

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Net Position (Unaudited)
As of March 31, 2014 and June 30, 2013
(Amounts in Thousands)

	March 31, 2014	June 30, 2013
Assets		
Current assets		
Cash and cash equivalents	\$ 42,601	\$ 31,525
Short-term investments	126,286	124,981
Patient accounts receivable, net of allowance for uncollectables of \$43,149 and \$47,312, respectively	195,714	170,959
Inventories	13,506	12,659
Prepaid expenses and other current assets	50,009	50,031
Assets whose use is restricted, current portion	27,260	46,733
Total current assets	<u>455,376</u>	<u>436,888</u>
Assets whose use is restricted, less current portion	316,186	309,359
Capital assets, net	725,497	705,648
Other assets	207,667	199,281
Total assets	<u>1,704,726</u>	<u>1,651,176</u>
Deferred outflows of resources		
Accumulated decrease in fair value of hedging derivatives	36,617	39,425
Deferred loss on debt refunding	664	765
Total deferred outflows of resources	<u>37,281</u>	<u>40,190</u>
Liabilities		
Current liabilities		
Long-term debt, current portion	21,698	20,745
Capital lease obligations, current portion	182	663
Accounts payable and accrued expenses	78,902	64,950
Accrued salaries and leave payable	49,288	43,896
Estimated third-party payor settlements	55,841	48,326
Total current liabilities	<u>205,911</u>	<u>178,580</u>
Long-term liabilities		
Long-term debt, less current portion	554,083	571,907
Capital lease obligations, less current portion	1,228	501
Other liabilities	53,653	57,126
Total long-term liabilities	<u>608,964</u>	<u>629,534</u>
Total liabilities	<u>814,875</u>	<u>808,114</u>
Deferred inflows of resources		
Deferred gain on debt refunding	11,895	12,578
Net position		
Net investment in capital assets	246,592	220,754
Restricted		
Nonexpendable	97	97
Expendable	8,884	7,357
Unrestricted	659,664	642,466
Total net position	<u>\$ 915,237</u>	<u>\$ 870,674</u>

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Revenues, Expenses and Changes in Net Position (Unaudited)
For the Nine Months Ended March 31, 2014 and 2013
(Amounts in Thousands)

	2014	2013
Operating revenues		
Net patient service revenue, net of provision for bad debts of \$70,310 and \$56,158 respectively	\$ 877,300	\$ 832,586
Other operating revenue	16,930	13,635
Total operating revenues	894,230	846,221
Operating expenses		
Salaries and benefits	412,490	376,075
Supplies and services	381,226	355,671
Depreciation and amortization	42,273	40,811
Total operating expenses	835,989	772,557
Operating income	58,241	73,664
Nonoperating revenues (expenses)		
State appropriations	5,288	5,625
Interest expense	(15,409)	(12,233)
Investment income, net	4,494	5,063
Realized gains on investments, net	17,033	4,799
Change in fair value of investments	2,530	9,191
Change in fair value of derivative instruments	2,106	(1,931)
(Loss) Gain on disposal of assets, net	(133)	8
Loss on extinguishment of long-term debt	-	(211)
Other nonoperating revenues, net	3,029	3,366
Total nonoperating revenues, net	18,938	13,677
Excess of revenues over expenses before transfers, capital contributions, and other changes in net position	77,179	87,341
Transfers and expenditures in support of the University of Florida and its medical programs	(34,505)	(34,818)
Capital contributions	362	945
Other changes in net position	1,527	(222)
Increase in net position	44,563	53,246
Net position		
Beginning balance	870,674	799,496
Ending balance	\$ 915,237	\$ 852,742

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidated Basic Statements of Cash Flows (Unaudited)
For the Nine Months Ended March 31, 2014 and 2013
(Amounts in Thousands)

