Consolidated Financial Statements

Indiana University Health, Inc. and subsidiaries
Years Ended December 31, 2015 and 2014
With Report of Independent Auditors

Ernst & Young LLP

Building a better
working world

Indiana University Health, Inc. and subsidiaries

Consolidated Financial Statements

Years Ended December 31, 2015 and 2014

Contents

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Report of Independent Auditors

The Board of Directors
Indiana University Health, Inc. and subsidiaries

We have audited the accompanying consolidated financial statements of Indiana University Health, Inc. and subsidiaries, which comprise the consolidated balance sheets as of December 31, 2015 and 2014, and the related consolidated statements of operations and changes in net assets and cash flows for the years then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Indiana University Health, Inc. and subsidiaries at December 31, 2015 and 2014, and the consolidated results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

Ernst & Young LLP

March 25, 2016

Indiana University Health, Inc. and subsidiaries

Consolidated Balance Sheets

(Dollars in Thousands)

	December 31	
	2015	**2014**
Assets		
Current assets:		
Cash and cash equivalents	**$ 516,702**	$ 527,682
Patient accounts receivable, less allowance for uncollectible accounts of $214,119 and $197,120 at 2015 and 2014, respectively	**809,785**	684,108
Other receivables	**159,628**	150,264
Prepaid expenses	**39,199**	48,577
Inventories	**83,724**	75,355
Total current assets	**1,609,038**	1,485,986
Assets limited as to use:		
Board-designated investment funds and other investments	**3,655,641**	3,113,805
Donor-restricted investment funds	**69,502**	76,887
Total assets limited as to use, less current portion	**3,725,143**	3,190,692
Property and equipment:		
Cost of property and equipment in service	**5,970,516**	5,845,564
Less accumulated depreciation	**(3,398,994)**	(3,177,729)
	2,571,522	2,667,835
Construction-in-progress	**52,203**	32,997
Total property and equipment, net	**2,623,725**	2,700,832
Other assets:		
Equity interest in unconsolidated subsidiaries	**71,128**	49,202
Interest in net assets of foundations	**14,035**	13,976
Goodwill, intangibles, and other assets	**239,844**	219,981
Total other assets	**325,007**	283,159
Total assets	**$ 8,282,913**	$ 7,660,669

	December 31	
	2015	**2014**
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	**$ 489,567**	$ 400,269
Accrued salaries, wages, and related liabilities	**248,857**	293,112
Accrued health claims	**61,126**	56,469
Estimated third-party payor allowances	**106,859**	107,679
Current portion of long-term debt	**55,657**	78,757
Total current liabilities	**962,066**	936,286
Noncurrent liabilities:		
Long-term debt, less current portion	**1,610,097**	1,612,696
Interest rate swaps	**112,675**	145,339
Accrued pension obligations	**99,448**	96,211
Accrued medical malpractice claims	**60,893**	63,663
Other	**44,574**	57,496
Total noncurrent liabilities	**1,927,687**	1,975,405
Total liabilities	**2,889,753**	2,911,691
Net assets:		
Indiana University Health	**5,090,916**	4,464,244
Noncontrolling interest in subsidiaries	**211,784**	186,587
Total unrestricted	**5,302,700**	4,650,831
Temporarily restricted	**23,093**	30,905
Permanently restricted	**67,367**	67,242
Total net assets	**5,393,160**	4,748,978
Total liabilities and net assets	**$ 8,282,913**	$ 7,660,669

See accompanying notes.

Indiana University Health, Inc. and subsidiaries

Consolidated Statements of Operations and Changes in Net Assets

(Dollars in Thousands)

	Year Ended December 31	
	2015	**2014**
Revenues:		
Patient service revenue (net of contractuals and discounts)	**$ 5,745,401**	$ 5,557,672
Provision for uncollectible accounts	**(243,423)**	(299,255)
Net patient service revenue	**5,501,978**	5,258,417
Member premium revenue	**394,303**	259,771
Other revenue	**204,534**	208,395
Total operating revenues	**6,100,815**	5,726,583
Expenses:		
Salaries, wages, and benefits	**2,723,915**	2,501,644
Supplies, drugs, purchased services, and other	**1,838,176**	1,735,338
Hospital assessment fee	**109,558**	197,994
Health claims to providers	**307,769**	170,970
Depreciation and amortization	**268,920**	251,210
Interest	**53,215**	56,630
Total operating expenses	**5,301,553**	4,913,786
Operating income before educational and research support	**799,262**	812,797
Educational and research support to Indiana University	**(17,500)**	(17,500)
Total operating income	**781,762**	795,297
Nonoperating (loss) income:		
Investment (loss) income, net	**(67,220)**	38,755
Gains (losses) on interest rate swaps, net	**18,977**	(21,939)
Inherent contribution of acquired entities	**–**	2,665
Debt extinguishment and other	**(15,782)**	926
Total nonoperating (loss) income	**(64,025)**	20,407
Consolidated excess of revenues over expenses	**717,737**	815,704
Less amounts attributable to noncontrolling interest in subsidiaries	**105,061**	90,175
Excess of revenues over expenses attributable to Indiana University Health and subsidiaries	**$ 612,676**	$ 725,529

Indiana University Health, Inc. and subsidiaries

Consolidated Statements of Operations and Changes in Net Assets (continued)

(Dollars in Thousands)

	December 31, 2015			December 31, 2014		
	Total	**Controlling**	**Noncontrolling**	**Total**	**Controlling**	**Noncontrolling**
Unrestricted net assets:						
Excess of revenues over expenses	**$ 717,737**	**$ 612,676**	**$ 105,061**	$ 815,704	$ 725,529	$ 90,175
Change in pension obligations	**(3,769)**	**(3,769)**	**–**	(72,149)	(72,149)	–
Contributions for capital expenditures	**8,282**	**8,282**	**–**	5,652	5,652	–
Distributions to noncontrolling interests	**(96,437)**	**–**	**(96,437)**	(92,026)	–	(92,026)
Issuance of noncontrolling interests related to acquisition	**6,068**	**–**	**6,068**	–	–	–
Contributions from noncontrolling interests	**6,721**		**6,721**	–	–	–
Purchase of controlling interests	**3,108**	**3,108**	**–**	–	–	–
Purchase of noncontrolling interests	**2,970**	**–**	**2,970**	–	–	–
Sale of member interest to noncontrolling member	**–**	**–**	**–**	5,194	(834)	6,028
Restriction reclassification	**4,610**	**4,610**	**–**	2,698	2,698	–
Other	**2,579**	**1,765**	**814**	2,447	717	1,730
	651,869	**626,672**	**25,197**	667,520	661,613	5,907
Temporarily restricted net assets:						
Change in beneficial interest in net assets of foundations	**(74)**	**(74)**	**–**	352	352	–
Contributions	**5,108**	**5,108**	**–**	6,416	6,416	–
Investment return	**(2,509)**	**(2,509)**	**–**	(1,049)	(1,049)	–
Net assets released from restrictions	**(5,727)**	**(5,727)**	**–**	(9,670)	(9,670)	–
Restriction reclassification	**(4,610)**	**(4,610)**	**–**	(2,698)	(2,698)	–
Other	**–**	**–**	**–**	(4,000)	(4,000)	–
	(7,812)	**(7,812)**	**–**	(10,649)	(10,649)	–
Permanently restricted net assets:						
Change in beneficial interest in net assets of foundations	**(122)**	**(122)**	**–**	428	428	–
Contributions and other	**247**	**247**	**–**	254	254	–
	125	**125**	**–**	682	682	–
Increase in net assets	**644,182**	**618,985**	**25,197**	657,553	651,646	5,907
Net assets at beginning of year	**4,748,978**	**4,562,391**	**186,587**	4,091,425	3,910,745	180,680
Net assets at end of year	**$ 5,393,160**	**$ 5,181,376**	**$ 211,784**	$ 4,748,978	$ 4,562,391	$ 186,587

See accompanying notes.

Indiana University Health, Inc. and subsidiaries

Consolidated Statements of Cash Flows

(Dollars in Thousands)

	Year Ended December 31	
	2015	**2014**
Operating activities		
Increase in net assets	**$ 644,182**	$ 657,553
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in fair value of interest rate swaps	**(32,664)**	6,267
Change in pension liability	**3,769**	72,149
Income in unconsolidated subsidiaries	**(14,620)**	(1,066)
Provision for uncollectible accounts	**243,423**	299,255
Issuance of noncontrolling interests related to acquisition	**(6,068)**	–
Contributions from noncontrolling interests	**(6,721)**	–
Inherent contribution of acquired entities	**–**	(2,665)
Impairment of unconsolidated subsidiaries	**–**	2,073
Depreciation and amortization	**268,920**	251,210
Amortization of deferred gain on sale of medical office buildings	**(1,617)**	(2,122)
Loss on extinguishment of debt	**15,778**	2,313
Restricted contributions and investment return	**(2,650)**	(6,401)
Purchase of controlling interests	**(3,108)**	–
Purchase of noncontrolling interests	**(2,970)**	–
Proceeds from the sale of member interests to noncontrolling member	**–**	(5,194)
Distributions to noncontrolling interests	**96,437**	92,026
Trading securities	**(534,451)**	(561,448)
Net changes in operating assets and liabilities:		
Patient accounts receivable	**(368,767)**	(323,961)
Other assets	**(14,464)**	(14,289)
Accounts payable, accrued liabilities, and other liabilities	**76,475**	(57,909)
Acccrued salaries, wages, and related liabilities	**(44,270)**	23,471
Estimated third-party payor allowances	**(820)**	17,212
Net cash provided by operating activities	**315,794**	448,474

Indiana University Health, Inc. and subsidiaries

Consolidated Statements of Cash Flows (continued)

(Dollars in Thousands)

	Year Ended December 31	
	2015	**2014**
Investing activities		
Purchase of property and equipment, net of disposals	**$ (184,805)**	$ (180,034)
Acquisition of subsidiary, net of cash received	**(15,932)**	–
Net cash used in investing activities	**(200,737)**	(180,034)
Financing activities		
Increase in restricted net assets	**2,650**	6,401
Repayments on long-term debt	**(552,787)**	(172,964)
Proceeds from issuance of long-term debt	**507,738**	69,965
Contributions from noncontrolling interests	**6,721**	–
Purchase of controlling interests	**3,108**	–
Purchase of noncontrolling interests	**2,970**	–
Proceeds from sale of member interests to noncontrolling member	**–**	5,194
Distributions to noncontrolling interests	**(96,437)**	(92,026)
Net cash used in financing activities	**(126,037)**	(183,430)
(Decrease) increase in cash and cash equivalents	**(10,980)**	85,010
Cash and cash equivalents at beginning of year	**527,682**	442,672
Cash and cash equivalents at end of year	**$ 516,702**	$ 527,682

See accompanying notes.

Mission Statement

Indiana University Health's mission is to improve the health of our patients and community through innovation and excellence in care, education, research, and service.

Value Statement

Indiana University Health will preserve, strengthen, and build upon these values:
*Total patient **care**, including mind, body, and spirit*
*Excellence in **education** for health care providers*
*Quality of care and **respect** for life*
***Charity**, equality and justice in health care*
*Leadership in health promotion and **wellness***
*Excellence in **research***
*An internal community of **trust** and respect*

1. Organization and Nature of Operations

History and Organization

Indiana University Health, Inc. (Indiana University Health) and subsidiaries operate as a health care delivery system, which includes an academic health center affiliated with Indiana University, providing health care services throughout the state of Indiana. Health care services provided by Indiana University Health and its subsidiaries (hereinafter referred to as the Indiana University Health System) include acute, nonacute, tertiary, and quaternary care services on an inpatient, outpatient, and emergency basis; medical education and research; medical management services; health care diagnostic and treatment services for individuals and families in physician clinics and physician-group practices; and personal and home health care.

