

ORIGINAL 81
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APPLICATION FOR

AUTHORITY TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE WITHIN THE STATE OF FLORIDA

for *910052-TX*

SHANDS TEACHING HOSPITAL AND CLINICS, INC.

1. This is an application for (check one):

- Original authority (new company)**
- Approval of transfer (to another certificated company)**
- Approval of assignment of existing certificate (to a noncertificated company)**
- Approval for transfer of control (to another certificated company)**

2. Name of applicant:

Shands Teaching Hospital and Clinics, Inc.

3. A. National mailing address including street name, number, post office box, city, state, zip code and phone number.

1600 SW Archer Road
 Box 100366
 Gainesville, Florida 32610-0366
 Phone: (352) 395-0056
 Fax: (352) 395-0209

- ACK _____
- AFA _____
- APP _____
- CAF _____
- CMU _____
- CTR _____
- EAG _____
- LEG _____
- LIN _____
- OPC _____
- RCH _____
- SEC _____
- WAS _____
- OTH _____

B. Florida mailing address including street name, number, post office box, city, state, zip code and phone number.

1600 SW Archer Road
 Box 100366
 Gainesville, Florida 32610-0366
 Phone: (352) 395-0056
 Fax: (352) 395-0056

FORM PSC/CMU 8 (07/95)
Required by Chapter 364.337 F.S.

DOCUMENT NUMBER-DATE
 00295 JAN-96
 FPSC-RECORDS/REPORTING

C. Physical address of alternative local exchange service in Florida including street name, number, post office box, city, zip code and phone number.

1600 SW Archer Road
Box 100366
Gainesville, Florida 32610-0366
Phone: (352) 395-0056
Fax: (352) 395-0209

4. Structure of organization:

- | | |
|--|--|
| <input type="checkbox"/> Individual | <input checked="" type="checkbox"/> Corporation |
| <input type="checkbox"/> Foreign Corporation | <input type="checkbox"/> Foreign Partnership |
| <input type="checkbox"/> General Partnership | <input type="checkbox"/> Limited Partnership |
| <input type="checkbox"/> Joint Venture | <input type="checkbox"/> Other, Please explain _____ |

5. If incorporated, please provide proof from the Florida Secretary of State that the applicant has authority to operate in Florida.

Corporate charter number: 749322

6. Name under which the applicant will do business (d/b/a):

Shands Teaching Hospital and Clinics, Inc.

7. If applicable, please provide proof of fictitious name (d/b/a) registration.

Fictitious name registration number: N/A

8. If applicant is an individual, partnership, or joint venture, please give name, title and address of each legal entity.

N/A

9. State whether any of the officers, directors, or any of the ten largest stockholders have previously been adjudged bankrupt, mentally incompetent, or found guilty of any felony or of any crime, or whether such actions may result from pending proceedings. If so, please explain.

No

10. Please provide the name, title, address, telephone number, internet address and facsimile number for the person serving as ongoing liaison with the Commission, and if different the liaison responsible for this application.

Larry E. Benton
Shands Hospitals
1600 SW Archer Road, Box 100366
Gainesville, Florida 32610-0366
Phone: (352) 395-0056
Fax: (352) 395-0209
Internet: benton.engops@shands.ufl.edu

11. Please list other states in which the applicant is currently providing or has applied to provide local exchange or alternative local exchange service.

None

12. Has the applicant been denied certification in any other state? If so, please list the state and reason for denial.

No

13. Have penalties been imposed against the applicant in any other state? If so, please list the state and reason for penalty.

No

14. Please indicate how a customer can file a service complaint with your company.

Customers can call customer service at (352) 395-0056 or (888) 742-6376

15. Please provide all available documentation demonstrating that the applicant has the following capabilities to provide alternative local exchange service in Florida.

A. Financial Capability:

See Attachment A

B. Managerial Capability:

See Attachment B


C. Technical Capability:

See Attachment C

AFFIDAVIT

By my signature below, I, the undersigned officer, attest to the accuracy of the information contained in this application and attached documents and that the applicant has the technical expertise, managerial ability, and financial capability to provide alternative local exchange service in the State of Florida. I have read the foregoing and declare that to the best of my knowledge and belief, the information is true and correct. I attest that I have the authority to sign on behalf of my company and agree to comply, now and in the future, with all applicable Commission rules and orders.

Further, I am aware that pursuant to Chapter 837.06, Florida Statutes, "Whoever knowingly makes a false statement in writing with the intent to mislead a public servant in the performance of his official duty shall be guilty of a misdemeanor of the second degree, punishable as provided in s. 775.082 and s. 775.083".

Official:  December 26, 1996
Signature Date

Title: VP, Facilities and Information Services (352) 395-0220
Shands at UF Telephone Number

Address: 1600 SW Archer Road, Box 100327
Gainesville, Florida 32610-0327

ATTACHMENT A

Financial Capability

Shands Teaching Hospital and Clinics, Inc. ("Shands") has adequate capital to maintain local exchange service as a reseller. All space and equipment needed will be provided by Shands. Audited financial statements for the past three fiscal years are attached and demonstrate the financial stability of Shands.

ATTACHMENT B

Managerial Capability

1. Paul E. Metts, C.P.A., Chief Executive Officer

Education: M.H.A., University of Minnesota; B.A., University of South Florida.
Experience: 1987 to present, Chief Executive Officer, Shands Teaching Hospital and Clinics, Inc. ("Shands"); 1988 to present, Adjunct Professor, Department of Health Services Administration, University of Florida; 1986 to 1987, Associate Executive Vice President, Shands; 1980 to 1986, Vice President for Administrative Services, Shands; 1977 to 1980, Director of Administrative Services, Shands; 1973 to 1977, Treasurer, The Dormavac Corporation and Vice President, Low Pressure Storage Systems, Inc.; 1967 to 1973, Manager, Ernst & Ernst, now Ernst & Young, LLP.

2. Gregory H. Gay, C.P.A., Vice President and Chief Financial Officer

Education: B.S., Palm Beach Atlantic College
Experience: May 1996 to present, Vice President and Chief Financial Officer, Shands; 1994 to present, Controller, Shands; 1990 to 1994, Director of Accounting, Shands; 1986 to 1990, Senior Auditor, Coopers & Lybrand, LLP; 1984 to 1986, Staff Accountant, Cook International, Inc.

3. Ralph W. Swain, Ph.D., Vice President, Facilities & Information Services

Education: Ph.D., Cornell University; B.S. The John Hopkins University
Experience: February 1996 to present, Vice President, Facilities & Information Services, Shands; March 1994 to February 1996, jointly responsible for Information Services Division with the Vice President for Operations, Shands; December 1992 to February 1996, Vice President for Planning, Facilities & Marketing, Shands; December 1991 to present, Assistant Vice President for Health Science Center Facilities, University of Florida; July 1987 to December 1992, Vice President, Facilities and Support Services, Shands; July 1981 to June 1987, Assistant to Vice President for Administration, Shands.

4. Larry E. Benton, Director, Communication

Education: Lake City Community College
Experience: December 1983 to present, Director, Communications, Shands; December 1982 to December 1983, Supervisor for Engineering Operations, Shands; December 1978 to December 1982, Supervisor, Electrical Shop, Physical Plant, State of Florida; November 1977 to December 1978, Electrician, Physical Plant, State of Florida; 1974 to November 1977, Plumber and Electrician, High Plumbing and Electric.

All members of Shands Teaching Hospital and Clinics, Inc.'s communications' support staff reports to the Director, Communications who has the responsibility for maintaining the technical operability of Shands Teaching Hospital and Clinics, Inc. Shands' staff of full time technicians have many years of experience and have been certified by NEC for installation, service and maintenance.

ATTACHMENT C

Technical Capability

Shands Teaching Hospital and Clinics, Inc. initially intends to resell local telephone service utilizing its existing telephone switching equipment and installed cabling plant. The NEC telephone switches have a capacity for more than 25,000 lines, redundant processors, and is backed up by emergency power generators. The switches are connected to Bell South's network over high speed T-1, as well as analog trunking facilities. The switch is administered with state-of-the-art software applications for service provisioning, alarm monitoring, systems administration, traffic management, and call accounting. The existing cabling plant adheres to BICSI and EIA/TIA standards. Horizontal cabling consists of Category 3 for voice, and Category 5 for data. Both fiber and copper cable are used for aerial and riser cables.

**SHANDS TEACHING HOSPITAL AND
CLINICS, INC. AND SUBSIDIARIES
GAINESVILLE, FLORIDA**

CONSOLIDATED FINANCIAL STATEMENTS

for the years ended June 30, 1996 and 1995

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Report of Independent Accountants

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

We have audited the accompanying consolidated balance sheets of Shands Teaching Hospital and Clinics, Inc. and Subsidiaries (Shands) as of June 30, 1996 and 1995, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of Shands' management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Shands as of June 30, 1996 and 1995, and the consolidated results of their operations, changes in net assets, and cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audit was conducted for the purpose of forming an opinion on the basic consolidated financial statements taken as a whole. The consolidating financial information is presented for purposes of additional analysis and is not a required part of the basic consolidated financial statements of Shands. Such information has been subjected to the auditing procedures applied in our audit of the basic consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic consolidated financial statements taken as a whole.

Coopers & Lybrand L.L.P.

Jacksonville, Florida
September 13, 1996, except for the last paragraph of Note 7,
for which the date is October 22, 1996

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Balance Sheets
June 30, 1996 and 1995

| ASSETS | 1996 | 1995 |
|--|-----------------------|-----------------------|
| | <u> </u> | <u> </u> |
| Current assets: | \$ 6,210,910 | \$ 12,659,939 |
| Cash and cash equivalents | 34,454,886 | 13,728,520 |
| Marketable securities | | |
| Patient accounts receivable, net of estimated uncollectibles of \$37,719,000 in 1996 and \$18,985,000 in 1995 | 101,608,334 | 71,291,044 |
| Due from Medicare, Medicaid, and other third-party programs | 9,247,196 | 10,909,447 |
| Prepaid expenses and other current assets | 15,807,789 | 9,613,013 |
| Assets limited as to use | 8,050,178 | 7,109,819 |
| Total current assets | <u>175,379,293</u> | <u>125,311,782</u> |
| Assets limited as to use: | | |
| Held by trustees | 60,524,476 | 1,734,463 |
| Internally designated for capital acquisition | 73,853,028 | 102,975,211 |
| | <u>134,377,504</u> | <u>104,709,674</u> |
| | (8,050,178) | (7,109,819) |
| Less amount required to meet current obligations | <u>126,327,326</u> | <u>97,599,855</u> |
| Property and equipment, net | 327,174,050 | 234,606,893 |
| Excess of cost over fair value of net assets acquired, net | 45,914,899 | - |
| Deferred charges and other assets | 24,408,040 | 11,382,793 |
| | <u>699,203,608</u> | <u>468,901,323</u> |
| Total assets | | |
| LIABILITIES AND NET ASSETS | | |
| Current liabilities: | \$ 14,854,309 | \$ 4,661,976 |
| Notes payable and long-term debt, current portion | 20,225,861 | 13,836,427 |
| Accounts payable | 33,354,046 | 22,663,754 |
| Accrued expenses | 68,434,216 | 41,162,157 |
| Total current liabilities | <u>284,868,975</u> | <u>133,206,219</u> |
| Long-term debt, net of current portion | 31,477,644 | 7,122,247 |
| Other liabilities | | |
| Total liabilities | <u>384,780,835</u> | <u>181,490,623</u> |
| Net assets, unrestricted | <u>314,422,773</u> | <u>287,410,700</u> |
| Total liabilities and net assets | <u>\$ 699,203,608</u> | <u>\$ 468,901,323</u> |

See accompanying notes to consolidated financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Consolidated Statements of Operations

for the years ended June 30, 1996 and 1995

| | 1996 | 1995 |
|--|----------------|----------------|
| Unrestricted revenues, gains and other support: | | |
| Net patient service revenue | \$ 425,770,722 | \$ 346,397,237 |
| State educational support | 4,468,220 | 4,010,339 |
| Investment income | 17,281,302 | 6,966,740 |
| Cafeteria sales and miscellaneous income | 9,791,860 | 6,875,191 |
| Total unrestricted revenues, gains and other support | 457,312,104 | 364,249,507 |
| Expenses and losses: | | |
| Salaries, wages and benefits | 201,512,985 | 160,225,142 |
| Supplies and services | 158,253,521 | 126,156,862 |
| Interest | 11,219,431 | 8,305,188 |
| Depreciation and amortization | 23,402,546 | 20,253,192 |
| Net loss on disposals of property and equipment | 33,273 | 711,961 |
| Provision for bad debts | 18,462,706 | 19,969,130 |
| Total expenses and losses | 412,884,462 | 335,621,475 |
| Subtotal | 44,427,642 | 28,628,032 |
| Expenditures in support of the University of Florida and its integrated healthcare delivery system | 17,661,439 | 7,431,060 |
| Excess of revenues, gains, and other support over expenses and losses | 26,766,203 | 21,196,972 |
| Net assets released from restrictions used for pediatric equipment | 245,070 | 362,195 |
| Increase in unrestricted net assets | \$ 27,012,073 | \$ 21,559,167 |

See accompanying notes to consolidated financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Statements of Changes in Net Assets

for the years ended June 30, 1996 and 1995

| | <u>1996</u> | <u>1995</u> |
|---|-----------------------|-----------------------|
| Unrestricted net assets: | | |
| Excess of revenues, gains, and other support over expenses and losses | \$ 26,766,203 | \$ 21,196,972 |
| Net assets released from restrictions used for pediatric equipment | <u>245,870</u> | <u>362,195</u> |
| Increase in unrestricted net assets | 27,012,073 | 21,559,167 |
| Temporarily restricted net assets: | | |
| Contributions from Southeastern Healthcare Foundation, Inc. for pediatric equipment | 245,870 | 362,195 |
| Net assets released from restrictions used for pediatric equipment | <u>(245,870)</u> | <u>(362,195)</u> |
| Change in temporarily restricted net assets | <u>-</u> | <u>-</u> |
| Increase in net assets | 27,012,073 | 21,559,167 |
| Net assets, beginning of year | <u>287,410,700</u> | <u>265,851,533</u> |
| Net assets, end of year | <u>\$ 314,422,773</u> | <u>\$ 287,410,700</u> |

See accompanying notes to consolidated financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries Consolidated Statements of Cash Flows

for the years ended June 30, 1996 and 1995

| | 1996 | 1995 |
|--|----------------|----------------|
| Cash flows from operating activities and gains and losses: | | |
| Cash received from patients and third-party payors | \$ 389,421,592 | \$ 342,965,053 |
| Other receipts from operations | 23,288,841 | 10,701,323 |
| Salaries, wages and benefits paid to employees | (206,753,955) | (156,564,380) |
| Payments to suppliers and vendors | (150,282,950) | (120,065,535) |
| Payments in support of the University of Florida and its integrated healthcare delivery system | (17,661,439) | (7,432,981) |
| Investment income received | 14,650,940 | 7,397,916 |
| Interest paid, net of amount capitalized | (10,138,161) | (8,208,295) |
| Net cash provided by operating activities and gains and losses | 42,524,868 | 68,793,101 |
| Cash flows from investing activities: | | |
| Payments received on notes receivable | 642,768 | 94,794 |
| Proceeds from sale of property and equipment | 2,927 | 29,668 |
| Purchase of marketable securities | (47,552,330) | (41,374,578) |
| Proceeds from sale of marketable securities | 30,000,000 | 46,369,750 |
| Purchase of property and equipment, including capitalized interest | (21,807,798) | (19,409,075) |
| Acquisition of entities | (120,551,176) | - |
| Loan to College of Medicine | (7,384,898) | - |
| Loan to University of Florida Health Services, Inc. | (862,244) | - |
| Deposit related to plant acquisition | (5,010,283) | - |
| (Increase) decrease in assets held by trustees, net | (58,790,013) | 2,661,256 |
| (Increase) decrease in assets internally designated for capital acquisition, net | 29,122,183 | (43,613,582) |
| Net cash used in investing activities | (202,190,864) | (55,241,767) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of debt | 190,000,000 | - |
| Payments of notes payable and long-term debt | (34,829,062) | (7,374,062) |
| Payment of bond issuance costs | (2,199,841) | - |
| Donor restricted funds received for equipment purchases | 245,870 | 362,195 |
| Net cash provided by (used in) financing activities | 153,216,967 | (7,011,867) |
| Net (decrease) increase in cash and cash equivalents | (6,449,029) | 6,539,467 |
| Cash and cash equivalents at beginning of year | 12,659,939 | 6,120,472 |
| Cash and cash equivalents at end of year | \$ 6,210,910 | \$ 12,659,939 |

See accompanying notes to consolidated financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Statements of Cash Flows (Continued)

for the years ended June 30, 1996 and 1995

| | <u>1996</u> | <u>1995</u> |
|--|----------------------|----------------------|
| Reconciliation of increase in net assets to net cash provided by operating activities and gains and losses: | | |
| Change in net assets | \$ 27,012,073 | \$ 21,559,167 |
| Adjustments to reconcile increase in net assets to net cash provided by operating activities and gains and losses: | | |
| Depreciation and amortization | 23,402,546 | 20,253,192 |
| Provision for bad debts | 18,462,706 | 19,969,130 |
| Net unrealized gains on marketable equity securities | - | (1,033,749) |
| (Gain) loss on sale of marketable equity securities | (3,174,036) | 1,309,353 |
| Other nonoperating expenses | 33,273 | 460,211 |
| Amortization of deferred charges and original issue discount | 349,322 | 144,579 |
| Restricted contributions received | (245,870) | (362,195) |
| (Increase) decrease in assets: | | |
| Patient accounts receivable | (31,046,385) | (15,168,644) |
| Due from Medicare, Medicaid and other third-party programs | 1,662,251 | 10,493,080 |
| Prepaid pension cost | 1,460,583 | 888,108 |
| Prepaid expenses and other current assets | (4,230,956) | 3,509,292 |
| Increase (decrease) in liabilities: | | |
| Accounts payable | 2,714,926 | 3,744,586 |
| Accrued expenses | 6,174,029 | 726,508 |
| Other liabilities | (49,594) | 2,300,483 |
| Total adjustments | <u>15,512,795</u> | <u>47,233,934</u> |
| Net cash provided by operating activities and gains and losses | <u>\$ 42,524,868</u> | <u>\$ 68,793,101</u> |

Supplemental schedule of non-cash investing and financing activities:

The acquisition of entities is summarized as follows:

| | |
|--|-----------------------|
| Acquisition of hospital facilities and related assets from SantaFe Healthcare, Inc. | \$ 159,828,886 |
| Liabilities assumed, including \$24,792,000 of projected loss to Shands over a three year period of a capitated services contract assumed from seller and the assumption of a capital lease obligation with a net present value of \$6,371,521 | 39,277,710 |
| Net cash paid | <u>\$ 120,551,176</u> |

See accompanying notes to consolidated financial statements.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries Notes to Consolidated Financial Statements

1. Organization and Summary of Significant Accounting Policies:

Shands Teaching Hospital and Clinics, Inc. ("the Corporation") was incorporated October 15, 1979 as a not-for-profit corporation. The Corporation operates a multi-hospital system. The primary facility is a 576 licensed bed teaching hospital located in Gainesville, Florida ("Shands Hospital"). Shands Hospital is a major tertiary care teaching institution and leading referral center in the State of Florida and the southeast United States, and facilitates medical education programs at the University of Florida.

