dollars)

Year Ending June 30	Debt Service Principal	Debt Service Interest
2017	\$ 16,023	\$ 25,600
2018	15,542	25,495
2019	8,792	25,275
2020	11,562	25,077
2021	11,642	24,877
2022-2026	74,860	121,149
2027-2031	80,345	112,125
2032-2036	203,450	100,466
2037-2041	138,390	78,653
2042-2046	274,415	24,050
	<u>\$ 835,021</u>	<u>\$ 562,767</u>

Cash paid for interest, net of amounts capitalized, was approximately \$23,452,000 and \$23,019,000 for the years ended June 30, 2016 and 2015, respectively.

Shands entered into a Master Trust Indenture (“MTI”) with U.S. Bank, National Association (“U.S. Bank”) which serves as the primary financing document for Shands excluding ElderCare, Foundation, and joint ventures. All of Shands’ long-term debt is covered by the MTI with the exception of installment debt. Under the terms of the MTI, Shands has pledged a security interest in its gross revenues. The MTI provides for specific restrictive covenants, including a debt service coverage requirement. Shands was in compliance with all such restrictive covenants as of June 30, 2016 and 2015.

Series 1996A Health Facilities Revenue Bonds

In April 1996, the Alachua County Health Facilities Authority (“Authority”) issued the Series 1996A Health Facilities Revenue Bonds (“Series 1996A Bonds”) on behalf of Shands. The proceeds of the Series 1996A Bonds were used to finance capital improvement projects and pay related costs of issuance.

The Series 1996A Bonds are fixed rate bonds, which are collateralized by the unconditional and irrevocable guarantee of the Municipal Bond Investors Assurance Corporation. The interest rate on the Series 1996A Bonds is 6.25% and is payable semiannually.

Series 2007A and Series 2007B Health Facilities Revenue Bonds

In March 2007, the Authority issued the Series 2007A Health Facilities Revenue Bonds (“Series 2007A Bonds”) and the Series 2007B Health Facilities Revenue Bonds (“Series 2007B Bonds”) on behalf of Shands. The proceeds of the Series 2007A Bonds were used to finance capital improvement projects and pay related costs of issuance. The proceeds of the Series 2007B Bonds were used to partially refund outstanding principal of the Series 1996A Bonds and pay related costs of issuance.

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The Series 2007A Bonds and Series 2007B Bonds are variable rate bonds based upon 67% of three month London Interbank Offered Rate ("LIBOR") plus 0.87%. The interest rate on the bonds is reset quarterly and the interest rate was 1.32% and 1.06% at June 30, 2016 and 2015, respectively. The Series 2007A Bonds and Series 2007B Bonds maturing on or after June 1, 2017 are redeemable at Shands' option at par value.

Series 2008A Health Facilities Revenue Bonds

In June 2008, the Authority issued the Series 2008A Health Facilities Revenue Bonds ("Series 2008A Bonds") on behalf of Shands. The proceeds of the Series 2008A Bonds were used to retire the Series 2007C Bonds.

The Series 2008A Bonds are variable rate bonds issued in the Unit Pricing Mode. Interest periods range from 1 to 270 days. The weighted average interest rate on the Series 2008A Bonds was 0.44% and 0.10% at June 30, 2016 and 2015, respectively. The Series 2008A Bonds are backed by a bank letter of credit for approximately \$50,709,000 that expires in December 2020. There were no amounts outstanding under this letter of credit at June 30, 2016 and 2015. The Series 2008A Bonds are redeemable at the option of Shands at par value plus accrued interest at any interest payment date.

Series 2008C Health Facilities Revenue Bonds

In November 2008, the Authority issued the Series 2008C Health Facilities Revenue Bonds ("Series 2008C Bonds") on behalf of Shands. The proceeds of the Series 2008C Bonds were used to refund the Series 1996B Bonds and pay related costs of issuance.

The Series 2008C Bonds are variable rate bonds based upon 65% of one month LIBOR plus 1.30%. The interest rate on the Series 2008C Bonds was 1.60% and 1.42% at June 30, 2016 and 2015, respectively.

Series 2008D1 and Series 2008D2 Health Facilities Revenue Bonds

In November 2008, the Authority issued the Series 2008D1 Health Facilities Revenue Bonds ("Series 2008D1 Bonds") and the Series 2008D2 Health Facilities Revenue Bonds ("Series 2008D2 Bonds") on behalf of Shands. The proceeds of the Series 2008D1 Bonds and Series 2008D2 Bonds were used to refund a portion of the Series 2007A Bonds.

In 2016, the Series 2008D1 Bonds and Series 2008D2 Bonds were advance refunded with the proceeds from the issuance of the Series 2016A Health Facilities Revenue Refunding Bonds.

Series 2010A Health Facilities Revenue Bonds

In June 2010, the Authority issued the Series 2010A Health Facilities Revenue Bonds ("Series 2010A Bonds") on behalf of Shands. The proceeds of the Series 2010A Bonds were used to finance capital improvement projects and pay related costs of issuance.

The Series 2010A Bonds are variable rate bonds based upon 65% of one month LIBOR plus 1.105% with a minimum rate floor of 1.29%. The interest rate on the Series 2010A Bonds was 1.40% and 1.29% at June 30, 2016 and 2015, respectively.

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Series 2012A and Series 2012B Health Facilities Revenue Bonds

In December 2012, the Authority issued the Series 2012A Health Facilities Revenue Bonds (“Series 2012A Bonds”) and the Series 2012B Health Facilities Revenue Bonds (“Series 2012B Bonds”) on behalf of Shands. The proceeds of the Series 2012A Bonds and Series 2012B Bonds were used to refund outstanding principal of the Series 2008B Bonds and partially refund outstanding principal of the Series 2008A Bonds.

The Series 2012A Bonds and Series 2012B Bonds are variable rate bonds based upon 67% of one month LIBOR plus 0.85% and 67% of one month LIBOR plus 0.93%, respectively. Prior to July 1, 2015 the variable rate on the Series 2012A Bonds and Series 2012B Bonds were based upon 67% of one month LIBOR plus 0.98% and 67% of one month LIBOR plus 1.05%, respectively. The interest rate on the Series 2012A Bonds and Series 2012B Bonds was 1.16% and 1.24%, respectively, at June 30, 2016 and 1.10% and 1.17%, respectively, at June 30, 2015.

Series 2014A and Series 2014B Health Facilities Revenue Bonds

In October 2014, the Authority issued the Series 2014A Health Facilities Revenue Bonds (“Series 2014A Bonds”) and the Series 2014B Health Facilities Revenue Bonds (“Series 2014B Bonds”) on behalf of Shands. The proceeds of the Series 2014A Bonds and Series 2014B Bonds are being used to finance capital improvement projects and pay related costs of issuance.

The Series 2014A Bonds and Series 2014B Bonds are unenhanced fixed rate bonds. Interest rates on the Series 2014A Bonds range from 4.00% to 5.00% and the interest rate on the Series 2014B Bonds is 5.00% and are payable semiannually. The Series 2014A Bonds and Series 2014B Bonds maturing on or after December 1, 2024 are redeemable at Shands’ option at par value.

Series 2016A Health Facilities Revenue Refunding Bonds

In May 2016, the Authority issued the Series 2016A Health Facilities Revenue Refunding Bonds (“Series 2016A Bonds”) on behalf of Shands. The proceeds of the Series 2016A Bonds were used to advance refund the Series 2008D1 Bonds and Series 2008D2 Bonds and pay related costs of issuance. The interest rate on the Series 2016A Bonds is fixed at 2.15% and is payable quarterly.

Shands advance refunded the Series 2008D1 Bonds and Series D2 Bonds to reduce its total debt service payments over the next 14.5 years by approximately \$10,935,000 and to obtain an economic gain (difference between the present value of the debt service on the new debt and the refunded debt) of approximately \$9,247,000. The advance refunding resulted in the recognition of a deferred outflow of approximately \$7,029,000 which will be amortized over the life of the Series 2016A Bonds.

Series 2013A Taxable Notes

In March 2013, Shands issued the Series 2013A Taxable Notes (“Series 2013A Notes”). The proceeds of the Series 2013A Notes were used to finance capital improvement projects, other business purposes, and pay related costs of issuance.

The interest rate on the Series 2013A Notes is fixed at 4.741% and is payable semiannually.

Bank Note

In 2012, PNC Bank issued a seven year taxable loan to Shands to finance a property purchase, renovations, and equipment. The interest rate on the loan is fixed at 2.08%. Principal and interest payments are payable monthly through final maturity in March 2019.