	March 31, 2014	March 31, 2013
<u>Cash flows from operating activities</u>		
Cash received from patients and third-party payors	\$ 886,036	\$ 790,580
Other receipts from operations	16,283	15,008
Salaries and benefits paid to employees	(406,796)	(371,343)
Payments to suppliers and vendors	(379,836)	(330,065)
Net cash provided by operating activities	<u>115,687</u>	<u>104,180</u>
<u>Cash flows from noncapital financing activities</u>		
Payments received on notes receivable	7,191	1,883
Payments in support of the University of Florida and its medical programs	(36,589)	(34,818)
Payments in support of University of Florida medical education building	(2,000)	-
Donations and pledge receipts	3,880	6,036
Net cash used in noncapital financing activities	<u>(27,518)</u>	<u>(26,899)</u>
<u>Cash flows from capital and related financing activities</u>		
Purchase of capital assets	(61,620)	(44,244)
Medical Office Building construction project	-	17,839
Proceeds from sale of capital assets	3	6
Proceeds from issuance of debt	-	196,820
Payments of long-term debt and capital lease obligations	(21,916)	(88,466)
Loss on extinguishment of long-term debt	-	(211)
Interest payments	(12,848)	(10,667)
Capital contributions	362	945
Net cash (used in) provided by capital and related financing activities	<u>(96,019)</u>	<u>72,022</u>
<u>Cash flows from investing activities</u>		
Investment income received	3,208	3,420
Purchase of short-term investments and assets whose use is restricted	(54,635)	(205,801)
Sale of short-term investments and assets whose use is restricted	64,880	38,816
Other investing activity	5,473	(1,348)
Net cash provided by (used in) investing activities	<u>18,926</u>	<u>(164,913)</u>
Net increase (decrease) in cash and cash equivalents	11,076	(15,610)
Cash and cash equivalents		
Beginning of period	31,525	24,060
End of period	<u>\$ 42,601</u>	<u>\$ 8,450</u>
Reconciliation of operating income to net cash provided by operating activities		
Operating income	\$ 58,241	\$ 73,664
Adjustments to reconcile operating income to net cash provided by operating activities		
Depreciation and amortization	42,273	40,811
Provision for bad debts	70,310	56,158
Changes in:		
Patient accounts receivable	(88,507)	(78,444)
Prepaid expenses and other current assets	483	5,502
Inventories	(846)	(68)
Other assets	(16,699)	29,045
Accounts payable and accrued expenses	17,805	(6,876)
Accrued salaries and leave payable	5,392	5,469
Estimated third-party payor settlements	26,933	(21,347)
Other liabilities	302	266
Total adjustments	<u>57,446</u>	<u>30,516</u>
Net cash provided by operating activities	<u>\$ 115,687</u>	<u>\$ 104,180</u>
Supplemental noncash investing, capital and financing activities		
Capital assets acquired through financing and capital leases	\$ 3,583	\$ -

