



SHRINERS HOSPITALS FOR CHILDREN

Combined Financial Statements

December 31, 2015 and 2014

(With Independent Auditors' Report Thereon)

SHRINERS HOSPITALS FOR CHILDREN

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KPMG LLP
Suite 1700
100 North Tampa Street
Tampa, FL 33602

Independent Auditors' Report

The Board of Directors
Shriners Hospitals for Children:

We have audited the accompanying combined financial statements of Shriners Hospitals for Children, which comprise the combined statements of financial position as of December 31, 2015 and 2014, and the related combined statements of operations and changes in unrestricted net assets, changes in net assets, and cash flows for the years then ended, and the related notes to the combined financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

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

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

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

Opinion

In our opinion, the combined financial statements referred to above present fairly in all material respects, the financial position of Shriners Hospitals for Children as of December 31, 2015 and 2014, and the changes in their net assets and their cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

KPMG LLP

April 11, 2016
Certified Public Accountants

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Financial Position

December 31, 2015 and 2014

(In thousands)

Assets	2015	2014
Cash and cash equivalents	\$ 14,121	8,560
Cash and cash equivalents held as collateral under securities lending transactions	347,162	623,165
Patient accounts receivable, net of allowance for doubtful accounts of approximately \$125,277 in 2015 and \$123,945 in 2014	35,123	40,802
Receivables, net	4,970	9,939
Accrued interest and dividends	19,616	20,175
Inventories and deferred charges	30,257	28,808
Patient transportation funds held by Shrine temples	56,985	57,353
Long-term investments:		
Marketable securities	6,887,215	7,348,090
Charitable gift annuities	36,815	34,834
Beneficial interest in trusts	528,188	543,920
Real estate and mineral interests	293,064	268,614
Miscellaneous investments	20,448	20,284
Estates in process	269,697	258,971
Land, buildings, and equipment, net of accumulated depreciation	866,600	811,421
Total assets	\$ <u>9,410,261</u>	<u>10,074,936</u>
Liabilities and Net Assets		
Liabilities:		
Accounts payable and accrued expenses	\$ 133,085	126,800
Line of credit payable	40,000	10,000
Pension benefits	171,678	184,976
Liabilities under securities lending transactions	347,162	623,165
Other liabilities	38,186	37,889
Total liabilities	<u>730,111</u>	<u>982,830</u>
Net assets (net of cumulative foreign currency translation adjustment of \$8,732 in 2015 and \$8,955 in 2014):		
Unrestricted	7,282,673	7,698,167
Temporarily restricted	295,809	296,919
Permanently restricted	1,101,668	1,097,020
Total net assets	<u>8,680,150</u>	<u>9,092,106</u>
Total liabilities and net assets	\$ <u>9,410,261</u>	<u>10,074,936</u>

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Operations and Changes in Unrestricted Net Assets

Years ended December 31, 2015 and 2014

(In thousands)

	2015	2014
Operating revenues and other support:		
Patient service revenue (net of contractual adjustments)	\$ 175,478	191,166
Provision for Shriners assist	(41,068)	(58,889)
Net patient service revenue less provision for Shriners assist	134,410	132,277
Operating revenues and other support:		
Investment income:		
Interest	68,503	80,787
Dividends	107,969	117,024
Other investment income	54,894	42,051
Investment management fees	(18,642)	(15,866)
Amounts released from restrictions used for operations	168,996	176,252
Donations	69,231	57,023
Fund raising and special events	34,453	28,888
Hospital assessments	1,163	1,228
Reimbursements from Canadian Provinces	5,387	5,427
Other governmental revenue	13,763	31,205
Other	4,125	2,901
Total revenues and other support	644,252	659,197
Operating expenses:		
Hospitals	601,558	594,363
Research	32,172	33,396
Revenue cycle	13,295	13,495
Information systems	32,938	29,624
Headquarters, administrative, and board related	52,989	46,854
Donor relations, fund raising and special events	36,910	32,146
Total operating expenses	769,862	749,878
Decrease in net assets from operating activities	(125,610)	(90,681)
Nonoperating (losses) gains, net:		
Gains (losses) on investments:		
Net realized gain from investments	157,175	384,525
Net unrealized losses on investments	(443,764)	(321,901)
Total gains (losses) on investments, net	(286,589)	62,624
Life memberships	203	95
Change in patient transportation funds held by Shrine temples	(368)	2,486
Pension-related changes other than net periodic pension costs	6,419	(100,698)
Other, net	(9,326)	(7,236)
Foreign currency translation adjustments	(223)	128
Total nonoperating losses, net	(289,884)	(42,601)
Decrease in unrestricted net assets	\$ (415,494)	(133,282)

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Changes in Net Assets

Years ended December 31, 2015 and 2014

(In thousands)

	<u>2015</u>	<u>2014</u>
Unrestricted net assets:		
Decrease in net assets from operating activities	\$ (125,610)	(90,681)
Nonoperating (losses) gains, net:		
Gains (losses) on investments:		
Net realized gains from investments	157,175	384,525
Net unrealized losses on investments	<u>(443,764)</u>	<u>(321,901)</u>
Total gains (losses) on investments, net	(286,589)	62,624
Life memberships	203	95
Change in patient transportation funds held by Shrine temples	(368)	2,486
Pension related changes other than net periodic pension costs	6,419	(100,698)
Other, net	(9,326)	(7,236)
Foreign currency translation adjustments	<u>(223)</u>	<u>128</u>
Total nonoperating losses, net	<u>(289,884)</u>	<u>(42,601)</u>
Decrease in unrestricted net assets	<u>(415,494)</u>	<u>(133,282)</u>
Temporarily restricted net assets:		
Bequests	153,156	151,870
Donations	31,291	7,171
Other, net	(835)	(999)
Net realized gains from investment	920	1,243
Net unrealized (losses) gains from investments	(16,646)	3,977
Net assets released from restrictions used for operations	<u>(168,996)</u>	<u>(176,252)</u>
Decrease in temporarily restricted net assets	<u>(1,110)</u>	<u>(12,990)</u>
Permanently restricted net assets:		
Bequests	13,875	9,221
Donations	2	560
Other investment (expense) income	6	(105)
Net realized gain from investment	181	360
Net unrealized (losses) gains from investments	<u>(9,416)</u>	<u>6,851</u>
Increase in permanently restricted net assets	<u>4,648</u>	<u>16,887</u>
Decrease in net assets	(411,956)	(129,385)
Net assets, beginning of year	<u>9,092,106</u>	<u>9,221,491</u>
Net assets, end of year	\$ <u><u>8,680,150</u></u>	<u><u>9,092,106</u></u>

See accompanying notes to combined financial statements.