The Corporation 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, 2030, with renewal provisions. The contractual agreement also provides for the transfer to the Corporation of all other assets and liabilities arising from the operation of the hospital facilities prior to July 1, 1980. At termination of the contractual agreement, the net assets of the Shands Hospital facility revert to the State Board of Education. Legal title to all buildings and improvements transferred to the Corporation 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 the Corporation. In addition, the contractual agreement limits the right of the State Board of Education to terminate the contractual agreement solely to the circumstance when the Corporation declares bankruptcy and, in such event, requires net revenues derived from the operation of the hospital facilities to continue to be applied to the payment of the Corporation's debts.

Under the terms of the contractual agreement, the Corporation is obligated to manage, operate, maintain and insure the hospital facilities in support of the programs of the Health Center at the University of Florida and further agrees to contract with the State Board of Education for the provision of these programs.

As of February 1, 1996, the Corporation purchased specific assets and assumed certain liabilities of certain entities of SantaFe Healthcare, Inc. and on June 1, 1996 the Corporation purchased specific assets of Doctors' Management, Inc. (Note 2). The consolidated financial statements include the accounts of the Corporation and the acquired entities (collectively, "the Acquired Entities") as follows:

- *Alachua General Hospital* - is an acute care community hospital located in Gainesville, Florida and licensed to operate 410 beds.
- *Lake Shore Hospital* - is an acute care community hospital located in Lake City, Florida and licensed to operate 125 beds.
- *Bradford Hospital* - is an acute care community hospital located in Starke, Florida and licensed to operate 54 beds.

Notes to Consolidated Financial Statements, Continued

1. Organization and Summary of Significant Accounting Policies, Continued:

- *Suwannee Hospital* - is an acute care community hospital located in Live Oak, Florida and licensed to operate 30 beds.
- *Vista Pavilion* - is an inpatient psychiatric and substance abuse facility located in Gainesville, Florida and licensed to operate 83 beds of which 59 are psychiatric and 24 are substance abuse.
- *Upreach Rehabilitation Hospital* - is a 40-bed inpatient rehabilitation hospital located on the same campus as Vista Pavilion.
- *Wellness* - is an entity that consists of a condominium medical office building, an outpatient oncology and radiation therapy center, a full service retail pharmacy, and non-medical center buildings.
- *SantaFe Community Care, Inc.* - provides meals, transportation and other services to the elderly in Alachua County, Florida.
- *Doctors' Management* - is a professional services billing and consulting organization.

SantaFe Community Care, Inc. and Doctors' Management are wholly owned subsidiaries of the Corporation. Lake Shore Hospital is a separate corporate entity under the control of the Corporation. All other entities described above operate as divisions of the Corporation. The accompanying financial statements consolidate the accounts of the Corporation and the Acquired Entities as of the date of acquisition (collectively, "Shands"). All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation - The accompanying consolidated financial statements have been prepared on the accrual basis and are prepared under the guidance of Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations," which was adopted effective July 1, 1995. SFAS No. 117 requires a change in the display of the consolidated financial statements based on the concept of net assets. Net assets are identified as unrestricted, temporarily restricted, or permanently restricted. The impact of this accounting change on 1995 net assets is not material.

Income Tax Status - The Corporation and substantially all of the Acquired Entities are organized as not-for-profit corporations as described in Section 501(c)(3) of the Internal Revenue Code ("Code") and are exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. They are also exempt from state income taxes on related income pursuant to Chapter 220 of the Florida Statutes. The Code provides for taxation of unrelated business income under certain circumstances. Shands has no material unrelated business income; however, such status is subject to final determination upon examination of the related income tax returns by the appropriate taxing authorities.

Notes to Consolidated Financial Statements, Continued

1. Organization and Summary of Significant Accounting Policies, Continued:

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with original maturities of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements. Shands routinely invests its surplus operating funds in money market mutual funds. These funds generally invest in highly liquid U.S. government and agency obligations.

Investments and Investment Income - Marketable equity securities included in investment portfolios are carried at the lower of aggregate cost or market value at the balance sheet date. Other investments are stated at cost, which approximates market value. The average cost method is used to determine the cost of investments sold.

Assets Limited as to Use - Assets limited as to use primarily include designated assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, as well as assets held by trustees under indenture agreements. Amounts required to meet current liabilities have been reclassified in the consolidated balance sheets at June 30, 1996 and 1995.

Property and Equipment - Property and equipment acquisitions are recorded at cost. Property and equipment donated for hospital operations is recorded at fair value at the date of receipt as an addition to net assets. Depreciation for financial reporting purposes is computed using the straight-line method over the estimated useful lives of the related depreciable assets. Property and equipment under capital leases are amortized using the straight-line method over the shorter period of the lease term or the estimated useful life of the related assets. Gains and losses on dispositions are recorded in the year of disposal.

Net Patient Service Revenue - Shands has agreements with third-party payors that provide for payments for services and supplies at amounts different from its established rates. Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Charity Care - Shands provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Shands does not pursue collection of accounts that qualify as charity care, they are not reported as revenue.

Notes to Consolidated Financial Statements, Continued

1. Organization and Summary of Significant Accounting Policies, Continued:

Costs of Borrowing - 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. Deferred financing costs and original issue discounts are amortized over the period the obligation is outstanding using the interest method. Amortization of deferred financing costs and original issue discounts is capitalized during the period of construction of capital assets.

Other Assets - The excess of the acquisition cost over the fair value of the net assets of businesses acquired is amortized on a straight-line basis over a 20-year period. (Note 2.) This amortization was \$977,000 for the year ended June 30, 1996. The Corporation continually evaluates whether events and circumstances have occurred that indicate whether long-lived assets (including property and equipment) have been impaired. Measurement is based on those assets' estimated fair values. There were no significant impairments in 1996 or 1995.

New Accounting Standard - In November 1995, the Financial Accounting Standards Board released Statement of Financial Accounting Standards No. 124, "Accounting for Certain Investments Held by Not-for-Profit Organizations." This statement will be effective for Shands' fiscal year ending June 30, 1997. Generally it requires that investments in equity securities with readily determinable fair values and all investments in debt securities be reported at fair value with gains and losses included in a statement of operations.

Reclassifications - Certain amounts in the 1995 consolidated financial statements have been reclassified to conform to the 1996 financial statement presentation. These reclassifications have no effect on the increase in unrestricted net assets.

2. Acquisitions:

As described in Note 1, during 1996 the Corporation purchased specific assets and assumed certain liabilities of SantaFe Healthcare, Inc. and purchased specific assets of Doctors' Management, Inc. The acquisitions were accounted for as purchases, accordingly, the purchase price was allocated to assets acquired based on their estimated fair values. The operations of the entities acquired are included in the accompanying financial statements from their respective dates of acquisition.

The Corporation paid cash of approximately \$120,551,000 to purchase the specific assets (total cost of approximately \$159,829,000) and assumed liabilities of approximately \$39,278,000 which included the assumption of a capital lease obligation for Lake Shore Hospital and a projected liability assumed for a three-year capitated services contract with a Health Maintenance Organization (HMO). This projected liability, included in other liabilities in the accompanying consolidated balance sheet is being amortized over a three-year period. Included in the cost of assets acquired is goodwill of approximately \$46,891,000 (excess of cost of net assets acquired over estimated fair value of tangible and identifiable intangible assets) relating to the purchases.

Notes to Consolidated Financial Statements, Continued

2. Acquisitions, Continued:

As a contingent term of the purchase of the Acquired Entities, an adjustment of the purchase price is to be made based upon audited financial statements of the Acquired Entities for the period ended January 31, 1996 and upon certain representations and warranties of the seller. Remedies are provided to resolve any disputed amounts related to the purchase price of the net assets acquired. The Corporation has submitted a claim to the seller for a reduction of the purchase price; however, the amount of any refund from the ultimate resolution of this matter is not presently known.

3. Charity Care:

Shands maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The approximate charges foregone, based on established rates, for charity care provided for fiscal 1996 and 1995 were approximately \$35,700,000 and \$28,000,000, respectively.

4. Net Patient Service Revenue:

Shands has agreements with third-party payors that provide for payments for services and supplies at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

- **Medicare** - Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain outpatient services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Shands is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits thereof by the Medicare fiscal intermediary. Shands Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 1993. As part of acquisition of the Acquired Entities described previously in Notes 1 and 2, the Corporation did not assume any liabilities or obligations prior to February 1, 1996 under the terms of the Medicare, Medicaid, Blue Cross or other third-party payor programs. Shands' classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization under contract with Shands.
- **Medicaid** - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. Shands is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits thereof by the Medicaid fiscal intermediary. Shands Hospital's Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 1993.

Notes to Consolidated Financial Statements, Continued

4. Net Patient Service Revenue, Continued:

- **Other** - Shands has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to Shands under these agreements includes prospectively determined rates per discharge and per day, discounts from established charges, and monthly capitation payments based on the number of the HMO's participants.

5. Investments:

The composition of investments at June 30, 1996 and 1995 is set forth in the following table. Assets limited as to use that are required for obligations classified as current liabilities are reported in current assets. Investments are stated at the lower of cost or market.

| | <u>1996</u> | <u>1995</u> |
|---|-----------------------|-----------------------|
| Current Assets | | |
| Marketable securities: | | |
| Fixed income mutual funds | \$ 34,454,886 | \$ 13,728,520 |
| Assets Limited as to Use | | |
| Internally designated for capital acquisitions and by agreements with third-party payors for funded depreciation: | | |
| Marketable securities: | | |
| Fixed income mutual funds | \$ 42,616,537 | \$ 63,489,185 |
| Equity funds | 31,236,491 | 39,486,026 |
| | <u>73,853,028</u> | <u>102,975,211</u> |
| Held by trustees—under indenture agreement: | | |
| Cash and short-term investments | 60,524,476 | 1,734,463 |
| | <u>\$ 134,377,504</u> | <u>\$ 104,709,674</u> |
| Investment income includes: | | |
| | <u>1996</u> | <u>1995</u> |
| Interest and dividends earned on investments | \$ 14,107,266 | \$ 7,242,344 |
| Unrealized gains on marketable securities | - | 1,033,749 |
| Realized gains (losses) on marketable securities | 3,174,036 | (1,309,353) |
| | <u>\$ 17,281,302</u> | <u>\$ 6,966,740</u> |

Gross realized gains and (losses) on sales of marketable securities were \$3,174,036 and \$0 and \$0 and \$(1,309,353), respectively, for fiscal 1996 and 1995.

Notes to Consolidated Financial Statements, Continued

6. Property and Equipment:

A summary of property and equipment follows:

| | <u>1996</u> | <u>1995</u> |
|--|-----------------------|-----------------------|
| Land | \$ 8,184,720 | \$ 2,223,825 |
| Buildings and leasehold improvements | 300,246,014 | 228,328,037 |
| Furniture and equipment | 172,463,138 | 138,401,593 |
| | <u>480,893,872</u> | <u>368,953,455</u> |
| Less accumulated depreciation and amortization | (158,506,831) | (139,956,358) |
| | <u>322,387,041</u> | <u>228,997,097</u> |
| Construction in progress | 4,787,009 | 5,609,796 |
| | <u>4,787,009</u> | <u>5,609,796</u> |
| Property and equipment, net | <u>\$ 327,174,050</u> | <u>\$ 234,606,893</u> |

Depreciation and amortization expense related to the property and equipment for fiscal 1996 and 1995 was \$22,155,445 and \$20,004,587, respectively.

7. Notes Payable and Long-Term Debt:

A summary of notes payable and long-term debt, including a capital lease obligation, is as follows:

| | <u>1996</u> | <u>1995</u> |
|---|-----------------------|-----------------------|
| Health Facilities Revenue Bonds: | | |
| Series 1988, interest of 6.875% at June 30, 1996, final maturity December 1996 | \$ 1,000,000 | \$ 2,000,000 |
| Series 1992R, coupon interest rate of 5.3% to 6.2% and effective interest rate of 4.9% to 6.39% at June 30, 1996, principal maturing in varying annual amounts, final maturity December 2015 | 129,190,000 | 131,575,000 |
| Series 1996A, coupon interest rate of 3.75% to 6.25% and effective interest rate of 3.75% to 5.86% at June 30, 1996, principal maturing in varying annual amounts, final maturity December 2026 | 75,000,000 | - |
| Health Facilities Revenue Note, Series 1993, interest of 3.86% to 3.92% at June 30, 1996, final maturity February 2001 | 6,618,618 | 8,062,680 |
| Notes payable to Banks, interest of 5.8125% at June 30, 1996, interest payable monthly based on LIBOR plus .375% | 85,000,000 | - |
| Capital lease obligation | 6,347,501 | - |
| | <u>303,156,119</u> | <u>141,637,680</u> |
| Less net unamortized bond discount | (3,432,835) | (3,769,485) |
| Total notes payable and long-term debt | <u>299,723,284</u> | <u>137,868,195</u> |
| Less current portion (less net bond discount of \$184,753 and \$167,086 for 1996 and 1995, respectively) | (14,854,309) | (4,661,976) |
| Long-term portion | <u>\$ 284,868,975</u> | <u>\$ 133,206,219</u> |

Notes to Consolidated Financial Statements, Continued

7. Notes Payable and Long-Term Debt, Continued:

Principal payments on long-term debt and payments on the capital lease obligation are as follows:

| | <u>Long-Term Debt</u> | <u>Capital Lease Obligation</u> |
|--|---------------------------|-------------------------------------|
| Year ending June 30: | | |
| 1997 | \$ 15,039,062 | \$ 536,517 |
| 1998 | 6,349,062 | 538,825 |
| 1999 | 6,614,062 | 541,353 |
| 2000 | 6,874,062 | 544,107 |
| 2001 | 6,557,370 | 547,091 |
| Thereafter | <u>255,375,000</u> | <u>18,874,931</u> |
| | <u>\$ 296,808,618</u> | <u>21,582,824</u> |
| Less amount representing interest under capital lease obligation | | <u>(15,235,323)</u> |
| Present value of net minimum lease payments | | <u>\$ 6,347,501</u> |

Deferred charges and other assets include bond issuance costs of \$4,713,070 and \$2,772,540 as of June 30, 1996 and 1995, respectively. Amortization of bond issuance costs, net of capitalization, was \$243,225 and \$221,639 for fiscal 1996 and 1995, respectively. Such amortization is included in depreciation and amortization in the consolidated statements of operations.

A summary of interest expense follows:

| | <u>1996</u> | <u>1995</u> |
|---------------------------|----------------------|---------------------|
| Total interest incurred | \$ 11,702,301 | \$ 8,491,561 |
| Less interest capitalized | (482,870) | (186,373) |
| Interest expense, net | <u>\$ 11,219,431</u> | <u>\$ 8,305,188</u> |

The Corporation entered into a Master Trust Indenture dated March 1, 1996 with First Union National Bank of Florida as Master Trustee. The Master Trust Indenture serves as the basic financing document for the Corporation. The Master Trust Indenture provides the ability for other legal entities to join with the Corporation in pooling credit resources in order to achieve lower borrowing costs and to become jointly and severally liable with the Corporation for the payment of obligations issued under the Master Trust Indenture. Such entities, together with the Corporation, comprise the Obligated Group. Certain other entities whose resources are subject to the control of an Obligated Group member may be designated as Restricted Affiliates and will also be counted for purposes of pooling of credit resources. In addition, certain other entities may be designated as Limited Obligors by entering into a guarantee relationship with the Obligated Group in which event a portion of such entities' revenues may be combined with those of the Obligated Group for the determination of net revenue available for debt service. Lake Shore Hospital, SantaFe Community Care, Inc., and Doctors' Management are not members of the Obligated Group, nor are they designated as Restricted Affiliates or Limited Obligors. The Master Trust Indenture provides for specific restrictive covenants, including a debt service coverage requirement.