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Net Position (Unaudited)
As of March 31, 2014
(Amounts in Thousands)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	Shands Homecare	Property Management	Eliminations	Total Obligated Group	Other	Eliminations	Shands Teaching Hospital and Clinics, Inc.
Assets												
Current assets												
Cash and cash equivalents	\$ 36,191	\$ 1	\$ -	\$ -	\$ 36,192	\$ -	\$ -	\$ -	\$ 36,192	\$ 6,409	\$ -	\$ 42,601
Short-term investments	126,262	-	-	-	126,262	-	-	-	126,262	24	-	126,286
Patient accounts receivable, net	184,114	5,667	4,030	-	193,811	1,903	-	-	195,714	-	-	195,714
Inventories	13,506	-	-	-	13,506	-	-	-	13,506	-	-	13,506
Prepaid expenses and other current assets	47,864	744	80	(2)	48,686	416	-	-	49,102	907	-	50,009
Assets whose use is restricted, current portion	27,260	-	-	-	27,260	-	-	-	27,260	-	-	27,260
Total current assets	435,197	6,412	4,110	(2)	445,717	2,319	-	-	448,036	7,340	-	455,376
Assets whose use is restricted, less current portion	316,186	-	-	-	316,186	-	-	-	316,186	-	-	316,186
Capital assets, net	708,038	8,985	1,870	-	718,893	66	5,014	-	723,973	1,524	-	725,497
Due from affiliated entities, net	7,981	-	-	(1,965)	6,016	-	457	(752)	5,721	-	(5,721)	-
Other assets	179,075	4,365	3,076	-	186,516	1,422	-	-	187,938	19,729	-	207,667
Total assets	1,646,477	19,762	9,056	(1,967)	1,673,328	3,807	5,471	(752)	1,681,854	28,593	(5,721)	1,704,726
Deferred outflows of resources												
Accumulated decrease in fair value of hedging derivatives	36,617	-	-	-	36,617	-	-	-	36,617	-	-	36,617
Deferred loss on debt refunding	664	-	-	-	664	-	-	-	664	-	-	664
Total deferred outflows of resources	37,281	-	-	-	37,281	-	-	-	37,281	-	-	37,281
Liabilities												
Current liabilities												
Long-term debt, current portion	21,698	-	-	-	21,698	-	-	-	21,698	-	-	21,698
Capital lease obligations, current portion	182	-	-	-	182	-	-	-	182	-	-	182
Accounts payable and accrued expenses	75,195	1,891	399	-	77,485	406	16	-	77,907	995	-	78,902
Accrued salaries and leave payable	49,154	60	35	-	49,249	10	-	-	49,259	29	-	49,288
Estimated third-party payor settlements	55,810	33	-	(2)	55,841	-	-	-	55,841	-	-	55,841
Total current liabilities	202,039	1,984	434	(2)	204,456	416	16	-	204,887	1,024	-	205,911
Long-term liabilities												
Long-term debt, less current portion	554,083	-	-	-	554,083	-	-	-	554,083	-	-	554,083
Capital lease obligations, less current portion	1,228	-	-	-	1,228	-	-	-	1,228	-	-	1,228
Due to affiliated entities, net	175	1,647	143	(1,965)	-	752	-	(752)	-	5,721	(5,721)	-
Other liabilities	53,443	66	36	-	53,545	28	-	-	53,573	80	-	53,653
Total long-term liabilities	608,929	1,713	179	(1,965)	608,854	780	-	(752)	608,884	5,801	(5,721)	608,964
Total liabilities	810,968	3,697	613	(1,967)	813,310	1,196	16	(752)	813,771	6,825	(5,721)	814,875
Deferred inflows of resources												
Deferred gain on debt refunding	11,895	-	-	-	11,896	-	-	-	11,895	-	-	11,895
Net position												
Net investment in capital assets	230,657	8,985	1,870	-	241,512	66	5,014	-	246,592	-	-	246,592
Restricted												
Nonexpendable	97	-	-	-	97	-	-	-	97	-	-	97
Expendable	8,614	-	-	-	8,614	-	-	-	8,614	270	-	8,884
Unrestricted	621,527	7,080	6,573	-	635,180	2,545	441	-	638,166	21,498	-	659,664
Total net position	\$ 860,895	\$ 16,065	\$ 8,443	\$ -	\$ 885,403	\$ 2,611	\$ 5,455	\$ -	\$ 893,469	\$ 21,768	\$ -	\$ 915,237

Certain subsidiaries, separately presented in the fiscal 2013 consolidating basic statements, have been combined with other subsidiaries in the fiscal 2014 presentation.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries
Consolidating Basic Statements of Revenues, Expenses and
Changes in Net Position (Unaudited)
For the Nine Months Ended March 31, 2014
(Amounts in Thousands)