Indiana University Health was formed as an Indiana nonprofit corporation through a consolidation, as of January 1, 1997, under the terms of a Definitive Health Care Resources Consolidation Agreement, as amended (the Consolidation Agreement), and certain other related agreements by and between the Trustees of Indiana University and Methodist Health Group, Inc. (formerly known as Methodist Hospital of Indiana, Inc.). The facilities and operations of Indiana University Health University Hospital (University Hospital), Riley Hospital for Children at Indiana University Health (Riley Hospital), and Indiana University Health Methodist Hospital (Methodist Hospital) (collectively, the Downtown Hospitals of the Academic Health Center)

1. Organization and Nature of Operations (continued)

were merged and consolidated to form a single corporate entity, which was then licensed as a single acute care hospital and operates as an academic health center. Members of the Board of Directors (the Board) of Indiana University Health are selected by its two classes of members: the Methodist Class (members of which are members of Methodist Health Group, Inc.) and the University Class (members of which are the individuals who are the Trustees of Indiana University).

The Consolidation Agreement requires Indiana University Health to fund the salaries and related employee benefit costs for medical doctor interns and residents of the Indiana University School of Medicine (the School of Medicine) who provide services at the Indiana University Health System’s facilities. The Board annually reviews and determines the level of support to provide to the School of Medicine for these programs and the number of internships and residencies to be supported. The Consolidation Agreement also requires Indiana University Health to provide additional support to the School of Medicine to recognize, as a result of the consolidation, the enhanced and increased level of services being provided, including services to the medically indigent through medical education and research.

Nature of Operations

The Indiana University Health System operates as an integrated health care delivery system comprising nonprofit and for-profit entities, with coordinated activities and policies designed to meet the mission of the Indiana University Health System. The principal operating activities of the Indiana University Health System are conducted at majority-owned or controlled subsidiaries and consist of the following.

Downtown Hospitals of the Academic Health Center (Hospital Campuses) – Consist of three acute, tertiary, quaternary care, and diagnostic facilities, licensed as a single hospital, which constitutes the principal hospital activities of the academic health center and whose operations are located in the downtown area of Indianapolis, Indiana. These three hospitals, Methodist Hospital, University Hospital, and Riley Hospital, are located on or near the campus of Indiana University-Purdue University Indianapolis and the School of Medicine.

1. Organization and Nature of Operations (continued)

Central Indiana Facilities – Consist of three acute care hospitals, a critical access hospital, and an acute care rehabilitation hospital located in the western and northern suburban areas of metropolitan Indianapolis, Indiana. Principal hospital subsidiaries include Indiana University Health North Hospital, Inc. (North), Indiana University Health Tipton Hospital, Inc. (Tipton), Indiana University Health West Hospital, Inc. (West), and Rehabilitation Hospital of Indiana, Inc. (RHI). Indiana University Health Saxony Hospital (Saxony) operates as a division of the academic health center.

Statewide Facilities – Consist of acute care hospitals and health care systems located in Bedford, Bloomington, Goshen, Hartford City, Knox, Lafayette, La Porte, Monticello, Muncie, and Paoli, Indiana. Principal hospital subsidiaries include Indiana University Health Bedford, Inc. (Bedford), Indiana University Health Arnett, Inc. (Arnett), Indiana University Health La Porte Hospital and subsidiaries (La Porte) including Indiana University Health Starke Hospital, LLC (Starke), Goshen Health System, Inc. and subsidiaries (Goshen), Indiana University Health Ball Memorial Hospital, Inc. and subsidiaries (Ball Memorial) including Indiana University Health Blackford Hospital, Inc. (Blackford), Indiana University Health Bloomington, Inc. and subsidiaries (Bloomington) including Indiana University Health Paoli, Inc. (Paoli), and Indiana University Health White Memorial Hospital, Inc. (White). As of April 1, 2015, Indiana University Health Morgan, Inc. (Morgan) was converted to an outpatient center and operates as a division of the academic health center.

Physician Operations – Consist of physician offices and physician-group practices and clinics. Principal subsidiaries or divisions include Indiana University Health Physicians (IUHP), a nonprofit organization with locations primarily in Indianapolis, Indiana, Indiana University Health Arnett Physicians, Indiana University Health Ball Memorial Physicians, Inc., Indiana University Health Southern Indiana Physicians, Inc., Indiana University Health La Porte Physicians, Inc., Indiana University Health Goshen Physicians, and Indiana University Health Transplant Institute, Inc.

Ambulatory Care – Consists of personal and home health care services, occupational health services, outpatient oncology services, outpatient surgery centers, and urgent care centers which are located throughout the state of Indiana. Principal divisions or subsidiaries include Indiana University Health Home Care, Indiana University Occupational Health Centers, Workplace Health Services, LLC, Indiana University Health Central Indiana Cancer Centers, eight surgery center joint ventures, and one urgent care center joint venture.

1. Organization and Nature of Operations (continued)

Medical Risk – Consists of the medical management of health care services of members whose health care coverage is provided by the managed care networks of the Indiana University Health System. Includes health maintenance organizations and other insurance-related organizations that provide health plan services to insured and self-insured members predominantly residing in Indiana. Insurance offerings include commercial group products (self-funded and insured), products on the Health Insurance Marketplace (Exchange), Medicare Advantage products, and Medicaid management services.

Foundations – Indiana University Health is the sole corporate member of Methodist Health Foundation, Inc. (Methodist Health Foundation), which aids and supports Methodist Hospital and other programs and areas of Indiana University Health. Tipton is the sole corporate member of Tipton County Health Care Foundation, Inc. (Tipton Foundation), which aids in carrying out the mission of Tipton. Ball Memorial is the sole corporate member of Indiana University Ball Memorial Hospital Foundation, Inc. (BMH Foundation), which aids in carrying out the mission of Ball Memorial and Blackford. Morgan is the sole corporate member of Indiana University Health Morgan Foundation (Morgan Foundation), which aids and supports Morgan. Arnett is the sole corporate member of Indiana University Health Arnett Hospital Foundation, Inc. (Arnett Foundation), which aids and supports Arnett. RHI is the sole corporate member of RHI Foundation, Inc. (RHI Foundation), which aids and supports RHI. Goshen is the sole corporate member of IU Health Goshen Foundation, Inc. (Goshen Foundation), which aids and supports Goshen. The Corporate members of Indiana University Health Paoli Hospital Foundation, Inc. (Paoli Foundation), which aids and supports Paoli, are Paoli, Bloomington, and the Board of Commissioners of Orange County, Indiana.

2. Community Benefit and Charity Care

The Indiana University Health System provides health care services and other financial support through various programs that are designed, among other matters, to enhance the health of the community, improve the health of low-income patients, and foster medical education and research through its affiliation with the School of Medicine. In addition, the Indiana University Health System provides services intended to benefit the poor and underserved, including those persons who cannot afford health insurance because of inadequate resources or those who are uninsured or underinsured. Health care services to patients under government programs, such as Medicare and Medicaid, are also considered part of the Indiana University Health System's

2. Community Benefit and Charity Care (continued)

benefit provided to the community since a substantial portion of such services are reimbursed at amounts less than cost.

The Indiana University Health System's financial assistance policies are designed to provide care to all patients regardless of their ability to pay, and all uninsured patients are eligible for discounted care. In-state patients with household incomes up to 200% of the federal poverty level were eligible for free care, and patients with household incomes between 200% and 400% of the federal poverty level were eligible for a sliding-scale discount based on household income. Other patients who are victims of certain catastrophic events, or those who meet criteria to be part of the Indiana University Health System's medical education and research programs, were provided care without charge. As of January 1, 2016, the policy was changed to afford charitable discounts only for uninsured patients equivalent to the amounts generally billed, and eligibility for full charity for emergent encounters for uninsured patients less than 200% of the federal poverty level who meet application criteria. Patients whose liability is deemed catastrophic relative to their annual household income are also eligible for reduced charges.

Net patient service revenue is reported at estimated net realizable amounts for services rendered. The Indiana University Health System recognizes patient service revenue associated with patients who have third-party payor coverage on the basis of contractual rates for the services rendered. For uninsured patients who do not qualify for charity care, revenue is recognized on the basis of discounted rates in accordance with the uninsured discount policy.

The amount of charity care provided is determined based on the qualifying criteria, as defined in the financial assistance policies, through approved applications completed by patients and their families or beneficiaries, or based on analysis of patients without third-party insurance coverage who did not apply for charity and whose income was equal to or less than 200% of federal poverty income guidelines. No payment for services is anticipated for those patients whose charity care applications have been approved, as well as for those other patient accounts whose income is equal to or less than 200% of federal poverty income guidelines and meet certain other criteria. The cost to provide charity care using the consolidated cost to charge ratio was $139,283 and $173,759 for 2015 and 2014, respectively.

In addition, the Indiana University Health System provides a significant amount of uncompensated care to other uninsured and underinsured patients, which is included in the provision for uncollectible accounts in the consolidated statements of operations and changes in net assets.

2. Community Benefit and Charity Care (continued)

The Patient Protection and Affordable Care Act (the Affordable Care Act) required, among other things, that hospital organizations establish a financial assistance policy and a policy relating to emergency medical care. The hospital organizations of the Indiana University Health System have adopted a financial assistance policy that conforms with the Affordable Care Act and includes financial assistance eligibility criteria, the basis for calculating amounts charged to patients, the method for applying for financial assistance, billing and collections policies with regard to actions that may be taken in the case of nonpayment, as well as measures to widely publicize the policy within the communities served. Additionally, the Indiana University Health System's hospital organizations have adopted policies requiring the organizations to provide, without discrimination, care for emergency medical conditions to individuals regardless of their eligibility under their financial assistance policy. These hospital organizations have also adopted policies to limit the amount charged for emergency or other medically necessary care that is provided to individuals eligible for assistance under the organizations' financial assistance policy to not more than the amounts generally billed to individuals who have insurance covering such care.

Reimbursements are received by the Indiana University Health System for Medicare and Medicaid beneficiaries in accordance with federal and state reimbursement agreements and related regulatory rules and regulations. Also, the Indiana University Health System receives certain additional Medicaid Disproportionate Share (DSH) payments and payments under the Medicaid Assessment Fee program from the state of Indiana (see Note 3). These reimbursements and payments are less than the cost of providing the related services.

The Indiana University Health System also provides education for health care providers, including support to the School of Medicine; chaplaincy programs that support patients' medical, spiritual, and emotional needs; programs to enhance quality of and respect for life, including neighborhood revitalization, community health clinics, and school-based health programs; charity, equality, and justice programs, including education programs available to independent health providers, and obesity prevention programs such as Garden on the Go® and Indy Urban Acres; other medical research, and support to the Children's Values Fund; and fosters an internal community of trust, respect, and empowerment.

2. Community Benefit and Charity Care (continued)

Through the statewide facility-by-facility community health needs assessments Indiana University Health conducted, the following community health needs were identified and selected as priority areas in which Indiana University Health will focus on community benefit efforts: access to affordable health care, behavioral health, obesity prevention, and Pre-K education. The costs of providing these programs and services are included in expenses in the accompanying consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of Indiana University Health and all majority-owned or controlled subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Fair Values of Financial Instruments

Financial instruments include cash and cash equivalents, patient and other accounts receivable, assets limited as to use, accounts payable and accrued expenses, estimated third-party payor allowances, notes payable to banks, long-term debt, derivative financial instruments (i.e., fixed-pay and basis swaps), and certain other current assets and liabilities.

