

CONSOLIDATED FINANCIAL STATEMENTS

Indiana University Health, Inc. and Subsidiaries  
Years Ended December 31, 2018 and 2017  
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, 2018 and 2017

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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, 2018 and 2017, 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 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 financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the 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 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, 2018 and 2017, 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.

## **Changes in Accounting Principles**

As discussed in Note 3 to the consolidated financial statements, in 2018, Indiana University Health, Inc. and Subsidiaries changed its method of revenue recognition, accounting for pension and postretirement benefit costs and financial statement presentation as a result of the adoption of Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, ASU 2017-07, *Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost*, and ASU 2016-14, *Presentation of Financial Statements of Not-For-Profit Entities*, respectively. Our opinion is not modified with respect to these matters.

*Ernst + Young LLP*

February 28, 2019

Indiana University Health, Inc. and Subsidiaries

Consolidated Balance Sheets  
(Thousands of Dollars)

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 345,025	\$ 414,674
Short-term investments	57,591	5,081
Current portion of assets limited as to use	156,060	143,611
Patient accounts receivable	858,270	870,252
Other receivables	184,634	156,281
Prepaid expenses	58,638	46,026
Inventories	101,990	85,856
Total current assets	<u>1,762,208</u>	<u>1,721,781</u>
Assets limited as to use:		
Board-designated investment funds and other investments	5,139,501	4,791,654
Donor-restricted investment funds	90,247	88,239
Total assets limited as to use, less current portion	<u>5,229,748</u>	<u>4,879,893</u>
Property and equipment:		
Cost of property and equipment in service	5,566,805	5,536,733
Less accumulated depreciation	<u>(3,246,007)</u>	<u>(3,267,111)</u>
	2,320,798	2,269,622
Construction-in-progress	100,405	69,775
Total property and equipment, net	<u>2,421,203</u>	<u>2,339,397</u>
Other assets:		
Equity interest in unconsolidated subsidiaries	20,903	44,103
Interest in net assets of foundations	22,627	22,038
Goodwill, intangibles, and other assets	340,635	341,810
Total other assets	<u>384,165</u>	<u>407,951</u>
Total assets	<u>\$ 9,797,324</u>	<u>\$ 9,349,022</u>

Continued on next page.

Indiana University Health, Inc. and Subsidiaries

Consolidated Balance Sheets (continued)

(Thousands of Dollars)

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
<b>Liabilities and net assets</b>		
Current liabilities:		
Accounts payable and accrued expenses	\$ 492,667	\$ 525,199
Accrued salaries, wages, and related liabilities	347,550	296,053
Accrued health claims	69,898	95,844
Estimated third-party payer allowances	105,746	87,215
Current portion of long-term debt	52,550	100,105
Total current liabilities	<u>1,068,411</u>	<u>1,104,416</u>
Noncurrent liabilities:		
Long-term debt, less current portion	1,529,648	1,351,115
Interest rate swaps	43,700	75,813
Accrued pension obligations	15,134	10,134
Accrued medical malpractice claims	63,133	63,626
Other	35,638	33,876
Total noncurrent liabilities	<u>1,687,253</u>	<u>1,534,564</u>
Total liabilities	<u>2,755,664</u>	<u>2,638,980</u>
Net assets:		
Indiana University Health	6,663,366	6,368,314
Noncontrolling interest in subsidiaries	261,563	225,806
Total without donor restrictions	<u>6,924,929</u>	<u>6,594,120</u>
With donor restrictions	116,731	115,922
Total net assets	<u>7,041,660</u>	<u>6,710,042</u>
Total liabilities and net assets	<u><u>\$ 9,797,324</u></u>	<u><u>\$ 9,349,022</u></u>

See accompanying notes to consolidated financial statements.

Indiana University Health, Inc. and Subsidiaries

Consolidated Statements of Operations and Changes in Net Assets  
(Thousands of Dollars)

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
Revenues:		
Patient service revenue	\$ 5,845,074	\$ 5,450,223
Member premium revenue	343,383	584,927
Other revenue	239,385	305,944
Total operating revenues	<u>6,427,842</u>	6,341,094
Expenses:		
Salaries, wages, and benefits	3,126,015	2,911,996
Supplies, drugs, purchased services, and other	2,023,867	1,969,110
Hospital assessment fee	146,391	132,069
Health claims to providers	239,137	474,623
Depreciation and amortization	237,297	231,009
Interest	43,215	34,470
Total operating expenses	<u>5,815,922</u>	5,753,277
Operating income	<u>611,920</u>	587,817
Nonoperating (loss) income:		
Investment (loss) income, net	(202,401)	504,915
Gains on interest rate swaps, net	12,962	5,720
Inherent contribution of acquired entity	31,935	—
Debt extinguishment and other	(17,856)	2,280
Total nonoperating (loss) income	<u>(175,360)</u>	512,915
Consolidated excess of revenues over expenses	<u>436,560</u>	1,100,732
Less amounts attributable to noncontrolling interest in subsidiaries	<u>140,338</u>	111,483
Excess of revenues over expenses attributable to Indiana University Health and subsidiaries	<u><u>296,222</u></u>	<u>989,249</u>

Continued on next page.