SHRINERS HOSPITALS FOR CHILDREN

Combined Statements of Cash Flows

Years ended December 31, 2015 and 2014

(In thousands)

	2015	2014
Cash flows from operating activities:		
Change in net assets	\$ (411,956)	(129,385)
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation	54,614	52,666
Loss on disposal of property and equipment	122	7,514
Realized and unrealized losses (gains) on investments	311,550	(73,223)
Gifts and bequests designated by the board or restricted by donor for long-term investment	(167,236)	(161,746)
Change in value of patient transportation funds held by Shrine temples	368	(2,486)
Provision for Shriners assist	41,068	58,889
Pension related changes other than net period pension costs	(6,419)	100,698
Changes in operating assets and liabilities:		
Patient accounts receivable	(35,389)	(67,930)
Receivables	4,969	(3,594)
Accrued interest and dividends	559	2,904
Inventories and deferred charges	(1,449)	2,162
Beneficial interest in trusts	15,732	(8,799)
Estates in process	(10,726)	5,016
Accounts payable and accrued expenses	6,285	7,307
Pension benefits	(6,879)	(13,909)
Net cash used in operating activities	(204,787)	(223,916)
Cash flows from investing activities:		
Additions to property and equipment	(109,915)	(100,350)
Proceeds from sale of investments	3,340,624	4,342,257
Investment purchases	(3,217,894)	(4,200,655)
Net cash provided by investing activities	12,815	41,252
Cash flows from financing activities:		
Gifts and bequests designated for board endowment	153,156	151,870
Gifts and bequests permanently restricted by donors	13,877	9,781
Life memberships	203	95
Borrowings from line of credit	90,000	80,000
Payments on the line of credit	(60,000)	(70,000)
Change in other liabilities	297	907
Net cash provided by financing activities	197,533	172,653
Net increase (decrease) in cash and cash equivalents	5,561	(10,011)
Cash and cash equivalents at beginning of year	8,560	18,571
Cash and cash equivalents at end of year	\$ 14,121	8,560
Supplemental disclosures of cash flow information:		
Transfer of estates in process to real estate	\$ —	16,875
Transfer of buildings to real estate	35,728	—

See accompanying notes to combined financial statements.

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

(1) Summary of Significant Accounting Policies

(a) Combined Organizations

Shriners Hospitals for Children (herein SHC) provides quality, specialized medical care, in the areas of orthopaedics, severe burns, and spinal cord injuries, through a network of 22 facilities located throughout the United States, Canada, and Mexico. Medical care is provided regardless of the patient or family's ability to pay. SHC also funds intensive programs in pediatric orthopedic and burns research. SHC relies principally on gifts and investment earnings to support their operations and research programs.

The combined financial statements of SHC include the following organizations:

- Shriners Hospitals for Children, a Colorado Corporation
- Shriners Hospitals for Children, a Canadian Corporation
- Shriners Hospitals for Children (Quebec) Inc.
- The Shriners' Hospital for Children, a Massachusetts Corporation
- Shriners Hospitals for Children, a Mexican Association
- Shriners Hospitals for Children Pediatric Orthotic and Prosthetic LLCs (POPS)

Shriners Hospitals for Children, a Colorado Corporation and The Shriners' Hospital for Children, a Massachusetts Corporation, have been recognized as exempt from U.S. federal income tax on related income under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3) of the Internal Revenue Code. The Canadian and Quebec Corporations and the Mexican Association are also exempt from income tax on related income in accordance with the laws of their respective countries. Shriners Hospitals for Children POPS are wholly-owned limited liability companies that provide orthotic and prosthetic services and related functions.

(b) Use of Estimates

The preparation of the combined financial statements in accordance with generally accepted accounting principles requires management of SHC to make a number of estimates and assumptions that affect the reported amounts in the combined financial statements and accompanying notes to the combined financial statements. Actual results could differ from those estimates.

Significant estimates have been made by management with regard to patient accounts receivable, net of allowance for doubtful accounts, estates in process, and beneficial interests in trusts. These estimates are subject to significant fluctuation due to changes in payment trends and changes that occur in the valuation of assets associated with these estates and trusts and the timing of information received from trustees and executors of these estates and trusts. Actual results could differ materially from these estimates, making it reasonably possible that a material change in these estimates could occur in the near term.

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

(c) ***Basis of Presentation***

The combined financial statements are presented on the accrual basis of accounting. Contributions received and unconditional promises to give are measured at their fair values and are reported as increases in net assets. SHC reports gifts of cash and other assets as restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statements of operations and changes in unrestricted net assets, and changes in net assets as net assets released from restrictions. Donor-restricted contributions whose restrictions are met in the same reporting period are reported as unrestricted support:

- Unrestricted net assets consist of investments and otherwise unrestricted amounts that are available for use in carrying out the activities of SHC. The majority of unrestricted net assets as of December 31, 2015 and 2014 represent board-designated endowment.
- Temporarily restricted net assets represent those amounts, which are not available until future periods or are donor restricted for specific purposes. SHC reports estates in process, charitable lead trusts, and charitable remainder trusts, as increases in temporarily restricted net assets as these assets are not available for expenditure until future periods.
- Permanently restricted net assets result from gifts and bequests from donors who place restrictions on the use of the funds, which mandate that the original principal be invested in perpetuity. Permanently restricted net assets also include perpetual lead trusts.

(d) ***Operating Measure***

Changes in unrestricted net assets from operating activities represent the revenues, gains, and other support designated to operate SHC, less expenses and other costs associated with SHC operating and research activities and costs to generate operating revenues.

(e) ***Liquidity***

Assets are presented in the accompanying combined statements of financial position according to their nearness of conversion to cash, and liabilities according to the nearness of their maturity and resulting use of cash.

(f) ***Cash and Cash Equivalents***

SHC considers all highly liquid investments made from operating cash accounts and with a maturity of three months or less when purchased to be cash equivalents.

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

(g) *Securities Loaned*

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 860, *Transfers and Servicing*, requires SHC to recognize cash received as collateral for assets transferred to brokers in security lending transactions along with the obligation to return the cash. SHC generally receives collateral in the form of cash in an amount in excess of the fair value of securities loaned. SHC monitors the fair value of securities loaned on a monthly basis with additional collateral obtained as necessary. At December 31, 2015 and 2014, SHC held \$347,162 and \$623,165, respectively, of cash and marketable securities as collateral deposits. The collateral is included as both an asset and a liability in SHC's combined statements of financial position. The securities on loan had a fair value of \$339,632 and \$606,093 at December 31, 2015 and 2014, respectively, and are included in marketable securities in the accompanying combined statements of financial position.

(h) *Inventories*

Inventories of supplies are stated at the lower of cost (first-in, first-out method) or market.