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8. Interest Rate Swaps

On June 30, 2016 and 2015, Shands had the following derivative instruments outstanding:

(in thousands of dollars)

Item	Type	Objective	Shands Notional Amount	Counterparty Notional Amount	Effective Date	Maturity Date	Terms	2016 Fair Value	2015 Fair Value
1996B	Fixed rate payer interest rate swap	Hedge of changes in cash flows on the Series 1996B Bonds refinanced in 2008	\$ 75,000	\$ 75,000	7/03/2003	12/01/2026	Pay fixed rate of 3.175%. Receive 67% of one month LIBOR.	\$ (10,689)	\$ (8,770)
1996B	Fixed rate receiver interest rate swap	Hedge of changes in cash flows on the 1996B fixed rate payer interest rate swap	\$ 75,000	\$ 75,000	6/03/2009	12/01/2026	Pay SIFMA Municipal Swap Index rate. Receive fixed rate of 3.40%.	\$ 10,902	\$ 9,012
2007A	Fixed rate payer interest rate swap	Hedge of changes in cash flows on the Series 2007A Bonds	\$ 100,395	\$ 100,395	3/30/2007	12/01/2037	Pay fixed rate of 4.349%. Receive 67% of three month LIBOR plus 87 basis points.	\$ (37,341)	\$ (24,511)
2007B	Fixed rate payer interest rate swap	Hedge of changes in cash flows on the Series 2007B Bonds	\$ 35,000	\$ 35,000	3/30/2007	12/01/2037	Pay fixed rate of 4.349%. Receive 67% of three month LIBOR plus 87 basis points.	\$ (11,695)	\$ (7,872)
2007A	Total return interest rate swap	Hedge of changes in cash flows on the Series 2007A Bonds	\$ 27,950	\$ 40,000	1/27/2011	12/01/2019	Pay SIFMA Municipal Swap Index rate plus 100 basis points. Receive 67% of three month LIBOR plus 87 basis points.	\$ 7,748	\$ 3,793
2007A	Total return interest rate swap	Hedge of changes in cash flows on the Series 2007A Bonds	\$ 14,900	\$ 20,000	1/10/2014	12/01/2019	Pay SIFMA Municipal Swap Index rate plus 100 basis points. Receive 67% of three month LIBOR plus 87 basis points.	\$ 2,204	\$ (350)
2007B	Total return interest rate swap	Hedge of changes in cash flows on the Series 2007B Bonds	\$ 24,456	\$ 35,000	1/27/2011	12/01/2019	Pay SIFMA Municipal Swap Index rate plus 100 basis points. Receive 67% of three month LIBOR plus 87 basis points.	\$ 7,035	\$ 3,806
2008A	Fixed rate payer interest rate swap	Hedge of changes in cash flows on the Series 2008A Bonds	\$ 49,990	\$ 49,990	11/07/2007	12/01/2037	Pay fixed rate of 3.538%. Receive 67% of one month LIBOR.	\$ (19,952)	\$ (13,379)
2008C	Fixed rate payer interest rate swap	Hedge of changes in cash flows on the Series 2008C Bonds	\$ 46,875	\$ 46,875	11/05/2008	10/02/2028	Pay fixed rate of 4.18%. Receive 65% of one month LIBOR plus 130 basis points.	\$ (6,032)	\$ (4,844)
								<u>\$ (57,820)</u>	<u>\$ (43,115)</u>

At June 30, 2016, approximately \$27,889,000 and \$85,709,000 and at June 30, 2015, approximately \$16,611,000 and \$59,726,000 related to the fair value of interest rate swaps are recorded in other assets and other liabilities, respectively, in the accompanying consolidated basic statements of net position.

Credit Risk

Shands has sought to limit its counterparty risk. As of June 30, 2016 and 2015, the Moody's and Standard & Poor's credit ratings for the counterparty for the swap agreements, with the exception of the 2007A total return swap agreement effective January 10, 2014 and the 2008C interest rate swap agreement, were Baa2/NR, the Moody's and Standard & Poor's credit ratings for the counterparty of the 2007A total return swap agreement effective January 10, 2014 were A1/A, and the Moody's and Standard & Poor's credit ratings for the counterparty of the 2008C interest rate swap agreement were Baa2/BBB+. The counterparty for all of the swap agreements, with the exception of the 2008A and 2008C interest rate swap agreements, may be required to post

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collateral if the fair value of the interest rate swap is positive and meets certain thresholds. Collateral in the amount of approximately \$11,780,000 and \$4,740,000 was required to be posted by the counterparty with Shands as of June 30, 2016 and 2015, respectively.

Interest Rate Risk

Shands is not exposed to interest rate risk on its fixed rate payer interest rate swap agreements as they are structured in a receive variable, pay fixed rate mode. The 1996B fixed receiver swap is structured in a receive fixed, pay variable rate mode. However, the 1996B fixed receiver swap hedges the cash flows associated with the 1996B fixed payer swap. The 2007A and 2007B total return swaps are structured in a receive variable, pay variable rate mode and hedge the cash flows associated with the Series 2007A Bonds and Series 2007B Bonds.

Basis Risk

Shands is exposed to basis risk on its 2008A fixed rate payer swap agreement because the variable-rate payments received by Shands on the hedging derivative instrument are based on a rate or index other than the interest rates that Shands pays on its hedged variable rate debt, which is remarketed in varying amounts and at various dates. As of June 30, 2016 and 2015, the weighted variable interest rate on Shands' hedged variable rate debt is 0.44% and 0.10%, respectively, while the swap index is 67% of one month LIBOR, or 0.31% and 0.13%, respectively.

Termination Risk

The interest rate swap agreements use the International Swap Dealers Association Master Agreement, which includes standard termination event provisions, such as failure to pay and bankruptcy.

Commitments

Several of Shands' interest rate swap agreements require collateral to be posted if the fair value of the interest rate swap is negative and meets certain thresholds. The threshold amount depends on Shands' unenhanced credit rating as determined by Moody's and Standard & Poor's. Collateral in the amount of approximately \$34,991,000 and \$21,963,000 was required to be posted by Shands with the counterparty as of June 30, 2016 and 2015, respectively.

9. Retirement Benefit Plans

Defined Contribution Plans

Shands sponsors two defined contribution plans that cover eligible employees, the Shands HealthCare Matched Savings Account 403(b) Plan ("403(b) Plan") and the Shands HealthCare Matched Savings Account 401(a) Plan ("401(a) Plan"). Under the provisions of the 403(b) Plan, employees may elect to defer up to 75% of annual compensation (as defined) subject to Internal Revenue Code limitations. Under the 401(a) Plan, Shands makes a non-elective discretionary contribution on behalf of employees (a percentage of compensation based upon years of service) and a matching contribution equal to 75% of the first 4% of compensation that an employee contributes to the 403(b) Plan. Shands' contributions to the 401(a) Plan were approximately \$30,007,000 and \$28,856,000 for the years ended June 30, 2016 and 2015, respectively.

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Defined Benefit Pension Plan

Plan Description

The Shands HealthCare Pension Plan is a single employer defined benefit pension plan covering eligible employees (as defined by the Plan) of Shands Teaching Hospital and Clinics, Inc. (the Plan Sponsor) who were hired as of June 30, 2010. The Plan was subsequently frozen effective July 1, 2013. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 ("ERISA"), as amended. The Plan's stand-alone financial statement is filed with the Internal Revenue Service Form 5500 which is available to the public on the Department of Labor's Employee Benefits Security Administration website.

Benefits Provided

The Plan provides for retirement and death benefits. Retirement benefits are determined based upon varying formulas dependent upon hire date and years of service. For participants hired prior to July 1, 1997, the Plan provided benefits under a traditional benefit formula (1.6% of the employee's 5 highest years average annual compensation times the employee's years of credited service) through July 1, 2011 when the Plan was amended to cease traditional pension benefits. For participants hired as of July 1, 1997 and subsequent new hires through June 30, 2010, and as of July 1, 2011 for participants who were previously receiving benefits under the traditional pension formula, the Plan provided cash balance benefits, with a hypothetical account maintained for each participant in which contributions were credited for the benefit of the individual based on a participant's years of credited vesting service. Participants continued to accrue cash balance benefits through June 30, 2013, when the Plan was amended to cease accrual of cash balance benefits. Employees hired on or after July 1, 2010 receive benefits through the 401(a) Plan.

Benefit terms provide for annual cost-of-living adjustments to retired participants and beneficiaries of participants receiving benefits under the traditional pension formula. Benefit payments are adjusted each October 1 following benefit commencement to reflect the changes in the Consumer Price Index for the twelve months ending the preceding June 30. The increase is limited to 3% per year.

Employees Covered by Benefit Terms

At June 30, 2015, the measurement date for the pension liability, the following employees were covered by the benefit terms:

Participant data as of July 1, 2014

Active	5,403
Terminated vested	4,139
Retired	2,159
	11,701

Contributions

The Plan Sponsor's funding policy is to make contributions to meet the minimum funding requirements of Internal Revenue Code Sections 412(a) and 430 as determined by an independent actuary. Additionally, the Plan Sponsor may contribute an amount above the required contribution. The Plan Sponsor's contributions of approximately \$21,863,000 and \$23,736,000 for the years ended June 30, 2016 and 2015, respectively, meet the minimum funding requirements of ERISA.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Notes to Consolidated Basic Financial Statements
June 30, 2016 and 2015

Net Pension Liability

The Shands' net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of July 1, 2014.

The total pension liability in the July 1, 2014 actuarial valuation was determined using the following actuarial assumptions, applied to all periods in the measurement:

Inflation	2.0%
Investment Rate of Return	6.50%, net of pension plan investment expense, including inflation
Salary increases	N/A

Mortality rates were based upon the RP2014 mortality rates published in 2014 by the Society of Actuaries with future mortality improvement that follows the Mercer Modified MP 2014 mortality improvement scale.

The actuarial assumptions used in the July 1, 2014 valuation related to retirement and termination rates were based on the results of an actual experience study for the period July 1, 2010 through March 31, 2015.