Indiana University Health, Inc. and Subsidiaries

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

	Year Ended December 31, 2018		
	Total	Controlling	Noncontrolling
Without donor restriction:			
Consolidated excess of revenues over expenses	\$ 436,560	\$ 296,222	\$ 140,338
Change in pension obligations	(2,884)	(2,884)	–
Contributions for capital expenditures	833	833	–
Distributions to noncontrolling interests	(120,654)	–	(120,654)
Issuance of noncontrolling interests related to joint venture	17,292	–	17,292
Other	(338)	881	(1,219)
	<b>330,809</b>	<b>295,052</b>	<b>35,757</b>
With donor restriction:			
Change in beneficial interest in net assets of foundations	592	592	–
Contributions	7,363	7,363	–
Investment return	422	422	–
Change in split interest agreements	(1,219)	(1,219)	–
Net assets released from restrictions	(4,821)	(4,821)	–
Other	(1,528)	(1,528)	–
	<b>809</b>	<b>809</b>	<b>–</b>
Increase in net assets	<b>331,618</b>	<b>295,861</b>	<b>35,757</b>
Net assets at beginning of period	<b>6,710,042</b>	<b>6,484,236</b>	<b>225,806</b>
Net assets at end of period	<b>\$ 7,041,660</b>	<b>\$ 6,780,097</b>	<b>\$ 261,563</b>
	Year Ended December 31, 2017		
	Total	Controlling	Noncontrolling
Without donor restriction:			
Consolidated excess of revenues over expenses	\$ 1,100,732	\$ 989,249	\$ 111,483
Change in pension obligations	(1,098)	(1,098)	–
Contributions for capital expenditures	8,084	8,084	–
Distributions to noncontrolling interests	(133,231)	–	(133,231)
Contributions from noncontrolling interests	38,097	–	38,097
Other	(12,031)	(12,031)	–
	<b>1,000,553</b>	<b>984,204</b>	<b>16,349</b>
With donor restriction:			
Change in beneficial interest in net assets of foundations	8,263	8,263	–
Contributions	2,665	2,665	–
Investment return	3,919	3,919	–
Change in split interest agreements	838	838	–
Net assets released from restrictions	(3,437)	(3,437)	–
Other	14,437	14,437	–
	<b>26,685</b>	<b>26,685</b>	<b>–</b>
Increase in net assets	<b>1,027,238</b>	<b>1,010,889</b>	<b>16,349</b>
Net assets at beginning of period	<b>5,682,804</b>	<b>5,473,347</b>	<b>209,457</b>
Net assets at end of period	<b>\$ 6,710,042</b>	<b>\$ 6,484,236</b>	<b>\$ 225,806</b>

See accompanying notes to consolidated financial statements.



# Indiana University Health, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows (Thousands of Dollars)

	Year Ended December 31	
	2018	2017
<b>Operating activities</b>		
Increase in net assets	\$ 331,618	\$ 1,027,238
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in fair value of interest rate swaps	(16,987)	(16,427)
Change in pension liability	2,884	1,098
Gain in unconsolidated subsidiaries	(1,285)	(266)
Inherent contribution of acquired entity	(31,935)	-
Contributions from noncontrolling interests	-	(38,097)
Gain on sale of membership interests	(4,572)	(68,152)
Gain on sale of business unit	-	(25,285)
Depreciation and amortization	237,297	231,601
Amortization of deferred gain on sale of medical office buildings	(740)	(842)
Loss (gain) on extinguishment of debt	1,653	(17)
Contributions and investment return with donor restrictions	(7,158)	(15,686)
Distributions to noncontrolling interests	120,654	133,231
Assets limited as to use	(414,814)	(744,194)
Net changes in operating assets and liabilities:		
Patient accounts receivable	17,625	(94,072)
Other assets	(62,298)	(11,251)
Accounts payable, accrued liabilities, and other liabilities	(61,779)	(137,950)
Accrued salaries, wages, and related liabilities	49,475	54,537
Estimated third-party payer allowances	18,531	25,996
Net cash provided by operating activities	178,169	321,462
<b>Investing activities</b>		
Proceeds from sale of a business unit	-	25,763
Acquisition of subsidiary, net of cash received	9,243	(33,410)
Proceeds from exercise of put option in joint venture	19,980	-
Proceeds from sale of membership interests	-	49,108
Purchase of property and equipment, net of disposals	(295,035)	(188,702)
Net cash used in investing activities	(265,812)	(147,241)
<b>Financing activities</b>		
Increase in net assets with donor restrictions	7,158	15,686
Repayments on long-term debt	(224,976)	(314,961)
Proceeds from issuance of long-term debt	354,301	219,002
Proceeds from issuance of noncontrolling interests related to joint venture	17,292	-
Termination of swaps	(15,127)	-
Contributions from noncontrolling interests	-	38,097
Distributions to noncontrolling interests	(120,654)	(133,231)
Net cash provided by (used in) financing activities	17,994	(175,407)
Decrease in cash and cash equivalents	(69,649)	(1,186)
Cash and cash equivalents at beginning of period	414,674	415,860
Cash and cash equivalents at end of period	\$ 345,025	\$ 414,674