The fair values for cash and cash equivalents, patient and other accounts receivable, accounts payable and accrued expenses, estimated third-party payor allowances, and certain other current assets and liabilities approximate the carrying amounts reported in the consolidated balance sheets and, in the opinion of management, represent highly liquid assets or short-term obligations. The fair values for assets limited as to use, debt, and derivative financial instruments are described in Notes 5, 7, 8, and 9.

3. Summary of Significant Accounting Policies (continued)

Derivative Financial Instruments

The Indiana University Health System has entered into certain interest rate swap transactions (fixed-pay swaps and basis swaps). As of and for the years ended December 31, 2015 and 2014, the Indiana University Health System's fixed-pay swap and basis swap agreements did not qualify for hedge accounting. Therefore, the changes in fair value of these interest rate swaps during these years are reported in nonoperating (loss) income in the consolidated statements of operations and changes in net assets.

Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts from patients, third-party payors, and others at the time services are rendered. Certain revenue is subject to estimated retroactive revenue adjustments under reimbursement agreements with third-party payors due to future audits, reviews, and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period that the related services are rendered, and such amounts are adjusted in future periods as adjustments become known.

For the year ended December 31, 2015, the percentage of patient service revenue (net of contractuals and discounts) derived under Medicare, Medicaid, and managed care programs approximated 23%, 10%, and 58%, respectively (23%, 7%, and 57%, respectively, for the year ended December 31, 2014). A managed care provider represented 30% of patient service revenue in both 2015 and 2014. Provision has been made, by a charge to contractual allowances as an offset to patient service revenue, for the differences between gross charges for patient services and estimated reimbursement from these government and insurance programs.

During 2012, the Indiana General Assembly approved a hospital assessment fee program (Medicaid Assessment Fee). Under this program, the Office of Medicaid Policy and Planning collects a fee from eligible hospitals. The fee is used in part to increase reimbursement to eligible hospitals for services provided in both fee-for-service and managed care programs, and as the state share of DSH payments. The program was effective retroactively from July 1, 2011, and continued through June 30, 2013. Subsequently, the Indiana General Assembly approved the extension of the Medicaid Assessment Fee program for another four years. On March 21, 2014, the Centers for Medicare and Medicaid Services (CMS) approved the extension of the program for another four years. This approval reinstated the program retroactively to July 1, 2013. The

3. Summary of Significant Accounting Policies (continued)

Indiana University Health System recorded the increased revenue and assessment fee expense related to claims occurring after July 1, 2013, in the first quarter of 2014.

For the year ended December 31, 2015, increased reimbursement related to the Medicaid Assessment Fee program was recorded within net patient revenue on the consolidated statements of operations and changes in net assets totaling $221,422. For the year ended December 31, 2014, increased reimbursement related to the Medicaid Assessment Fee program was recorded within net patient revenue on the consolidated statements of operations and changes in net assets totaling $514,703, of which $166,729 related to 2013. During the year ended December 31, 2015, an assessment fee was recognized of $109,558. During the year ended December 31, 2014, an assessment fee was recognized of $197,994, of which $72,906 related to 2013. This fee was recorded within the hospital assessment fee on the consolidated statements of operations and changes in net assets.

Indiana University Health is a Medicaid DSH provider under Indiana law (IC 12-15-16(1-3)) and, as such, is eligible to receive state DSH payments. The amount of these additional state DSH funds is dependent on regulatory approval by agencies of the federal and state governments and is determined by the level, extent, and cost of uncompensated care (as defined) and various other factors. For the years ended December 31, 2015 and 2014, state DSH payments have been made by the state of Indiana, and amounts were recorded as revenue based on data acceptable to the state of Indiana, less any amounts management believes may be subject to adjustment. State DSH payments by the state of Indiana are based on the fiscal year of the state, which ends June 30 of each year. State DSH reimbursement is recognized as revenue after eligibility is determined by the state and payments are probable and reasonably estimable. For the state fiscal years 2014 and 2015, state DSH payments of $104,089 recognized by Indiana University Health and certain subsidiaries were recorded in net patient service revenue in the accompanying consolidated statements of operations and changes in net assets for the year ended December 31, 2015. For the partial state fiscal year 2014, state DSH payments of $14,794 recognized by Indiana University Health and certain subsidiaries were recorded in net patient service revenue in the accompanying consolidated statements of operations and changes in net assets for the year ended December 31, 2014.

(Thousands of Dollars)

3. Summary of Significant Accounting Policies (continued)

Laws and regulations governing Medicare, Medicaid, and other governmental programs are extremely complex, subject to interpretation, and sometimes provide for retroactive adjustments. As a result, there is a reasonable possibility that recorded estimated settlements could change by a material amount in the near term. The Indiana University Health System believes it is in compliance with applicable laws and regulations governing Medicare, Medicaid, and other governmental programs and that adequate provisions have been recorded for any adjustments that may result from final settlements. However, any adjustments to the currently estimated settlements are recorded in future periods.

Patient service revenue, net of contractual allowances and discounts and before the provision for bad debts, recognized in the year from major payor sources is as follows:

	Year Ended December 31 2015	2014
Third-party payors	**$ 5,716,509**	$ 5,416,315
Self-pay patients	**28,892**	141,357
Total payors	**$ 5,745,401**	$ 5,557,672

The decrease in self-pay patients' revenue for 2015 is due to a reduction in self-pay revenue due to the expansion of Medicaid programs and the health insurance marketplace, and the identification of prior year accounts requiring reclassification from the provision for bad debts to charity care.

Member Premium Revenue and Health Claims

The Indiana University Health System has agreements to provide medical services to subscribing participants or members that generally provide for predefined payments (on a per member or per month basis) regardless of services actually performed. The cost to provide health care services under these agreements is accrued in the period in which the health care services are provided to a member based, in part, on estimates, including an accrual for medical services provided but not yet reported. Expenses to providers are reported as health claims to providers in the accompanying consolidated statements of operations and changes in net assets. The accrual for medical services provided, but not yet reported, is reflected as accrued health claims in the accompanying consolidated balance sheets.

3. Summary of Significant Accounting Policies (continued)

Meaningful Use Revenue

The American Recovery and Reinvestment Act of 2009 established incentive payments under Medicare and Medicaid programs for certain eligible professionals, hospitals, and critical access hospitals (Providers). Providers can receive incentive payments by adopting, implementing, and upgrading electronic health records (EHR) technology. Providers can also receive incentive payments for demonstrating meaningful use of EHR technology. Upon satisfaction of the meaningful use criteria, using a grant accounting model, the Indiana University Health System recognized $5,406 and $14,152 of these incentive payments within other revenue in the accompanying consolidated statements of operations and changes in net assets for the years ended December 31, 2015 and 2014, respectively.

Cash Equivalents

Investments in highly liquid instruments with an original maturity of three months or less when purchased, excluding assets limited as to use, are considered by management to be cash equivalents.

The Indiana University Health System routinely invests in money market funds, including both treasury and agency money market funds and prime money market funds that are considered by management to be cash equivalents. Such instruments, as well as bank deposits, are potentially subject to concentrations of credit risk. In order to mitigate such risk, the Indiana University Health System generally places its cash and cash equivalents with institutions of high credit quality.

Patient Accounts Receivable and Allowance for Uncollectible Accounts

The Indiana University Health System does not require collateral or other security for the delivery of health care services from its patients, substantially all of whom are residents of the state of Indiana. However, assignment of benefit payments payable under patients' health insurance programs and plans (e.g., Medicare, Medicaid, health maintenance organizations, and commercial insurance policies) is routinely obtained, consistent with industry practice.

(Thousands of Dollars)

3. Summary of Significant Accounting Policies (continued)

The provision for uncollectible accounts, for all payors, is recognized when services are provided based upon management's assessment of historical and expected net collections, taking into consideration business and economic conditions, changes and trends in health care coverage, and other collection indicators. Periodically, management assesses the adequacy of the allowance for uncollectible accounts based upon accounts receivable payor composition and aging, the significance of individual payors to outstanding accounts receivable balances, and historical write-off experience by payor category, as adjusted for collection indicators. The results of this review are then used to make any modifications to the provision for uncollectible accounts and the allowance for uncollectible accounts. In addition, the Indiana University Health System follows established guidelines for placing certain past due patient balances with collection agencies. Patient accounts that are uncollected, including those placed with collection agencies, are initially charged against the allowance for uncollectible accounts in accordance with collection policies of the Indiana University Health System and, in certain cases, are reclassified to charity care if deemed to otherwise meet financial assistance policies of the Indiana University Health System.

The composition of net patient accounts receivable is summarized as follows as of December 31:

	2015	**2014**
Managed care	**54%**	53%
Medicare	**17**	20
Medicaid	**13**	8
Other third-party payors	**11**	12
Patients	**5**	7
	100%	100%

A managed care payor represented 22% and 26% of net patient accounts receivables at December 31, 2015 and 2014, respectively.

The allowance for uncollectible accounts for self-pay patients, including self-pay discounts and charity care, was 80% and 83% of self-pay accounts receivable as of December 31, 2015 and 2014, respectively. Overall, the net of self-pay discounts and write-offs has not changed significantly for the years ended December 31, 2015 and 2014. Effective July 1, 2014, the

3. Summary of Significant Accounting Policies (continued)

Indiana University Health System changed their financial assistance policy to remove both out-of-state patients and those above 400% of the federal poverty level from being eligible to participate.

Inventories

Inventories consist primarily of drugs and supplies, are stated at the lower of cost or market, and are generally valued using the average cost method.

Assets Limited as to Use

Assets limited as to use include the following: (i) cash and cash equivalents and designated investment assets, including those funds held by the consolidated foundations, set aside by the Board for future capital improvements, over which the Board retains control and may, in certain circumstances, use for other purposes; (ii) donor-restricted investment assets, the use of which has been specified by the donor; and (iii) assets held by trustees under bond or trust indenture agreements for construction and debt service. Substantially all assets limited as to use are invested and managed by professional investment managers and are held in custody by financial institutions. These funds are classified as trading securities. Accordingly, changes in unrealized gains and losses in the fair value of investments are included in nonoperating (loss) income within investment income in the accompanying consolidated statements of operations and changes in net assets. The Indiana University Health System is a limited partner in certain funds that employ hedged investment strategies and funds that employ investment strategies that require long holding periods to create value. These investments are accounted for using the equity method of accounting, based on the fund’s financial information.

Property and Equipment

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the assets.

Property and equipment under capital lease obligations are amortized on the straight-line method over the lease term or the estimated useful life of the equipment, whichever period is shorter. Such amortization is included with depreciation in the accompanying consolidated statements of

3. Summary of Significant Accounting Policies (continued)

operations and changes in net assets. Interest cost incurred on borrowed funds during the period of construction and other interest costs related to tax-exempt bonds are capitalized as a component of the cost of constructing the assets. In addition, interest earnings on unexpended borrowed funds related to tax-exempt financings offset capitalized tax-exempt interest. Repair and maintenance costs are expensed when incurred.

The Indiana University Health System evaluates when events or changes in circumstances have occurred that would indicate that the remaining estimated useful life of long-lived assets warrant revision or that the remaining balance of such assets may not be recoverable. The carrying amount of a long-lived asset is not recoverable if it exceeds the sum of the undiscounted cash flows expected to result from the use and eventual disposition of the asset or asset group. If undiscounted cash flows are insufficient to recover the carrying value of the long-lived asset, such asset is written down to its fair value.