(i) *Long-Term Investments*

The following long-term investments comprise SHC's endowment: marketable securities, charitable gift annuities, beneficial interest in trusts, real estate and mineral interests and miscellaneous investments. It is SHC's Board of Directors (Board) policy to maintain a long-term investment portfolio to support the operating and research activities of SHC.

Marketable securities are measured at fair value based on quoted market prices at the reporting date for these or similar investments. Investments in real estate and mineral interests, and miscellaneous investments are reported at fair value at the date of contribution and subsequently measured at fair value based on various sources of information depending on the asset type. Investment income (including realized and unrealized gains and losses on investments, interest, and dividends) is included in the combined statements of operations and changes in unrestricted net assets as increases or decreases in unrestricted net assets unless the income is restricted by donor or law.

SHC has a beneficial interest in a variety of trust agreements. Many of these trusts are charitable lead trusts where SHC receives distributions from the trust, which in most cases are administered by a third party. Perpetual lead trusts are recorded at the fair value of the trust's underlying assets and are classified as permanently restricted net assets. All other charitable lead trusts are recorded at the present value of the estimated future distributions expected to be received by SHC, and are classified as temporarily restricted net assets.

Charitable remainder trusts and pooled income funds represent trust agreements where SHC maintains custody of the related assets and makes specified distributions to a designated beneficiary or beneficiaries over the term of the trust. Assets under both types of trusts are recorded at fair value. Annuity liabilities associated with charitable remainder trusts are determined based on the present value of the estimated future payments to be paid to the designated beneficiaries, based upon actuarial estimate. Deferred income is recognized on gifts to pooled income funds representing the discounted value of the assets for the estimated time period until the donor's death. The difference between the

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

recorded assets and the annuity liabilities or deferred income associated with pooled income funds is classified as temporarily restricted net assets.

Subsequent adjustments to the carrying value of the respective assets and related liabilities or deferred income are recognized in the combined statements of operations and changes in unrestricted net assets, and combined statements of changes in net assets and are included in unrealized gains and losses in their respective net asset category.

Included in other liabilities in the accompanying combined statements of financial position are annuity liabilities of \$20,735 and \$21,898 and deferred income of \$17,235 and \$15,991 at December 31, 2015 and 2014, respectively.

(j) *Estates in Process*

SHC recognizes a receivable and revenue for its interest in estates in process based on the inventories of estate assets and conditions contained in the respective wills. Amounts expected to be received in future years are discounted to provide estimates in current year dollars. SHC records estates in process (when the court declares the related will valid) as either temporarily restricted net assets, as these assets will not be available for expenditures until future periods (typically one to five years), or as permanently restricted net assets. As funds from an estate (other than permanently restricted) are collected, temporarily restricted net assets are reclassified to unrestricted net assets, and reported in the combined statements of operations and changes in unrestricted net assets, and combined statements of changes in net assets as net assets released from restrictions.

(k) *Land, Buildings, and Equipment*

Land, land improvements, buildings, and equipment are stated at cost, if purchased, or at estimated fair value at date of receipt if acquired by gift. Depreciation is calculated using the straight-line method over the estimated useful lives of the assets.

(l) *Impairment or Disposal of Long-Lived Assets*

SHC accounts for long-lived assets in accordance with the provisions of FASB ASC Section 360-10-35, *Property, Plant, and Equipment – Subsequent Measurement*, which requires that long-lived assets be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

SHC reviews whether events and circumstances have occurred to indicate if the remaining estimated useful life of long-lived assets may warrant revision or that the remaining balance of an asset may not be recoverable. If such an event occurs, an assessment of possible impairment is based on whether the carrying amount of the asset exceeds the expected total undiscounted cash flows expected to result from the use of the assets and their eventual disposition. No impairments were recorded in 2015 or 2014.

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

(m) Foreign Currency Translation

Revenues and expenses of the Canadian and Quebec corporations and the Mexican Association are translated using average exchange rates during the year, while monetary assets and liabilities are translated into U.S. dollars using current exchange rates at the end of the year.

Nonmonetary asset and liability items (land, buildings, and equipment) and related revenues, expenses, gains, and losses are remeasured using historical exchange rates. Resulting translation adjustments are accumulated in the combined statements of financial position caption "Cumulative foreign currency translation adjustment," as a component of unrestricted net assets.

(n) Contributed Services

No amounts have been reflected in the combined financial statements for contributed services. SHC's programs pay for most services requiring specific expertise. However, many individuals (Shriners and non-Shriners) volunteer their time at SHC and perform a variety of tasks that assist SHC with specific programs and various committee assignments.

(o) Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others for services. SHC has agreements with third-party payors that provide for payments to SHC at amounts different from its established rates. Payment arrangements include prospectively determined rates per discharge, reimbursed costs, and discounted charges.

Revenue from the Medicaid program accounted for approximately 41% and 38%, and less than one percent of SHC's net patient service revenue from the Medicare program, for the years ended December 31, 2015 and 2014, respectively. The composition of patient service revenue (net of contractual adjustments) but before the provision for Shriners assist recognized from these major payor sources is as follows (in thousands):

	<u>2015</u>	<u>2014</u>
Medicaid	\$ 84,519	116,270
Commercial payors	90,959	74,896
Total all payors	<u>\$ 175,478</u>	<u>191,166</u>

SHC analyzes its past collection history and identifies trends by each of its major payor sources of patient service revenue to estimate the appropriate allowance for doubtful accounts and provision for Shriners assist. Management regularly reviews data about the major payor sources of patient service revenue in evaluating the adequacy of the allowance for doubtful accounts.

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

SHC analyzes contractual amounts due from third-party payors and provides an allowance for doubtful accounts and a provision for Shriners assist. For uninsured and Shriners assist patients, which includes those patients without insurance coverage and patients with deductibles and copayment balances for which third-party coverage exists for a portion of the bill, SHC records a significant provision for Shriners assist for patients that are unable to pay for any portion of the bill. Account balances are charged off against the allowance for Shriners assist.

SHC's allowance for doubtful accounts for Shriners assist patients was 45% and 41% of patient accounts receivable as of December 31, 2015 and 2014, respectively. SHC has not experienced significant changes in write-off trends and has not changed its uninsured or charity care policies for the years ended December 31, 2015 and 2014.

Laws and regulations governing the Medicaid and Medicare programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates associated with these programs will change by a material amount in the near term. As a result, provisions for third-party payor settlements and adjustments are estimated in the period the related services are provided and adjusted in future periods as additional information becomes available and as final settlements are determined or as years are no longer subject to audits, reviews and investigations.

Net patient accounts receivable included approximately \$12,481 and \$11,561 or 40% and 35% from the Medicaid programs, and less than one percent from the Medicare programs as of December 31, 2015 and 2014. The credit risk for other concentrations of receivables is limited due to the large number of insurance companies and other payors that provide payments for services.