Notes to Consolidated Financial Statements, Continued

7. Notes Payable and Long-Term Debt, Continued:

The Alachua County Health Facilities Authority (the "Authority") has issued the Health Facilities Revenue Bonds on behalf of Shands for construction, renovation, equipment, certain refinancings and acquisition of the Acquired Entities. The Series 1988, Series 1992R, and Series 1996A bonds are collateralized by the unconditional and irrevocable guarantee of the Municipal Bond Investors Assurance Corporation. The Health Facilities Revenue Bonds and Note are subject to specific restrictive covenants, including minimum debt service coverage under the Master Trust Indenture. The Series 1992R bonds maturing on or after December 1, 2003 are redeemable at Shands' option at par value. The Series 1996A bonds maturing on December 1, 2006 and 2007 are redeemable at Shands' option at 102% and 101% of par value, respectively. The Series 1996A bonds maturing on or after December 1, 2008 are redeemable at Shands' option at par value.

In January 1996, Shands issued bank notes of \$115,000,000 to finance the acquisition of the Acquired Entities. Interest is payable monthly based on LIBOR plus .375%. The notes mature January 28, 1997.

In December 1993, Shands issued a \$10,000,000 Revenue Note, Series 1993, to acquire medical and computer equipment. The note is payable in monthly installments of \$120,338 plus interest ranging from 3.86% to 3.92% through February 1, 2001.

Pursuant to an Escrow Deposit Agreement dated December 1, 1985, an Escrow Fund was established with proceeds from the issuance of Series 1985R bonds to acquire government obligations to provide for the payment of the principal, premium, if any, and interest on Series 1982 bonds as the same becomes due and payable. The amount of debt considered extinguished as of June 30, 1996 and 1995 is \$1,740,000.

Pursuant to an Escrow Deposit Agreement dated January 1, 1992, an Escrow Fund was established with proceeds from the issuance of Series 1992R bonds and existing debt service reserves previously held for the defeased bonds to acquire government obligations to provide for the payment of the principal, premium, if any, and interest on the refunded portions of Series 1985, Series 1985A, Series 1985R, and Series 1988 bonds as the same becomes due and payable. The amount of the debt considered extinguished as of June 30, 1996 and 1995 is \$17,720,000.

Substantially all of the land, buildings and equipment of Lake Shore Hospital are leased to Lake Shore Hospital under a capital lease arrangement with payments due monthly, in varying amounts which range from approximately \$42,000 to \$67,000. The lease expires March 2031.

On October 22, 1996, the Corporation issued \$75,000,000 of Series 1996B Health Facilities Revenue Bonds to refinance \$75,000,000 of the \$85,000,000 Notes Payable to Banks which were scheduled to mature in January 1997. Because of this refinancing, the \$75,000,000 is classified as long-term as of June 30, 1996 in the accompanying balance sheets. The Bonds

Notes to Consolidated Financial Statements, Continued

7. Notes Payable and Long-Term Debt, Continued:

are to be repaid beginning in 2016 with final maturity in 2026 and bear interest at a variable rate not to exceed 12%. The Series 1996B bonds are collateralized by the unconditional and irrevocable guarantee of the Municipal Bond Investors Assurance Corporation.

8. Pension Plan:

Effective April 1, 1980, the Corporation adopted a defined benefit pension plan covering all of the Corporation's employees who have attained the age of 21 and have more than one year of service. Effective July 1, 1980, the Corporation assumed liability for funding pension and retirement benefits, including past service costs, for all vested and non-vested employees who had terminated employment with the State of Florida to accept employment with the Corporation. The Corporation's policy is to fund the ERISA minimum requirement. Effective June 30, 1995, the Plan elected to change the assumption used for mortality rates to the 1983 group annuity mortality table for males and females; however, this change does not materially affect pension costs for the current year.

Employees who had earned one or more years of credited service as an employee of one of the Acquired Entities were admitted into the plan on February 1, 1996 and began accruing benefits as of that date.

The actuarially computed net periodic pension cost for 1996 and 1995 follows:

| | <u>1996</u> | <u>1995</u> |
|--|----------------------|----------------------|
| Service cost for benefits earned during the year | \$ 9,415,577 | \$ 7,873,887 |
| Interest cost on projected benefit obligation | 8,656,540 | 7,006,564 |
| Actual return on plan assets | (22,367,758) | (4,029,442) |
| Net amortization and deferral | <u>17,044,989</u> | <u>(52,034)</u> |
| Net periodic pension cost | <u>\$ 12,749,348</u> | <u>\$ 10,798,975</u> |

The following summarizes the funded status of the plan and the prepaid pension cost recognized in Shands' consolidated balance sheets:

| | <u>1996</u> | <u>1995</u> |
|--|----------------------|----------------------|
| Actuarial present value of benefit obligations: | | |
| Vested benefits | \$ (80,379,863) | \$ (66,171,590) |
| Nonvested benefits | (14,222,081) | (10,784,218) |
| Accumulated benefit obligation | (94,601,944) | (76,955,808) |
| Effect of projected future salary increases | (35,481,521) | (31,460,437) |
| Projected benefit obligation | <u>(130,083,465)</u> | <u>(108,416,245)</u> |
| Plan assets at fair value | 112,773,100 | 82,065,651 |
| Projected benefit obligation in excess of plan assets | (17,310,365) | (26,350,594) |
| Unrecognized net loss | 17,326,277 | 32,931,643 |
| Unrecognized net asset | (3,306,973) | (4,013,591) |
| Unrecognized prior service cost | <u>4,142,262</u> | <u>491,873</u> |
| Prepaid pension cost included in deferred charges and other assets in the accompanying consolidated balance sheets | <u>\$ 851,201</u> | <u>\$ 3,059,331</u> |

Notes to Consolidated Financial Statements, Continued

8. Pension Plan, Continued:

| | <u>1996</u> | <u>1995</u> |
|--------------------------|-------------|-------------|
| Assumptions: | | |
| Settlement rate | 7.75% | 8.00% |
| Long term rate of return | 9.50% | 9.50% |
| Salary scale | 6.00% | 6.00% |

Plan assets consist principally of investments in common stocks, fixed income and equity mutual funds, and short-term investment funds.

Additionally, Shands provides a supplemental pension plan and a deferred compensation plan for certain key employees. The cost of the deferred compensation plan for 1996 and 1995 was approximately \$358,000 and \$413,000, respectively. The cost of the supplemental pension plan for 1996 and 1995 follows:

| | <u>1996</u> | <u>1995</u> |
|---------------------------|-------------------|-------------------|
| Current service cost | \$ 119,000 | \$ 221,000 |
| Prior service cost | 232,000 | 165,000 |
| Interest cost | 263,000 | 219,000 |
| Supplemental pension cost | <u>\$ 614,000</u> | <u>\$ 605,000</u> |

Net periodic pension cost, the cost of the deferred compensation plan and the cost of the supplemental pension plan are included in salaries, wages and benefits in the consolidated statements of operations.

9. Postretirement Benefits Other Than Pensions:

Shands provides health insurance benefits for retired employees and certain dependents when the employee becomes eligible for these benefits by satisfying plan provisions which include certain age and/or service requirements. Employees of the Acquired Entities who met the appropriate requirements as of February 1, 1996 are eligible to receive postretirement health benefits. Health benefits are provided through a VEBA trust. The health insurance plan covers substantially all employees and is a contributory plan with contributions adjusted annually, and contains other cost sharing features such as deductibles and coinsurance. The plan is unfunded. Shands sponsors no other postretirement benefit plans.

Postretirement health insurance benefits cost for 1996 and 1995 follows:

| | <u>1996</u> | <u>1995</u> |
|---------------------------------------|---------------------|-------------------|
| Service cost | \$ 487,000 | \$ 471,000 |
| Interest cost | 393,000 | 327,000 |
| Amortization of transition obligation | 157,000 | 157,000 |
| Postretirement benefit cost | <u>\$ 1,037,000</u> | <u>\$ 955,000</u> |

Notes to Consolidated Financial Statements, Continued

9. Postretirement Benefits Other Than Pensions, Continued:

The following summarizes the funded status of the plan and the accrued postretirement benefit liability included in other liabilities in Shands' consolidated balance sheets:

| | June 30, | |
|--|---------------------|---------------------|
| | 1996 | 1995 |
| Accumulated postretirement benefit obligation (APBO): | | |
| Retirees and surviving spouses | \$ 563,000 | \$ 574,000 |
| Fully eligible active plan participants | 2,935,000 | 733,000 |
| Other active plan participants | 4,346,000 | 3,161,000 |
| Total APBO | <u>7,844,000</u> | <u>4,468,000</u> |
| Plan assets at fair value | - | - |
| Accumulated postretirement benefit obligation in excess of plan assets | 7,844,000 | 4,468,000 |
| Unrecognized transition obligation | (2,677,000) | (2,834,000) |
| Unrecognized net loss | (2,554,000) | 30,000 |
| Accrued postretirement benefit liability | <u>\$ 2,613,000</u> | <u>\$ 1,664,000</u> |

The discount rate used in determining the accumulated postretirement benefit obligation was 7.75% at June 30, 1996, and 8% at June 30, 1995. The annual assumed rate of increase in the health care cost trend rate was 10.3% for June 30, 1996, and 11.4% for June 30, 1995. It is anticipated to decrease gradually to 5.5% by the year 2007. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement obligation as of June 30, 1996 and 1995 by approximately \$638,000 and \$565,000, respectively. The net periodic postretirement benefit cost would increase by \$110,000 and \$128,000 for 1996 and 1995, respectively.

10. Professional Liability:

Shands participates in the J. Hillis Miller Health Center Insurance Trust Fund pursuant to Section 240.513 (3) (d), Florida Statutes, for professional liability (malpractice) coverage (occurrence basis) up to \$2,000,000 per specific claim and \$5,000,000 for annual aggregate claims. Above these limits, excess professional liability insurance (claims-made basis) in the amount of \$30,000,000 is provided by commercial insurance carriers. To the extent any such commercial insurance carrier is unable to meet its obligations, Shands could be liable for any defaulted amounts. In Shands' normal conduct of its business, it is a party to certain malpractice litigation. In the opinion of management, the ultimate outcome of any such litigation will not materially affect its consolidated financial statements.

Notes to Consolidated Financial Statements, Continued

11. Self-Insurance:

Shands has a self-insurance plan for health and medical coverages for the employees of Shands Hospital. Amounts contributed by Shands and its employees to the plan are determined by the level of benefits coverage selected by each employee. Shands has contracted with a commercial insurance company to provide stop-loss coverage. The stop-loss provision provides for 100% reimbursement of specific claims for services incurred and paid in the same plan year in excess of \$150,000. Expense related to the self-insured health and medical plan for 1996 and 1995 was approximately \$7,112,000 and \$7,392,000, respectively.

Shands is self-insured for workers' compensation up to \$400,000 per occurrence, and has purchased excess coverage from commercial carriers up to the amount allowed by Florida Statutes.

12. Commitments:

Property and Equipment Commitments - Shands has contracts of approximately \$9,300,000 for the construction and remodeling of Shands Hospital facilities and for the purchase and installation of computer application software for its core operation systems. As of June 30, 1996 the remaining commitment on these contracts was approximately \$5,800,000.

Obligations Under Operating Leases - Shands leases a helicopter for emergency medical services and certain other property and equipment under operating leases with renewal terms generally from one to five years. In addition to the base rent payments, on some property leases Shands pays a monthly allocation of the buildings' operating expenses, while the helicopter lease provides for additional payments based on actual flight time. Future minimum lease payments under noncancelable operating leases with initial or remaining terms in excess of one year as of June 30, 1996 follow:

| | <u>Minimum Lease Payments</u> |
|----------------------|---------------------------------------|
| Year ending June 30: | |
| 1997 | \$ 1,846,000 |
| 1998 | 1,805,000 |
| 1999 | 1,618,000 |
| 2000 | 1,365,000 |
| 2001 | 1,158,000 |
| Thereafter | <u>136,000</u> |
| | <u>\$ 7,928,000</u> |

Notes to Consolidated Financial Statements, Continued

12. Commitments, Continued:

Rental expense for the years ended June 30, 1996 and 1995 was approximately \$4,220,000 and \$3,016,000, respectively.

Other Commitment - At June 30, 1996 Shands has issued a guaranty of the outstanding bond indebtedness of Lake Shore Hospital Authority of approximately \$3,900,000 plus interest. Shands has not previously been required to assume any responsibility for the indebtedness and is not currently aware of any conditions which would cause a financial loss. As a result, Shands believes that risk of loss relative to the guaranty is remote.

13. Transactions with Related Parties:

The University of Florida College of Medicine (College of Medicine) conducts its primary teaching and clinical activities at Shands Hospital through the services of attending faculty physicians, other healthcare professionals and medical students in the care and treatment of patients seen at Shands Hospital. University of Florida Health Services, Inc. (UFHSI) was established in February 1995 as a Florida Board of Regents Direct Support Organization to support the programs of the University of Florida Health System by developing a comprehensive integrated healthcare delivery system.

Exclusive of the State of Florida funding for indigent care and mandated programs, Shands has various agreements for services provided by the University of Florida for support of the educational, clinical and research activities of the College of Medicine, maintenance, security, utilities and various other services. Expenses related to these agreements were approximately \$28,000,000 and \$27,500,000 in 1996 and 1995, respectively. At June 30, 1996 and 1995, approximately \$2,534,000 and \$3,684,000, respectively, were owed to the University of Florida under these contracts and has been included in accounts payable in the consolidated balance sheets.

Shands provides contracted services at cost to the University of Florida 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 were approximately \$4,894,000 and \$4,694,000 in 1996 and 1995, respectively. At June 30, 1996 and 1995, approximately \$992,000 and \$1,226,000, respectively, was owed to Shands under these agreements and is included in prepaid expenses and other current assets in the consolidated balance sheets.

Notes to Consolidated Financial Statements, Continued

13. Transactions with Related Parties, Continued:

Expenditures in support of the University of Florida and its integrated healthcare delivery system during the years ended June 30, 1996 and 1995 were \$17,661,439 and \$7,431,060, respectively. These expenditures include the following:

| | <u>1996</u> | <u>1995</u> |
|--|----------------------|---------------------|
| Enhancement of academic and clinical research for the College of Medicine | \$ 5,000,000 | \$ 5,000,000 |
| Funding for development of the University of Florida Brain Institute | 5,750,000 | - |
| Funding support for UFHSI | 3,300,000 | 1,121,836 |
| Funding of satellite clinic operations for the College of Medicine | 1,238,650 | - |
| Project costs relating to the portion of the chiller plant to be utilized by the College of Medicine | 995,464 | 402,190 |
| Other | <u>1,377,325</u> | <u>907,034</u> |
| | <u>\$ 17,661,439</u> | <u>\$ 7,431,060</u> |

In addition to the amount shown above Shands has loaned the College of Medicine \$7,384,898 to develop the Brain Institute. The loan is to be repaid in equal installments over three years beginning in 1997.

On April 24, 1996, the Corporation's Board of Directors approved an initiative to more fully integrate the management and operations of the Corporation, the College of Medicine and UFHSI. Subsequent to year-end, the Board plans to provide further direction with respect to this proposed reorganization.

14. Financial Instruments:

Pursuant to Statement of Financial Accounting Standards Number 107, "Disclosures About Fair Value of Financial Instruments," the following information is presented relative to Shands' financial instruments.

As of June 30, 1996 and 1995, the carrying amount of certain of Shands' financial instruments including cash and cash equivalents and assets limited as to use (held in trust) approximated fair value because of their short maturities.

The fair value for marketable equity securities and assets limited as to use (internally designated) are based on quoted market prices and dealer quotes. The estimated fair value as of June 30, 1996 and 1995 was approximately \$115,244,000 and \$124,833,000, respectively. The carrying amount as of June 30, 1996 and 1995 was approximately \$108,308,000 and \$16,704,000, respectively.

Notes to Consolidated Financial Statements, Continued

14. Financial Instruments, Continued:

The fair value of long-term debt is estimated based on dealer quotes for hospital 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 estimated fair value as of June 30, 1996 and 1995 was approximately \$295,241,000 and \$142,736,000, respectively. The carrying amount as of June 30, 1996 and 1995 was \$293,376,000 and \$137,868,000 respectively. These values merely represent a general approximation of possible value and may never actually be realized.

Certain financial instruments potentially subject Shands to concentrations of credit risk and market risk. These financial instruments consist primarily of cash and cash equivalents, marketable equity securities, fixed income mutual funds and equity funds, short-term investments, and patient accounts receivable.

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 and investments with what management believes to be high quality financial institutions and thus limits its credit exposure.