Equity Interest in Unconsolidated Subsidiaries

Indiana University Health or its subsidiaries have also entered into certain limited liability company agreements with third parties that provide health care-related services. Where applicable, these arrangements are accounted for using the equity method of accounting. Indiana University Health's largest equity interest venture is a 50% membership interest in MDWise, Inc., which holds a health maintenance organization license and manages a network of health care providers serving Medicaid patients throughout the state of Indiana. The balance of this equity interest was $39,497 and $15,566 as of December 31, 2015 and 2014, respectively. Overall, equity interest in unconsolidated subsidiaries was $71,128 and $49,202 as of December 31, 2015 and 2014, respectively. The Indiana University Health System has recorded its equity in the income of its unconsolidated subsidiaries within other operating revenue, totaling $14,620 and $1,066 for the years ended December 31, 2015 and 2014, respectively.

Unamortized Bond Issuance Costs and Bond Discount or Premium

Costs incurred in connection with the issuance of long-term debt and bond discounts or premiums are amortized or accreted using the effective interest rate method. Amortization and accretion are included in interest expense in the accompanying consolidated statements of operations and changes in net assets (see Note 7).

3. Summary of Significant Accounting Policies (continued)

In April 2015, the Financial Accounting Standards Board (FASB) issued guidance related to the financial statement presentation of debt issuance costs, which would require that debt issuance costs related to a recognized debt liability presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This new guidance dictates that the standard be applied retrospectively to each prior reporting period presented at the date of initial application. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2015. The recognition and measurement guidance for debt issuance costs are not affected by the update. Indiana University Health early adopted this guidance as of and for the year ended December 31, 2015. Debt issuance costs are shown within the current portion of long-term debt and long-term debt, net of the current portion in the consolidated balance sheets.

Contributions

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is made. Conditional promises to give, including indications of an intention to give, are reported at fair value at the date the gift is made. If the gifts are made with donor stipulations that limit the use of the donated assets, the gifts are reported as either temporarily or permanently restricted. Donor-restricted contributions for which restrictions are met in the same year as made are reported as unrestricted contributions in the accompanying consolidated financial statements.

Noncontrolling Interest in Subsidiaries

The Indiana University Health System attributed income of $105,061 and $90,175 for the years ended December 31, 2015 and 2014, respectively, to the noncontrolling interests based on the ownership percentage of the noncontrolling interests in certain of the Indiana University Health System's consolidated subsidiaries. These amounts primarily relate to the eight surgery center joint ventures and are reflected in unrestricted net assets in the consolidated balance sheets. For the years ended December 31, 2015 and 2014, the eight surgery center joint ventures accounted for $102,625 and $89,120 of the income attributed to the noncontrolling interests. The eight surgery center joint ventures realized operating revenue of $253,422 and $220,703, and operating income of $139,115 and $121,287 in 2015 and 2014, respectively. The operating revenue and operating income are reflected in total operating revenue and total operating income on the consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies (continued)

Temporarily and Permanently Restricted Net Assets

Temporarily and permanently restricted net assets are those assets whose use has been limited by donors to a specific time period or purpose. These net assets are generally restricted for medical education and research programs, medical supplies and equipment, and patient care services.

Interests in net assets of unconsolidated foundations are included in other assets in the accompanying consolidated balance sheets (see Note 14). The underlying assets of these interests in foundations consist primarily of cash and cash equivalents, money market and mutual funds, and marketable equity and debt securities.

Business Combinations

The Indiana University Health System allocates the purchase price of an acquisition to the various components of the acquisition based upon the fair value of each component, which may be derived from various observable or unobservable inputs and assumptions. Also, the Indiana University Health System may utilize third-party valuation specialists. These components typically include buildings, land, and equipment and may also include intangibles related to noncompete agreements or other specifically identified intangible assets. The excess of the fair value of assets acquired over liabilities assumed and the fair value of any noncontrolling interest is recorded as an inherent contribution within the performance indicator. Goodwill is recorded to the extent that liabilities assumed and noncontrolling interests exceed the fair value of assets acquired.

Goodwill and Intangible Assets

In connection with business combinations, the Indiana University Health System has recorded goodwill and definite-lived intangible assets on the accompanying consolidated balance sheets.

The Indiana University Health System evaluates goodwill for impairment annually, or more frequently if events or changes in circumstances suggest that the carrying value of an asset may not be recoverable. The goodwill impairment analysis, performed at the reporting unit level, generally includes estimating the fair value and comparing that to the carrying value. If fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is not considered

3. Summary of Significant Accounting Policies (continued)

to be impaired. These valuation methods require the Indiana University Health System to make estimates and assumptions regarding future operating results, cash flows, changes in working capital, capital expenditures, profitability, and the cost of capital.

The Indiana University Health System also reviews if events or changes in circumstances suggest impairment may have occurred related to the carrying value of the definite-lived intangible assets, which are amortized over periods of 5 to 35 years. It has been determined that there was no impairment to goodwill or definite-lived intangible assets during 2015 and 2014. Intangible assets included in other assets on the accompanying consolidated balance sheets as of December 31, 2015 and 2014, were $199,485 and $180,776, respectively, which include goodwill of $184,509 and $166,552, respectively.

Operating and Performance Indicators

The activities of the Indiana University Health System are primarily related to providing health care services, and accordingly, expense information by functional classification is not used as a basis for measuring performance. Furthermore, since substantially all resources are derived from providing health care services, similar to that if provided by a business enterprise, the following indicators are considered important in evaluating how well management has discharged its stewardship responsibilities:

> **Operating Indicator (Operating Income) –** Includes all unrestricted revenue, gains, donor contributions to offset operating expenses, other support, equity income or loss of unconsolidated health care subsidiaries, and expenses directly related to the recurring and ongoing health care operations during the reporting period. The operating indicator excludes investment income or losses on assets limited as to use (including changes in unrealized gains and losses on investments), changes in the fair value of fixed-pay and basis swaps, gain or loss on the extinguishment of debt, inherent contribution of acquired entities, noncontrolling interest, and gains and losses deemed by management not to be directly related to providing health care services.
>
> **Performance Indicator (Excess of Revenues Over Expenses) –** Includes operating income and nonoperating income and losses. The performance indicator excludes certain changes in pension obligations and contributions for capital expenditures, distributions, and net assets released from restricted funds.

3. Summary of Significant Accounting Policies (continued)

Income Taxes

The Internal Revenue Service (IRS) has determined that Indiana University Health and certain of its affiliated entities are tax-exempt organizations as defined in Section 501(c)(3) of the Internal Revenue Code (IRC).

Certain subsidiaries of Indiana University Health are taxable entities. The tax expense and liabilities of these subsidiaries are not material to the consolidated financial statements.

Subsequent Events

For the consolidated financial statements as of and for the year ended December 31, 2015, management has evaluated subsequent events through March 25, 2016, the date that these consolidated financial statements were issued.

Reclassifications

Certain amounts in the 2014 consolidated financial statements have been reclassified to conform to the 2015 presentation. Such reclassifications had no effect on previously reported excess of revenues over expenses, or net assets.

New Accounting Guidance Not Yet Applicable

In February 2016, the FASB issued guidance related to leases. One of the primary changes brought about by the new standard is the reporting of operating leases on the balance sheet. This new guidance dictates that the implementation of the new standard would recognize and measure leases at the beginning of the earliest period presented using a modified retrospective approach. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2018.

In May 2015, the FASB issued guidance related to fair value disclosures of certain investments. Investments for which fair value is measured at net asset value per share (or its equivalent) using the practical expedient provisions of the fair value measurement guidance are no longer required to be included within the fair value hierarchy leveling tables. This new guidance is effective for

3. Summary of Significant Accounting Policies (continued)

fiscal years and interim periods within those fiscal years beginning after December 15, 2016, with early adoption permitted. Indiana University Health has not early adopted as of December 31, 2015. No changes to fair value measurements will result from adopting this guidance, only changes to amounts disclosed within the consolidated footnotes.

In May 2014, the FASB issued guidance related to recognizing revenue from contracts with customers. This new guidance dictates that the standard be applied either retrospectively to each prior reporting period presented, or retrospectively with the cumulative effect of initially applying the revenue recognition standard recognized at the date of initial application. This new guidance is effective for fiscal years and interim periods within those fiscal years beginning after December 15, 2017. Indiana University Health is evaluating the effect this guidance will have on its consolidated financial statements.

4. Significant Transactions

La Porte

On December 24, 2015, a Contribution and Sale Agreement was executed by and among Indiana University Health, La Porte, Frankfort Health Partner, Inc. and Community Health Services, Inc. (CHS) and other affiliated entities. In anticipation of the agreement, Indiana University Health and La Porte formed a limited liability company with Indiana University Health holding a 20% interest and La Porte holding 80%. Upon closing of the agreement, La Porte and certain of its affiliated entities contributed assets to the limited liability company and certain of its affiliated entities. Also upon the closing on March 1, 2016, Frankfort Health Partner, Inc., a subsidiary of Community Health Systems, Inc., purchased La Porte's 80% interest in the limited liability company for $96,496, plus the net working capital minus any long-term debt or capital leases. Pursuant to the limited liability company agreement 20% of the assets contributed to the limited liability company are deemed to have been contributed on behalf of Indiana University Health, the value of which has been credited to Indiana University Health's capital account. The proceeds of the sale, net of the settlement of La Porte's liabilities existing on the date of sale and a portion to be retained by Indiana University Health under the agreement, was contributed to a foundation in support of the La Porte community. Indiana University Health will recognize a nonoperating loss of approximately $180,000 related to the transaction in the first quarter of 2016.

4. Significant Transactions (continued)

In anticipation of the closing of this transaction, during 2015 Indiana University Health, acting as Obligated Group Agent, effectuated the removal of IU Health La Porte from the Obligated Group. For the year ended December 31, 2015, IU Health La Porte and subsidiaries, including IU Health Starke, together represented approximately 3.6% of the total operating revenues of the Indiana University Health System.

Academic Health Center

In support of the newly designed model of care of Indiana University Health, in April 2015, the Indiana University Health Board of Directors approved a plan to consolidate downtown Indianapolis adult services to one medical campus centered on Capitol Avenue and 16th Street (current site of Methodist Hospital), with women's services consolidated at or near the existing Riley Hospital campus. As Indiana University Health is committed to improving the health of our patients and communities, the plan also includes the development of an array of ambulatory care services for residents of the neighborhoods around the downtown Indianapolis campus. The adult service medical campus is expected to include a medical education building and faculty offices on site to enhance ongoing collaboration with the IUSOM and support the tripartite mission of clinical care, research and education. The Board of Directors has not yet approved the capital expenditures related to the plan. In response to this plan, the useful lives of assets currently in place were evaluated, resulting in accelerated depreciation of $3,600 reflected in the December 31, 2015, consolidated financial statements

Bloomington

The Indiana University Health Board of Directors recently approved a plan to create a regional academic health campus in Bloomington, Indiana, which will increase Bloomington's ability to improve patient care, by providing more opportunities for collaboration among clinical, research, and medical staff and faculty. This plan will allow the Indiana University School of Medicine to expand its medical education programs and research opportunities on the Indiana University Bloomington campus. As part of this plan, Bloomington will build a replacement hospital, which will further its mission of providing cutting-edge health services to the region. The Board of Directors has not yet approved the capital expenditures related to the plan. In response to this plan, the useful lives of assets currently in place were evaluated, resulting in accelerated depreciation of $5,354 reflected in the December 31, 2015, consolidated financial statements.