	UF Health Shands Hospital	UF Health Shands Psychiatric Hospital	UF Health Shands Rehab Hospital	Eliminations	Total Alachua County Hospital Group	Shands Homecare	Property Management	Eliminations	Total Obligated Group	Other	Eliminations	Shands Teaching Hospital and Clinics, Inc.
Operating revenues												
Net patient service revenue, net of provision for bad debts	\$ 840,865	\$ 18,751	\$ 13,250	\$ (403)	\$ 872,463	\$ 4,837	\$ -	\$ -	\$ 877,300	\$ -	\$ -	\$ 877,300
Other operating revenue	14,050	527	-	-	14,577	-	730	(296)	15,011	2,108	(189)	16,930
Total operating revenues	854,915	19,278	13,250	(403)	887,040	4,837	730	(296)	892,311	2,108	(189)	894,230
Operating expenses												
Salaries and benefits	385,410	13,147	8,433	1,084	408,074	3,670	-	-	411,744	746	-	412,490
Supplies and services	371,670	5,937	3,081	(1,487)	379,201	1,119	291	(296)	380,315	1,100	(189)	381,226
Depreciation and amortization	41,534	437	143	-	42,114	39	120	-	42,273	-	-	42,273
Total operating expenses	798,614	19,521	11,657	(403)	829,389	4,828	411	(296)	834,332	1,846	(189)	835,989
Operating income (loss)	56,301	(243)	1,593	-	57,651	9	319	-	57,979	262	-	58,241
Nonoperating revenues (expenses)												
State appropriations	5,288	-	-	-	5,288	-	-	-	5,288	-	-	5,288
Interest expense	(15,409)	-	-	-	(15,409)	-	-	-	(15,409)	-	-	(15,409)
Investment income, net	4,464	-	-	-	4,464	-	-	-	4,464	30	-	4,494
Realized capital gains on investments, net	17,033	-	-	-	17,033	-	-	-	17,033	-	-	17,033
Change in fair value of investments	2,529	-	-	-	2,529	-	-	-	2,529	1	-	2,530
Change in fair value of derivative instruments	2,106	-	-	-	2,106	-	-	-	2,106	-	-	2,106
Gain (loss) on disposal of assets, net	(136)	-	3	-	(133)	-	-	-	(133)	-	-	(133)
Other nonoperating revenues	4,046	6	-	-	4,052	-	-	-	4,052	(1,023)	-	3,029
Total nonoperating revenues, net	19,921	6	3	-	19,930	-	-	-	19,930	(992)	-	18,938
Excess (deficit) of revenues over expenses before transfers, capital contributions, and other changes in net position	76,222	(237)	1,596	-	77,581	9	319	-	77,909	(730)	-	77,179
Transfers and expenditures in support of the University of Florida and its medical programs	(33,897)	(608)	-	-	(34,505)	-	-	-	(34,505)	-	-	(34,505)
Transfer of net assets in association with consolidation and support of other operations and divisions of the Corporation	1,173	-	-	-	1,173	-	-	-	1,173	(1,173)	-	-
Capital contributions	362	-	-	-	362	-	-	-	362	-	-	362
Other changes in net position	1,517	-	-	-	1,517	-	-	-	1,517	10	-	1,527
Increase (decrease) in net position	45,377	(845)	1,596	-	46,128	9	319	-	46,456	(1,893)	-	44,563
Net position												
Beginning balance	815,518	16,910	6,847	-	839,275	2,602	5,136	-	847,013	23,661	-	870,674
Ending balance	\$ 860,895	\$ 16,065	\$ 8,443	\$ -	\$ 885,403	\$ 2,611	\$ 5,455	\$ -	\$ 893,469	\$ 21,768	\$ -	\$ 915,237

Certain subsidiaries, separately presented in the fiscal 2013
consolidating basic statements, have been combined with other
subsidiaries in the fiscal 2014 presentation.

Shands Teaching Hospital and Clinics, Inc. and Subsidiaries

Management's Discussion and Analysis (Unaudited)

March 31, 2014 and 2013

Introduction

This section of the Shands Teaching Hospital and Clinics, Inc. and Subsidiaries' ("Shands") financial report presents Shands' analysis of its consolidated basic statements of net position as of March 31, 2014 (unaudited) with comparative information as of June 30, 2013. This section also presents Shands' condensed consolidated basic statements of revenues, expenses and changes in net position for the nine months ended March 31, 2014 (unaudited) with comparative information for the nine months ended March 31, 2013 (unaudited). This discussion has been prepared by management and should be read in conjunction with the consolidated basic financial statements.

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

In 2013, a branding campaign introduced University of Florida Health or "UF Health", which encompasses the UF Health Science Center and the Shands family of hospitals and services. As a result, Shands and certain of its affiliated entities operate under d/b/a's beginning with "UF Health." The following identifies the significant affiliates of Shands and their respective primary operations:

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

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

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

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

Property Management leases properties in Gainesville, Florida.