The long-term expected rate of return on pension plan investments was determined using a building block method in which best-estimate ranges of expected real rates of return (expected returns, net of plan investment expenses and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and adding expected inflation. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Target Allocation	Real Rate of Return
Domestic Equity	26.0%	4.55%
International Equity	26.0%	4.75%
Core Fixed Income	12.5%	1.65%
Long Duration Fixed Income	10.0%	1.75%
Long Credit Fixed Income	10.0%	2.50%
High Yield Fixed Income	8.0%	3.45%
Private Equity	7.5%	7.10%
Total	<u>100.0%</u>	

The discount rate used to measure the total pension liability was 6.50%. The projection of cash flows used to determine the discount rate assumed that employer contributions will be made in amounts equal to the actuarially determined contributions. Based on that assumption, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current active and inactive employees. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Notes to Consolidated Basic Financial Statements
June 30, 2016 and 2015

Changes in the net pension liability (asset) are summarized in the following table:

(in thousands of dollars)

	Increase (Decrease)		
	Total Pension Liability (a)	Plan Fiduciary Net Position (b)	Net Pension Liability (Asset) (a)-(b)
Balances at June 30, 2015	\$ 781,620	\$ 835,869	\$ (54,249)
Changes for the year:			
Interest	55,119	-	55,119
Difference between expected and actual experience	402	-	402
Employer contributions	-	23,736	(23,736)
Net investment income	-	27,578	(27,578)
Benefit payments	(42,722)	(42,722)	-
Administrative expense	-	(6,770)	6,770
Changes of assumptions	79,285	-	79,285
Net changes	<u>92,084</u>	<u>1,822</u>	<u>90,262</u>
Balances at June 30, 2016	<u>\$ 873,704</u>	<u>\$ 837,691</u>	<u>\$ 36,013</u>

The recurring fair value measurement of the Plan fiduciary net position at June 30, 2016 is as follows:

(in thousands of dollars)

	Fair Value	Quoted Prices in Active Markets for Identical Securities (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level				
Interest bearing cash	\$ 189	\$ 189	\$ -	\$ -
Fixed income funds	329,601	162,571	167,030	-
Equity funds	257,701	-	257,701	-
Common stock	210,806	210,806	-	-
Total Investments by fair value level	<u>798,297</u>	<u>\$ 373,566</u>	<u>\$ 424,731</u>	<u>\$ -</u>
Investments measured at the NAV				
Private equity funds	35,885			
Total Investments measured at the NAV	<u>35,885</u>			
Total Investments measured at fair value	<u>834,182</u>			
Other				
Other plan net assets, net	3,509			
	<u>\$ 837,691</u>			

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Notes to Consolidated Basic Financial Statements
June 30, 2016 and 2015

The recurring fair value measurement of the Plan fiduciary net position at June 30, 2015 is as follows:

(in thousands of dollars)

	Fair Value	Quoted Prices in Active Markets for Identical Securities (Level 1)	Other Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investments by fair value level				
Interest bearing cash	\$ 79	\$ 79	\$ -	\$ -
Fixed income funds	330,797	262,785	68,012	-
Equity funds	258,870	-	258,870	-
Common stock	206,266	206,266	-	-
Total Investments by fair value level	796,012	\$ 469,130	\$ 326,882	\$ -
Investments measured at the NAV				
Private equity funds	36,422			
Total Investments measured at the NAV	36,422			
Total Investments measured at fair value	832,434			
Other				
Other plan net assets, net	3,435			
	\$ 835,869			

Interest bearing cash, fixed income mutual funds and common stock classified in Level 1 of the fair value hierarchy are valued at quoted market prices for identical assets in active markets. The core fixed income fund, fixed income high yield fund and equity funds classified in Level 2 of the fair value hierarchy are valued at market prices for similar assets in active markets. Private equity funds are measured at the NAV per share or its equivalent.

Sensitivity of the Net Pension Liability (Asset) to Changes in the Discount Rate

The following presents Shands' net pension liability (asset) calculated using the discount rate of 6.50%, as well as the net pension liability (asset) using a discount rate that is 1% lower (5.50%) or 1% higher (7.50%):

(in thousands of dollars)

	1% Decrease (5.50%)	Current Discount Rate (6.50%)	1% Increase (7.50%)
Net pension liability (asset)	\$ 155,004	\$ 36,012	\$ (61,088)

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Notes to Consolidated Basic Financial Statements
June 30, 2016 and 2015

Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Defined Benefit Pension

Shands recognized pension expense (benefit) of approximately \$18,943,000 and (\$6,441,000) for the years ended June 30, 2016 and 2015, respectively. At June 30, 2016, Shands reported deferred outflows of resources and deferred inflows of resources related to defined benefit pension from the following sources:

(in thousands of dollars)

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	\$ 2,471	\$ -
Changes of assumptions	63,123	-
Net differences between projected and actual earnings on pension plan investments	-	31,419
Contributions made during the year ended June 30, 2016 not yet recognized in fiduciary net position	21,863	-
Total	<u>\$ 87,457</u>	<u>\$ 31,419</u>

Amounts reported as deferred outflows of resources and deferred inflows of resources related to defined benefit pension will be recognized in pension expense as follows:

(in thousands of dollars)

Year ending June 30

2017	\$ 12,918
2018	6,648
2019	8,161
2020	6,448
Thereafter	-

Payable to the Defined Benefit Pension Plan

As of June 30, 2016 and 2015, there are no payables to the Plan.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Notes to Consolidated Basic Financial Statements
June 30, 2016 and 2015

10. Commitments and Contingencies

Lease Agreements

Shands entered into a contractual agreement as of July 1, 1980 with the State Board of Education of the State of Florida (the "State Board of Education"), as subsequently restated and amended, which provides for the use of hospital facilities (buildings and improvements) of the patient care and clinical education unit of the J. Hillis Miller Health Center at the University of Florida (the "Health Center") through December 31, 2057, with renewal provisions. The contractual agreement also provided for the transfer to Shands of all other assets and liabilities arising from the operation of the Shands facilities prior to July 1, 1980. At termination of the contractual agreement, the net assets of Shands revert to the State Board of Education. Legal title to all buildings and improvements transferred to Shands remains with the State of Florida during the term of the contractual agreement. The contractual agreement provides for a 12-month grace period for any event of default, other than the bankruptcy of Shands. In addition, the contractual agreement limits the right of the State Board of Education to terminate the contractual agreement solely to the circumstance when Shands declares bankruptcy and, in such event, requires net revenue derived from the operation of the hospital facilities to continue to be applied to the payment of Shands' debts.

Under the terms of the contractual agreement, Shands is obligated to manage, operate, maintain, and insure the hospital facilities in support of the programs of the Health Center, which include the College of Medicine, and further agrees to contract with the State Board of Education for the provision of these programs.

In connection with its minority interest in Lake Shore HMA, LLC, Shands provides a 40% guaranty and CHS provides a 60% guaranty on lease payments to the Lake Shore Hospital Authority. The monthly lease payments are approximately \$45,000 at June 30, 2016 and are subject to annual increases based upon the change in the Consumer Price Index. The lease expires June 30, 2040.

The following is a schedule, by year, of future minimum lease payments under capital and noncancelable operating leases together with the present value of net minimum capital lease payments as of June 30, 2016:

<i>(in thousands of dollars)</i>	Capital Leases	Operating Leases
Year Ending		
2017	\$ 263	\$ 3,888
2018	209	3,731
2019	120	2,624
2020	121	2,523
2021	123	1,998
Thereafter	329	5,002
Total minimum lease payments	1,165	\$ 19,766
Less: Amount representing interest	(195)	
Present value of net minimum lease payments	\$ 970	

Operating lease expense for the rental of property and equipment for the years ended June 30, 2016 and 2015 was approximately \$5,732,000 and \$6,349,000, respectively. At June 30, 2016 and 2015, gross assets under capital leases included in capital assets were approximately \$1,562,000. Accumulated amortization on capital leases as of June 30, 2016 and 2015 was approximately \$601,000 and \$408,000, respectively.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

Commitments

Shands has contracts for the construction and renovation of facilities and equipment purchases. As of June 30, 2016, the remaining commitments relating to these contracts were approximately \$155,644,000 (Note 6).

Shands has contracts for the maintenance of computer application software for its core operating systems. As of June 30, 2016, the remaining commitments relating to these contracts were approximately \$7,222,000.

Risk Management and Professional Liabilities

Shands is exposed to various risks of loss from torts; theft of, damage to, and destruction of assets; business interruption; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and employee health, dental, and accident benefits. Commercial insurance coverage is purchased for claims arising from such matters in excess of self-insured limits. Settled claims have not exceeded this commercial coverage for the years ended June 30, 2016 and 2015.

Effective July 1, 2011, Shands was granted sovereign immunity under the provision of Chapter 2011-114, Laws of Florida, and further codified in 768.28(2), Florida Statutes. As such, recovery in tort actions arising subsequent to June 30, 2011 was limited to \$100,000 for any one person for one incident and all recovery related to one incident was limited to a total of \$200,000. Effective October 1, 2011, the limits increased to \$200,000 for any one person for one incident and \$300,000 in total for one incident.

Shands participates with other health care providers in the University of Florida J. Hillis Miller Health Center Self-Insurance Program ("UFSIP"). UFSIP is an operating unit of the Board of Governors of the State of Florida ("FBOG"). UFSIP provides medical malpractice and general liability occurrence-based coverage to Shands. Insurance in excess of the coverage provided by UFSIP is provided by the University of Florida Healthcare Education Insurance Company ("UFHEIC"). UFHEIC is wholly-owned by FBOG. UFHEIC provides coverage to Shands on a claims reported basis. UFHEIC obtains reinsurance for a substantial portion of the insurance coverage that it provides to the participants in its insurance program. The policies between UFSIP and UFHEIC and Shands are not retrospectively rated. The costs incurred by Shands related to these policies are expensed in the period that coverage is provided.