5. Assets Limited as to Use

Board-designated and donor-restricted investment funds are invested in accordance with Board-approved policies. The estimated fair value of the assets limited as to use is determined using market information and other appropriate valuation methodologies. The methods and assumptions used to estimate the fair value of assets limited as to use are as follows: (i) cash and cash equivalents: the carrying amounts reported in the consolidated balance sheets approximate fair value; (ii) marketable securities: the fair values are based on quoted market prices or, if quoted market prices are not available, quoted market prices of comparable instruments and other observable inputs; and (iii) other investments, including alternative investments. Certain alternative investments (such as hedged strategies and private investments) are accounted for using the equity method of accounting based upon the net asset values as determined by third-party valuation firms and/or third-party administrators of each fund in consultation with and approval of the fund investment managers.

The Indiana University Health System is a limited partner in funds that employ hedged investment strategies and private funds that employ investment strategies that require long holding periods to create value, both of which are designed to reduce overall portfolio volatility.

In the case of hedge funds, redemptions generally may be made quarterly with written notice ranging from 30 to 90 days; however, some funds employ lock-up periods that restrict redemptions or charge a redemption fee during the lock-up period. Lock-up periods range from one to three years with redemption charges of up to 5% of net asset value for redemptions made on or before the anniversary date of the initial investment or additional contribution. Upon complete redemption, many of the funds have “hold-back” provisions that allow the fund to retain up to 10% of the assets until the fund completes its audited financial statements for the redemption period. These investments are accounted for using the equity method of accounting, based on the fund’s financial information.

In the case of private funds, capital is returned as monetization events occur, which may be infrequent in nature. Generally, capital is committed to a partnership for a period of five to ten years with the ability of the general partner to extend the life of the fund one to three additional years. Generally, during the first three to five years of a fund life, the general partner, in order to facilitate its funding of investments, will call capital from the limited partners up to the amount of its commitment. As of December 31, 2015, there is $201,089 of unfunded commitments relating to private funds, which is expected to be funded over the next five years. As of December 31, 2014, there was $57,676 of unfunded commitments relating to private fund investments.

5. Assets Limited as to Use (continued)

Alternative investments include certain other risks that may not exist with other investments that are more widely traded. These include reliance on the skill of the fund managers, who often employ complex strategies utilizing various financial instruments, including futures contracts, foreign currency contracts, structured notes, interest rate, total return, and credit default swaps. Additionally, alternative investments may provide limited information on a fund's underlying assets and have restrictive liquidity provisions. Management believes that the Indiana University Health System, in consultation with its investment consultants, has the capacity to analyze and interpret the risks associated with alternative investments and, with this understanding, has determined that these investments represent a prudent approach for use in its portfolio management.

The largest fund allocation to any fund manager, which is an alternative fund of funds investment, is $188,821 at December 31, 2015, and there are no investments in any individual fund greater than 18.5% of that fund's net assets. Changes in the value of these funds are included in nonoperating (loss) income in the accompanying consolidated statements of operations and changes in net assets.

(Thousands of Dollars)

5. Assets Limited as to Use (continued)

The composition of assets limited as to use is set forth below.

	December 31	
	2015	**2014**
Board designated investments and trustee-held funds:		
Cash and cash equivalents	**$ 31,983**	$ 57,627
Debt securities:		
Asset backed	**56,556**	46,871
Bank loans	**192,260**	144,493
Corporate debt	**321,165**	280,306
Government and agencies	**279,191**	257,236
Bond funds	**241,384**	266,013
Total debt securities	**1,090,556**	994,919
Equity securities:		
Domestic equities	**53,610**	53,503
Domestic equity funds	**594,162**	476,784
International equities	**66,520**	59,566
International equity funds	**450,333**	363,209
Total equity securities	**1,164,625**	953,062
Alternatives:		
Hedge funds	**1,224,697**	988,085
Private	**105,737**	88,260
Commodities	**107,545**	108,739
Total alternatives	**1,437,979**	1,185,084
Total assets limited to use	**$ 3,725,143**	$ 3,190,692

Assets limited as to use include funds held by the foundations whose fair values as of December 31, 2015, aggregated $177,193, of which $126,792 is considered board-designated investment funds and $50,401 is considered donor-restricted investment funds.

(Thousands of Dollars)

5. Assets Limited as to Use (continued)

The composition and presentation of investment income recognized in the accompanying consolidated statements of operations and changes in net assets are as follows:

	Year Ended December 31	
	2015	**2014**
Investment (loss) income:		
Interest and dividend income	**$ 41,055**	$ 45,371
Investment management and administration fees	**(6,610)**	(8,047)
Realized (losses) gains on sales of investments, net	**(13,009)**	41,863
Unrealized losses on investments	**(105,627)**	(24,778)
Equity gains (losses) on alternative investments	**16,971**	(15,654)
	$ (67,220)	$ 38,755

6. Property and Equipment

The cost of property and equipment in service is summarized as follows:

	December 31	
	2015	**2014**
Land and improvements	**$ 267,086**	$ 264,097
Buildings and improvements	**3,383,914**	3,329,333
Equipment	**2,319,516**	2,252,134
	$ 5,970,516	$ 5,845,564

Useful lives of each category of assets are based on the estimated useful time frame that the particular assets are expected to be in service, generally in accordance with guidelines established by the American Hospital Association. Assets are depreciated on a straight-line basis beginning in the month when placed in service, with asset lives ranging as follows: 20–30 years for land improvements, 15–40 years for buildings and improvements, and 3–10 years for equipment, including software developed for internal use.

(Thousands of Dollars)

6. Property and Equipment (continued)

Construction-in-progress for assets currently under development was $52,203 and $32,997 at December 31, 2015 and 2014, respectively, and includes commitments for the construction, refurbishment, and replacement of facilities and equipment.

Firm commitments for construction-in-progress totaled $54,285 at December 31, 2015.

Certain buildings, equipment, and software are accounted for as capital leases expiring in various years through 2037 and are included in property and equipment. Amortization of assets under capital leases is included in depreciation expense.

The following is a summary of property held under capital leases:

	December 31	
	2015	**2014**
Software	**$ –**	$ 1,219
Equipment	**8,347**	4,905
Buildings	**100,785**	101,157
	109,132	107,281
Less accumulated amortization	**(19,676)**	(9,535)
	$ 89,456	$ 97,746

Interest rates are imputed based on the lower of the incremental borrowing rate at the inception of each lease or the lessor's implicit rate of return.

7. Debt

Obligated Groups

The Indiana University Health System operates under two separate Master Trust Indentures (MTIs). Each MTI provides for the issuance of long-term debt and sets forth the terms pursuant to which underlying debt is issued. These MTIs set forth the provisions governing membership for the respective obligated groups, which presently consist of the following specific separate entities: (1) the Indiana University Health Obligated Group includes Indiana University Health (which entity includes divisions such as the Downtown Hospitals of the Academic Health Center, Saxony, and Morgan) as the sole member; and (2) the Rehabilitation Hospital of Indiana Obligated Group includes RHI as the sole member. During 2015, in anticipation of the sale transaction described in Note 4, Indiana University Health, acting as Obligated Group Agent, effectuated the removal of La Porte from the Indiana University Health Obligated Group. Each obligated group is required to meet certain covenants, and future members, if any, together with existing members will be jointly and severally liable for the obligations under their respective MTIs. Each is subject to financial performance covenants that, among other compliance requirements, require the maintenance of debt service ratios and limit its ability to encumber certain of its respective assets. As of December 31, 2015, the Indiana University Health System was in compliance with all financial covenants.

Issuance, Modification, and Extinguishment of Debt

The Indiana University Health Obligated Group has executed direct-pay letter-of-credit agreements in support of all of its publicly remarketed variable-rate bond series, which require the credit provider to purchase bonds in the event the bonds are not remarketed. In addition, it has executed direct purchase agreements, whereby the credit provider purchases bonds for a predetermined period of time, after which the agreement must be extended or the bonds must be remarketed or reissued. In each of these two instances, the bonds have a longer nominal maturity than the agreement, but the existence and terms of these agreements allow for the long-term classification of the associated variable-rate bond series. When these agreements have expiration dates within the succeeding twelve-month period, a greater portion of the associated debt is classified as current, because if not otherwise extended, these agreements would require the principal balance of the related bonds to be repaid over a shortened time frame. Accordingly, $8,429 and $31,852 was reclassified to current portion of long-term debt as of December 31, 2015 and 2014, respectively, to reflect the associated amount for 2016 and 2015, respectively.

7. Debt (continued)

On May 7, 2015, through the Indiana Finance Authority, Indiana University Health issued $287,395 in par value of Series 2015A tax-exempt fixed-rate bonds at a premium of $27,022. Proceeds were used to advance refund $117,130 in par of the Series 2006A tax-exempt, fixed-rate bonds; to refund the Series 2011J and 2011K taxable, variable-rate bonds outstanding in the amount of $151,550; to refund a variable-rate commercial bank loan in the amount of $37,975; and to pay certain costs related to the issuance.

Additionally, on May 7, 2015, through the Indiana Finance Authority, Indiana University Health issued at par $193,675 of Series 2015B and 2015C tax-exempt variable-rate bonds. Proceeds were used to advance refund $184,550 in par of the Series 2006A tax-exempt fixed-rate bonds and to pay certain costs related to the issuance.

Also on May 7, 2015, Indiana University Health drew $26,717 under its existing revolving line of credit to advance refund the final $25,490 in par of the Series 2006A tax-exempt, fixed-rate bonds. Subsequently, on June 25, 2015, this line of credit agreement was amended to defer the expiration date until June 30, 2018. Accordingly, the balance drawn is included as long-term debt at December 31, 2015.

The refunding of the Series 2006A, 2011J, and 2011K bonds and the commercial bank loan were all accounted for as debt extinguishments, resulting in losses aggregating $15,778 based upon the funds expended in excess of the carrying values net of unamortized discount and unamortized issuance costs associated with the refunded debt. This loss is shown within debt extinguishment and other nonoperating (loss) income on the consolidated statements of operations and changes in net assets.

7. Debt (continued)

On October 14, 2014, through the Indiana Finance Authority, Indiana University Health issued $69,945 in par value of Series 2014A tax-exempt, fixed rate bonds at a premium of $10,833. Proceeds were used to advance refund the Hospital Authority of Delaware County Hospital Revenue Bonds, Series 2006 (Ball Memorial Hospital, Inc. Obligated Group F/K/A Cardinal Health System Obligated Group) outstanding in the amount of $67,095; to advance refund the Hospital Authority of Delaware County Hospital Revenue Refunding Bonds, Series 2009A (Ball Memorial Hospital, Inc. Obligated Group) outstanding in the amount of $14,030; and to pay certain costs related to the issuance. The refinancing was accounted for as a debt extinguishment, resulting in a loss of $8,318 based upon the funds expended in excess of the carrying values net of unamortized discount and unamortized issuance costs associated with the refunded debt.

In August of 2014, through the Indiana Finance Authority, Indiana University Health reissued its Series 2011H and Series 2011I bonds. The transaction was accounted for as a modification of debt. As part of the reissuance, the rate calculation methodology for each was amended resulting in a reduction to the rate applicable to each; the principal payment schedule was amended; and the bank purchase period was extended to November of 2017.

In August of 2014, Indiana University Health repaid the outstanding balance of $11,936 and prepayment premium associated with a commercial bank loan, resulting in a $239 loss on extinguishment of debt.

In June of 2014, a direct bank loan (the proceeds of which were used to redeem Series 2003F bonds in 2008) was amended to defer the maturity date to June 30, 2016, with an interest rate based on one-month London Interbank Offered Rate (LIBOR).