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

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

Joint Ventures: Shands has a 40% minority partnership interest with Community Health Systems, Inc. ("CHS") in **Lake Shore HMA, LLC**, **Starke HMA, LLC**, and **Live Oak HMA, LLC** for three rural community hospitals (Shands Lake Shore located in Lake City, Florida; Shands Starke located in Starke, Florida; and Shands Live Oak located in Live Oak, Florida). CHS manages the operations of the three facilities. Prior to January 27, 2014 the partnership interest was with Health Management Associates, Inc. ("HMA"). On January 27, 2014 CHS acquired all of HMA's issued and outstanding stock. However, the LLCs will continue under the original name.

Shands has an equal partnership interest with **Solantic, LLC (d/b/a “Care Spot”)** in a walk-in urgent care center located in Gainesville, Florida. Care Spot manages the operations of the facility. Shands and the University of Florida Development Corporation (“UFDC”) are partners in **Innovation Square, LLC**. Situated between the UF campus and downtown Gainesville, Innovation Square is a planned mixed-use research neighborhood that advances the national and global profile of UF with Shands and the local biotech industry. Shands’ financial interest results from assets transferred to the LLC net of amounts received from UFDC representing their partnership interest.

Shands also has a partnership interest, based upon membership levels, with Shands Jacksonville Medical Center, Inc. (“SJMC”), a related party controlled by UF, in **First Coast Advantage, LLC (“FCA”)** which is a provider service network (“PSN”) established to provide services to Medicaid qualified individuals in certain regions of the state, as designated by the Agency for Health Care Administration (“AHCA”), the administrator of the Medicaid program in the State of Florida. In March 2013, FCA submitted a bid to AHCA to serve two (Regions 3 and 4) of the eleven regions under the Statewide Medicaid Managed Care Program. In September, AHCA announced its selections, which included FCA. However, FCA was only successful in its bid for Region 4, which is served by SJMC, and was not awarded Region 3, which is served by Shands. Consequently, Shands is unwinding its interest in FCA and has recorded an estimated impairment charge of \$0.3 million, reflected in other nonoperating revenues, net in the accompanying consolidated basic statement of revenues, expenses and changes in net position (unaudited) for the nine months ended March 31, 2014. Due to the unsuccessful bid, Shands has been reimbursed for the proposal submission fee of \$1.6 million, previously recorded as a receivable at June 30, 2013. Any remaining amounts involving FCA are immaterial.

Required Financial Statements

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

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

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

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

Financial Analysis of Shands

Statements of Net Position

The condensed consolidated basic statements of net position present the financial position of Shands as of March 31, 2014 and June 30, 2013 and include all assets, liabilities and deferred inflows and outflows of Shands. Shands' net position is one indicator of the current financial condition of Shands. Changes in net position are an indicator of whether the overall financial condition of the organization has improved or worsened over a period of time. They also provide the basis for evaluating the capital structure, as well as assessing the liquidity and financial flexibility of Shands. However, the financial statement user should consider other nonfinancial factors, such as changes in economic conditions, population change, regulations, and government legislation affecting the health care industry.

The following table presents Shands' condensed consolidated basic statements of net position as of March 31, 2014 and June 30, 2013:

<i>(in thousands of dollars)</i>	March 31, 2014	June 30, 2013
Cash and cash equivalents and short-term investments	\$ 168,887	\$ 156,506
Other current assets	286,489	280,382
Capital assets, net	725,497	705,648
Other assets	523,853	508,640
Total assets	<u>1,704,726</u>	<u>1,651,176</u>
Deferred outflows of resources	<u>37,281</u>	<u>40,190</u>
Current liabilities	205,911	178,580
Long-term liabilities	608,964	629,534
Total liabilities	<u>814,875</u>	<u>808,114</u>
Deferred inflows of resources	<u>11,895</u>	<u>12,578</u>
Net position		
Net investment in capital assets	246,592	220,754
Restricted		
Nonexpendable	97	97
Expendable	8,884	7,357
Unrestricted	659,664	642,466
Total net position	<u>\$ 915,237</u>	<u>\$ 870,674</u>

Cash and cash equivalents and short-term investments increased by \$12.4 million or 7.9% from June 30, 2013. Cash generated from operations was \$115.7 million. Other sources of cash included the release of \$21.0 million in funds internally designated for capital projects. Cash uses included payments of \$36.6 million in support of UF and its medical programs, purchase of capital assets of \$61.6 million, and payment of principal on debt of \$21.9 million including both current and noncurrent portions of debt and capital lease obligations.