(p) Charity Care

SHC, through its overall charitable policies, provides funding for cash requirements of the hospitals not met through normal operations. In addition, SHC provides care to patients who meet certain criteria under the charity care policies established by SHC without charge to its patients or families. Partial payments to which SHC is entitled from patients, third-party payors, Medicaid and others that meet SHC's charity care criteria are reported as net patient service revenue.

SHC provides necessary medical care regardless of the patient's ability to pay for services under its charity care policy. In addition, regulatory changes that may have the potential to alter charity classifications are monitored and incorporated into the policy, as necessary. SHC maintains records to identify and monitor the level of charity care. These records include the amount of charges foregone for services and supplies furnished under its charity care policy. The following measures the level of

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

charity care and other community benefits, as defined, at estimated costs for the years ended December 31, 2015 and 2014:

	2015	2014
Traditional charity care	\$ 600,954	594,363
Direct offsetting revenue	(148,136)	(168,909)
Net traditional charity care	\$ 452,818	425,454
As a percentage of total expense	59%	57%

(q) *Electronic Health Records Incentive Payments*

The American Recovery and Reinvestment Act of 2009 provides for incentive payments under the Medicare and Medicaid programs for certain hospitals and professionals that adopt and use electronic health records (EHR) in a meaningful way. Meaningful use is demonstrated by meeting established criteria that focus on capturing and using electronic health information to improve health care quality, efficiency, and patient safety.

SHC records incentive payments when it is reasonably assured that it has met the meaningful use requirements. SHC recognized \$5,424 and \$7,356 of incentive payments in other governmental revenue for the year ended December 31, 2015 and 2014, respectively. Incentive payment revenue is subject to change as the result of audits of compliance with meaningful use criteria and Medicare cost reports, with changes recorded in the period they occur.

(r) *Reclassifications*

Certain prior year amounts have been reclassified for consistency with the current year presentation. These reclassifications do not materially affect the previously reported combined financial statements.

(2) Long-Term Investments

Marketable securities at December 31, 2015 and 2014 consist of:

	2015		2014	
	Cost	Fair value	Cost	Fair value
Short-term investments	\$ 173,862	173,862	170,428	170,428
Common and preferred stocks	3,848,809	4,141,979	3,826,503	4,457,348
U.S. government securities	775,139	771,307	814,009	824,548
Corporate bonds	539,070	495,492	522,480	521,155
Other fixed income	1,075,202	1,005,991	1,249,460	1,229,078
Commodities fund	97,000	56,569	97,000	79,712
Fund of fund	229,031	242,015	60,000	65,821
	\$ 6,738,113	6,887,215	6,739,880	7,348,090

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

Investment income and total return on all long-term investments comprise the following components for the years ended December 31, 2015 and 2014:

	2015	2014
Interest	\$ 68,503	80,787
Dividends	107,969	117,024
Trust income	21,243	20,884
Rents and royalties	10,064	14,243
Other income	23,587	6,924
Less investment management fees	(18,642)	(15,866)
Total income from investments	212,724	223,996
Net realized gains from investments	157,175	384,525
Net unrealized losses from investments	(443,764)	(321,901)
Total return on investments	\$ (73,865)	286,620

(3) Land, Buildings, and Equipment

Land, buildings, and equipment at December 31, 2015 and 2014 consist of:

	2015	2014	Estimated useful lives
Land	\$ 29,655	40,243	—
Land improvements	12,211	11,916	5–20 years
Buildings	991,275	975,142	40–50 years
Equipment	402,642	386,029	4–25 years
	1,435,783	1,413,330	
Less accumulated depreciation	(757,558)	(743,105)	
	678,225	670,225	
Projects in process	300	19,144	
Construction in progress	188,075	122,052	
Land, buildings, and equipment, net	\$ 866,600	811,421	

Depreciation expense amounted to \$54,614 and \$52,666 for the years ending December 31, 2015 and 2014, respectively.

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

(4) Construction and Other Major Capital Projects

Construction and other major capital projects committed to by the Board are as follows:

Project	Total appropriation	Unexpended at December 31, 2015
Canada	\$ 122,000	16,441
Los Angeles	71,560	51,241
Lexington	54,000	40,570
St. Louis	48,000	4,405
Other	10,686	4,468
Approved equipment expenditures:		
Information systems projects	11,668	5,890
Other equipment	35,158	13,357
	<u>\$ 353,072</u>	<u>136,372</u>

(5) Line of Credit

During 2011, SHC entered into an unsecured line-of-credit agreement, for up to \$150 million, with a financial institution for the purpose of aiding in operations and cash management. During December of 2015, the line-of-credit agreement was renewed at a limit of \$150 million, with an option to increase the limit to \$250 million, upon need. On the date of a principal draw, SHC may elect to incur interest at one of two interest rate options. At December 31, 2015 and 2014, \$40 million and \$10 million, respectively, was outstanding.

(6) Transactions with Shriners International

SHC was founded by Shriners International (formerly known as the Imperial Council of the Ancient Arabic Order of the Nobles of the Mystic Shrine for North America).

The International Headquarters building and equipment is owned by SHC. A portion of the building is occupied by Shriners International, which is allocated a share of the operating costs and depreciation of the building and equipment. The allocation of the costs is based upon the portion of the building occupied by Shriners International in relation to the total occupied space in the building.

SHC and Shriners International also share other costs based on the estimated fair value received by each organization. Additionally, hospital assessments, donations, and other charitable receipts from Shrine temples are collected and remitted to SHC by Shriners International.

At December 31, 2015 and 2014, amounts of \$1,320 and \$109, respectively, were due from Shriners International, and are included in receivables, net in the accompanying combined statements of financial position.

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(In thousands)

(7) Donor Relations, Fund-Raising Activities, and Special Events

SHC is financially supported through each Shriner's annual hospital assessment, income from investments, gifts, and bequests from the general public and from Shriners, and certain fund-raising activities conducted by Shriners. Shrine temples and Shriners raise funds for both fraternal and charitable purposes. Shrine fund-raising activities consist of paper sale donations, football games, golf tournaments, and other miscellaneous activities. The name "Shriners Hospitals for Children" may be used in connection with a fund-raising activity by a Shrine temple or Shriner only with the written consent of Shriners International and SHC when the proceeds are to benefit SHC. Some of these funds are retained by individual Shrine temples for the support of their respective hospital patient transportation fund.

SHC also engages in other fund-raising activities to generate donations and to develop their donor base. These activities are conducted through an agreement with an unrelated third party.

Fund-raising and special events revenues and costs for the years ended December 31, 2015 and 2014 consist of the following:

	2015	2014
Revenues from Shrine temple sponsored events	\$ 6,408	6,441
Direct mail revenue	20,658	14,992
Other revenue	7,387	7,455
	\$ 34,453	28,888
Fund-raising costs paid directly by Shrine temples in connection with fund-raising events	\$ 622	572
Direct mail expense	8,451	6,682
Other costs	12,244	12,106
	\$ 21,317	19,360

Revenues from Shrine temple sponsored events are reported net of direct costs of \$3,250 and \$3,047 for 2015 and 2014, respectively.