Shands could be subject to malpractice claims in excess of insurance coverage through UFSIP or UFHEIC; however, the estimated potential loss, if any, cannot be estimated. Management of Shands is not aware of any potential uninsured losses that could materially affect the consolidated financial position of Shands.

Health Insurance

Shands participates with other related party employers controlled by UF including Shands Jacksonville Medical Center ("SJMC"), University of Florida Foundation, Inc. ("UF Foundation"), UFICO, and other eligible employees of the University of Florida in "GatorCare", a premium based plan, to provide health and pharmaceutical coverage to its employees. GatorCare Health Management Corporation ("GCHMC") was incorporated to coordinate and facilitate the management of GatorCare. Premium amounts collected by GCHMC are determined by the level of benefits coverage selected by each employee and to cover administrative costs of the plan. Cash held by GCHMC is largely restricted for payments of health and pharmacy claims of Shands and the related party employers, with the remaining cash available to cover the administrative functions of GCHMC.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

Expenses net of employee contributions related to the health and pharmaceutical plan for the years ended June 30, 2016 and 2015 were approximately \$68,577,000 and \$67,452,000, respectively.

In addition, Shands provides certain other postemployment benefits (“OPEB”) for approximately 1,300 eligible active and retired employees through the Shands Retiree Medical Plan. Many of Shands’ employees may become eligible for those benefits if they reach retirement age while working for Shands. OPEB expense was approximately \$462,000 and \$427,000 for the years ended June 30, 2016 and 2015, respectively. At June 30, 2016 and 2015, the net OPEB obligation of approximately \$3,260,000 and \$2,798,000, respectively, is included in other liabilities in the accompanying consolidated basic statements of net position.

Workers’ Compensation Insurance

Shands is self-insured for workers’ compensation up to \$600,000 per occurrence for the years ended June 30, 2016 and 2015. Shands has purchased excess coverage from a commercial carrier up to the amount allowed by Florida Statutes. Total workers’ compensation expenses for the years ended June 30, 2016 and 2015 were approximately \$1,567,000 and \$1,078,000, respectively.

Litigation

Shands is involved in litigation arising in the normal course of business. After consultation with legal counsel, management believes that these matters will be resolved without material adverse effect on Shands’ future financial position or results of operations.

Other Industry Risks

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. Compliance with these laws and regulations can be subject to government review and interpretation, as well as regulatory actions unknown and unasserted at this time. Federal government activity has increased with respect to investigations and allegations concerning possible violations by health care providers of regulations, which could result in the imposition of significant fines and penalties, as well as significant repayments of previously billed and collected revenue from patient services. There have also been numerous lawsuits filed against nonprofit hospitals related to charity care. These lawsuits allege various hospital practices related to the uninsured, including, among other things, charging uninsured patients more than what insurers would pay for the same services, rapidly rising prices, and aggressive collection policies. Management believes that Shands is in compliance with current laws and regulations and that Shands’ ultimate exposure from any such matters would not have a material effect on Shands’ consolidated basic financial statements.

11. Transactions with Related Parties

Shands has various agreements for services provided by UF for support of the educational, clinical, and research activities of the College of Medicine, maintenance, security, utilities, and various services. Expenses related to these agreements were approximately \$176,494,000 and \$170,720,000 for the years ended June 30, 2016 and 2015, respectively, of which approximately \$63,416,000 and \$66,533,000 for the years ended June 30, 2016 and 2015, respectively, are transfers and expenditures in support of UF and its medical programs included under this caption in the accompanying consolidated basic statements of revenues, expenses and changes in net position. At June 30, 2016 and 2015, approximately \$10,204,000 and \$12,925,000, respectively, was owed to UF under these agreements and is included in accounts payable and accrued expenses in the accompanying consolidated basic statements of net position.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

Shands provides contracted services at cost to UF for support of the clinical and research activities of the College of Medicine, maintenance, utilities, telephone communication, and various other services. The amount credited against expenses for these contracted services was approximately \$91,582,000 and \$82,600,000 for the years ended June 30, 2016 and 2015, respectively. At June 30, 2016 and 2015, approximately \$7,510,000 and \$5,565,000, respectively, was owed to Shands under these agreements and is included in prepaid expenses and other current assets in the accompanying consolidated basic statements of net position.

Shands has an agreement whereby UF provides billing services for emergency room physician fees. UF remits the collections to Shands on a monthly basis less an administrative fee. The amount collected by UF on Shands' behalf less the administrative fee for the years ended June 30, 2016 and 2015 was approximately \$12,384,000 and \$11,862,000, respectively. At June 30, 2016 and 2015, approximately \$1,224,000 and \$1,725,000, respectively, was owed to Shands and is included in prepaid expenses and other current assets in the accompanying consolidated basic statements of net position.

Shands has an investment management agreement with UFICO to manage a portion of its investments. UFICO was created by the UF Trustees for the purpose of managing assets held by UF and its related corporations. As of June 30, 2016 and 2015, the fair value of investments managed by UFICO on Shands' behalf was approximately \$427,084,000 and \$412,267,000, respectively. Investment management fees of approximately \$454,000 and \$350,000 were incurred for the years ended June 30, 2016 and 2015, respectively.

Shands provides contracted services at cost to SJMC for administrative and information technology support services. The amount credited against expenses for these contracted services was approximately \$6,686,000 and \$7,089,000 for the years ended June 30, 2016 and 2015, respectively. At June 30, 2016 and 2015, approximately \$455,000 and \$567,000, respectively, was owed to Shands under these agreements and is included in prepaid expenses and other current assets in the accompanying consolidated basic statements of net position.

SJMC provides organ procurement services for Shands. Expenses related to these services were approximately \$490,000 and \$538,000 for the years ended June 30, 2016 and 2015, respectively.

At June 30, 2016 and 2015, Shands had a note receivable of approximately \$17,071,000 and \$35,777,000, respectively, due from SJMC. The current portion of the note receivable of approximately \$855,000 and \$1,636,000 is included within prepaid expenses and other current assets and the long-term portion of the note receivable of approximately \$16,216,000 and \$34,141,000 at June 30, 2016 and 2015, respectively, is included within other assets in the accompanying consolidated basic statements of net position. The original note amount was approximately \$42,276,000 to be paid in quarterly installments of approximately \$805,000 including interest of 4.5%, maturing on October 1, 2030. The quarterly payment due July 1, 2015 was made, leaving a net balance receivable of approximately \$35,375,000. On September 30, 2015, after assessment of each organization's financial position, Shands' Board of Directors agreed to reduce the note receivable due from SJMC by approximately \$17,688,000, effective July 1, 2015. Beginning with the payment due on October 1, 2015, quarterly installments of principal and interest will be approximately \$402,000, with the interest rate and maturity date remaining unchanged. The reduction in the note receivable of \$17,688,000 was recorded in other transfers in the accompanying consolidated basic statements of revenues, expenses, and changes in net position.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Notes to Consolidated Basic Financial Statements
June 30, 2016 and 2015

At June 30, 2015, Shands had a receivable of approximately \$6,149,000 due from SJMC for its share of electronic medical record system implementation costs which was included within prepaid expenses and other current assets in the consolidated basic statements of net position. In September 2015, an interest rate of 3% was applied to the monthly amounts outstanding from July 2011 through June 2015. In September 2015, Shands recognized interest income of approximately \$1,584,000 from inception through June 2015. The outstanding balance of the receivable and corresponding interest was repaid in full by June 2016.

GCHMC collects monthly premiums from Shands for health and pharmacy insurance coverage for eligible employees. GCHMC pays the health and pharmacy claims on behalf of Shands. Premium expense for the years ended June 30, 2016 and 2015 was approximately \$77,492,000 and \$75,892,000, respectively. At June 30, 2016 and 2015, approximately \$8,651,000 and \$852,000, respectively, was due from GCHMC and is included in other assets in the accompanying consolidated basic statements of net position.

Shands provides administrative services to GCHMC. The amount credited against expenses for these contracted services for the years ended June 30, 2016 and 2015 was approximately \$741,000 and \$282,000, respectively. At June 30, 2016 and 2015, approximately \$165,000 and \$113,000, respectively, was owed to Shands and is included in prepaid expenses and other current assets in the accompanying consolidated basic statements of net position.

Shands provides pharmacy discounts to GCHMC beginning October 2015. The discounts for the year ended June 30, 2016 were approximately \$241,000. At June 30, 2016, approximately \$83,000 was owed to GCHMC and is included in accounts payable and accrued expenses in the accompanying consolidated basic statements of net position.

Shands leases medical and administrative space from Innovation Square. Expense associated with the leased space was approximately \$342,000 and \$327,000 for the years ended June 30, 2016 and 2015, respectively.

Shands entered into a three year pledge commitment to donate \$7,500,000 to the UF Foundation towards the construction of a UF medical education building. Pledge payments of \$2,000,000 annually were made during 2015 and 2014 and \$3,500,000 during 2013.

12. Concentrations of Credit Risk

Shands grants credit without collateral to its patients, many of whom are local residents and are insured under third-party payor agreements. Shands does not charge interest on accounts receivable. The composition of receivables from patients and third-party payors is as follows:

	2016	2015
Medicare (includes HMOs)	28.4%	28.7%
Medicaid (includes HMOs)	18.9%	19.4%
Blue Cross	15.1%	14.9%
Commercial	5.7%	4.9%
Managed Care	24.3%	25.6%
Other third-party payors	7.2%	6.3%
Patients	0.4%	0.2%
	<u>100.0%</u>	<u>100.0%</u>

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Notes to Consolidated Basic Financial Statements

June 30, 2016 and 2015

Concentrations of credit risk with respect to patient accounts receivable are limited to Medicare, Medicaid and various commercial payors.