Other current assets, including net patient accounts receivable, inventories, prepaid expenses and other current assets, and assets whose use is restricted, current portion increased by \$6.1 million or 2.2%. A primary driver for the increase is patient accounts receivable, net, which increased by \$24.8 million. This increase in receivables from June 30 was due to two factors: (1) increases in net patient service revenue

and (2) the conversion to a new patient financial system in July, 2013. In the early stages of a system conversion, accounts receivable levels tend to increase as improved work flows are implemented. Management expected this increase and is focused on a continued, smooth transition to the new revenue system. Other factors affecting the increase in other current assets included increases in inventories of \$0.8 million, partially offset by a decrease in assets whose use is restricted of \$19.5 million as corresponding current liabilities decreased.

Capital assets, net, increased by \$19.8 million or 2.8% from June 30, 2013 reflecting purchases of \$61.6 million and non-cash additions of \$3.6 million, partially offset by depreciation and amortization of \$42.3 million and a decrease in retainage payable of \$3.1 million. In 2014, capital asset additions have included the purchases of land of \$1.9 million, building renovations of \$40.7 million, and equipment purchases of \$19.0 million. Equipment acquisitions have included \$9.7 million for a replacement helicopter and \$4.3 million for implementation costs related to the electronic medical records (EMR) system.

Other assets increased by \$15.2 million or 3.0%, due primarily to Shands funding its defined-benefit plan \$13.6 million in excess of required levels. Other activity included an increase of \$0.5 million in collateral deposits on swap agreements.

Deferred outflows of resources decreased by \$2.9 million or 7.2% due to improved fair value of the hedged interest rate swaps.

Current liabilities increased by \$27.3 million or 15.3% due to increases of \$13.9 million in accounts payable and accrued expenses, \$7.5 million in third-party settlement liabilities, \$5.4 million in accrued salaries and leave payable, \$1.0 million increase in the current portion of long-term debt and a \$0.5 million decrease in the current portion of capital lease obligations. The net change in the current portions of debt and capital lease obligations include an increase of \$2.8 million for capital assets acquired through financing offset by \$2.3 million in principal payments. The increase in third-party settlement liabilities is due to the net impact of a legal settlement payment of \$19.4 million (see page 8) more than offset by collection of \$17.2 million in prior year settlements, liability estimate of \$6.1 million for the current fiscal year, and deferral of cash received of \$3.6 million related to the change in methodology for Medicaid inpatient reimbursement.

Long-term liabilities decreased by \$20.6 million or 3.3% primarily due primarily to \$19.6 million in payments for the long-term portion of debt. Capital lease obligations include \$0.8 million for capital assets acquired through capital leases.

Deferred inflows of resources decreased by \$0.7 million or 5.4% due to amortization of deferred gains on debt refunding.

Total net position increased by \$44.6 million or 5.1%. The increase was due to favorable operating performance.

Statements of Revenues, Expenses and Changes in Net Position

The following table presents Shands' condensed consolidated basic statements of revenues, expenses and changes in net position for the nine months ended March 31, 2014 and 2013:

(in thousands of dollars)

	2014	2013
Net patient service revenue	\$ 877,300	\$ 832,586
Other operating revenue	<u>16,930</u>	<u>13,635</u>
Total operating revenues	894,230	846,221
Operating expenses	<u>835,989</u>	<u>772,557</u>
Operating income	58,241	73,664
Nonoperating revenues, net	<u>18,938</u>	<u>13,677</u>
Excess of revenues over expenses	77,179	87,341
Other changes in net position		
Transfers and expenditures in support of the University of Florida and its medical programs	(34,505)	(34,818)
Capital contributions	362	945
Other changes in net position	<u>1,527</u>	<u>(222)</u>
Increase in net position	44,563	53,246
Net position		
Beginning balance	<u>870,674</u>	<u>799,496</u>
Ending balance	<u>\$ 915,237</u>	<u>\$ 852,742</u>

Operating Revenues

For the nine months ended March 31, 2014 total operating revenues increased by \$48.0 million or 5.7% compared to the nine months ended March 31, 2013.