The Stonehenge Community Development VII, LLC, Fixed-Rate, Unsecured New Market Tax Credit Notes A and B were called by the lender for a one-time payment of $18,700 in March of 2014. This transaction resulted in a $6,296 gain on extinguishment of debt included in debt extinguishment and other in the accompanying consolidated statements of operations and changes in net assets.

(Thousands of Dollars)

7. Debt (continued)

Long-term debt consists of the following:

	December 31	
	2015	**2014**
Indiana University Health Obligated Group MTI Debt		
Indiana Finance Authority:		
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2015A Serial and Term Bonds, payable in varying principal installments through 2040, with interest rates ranging from 4.00% to 5.00% at December 31, 2015	**$ 287,395**	$ –
Variable-Rate Demand Notes, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2015B and C, payable in varying installments through 2042, with variable interest rates of 0.53% and 0.70%, respectively, at December 31, 2015	**193,675**	–
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2014A Serial Bonds, payable in varying principal installments through 2030, with interest rates ranging from 3.00% to 5.00% at December 31, 2015	**66,130**	69,945
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2011N Serial and Term Bonds, payable in varying principal installments through 2038, with interest rates ranging from 3.00% to 5.13% at December 31, 2015	**155,060**	169,920
Variable Rate Demand Notes, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2011A, B, C, D, E, H, I, L, and M, payable in varying installments through 2036, with variable interest rates ranging from 0.01% to 0.79% at December 31, 2015	**430,320**	441,270
Variable-Rate Demand Notes, Taxable Hospital Revenue Bonds, Series 2011J and K, repaid in 2015	–	155,715
Indiana Health and Educational Facility Financing Authority:		
Fixed-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2006A Serial and Term Bonds, defeased in 2015	–	327,170
Fixed-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2006B Serial and Term Bonds, payable in varying principal installments through 2033, with interest rates ranging from 4.75% to 5.00% at December 31, 2015	**327,100**	333,500
Variable-Rate Commercial Bank Loan, repaid in 2015	–	39,025

(Thousands of Dollars)

7. Debt (continued)

	December 31	
	2015	**2014**
Variable-Rate Commercial Bank Revolving Line of Credit, maturing June 30, 2018, with an interest rate of 0.88% as of December 31, 2015	**26,717**	–
Rehabilitation Hospital of Indiana Obligated Group MTI Debt		
Indiana Finance Authority:		
Variable-Rate Demand Notes, Tax-Exempt Hospital Revenue Bonds, Series 2011A, payable in varying principal installments through 2031, with an interest rate of 0.01% at December 31, 2015	**14,365**	14,980
Variable-Rate, Subordinated Promissory Note, principal payable in full at maturity in 2017, with an interest rate of 0.19% at December 31, 2015	**1,500**	1,500
Other Debt		
Mortgage obligations (interest rates ranging from 1.49% to 1.74%) at December 31, 2015	**2,837**	3,130
Capital lease obligations	**98,614**	96,104
Other	**18,003**	21,059
Total long-term debt	**1,621,716**	1,673,318
Unamortized premium, net of unamortized discount	**51,185**	24,251
Unamortized bond issue costs	**(7,147)**	(6,116)
Less current portion	**(55,657)**	(78,757)
Long-term debt, less current portion	**$ 1,610,097**	$ 1,612,696

(Thousands of Dollars)

7. Debt (continued)

The scheduled maturities and mandatory redemptions of long-term debt, assuming remarketing of variable-rate bonds, are as follows:

	Indiana University Health Obligated Group MTI Debt	RHI Obligated Group MTI Debt	Other	Total
Year ending December 31:				
2016	$ 48,044	$ 650	$ 6,963	$ 55,657
2017	72,339	2,195	5,646	80,180
2018	102,557	740	5,127	108,424
2019	61,282	785	6,083	68,150
2020	47,205	840	4,691	52,736
Thereafter	1,154,970	10,655	90,944	1,256,569
	$ 1,486,397	$ 15,865	$ 119,454	$ 1,621,716

The estimated valuation of the revenue bonds is obtained from a third-party pricing service and is derived by utilizing well-priced, liquid bonds with similar characteristics such as currency, market type, industry, and credit rating. Pricing data for these reference bonds incorporates simple averages of indicative and executable price quotes obtained from various contributors, including brokers and other market makers, over a specified time window. These prices are used to construct a fair value curve, which in turn is used to discount the future cash flows of the revenue bonds. Based on the inputs used in determining the estimated fair value of these securities, this liability would be classified as Level 2 in the fair value hierarchy described in Note 9.

The estimated fair value of the revenue bonds at December 31, 2015 and 2014, amounted to $1,531,322 (which includes RHI – $14,365) and $1,564,659 (which includes RHI – $14,980). The carrying value of the revenue bonds at December 31, 2015 and 2014, amounted to $1,474,045 and $1,512,500, respectively. The recorded value of all debt obligations not traded in the secondary credit markets approximated fair value at December 31, 2015 and 2014.

7. Debt (continued)

Subsequent to December 31, 2015, on February 18, 2016, through the Indiana Finance Authority, Indiana University Health issued $158,205 in par value of Series 2016A tax-exempt, fixed-rate bonds at a premium of $32,406. Proceeds were used to refund (on a current basis) $189,415 in par of the Series 2006B tax-exempt, fixed-rate bonds and to pay certain costs related to the issuance.

Additionally, on February 18, 2016, through the Indiana Finance Authority, Indiana University Health issued at par $100,000 of Series 2016B and 2016C tax-exempt, variable-rate bonds. Proceeds were used to refund (on a current basis) $99,555 in par of the Series 2006B tax-exempt, fixed-rate bonds and to pay certain costs related to the issuance.

Also on February 18, 2016, Indiana University Health drew $10,050 under its existing revolving line of credit to refund (on a current basis) $10,050 in par of the Series 2006B tax-exempt, fixed-rate bonds. The remaining $21,590 in par (after a routine principal payment of $6,490 on February 15, 2016) of the Series 2006B tax-exempt, fixed-rate bonds was repaid with cash.

Indiana University Health will account for these transactions as extinguishments of debt in the first quarter of 2016.

As of December 31, 2015 and 2014, the Indiana University Health System maintained several lines of credit totaling $105,000 and $91,000, respectively. As of December 31, 2015, the total balance drawn of the lines of credit was $26,717, included in long-term debt. As of December 31, 2014, there was no balance drawn on the lines of credit.

Total interest paid on long-term debt for the years ended December 31, 2015 and 2014, aggregated $74,164 and $77,403, respectively. Total interest capitalized during the years ended December 31, 2015 and 2014, amounted to $510 and $3,569, respectively.

(Thousands of Dollars)

8. Derivative Financial Instruments

Long-term interest rate swap arrangements have been entered into with the primary objective being to mitigate interest rate risk. The following fixed-pay swaps, stated at current notional amounts, remain in place as of December 31, 2015:

Notional Amount	Effective Date	Maturity Date	Rate Received	Rate Paid
$ 39,200	11/15/2005	02/16/2021	62.30% LIBOR plus 0.24%	3.19%
60,195	06/23/2011	03/01/2036	62.30% LIBOR plus 0.24%	2.68%
67,950	11/15/2005	02/15/2030	62.30% LIBOR plus 0.24%	3.35%
68,200	06/20/2011	02/15/2030	62.30% LIBOR plus 0.24%	3.35%
56,675	06/26/2003	03/01/2033	LIBOR	4.92%
18,883	06/16/2011	03/01/2033	LIBOR	4.92%
75,530	06/16/2011	03/01/2033	LIBOR	4.92%
18,875	06/16/2011	03/01/2033	LIBOR	4.92%
18,875	06/26/2003	03/01/2033	LIBOR	4.92%
7,600	01/27/2006	11/02/2020	Securities Industry and Financial Markets Association Municipal Swap Index (SIFMA)	3.98%
1,181	06/01/2006	06/01/2026	LIBOR plus 1.25%	7.15%
114	10/01/1999	10/01/2019	Prime minus 1.86%	7.72%

(Thousands of Dollars)

8. Derivative Financial Instruments (continued)

After giving effect to the above derivative transactions, the Indiana University Health System's variable-rate debt was approximately 14.1% and 11.9% of total debt outstanding as of December 31, 2015 and 2014, respectively.

In addition, long-term basis swap arrangements were entered into for the purpose of managing the effect of interest rates on cash flows and were in place as of December 31, 2015, as follows:

Notional Amount	Effective Date	Maturity Date	Swap Type	Rate Received	Rate Paid
$ 140,446	03/10/2021	02/15/2033	Forward starting basis	75.00% three-month LIBOR minus 0.05%	SIFMA
309,200	03/10/2021	01/07/2033	Forward starting basis	75.00% three-month LIBOR minus 0.04%	SIFMA
309,200	01/07/2020	01/07/2033	Forward starting basis	72.00% three-month 75.0% one-month LIBOR	SIFMA
250,000	06/01/2016	09/30/2038	Forward starting basis	77.00% three-month LIBOR minus 0.11%	SIFMA
250,000	06/01/2016	9/30/2038	Forward starting basis	77.00% three-month LIBOR minus 0.11%	SIFMA

Guidance on fair value accounting stipulates that a credit valuation adjustment (CVA) should be applied to the mark-to-market valuation position of interest rate swaps to more closely capture the fair value of such instruments. Collateral arrangements reduce the credit exposure and are considered in determining the CVA. As of December 31, 2015, the fair value of interest rate swaps was a liability of $112,675, which is net of CVA of $11,841. As of December 31, 2014, the fair value of interest rate swaps was a liability of $145,339, which is net of CVA of $9,837. The fair values of the swaps have been included with noncurrent liabilities in the accompanying consolidated balance sheets.

(Thousands of Dollars)

8. Derivative Financial Instruments (continued)

The Indiana University Health System recorded the following gains (losses), within nonoperating (loss) income, in the accompanying consolidated statements of operations and changes in net assets related to these derivative financial instruments:

	Year Ended December 31	
	2015	**2014**
Gains (losses) on interest rate swaps, net:		
Unrealized gains (losses) on interest rate swaps	**$ 34,367**	$ (6,267)
Realized losses on interest rate swaps	**(15,390)**	(15,672)
	$ 18,977	$ (21,939)

As of December 31, 2015, interest rate swaps had a total notional amount of $1,692,124, including $433,278 of fixed-pay swaps and $1,258,846 of forward basis swaps. Under agreements executed with counterparties, Indiana University Health is obligated to fund collateral amounts when the aggregate market value of swaps with a given counterparty exceeds a threshold set forth in the related agreement. The aggregate fair value of all derivative instruments, consisting of fixed-pay and basis swaps, with credit-risk-related contingent features that are in a liability position on December 31, 2015 and 2014, was $101,208 and $132,509, respectively. No collateral was posted as of December 31, 2015 and 2014.

During December 2015, Indiana University Health terminated a basis swap with notional amount of $168,952 and a maturity date of February 15, 2033, for a one-time cash payment of $1,450, which was recorded as a realized gain, after which no payments or other amounts are owed to either party with respect to this swap.

Also during December 2015, Indiana University Health partially terminated three additional basis swaps: (1) a basis swap with notional amount of $309,200 and a maturity date of January 7, 2033, for a one-time cash receipt of $1,280, which was recorded as a realized gain, whereby no payments will accrue until January 7, 2020; (2) two identical basis swaps, both with notional amounts of $250,000 and maturity dates of September 30, 2038, for one-time cash receipts of $270 each, which was recorded as a realized gain, whereby no payments will accrue until June 1, 2016.