Shands places its cash and cash equivalents with what management believes to be high-quality financial institutions and thus limits its credit exposure. Shands has deposits in excess of the federal insured amount of \$250,000. Management does not anticipate nonperformance risk by the financial institutions.

13. Subsequent Events

Shands has assessed the impact of subsequent events through September 20, 2016, the date the audited consolidated basic financial statements were issued, and has concluded that there were no such events that require adjustment to the consolidated basic financial statements or disclosure in the notes to the consolidated basic financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Schedule of Changes in the Net Pension Liability and Related Ratios (Unaudited)
June 30, 2016 and 2015

<i>(in thousands of dollars)</i>	2016	2015
Total pension liability		
Service cost	\$ -	\$ -
Interest	55,119	53,701
Changes of benefit terms	-	-
Differences between expected and actual experience	402	149
Changes of assumptions	79,285	2,689
Benefit payments	<u>(42,722)</u>	<u>(35,351)</u>
Net change in total pension liability	92,084	21,188
Total pension liability – beginning	<u>781,620</u>	<u>760,432</u>
Total pension liability – ending (a)	<u>\$ 873,704</u>	<u>\$ 781,620</u>
Plan fiduciary net position		
Employer contributions	\$ 23,736	\$ 35,758
Net investment income	27,578	124,555
Benefit payments	(42,722)	(35,351)
Administrative expense	<u>(6,770)</u>	<u>(5,790)</u>
Net change in plan fiduciary net position	1,822	119,172
Plan fiduciary net position – beginning	<u>835,869</u>	<u>716,697</u>
Plan fiduciary net position – ending (b)	<u>\$ 837,691</u>	<u>\$ 835,869</u>
Net pension liability (asset) – ending (a)-(b)	<u>\$ 36,013</u>	<u>\$ (54,249)</u>
Plan fiduciary net position as a percentage of total pension liability	95.88%	106.94%
Covered employee payroll	\$ 292,099	\$ 304,720
Net pension liability (asset) as a percentage of covered employee payroll	12.33%	(17.8%)

Notes to Schedule

Changes of assumptions 2016:

The investment return assumption was decreased from 7.25% to 6.50% to reflect the updated capital market outlook.

The cost of living assumption ultimate rate was decreased from 2.5% to 2.0%.

The mortality assumption was updated to the RP2014 mortality tables with future mortality improvement that follows the Mercer Modified MP2014 mortality improvement scale.

Retirement rates and withdrawal rates were updated based on the results of an experience study performed in 2015.

Changes of assumptions 2015:

The interest credit ultimate rate was changed from 3.83% to 4.10%.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Schedule of Employer Contributions (Unaudited)
July 1, 2005 Through June 30, 2016

<i>(in thousands of dollars)</i>	2016	2015
Actuarially determined contribution	\$ -	\$ -
Contributions in relation to the actuarially determined contribution	<u>21,863</u>	<u>23,736</u>
Contribution excess	<u>\$ (21,863)</u>	<u>\$ (23,736)</u>
Covered employee payroll	\$ 292,099	\$ 304,720
Contributions as a percentage of covered - employee payroll	7.48%	7.79%

Notes to Schedule

Contributions are based on ERISA minimum funding requirements and shown for the plan year. Assumptions and methods used to determine those contributions vary by year, but for the most recent year are:

Valuation date	July 1, 2015
Actuarial cost method	Projected Unit Credit
Asset valuation method	Market value including receivables
Inflation	2.00%
Investment rate of return	6.50% net of pension plan investment expense, including inflation
Salary increase	N/A
Retirement age	Traditional plan and retirement growth account retirement rates vary by age
Mortality	RP2014 mortality tables with future mortality improvement that follows the Mercer Modified MP2014 mortality improvement scale

Other information:

Benefit accruals under the plan were frozen effective July 1, 2013

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Net Position
June 30, 2016

(in thousands of dollars)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	UF Health Shands Home Care	Property Management	Eliminations	Total Obligated Group	Other	Eliminations	Consolidated Total
Assets												
Current assets												
Cash and cash equivalents	\$ 40,313	\$ 1	\$ -	\$ -	\$ 40,314	\$ -	\$ -	\$ -	\$ 40,314	\$ 12,616	\$ -	\$ 52,930
Short-term investments	155,152	-	-	-	155,152	-	-	-	155,152	39	-	155,191
Patient accounts receivable, net	202,805	3,295	2,304	-	208,404	1,648	-	-	210,052	959	-	211,011
Inventories	15,153	-	-	-	15,153	-	-	-	15,153	-	-	15,153
Prepaid expenses and other current assets	47,011	684	157	(114)	47,738	318	17	-	48,073	2,607	-	50,680
Assets whose use is limited, current portion	35,202	-	-	-	35,202	-	-	-	35,202	-	-	35,202
Total current assets	495,636	3,980	2,461	(114)	501,963	1,966	17	-	503,946	16,221	-	520,167
Assets whose use is limited, less current portion	433,276	-	-	-	433,276	-	-	-	433,276	-	-	433,276
Assets whose use is restricted	159,135	-	-	-	159,135	-	-	-	159,135	-	-	159,135
Capital assets, net	831,573	8,743	1,586	-	841,902	24	4,658	-	846,584	1,522	-	848,106
Due from affiliates, net	5,828	-	-	-	5,828	-	-	(23)	5,805	-	(5,805)	-
Other assets	59,806	953	1,255	-	62,014	-	-	-	62,014	27,228	-	89,242
Total assets	1,985,254	13,676	5,302	(114)	2,004,118	1,990	4,675	(23)	2,010,760	44,971	(5,805)	2,049,926
Deferred outflows of resources												
Accumulated decrease in fair value of hedging derivatives	72,224	-	-	-	72,224	-	-	-	72,224	-	-	72,224
Deferred loss on debt refunding	416	-	-	-	416	-	-	-	416	-	-	416
Deferred outflows on pension	87,457	-	-	-	87,457	-	-	-	87,457	-	-	87,457
Total deferred outflows of resources	160,097	-	-	-	160,097	-	-	-	160,097	-	-	160,097
Liabilities												
Current liabilities												
Long-term debt, current portion	17,034	-	-	-	17,034	-	-	-	17,034	-	-	17,034
Capital lease obligations, current portion	214	-	-	-	214	-	-	-	214	-	-	214
Accounts payable and accrued expenses	112,202	802	424	-	113,428	355	64	-	113,847	8,483	-	122,330
Accrued salaries and leave payable	56,505	57	53	-	56,615	17	-	-	56,632	45	-	56,677
Estimated third-party payor settlements	76,779	-	-	(114)	76,665	-	-	-	76,665	335	-	77,000
Total current liabilities	262,734	859	477	(114)	263,958	372	64	-	264,392	8,863	-	273,255
Long-term liabilities												
Long-term debt, less current portion	838,652	-	-	-	838,652	-	-	-	838,652	-	-	838,652
Capital lease obligations, less current portion	756	-	-	-	756	-	-	-	756	-	-	756
Due to affiliates, net	-	-	-	-	-	-	23	(23)	-	5,805	(5,805)	-
Other liabilities	128,302	92	52	-	128,446	38	-	-	128,484	83	-	128,567
Total long-term liabilities	967,710	92	52	-	967,853	38	23	(23)	967,892	5,888	(5,805)	967,975
Total liabilities	1,230,444	951	529	(114)	1,231,811	410	87	(23)	1,232,284	14,751	(5,805)	1,241,230
Deferred inflows of resources												
Deferred gain on debt refunding	2,936	-	-	-	2,936	-	-	-	2,936	-	-	2,936
Deferred inflows on pension	31,419	-	-	-	31,419	-	-	-	31,419	-	-	31,419
Total deferred inflows of resources	34,355	-	-	-	34,355	-	-	-	34,355	-	-	34,355
Net position												
Net investment in capital assets	84,359	8,743	1,586	-	94,688	24	4,658	-	99,370	-	-	99,370
Restricted												
Nonexpendable	97	-	-	-	97	-	-	-	97	-	-	97
Expendable	9,716	-	-	-	9,716	-	-	-	9,716	243	-	9,959
Unrestricted	786,380	3,982	3,187	-	793,549	1,556	(70)	-	795,035	29,977	-	825,012
Total net position	\$ 880,552	\$ 12,725	\$ 4,773	\$ -	\$ 898,049	\$ 1,580	\$ 4,588	\$ -	\$ 904,218	\$ 30,220	\$ -	\$ 934,438