Net patient service revenue increased by \$44.7 million or 5.4% reflecting continued increases in patient acuity, increases in admissions of 7.3% and outpatient visits of 4.1%, and modest rate increases from non-governmental payors, partially offset by an increase in observation cases, which yields lower reimbursement. Regarding rate changes, effective July 1, 2013, AHCA converted the Medicaid inpatient payment methodology from a per diem reimbursement system to a "per case" model. Based on an internal analysis, Medicaid payments on a "per case" method are approximately 11% less than the previous "per diem" method.

For the nine months ended March 31, 2014 and 2013, changes in prior year estimated third-party payer settlements increased net patient service revenue by \$5.0 million and \$5.3 million, respectively.

Other operating revenues increased by \$3.3 million or 24.2%. The increase in other operating revenue is largely due to funding from Medicare and Medicaid totaling \$2.4 million for meeting additional "meaningful use" benchmarks associated with implementation of the EMR system. Also contributing to the increase is a contract pharmacy arrangement in which Shands contracts with outside pharmacies to provide pharmacy services. This activity is new for Shands and has yielded revenue of \$1.5 million through March 31, 2014.

Operating Expenses

Operating expenses increased by \$63.4 million or 8.2%. Salaries and benefits increased by \$36.4 million or 9.7% reflecting increases in staffing levels, wage increases, health benefits and pension expense. Supplies and services increased by \$25.6 million or 7.2% resulting from the increased patient volume as well as cost increases associated with improved clinical technologies, pharmaceutical supplies and certain purchased services. Depreciation and amortization increased by \$1.5 million or 3.6%.

Nonoperating Revenues, net

Nonoperating results reflect investment performance and fair value changes on nonhedging interest rate swaps, which can vary significantly from year to year, and interest expense (due to Governmental Accounting Standards Board reporting requirements). Nonoperating revenues, net increased by \$5.3 million or 38.5%. Nonoperating investment income was \$26.2 million and \$17.1 million for the nine months ended March 31, 2014 and 2013, respectively. The increase reflects continued favorable results in the financial markets and Shands' investment portfolio. Interest expense increased by \$3.2 million, largely resulting from the \$125.0 million Series 2013A Taxable Notes issued in March, 2013.

Patient Volumes

The following tables present the associated volumes of each facility on a comparative basis for the nine months ended March 31, 2014 and 2013.

	Nine Months Ended		Net Change	% Change
	March 31,			
	2014	2013		
Inpatient Admissions (1)				
UF Health Shands Hospital	35,642	33,326	2,316	6.9%
UF Health Shands Psychiatric Hospital	2,399	2,155	244	11.3%
UF Health Shands Rehab Hospital	661	604	57	9.4%
Total	<u>38,702</u>	<u>36,085</u>	<u>2,617</u>	<u>7.3%</u>
	2014	2013	Net Change	% Change
Outpatient Visits (2)				
UF Health Shands Hospital	595,545	572,432	23,113	4.0%
UF Health Shands Psychiatric Hospital	19,773	18,999	774	4.1%
UF Health Shands Rehab Hospital	315	136	179	131.6%
Total	<u>615,633</u>	<u>591,567</u>	<u>24,066</u>	<u>4.1%</u>

(1) Includes observation cases

(2) Includes emergency room and trauma visits

For the nine months ended March 31, 2014 inpatient admissions increased by 7.3% compared to the nine months ended March 31, 2013. Outpatient visits increased by 4.1%.