8. Derivative Financial Instruments (continued)

During July 2015, Indiana University Health terminated a basis swap with notional amount of $309,200 and a maturity date of March 7, 2021, for a one-time cash receipt of $44, which was recorded as a realized gain, after which no payments or other amounts are owed to either party with respect to this swap.

During June 2015, Indiana University Health terminated a basis swap with notional amount of $168,952 and a maturity date of February 15, 2021, for a one-time cash receipt of $37, which was recorded as a realized gain, after which no payments or other amounts are owed to either party with respect to this swap.

9. Fair Value Measurements

The accounting guidance for the application of fair value provides, among other matters, for the following: defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date and establishes a framework for measuring fair value; establishes a three-level hierarchy for fair value measurements based upon the observability of inputs to the valuation of an asset or liability as of the measurement date; requires consideration of nonperformance risk when valuing liabilities; and expands disclosures about instruments measured at fair value. The three-level hierarchy is based upon the nature of valuation techniques and whether such techniques are based upon observable or unobservable inputs, as defined.

Observable inputs are intended to reflect market data obtained from independent sources, while unobservable inputs may reflect market assumptions made by management or measurements made by financial specialists generally associated with the financial asset or liability. These two types of inputs create the following fair value hierarchy:

- Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities as of the reporting date. Includes debt issued by U.S. agencies.

- Level 2 – Pricing inputs other than quoted prices included in Level 1 that are either directly observable or that can be derived or supported from observable data as of the reporting date. Includes all collective trusts and off-shore mutual funds.

9. Fair Value Measurements (continued)

- Level 3 – Pricing inputs include those that are significant to the fair value of the financial asset or financial liability and are not observable from objective sources. In evaluating the significance of inputs, the Indiana University Health System generally classifies assets or liabilities as Level 3 when their fair value is determined using unobservable inputs that, individually or when aggregated with other unobservable inputs, represent more than 10% of the fair value of the assets or liabilities. These inputs may be used with internally developed methodologies that result in management's best estimate of fair value.

The following tables set forth by level within the fair value hierarchy the Indiana University Health System's financial assets and liabilities that were accounted for at fair value on a recurring basis as of December 31, 2015 and 2014. The financial assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The assessment of the significance of a particular input to the fair value measurement requires judgment, could be subject to change or variation, and may affect the valuation of fair value assets and liabilities and their classification within the fair value hierarchy levels.

(Thousands of Dollars)

9. Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	Total
December 31, 2015				
Assets				
Cash and cash equivalents	**$ 388,045**	**$ –**	**$ –**	**$ 388,045**
Debt securities:				
Asset backed	**–**	**56,556**	**–**	**56,556**
Bank loans	**–**	**180,696**	**11,564**	**192,260**
Corporate debt	**–**	**321,165**	**–**	**321,165**
Government and agencies	**279,191**	**–**	**–**	**279,191**
Bond funds	**115,253**	**126,131**	**–**	**241,384**
Equity securities:				
Domestic equities	**53,610**	**–**	**–**	**53,610**
Domestic equity funds	**230,469**	**363,693**	**–**	**594,162**
International equities	**66,520**	**–**	**–**	**66,520**
International equity funds	**137,794**	**312,539**	**–**	**450,333**
Alternatives:				
Commodities	**107,545**	**–**	**–**	**107,545**
Beneficial interests in charitable remainder and perpetual trusts	**–**	**9,462**	**–**	**9,462**
Total assets measured at fair value on a recurring basis	**$1,378,427**	**$1,370,242**	**$ 11,564**	**$ 2,760,233**
Liabilities				
Interest rate swaps	**$ –**	**$ –**	**$112,675**	**$ 112,675**
Total liabilities measured at fair value on a recurring basis	**$ –**	**$ –**	**$112,675**	**$ 112,675**

(Thousands of Dollars)

9. Fair Value Measurements (continued)

	Level 1	Level 2	Level 3	Total
December 31, 2014				
Assets				
Cash and cash equivalents	$ 485,320	$ –	$ –	$ 485,320
Debt securities:				
Asset backed	–	46,871	–	46,871
Bank loans	–	141,893	2,600	144,493
Corporate debt	–	280,306	–	280,306
Government and agencies	257,236	–	–	257,236
Bond funds	155,306	110,707	–	266,013
Equity securities:				
Domestic equities	49,897	3,606	–	53,503
Domestic equity funds	197,873	278,911	–	476,784
International equities	58,766	800	–	59,566
International equity funds	140,785	222,424	–	363,209
Alternatives:				
Commodities	108,739	–	–	108,739
Beneficial interests in charitable remainder and perpetual trusts	–	10,005	–	10,005
Total assets measured at fair value on a recurring basis	$1,453,922	$ 1,095,523	$ 2,600	$ 2,552,045
Liabilities				
Interest rate swaps	$ –	$ 145,339	$ –	$ 145,339
Total liabilities measured at fair value on a recurring basis	$ –	$ 145,339	$ –	$ 145,339

(Thousands of Dollars)

9. Fair Value Measurements (continued)

The fair value of cash and cash equivalents, which consist mainly of funds invested in money market funds, is based on quoted market prices and classified as Level 1. The fair value of Level 1 trading securities is based on quoted market prices from an active exchange or deemed to have similar liquidity characteristics. The fair value of Level 2 trading securities is based on third-party market quotes in an inactive market or similar securities in an active market and other observable inputs. The fair value of interest rate swaps is based upon forward interest rate curves, as adjusted for CVA (see Note 8).

Cash and cash equivalents not held in money market funds aggregated $160,640 and $99,989 as of December 31, 2015 and 2014, respectively, and are not included in the tables. The Indiana University Health System's $1,330,434 and $1,076,345 of hedge funds and private investments as of December 31, 2015 and 2014, respectively, are not included in the tables because they are accounted for using the equity method of accounting (see Note 5). The beneficial interests in charitable remainder and perpetual trusts are shown within other long-term assets on the accompanying consolidated balance sheets.

The following table is a rollforward of the amounts included in the consolidated balance sheets for derivative financial instruments classified within Level 3 of the valuation hierarchy defined above:

	Financial Liabilities for Derivative Financial Instruments
Fair value at January 1, 2015	$ –
Transfer in	145,339
Unrealized gains	(34,367)
Capitalization of partial swap termination receipts	1,703
Fair value at December 31, 2015	$ 112,675

9. Fair Value Measurements (continued)

The Indiana University Health System engages a third party to assist in valuing the CVA. The third party uses the Income Approach to present value the cash flows using the relevant rate of return for the corresponding swap contracts. Where observable, this return would be the observed market rate(s) of return associated with the swap counterparty in a liability position. Collateral amounts posted, if any, are also taken into consideration. The CVA depicts the difference in the mark-to-market absent any credit risk, and the fair value of the swap that incorporates the credit risk of the party holding the swap in a liability position at that point in time. For swaps for which Indiana University Health is in a liability position, this credit risk is measured by comparing the mark-to-market value derived using the LIBOR swap curve to the fair value derived using a published AA-rated Municipal Healthcare curve (or the AA+ rated Municipal General Obligation curve for the swaps insured by Assured Guaranty Municipal Corporation) or comparable market data, adjusted to a taxable basis using the relevant SIFMA/LIBOR ratio.

The value of the CVA may vary depending upon the following factors:

- Whether the Indiana University Health System is required to post collateral under the swap agreements, or
- To the extent that the credit rating of the Indiana University Health System increases or decreases, in which case the CVA would decrease or increase, respectively (assuming the swaps are in a liability position), or
- To the extent that the spread between the swap curves discussed above expands or compresses.

Generally, swaps are transferred between Level 2 and Level 3 when the CVA exceeds 10% of the gross valuation of the swap. Transfers are generally recorded at the end of the reporting period.

(Thousands of Dollars)

10. Commitments and Contingencies

The Indiana University Health System is from time to time subject to various legal proceedings and claims arising in the ordinary course of business. The Indiana University Health System's management does not expect that the outcome in any of its currently ongoing legal proceedings or the outcome of any other claims, individually or collectively, will have a material adverse effect on the Indiana University Health System's financial condition, results of operations, or cash flow.

Leases

Buildings and medical and office equipment are leased under noncancelable operating and capital leases. Future minimum lease payments as of December 31, 2015, are as follows:

	Operating Leases	Capital Leases
Year ending December 31:		
2016	$ 27,557	$ 10,173
2017	24,573	9,817
2018	19,593	9,059
2019	13,405	8,844
2020	9,753	8,982
Thereafter	14,194	164,047
Total minimum lease payments	$ 109,075	210,922
Less amount representing interest		112,308
Present value of net minimum lease payments		$ 98,614

10. Commitments and Contingencies (continued)

Rent and lease expense, included in supplies, drugs, purchased services, and other expenses in the accompanying consolidated statements of operations and changes in net assets, amounted to $57,862 and $80,576 for the years ended December 31, 2015 and 2014, respectively.

11. Medical Malpractice

The Indiana University Health System's medical malpractice coverage is provided through the Indiana University Health Risk Retention Group, Inc. (IUHRRG), a wholly owned subsidiary. The program of medical malpractice coverage considers limitations in claims and damages prescribed by the Indiana Medical Malpractice Act (the Act), which limits the amount of individual claims to $1,250 and annual aggregate claims to $7,500, of which up to $1,000 would be paid by the State of Indiana Patient Compensation Fund (the Fund) and $250 by the Indiana University Health System for each occurrence of malpractice. The Act also requires that health care providers meet certain requirements, including making funding payments to the Fund and maintaining certain insurance levels. The Indiana University Health System has met these requirements and is a qualified provider under the Act, retaining risk of $250 per occurrence and $7,500 in the annual aggregate.

The Indiana University Health System's medical malpractice program includes coverage offered by IUHRRG and reinsured by Indiana University Health Assurance SPC, a wholly owned subsidiary. This reinsurance also serves as excess insurance for general liability, automobile liability, employer's liability, managed care errors and omissions, and professional liability. This coverage is provided on a claims-made basis (aggregating $70,000 as of July 1, 2014, and $100,000 prior).

Contributions for coverage provided by the captive insurance companies are expensed as incurred, and loss reserves are established for incurred but not yet reported claims. Laws in the jurisdictions in which the captive insurance companies are domiciled require, among other matters, that certain capital and funding requirements be met. The actuarially determined amount of accrued medical malpractice claims is included in noncurrent liabilities in the accompanying consolidated balance sheets.

12. Retirement Plans

Defined-Contribution Plans

Retirement benefits are provided to substantially all employees of the Indiana University Health System, primarily through defined-contribution plans. Contributions, which are included in benefits expense, to the defined-contribution plans are based on compensation of qualified employees and amounted to $94,716 in 2015 and $85,289 in 2014 (net of forfeitures of $2,048 and $2,451 in 2015 and 2014, respectively).

Defined-Benefit Plans

Defined-benefit pension plans sponsored by Indiana University Health, La Porte, Ball Memorial, and Bloomington have been curtailed, with benefits frozen and no new participants allowed. The defined-benefit pension plans applicable to Indiana University Health were principally limited to current and former employees who elected not to participate in the defined-contribution plan established at the time of Indiana University Health’s formation.

Pension benefits are based on years of service and compensation of employees (as defined) and are actuarially determined. Where applicable, the funding policy is to annually contribute the amount required to comply with applicable legislation and IRS regulations. Adjustments to pension liabilities to reflect funded status are charged or credited to unrestricted net assets. An increase to the pension liability of $3,237 has been recorded in 2015 due to lower discount rates assumed for net period pension costs. An increase to the pension liability of $72,149 was recorded in 2014 due to lower discount rates assumed for net periodic pension costs and a change in mortality assumptions due to revised IRS guidelines.