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Net Position
June 30, 2015

(in thousands of dollars)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	UF Health Shands Home Care	Property Management	Eliminations	Total Obligated Group	Other	Eliminations	Consolidated Total
Assets												
Current assets												
Cash and cash equivalents	\$ 23,971	\$ 1	\$ -	\$ -	\$ 23,972	\$ -	\$ -	\$ -	\$ 23,972	\$ 9,685	\$ -	\$ 33,657
Short-term investments	150,630	-	-	-	150,630	-	-	-	150,630	39	-	150,669
Patient accounts receivable, net	177,831	3,327	2,995	-	184,153	2,892	-	-	187,045	1,221	-	188,266
Inventories	14,217	-	-	-	14,217	-	-	-	14,217	-	-	14,217
Prepaid expenses and other current assets	49,368	668	231	(187)	50,080	335	13	-	50,428	783	-	51,211
Assets whose use is limited, current portion	35,235	-	-	-	35,235	-	-	-	35,235	-	-	35,235
Total current assets	451,252	3,996	3,226	(187)	458,287	3,227	13	-	461,527	11,728	-	473,255
Assets whose use is limited, less current portion	419,022	-	-	-	419,022	-	-	-	419,022	-	-	419,022
Assets whose use is restricted	237,843	-	-	-	237,843	-	-	-	237,843	-	-	237,843
Capital assets, net	724,087	9,001	1,649	-	734,737	27	4,816	-	739,580	1,524	-	741,104
Due from affiliates, net	8,561	-	-	-	8,561	-	-	(5)	8,566	-	(8,556)	-
Other assets	113,454	953	1,255	-	115,662	-	-	-	115,662	34,700	-	150,362
Total assets	1,954,219	13,950	6,130	(187)	1,974,112	3,254	4,829	(5)	1,982,190	47,952	(8,556)	2,021,586
Deferred outflows of resources												
Accumulated decrease in fair value of hedging derivatives	47,809	-	-	-	47,809	-	-	-	47,809	-	-	47,809
Deferred loss on debt refunding	496	-	-	-	496	-	-	-	496	-	-	496
Deferred outflows on pension	41,573	-	-	-	41,573	-	-	-	41,573	-	-	41,573
Total deferred outflows of resources	89,878	-	-	-	89,878	-	-	-	89,878	-	-	89,878
Liabilities												
Current liabilities												
Long-term debt, current portion	23,742	-	-	-	23,742	-	-	-	23,742	-	-	23,742
Capital lease obligations, current portion	199	-	-	-	199	-	-	-	199	-	-	199
Accounts payable and accrued expenses	84,314	621	268	-	85,203	384	59	-	85,646	1,162	-	86,808
Accrued salaries and leave payable	51,263	81	57	-	51,401	16	-	-	51,417	34	-	51,451
Estimated third-party payor settlements	69,450	-	-	(187)	69,263	-	-	-	69,263	435	-	69,698
Total current liabilities	228,968	702	325	(187)	229,808	400	59	-	230,267	1,631	-	231,898
Long-term liabilities												
Long-term debt, less current portion	852,884	-	-	-	852,884	-	-	-	852,884	-	-	852,884
Capital lease obligations, less current portion	975	-	-	-	975	-	-	-	975	-	-	975
Due to affiliates, net	-	-	-	-	-	-	5	(5)	-	8,556	(8,556)	-
Other liabilities	65,556	78	43	-	65,677	34	-	-	65,711	80	-	65,791
Total long-term liabilities	919,415	78	43	-	919,536	34	5	(5)	919,570	8,636	(8,556)	919,650
Total liabilities	1,148,383	780	368	(187)	1,149,344	434	64	(5)	1,149,837	10,267	(8,556)	1,151,548
Deferred inflows of resources												
Deferred gain on debt refunding	10,758	-	-	-	10,758	-	-	-	10,758	-	-	10,758
Deferred inflows on pension	78,717	-	-	-	78,717	-	-	-	78,717	-	-	78,717
Total deferred inflows of resources	89,475	-	-	-	89,475	-	-	-	89,475	-	-	89,475
Net position												
Net investment in capital assets	45,360	9,001	1,649	-	56,010	27	4,816	-	60,853	-	-	60,853
Restricted												
Nonexpendable	97	-	-	-	97	-	-	-	97	-	-	97
Expendable	7,418	-	-	-	7,418	-	-	-	7,418	228	-	7,646
Unrestricted	753,364	4,169	4,113	-	761,646	2,793	(51)	-	764,388	37,457	-	801,845
Total net position	\$ 806,239	\$ 13,170	\$ 5,762	\$ -	\$ 825,171	\$ 2,820	\$ 4,765	\$ -	\$ 832,756	\$ 37,685	\$ -	\$ 870,441

Note: Certain subsidiaries consolidated in UF Health Shands Hospital and separately presented in the fiscal 2015 consolidating basic statements of net position have been combined with other subsidiaries for consistency in reporting to the fiscal 2016 presentation.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Revenues, Expenses and Changes in Net Position
Year Ended June 30, 2016

(in thousands of dollars)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	UF Health Shands Home Care	Property Management	Total Obligated Group	Other	Eliminations	Consolidated Total
Operating revenues											
Net patient service revenue, net of provision for bad debts	\$ 1,285,748	\$ 18,404	\$ 19,215	\$ (505)	\$ 1,322,862	\$ 7,665	\$ -	\$ 1,330,527	\$ 7,177	\$ -	\$ 1,337,704
Other operating revenue	16,371	42	-	-	16,413	-	718	17,131	3,576	(255)	20,452
Total operating revenues	1,302,119	18,446	19,215	(505)	1,339,275	7,665	718	1,347,658	10,753	(255)	1,358,156
Operating expenses											
Salaries and benefits	549,753	13,560	12,645	1,527	577,485	5,796	-	583,281	4,153	-	587,434
Supplies and services	562,857	4,550	4,161	(2,032)	569,536	1,505	410	571,451	3,564	(636)	574,379
Depreciation and amortization	56,406	617	174	-	57,197	2	158	57,357	-	-	57,357
Total operating expenses	1,169,016	18,727	16,980	(505)	1,204,218	7,303	568	1,212,089	7,717	(636)	1,219,170
Operating income (loss)	133,103	(281)	2,235	-	135,057	362	150	135,569	3,036	381	138,986
Nonoperating revenues (expenses)											
State appropriations	7,050	-	-	-	7,050	-	-	7,050	-	-	7,050
Interest expense	(22,966)	-	-	-	(22,966)	-	-	(22,966)	-	-	(22,966)
Net investment income, including change in fair value	22,938	-	-	-	22,938	-	-	22,938	68	-	23,006
Loss on disposal of capital assets, net	(138)	-	-	-	(138)	-	-	(138)	-	-	(138)
Other nonoperating revenues (expenses), net	3,727	384	-	-	4,111	-	-	4,111	(7,534)	(381)	(3,804)
Total nonoperating revenues (expenses), net	10,611	384	-	-	10,995	-	-	10,995	(7,466)	(381)	3,148
Excess (deficit) of revenues over expenses before transfers, capital contributions, and other changes in net position	143,714	103	2,235	-	146,052	362	150	146,564	(4,430)	-	142,134
Transfers and expenditures in support of the University of Florida and its medical programs	(60,307)	(998)	-	-	(61,305)	-	-	(61,305)	(2,111)	-	(63,416)
Other transfers	(17,688)	-	-	-	(17,688)	-	-	(17,688)	-	-	(17,688)
Transfer of net assets in association with consolidation and support of other operations and divisions of Shands	5,642	450	(3,224)	-	2,868	(1,602)	(327)	939	(939)	-	-
Capital contributions	654	-	-	-	654	-	-	654	-	-	654
Other changes in net position	2,298	-	-	-	2,298	-	-	2,298	15	-	2,313
Increase (decrease) in net position	74,313	(445)	(989)	-	72,879	(1,240)	(177)	71,462	(7,465)	-	63,997
Net position											
Beginning of year	806,239	13,170	5,762	-	825,171	2,820	4,765	832,756	37,685	-	870,441
End of year	\$ 880,552	\$ 12,725	\$ 4,773	\$ -	\$ 898,050	\$ 1,580	\$ 4,588	\$ 904,218	\$ 30,220	\$ -	\$ 934,438

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Consolidating Basic Statements of Revenues, Expenses and Changes in Net Position

Year Ended June 30, 2015

(in thousands of dollars)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	UF Health Shands Home Care	Property Management	Eliminations	Total Obligated Group	Other	Eliminations	Consolidated Total
Operating revenues												
Net patient service revenue, net of provision for bad debts	\$ 1,212,372	\$ 20,870	\$ 17,654	\$ (549)	\$ 1,250,347	\$ 7,389	\$ -	\$ -	\$ 1,257,736	\$ 4,322	\$ -	\$ 1,262,058
Other operating revenue	14,630	372	-	-	15,002	-	1,134	(395)	15,741	3,358	(255)	18,844
Total operating revenues	<u>1,227,002</u>	<u>21,242</u>	<u>17,654</u>	<u>(549)</u>	<u>1,265,349</u>	<u>7,389</u>	<u>1,134</u>	<u>(395)</u>	<u>1,273,477</u>	<u>7,680</u>	<u>(255)</u>	<u>1,280,902</u>
Operating expenses												
Salaries and benefits	507,230	15,090	12,588	1,647	536,555	5,458	-	-	542,013	2,804	-	544,817
Supplies and services	533,262	6,792	4,153	(2,435)	541,772	1,719	454	(395)	543,550	2,781	(255)	546,076
Depreciation and amortization	55,626	611	184	-	56,421	27	158	-	56,606	-	-	56,606
Total operating expenses	<u>1,096,118</u>	<u>22,493</u>	<u>16,925</u>	<u>(788)</u>	<u>1,134,748</u>	<u>7,204</u>	<u>612</u>	<u>(395)</u>	<u>1,142,169</u>	<u>5,585</u>	<u>(255)</u>	<u>1,147,499</u>
Operating income (loss)	<u>130,884</u>	<u>(1,251)</u>	<u>729</u>	<u>239</u>	<u>130,601</u>	<u>185</u>	<u>522</u>	<u>-</u>	<u>131,308</u>	<u>2,095</u>	<u>-</u>	<u>133,403</u>
Nonoperating revenues (expenses)												
State appropriations	7,050	-	-	-	7,050	-	-	-	7,050	-	-	7,050
Interest expense	(25,235)	-	-	-	(25,235)	-	-	-	(25,235)	-	-	(25,235)
Net investment income, including change in fair value	8,083	-	-	-	8,083	-	-	-	8,083	57	-	8,140
Loss on disposal of capital assets, net	(925)	-	(6)	-	(931)	-	-	-	(931)	-	-	(931)
Other nonoperating revenues (expenses), net	7,427	261	-	(239)	7,449	-	-	-	7,449	4,460	-	11,909
Total nonoperating revenues (expenses), net	<u>(3,600)</u>	<u>261</u>	<u>(6)</u>	<u>(239)</u>	<u>(3,584)</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>(3,584)</u>	<u>4,517</u>	<u>-</u>	<u>933</u>
Excess (deficit) of revenues over expenses before transfers, capital contributions, and other changes in net position	127,284	(990)	723	-	127,017	185	522	-	127,724	6,612	-	134,336
Transfers and expenditures in support of the University of Florida and its medical programs	(63,224)	(2,013)	-	-	(65,237)	-	-	-	(65,237)	(1,296)	-	(66,533)
Transfer of net assets in association with consolidation and support of other operations and divisions of Shands	4,677	(1,727)	(3,438)	-	(488)	(439)	(722)	-	(1,649)	1,649	-	-
Capital contributions	6,433	-	-	-	6,433	-	-	-	6,433	-	-	6,433
Other changes in net position	(223)	-	-	-	(223)	-	-	-	(223)	-	-	(223)
Increase (decrease) in net position	74,947	(4,730)	(2,715)	-	67,502	(254)	(200)	-	67,048	6,965	-	74,013
Net position												
Beginning of year	731,292	17,900	8,477	-	757,669	3,074	4,965	-	765,708	30,720	-	796,428
End of year	<u>\$ 806,239</u>	<u>\$ 13,170</u>	<u>\$ 5,762</u>	<u>\$ -</u>	<u>\$ 825,171</u>	<u>\$ 2,820</u>	<u>\$ 4,765</u>	<u>\$ -</u>	<u>\$ 832,756</u>	<u>\$ 37,685</u>	<u>\$ -</u>	<u>\$ 870,441</u>