In addition to the fund-raising and special events expenses above, SHC incurred \$15,593 and \$12,786 of donor relation expense for the years ended December 31, 2015 and 2014, respectively. Such expenses are incurred to enhance donor relationships. Donations and bequests from such donors amounted to \$267,555 and \$225,845 for the years ended December 31, 2015 and 2014, respectively. Such development activities of SHC are overseen by the donor relations committee.

During the year ended December 31, 2008, SHC became the Host Organization and Title Sponsor of a PGA Tour golf tournament. Beginning in 2013, this tournament became part of the Fed-Ex tour. The term of this agreement commenced with the 2008 event and will conclude after the 2017 tournament. The 2015 event yielded \$5,881 in revenues. Expenses incurred on this event in 2015 were \$10,902, creating a cost of the

SHRINERS HOSPITALS FOR CHILDREN

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(In thousands)

project of \$5,021. The 2014 event yielded \$6,257 in revenues. Expenses incurred on this event in 2014 were \$10,710, creating a cost of the project of \$4,453.

(8) Patient Transportation Funds Held by Shrine Temples

Shrine temples pay for substantially all of the costs of transporting patients to individual Shriners Hospitals from their temple hospital transportation funds. These costs are supported by funds authorized to be retained from fund-raising events held for the benefit of SHC (note 7), as well as local donations from Shriners and the general public. The activities of the Shrine temple patient transportation funds are reflected as a nonoperating change in patient transportation funds held by Shrine temples in the accompanying combined statements of operations and changes in unrestricted net assets.

The activities of the patient transportation funds reflected for the years ended December 31, 2015 and 2014 are as follows:

	<u>2015</u>	<u>2014</u>
Temple revenues restricted for patient transportation	\$ 16,201	17,295
Patient transportation costs	<u>(16,569)</u>	<u>(14,809)</u>
Change in patient transportation funds	\$ <u>(368)</u>	<u>2,486</u>

(9) Fair Value Measurements

FASB ASC Topic 820, *Fair Value Measurement*, defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. FASB ASC Topic 820 requires investments to be grouped into three categories based on certain criteria as noted below:

Level 1: Fair value is determined by using quoted prices for identical assets or liabilities in active markets.

Level 2: Fair value is determined by using other than quoted prices that are observable for the asset or liability (e.g., quoted prices for identical assets or liabilities in inactive markets, quoted prices for similar assets or liabilities in active markets, observable inputs other than quoted prices, and inputs derived principally from or corroborated by observable market data by correlation or other means).

Level 3: Fair value is determined by using inputs based on management assumptions that are not directly observable.

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(In thousands)

The tables below summarize SHC's significant financial assets and liabilities measured at fair value on a recurring basis as of December 31, 2015 and 2014:

	December 31, 2015	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Long-term investments:				
Short-term investments	\$ 173,862	173,862	—	—
Common and preferred stocks	4,141,979	2,032,479	2,108,508	992
U.S. government securities	771,307	771,307	—	—
Corporate bonds	495,492	—	495,492	—
Other fixed income securities	1,005,991	—	1,001,628	4,363
Commodities fund	56,569	—	56,569	—
Fund of funds	242,015	—	242,015	—
Charitable gift annuities	36,815	—	36,815	—
Beneficial interests in trusts	528,188	—	528,188	—
Real estate and mineral interests	293,064	—	—	293,064
Miscellaneous investments	20,448	—	20,448	—
Total	<u>\$ 7,765,730</u>	<u>2,977,648</u>	<u>4,489,663</u>	<u>298,419</u>
Collateral under securities lending transactions	\$ 347,162	347,162	—	—
Liabilities:				
Annuity liabilities	\$ 20,735	—	20,735	—
Liabilities under securities lending transactions	347,162	347,162	—	—

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Notes to Combined Financial Statements

December 31, 2015 and 2014

(In thousands)

	December 31, 2014	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Long-term investments:				
Short-term investments	\$ 170,428	170,428	—	—
Common and preferred stocks	4,457,348	2,048,927	2,407,316	1,105
U.S. government securities	824,548	824,548	—	—
Corporate bonds	521,155	—	521,155	—
Other fixed income securities	1,229,078	—	1,223,685	5,393
Commodities fund	79,712	—	79,712	—
Fund of funds	65,821	—	65,821	—
Charitable gift annuities	34,834	—	34,834	—
Beneficial interests in trusts	543,920	—	543,920	—
Real estate and mineral interests	268,614	—	—	268,614
Miscellaneous investments	20,284	—	20,284	—
Total	<u>\$ 8,215,742</u>	<u>3,043,903</u>	<u>4,896,727</u>	<u>275,112</u>
Collateral under securities lending transactions	\$ 623,165	623,165	—	—
Liabilities:				
Annuity liabilities	\$ 21,898	—	21,898	—
Liabilities under securities lending transactions	623,165	623,165	—	—

SHC's Level 1 assets and liabilities include investments in cash, cash equivalents, common and preferred stocks, and U.S. government securities and are valued at quoted market prices.

SHC's Level 2 assets include investments in foreign common and preferred stock, corporate debt securities, other fixed income securities, commodities fund, fund of funds, charitable gift annuities, beneficial interest in trusts, and miscellaneous investments with fair values modeled by external pricing vendors. Liabilities include annuity liabilities.

Level 3 assets include foreign and domestic common and preferred stocks, real estate and mineral interests, and investments in foreign and domestic corporate bonds.

SHC's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date the event or change in circumstances that caused the transfer. There were no transfers between Level 1 and Level 2 securities during the year.

There were \$35,728 of transfers into Level 3 of real estate and mineral interests from property, plant, and equipment for assets that have been retired and are held for sale. There were \$573 of investments transferred out of Level 3 into Level 2 for the year ended December 31, 2014. There were \$16,875 of transfers into Level 3 of real estate from estates in process for the year ended December 31, 2014.