*See accompanying notes to consolidated financial statements.*

# Indiana University Health, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (Thousands of Dollars)

December 31, 2018 and 2017

### **Enterprise Vision:**

We will lead the transformation of healthcare through quality, innovation & education, and make Indiana one of the nation's healthiest states.

### **Promise:**

The Best Care, Designed for You.

### **Values:**

Purpose. Excellence. Compassion. Team.

## **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 in 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 Indianapolis Hospitals of the Academic Health Center) 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).

# Indiana University Health, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

### 1. Organization and Nature of Operations (continued)

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 as of December 31, 2018:

**Downtown Indianapolis 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.

**Suburban Indianapolis 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 West Hospital, Inc. (West), Indiana University Health Saxony Hospital (Saxony), Indiana University Health Tipton Hospital, Inc. (Tipton), and Rehabilitation Hospital of Indiana, Inc. (RHI).

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 1. Organization and Nature of Operations (continued)

**Statewide Facilities** – Consist of acute care hospitals and health care systems located in Lafayette, Monticello, Frankfort, Muncie, Hartford City, Portland, Bloomington, Bedford, and Paoli, Indiana. Principal hospital subsidiaries include Indiana University Health Arnett, Inc. (Arnett), Indiana University Health White Memorial Hospital, Inc. (White), Indiana University Health Frankfort Hospital, Inc. (Frankfort), Indiana University Health Ball Memorial Hospital, Inc. and subsidiaries (Ball Memorial) including Indiana University Health Blackford Hospital, Inc. (Blackford), Indiana University Health Jay, Inc. (Jay), Indiana University Health Bloomington, Inc. and subsidiaries (Bloomington), Indiana University Health Bedford, Inc. (Bedford), and Indiana University Health Paoli, Inc. (Paoli).

**Physician Operations** – Consist of physician offices and physician-group practices and clinics. Principal subsidiaries or divisions include Indiana University Health Physicians (IUHP), an organization with locations primarily in Indianapolis, Indiana, Indiana University Health Arnett Physicians, Indiana University Health Ball Memorial Physicians, Inc., Indiana University Health Fort Wayne, and Indiana University Health Southern Indiana Physicians, Inc.

**Ambulatory Care** – Consists of personal and home health care services, occupational health services, outpatient oncology services, outpatient surgery centers, and urgent care centers that 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, Indiana University Health Central Indiana Cancer Centers, Indiana University Health Morgan, surgery center joint ventures, and an urgent care center joint venture.

**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 fully-insured and self-insured members residing in Indiana. Insurance offerings include commercial group products (fully-insured and self-insured), Medicare Advantage products, and Medicaid management services. The Indiana University Health System also participates in the medical management of Medicare fee-for-service members through a NextGen Accountable Care Organization contract with the Centers for Medicare and Medicaid (CMS).

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 1. Organization and Nature of Operations (continued)

**Foundations** – Consist of three main entities which aid in carrying out the mission of the Indiana University Health System: Indiana University Health Foundation, Inc. (Indiana University Health Foundation), Ball Memorial Hospital Foundation, Inc. (BMH Foundation) and RHI Foundation, Inc. (RHI Foundation).

#### 2. Community Benefit

The Indiana University Health System provides health care services and financial support through various programs that are designed 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 benefit provided to the community, since a substantial portion of such services is reimbursed at amounts less than cost.

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 Jump IN for Healthy Kids and Playworks; other medical research, including support to the Indiana University Health Values Children's Fund; and the fostering of an internal community of trust, respect, and empowerment.