The following table sets forth the funded status of the defined-benefit pension plans and amounts recognized in the consolidated financial statements. The discount rates used vary with each plan based on plan characteristics such as the average age of participants.

(Thousands of Dollars)

12. Retirement Plans (continued)

	December 31	
	2015	**2014**
Changes in benefit obligation of the plans:		
Benefit obligation at beginning of year	**$ 531,681**	$ 446,753
Service cost and other	**–**	144
Interest cost	**21,464**	21,214
Actuarial (loss) gain	**(28,856)**	86,693
Benefits paid	**(26,059)**	(23,123)
Benefit obligation at end of year	**$ 498,230**	$ 531,681
Changes in assets of the plans:		
Fair value of assets at beginning of year	**$ 435,470**	$ 422,760
Actual (loss) return on assets	**(11,185)**	35,362
Employer contributions	**556**	471
Benefits paid	**(26,059)**	(23,123)
Fair value of assets at end of year	**$ 398,782**	$ 435,470
Funded deficiency at December 31	**$ (99,448)**	$ (96,211)
Items not yet recognized as a component of net periodic pension cost:		
Net actuarial loss	**$ 155,765**	$ 151,996
	$ 155,765	$ 151,996

(Thousands of Dollars)

12. Retirement Plans (continued)

	December 31	
	2015	**2014**
Components of net pension benefit cost:		
Service cost	**$ –**	$ 374
Interest cost	**21,464**	21,214
Expected return on assets	**(27,268)**	(26,719)
Amortization of unrecognized net loss	**4,183**	4,532
Termination benefit and settlement expense	**1,608**	1,123
Net periodic pension (income) cost	**$ (13)**	$ 524
Weighted-average actuarial assumptions to determine benefit cost:		
Discount rate for net periodic pension cost	**4.08%**	4.98%
Discount rate for benefit obligations	**4.49**	4.11
Expected rate of return on plan assets	**6.25**	6.44
Accumulated benefit obligation	**$ 498,230**	$ 531,681
Fair value of assets at end of year	**398,782**	435,470
Accumulated benefit obligation exceeding fair value of plan assets	**$ 99,448**	$ 96,211
Expected future benefit payments:		
2016		$ 26,980
2017		28,439
2018		29,533
2019		30,037
2020		30,846
2021–2025		157,884

(Thousands of Dollars)

12. Retirement Plans (continued)

Accumulated adjustments to unrestricted net assets at December 31, 2015, include amounts related to net actuarial loss and prior service costs that have not yet been recognized in net pension benefit cost. Expected amortization of amounts in unrestricted net assets is expected to increase net periodic pension costs by $3,842 during the year ending December 31, 2016. Required contributions are expected to aggregate $583 to the defined-benefit pension plans during 2016.

The plans' assets are held in a group trust. The principal long-term determinant of a plan's investment return is the asset allocation of the group trust. The group trust's allocations are weighted toward growth-oriented assets versus duration-oriented investments. The expected long-term rate of return assumption is based on the mix of assets in the plans and the long-term earnings expected to be associated with each asset class. These assumptions are periodically benchmarked against peer plans.

The weighted-average asset allocations of the plans, by asset category, are as follows:

	December 31	
	2015	**2014**
Asset category		
Cash and cash equivalents	**1%**	1%
Debt securities:		
Bank loans	**1**	–
Corporate debt	**6**	–
Government and agencies	**12**	–
Bond funds	**19**	38
Equity securities:		
Domestic equity funds	**19**	22
International equity funds	**20**	19
Alternatives:		
Hedge funds	**22**	20
	100%	100%

(Thousands of Dollars)

12. Retirement Plans (continued)

The allocation strategy for the group trust in which the plans participate is currently composed of approximately 60% to 70% of growth-oriented investments and 30% to 40% of duration-oriented investments. The largest component of these growth-oriented assets is public equity securities that are diversified and invested in U.S. and international companies.

The following tables present the plans' financial instruments as of December 31, 2015 and 2014, measured at fair value on a recurring basis within the fair value hierarchy as disclosed in Note 9:

	Level 1	Level 2	Level 3	Total
December 31, 2015				
Assets				
Cash and cash equivalents	$ 5,794	$ –	$ –	$ 5,794
Debt securities:				
Bank loans	–	2,722	–	2,722
Corporate debt	–	24,522	–	24,522
Government and agencies	48,333	–	–	48,333
Bond funds	48,599	25,436	–	74,035
Equity securities:				
Domestic equity funds	18,454	58,891	–	77,345
International equity funds	39,130	39,627	–	78,757
Alternatives:				
Hedge funds	–	87,274	–	87,274
Total assets measured at fair value on a recurring basis	$ 160,310	$ 238,472	$ –	$ 398,782

(Thousands of Dollars)

12. Retirement Plans (continued)

	Level 1	Level 2	Level 3	Total
December 31, 2014				
Assets				
Cash and cash equivalents	$ 4,633	$ –	$ –	$ 4,633
Debt securities:				
Bond funds	165,617	–	–	165,617
Equity securities:				
Domestic equity funds	23,227	71,433	–	94,660
International equity funds	40,144	44,018	–	84,162
Alternatives:				
Hedge funds	–	86,398	–	86,398
Total assets measured at fair value on a recurring basis	$ 233,621	$ 201,849	$ –	$ 435,470

The fair value of cash equivalents, which consist mainly of funds invested in money market funds, is based on quoted market prices and classified as Level 1. The fair value of Level 1 investments is based on quoted market prices from an active exchange. The fair value of Level 2 investments is based on third-party quotes in an inactive market or similar securities in an active market and other observable inputs.

The plans invest in hedged funds for which the net asset value per share represents the fair value of the investment held. Risks and redemption restrictions for these investments are similar to the alternative investments described in Note 5.

13. Endowments

Endowment funds of Methodist Health Foundation and BMH Foundation consist of donor-restricted endowment funds held for various specific purposes. As required by GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Board of Directors of both foundations have interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) 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, the foundations classify as permanently restricted net assets the following: (a) the original value of gifts donated to the permanent endowment, (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 fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the foundations in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the foundations consider the various factors in making a determination to appropriate or accumulate donor-restricted endowment funds, such as the duration and preservation of the fund, the purposes of the foundations and the donor-restricted endowment fund, general economic conditions, the possible effect of inflation and deflation, the expected total return from income and the appreciation of investments, other resources of the organization, and the investment policies of the foundations.

(Thousands of Dollars)

13. Endowments (continued)

Changes in and composition of donor-restricted endowment net assets for both foundations for the years ended December 31, 2015 and 2014, were as follows:

	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets at January 1, 2014	$ 14,635	$ 45,150	$ 59,785
Investment return	2,133	204	2,337
Appropriation of endowment assets for expenditures	(2,691)	–	(2,691)
Endowment net assets at December 31, 2014	14,077	45,354	59,431
Contributions	**–**	**247**	**247**
Investment loss	**(710)**	**–**	**(710)**
Appropriation of endowment assets for expenditures	**(1,423)**	**–**	**(1,423)**
Endowment net assets at December 31, 2015	**$ 11,944**	**$ 45,601**	**$ 57,545**

In 2015, Methodist Health Foundation and BMH Foundation transferred $169 from unrestricted net assets to temporarily restricted net assets to maintain donor-restricted endowment funds at the level required by the donor stipulations or law.

Methodist Health Foundation and BMH Foundation have adopted separate investment and spending policies for endowment assets. Policies for both foundations attempt to preserve capital, maximize the return within reasonable and prudent levels of risk, and provide a return to the restricted funds. Endowment assets are invested in a manner that is intended to produce results that exceed the initial recorded value of the investment and yield a targeted long-term rate while assuming a moderate level of investment risk. Disbursements are made for the purposes of supporting various Indiana University Health and Ball Memorial program services. Each foundation has set a threshold for the amount available to distribute each year.

14. Related-Party Transactions

Indiana University School of Medicine

The Consolidation Agreement requires that Indiana University Health fund salaries and related employee benefit costs for medical doctor interns and residents of the School of Medicine who provide services at the Indiana University Health System's facilities. These costs totaled $41,950 and $46,472 in 2015 and 2014, respectively, and have been reported with salaries, wages, and benefits expense in the accompanying consolidated statements of operations and changes in net assets.

The Indiana University Health System purchases certain services from the School of Medicine. These expenses, principally for certain physician and staff salaries, medical directors, medical care case management services, utilities, laboratory services, and other services, totaled $64,660 and $52,730 for the years ended December 31, 2015 and 2014, respectively, and have been reported within salaries, wages, and benefits, supplies, drugs, purchased services, and other expenses in the accompanying consolidated statements of operations and changes in net assets.

The Indiana University Health System also provides additional support to the School of Medicine to assist with medical education and research. During 2015 and 2014, Indiana University Health expensed $52,402 and $43,728, respectively, within educational and research support to Indiana University and supplies, drugs, purchased services, and other expenses in the accompanying consolidated statements of operations and changes in net assets.

Additionally, in 2012, Indiana University Health committed to support ratably for a five-year period ending December 31, 2016, certain basic, clinical, and translational research programs of the School of Medicine. The total commitment aggregates $75,000, subject to Board approval annually, and will be used to reimburse expenses incurred by the School of Medicine. For the years ended December 31, 2015 and 2014, the Indiana University Health System expensed $15,000 under this agreement within supplies, drugs, purchased services, and other expenses in the accompanying consolidated statements of operations and changes in net assets, of which $31,462 and $28,066 was accrued within accounts payable and accrued expenses at December 31, 2015 and 2014, respectively.

14. Related-Party Transactions (continued)

Other Foundations

Bloomington Hospital Foundation, Inc., Tipton County Foundation, Inc., IU Health White Memorial Hospital Foundation, Inc., White County Community Foundation, and the Community Foundation of Greater Lafayette, Inc. are tax-exempt organizations under Section 501(c)(3) of the IRC; these foundations hold funds solely on behalf of Bloomington, Tipton, White, and Arnett Foundation, respectively.

The financial statements of these foundations are not included in the consolidated financial statements. The interests in net assets of these other foundations, which totaled $14,035 and $13,976 at December 31, 2015 and 2014, respectively, are included with other assets and net assets in the accompanying consolidated balance sheets and principally represent donor-restricted funds. These foundations also hold other net assets that are subject to the direction of their respective Boards of Directors. Other changes in the net assets of these foundations are generally reflected within temporarily and permanently restricted net assets.

15. Health Care Legislation and Regulation

The health care industry is subject to numerous laws and regulations of federal, state, and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, participation requirements, reimbursement for patient services, Medicare and Medicaid fraud and abuse, and security, privacy, and standards of health information. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and noncompliance with regulations by health care providers. Violations of these laws and regulations could result in expulsion from government health care programs together with the imposition of significant fines and penalties, significant repayments for patient services previously billed, and disruptions or delays in processing administrative transactions, including the adjudication of claims and payment.

15. Health Care Legislation and Regulation (continued)

In the opinion of management, there are no known regulatory inquiries that are expected to have a material adverse effect on the consolidated financial statements of the Indiana University Health System; however, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

The Affordable Care Act and its associated legislation are designed, in part, to expand access to coverage to substantively all U.S. citizens through a combination of states' expansion of their Medicaid programs and the health insurance marketplace. For Indiana, CMS approved the Healthy Indiana Plan (HIP) 2.0, which was Indiana's response to expanding its Medicaid program. Changes to existing Medicare and Medicaid coverage and payments have also occurred as a result of this legislation. A body of regulations is generally required for legislative acts such as the Affordable Care Act, which are often adopted over a period of years.

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