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Notes to Combined Financial Statements

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(In thousands)

The tables below summarize the changes in Level 3 assets for the years ended December 31, 2015 and 2014:

	Fair value measurements using significant unobservable inputs (Level 3)		
	Common and preferred stock and fixed income investments	Other investments	Total
2015:			
Beginning balance	\$ 6,498	268,614	275,112
Total losses (realized/unrealized) included in decrease in unrestricted net assets	(233)	(6,124)	(6,357)
Purchases	550	841	1,391
Sales	(1,460)	(5,995)	(7,455)
Transfers into/out of Level 3	—	35,728	35,728
Ending balance	\$ <u>5,355</u>	<u>293,064</u>	<u>298,419</u>

	Fair value measurements using significant unobservable inputs (Level 3)		
	Common and preferred stock and fixed income investments	Other investments	Total
2014:			
Beginning balance	\$ 1,665	239,566	241,231
Total gains (losses) (realized/unrealized) included in increase (decrease) in unrestricted net assets	(322)	10,605	10,283
Purchases	6,626	3,694	10,320
Sales	(898)	(2,126)	(3,024)
Transfers into/out of Level 3	(573)	16,875	16,302
Ending balance	\$ <u>6,498</u>	<u>268,614</u>	<u>275,112</u>

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Realized and unrealized gains included in changes in net assets in Level 3 securities for the years ended December 31, 2015 and 2014 are reported in investment income as follows:

	2015	2014
Total gains (losses) included in increase in unrestricted net assets	\$ (12,585)	10,283
Change in unrealized gains (losses) relating to assets still held at reporting date	(12,352)	10,605

The fair values of the following investments have been estimated using the net asset value per share of the investments as of December 31, 2015 and 2014. There are no unfunded commitments on any of these funds.

	Fair value December 31, 2015	Fair value December 31, 2014	Redemption frequency	Redemption notice period
Northern Trust Global Investments				
Collective Daily S&P 500 Equity				
Index Fund – Lending (a)	\$ 906,581	965,149	Daily	None
Common Daily EAFE Index – Lending (b)	538,596	520,571	Daily	None
WTC CTF Opportunistic Fixed Income (c)	421,975	437,837	Monthly	30 days
Capital Guardian Absolute Income (d)	92,112	97,306	Monthly	5 days
Gresham TAP Fund (e)	56,570	79,713	Monthly	5 days
State Street Fund REIT (f)	48,656	—	Monthly	15 days
AQR Delta Fund (g)	100,847	33,286	Monthly	30 days
Aetos Capital Multi-Strategy (g)	92,513	32,535	Monthly	30 days
Pyramis High Yield (c)	153,256	130,514	Monthly	30 days
Total	\$ 2,411,106	2,296,911		

- (a) The primary investment objective of the equity index fund is to match the risk and return characteristics of the S&P 500 Index. Funds that participate in the securities lending program have a twice-per-month redemption restriction, and a total redemption would require SHC to fund its portion of any collateral shortfall.
- (b) The primary objective of the fund is to approximate the risk and return characteristics of the Morgan Stanley Europe, Australasia, and Far East (MSCI EAFE) Index. This Index is commonly used to represent the non-U.S. equity markets. This Fund may participate in securities lending.
- (c) The fund's investment objective is an unconstrained, nonbenchmark oriented investment approach. Barclays Capital U.S. Aggregate Bond Index will be used as the primary reference benchmark.

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(In thousands)

- (d) The investment objective of the fund is to seek a level of income that exceeds the average yield on U.S. stocks generally, to grow such income annually, and to distribute an increasing amount of income per unit of the fund.
- (e) The investment objective of this fund is to provide a return that exceeds the Dow Jones/UBS Commodities Index.
- (f) The State Street Fund REIT seeks an investment return that approximates the performance of the Dow Jones US select REIT index over the long term. In seeking to accomplish this objective the strategy may invest directly or indirectly in securities and other instruments, including other pooled vehicles of the Trustee.
- (g) The fund's investment objective is to provide a return that exceeds the HFRI fund of funds composite.

(10) Retirement Plans and Other Postretirement Benefits

The employees of the U.S. hospitals are included in the Shriners Hospitals for Children Employees' Retirement Plan and the Shriners Hospitals for Children Supplemental Retirement Plan (collectively, the Pension Plans). Benefits are based on years of service and the employees' compensation during the highest five consecutive years of employment. Contributions are made to the Pension Plans in accordance with ERISA requirements. In addition, SHC sponsors a postretirement life insurance plan (the Postretirement Plan). In March 2009, the Board voted to freeze entry of new participants into the Pension Plans effective May 1, 2009.

The actuarially computed net periodic pension cost for the Shriners' Hospital Pension Plans and the Postretirement Plan for the years ended December 31, 2015 and 2014 included the following components:

	Pension Plans		Postretirement Plan	
	2015	2014	2015	2014
Service cost – benefits earned during the period	\$ 21,817	17,179	365	312
Interest cost on projected benefit obligation	26,733	26,220	540	584
Expected return on plan assets	(33,963)	(31,477)	—	—
Net amortized and deferral of unrecognized gains and losses	18,747	6,842	—	(33)
Net periodic pension cost	\$ 33,334	18,764	905	863

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(In thousands)

The following table sets forth the Pension Plans' and the Postretirement Plan's funded status and amounts recognized in the combined statements of financial position as of December 31, 2015 and 2014, respectively, (using a measurement date of December 31):

	Pension Plans		Postretirement Plan	
	2015	2014	2015	2014
Change in benefit obligation:				
Benefit obligation at beginning of year	\$ 657,274	516,969	13,296	11,543
Service cost	21,817	17,189	365	312
Interest cost	26,733	26,220	540	584
Actuarial gain (loss)	(59,493)	136,742	(1,366)	1,107
Benefits paid	(20,846)	(39,846)	(340)	(250)
Benefit obligation at end of year	<u>625,485</u>	<u>657,274</u>	<u>12,495</u>	<u>13,296</u>
Change in plan assets:				
Fair value of plan assets at beginning of year	485,594	430,325	—	—
Actual return on plan assets	(14,568)	61,795	—	—
Employer contributions	16,122	33,320	3,320	250
Benefits paid	(20,846)	(39,846)	(3,320)	(250)
Fair value of plan assets at end of year	<u>466,302</u>	<u>485,594</u>	<u>—</u>	<u>—</u>
Funded status at end of year	<u>\$ (159,183)</u>	<u>(171,680)</u>	<u>(12,495)</u>	<u>(13,296)</u>

The accumulated benefit obligation for the Pension Plans was \$566,606 and \$579,912 at December 31, 2015 and 2014, respectively. The accumulated benefit obligation differs from the benefit obligation above in that it includes no assumption about future compensation levels. It represents the actuarial present value of future payments to plan participants using current and past compensation levels.

Weighted average assumptions used to determine projected benefit obligations at December 31, 2015 and 2014 were as follows:

	Pension Plans		Postretirement Plan	
	2015	2014	2015	2014
Discount rate	4.50%	4.00%	4.50%	4.00%
Rate of compensation increase	3.00	3.50	N/A	N/A

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(In thousands)

Weighted average assumptions used to determine the net periodic benefit costs of the Pension Plans and the Postretirement Plan are:

	Pension Plans		Postretirement Plan	
	2015	2014	2015	2014
Discount rate	4.50%	4.00%	4.50%	4.00%
Expected long-term rate of return on plan assets	7.00	7.50	N/A	N/A
Rate of compensation increase	3.50	3.50	N/A	N/A

The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based exclusively on historical returns, without adjustments.