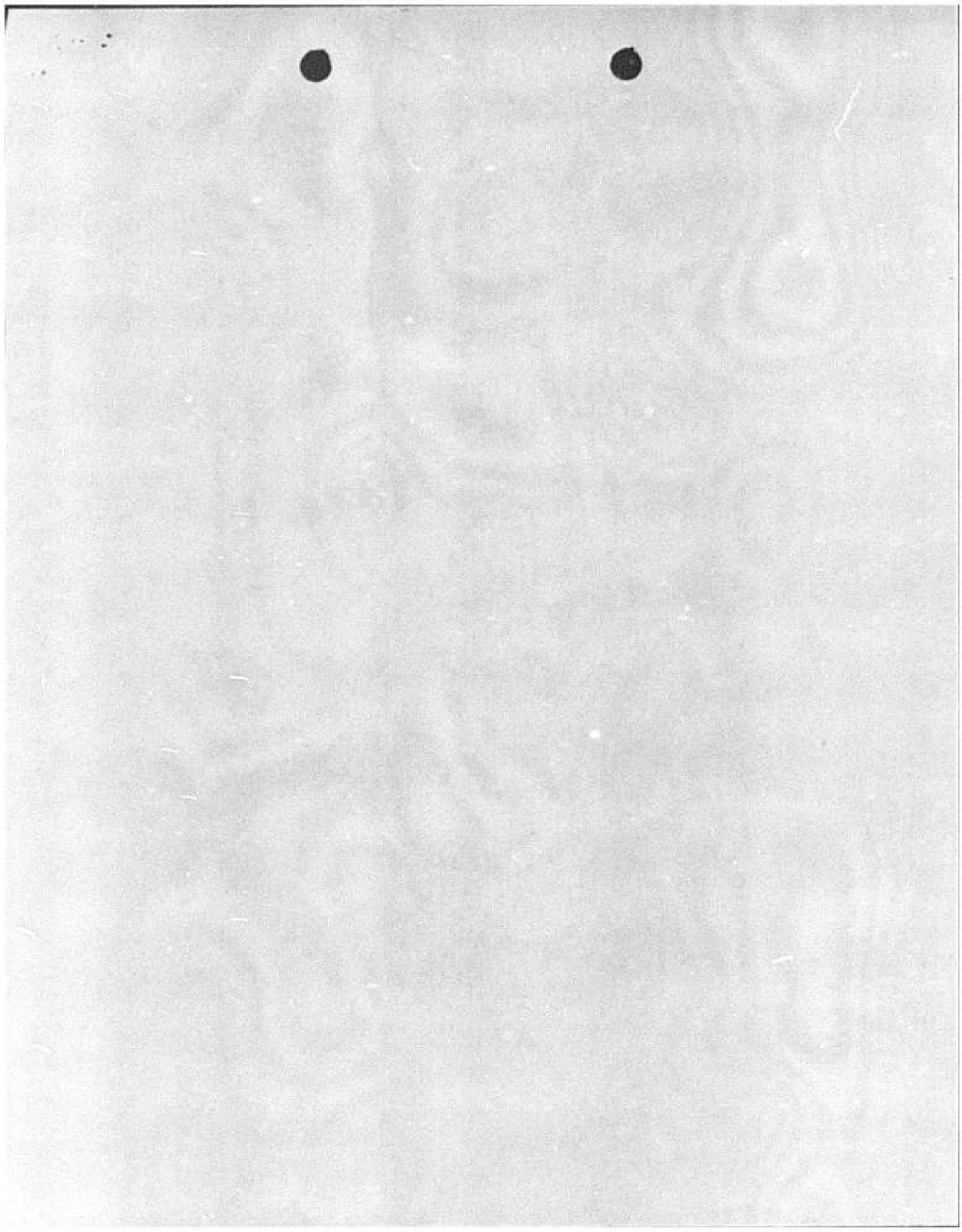
Supplemental Information

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Balance Sheet
June 30, 1996

| ASSETS | Shands at UF | Shands at A/GH | Shands at Lake Shore | Shands at Starke | Shands at Live Oak | Shands at Vista | Upreach Rehabilitation Hospital | Other | Consolidating Entries and Eliminations | Total |
|--|-----------------|----------------|----------------------|------------------|--------------------|-----------------|---------------------------------|---------------|--|----------------|
| | Current assets: | \$ 1,724,560 | \$ 4,375,937 | \$ 7,206 | \$ - | \$ - | \$ - | \$ - | \$ 603,297 | \$ - |
| Cash and cash equivalents | 34,454,896 | - | - | - | - | - | - | - | - | 34,454,896 |
| Marketable securities | 69,403,292 | 11,102,523 | 3,819,152 | 1,464,272 | 1,168,419 | 846,734 | 5,516,705 | 12,498,237 | - | 101,808,334 |
| Patient accounts receivable, net of estimated uncollectibles | 1,051,483 | - | 302,466 | - | - | - | 120,000 | 7,773,247 | - | 9,247,196 |
| Due from Medicare, Medicaid, and other third party programs | 12,483,006 | 1,938,774 | 261,728 | 130,176 | 212,348 | 9,115 | - | 642,554 | - | 15,807,789 |
| Prepaid expenses and other current assets | 8,050,178 | - | - | - | - | - | - | - | - | 8,050,178 |
| Assets held as to use | 127,165,495 | 17,417,234 | 4,320,552 | 1,584,448 | 1,380,765 | 858,849 | 1,636,705 | 31,005,245 | - | 175,379,293 |
| Total current assets | \$ 1,724,560 | \$ 4,375,937 | \$ 7,206 | \$ - | \$ - | \$ - | \$ - | \$ 603,297 | \$ - | \$ 6,708,810 |
| Assets held as to use: | | | | | | | | | | |
| Held by trustees | 60,524,476 | - | - | - | - | - | - | - | - | 60,524,476 |
| Intensely depreciated for capital acquisition | 73,853,028 | - | - | - | - | - | - | - | - | 73,853,028 |
| Less amount required to meet current obligations | 134,377,504 | - | - | - | - | - | - | - | - | 134,377,504 |
| | (8,050,178) | - | - | - | - | - | - | - | - | (8,050,178) |
| Noncurrent assets held as to use | 126,327,326 | - | - | - | - | - | - | - | - | 126,327,326 |
| Property and equipment, net | 232,843,900 | 49,292,306 | 6,862,826 | 6,625,473 | 4,415,305 | 6,958,578 | 3,702,723 | 16,632,859 | - | 327,174,000 |
| Excess of cost over fair value of net assets acquired, net | 1,478,635 | 32,060,253 | 2,495,793 | 811,944 | 725,300 | 3,028,279 | 4,108,795 | 1,000,810 | - | 45,914,869 |
| Investment in affiliated entities | 160,066,225 | 1,276,140 | 230,954 | - | - | - | - | - | (181,573,319) | - |
| Deferred charges and other assets: | | | | | | | | | | |
| Due from affiliated entities, net | 404,482 | - | - | 32,315 | 386,792 | 871,362 | 1,177,989 | 646,744 | (3,519,694) | - |
| Other assets | 24,408,040 | - | - | 32,315 | 386,792 | 871,362 | 1,177,989 | 646,744 | - | 24,408,040 |
| Total deferred charges and other assets | \$ 24,812,522 | \$ - | \$ - | \$ 32,315 | \$ 386,792 | \$ 871,362 | \$ 1,177,989 | \$ 646,744 | \$ (3,519,694) | \$ 24,408,040 |
| Total assets | \$ 672,794,103 | \$ 100,046,913 | \$ 13,860,225 | \$ 8,964,180 | \$ 6,918,252 | \$ 11,717,168 | \$ 10,626,712 | \$ 20,300,458 | \$ (165,003,003) | \$ 699,203,608 |
| LIABILITIES AND NET ASSETS | | | | | | | | | | |
| Current liabilities: | | | | | | | | | | |
| Notes payable and long term debt, current portion | 14,854,309 | - | - | - | - | - | - | - | - | 14,854,309 |
| Accounts payable | 16,803,110 | 1,670,740 | 520,242 | 88,166 | 227,469 | 82,685 | 180,436 | 642,891 | - | 20,275,881 |
| Accrued expenses | 24,069,151 | 3,166,624 | 900,302 | 370,493 | 605,242 | 333,851 | 847,811 | 3,960,372 | - | 33,354,046 |
| Total current liabilities | 55,726,570 | 4,837,364 | 1,420,544 | 468,659 | 832,751 | 418,636 | 1,028,349 | 3,703,363 | - | 68,434,216 |
| Long term liabilities: | | | | | | | | | | |
| Long term debt, net of current portion | 278,521,474 | - | 6,347,501 | - | - | - | - | - | - | 284,868,975 |
| Due to affiliated entities | 9,825,347 | 2,729,137 | 272,808 | 877,026 | 711,746 | 471,522 | 475,253 | 517,341 | (3,519,694) | 31,477,644 |
| Other liabilities | 344,083,391 | 23,371,897 | 10,474,423 | 1,345,695 | 1,544,477 | 988,158 | 1,503,602 | 4,868,876 | (1,519,684) | 384,780,835 |
| Total liabilities | 328,710,712 | 76,474,116 | 3,375,802 | 7,618,485 | 5,373,775 | 10,829,810 | 8,122,810 | 34,491,582 | (1,519,684) | 314,422,773 |
| Net assets, unrestricted | \$ 672,794,103 | \$ 100,046,913 | \$ 13,860,225 | \$ 8,964,180 | \$ 6,918,252 | \$ 11,717,168 | \$ 10,626,712 | \$ 20,300,458 | \$ (165,003,003) | \$ 699,203,608 |

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Statement of Operations
 for the year ended June 30, 1996

| | Shands at UF | Shands at AHCN | Shands at Lake Shore | Shands at Starke | Shands at Live Oak | Shands at Viera | Upchurch Rehabilitation Hospital | Other | Consolidating Entries and Eliminations | Total |
|---|----------------|----------------|----------------------|------------------|--------------------|-----------------|----------------------------------|---------------|--|----------------|
| Unrestricted revenues, gains and other support | \$ 322,746,783 | \$ 36,919,662 | \$ 9,890,401 | \$ 4,015,775 | \$ 3,218,181 | \$ 2,216,115 | \$ 3,345,599 | \$ 43,516,239 | \$ - | \$ 425,770,722 |
| Net patient service revenue | 4,469,220 | - | - | - | - | - | - | - | - | 4,469,220 |
| State educational support | 17,043,811 | 32,668 | 28,459 | 4,585 | 21,751 | 113,506 | 394 | 28,128 | - | 17,281,302 |
| Investment income | 7,052,009 | 280,253 | 66,583 | 15,054 | 13,292 | 13,362 | 18,283 | 2,182,988 | - | 9,791,860 |
| Cashless sales and miscellaneous income | - | - | - | - | - | - | - | - | - | - |
| Total unrestricted revenues, gains and other support | 301,352,823 | 37,482,593 | 9,785,453 | 4,035,414 | 3,253,229 | 2,342,963 | 3,364,243 | 45,725,366 | - | 405,312,104 |
| Expenses and losses: | | | | | | | | | | |
| Salaries, wages and benefits | 144,711,487 | 14,213,235 | 3,952,812 | 1,527,137 | 1,078,843 | 954,118 | 1,634,846 | 33,435,407 | - | 201,512,865 |
| Supplies and services | 125,303,145 | 11,890,032 | 3,187,261 | 1,230,291 | 1,088,692 | 473,751 | 688,702 | 14,323,737 | - | 198,253,521 |
| Interest | 10,993,451 | - | 225,980 | - | - | - | - | - | - | 11,219,431 |
| Depreciation and amortization | 19,578,860 | 2,079,281 | 219,182 | 195,852 | 149,192 | 187,857 | 198,772 | 607,790 | - | 23,602,548 |
| Net loss (gain) on disposals of property and equipment | 40,299 | (8,000) | (1,000) | - | - | - | - | 1,074 | - | 33,273 |
| Provision for bad debts | 7,775,053 | 4,100,783 | 1,217,602 | 587,221 | 454,879 | 154,870 | 143,244 | 4,018,574 | - | 18,482,708 |
| Total expenses and losses | 308,402,295 | 32,356,411 | 8,802,737 | 3,560,911 | 2,771,606 | 1,785,796 | 2,843,564 | 52,581,542 | - | 412,884,462 |
| Subtotal | 42,950,528 | 5,046,182 | 982,716 | 514,503 | 481,623 | 577,587 | 720,679 | (8,856,176) | - | 44,627,642 |
| Expenditures in support of the University of Florida and its integrated delivery system | 17,561,429 | - | - | - | - | - | - | - | - | 17,561,429 |
| Excess of unrestricted revenues, gains, and other support over expenses and losses | 25,299,099 | 5,046,182 | 982,716 | 514,503 | 481,623 | 577,587 | 720,679 | (8,856,176) | - | 26,796,203 |
| Transfer of net assets purchased by Shands Teaching Hospital and Clinics, Inc. | - | 71,427,935 | 2,303,086 | 7,103,082 | 4,862,152 | 10,251,423 | 8,401,931 | 18,090,867 | (120,551,176) | - |
| Transfers from hospital operations to support home care operations | - | - | - | - | - | - | - | 17,871,621 | (17,871,621) | - |
| Net assets retained from restrictions used for public equipment | 245,870 | - | - | - | - | - | - | - | - | 245,870 |
| Increase in unrestricted net assets | \$ 25,534,969 | \$ 78,474,117 | \$ 3,275,802 | \$ 7,618,485 | \$ 5,373,775 | \$ 10,829,010 | \$ 9,122,810 | \$ 26,806,162 | \$ (138,222,847) | \$ 27,012,073 |



**SHANDS TEACHING HOSPITAL
AND CLINICS, INC.
GAINESVILLE, FLORIDA**

FINANCIAL STATEMENTS

for the years ended June 30, 1995 and 1994

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Report of Independent Accountants

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

We have audited the accompanying balance sheets of Shands Teaching Hospital and Clinics, Inc. (Shands) as of June 30, 1995 and 1994, and the related statements of revenue and expenses, changes in fund balance and cash flows for the years then ended. These financial statements are the responsibility of Shands' management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Shands as of June 30, 1995 and 1994, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 9 to the financial statements, Shands changed its method of accounting for postretirement benefits other than pensions during the year ended June 30, 1994.

Coopers & Lybrand LLP

Jacksonville, Florida
September 15, 1995

Shands Teaching Hospital and Clinics, Inc.
Balance Sheets

June 30, 1995 and 1994

| ASSETS | 1995 | 1994 |
|--|-----------------------|-----------------------|
| Current Assets: | | |
| Cash and cash equivalents | \$ 12,659,939 | \$ 6,120,472 |
| Marketable securities | 13,728,520 | 18,999,297 |
| Patient accounts receivable, net of estimated uncollectibles of \$18,985,000 in 1995 and \$15,993,000 in 1994 | 71,291,044 | 76,091,530 |
| Due from Medicare, Medicaid and other third-party programs | 10,909,447 | 21,402,527 |
| Prepaid expenses and other current assets | 9,613,013 | 13,189,622 |
| Assets whose use is limited and that are required for current liabilities | 7,109,819 | 9,567,231 |
| Total current assets | <u>125,311,782</u> | <u>145,370,679</u> |
| Assets Whose Use is Limited: | | |
| Held in trust | 1,734,463 | 4,395,719 |
| Designated by board | 102,975,211 | 59,361,628 |
| Total assets whose use is limited | <u>104,709,674</u> | <u>63,757,347</u> |
| Less assets whose use is limited and that are required for current liabilities | (7,109,819) | (9,567,231) |
| Noncurrent assets whose use is limited | <u>97,599,855</u> | <u>54,190,116</u> |
| Property and Equipment, net | 234,606,893 | 236,197,983 |
| Notes Receivable, noncurrent portion | 1,896,304 | 1,923,781 |
| Deferred Charges and Other Assets | 9,486,489 | 10,880,155 |
| Total Assets | <u>\$ 468,901,323</u> | <u>\$ 448,562,714</u> |
| LIABILITIES AND FUND BALANCE | | |
| Current Liabilities: | | |
| Long-term debt, current portion | \$ 4,661,976 | \$ 7,245,126 |
| Accounts payable | 13,836,427 | 12,481,344 |
| Accrued expenses | 22,663,754 | 20,091,270 |
| Total current liabilities | <u>41,162,157</u> | <u>39,817,740</u> |
| Long-Term Debt, noncurrent portion | 133,206,219 | 137,868,195 |
| Other Long-Term Liabilities | 7,122,247 | 5,025,246 |
| Total liabilities | <u>181,490,623</u> | <u>182,711,181</u> |
| Commitments and Contingencies (Notes 3, 6, 8, 9, 10, 11, 12 and 13) | | |
| Fund Balance | <u>287,410,700</u> | <u>265,851,533</u> |
| | <u>\$ 468,901,323</u> | <u>\$ 448,562,714</u> |

See accompanying notes to financial statements.

Shands Teaching Hospital and Clinics, Inc.
Statements of Revenue and Expenses

for the Years Ended June 30, 1995 and 1994

| | 1995 | 1994 |
|--|--------------------------|--------------------------|
| Net Patient Service Revenue | <u>\$ 346,397,237</u> | <u>\$ 318,997,383</u> |
| Other Revenue: | | |
| State educational support | 4,010,339 | 3,895,798 |
| Cafeteria sales | 3,524,222 | 3,431,895 |
| Other | <u>3,350,969</u> | <u>3,029,108</u> |
| Total other revenue | <u>10,885,530</u> | <u>10,356,801</u> |
| Total Revenue | <u>357,282,767</u> | <u>329,354,184</u> |
| Expenses: | | |
| Salaries and wages | 160,225,142 | 144,225,786 |
| Supplies and services | 126,156,862 | 122,066,076 |
| Interest | 8,305,188 | 8,126,830 |
| Depreciation and amortization | 20,253,192 | 20,957,597 |
| Provision for bad debts | <u>19,969,130</u> | <u>11,489,989</u> |
| Total expenses | <u>334,909,514</u> | <u>306,866,278</u> |
| Income from Operations | <u>22,373,253</u> | <u>22,487,906</u> |
| Nonoperating Gains (Losses) exclusive of expenditures in support of integrated healthcare delivery system: | | |
| Investment income | 6,966,740 | 1,914,708 |
| Loss on disposals of plant and equipment | <u>(711,961)</u> | <u>(1,588,021)</u> |
| | <u>6,254,779</u> | <u>326,687</u> |
| Subtotal | <u>28,628,032</u> | <u>22,814,593</u> |
| Nonoperating loss, expenditures in support of University of Florida's integrated healthcare delivery system | <u>7,431,060</u> | <u>7,899,696</u> |
| Revenue and Gains in Excess of Expenses and Losses | <u>\$ 21,196,972</u> | <u>\$ 14,914,897</u> |

See accompanying notes to financial statements.