Note: Certain subsidiaries consolidated in UF Health Shands Hospital and separately presented in the fiscal 2015 consolidating basic statements of revenues, expenses and changes in net position have been combined with other subsidiaries for consistency in reporting to the fiscal 2016 presentation.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Schedule of Expenditures of State Financial Assistance
Year Ended June 30, 2016

Grantor/Pass-Through Grantor/Program or Cluster Title	CSFA#	Contract Identification Number	Award Amount	Grant Period	State Expenditures
State of Florida, Department of Health:					
Emergency Medical Services Matching Awards	64.003	M4063	\$ 9,394	06/01/15-06/30/16	\$ 6,665
Trauma Center Financial Support	64.075	TRA-16	N/A	07/01/15-06/30/16	611,611
Total State of Florida, Department of Health			<u>9,394</u>		<u>618,276</u>
Florida Department of State and Secretary of State:					
Specific Cultural Projects/Artists in Residence Program	45.061	16.6.114.079	29,850	07/01/15-06/30/16	29,850
Total Florida Department of State and Secretary of State			<u>29,850</u>		<u>29,850</u>
State of Florida, Department of Elder Affairs:					
<i>Pass-Through Program from Mid-Florida Area Agency on Aging, Inc. and Department of Elder Affairs:</i>					
Community Care for the Elderly	65.010	CCE-15-ALA	386,904	07/01/15-06/30/16	386,720
Home Care for the Elderly	65.001	HCE-15-ALA	29,692	07/01/15-06/30/16	29,691
Alzheimer's Disease Initiative - Model Day Care	65.002	ADI-15-ALA	113,355	07/01/15-06/30/16	113,355
Local Service Program - Expanded Adult Day Care	65.009	LSP-15-ALA	20,433	07/01/15-06/30/16	20,433
Alzheimer's Disease Initiative - In Home Respite	65.004	ADI-15-ALA	133,288	07/01/15-06/30/16	133,288
Total State of Florida, Department of Elder Affairs			<u>683,672</u>		<u>683,487</u>
Total Expenditures of State Financial Assistance			<u>\$ 722,916</u>		<u>\$ 1,331,613</u>

The accompanying note is an integral part of this Schedule of Expenditures of State Financial Assistance.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Note to Schedule of Expenditures of State Financial Assistance
June 30, 2016

1. Basis of Presentation

The accompanying Schedule of Expenditures of State Financial Assistance (the "Schedule") includes the state grant activity of Shands Teaching Hospital and Clinics, Inc. and Subsidiaries ("Shands"), and is presented on the accrual basis of accounting.

The information in this Schedule is presented in accordance with the requirements of Chapter 10.550, *Rules of the Auditor General*. Because the Schedule presents only a selected portion of the operations of Shands, it is not intended to and does not present the financial position, changes in net position, or cash flows of Shands. The purpose of the Schedule is to present a summary of those activities of Shands for the year ended June 30, 2016, which have been financed by the state government. For purposes of the Schedule, state financial assistance includes any assistance provided by a state agency directly or indirectly in the form of grants and contracts.

Direct and indirect costs are charged to awards in accordance with cost principles contained in the Department of Health and Human Services, Office of the Assistant Secretary Comptroller ("OASC"), OASC-3, *A Guide for Hospitals*. Under these cost principles, certain types of expenditures are not allowable or are limited as to reimbursement.



Report of Independent Certified Public Accountants on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

To the Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

We have audited, in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the consolidated basic financial statements of Shands Teaching Hospital and Clinics, Inc. and Subsidiaries ("Shands"), which comprise the consolidated basic statements of net position as of June 30, 2016, and the related consolidated basic statements of revenues, expenses and changes in net position and consolidated basic statements of cash flows for the year then ended, and the related notes to the consolidated basic financial statements, and have issued our report thereon dated September 20, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the consolidated basic financial statements, we considered Shands' internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of Shands' internal control. Accordingly, we do not express an opinion on the effectiveness of Shands' internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether Shands' consolidated basic financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Shands' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Shands' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

PricewaterhouseCoopers LLP

September 20, 2016



Report of Independent Certified Public Accountants on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major State Financial Assistance Program and on Internal Control Over Compliance in Accordance with Chapter 10.550, *Rules of the Auditor General*

To the Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Report on Compliance for Each Major State Financial Assistance Program

We have audited Shands Teaching Hospital and Clinics, Inc. and Subsidiaries' ("Shands") compliance with the types of compliance requirements described in the *Department of Financial Services State Projects Compliance Supplement* that could have a direct and material effect on each of Shands' major state programs for the year ended June 30, 2016. Shands' major state programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its state financial assistance programs.

Independent Certified Public Accountants' Responsibility

Our responsibility is to express an opinion on compliance for each of Shands' major state financial assistance programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Chapter 10.550, *Rules of the Auditor General*. Those standards and Chapter 10.550, *Rules of the Auditor General*, require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major state program occurred. An audit includes examining, on a test basis, evidence about Shands' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major state financial assistance program. However, our audit does not provide a legal determination of Shands' compliance.

Opinion on Each Major State Financial Assistance Program

In our opinion, Shands complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major state financial assistance programs for the year ended June 30, 2016.



Report on Internal Control Over Compliance

Management of Shands is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Shands' internal control over compliance with the types of requirements that could have a direct and material effect on each major state financial assistance program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major state financial assistance program and to test and report on internal control over compliance in accordance with Chapter 10.550, *Rules of the Auditor General*, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Shands' internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a state financial assistance program on a timely basis. *A material weakness in internal control over compliance* is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a state program will not be prevented, or detected and corrected, on a timely basis. *A significant deficiency in internal control over compliance* is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a state financial assistance program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of Chapter 10.550, *Rules of the Auditor General*. Accordingly, this report is not suitable for any other purpose.

PricewaterhouseCoopers LLP

November 11, 2016

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Schedule of Findings and Questioned Costs
Year Ended June 30, 2016

Section I: Summary of Auditor's Results

Financial Statements

Type of auditor's report issued: Unmodified
 Internal control over financial reporting:
 Material weaknesses identified? Yes No
 Significant deficiencies identified that are not considered to be material weaknesses? Yes None reported
 Noncompliance material to the financial statements noted? Yes No

State Financial Assistance

Internal control over state assistance:
 Material weaknesses identified? Yes No
 Significant deficiencies identified that are not considered to be material weaknesses? Yes None reported

Type of auditor's report issued on compliance for state assistance: Unmodified

Any audit findings disclosed that are required to be reported in accordance with of Chapter 10.550, *Rules of the Auditor General*? Yes No

Identification of major state financial assistance programs:

State Financial Assistance:

CSFA Number
 64.075
 65.002

Name of State Financial Assistance Project
 Trauma Center Financial Support
 Alzheimer's Disease Initiative – Model Day Care

Dollar threshold used to distinguish between Type A and Type B programs: \$300,000

Auditee qualified as low-risk pursuant to the Single Audit Act of the State of Florida? Yes No

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Schedule of Findings and Questioned Costs
Year Ended June 30, 2016

Section II: Financial Statement Findings

None noted.

Section III: State Financial Assistance Projects Findings and Questioned Costs

None noted.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Summary Schedule of Prior Audit Findings
Year Ended June 30, 2016

None noted.



Report of Independent Certified Public Accountants

To the Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

We have examined Shands Teaching Hospital and Clinics, Inc. and Subsidiaries' ("Shands") compliance with Section 218.415, Florida Statutes, regarding the investment of public funds during the year ended June 30, 2016. Shands' management is responsible for its compliance with those requirements. Our responsibility is to express an opinion on Shands' compliance based on our examination.