The following are deferred pension costs, which have not yet been recognized in periodic pension expense but instead are accrued in unrestricted net assets as of December 31, 2015. Unrecognized actuarial losses represent unexpected changes in the projected benefit obligation and plan assets over time, primarily due to changes in assumed discount rates and investment experience. Unrecognized prior service cost is the impact of changes in plan benefits applied retrospectively to employee service previously rendered. Deferred pension costs are amortized into annual pension expense over the average remaining assumed service period for active employees.

	Pension Plans		Postretirement Plan	
	Amounts in unrestricted net assets to be recognized during the next fiscal year	Amounts recognized in unrestricted net assets at December 31, 2015	Amounts in unrestricted net assets to be recognized during the next fiscal year	Amounts recognized in unrestricted net assets at December 31, 2015
Actuarial loss	\$ 166,475	10,363	1,761	45
Prior service cost	(33)	(6)	—	—
Total	<u>\$ 166,442</u>	<u>10,357</u>	<u>1,761</u>	<u>45</u>

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(In thousands)

(a) *Plan Assets*

The weighted average allocation of the Pension Plans' assets at December 31, 2015 and 2014 was as follows:

<u>Asset category</u>	<u>2015</u>	<u>2014</u>
Short-term investments	1%	2%
Common and preferred stock	51	48
Corporate and miscellaneous bonds	20	21
Mutual funds	28	29
Total assets	<u>100%</u>	<u>100%</u>

SHC's investment policies and strategies for pension benefits do not use target allocations for the individual asset categories. The Hospitals' investment goals are to maximize returns subject to specific risk management policies.

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(In thousands)

The table below summarizes the Pension Plans' significant financial assets measured at fair value on a recurring basis using the net asset value per share of the investments as of December 31, 2015:

	December 31, 2015	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Assets:				
Northern Trust Global Investments Collective Funds Trust (a)	\$ 5,547	5,547	—	—
Dimensional Fund Advisors (DFA) Emerging Markets Value (b)	18,254	—	18,254	—
Blackrock Global Allocation Fund (c)	21,102	—	21,102	—
Blackrock World Ex-U.S. Alpha Tilts L Fund (d)	46,682	—	46,682	—
Northern Trust Global Investments Collective Russell 2000 Index Fund – Nonlending (e)	45,441	—	45,441	—
Northern Trust Global U.S. Treasury Interest Strips (f)	93,626	—	93,626	—
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund – Nonlending (g)	144,455	—	144,455	—
Pacific Investment Management:				
Long Duration Total Return Funds (h)	70,150	—	70,150	—
Series All AST funds (i)	21,045	—	21,045	—
Total	\$ 466,302	5,547	460,755	—

- (a) This fund is composed of high-grade money market instruments with short maturities. The fund seeks to provide an investment vehicle for cash reserves while offering a competitive rate of return.
- (b) The fund seeks to provide long-term growth of capital by investing primarily in a wide variety of international equity securities issued throughout the world, normally excluding the U.S.
- (c) This fund seeks to exceed the S&P 500.

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(In thousands)

- (d) This fund seeks to exceed the Morgan Stanley Capital International World Ex-US Europe Australasia Far East Free Index.
- (e) The primary objective of this fund is to approximate the risk and return characterized by the Russell 2000 Index. This index is commonly used to represent the small cap segment of the U.S. equity market. The fund does not participate in securities lending.
- (f) This fund seeks to provide a growth of capital by investing in U.S. Treasury Separate Trading of Registered Interest and Principal Securities or STRIPS.
- (g) This fund seeks to maximize current income and capital appreciation while maintaining exposure consistent with its benchmark. The fund maintains duration within two years of the Barclays Capital Long Term Government/Credit Index.
- (h) The primary objective of this fund is to approximate the risk and return characteristics of the S&P 500 Index. The Index is commonly used to represent the large-cap segment of the U.S. equity market. This fund does not participate in securities lending.
- (i) This fund seeks maximum real return, consistent with preservation of real capital and prudent investment management. While the fund is nondiversified, it invests in diversified underlying holdings.

The table below summarizes the Pension Plans' significant financial assets measured at fair value on a recurring basis using the net asset value per share of the investments as of December 31, 2014:

	<u>December 31,</u> <u>2014</u>	<u>Fair value measurements at reporting</u> <u>date using</u>		
		<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Assets:				
Northern Trust Global Investments Collective Funds Trust (a)	\$ 10,247	10,247	—	—
Dimensional Fund Advisors (DFA) Emerging Markets Value (b)	21,550	—	21,550	—
Blackrock Global Allocation Fund (c)	21,958	—	21,958	—
Blackrock World Ex-U.S. Alpha Tilts L Fund (d)	45,442	—	45,442	—
Northern Trust Global Investments Collective Russell 2000 Index Fund – Nonlending (e)	49,903	—	49,903	—

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(In thousands)

	December 31, 2014	Fair value measurements at reporting date using		
		Level 1	Level 2	Level 3
Northern Trust Global U.S. Treasury Interest Strips (f)	\$ 101,504	—	101,504	—
Northern Trust Global Investments Collective Daily S&P 500 Equity Index Fund – Nonlending (g)	140,063	—	140,063	—
Pacific Investment Management: Long Duration Total Return Funds (h) Series All AST funds (i)	72,956 21,971	— —	72,956 21,971	— —
Total	\$ 485,594	10,247	475,347	—

- (a) This fund is composed of high-grade money market instruments with short maturities. The fund seeks to provide an investment vehicle for cash reserves while offering a competitive rate of return.
- (b) The fund seeks to provide long-term growth of capital by investing primarily in a wide variety of international equity securities issued throughout the world, normally excluding the U.S.
- (c) This fund seeks to exceed the S&P 500.
- (d) This fund seeks to exceed the Morgan Stanley Capital International World Ex-US Europe Australasia Far East Free Index.
- (e) The primary objective of this fund is to approximate the risk and return characterized by the Russell 2000 Index. This index is commonly used to represent the small cap segment of the U.S. equity market. The fund does not participate in securities lending.
- (f) This fund seeks to provide a growth of capital by investing in U.S. Treasury Separate Trading of Registered Interest and Principal Securities or STRIPS.
- (g) This fund seeks to maximize current income and capital appreciation while maintaining exposure consistent with its benchmark. The fund maintains duration within two years of the Barclays Capital Long Term Government/Credit Index.
- (h) The primary objective of this fund is to approximate the risk and return characteristics of the S&P 500 Index. The Index is commonly used to represent the large-cap segment of the U.S. equity market. This fund does not participate in securities lending.