Shands Teaching Hospital and Clinics, Inc.
Statements of Changes in Fund Balance
for the Years Ended June 30, 1995 and 1994

| | |
|--|-----------------------|
| Fund Balance, June 30, 1993 | \$ 250,793,656 |
| Revenue and Gains in Excess of Expenses and Losses | 14,914,897 |
| Equipment Purchased with Donor Restricted Funds | <u>142,980</u> |
| Fund Balance, June 30, 1994 | 265,851,533 |
| Revenue and Gains in Excess of Expenses and Losses | 21,196,972 |
| Equipment Purchased with Donor Restricted Funds | <u>362,195</u> |
| Fund balance, June 30, 1995 | <u>\$ 287,410,700</u> |

See accompanying notes to financial statements.

Shands Teaching Hospital and Clinics, Inc.
Statements of Cash Flows

for the Years Ended June 30, 1995 and 1994

| | 1995 | 1994 |
|--|----------------------|---------------------|
| Cash Flows From Operating Activities and Gains and Losses: | | |
| Cash received from patients and third-party payors | \$ 342,965,053 | \$ 312,471,355 |
| Other receipts from operations | 10,701,323 | 11,954,368 |
| Salaries and wages paid to employees | (156,564,380) | (144,958,721) |
| Payments to suppliers and vendors | (120,065,535) | (125,035,864) |
| Payments in support of the University of Florida's integrated healthcare delivery system | (7,432,981) | (7,646,883) |
| Interest received | 7,397,916 | 3,061,472 |
| Interest paid, net of amount capitalized | (8,208,295) | (8,070,531) |
| Net cash provided by operating activities and gains and losses | <u>68,793,101</u> | <u>41,775,196</u> |
| Cash Flows From Investing Activities: | | |
| Payments received on notes receivable | 94,794 | 262,114 |
| Proceeds from sale of property and equipment | 29,668 | 65,929 |
| Purchase of marketable securities | (41,374,578) | (18,999,297) |
| Proceeds from sale of marketable securities | 46,369,750 | 23,918,199 |
| Purchase of property and equipment | (19,483,829) | (23,951,537) |
| (Increase) decrease in other assets | 74,754 | 1,894,669 |
| Donor restricted funds received for equipment purchases | 362,195 | 142,980 |
| (Increase) decrease in assets held in trust, net | 2,661,256 | (166,151) |
| Increase in assets designated by board, net | (43,613,582) | (26,405,401) |
| Net cash used in investing activities | <u>(54,879,572)</u> | <u>(43,238,495)</u> |
| Cash Flows From Financing Activities: | | |
| Proceeds from issuance of long-term debt | 0 | 10,000,000 |
| Payments of long-term debt | (7,374,062) | (5,213,259) |
| Net cash provided by (used in) financing activities | <u>(7,374,062)</u> | <u>4,786,741</u> |
| Net Increase in Cash and Cash Equivalents | 6,539,467 | 3,323,442 |
| Cash and Cash Equivalents at Beginning of Year | <u>6,120,472</u> | <u>2,797,030</u> |
| Cash and Cash Equivalents at End of Year | <u>\$ 12,659,939</u> | <u>\$ 6,120,472</u> |

See accompanying notes to financial statements.

Shands Teaching Hospital and Clinics, Inc.
Statements of Cash Flows (Continued)

for the Years Ended June 30, 1995 and 1994

| | 1995 | 1994 |
|--|----------------------|----------------------|
| Reconciliation of Revenue and Gains in Excess of Expenses and Losses to Net Cash Provided by Operating Activities and Gains and Losses: | | |
| Revenue and gains in excess of expenses and losses | <u>\$ 21,196,972</u> | <u>\$ 14,914,697</u> |
| Adjustments to reconcile revenue and gains in excess of expenses and losses to net cash provided by operating activities and gains and losses: | | |
| Net unrealized losses (gains) on marketable equity securities | (1,033,749) | 997,086 |
| Loss on sale of marketable equity securities | 1,309,353 | 13,985 |
| Depreciation and amortization | 20,253,192 | 20,957,697 |
| Provision for bad debts | 19,989,130 | 11,489,989 |
| Other nonoperating expenses | 460,211 | 1,639,771 |
| Amortization of deferred charges and original issue discount | 144,579 | 96,696 |
| (Increase) decrease in assets: | | |
| Patient accounts receivable | (15,168,644) | (13,177,939) |
| Due from Medicare, Medicaid and other third-party programs | 10,493,080 | 4,491,641 |
| Prepaid pension cost | 888,108 | (951,005) |
| Prepaid expenses and other current assets | 3,509,292 | 172,122 |
| Increase (decrease) in liabilities: | | |
| Accounts payable | 3,744,586 | 711,757 |
| Accrued expenses | 726,506 | (999,027) |
| Other long-term liabilities | 2,300,483 | 1,217,426 |
| Total adjustments | <u>47,590,129</u> | <u>26,860,299</u> |
| Net Cash Provided by Operating Activities and Gains and Losses | <u>\$ 68,793,101</u> | <u>\$ 41,776,106</u> |

Supplemental Schedule of Non-Cash Investing and Financing Activities:

Shands sold a parking garage on June 30, 1994 to the University of Florida Foundation, Inc. in exchange for a \$3,000,000 non-interest bearing note. The note was recorded at its discounted present value of \$1,382,470.

See accompanying notes to financial statements.

Shands Teaching Hospital and Clinics, Inc. Notes to Financial Statements

1. Summary of Significant Accounting Policies:

Organization - Shands Teaching Hospital and Clinics, Inc. (Shands) was incorporated October 15, 1979, as a not-for-profit corporation. Shands is located in the north central Florida city of Gainesville and is a major tertiary care teaching institution. It is a leading referral center in the State of Florida and the southeast United States, and facilitates medical education programs at the University of Florida.

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, 2030, with renewal provisions. The contractual agreement also provides for the transfer to Shands of all other assets and liabilities arising from the operation of the hospital 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 revenues 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 at the University of Florida and further agrees to contract with the State Board of Education for the provision of these programs.

Income Tax Status - Shands is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Shands is also exempt from state income taxes on related income pursuant to Chapter 220 of the Florida Statutes.

Charity Care - Shands provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Shands does not pursue collection of accounts that qualify as charity care, they are not reported as revenue.

Use of Estimates - The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements. Estimates also affect the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Net Patient Service Revenue - Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Notes to Financial Statements, Continued

1. Summary of Significant Accounting Policies, Continued:

Investments and Investment Income - Marketable equity securities included in investment portfolios are carried at the lower of aggregate cost or market value at the balance sheet date. Other investments are stated at cost, which approximates market value. The average cost method is used to determine the cost of investments sold.

Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, is reported as other revenue. Investment income from all other investments is reported as nonoperating gains.

Costs of Borrowing - Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Deferred financing costs and original issue discounts are amortized over the period the obligation is outstanding using the interest method. Amortization of deferred financing costs and original issue discounts is capitalized during the period of construction of capital assets.

Statement of Revenue and Expenses - For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as gains and losses.

Cash and Cash Equivalents - Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements.

Assets Whose Use is Limited - Assets whose use is limited include assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets held by trustees under indenture agreements.

Property and Equipment - Property and equipment acquisitions are recorded at cost. Property and equipment donated for hospital operations is recorded at fair value at the date of receipt as an addition to fund balance. Depreciation for financial reporting purposes is computed using the straight-line method over the estimated useful lives of the related depreciable assets. Gains and losses on dispositions are recorded in the year of disposal, and are included in other nonoperating expenses in the statements of revenue and expenses.

Reclassifications - Certain amounts in the 1994 financial statements have been reclassified to conform to the 1995 financial statement presentation. These reclassifications have no effect on excess of revenues over expenses or fund balance.

2. Charity Care:

Shands maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The approximate charges foregone, based on established rates, for charity care provided for 1995 and 1994 was \$28,000,000 and \$27,000,000, respectively.

Notes to Financial Statements, Continued

3. Third-Party Reimbursement:

Shands has agreements with third-party payors that provide for payments for services and supplies at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

- **Medicare** - Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain outpatient services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Shands is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits thereof 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 by a peer review organization under contract with Shands. Shands' Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 1992.
- **Medicaid** - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. Shands is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits thereof by the Medicaid fiscal intermediary. Shands' Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 1992.
- **Other** - Shands has also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The basis for payment to Shands under these agreements includes prospectively determined rates per discharge and discounts from established charges.

4. Investments:

The composition of investments at June 30, 1995 and 1994 is set forth in the following table. Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets.

| | 1995 | 1994 |
|---|----------------------|----------------------|
| Current Assets | | |
| Marketable securities: | | |
| Fixed income mutual funds | \$ 13,728,520 | \$ 0 |
| U.S. Governmental adjustable rate mortgage mutual funds | 0 | 19,402,877 |
| Valuation allowance | 0 | (403,580) |
| | <u>\$ 13,728,520</u> | <u>\$ 18,999,297</u> |

Notes to Financial Statements, Continued

4. Investments, Continued:

| | 1995 | 1994 |
|--|-----------------------|----------------------|
| Assets Whose Use is Limited | | |
| By board for capital improvements and by agreements with third-party payors for funded depreciation: | | |
| Marketable securities: | | |
| U.S. Government adjustable rate mortgage mutual funds | \$ 0 | \$ 30,226,047 |
| Fixed income mutual funds | 63,489,185 | 0 |
| Equity funds | 39,486,026 | 29,765,750 |
| Valuation allowance | 0 | (630,169) |
| | <u>102,975,211</u> | <u>59,361,628</u> |
| Under indenture agreement—held by trustee: | | |
| Cash and short-term investments | 1,734,463 | 4,395,719 |
| | <u>\$ 104,709,674</u> | <u>\$ 63,757,347</u> |

Investment income includes:

| | 1995 | 1994 |
|--|---------------------|---------------------|
| Interest and dividends earned on investments | \$ 7,107,223 | \$ 2,857,489 |
| Interest earned on notes receivable | 135,121 | 68,290 |
| Unrealized gains (losses) on marketable securities | 1,033,749 | (997,086) |
| Realized loss on marketable securities | (1,309,353) | (13,985) |
| | <u>\$ 6,966,740</u> | <u>\$ 1,914,708</u> |

Gross realized losses on sales of marketable securities were \$1,309,353 and \$13,985 for fiscal 1995 and 1994, respectively.

5. Property and Equipment:

A summary of property and equipment follows:

| | 1995 | 1994 |
|--------------------------------------|-----------------------|-----------------------|
| Land | \$ 2,223,825 | \$ 2,223,825 |
| Buildings and leasehold improvements | 228,328,037 | 223,341,415 |
| Furniture and equipment | 138,401,593 | 128,398,946 |
| | <u>368,953,455</u> | <u>353,964,186</u> |
| Less accumulated depreciation | (139,956,358) | (123,566,577) |
| | <u>228,997,097</u> | <u>230,397,609</u> |
| Construction in progress | 5,609,796 | 5,800,374 |
| | <u>\$ 234,606,893</u> | <u>\$ 236,197,983</u> |

Depreciation expense related to the property and equipment for 1995 and 1994 was \$20,004,587 and \$20,703,876, respectively.

Notes to Financial Statements, Continued

6. Notes Receivable:

Shands has extended a \$2,000,000 line of credit to Southeastern Healthcare Foundation, Inc. (the Foundation) and its controlled affiliate, Radiation Therapy of Gainesville, Inc. The Foundation and its controlled affiliate are not-for-profit corporations, formed to support Shands and the Health Center. Certain members of the Shands Board of Directors are also members of the Board of Directors of each of those entities. Borrowings under the line of credit bear interest at 8% and are payable through 2017. Borrowings are cross-collateralized by the assets of the entities.

Shands completed construction of a parking garage in August 1993. Shands sold the garage to the University of Florida Foundation in exchange for a \$3,000,000 non-interest bearing note. Annual payments of \$100,000 are to be received each year beginning September 1, 1994 and the note matures on September 1, 2024. The note was recorded based upon the present value of the stream of payments to be received and discounted using an interest rate of 6.45%. The note is collateralized by a non-recourse mortgage encumbering the real property upon which the garage was constructed. No material gain or loss was recognized on this transaction.

A summary of notes receivable follows:

| | 1995 | 1994 |
|---|---------------------|---------------------|
| Note—University of Florida Foundation | \$ 1,297,332 | \$ 1,382,470 |
| Note—Southeastern Healthcare Foundation Inc. and Radiation Therapy of Gainesville, Inc. | 626,446 | 636,102 |
| Total notes receivable | <u>1,923,778</u> | <u>2,018,572</u> |
| Less current portion (included in prepaid expenses and other current assets) | <u>(27,474)</u> | <u>(94,791)</u> |
| | <u>\$ 1,896,304</u> | <u>\$ 1,923,781</u> |

7. Long-Term Debt:

A summary of long-term debt follows:

| | 1995 | 1994 |
|--|-------------|-------------|
| Health Facilities Revenue Bonds: | | |
| Series 1985, final maturity December 1994 | \$ 0 | \$ 935,000 |
| Series 1985A, final maturity December 1994 | 0 | 365,000 |
| Series 1988, interest of 6.75% to 6.875% at June 30, 1995, final maturity December 1996 | 2,000,000 | 3,000,000 |
| Series 1992R, coupon interest rate of 5.3% to 6.2% and effective interest rate of 4.7% to 6.39% at June 30, 1995, final maturity December 2015 | 131,575,000 | 135,205,000 |

Notes to Financial Statements, Continued

7. Long-Term Debt, Continued:

| | 1995 | 1994 |
|--|-----------------------|-----------------------|
| Health Facilities Revenue Note, Series 1993, interest of 3.86% to 3.92% at June 30, 1995, final maturity February 2001 | 8,062,680 | 9,506,741 |
| | <u>141,637,680</u> | <u>149,011,741</u> |
| Less unamortized bond discount | (3,769,485) | (3,898,420) |
| Total long-term debt | 137,868,195 | 145,113,321 |
| Less current portion (less bond discount of \$167,086 and \$128,936 for 1995 and 1994, respectively) | (4,661,976) | (7,245,126) |
| | <u>\$ 133,206,219</u> | <u>\$ 137,868,195</u> |

Principal payments on long-term debt for each of the next five years are as follows:

Year Ending June 30:

| | |
|------|--------------|
| 1996 | \$ 4,829,062 |
| 1997 | 5,039,062 |
| 1998 | 5,264,062 |
| 1999 | 5,489,062 |
| 2000 | 5,704,062 |

Deferred charges and other assets include bond issuance costs of \$2,772,540 and \$2,994,178 as of June 30, 1995 and 1994. Amortization of bond issuance costs, net of capitalization, was \$221,639 and \$226,756 for 1995 and 1994, respectively. Such amortization is included in depreciation and amortization.

A summary of interest expense follows:

| | 1995 | 1994 |
|-----------------------------------|---------------------|---------------------|
| Total interest expense incurred | \$ 8,491,561 | \$ 8,618,862 |
| Less interest expense capitalized | (186,373) | (492,032) |
| Interest expense, net | <u>\$ 8,305,188</u> | <u>\$ 8,126,830</u> |

The Alachua County Health Facilities Authority (the Authority) has issued the above-mentioned Health Facilities Revenue Bonds on behalf of Shands for construction, renovation, equipment and certain refinancings. All series bonds are collateralized by a first lien and security interest in the gross revenues of Shands including present and future accounts receivable, contract rights and general intangibles. The Series 1988 and Series 1992R bonds are also collateralized by the unconditional and irrevocable guarantee of the Municipal Bond Investors Assurance Corporation. The Series 1993 note is also collateralized by a purchase

Notes to Financial Statements, Continued

7. Long-Term Debt, Continued:

money security interest in the equipment. The Series 1993 note is also collateralized by a purchase money security interest in the equipment. The bond documents provide for specific restrictive covenants, such as meeting minimum debt service coverage. The Series 1992R bonds maturing on or after December 1, 2003 are redeemable at Shands' option at par value.

In December 1993, Shands issued a \$10,000,000 Revenue Note, Series 1993, to acquire medical and computer equipment. The note is payable in monthly installments of \$120,338 plus interest ranging from 3.86% to 3.92% through February 1, 2001.

Pursuant to an Escrow Deposit Agreement dated December 1, 1985, an Escrow Fund was established with proceeds from the issuance of Series 1985R bonds to acquire government obligations to provide for the payment of the principal, premium, if any, and interest on Series 1982 bonds as the same becomes due and payable. The amount of debt considered extinguished as of June 30, 1995 and 1994 is \$1,740,000.

Pursuant to an Escrow Deposit Agreement dated January 1, 1992, an Escrow Fund was established with proceeds from the issuance of Series 1992R bonds and existing debt service reserves previously held for the defeased bonds to acquire government obligations to provide for the payment of the principal, premium, if any, and interest on the refunded portions of Series 1985, Series 1985A, Series 1985R, and Series 1988 bonds as the same becomes due and payable. The amount of the debt considered extinguished as of June 30, 1995 and 1994 is \$17,720,000 and \$111,925,000, respectively.