Statements of Cash Flows

The consolidated basic statements of cash flows provide additional information in regards to Shands' financial results by reporting the major sources and uses of cash. For the nine months ended March 31,

2014, cash and cash equivalents increased by \$11.1 million or 35.1%. Cash in-flows were primarily a result of net cash provided by operating activities of \$115.7 million as well as the release of \$21.0M in project funds to reimburse operating cash for capital spending. Cash out-flows included payments of \$36.6 million in support of UF and its medical programs, payments for acquisition of capital assets of \$61.6 million, and principal and interest payments of \$34.8 million on outstanding debt. Shands also funded the defined benefit pension plan by \$13.6 million in excess of pension expense as management proactively works toward improving the plan's funded status. At March 31, 2014, the funded status is 74.7%, up from 68.9% as of June 30, 2013.

Debt Outstanding

As of March 31, 2014, Shands had approximately \$575.8 million in debt outstanding compared to approximately \$592.7 million at June 30, 2013. Long-term debt is comprised of tax exempt bond issues, taxable notes, and installment debt. In fiscal year 2014, Shands entered into an installment debt agreement for \$2.7 million to finance a portion of the costs of an EMR system implementation.

Shands utilizes interest rate swaps in order to synthetically convert certain variable rate bonds to fixed rate bonds. Including the effect of the interest rate swaps, approximately 77% of Shands' bonds and notes outstanding are fixed while 23% are variable. The Series 1996A Bonds are fixed rate bonds insured by MBIA. The Series 2007A and Series 2007B Bonds, Series 2008C Bonds, and the Series 2008A Bonds are variable rate bonds with fixed rate payor interest rate swaps which synthetically convert them to fixed rate bonds. The Series 2008D1 and Series 2008D2 bonds and the Series 2010B Bonds are unenhanced fixed rate bonds. The Series 2010A Bonds and the Series 2012A and Series 2012B Bonds are variable rate bonds. The Series 2013A Taxable Notes and the 2012 Bank Note are taxable fixed rate notes.

Remote Emergency Department

In August 2013, Shands opened its remote, full-service, 24/7 emergency department. Located in the northwest section of Gainesville, the UF Health Shands Emergency Center – Springhill is housed in a completely renovated 8,500-square-foot building, retrofitted to include all of the technology and diagnostic resources necessary for emergency care. Total project cost amounted to \$4.6 million. The Center is staffed entirely by board-certified and board-eligible UF Health emergency medicine physicians and experienced emergency medicine nurses. The 911-receiving center is equipped with ten treatment spaces for patients, an onsite lab and diagnostic radiology services including X-ray and CT imaging systems. A permanently stationed ShandsCair ambulance transfers patients requiring hospitalization to UF Health Shands Hospital.

For the nine months ended March 31, 2014, emergency and trauma visits increased by 12,006 or 19.8% compared to the nine months ended March 31, 2013. Since opening, visit volume at the Center amounted to 8,034, accounting for 66.9% of the year-over-year volume increase.

Legal Settlement

In July 2013, Shands paid \$19.4 million to resolve allegations made under the False Claims Act that billing practices at Shands' hospitals resulted in overpayments by Medicare and Medicaid covering fiscal years 2003 through 2008. The settlement resulted from a whistleblower lawsuit filed in the U.S. District Court - Middle District Court of Florida - Jacksonville Division on April 30, 2008, which had been under court seal. The whistleblower was an independent consultant hired by Shands in 2006 and 2007 to conduct a routine audit of its billing practices. The audit showed inconsistent billing practices. In some instances, Shands billed Medicare and Medicaid for short overnight inpatient admissions rather than for outpatient or observation services. Shands officials fully cooperated with the state and federal investigation and negotiated the settlement agreement. While there has been no admission of liability, Shands paid \$18.8 million to the Medicare program and \$0.6 million to the State of Florida under its Medicaid program.

Payment of this settlement amount did not have a material impact on Shands' net position, key financial metrics or results of operations.

Credit Ratings

Shands has received underlying credit ratings of A2 from Moody's Investor Services and A from Standard & Poor's on all of its rated debt with a "Stable" outlook. Standard & Poor's credit rating was affirmed in April 2014 and Moody's credit rating was affirmed in February 2013.