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- (i) This fund seeks maximum real return, consistent with preservation of real capital and prudent investment management. While the fund is nondiversified, it invests in diversified underlying holdings.

(b) Contributions

Annual contributions are determined based upon calculations prepared by the plans' actuary. Expected contributions to the Pension Plans and the Postretirement Plan are \$11,714 and \$367, respectively, in 2016.

(c) Benefit Payments

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid out of the plans:

	<u>Pension Plans</u>	<u>Postretirement Plan</u>
Fiscal years:		
2016	\$ 23,016	367
2017	25,347	388
2018	27,651	410
2019	30,198	432
2020	30,870	455
2021–2025	187,611	2,663

SHC also has a retirement savings plan for all eligible employees. Under this plan, SHC matches 50% of the first 6% of voluntary contributions made from eligible compensation by employees. Matching contributions by SHC to the retirement savings plan were \$7,968 and \$6,679 in 2015 and 2014, respectively.

Canadian and Mexican hospital employees are included in government retirement programs of their respective countries.

(11) Estimated Malpractice Costs and Other Contingencies

SHC is self-insured for claims attributed to malpractice and workers' compensation from providing professional and patient care services. Claims alleging malpractice have been asserted against SHC and are currently in various stages of litigation. Additional claims may be asserted against SHC arising from services provided to patients through December 31, 2015. Liabilities for malpractice and workers' compensation claims are established based on specific identification and historical experience using actuarial methodologies. It is the opinion of management that estimated malpractice and workers' compensation claims accrued should be adequate to provide for potential losses resulting from both reported claims and claims incurred but not reported. Such amounts are not material and are recorded in accounts payable and accrued expenses on the accompanying combined statements of financial position.

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(In thousands)

SHC is also a party to various other claims and legal actions arising in the ordinary course of business. Management does not believe that the ultimate outcome of such claims and legal actions will have a material adverse effect on the financial position or activities of SHC.

(12) Endowment Funds

FASB ASC Subtopic 958-205, *Not-for-Profit Entities – Presentation of Financial Statements*, provides guidance on the net asset classification of donor-restricted endowment funds for a not-for-profit organization that is subject to an enacted version of the Uniform Prudent Management of Institutional Funds Act (UPMIFA). FASB ASC Subtopic 958-205 also requires enhanced disclosures about an organization's endowment funds, whether or not the organization is subject to an enacted version of UPMIFA. These disclosures shall enable users of financial statements to understand the net asset classification, net asset composition, changes in net asset composition, spending policy, and related investment policy of its endowment funds (both donor restricted and board designated). SHC follows the requirements of FASB ASC Subtopic 958-205.

SHC's endowment consists of marketable securities, charitable gift annuities, beneficial interest in trusts, real estate and mineral interests, and miscellaneous investments. The endowment consists of both donor-restricted funds, as well as funds designated by the Board of Trustees to function as endowments.

The Board has interpreted the wishes of donors and Colorado and Massachusetts state law as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, SHC classifies as permanently restricted net assets (a) the original value of gifts donated, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the endowment. Gifts given with a restriction of time or purpose are added to the endowment as temporarily restricted funds. Upon the passage of time or completion of purpose, these funds are released as unrestricted. Funds designated by the Board as endowment funds are included as unrestricted endowment funds.

Investment Return Objectives, Risk Parameters, and Strategies. SHC has adopted investment and spending policies, approved by the Investment Committee, for endowment assets that attempt to provide a predictable stream of funding to support the hospital system, while also maintaining the purchasing power of those endowment assets over the long term. Accordingly, the investment process seeks to achieve an after-cost total real rate of return, including investment income, as well as capital appreciation, which exceeds the budgeted annual distribution with acceptable levels of risk. Endowment assets are invested in a well-diversified asset mix, which includes equity and fixed-income securities that is intended to result in a rate of return that has sufficient liquidity to provide a high level of cash distribution, while growing the funds, if possible. Therefore, SHC expects its endowment assets, over time, to produce an average rate of return of approximately 7.25% annually. Actual returns in any given year may vary from this amount. Investment risk is measured in terms of the total endowment fund; investment assets and allocation between asset classes and strategies are managed to not expose the fund to unacceptable levels of risk.

Spending Policy. The Board does not have a formal endowment spending policy. Generally, all investment return (excluding capital appreciation) is utilized in funding SHC's programs. In making this funding

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(In thousands)

decision, the Board considers the long-term expected return on its investment assets, the nature and duration of the individual endowment funds, some of which must be maintained in perpetuity because of donor-restrictions, and the possible effects of inflation. The Board's goal is for its endowment funds to grow annually to maintain the purchasing power of the endowment assets, as well as, to provide additional real growth through new gifts and investment return.

Endowment asset composition by type of fund, as of December 31, 2015 and 2014, is as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total endowment assets</u>
2015:				
Board-designated endowment funds	\$ 7,237,540	—	—	7,237,540
Donor-restricted endowment funds	—	118,142	410,048	528,190
	<u>\$ 7,237,540</u>	<u>118,142</u>	<u>410,048</u>	<u>7,765,730</u>
2014:				
Board-designated endowment funds	\$ 7,672,021	—	—	7,672,021
Donor-restricted endowment funds	—	109,906	433,815	543,721
	<u>\$ 7,672,021</u>	<u>109,906</u>	<u>433,815</u>	<u>8,215,742</u>

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Changes in endowment assets for the years ended December 31, 2015 and 2014 are as follows:

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total endowment net assets</u>
2015:				
Balance, beginning of year	\$ 7,672,021	109,906	433,815	8,215,742
Donations and bequests	—	28,156	—	28,156
Investment income	216,443	—	6	216,449
Net depreciation	(298,472)	(15,726)	(23,773)	(337,971)
Reclassifications	18,472	(4,194)	—	14,278
Withdrawals	(370,924)	—	—	(370,924)
Balance, end of year	<u>\$ 7,237,540</u>	<u>118,142</u>	<u>410,048</u>	<u>7,765,730</u>
2014:				
Balance, beginning of year	\$ 7,723,326	108,400	426,721	8,258,447
Donations and bequests	—	7,159	560	7,719
Investment income	220,592	—	(105)	220,487
Net appreciation	62,624	5,022	6,639	74,285
Reclassifications	10,675	(10,675)	—	—
Withdrawals	(345,196)	—	—	(345,196)
Balance, end of year	<u>\$ 7,672,021</u>	<u>109,906</u>	<u>433,815</u>	<u>8,215,742</u>

(13) Subsequent Events

SHC has evaluated events and transactions occurring subsequent to December 31, 2015 as of April 11, 2016, which is the date the combined financial statements were available to be issued. Management believes that no material events have occurred since December 31, 2015 that require recognition or disclosure in the combined financial statements.