8. Pension Plan:

Effective April 1, 1980, Shands adopted a defined benefit pension plan covering all of Shands' employees who have attained the age of 21 and have more than one year of service. Effective July 1, 1980, Shands assumed liability for funding pension and retirement benefits, including past service costs, for all vested and non-vested employees who had terminated employment with the State of Florida to accept employment with Shands. Shands' policy is to fund the ERISA minimum requirement. Effective June 30, 1995, the Plan elected to change the assumption used for mortality rates to the 1983 group annuity mortality table for males and females; however, this change does not materially affect pension costs for the current year.

Pension cost for 1995 and 1994 follows:

| | 1995 | 1994 |
|--|----------------------|---------------------|
| Service cost for benefits earned during the year | \$ 7,873,887 | \$ 6,362,863 |
| Interest cost on projected benefit obligation | 7,006,564 | 5,754,330 |
| Actual return on plan assets and deferral | (4,029,442) | (8,827) |
| Net amortization and deferral | (52,034) | (3,945,826) |
| Net Pension Cost | <u>\$ 10,798,975</u> | <u>\$ 8,162,540</u> |

Notes to Financial Statements, Continued

8. Pension Plan, Continued:

The following summarizes the funded status of the plan and the prepaid pension cost recognized in Shands' balance sheet:

| | 1995 | 1994 |
|--|---------------------|---------------------|
| Actuarial present value of benefit obligations: | | |
| Vested benefits | \$ (66,171,590) | \$ (55,707,180) |
| Nonvested benefits | (10,784,218) | (9,127,312) |
| Accumulated benefit obligation | (76,955,808) | (64,834,492) |
| Effect of projected future salary increases | (31,460,437) | (29,966,789) |
| Projected benefit obligation | (108,416,245) | (94,801,281) |
| Plan assets at fair value | 82,065,651 | 69,442,217 |
| Plan assets under projected benefit obligation | (26,350,594) | (25,359,064) |
| Unrecognized net loss | 32,931,643 | 32,999,908 |
| Unrecognized net asset | (4,013,591) | (4,720,209) |
| Unrecognized prior service cost | 491,873 | 1,026,804 |
| Prepaid pension cost included in deferred charges and other assets | <u>\$ 3,059,331</u> | <u>\$ 3,947,439</u> |

| | 1995 | 1994 |
|--------------------------|-------|-------|
| Assumptions: | | |
| Settlement rate | 8.00% | 7.50% |
| Long term rate of return | 9.50% | 9.50% |
| Salary scale | 6.00% | 6.00% |

Plan assets consist principally of investments in common stocks, fixed income and equity mutual funds, and short-term investment funds.

Additionally, Shands recently adopted a supplemental pension plan and a new deferred compensation plan for certain key employees. The cost of the deferred compensation plan for the year ended June 30, 1995 was approximately \$413,000. The cost of the supplemental pension plan for the year ended June 30, 1995 was approximately \$605,000 and included current service cost of \$221,000, prior service cost of \$165,000, and interest cost of \$219,000.

9. Postretirement Benefits Other Than Pensions:

The hospital provides health insurance benefits for retired employees and certain dependents when the employee becomes eligible for these benefits by satisfying plan provisions which include certain age and/or service requirements. Health benefits are provided through a group benefit trust. The health insurance plan covers substantially all employees and is a contributory plan with contributions adjusted annually, and contains other cost sharing features such as deductibles and coinsurance.

As of July 1, 1993, the provisions of Statement of Financial Accounting Standard (SFAS) 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions," were adopted. This statement requires that the projected future cost of retiree health insurance be recognized as an expense as employees render service instead of when the benefits are paid. Prior to July 1,

Notes to Financial Statements, Continued

9. Postretirement Benefits Other Than Pensions, Continued:

1993, the hospital recognized retiree health insurance expense when benefits were paid. The hospital elected the prospective transition approach and is amortizing the transition obligation over a 20 year period. This change in method of accounting resulted in an excess expense of approximately \$778,000 for 1994 over the expense that would have been recognized using the prior method of accounting for health benefits.

Postretirement health insurance benefits cost for 1995 and 1994 follows:

| | 1995 | 1994 |
|---------------------------------------|-------------------|-------------------|
| Service cost | \$ 471,000 | \$ 379,000 |
| Interest cost | 327,000 | 281,000 |
| Amortization of transition obligation | 157,000 | 157,000 |
| Postretirement benefit cost | <u>\$ 955,000</u> | <u>\$ 817,000</u> |

The following summarizes the funded status of the plan and the accrued postretirement benefit liability recognized by Shands' balance sheet:

| | June 30 | |
|--|---------------------|-------------------|
| | 1995 | 1994 |
| Accumulated postretirement benefit obligation (APBO): | | |
| Retirees and surviving spouses | \$ 574,000 | \$ 554,000 |
| Fully eligible active plan participants | 733,000 | 613,000 |
| Other active plan participants | 3,161,000 | 2,757,000 |
| Total APBO | <u>4,468,000</u> | <u>3,924,000</u> |
| Plan assets at fair value | <u>0</u> | <u>0</u> |
| Accumulated postretirement benefit obligation in excess of plan assets | 4,468,000 | 3,924,000 |
| Unrecognized transition obligation | (2,834,000) | (2,991,000) |
| Unrecognized net gain (loss) | 30,000 | (155,000) |
| Accrued postretirement benefit liability | <u>\$ 1,664,000</u> | <u>\$ 778,000</u> |

The discount rate used in determining the accumulated postretirement benefit obligation was 8% at June 30, 1995, and 7.5% at June 30, 1994. The annual assumed rate of increase in the health care cost trend rate was 11.4% for June 30, 1995, and 12% for June 30, 1994. It is anticipated to decrease to 5.5% by the year 2003. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement obligation as of June 30, 1995 and 1994 by \$565,000 and \$521,000, respectively. The net periodic postretirement benefit cost would increase by \$128,000 and \$107,000 for 1995 and 1994, respectively.

10. Professional Liability:

Shands participates in the J. Hillis Miller Health Center Insurance Trust Fund pursuant to Section 240.513 (3) (d), Florida Statutes, for professional liability (malpractice) coverage

Notes to Financial Statements, Continued

10. Professional Liability, Continued:

(occurrence basis) up to \$2,000,000 per specific claim and \$5,000,000 for annual aggregate claims. Above these limits, excess professional liability insurance (claims-made basis) in the amount of \$30,000,000 is provided by commercial insurance carriers. To the extent any such commercial insurance carrier is unable to meet its obligations, Shands could be liable for any defaulted amounts. In Shands' normal conduct of its business, it is a party to certain malpractice litigation. In the opinion of management, the ultimate outcome of any such litigation will not materially affect its financial statements.

11. Self-Insurance:

Shands has a self-insurance plan for health and medical coverages for its employees. Amounts contributed by Shands and its employees to the plan are determined by the level of benefits coverage selected by each employee. Shands has contracted with a commercial insurance company to provide stop loss coverage. The stop-loss provision provides for 100% reimbursement of specific claims for services incurred and paid in the same plan year in excess of \$150,000. Expense related to the health and medical plan for 1995 and 1994 was \$7,392,000 and \$5,881,000, respectively.

Shands is also self-insured for workers' compensation up to \$400,000 per occurrence, and has purchased excess coverage from commercial carriers up to the amount allowed by Florida Statutes.

12. Commitments:

Construction Commitments - Contracts of approximately \$5,000,000 existed for the construction and remodeling of Shands' facilities as of June 30, 1995; and approximately \$1,300,000 was the remaining commitment at that date. Also, see Note 13 regarding other construction commitments.

Obligations Under Operating Leases - Shands leases certain property and equipment under operating leases with renewal terms generally from one to three years. Future minimum lease payments under noncancelable operating leases with initial or remaining terms in excess of one year as of June 30, 1995 follow:

| Year Ending June 30: | Minimum Lease Payments |
|----------------------|------------------------------|
| 1996 | \$ 501,469 |
| 1997 | 467,177 |
| 1998 | 398,819 |
| 1999 | 299,727 |
| 2000 | 146,250 |
| | <u>\$ 1,813,442</u> |

Notes to Financial Statements, Continued

12. Commitments, Continued:

Rental expense for the years ended June 30, 1995 and 1994 was \$1,516,000 and \$1,334,000, respectively, and is included in supplies and services.

Other Commitments - Shands contracts with an outside firm to provide and operate a helicopter for its emergency medical services. Certain costs under the agreement are adjusted annually based on the change in the Consumer Price Index. Expenses related to this contract were \$1,500,000 and \$1,456,000 for 1995 and 1994, respectively. Future minimum payments under the contract for the years ending June 30, 1996 and 1997 are \$1,641,728 and \$222,483, respectively.

13. Transactions with Related Parties:

The University of Florida College of Medicine (College of Medicine) conducts its primary teaching and clinical activities at Shands through the services of attending faculty physicians, other healthcare professionals and medical students in the care and treatment of patients seen at Shands. University of Florida Health Services, Inc. (UFHSI) was established in February 1995 as a Florida Board of Regents Direct Support Corporation to support the programs of the University of Florida Health System by developing a comprehensive integrated healthcare delivery system.

Exclusive of State funding for indigent care and mandated programs, Shands has various agreements for services provided by the University of Florida for support of the educational, clinical and research activities of the College of Medicine and UFHSI, maintenance, security, utilities and various other services. Expenses related to these agreements were \$34,000,000 and \$30,800,000 in 1995 and 1994, respectively. The above agreements are renewed on an annual basis, and management believes that expenditures in the subsequent year ending June 30, 1996 will be approximately \$39,000,000. At June 30, 1995 and 1994, \$3,684,000 and \$2,207,000, respectively, were owed to the University of Florida under these contracts and has been included in accounts payable.

Exclusive of the State of Florida funding for indigent care and mandated programs, Shands also has agreements with the University of Florida providing for reimbursement of certain expenses. The amount credited against expenses for these agreements were \$4,694,000 and \$4,231,000 in 1995 and 1994, respectively. At June 30, 1995 and 1994, \$1,226,000 and \$974,000, respectively, was owed to Shands under these agreements and is included in prepaid expenses and other current assets.

Shands' Board of Directors agreed to fund the construction of an administrative services building and parking facility ("ASB") which is jointly occupied with the College of Medicine at the University of Florida. The project was completed in November 1994. The project costs incurred as of June 30, 1995 and 1994, relating to the portion of the ASB occupied by the College of Medicine of approximately \$325,000 and \$2,700,000, respectively, has been recognized as an expense.

Notes to Financial Statements, Continued

13. Transactions with Related Parties, Continued:

Shands' Board of Directors has agreed to fund about \$7,300,000 towards the construction of a chiller plant to be jointly used by the hospital and the University of Florida. The project costs incurred as of June 30, 1995, relating to the portion of the chiller plant to be utilized by the University of Florida of \$402,190, has been recognized as an expense.

14. Financial Instruments:

Pursuant to Statement of Financial Accounting Standards Number 107, "Disclosures About Fair Value of Financial Instruments," the following information is presented relative to Shands' financial instruments.

As of June 30, 1995 and 1994, the carrying amount of certain of the hospital's financial instruments including cash and cash equivalents, assets whose use is limited (held in trust), and notes receivable approximated fair value. The following methods were used to determine the fair value of these financial instruments:

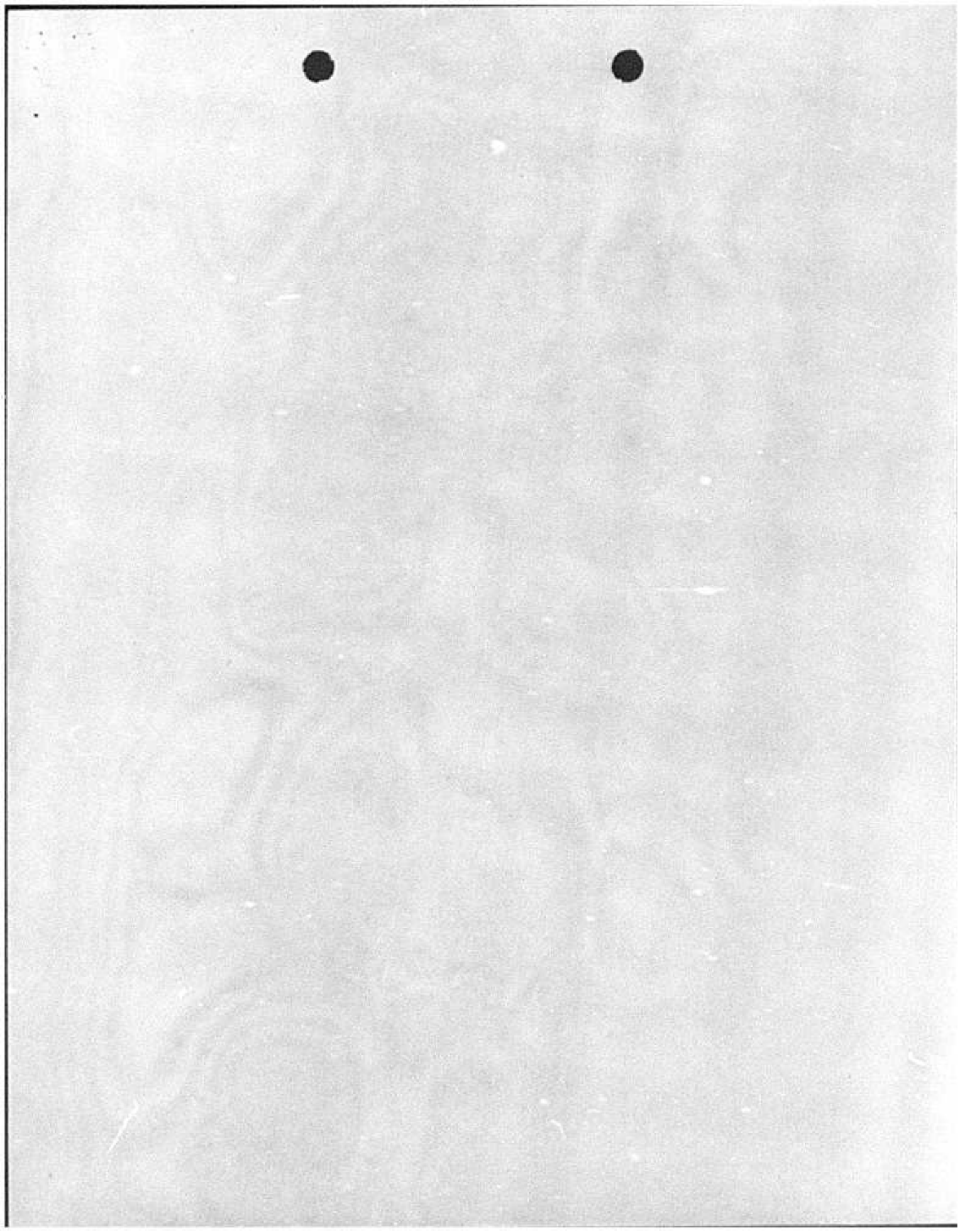
- **Cash and cash equivalents and assets whose use is limited (held in trust)** - Carrying amounts are assumed to approximate fair value because of their short maturities.
- **Notes receivable** - Future cash flows were discounted using the current interest rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities.

The fair value for marketable equity securities and assets whose use is limited (designated by board) are based on quoted market prices and dealer quotes. The estimated fair value as of June 30, 1995 and 1994 was \$124,832,824 and \$78,360,925, respectively. The carrying amount as of June 30, 1995 and 1994 was \$116,703,731 and \$79,394,674, respectively.

The fair value of long-term debt is estimated based on dealer quotes for hospital 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 estimated fair value as of June 30, 1995 and 1994 was \$142,736,000 and \$154,388,000, respectively. The carrying amount as of June 30, 1995 and 1994 was \$137,868,000 and \$145,113,000 respectively. These values merely represent a general approximation of possible value and may never actually be realized.

Certain financial instruments potentially subject Shands to concentrations of credit risk. These financial instruments consist primarily of cash and cash equivalents, marketable equity securities, fixed income mutual funds and equity funds, short-term investments, and patient accounts receivable.

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 and investments with what management believes to be high quality financial institutions and thus limits its credit exposure.



**SHANDS TEACHING HOSPITAL AND CLINICS, INC.
GAINESVILLE, FLORIDA**

FINANCIAL STATEMENTS
for the years ended June 30, 1994 and 1993

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REPORT OF INDEPENDENT ACCOUNTANTS

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

We have audited the accompanying balance sheets of Shands Teaching Hospital and Clinics, Inc. (Shands) as of June 30, 1994 and 1993, and the related statements of revenue and expenses, changes in fund balance and cash flows for the years then ended. These financial statements are the responsibility of Shands' management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Shands as of June 30, 1994 and 1993, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note 9 to the financial statements, Shands changed its method of accounting for postretirement benefits other than pensions during the year ended June 30, 1994.

Coopers & Lybrand L.L.P.