Our examination was conducted in accordance with attestation standards established by the American Institute of Certified Public Accountants and, accordingly, included examining, on a test basis, evidence about Shands' compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our examination provides a reasonable basis for our opinion. Our examination does not provide a legal determination on Shands' compliance with specified requirements.

In our opinion, Shands complied with the aforementioned requirements during the year ended June 30, 2016.

This report is intended solely for the information and use of Shands and the Auditor General, State of Florida, and is not intended to be and should not be used by anyone other than these specified parties.

PricewaterhouseCoopers LLP

September 20, 2016

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

**Letter of Comments and Recommendations
June 30, 2016**



November 11, 2016

Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Gainesville, Florida

Members of the Board of Directors:

In planning and performing our audit of the consolidated basic financial statements of Shands Teaching Hospital and Clinics, Inc. and Subsidiaries ("Shands"), as of and for the year ended June 30, 2016, in accordance with auditing standards generally accepted in the United States of America, we considered Shands' internal control over financial reporting as a basis for designing our auditing procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the consolidated basic financial statements, but not for the purpose of expressing an opinion on Shands' internal control over financial reporting. Accordingly, we do not express an opinion on Shands' internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified.

AU 325, *Communicating Internal Control Related Matters Identified in an Audit*, of the AICPA Professional Standards includes the following definitions of a deficiency, a significant deficiency and a material weakness:

Deficiency - a deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

Significant Deficiency - a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Material Weakness - a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

As we agreed in the Board of Directors meeting on September 20, 2016, we are providing you with a list of operational and business observations. See Sections I and II for detailed observations.



Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
November 11, 2016

Independent Certified Public Accountant's Responsibility

Additionally, we conducted our audit in accordance with the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and Chapter 10.550, *Rules of the Auditor General*.

Other Reports and Schedule

We have issued our Report of Independent Certified Public Accountants on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*, which is dated September 20, 2016 and the Report of Independent Certified Public Accountants on Compliance with Requirements That Could Have a Direct and Material Effect on Each State Financial Assistance Program and on Internal Control Over Compliance in Accordance with Chapter 10.550, *Rules of the Auditor General*; and Schedule of Findings and Questioned Costs. Disclosures in those reports and schedule, which are dated November 11, 2016, should be considered in conjunction with this Letter of Comments and Recommendations.

Prior Audit Findings

Section 10.554(1)(i)1., *Rules of the Auditor General*, requires that we determine whether or not corrective actions have been taken to address findings and recommendations made in the preceding annual financial audit report. The current status of comments reported in fiscal year 2015 is included in the status of prior year's recommendations in Section III of this Letter of Comments and Recommendations.

Official Title and Legal Authority

Section 10.554(1)(i)4., *Rules of the Auditor General*, requires that the name or official title and legal authority for the primary government and each component unit of the reporting entity be disclosed in this Letter of Comments and Recommendations, unless disclosed in the notes to the consolidated basic financial statements. Shands Teaching Hospital was established in 1958 by the University of Florida and leased to Shands Teaching Hospital and Clinics, Inc., a not-for-profit corporation, in 1980. Effective July 1, 2011, Shands was designated an instrumentality of the state under the provision of Chapter 2011-114, Laws of Florida.

Financial Condition

Section 10.554(1)(i)5.a., *Rules of the Auditor General*, requires that we report the results of our determination as to whether or not Shands has met one or more of the conditions described in Section 218.503(1), Florida Statutes, and identification of the specific condition(s) met. In connection with our audit, we determined that Shands did not meet any of the conditions described in Section 218.503(1), Florida Statutes.



Board of Directors of
Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
November 11, 2016

Pursuant to Sections 10.554(1)(i)5.c. and 10.556(8), *Rules of the Auditor General*, we applied financial condition assessment procedures. It is management's responsibility to monitor Shands' financial condition, and our financial condition assessment was based in part on representations made by management and the review of financial information provided by same. In connection with our audit, our procedures did not disclose deteriorating financial conditions as defined in the aforementioned section.

Annual Financial Report

Section 10.554(1)(i)5.b., *Rules of the Auditor General*, requires that we report the results of our determination as to whether the annual financial report for Shands for the fiscal year ended June 30, 2016, filed with the Florida Department of Financial Services pursuant to Section 218.32(1)(a), Florida Statutes, is in agreement with the annual financial audit report for the fiscal year ended June 30, 2016. In connection with our audit, we determined that these two reports were in agreement.

Other Matters

Section 10.554(1)(i)2., *Rules of the Auditor General*, requires that we address in the Letter of Comments and Recommendations any recommendations to improve financial management. In connection with our audit, we are submitting for consideration the accompanying recommendations designed to help improve financial management.

Section 10.554(1)(i)3., *Rules of the Auditor General*, requires that we address noncompliance with provisions of contracts or grant agreements, or abuse, that have occurred, or are likely to have occurred, that have an effect on the financial statements that is less than material but which warrants the attention of those charged with governance. In connection with our audit, we did not have any such findings.

Purpose of this Letter

This letter is intended solely for the information and use of the Board of Directors and Audit and Compliance Committee of Shands, the Legislative Auditing Committee, members of the Florida Senate and the Florida House of Representatives, the Florida Auditor General, state and other granting agencies, management, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties.

If you would like any further information or would like to discuss any of the issues raised, please contact Ann L. Payne, Engagement Partner, at (954) 356-5902.

Very truly yours,

PricewaterhouseCoopers LLP

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Letter of Comments and Recommendations
June 30, 2016

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Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Letter of Comments and Recommendations

June 30, 2016

I. Recent Accounting Pronouncements Applicable to Shands

1. **GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions***

In June 2015, the GASB issued GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions* ("GASB No. 75"). GASB No. 75 addresses accounting and financial reporting for other postemployment plans that are provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense. GASB No. 75 is effective for fiscal years beginning after June 15, 2017.

Management's Response:

Management is currently evaluating the impact of this pronouncement to identify any impact that it may have on the consolidated basic financial statements.

2. **GASB Statement No. 81, *Irrevocable Split-Interest Agreements***

In March 2016, the GASB issued GASB Statement No. 81, *Irrevocable Split-Interest Agreements* ("GASB No. 81"). GASB No. 81 improves accounting and financial reporting by establishing recognition and measurement requirements for irrevocable split-interest agreements which are a specific type of giving arrangement used by donors to provide resources to two or more beneficiaries, including governments. GASB No. 81 is effective for fiscal years beginning after December 15, 2016.

Management's Response:

Management is currently evaluating the impact of this pronouncement to identify any impact that it may have on the consolidated basic financial statements.

3. **GASB Statement No. 82, *Pension Issues – an Amendment of GASB Statements No. 67, No. 68, and No. 73***

In March 2016, the GASB issued GASB Statement No. 82, *Pension Issues – an Amendment of GASB Statements No. 67, No. 68, and No. 73* ("GASB No. 82"). This Statement addresses specific issues including presentation of payroll related measures in required supplementary information, selection of assumptions, and classification of employer paid member contributions. GASB No. 82 is effective for fiscal years beginning after June 15, 2016.

Management's Response:

Management is currently evaluating the impact of this pronouncement to identify any impact that it may have on the consolidated basic financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Letter of Comments and Recommendations

June 30, 2016

II. Focus on Cybersecurity

Cybersecurity incidents continue to rise and cybersecurity compromise is a matter of not if but rather when. The healthcare industry continues to be a prime target of cyber-attacks, which has both a financial and reputational impact for hospitals and other healthcare institutions that find themselves victim to cyber breach. Many healthcare institutions have been impacted with multiple breaches in recent years despite thinking that they were secure. As a result, today's elevated threat environment has left most organizations, in virtually every industry, wondering if they have already been (or soon will be) compromised. Many organizations are deliberating how to strengthen their cybersecurity program.

As these types of threats continue to increase and become more sophisticated, what is an appropriate response today may be outdated tomorrow. As a result, we recommend that all healthcare entities continuously assess the adequacy of their cybersecurity program to address the rapidly changing cyber-risk landscape.

Management's Response:

Management takes cybersecurity very seriously and is continually assessing its information security posture to reduce our exposure and to protect against the latest attacks.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Letter of Comments and Recommendations

June 30, 2016

III. Status of Prior Year's Recommendations

In connection with an audit of Shands' June 30, 2015 consolidated basic financial statements, we made certain comments and recommendations, which have been reviewed in order to determine the status of implementation. A summary of the status of prior year's recommendations is as follows:

Recommendations	Status
Recent Accounting Pronouncements:	
<ul style="list-style-type: none">• GASB Statement No. 72, <i>Fair Value Measurement and Application</i>	Shands adopted GASB No. 72 as of July 1, 2015.
<ul style="list-style-type: none">• GASB Statement No. 73, <i>Accounting and Financial Reporting for Pensions and Related Assets That Are Not Within the Scope of GASB Statement 68, and Amendments to Certain Provisions of GASB Statements 67 and 68</i>	Shands adopted GASB No. 73 as of July 1, 2015.
<ul style="list-style-type: none">• GASB Statement No. 75, <i>Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions</i>	Standard is effective for fiscal years beginning after June 15, 2017. Management is currently evaluating the impact of this pronouncement as discussed in the previous section.
<ul style="list-style-type: none">• GASB Statement No. 76, <i>The Hierarchy of Generally Accepted Accounting Principles for State and Local Governments</i>	Shands adopted GASB No. 76 as of July 1, 2015.