Jacksonville, Florida
September 14, 1994

SHANDS TEACHING HOSPITAL AND CLINICS, INC.
BALANCE SHEETS
June 30, 1994 and 1993

| | <u>1994</u> | <u>1993</u> |
|--|----------------------|----------------------|
| <u>ASSETS</u> | | |
| Current Assets: | | |
| Cash and cash equivalents | \$ 6,120,472 | \$ 2,797,030 |
| Marketable securities | 18,999,297 | 24,929,271 |
| Patient accounts receivable, net of estimated uncollectibles of \$15,993,000 in 1994 and \$23,880,000 in 1993 | 76,091,530 | 74,403,580 |
| Due from Medicare, Medicaid and other third-party programs | 21,402,527 | 25,894,168 |
| Prepaid expenses and other current assets | 13,189,622 | 13,279,365 |
| Assets whose use is limited and that are required for current liabilities | <u>9,567,231</u> | <u>7,263,525</u> |
| Total current assets | <u>145,370,679</u> | <u>148,566,939</u> |
| Assets Whose Use is Limited: | | |
| Held in trust | 4,395,719 | 4,229,568 |
| Designated by board | 59,361,628 | 32,956,226 |
| Total assets whose use is limited | <u>63,757,347</u> | <u>37,185,794</u> |
| Less assets whose use is limited and that are required for current liabilities | <u>(9,567,231)</u> | <u>(7,263,525)</u> |
| Noncurrent assets whose use is limited | <u>54,190,116</u> | <u>29,922,269</u> |
| Property and Equipment, net | 236,197,983 | 236,513,040 |
| Notes Receivable, noncurrent portion | 1,923,781 | 885,804 |
| Deferred Charges and Other Assets | <u>10,880,155</u> | <u>9,434,262</u> |
| | <u>\$448,562,714</u> | <u>\$425,322,314</u> |
| <u>LIABILITIES AND FUND BALANCE</u> | | |
| Current Liabilities: | | |
| Long-term debt, current portion | \$ 7,245,126 | \$ 4,638,345 |
| Accounts payable | 12,481,344 | 11,982,943 |
| Accrued expenses | <u>20,091,270</u> | <u>21,133,871</u> |
| Total current liabilities | 39,817,740 | 37,755,159 |
| Long-Term Debt, noncurrent portion | 137,868,195 | 135,606,580 |
| Other Long-Term Liabilities | <u>5,025,246</u> | <u>1,166,919</u> |
| Total liabilities | 182,711,181 | 174,528,658 |
| Commitments and Contingencies (Notes 3, 6, 8, 9, 10, 11, 12 and 13) | | |
| Fund Balance | <u>265,851,533</u> | <u>250,793,656</u> |
| | <u>\$448,562,714</u> | <u>\$425,322,314</u> |

See accompanying notes to financial statements.

SHANDS TEACHING HOSPITAL AND CLINICS, INC.
STATEMENTS OF REVENUE AND EXPENSES
for the Years Ended June 30, 1994 and 1993

| | <u>1994</u> | <u>1993</u> |
|--|----------------------|----------------------|
| Net Patient Service Revenue | <u>\$317,442,363</u> | <u>\$305,056,542</u> |
| Other Revenue: | | |
| State educational support | 3,895,798 | 4,010,407 |
| Cafeteria sales | 3,431,895 | 3,242,669 |
| Other | <u>4,584,128</u> | <u>5,314,785</u> |
| Total other revenue | <u>11,911,821</u> | <u>12,567,861</u> |
| Total Revenue | <u>329,354,184</u> | <u>317,624,403</u> |
| Expenses: | | |
| Salaries and wages | 144,261,858 | 133,333,593 |
| Supplies and services | 127,245,008 | 119,176,628 |
| Interest | 8,126,830 | 8,593,059 |
| Depreciation and amortization | 20,957,597 | 19,613,104 |
| Provision for bad debts | <u>11,489,989</u> | <u>11,671,591</u> |
| Total expenses | <u>312,081,292</u> | <u>292,387,975</u> |
| Income from Operations | <u>17,272,892</u> | <u>25,236,428</u> |
| Nonoperating Gains (Losses): | | |
| Investment income | 1,914,708 | 2,212,492 |
| Other nonoperating expenses | <u>(4,272,703)</u> | <u>(7,932,040)</u> |
| Nonoperating losses, net | <u>(2,357,995)</u> | <u>(5,719,548)</u> |
| Revenue and Gains in Excess of Expenses and Losses | <u>\$ 14,914,897</u> | <u>\$ 19,516,880</u> |

See accompanying notes to financial statements.

SHANDS TEACHING HOSPITAL AND CLINICS, INC.
STATEMENTS OF CHANGES IN FUND BALANCE
for the Years Ended June 30, 1994 and 1993

| | |
|--|----------------------|
| Fund Balance, June 30, 1992 | \$231,079,365 |
| Revenue and Gains in Excess of Expenses and Losses | 19,516,880 |
| Equipment Purchased with Donor Restricted Funds | <u>197,411</u> |
| Fund Balance, June 30, 1993 | 250,793,656 |
| Revenue and Gains in Excess of Expenses and Losses | 14,914,897 |
| Equipment Purchased with Donor Restricted Funds | <u>142,980</u> |
| Fund Balance, June 30, 1994 | <u>\$265,851,533</u> |

See accompanying notes to financial statements.

SHANDS TEACHING HOSPITAL AND CLINICS, INC.
STATEMENTS OF CASH FLOWS
for the Years Ended June 30, 1994 and 1993

| | <u>1994</u> | <u>1993</u> |
|---|---------------------|---------------------|
| Cash Flows From Operating Activities and Gains and Losses: | | |
| Cash received from patients and third-party payors | \$312,471,355 | \$ 297,163,683 |
| Other receipts from operations | 11,954,368 | 12,144,762 |
| Salaries and wages paid to employees | (144,977,185) | (136,051,982) |
| Payments to suppliers and vendors | (127,167,857) | (121,197,227) |
| Interest received | 3,061,472 | 3,535,108 |
| Interest paid, net of amount capitalized | <u>(8,070,531)</u> | <u>(8,586,640)</u> |
| Net cash provided by operating activities and gains and losses | <u>47,271,622</u> | <u>47,007,704</u> |
| Cash Flows From Investing Activities: | | |
| Payments received on notes receivable | 262,114 | 313,299 |
| Proceeds from sale of property and equipment | 65,929 | 59,664 |
| Purchase of marketable securities | (18,999,297) | (45,094,110) |
| Proceeds from sale of marketable securities | 23,918,199 | 42,120,690 |
| Purchase of property and equipment | (26,384,469) | (36,094,740) |
| (Increase) decrease in other assets | (1,168,825) | 223,754 |
| Donor restricted funds received for equipment purchases | 142,980 | 197,411 |
| (Increase) decrease in assets held in trust, net | (166,151) | 206,893 |
| Increase in assets designated by board, net | <u>(26,405,401)</u> | <u>(2,549,163)</u> |
| Net cash used in investing activities | <u>(48,734,921)</u> | <u>(40,616,302)</u> |
| Cash Flows From Financing Activities: | | |
| Proceeds from issuance of long-term debt | 10,000,000 | - |
| Payments of long-term debt | <u>(5,213,259)</u> | <u>(5,120,000)</u> |
| Net cash provided by (used in) financing activities | <u>4,786,741</u> | <u>(5,120,000)</u> |
| Net Increase in Cash and Cash Equivalents | 3,323,442 | 1,271,402 |
| Cash and Cash Equivalents at Beginning of Year | <u>2,797,030</u> | <u>1,525,628</u> |
| Cash and Cash Equivalents at End of Year | <u>\$ 6,120,472</u> | <u>\$ 2,797,030</u> |

See accompanying notes to financial statements.

SHANDS TEACHING HOSPITAL AND CLINICS, INC.
STATEMENTS OF CASH FLOWS (CONTINUED)
for the Years Ended June 30, 1994 and 1993

| | <u>1994</u> | <u>1993</u> |
|--|----------------------|----------------------|
| Reconciliation of Revenue and Gains in Excess of Expenses and Losses to Net Cash Provided by Operating Activities and Gains and Losses: | | |
| Revenue and gains in excess of expenses and losses | <u>\$ 14,914,897</u> | <u>\$ 19,516,880</u> |
| Adjustments to reconcile revenue and gains in excess of expenses and losses to net cash provided by operating activities and gains and losses: | | |
| Net unrealized losses (gains) on marketable equity securities | 997,086 | (195,768) |
| Loss on sale of marketable equity securities | 13,985 | 1,374,546 |
| Depreciation and amortization | 20,957,597 | 19,613,104 |
| Provision for bad debts | 11,489,989 | 11,671,591 |
| Other nonoperating expenses | 4,272,703 | 7,932,040 |
| Amortization of deferred charges and original issue discount | 3,142,772 | 2,968,670 |
| (Increase) decrease in assets: | | |
| Patient accounts receivable | (13,177,939) | (21,948,647) |
| Due from Medicare, Medicaid and other third-party programs | 4,491,641 | 9,846,988 |
| Prepaid pension cost | (951,005) | (2,708,397) |
| Prepaid expenses and other current assets | 172,122 | 1,171,520 |
| Increase (decrease) in liabilities: | | |
| Accounts payable | 711,757 | (3,348,509) |
| Accrued expenses | (981,409) | 1,134,609 |
| Other long-term liabilities | <u>1,217,426</u> | <u>(20,923)</u> |
| Total adjustments | <u>32,356,725</u> | <u>27,490,824</u> |
| Net Cash Provided by Operating Activities and Gains and Losses | <u>\$ 47,271,622</u> | <u>\$ 47,007,704</u> |

Supplemental Schedule of Non-Cash Investing and Financing Activities:

Shands sold a parking garage on June 30, 1994 to the University of Florida Foundation, Inc. in exchange for a \$3,000,000 non-interest bearing note. The note was recorded at its discounted present value of \$1,382,470.

See accompanying notes to financial statements.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993

1. Summary of Significant Accounting Policies:

Organization

Shands Teaching Hospital and Clinics, Inc. (Shands) was incorporated October 15, 1979, as a not-for-profit corporation. Shands is located in the north central Florida city of Gainesville and is a major tertiary care teaching institution. It is a leading referral center in the State of Florida and the southeast United States, and facilitates medical education programs at the University of Florida.

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, 2030, with renewal provisions. The contractual agreement also provides for the transfer to Shands of all other assets and liabilities arising from the operation of the hospital 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 revenues 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 at the University of Florida and further agrees to contract with the State Board of Education for the provision of these programs.

Income Tax Status

Shands is a not-for-profit corporation as described in Section 501(c)(3) of the Internal Revenue Code and is exempt from federal income taxes on related income pursuant to Section 501(a) of the Code. Shands is also exempt from state income taxes on related income pursuant to Chapter 220 of the Florida Statutes.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

1. Summary of Significant Accounting Policies, Continued:

Charity Care

Shands provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Because Shands does not pursue collection of accounts that qualify as charity care, they are not reported as revenue.

Net Patient Service Revenue

Net patient service revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined.

Investments and Investment Income

Marketable equity securities included in investment portfolios are carried at the lower of aggregate cost (determined on an average-cost basis) or market value at the balance sheet date. Other investments are stated at cost, which approximates market value.

Investment income on proceeds of borrowings that are held by a trustee, to the extent not capitalized, is reported as other revenue. Investment income from all other investments is reported as nonoperating gains.

Costs of Borrowing

Interest cost incurred on borrowed funds during the period of construction of capital assets is capitalized as a component of the cost of acquiring those assets. Deferred financing costs and original issue discounts are amortized over the period the obligation is outstanding using the interest method. Amortization of deferred financing costs and original issue discounts is capitalized during the period of construction of capital assets.

Statement of Revenue and Expenses

For purposes of display, transactions deemed by management to be ongoing, major, or central to the provision of health care services are reported as revenue and expenses. Peripheral or incidental transactions are reported as gains and losses.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

1. Summary of Significant Accounting Policies, Continued:

Cash and Cash Equivalents

Cash and cash equivalents include investments in highly liquid debt instruments with a maturity of three months or less, excluding amounts whose use is limited by board designation or other arrangements under trust agreements.

Assets Whose Use is Limited

Assets whose use is limited include assets set aside by the Board of Directors for future capital improvements, over which the Board retains control and may at its discretion subsequently use for other purposes, and assets held by trustees under indenture agreements.

Property and Equipment

Property and equipment acquisitions are recorded at cost. Property and equipment donated for hospital operations is recorded at fair value at the date of receipt as an addition to fund balance. Depreciation for financial reporting purposes is computed using the straight-line method over the estimated useful lives of the related depreciable assets. Gains and losses on dispositions are recorded in the year of disposal, and are included in other nonoperating expenses in the statements of revenue and expenses.

2. Charity Care:

Shands maintains records to identify and monitor the level of charity care it provides. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The approximate charges foregone, based on established rates, for charity care provided for 1994 and 1993 was \$27,000,000 and \$28,000,000, respectively.

3. Third-Party Reimbursement:

Shands has agreements with third-party payors that provide for payments for services and supplies at amounts different from its established rates. A summary of the payment arrangements with major third-party payors follows.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

3. Third-Party Reimbursement, Continued:

- **Medicare** - Inpatient services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain outpatient services and defined capital and medical education costs related to Medicare beneficiaries are paid based on a cost reimbursement methodology. Shands is reimbursed for cost reimbursable items at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits thereof 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 by a peer review organization under contract with Shands. Shands' Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 1991.

- **Medicaid** - Inpatient and outpatient services rendered to Medicaid program beneficiaries are reimbursed under a cost reimbursement methodology. Shands is reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by Shands and audits thereof by the Medicaid fiscal intermediary. Shands' Medicaid cost reports have been audited by the Medicaid fiscal intermediary through June 30, 1991.

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

4. Investments:

The composition of investments at June 30, 1994 and 1993 is set forth in the following table. Assets whose use is limited that are required for obligations classified as current liabilities are reported in current assets.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

| | | |
|--|---------------------|---------------------|
| 4. <u>Investments, Continued:</u> | <u>1994</u> | <u>1993</u> |
| <u>Current Assets</u> | | |
| Marketable securities: | | |
| U.S. Governmental adjustable rate mortgage mutual funds | \$19,402,877 | \$24,965,934 |
| Valuation allowance | <u>(403,580)</u> | <u>(36,663)</u> |
| | <u>\$18,999,297</u> | <u>\$24,929,271</u> |
| <u>Assets Whose Use is Limited</u> | | |
| By board for capital improvements and by agreements with third-party payors for funded depreciation: | | |
| Cash and short-term investments | \$ - | \$ 1,390,058 |
| Marketable securities: | | |
| U.S. Government adjustable rate mortgage mutual funds | 30,226,047 | 31,566,168 |
| Equity mutual funds | 29,765,750 | - |
| Valuation allowance | <u>(630,169)</u> | <u>-</u> |
| | 59,361,628 | 32,956,226 |
| Under indenture agreement—held by trustee: | | |
| Cash and short-term investments | <u>4,395,719</u> | <u>4,229,568</u> |
| | <u>\$63,757,347</u> | <u>\$37,185,794</u> |

Gross unrealized losses for 1994 and 1993 related to marketable securities were \$1,033,749 and \$36,663, respectively. Net unrealized (losses) gains for 1994 and 1993 related to marketable securities included in investment income were (\$997,086) and \$195,768, respectively. The net realized loss on sales of marketable securities included in investment income was \$13,985 and \$1,374,546 for 1994 and 1993, respectively. The average cost method was used to determine the cost of marketable securities sold.

Investment income includes:

| | | |
|--|---------------------|---------------------|
| | <u>1994</u> | <u>1993</u> |
| Interest earned on investments | \$ 2,857,489 | \$ 3,315,338 |
| Interest earned on notes receivable | 68,290 | 75,932 |
| Unrealized gains (losses) on marketable securities | (997,086) | 195,768 |
| Realized loss on marketable securities | <u>(13,985)</u> | <u>(1,374,546)</u> |
| | <u>\$ 1,914,708</u> | <u>\$ 2,212,492</u> |

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

5. Property and Equipment:

A summary of property and equipment follows:

| | June 30 | |
|--------------------------------------|----------------------|----------------------|
| | 1994 | 1993 |
| Land | \$ 2,223,825 | \$ 2,060,971 |
| Buildings and leasehold improvements | 223,341,415 | 211,759,356 |
| Furniture and equipment | <u>128,398,946</u> | <u>117,969,788</u> |
| | 353,964,186 | 331,790,115 |
| Less accumulated depreciation | <u>(123,566,577)</u> | <u>(104,706,252)</u> |
| | 230,397,609 | 227,083,863 |
| Construction in progress | <u>5,800,374</u> | <u>9,429,177</u> |
| | <u>\$236,197,983</u> | <u>\$236,513,040</u> |

Depreciation expense related to the property and equipment for 1994 and 1993 was \$20,703,876 and \$19,355,375, respectively.

6. Notes Receivable:

Shands has extended a \$10,000,000 line of credit to Southeastern Healthcare Foundation, Inc. (the Foundation) and its controlled affiliate, Radiation Therapy of Gainesville, Inc. In August 1993, the line of credit was reduced to \$2,000,000. The Foundation and its controlled affiliate are not-for-profit corporations, formed to support Shands and the Health Center. Certain members of the Shands Board of Directors are also members of the Board of Directors of each of those entities. Borrowings under the line of credit bear interest at 8% and are payable through 2017. Borrowings are cross-collateralized by the assets of the entities.

Shands completed construction of an administrative parking garage in August 1993. Shands sold the garage to the University of Florida Foundation in exchange for a \$3,000,000 non-interest bearing note. Annual payments of \$100,000 are to be received each year beginning September 1, 1994 and the note matures on September 1, 2024. The note was recorded based upon the present value of the stream of payments to be received and discounted using an interest rate of 6.45%. The note is secured by a non-recourse mortgage encumbering the real property upon which the garage was constructed. No material gain or loss was recognized on this transaction.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

6. Notes Receivable, Continued:

A summary of notes receivable follows:

| | June 30 | |
|--|--------------------|-------------------|
| | 1994 | 1993 |
| Note-University of Florida Foundation | \$1,382,470 | \$ - |
| Note-Southeastern Healthcare Foundation Inc. and Radiation Therapy of Gainesville, Inc. | <u>636,102</u> | <u>898,216</u> |
| Total notes receivable | 2,018,572 | 898,216 |
| Less current portion (included in prepaid expenses and other current assets) | <u>(94,791)</u> | <u>(12,412)</u> |
| | <u>\$1,923,781</u> | <u>\$ 885,804</u> |

7. Long-Term Debt:

A summary of long-term debt follows:

| | June 30 | |
|---|----------------------|----------------------|
| | 1994 | 1993 |
| Health Facilities Revenue Bonds: | | |
| Series 1985, interest of 7.75% at June 30, 1994, final maturity December 1994 | \$ 935,000 | \$ 1,780,000 |
| Series 1985A, interest of 7.75% at June 30, 1994, final maturity December 1994 | 365,000 | 695,000 |
| Series 1985R, final maturity December 1993 | - | 415,000 |
| Series 1988, interest of 6.6% to 6.875% at June 30, 1994, final maturity December 1996 | 3,000,000 | 4,000,000 |
| Series 1992R, coupon interest rate of 5.3% to 6.2% and effective interest rate of 4.4% to 6.39% at June 30, 1994, final maturity December 2015 | 135,205,000 | 137,335,000 |
| Health Facilities Revenue Note, Series 1993, interest of 3.86% to 3.92% at June 30, 1994, final maturity February 2001 | <u>9,506,741</u> | <u>-</u> |
| | 149,011,741 | 144,225,000 |
| Less unamortized bond discount | <u>(3,898,420)</u> | <u>(3,980,075)</u> |
| Total long-term debt | 145,113,321 | 140,244,925 |
| Less current portion (less bond discount of \$128,936 and \$81,655 for 1994 and 1993, respectively) | <u>(7,245,126)</u> | <u>(4,638,345)</u> |
| | <u>\$137,868,195</u> | <u>\$135,606,580</u> |

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

7. Long-Term Debt, Continued:

Principal payments on long-term debt for each of the next five years are as follows:

Year Ending June 30:

| | |
|------|-------------|
| 1995 | \$7,374,062 |
| 1996 | 4,829,062 |
| 1997 | 5,039,062 |
| 1998 | 5,264,062 |
| 1999 | 5,489,062 |

Deferred charges and other assets include bond issuance costs of \$2,994,178 and \$3,220,934 as of June 30, 1994 and 1993. Amortization of bond issuance costs, net of capitalization, was \$226,756 and \$230,763 for 1994 and 1993, respectively. Such amortization is included in depreciation and amortization.

A summary of interest expense follows:

| | <u>1994</u> | <u>1993</u> |
|-----------------------------------|--------------------|--------------------|
| Total interest expense incurred | \$8,618,862 | \$8,720,015 |
| Less interest expense capitalized | <u>(492,032)</u> | <u>(126,956)</u> |
| Interest expense, net | <u>\$8,126,830</u> | <u>\$8,593,059</u> |

The Alachua County Health Facilities Authority (the Authority) has issued Health Facilities Revenue Bonds, Series 1982, Series 1985, Series 1985A, Series 1985R, Series 1988, and Series 1992R, and Health Facilities Revenue Note, Series 1993, on behalf of Shands for construction, renovation, equipment and certain refinancings. All series bonds are collateralized by a first lien and security interest in the gross revenues of Shands including present and future accounts receivable, contract rights and general intangibles. The Series 1988 and Series 1992R bonds are also collateralized by the unconditional and irrevocable guarantee of the Municipal Bond Investors Assurance Corporation. The Series 1993 note is also collateralized by a purchase money security interest in the equipment. The Series 1985, 1985A, and 1985R bonds require bond reserves equal to the maximum amount required to pay principal and interest due in any one bond year to be held in trust. The bond documents provide for specific restrictive covenants, the most restrictive of which defines debt coverage. The Series 1992R bonds maturing on or after December 1, 2003 are redeemable at Shands' option at par value.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

7. Long-Term Debt, Continued:

Pursuant to an Escrow Deposit Agreement dated December 1, 1985, an Escrow Fund was established with proceeds from the issuance of Series 1985R bonds to acquire government obligations to provide for the payment of the principal, premium, if any, and interest on the Series 1982 bonds as the same becomes due and payable. The amount of debt considered extinguished as of June 30, 1994 and 1993 is \$1,740,000 and \$2,030,000, respectively.

Pursuant to an Escrow Deposit Agreement dated January 1, 1992, an Escrow Fund was established with proceeds from the issuance of Series 1992R bonds and existing debt service reserves previously held for the defeased bonds to acquire government obligations to provide for the payment of the principal, premium, if any, and interest on the refunded portions of the Series 1985, Series 1985A, Series 1985R, and Series 1988 bonds as the same becomes due and payable. The amount of the debt considered extinguished as of June 30, 1994 and 1993 is \$111,925,000 and \$129,830,000, respectively.

In December 1993, Shands issued a \$10,000,000 Revenue Note, Series 1993, to acquire medical and computer equipment. The note is payable in monthly installments of \$120,338 plus interest ranging from 3.86% to 3.92% through February 1, 2001.

8. Pension Plan:

Effective April 1, 1980, Shands adopted a defined benefit pension plan covering all of Shands' employees who have attained the age of 21 and have more than one year of service. Effective July 1, 1980, Shands assumed liability for funding pension and retirement benefits, including past service costs, for all vested and non-vested employees who had terminated employment with the State of Florida to accept employment with Shands. Shands' policy is to fund the ERISA minimum requirement. Shands has elected to change the measurement date for the pension plan to March 31 of each year beginning with the year ended June 30, 1993.

Pension cost for 1994 and 1993 follows:

| | <u>1994</u> | <u>1993</u> |
|--|----------------------------|----------------------------|
| Service cost for benefits earned during the year | \$ 6,362,863 | \$ 5,256,582 |
| Interest cost on projected benefit obligation | 5,754,330 | 4,888,637 |
| Actual return on plan assets and deferral | (8,827) | (6,793,007) |
| Net amortization and deferral | <u>(3,945,826)</u> | <u>3,143,882</u> |
| Net Pension Cost | <u>\$ 8,162,540</u> | <u>\$ 6,496,094</u> |

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

8. Pension Plan, Continued:

The following summarizes the funded status of the plan and the prepaid pension cost recognized in Shands' balance sheet:

| | June 30 | |
|--|----------------|----------------|
| | 1994 | 1993 |
| Actuarial present value of benefit obligations: | | |
| Vested benefits | \$(55,707,180) | \$(41,342,019) |
| Nonvested benefits | (9,127,312) | (6,881,579) |
| Accumulated benefit obligation | (64,834,492) | (48,223,598) |
| Effect of projected future salary increases | (29,966,789) | (24,228,234) |
| Projected benefit obligation | (94,801,281) | (72,451,832) |
| Plan assets at fair value | 69,442,217 | 61,455,218 |
| Plan assets under projected benefit obligation | (25,359,064) | (10,996,614) |
| Unrecognized net loss | 32,999,908 | 18,259,088 |
| Unrecognized net asset | (4,720,209) | (5,426,827) |
| Unrecognized prior service cost | 1,026,804 | 1,160,787 |
| Prepaid pension cost included in deferred charges and other assets | \$ 3,947,439 | \$ 2,996,434 |

| | June 30 | |
|--------------------------|---------|-------|
| | 1994 | 1993 |
| Assumptions: | | |
| Settlement rate | 7.50% | 8.00% |
| Long term rate of return | 9.50% | 9.50% |
| Salary scale | 6.00% | 6.00% |

Plan assets consist principally of investments in common stocks, treasury securities, and money market accounts.

9. Postretirement Benefits Other Than Pensions:

The hospital provides health insurance benefits for retired employees and certain dependents when the employee becomes eligible for these benefits by satisfying plan provisions which include certain age and/or service requirements. Health benefits are provided through a group benefit trust. The health insurance plan covers substantially all employees and is a contributory plan with contributions adjusted annually, and contains other cost sharing features such as deductibles and coinsurance.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

9. Postretirement Benefits Other Than Pensions, Continued:

As of July 1, 1993, the provisions of Statement of Financial Accounting Standard (SFAS) 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions," were adopted. This statement requires that the projected future cost of retiree health insurance be recognized as an expense as employees render service instead of when the benefits are paid. Prior to July 1, 1993, the hospital recognized retiree health insurance expense when benefits were paid. The hospital elected the prospective transition approach and is amortizing the transition obligation over a 20 year period. This change in method of accounting resulted in an excess expense of approximately \$778,000 for 1994 over the expense that would have been recognized using the prior method of accounting for health benefits.

The components of postretirement health insurance benefits cost for 1994 were as follows:

| | |
|---------------------------------------|------------------|
| Service cost | \$379,000 |
| Interest cost | 281,000 |
| Amortization of transition obligation | <u>157,000</u> |
| Postretirement benefit cost | <u>\$817,000</u> |

The funded status of the Plan at June 30, 1994 was as follows:

| | |
|--|-------------------|
| Accumulated postretirement benefit obligation (APBO): | |
| Retirees and surviving spouses | \$ 554,000 |
| Fully eligible active plan participants | 613,000 |
| Other active plan participants | <u>2,757,000</u> |
| Total APBO | 3,924,000 |
| Plan assets at fair value | <u>-</u> |
| Accumulated postretirement benefit obligation in excess of plan assets | 3,924,000 |
| Unrecognized transition obligation | (2,991,000) |
| Unrecognized net (gain) loss | <u>(155,000)</u> |
| Accrued postretirement benefit liability | <u>\$ 778,000</u> |

An 11.4 percent annual rate of increase in the per capita costs of covered health care benefits was assumed for 1995, gradually decreasing to 5.5 percent by the year 2003. Increasing the assumed health care cost trend rates by one percentage point in each year would increase the accumulated postretirement obligation as of June 30, 1994 by \$521,000 and increase the aggregate of the service cost and interest cost component of the postretirement benefit cost for 1994 by \$107,000. A discount rate of 7.5 percent was used to determine the accumulated postretirement benefit obligation.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

10. Professional Liability:

Shands participates in the J. Hillis Miller Health Center Insurance Trust Fund pursuant to Section 240.513 (3) (d), Florida Statutes, for professional liability (malpractice) coverage (occurrence basis) up to \$2,000,000 per specific claim and \$5,000,000 for annual aggregate claims. Above these limits, excess professional liability insurance (claims-made basis) in the amount of \$25,000,000 is provided by commercial insurance carriers. To the extent any such commercial insurance carrier is unable to meet its obligations, Shands could be liable for any defaulted amounts. In Shands' normal conduct of its business, it is a party to certain malpractice litigation. In the opinion of management, the ultimate outcome of any such litigation will not materially affect its financial statements.

11. Self-Insurance:

Shands is self-insured for workers' compensation up to \$400,000 per occurrence, and has purchased excess coverage in the amount of \$10,000,000 from commercial carriers. Workers' compensation losses and loss adjustment expenses charged to operations were \$790,000 and \$738,000 for 1994 and 1993, respectively.

Shands has a self-insurance plan for health and medical coverages for its employees. Amounts contributed by Shands and its employees to the plan are determined by the level of benefits coverage selected by each employee. A stop-loss provision provides for coverage by a commercial insurance company of specific claims for services incurred and paid in the same plan year in excess of \$125,000. Expense related to the health and medical plan for 1994 and 1993 was \$5,881,000 and \$6,362,000, respectively.

12. Commitments:

Construction Commitments

Contracts of \$7,755,000 exist for the construction and remodeling of Shands' facilities. At June 30, 1994, the remaining commitment on these contracts was \$3,782,000.

Obligations Under Operating Leases

Shands leases certain property and equipment under operating leases with renewal terms generally from one to three years. Future minimum lease payments under noncancellable operating leases with initial or remaining terms in excess of one year as of June 30, 1994 follow:

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

12. Commitments, Continued:

| <u>Year Ending June 30:</u> | <u>Minimum Lease Payments</u> |
|-----------------------------|-------------------------------|
| 1995 | \$346,000 |
| 1996 | 251,000 |
| 1997 | 116,000 |
| 1998 | 83,000 |
| 1999 | <u>28,000</u> |
| | <u>\$824,000</u> |

Rental expense for the years ended June 30, 1994 and 1993 was \$1,334,000 and \$1,018,000, respectively, and is included in supplies and services.

Other Commitments

Shands contracts with an outside firm to provide and operate a helicopter for its emergency medical services. Certain costs under the agreement are adjusted annually based on the change in the Consumer Price Index. Expenses related to this contract were \$1,456,000 and \$1,451,000 for 1994 and 1993, respectively. Future minimum payments under the contract for the years ending June 30, 1995, 1996, and 1997 are \$1,502,356, \$1,543,627, and \$214,643, respectively.

13. Transactions with the University of Florida:

Exclusive of State funding for indigent care and mandated programs, Shands has various agreements for services with the University of Florida for support of the educational, clinical and research activities of the College of Medicine, maintenance, security, utilities and various other services. Expenses related to these agreements were \$30,779,000 and \$24,867,000 in 1994 and 1993, respectively. At June 30, 1994 and 1993, \$2,207,000 and \$2,181,000, respectively, were owed to the University of Florida under these contracts and has been included in accounts payable.

Exclusive of the State of Florida funding for indigent care and mandated programs, Shands also has agreements with the University of Florida providing for reimbursement of certain expenses. The amount credited against expenses for these agreements were \$4,231,000 and \$3,512,000 in 1994 and 1993, respectively. At June 30, 1994 and 1993, \$974,000 and \$786,000, respectively, was owed to Shands under these agreements and is included in prepaid expenses and other current assets.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

13. Transactions with the University of Florida. Continued:

Shands' Board of Directors has agreed to fund the construction of an administrative services building and parking facility ("ASB") to be jointly occupied with the College of Medicine at the University of Florida. The project costs incurred as of June 30, 1994 and 1993, relating to the portion of the ASB to be occupied by the College of Medicine of \$2,684,682 and \$7,897,721 respectively, has been recognized as an expense and included in other nonoperating expenses in the statement of revenue and expenses.

14. Financial Instruments:

Pursuant to Statement of Financial Accounting Standards Number 107, "Disclosures About Fair Value of Financial Instruments," the following information is presented relative to Shands' financial instruments.

As of June 30, 1994 and 1993, the carrying amount of certain of the hospital's financial instruments including cash and cash equivalents, assets whose use is limited (held in trust), and notes receivable approximated fair value. The following methods were used to determine the fair value of these financial instruments:

- **Cash and cash equivalents and assets whose use is limited (held in trust) -** Carrying amounts are assumed to approximate fair value because of their short maturities.
- **Notes receivable -** Future cash flows were discounted using the current interest rates at which similar loans would be made to borrowers with similar credit ratings for the same remaining maturities.

The fair value for marketable equity securities and assets whose use is limited (designated by board) are based on quoted market prices. The estimated fair value as of June 30, 1994 and 1993 was \$78,360,925 and \$56,495,439, respectively. The carrying amount as of June 30, 1994 and 1993 was \$79,394,674 and \$56,532,102, respectively.

The fair value of long-term debt is estimated based on dealer quotes for hospital 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 estimated fair value as of June 30, 1994 and 1993 was \$154,388,000 and \$149,972,000, respectively. The carrying amount as of June 30, 1994 and 1993 was \$145,113,000 and \$140,245,000 respectively. These values merely represent a general approximation of possible value and may never actually be realized.

NOTES TO FINANCIAL STATEMENTS
Years Ended June 30, 1994 and 1993
(Continued)

14. Financial Instruments, Continued:

Certain financial instruments potentially subject Shands to concentrations of credit risk. These financial instruments consist primarily of cash and cash equivalents, marketable equity securities, U.S. Government Adjustable Rate Mortgage Mutual Funds, equity mutual funds, short-term investments, and patient accounts receivable.

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 and investments with high quality financial institutions and thus limits its credit exposure.

FLORIDA PUBLIC SERVICE COMMISSION
CAPITAL CIRCLE OFFICE CENTER - 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

97 JAN -9 PM 3:54

APPLICATION FORM
for

RECEIVED
MAIL ROOM
DEPOSIT TREAS. REC. DATE

D436

JAN 10 '97

AUTHORITY TO PROVIDE ALTERNATIVE LOCAL EXCHANGE SERVICE
WITHIN THE STATE OF FLORIDA

INSTRUCTIONS

1. This form is used for an original application for a certificate and for approval of sale, assignment or transfer of an existing alternative local exchange certificate. In case of a sale, assignment or transfer, the information provided shall be for the purchaser, assignee or transferee.
2. Respond to each item requested in the application and appendices. If an item is not applicable, please explain why.
3. Use a separate sheet for each answer which will not fit the allotted space.
4. If you have questions about completing the form, contact:

Florida Public Service Commission
Division of Communications, Certification & Compliance Section
2540 Shumard Oak Boulevard
Tallahassee, Florida 32399-0866
(904) 413-6600

5. Once completed, submit the original and six (6) copies of this form along with a non-refundable application fee of \$250 made payable to the Florida Public Service Commission at the above address.
-

FLORIDA PUBLIC SERVICE COMMISSION
CAPITAL CIRCLE OFFICE CENTER - 2540 SHUMARD OAK BOULEVARD
TALLAHASSEE, FLORIDA 32399-0850

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Check enclosed with this form and
forwarded to RAI for deposit.
Please send check to RAI with proof of deposit.
In person who forwarded check:

[Signature]