Through statewide facility-by-facility community health needs assessments, Indiana University Health identified and selected as priority community health needs on which Indiana University Health will focus on improving access to affordable health care, behavioral health, and obesity prevention. The costs of providing these programs and services are included in total operating expenses in the accompanying consolidated statements of operations and changes in net assets.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **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.

##### **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 treasury and agency 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**

Patient service revenue and patient accounts receivable are reported at the amount that reflects the consideration to which the Indiana University Health System expects to be entitled in exchange for providing patient care.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **Inventories**

Inventories consist primarily of drugs and supplies, are stated at the lower of cost or net realizable value, 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 and (ii) donor-restricted investment assets, the use of which has been specified by the donor. 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 income (loss) within investment income (loss) 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. Management has utilized the best available information for reported alternative investment values, which in some instances are valuations as of an interim date.

##### **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 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.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **3. Summary of Significant Accounting Policies (continued)**

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.

The Indiana University Health System has joint venture arrangements for health care-related services. Total equity interest in unconsolidated subsidiaries was \$20,903 and \$44,103 as of December 31, 2018 and 2017, respectively. The Indiana University Health System has recorded its interest in the income of its unconsolidated subsidiaries within other operating revenue on the consolidated statements of operations and changes in net assets.

#### **Goodwill and Intangible Assets**

In connection with business combinations, the Indiana University Health System has recorded goodwill and definite-lived intangible assets in 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 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.



## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **3. Summary of Significant Accounting Policies (continued)**

The Indiana University Health System also reviews whether 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 2018 or 2017. Intangible assets included in other assets in the accompanying consolidated balance sheets as of December 31, 2018 and 2017 were \$216,140 and \$219,632, respectively, which includes goodwill of \$196,646 and \$196,581, 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 9).

#### **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, 2018 and 2017, 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 income (loss) in the consolidated statements of operations and changes in net assets.

#### **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 donor 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.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **Noncontrolling Interest in Subsidiaries**

The Indiana University Health System recorded \$140,338 and \$111,483 for the years ended December 31, 2018 and 2017, respectively, of excess of revenues over expenses attributable to noncontrolling interest in subsidiaries 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 surgery center joint ventures. For the years ended December 31, 2018 and 2017, the surgery center joint ventures accounted for \$141,126 and \$129,808, respectively, of the excess of revenues over expenses attributable to noncontrolling interest in subsidiaries. The surgery center joint ventures realized operating revenue of \$335,672 and \$308,261 and operating income of \$190,252 and \$175,119 in 2018 and 2017, respectively. The operating revenue and operating income are reflected in total operating revenue and total operating income, respectively, on the consolidated statements of operations and changes in net assets.

##### **Net Assets with Donor Restriction**

Donor 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 16). 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 assets and liabilities based upon the relative fair value, which may be derived from various observable or unobservable inputs and assumptions. Also, the Indiana University Health System may use 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 are recorded as an inherent contribution within the performance indicator as defined below. Goodwill is recorded to the extent that liabilities assumed and noncontrolling interests exceed the fair value of assets acquired.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **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 payer 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 payer 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 6, 9, 10, and 11.

##### **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, 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.

##### **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). Indiana University Health and its tax-exempt affiliates are, however, subject to federal and state income taxes on unrelated business income under the provisions of IRC Section 511.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 3. Summary of Significant Accounting Policies (continued)

The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017. For tax-exempt entities, TCJA requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income subject to tax, pay an excise tax on compensation above certain thresholds, and record income or losses for tax determination purposes from unrelated business activities on an activity-by-activity basis, among other provisions. Regulations necessary to implement certain aspects of TCJA are expected to be promulgated by the IRS in 2019. As of and for the year ended December 31, 2018, Indiana University Health has made reasonable estimates of the provision for income taxes, the compensation excise tax, and the effects, if any, on existing deferred tax balances based on accounting guidance included in Accounting Standards Codification (ASC) 740, *Income Taxes*. Indiana University Health will continue to refine its calculations in future periods, as additional regulations and guidance are issued by the IRS.

Deferred income taxes which, as of December 31, 2018 and 2017, have no net carrying value, reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting and the amounts used for income tax purposes. As of December 31, 2018 and 2017, the Indiana University Health System had gross deferred tax assets of \$119,965 and \$93,794, respectively, primarily relating to net operating loss carryovers. Management determined that a full valuation allowance at December 31, 2018 and 2017 was necessary to reduce the deferred tax assets to the amount that would more likely than not be realized. ASC Topic 740-10-50-3, *Income Taxes: Disclosure*, requires a valuation allowance to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. The change in the valuation allowance for the current year is \$26,171. At December 31, 2018, the Indiana University Health System has available net operating loss carryforwards of \$482,349. Net operating losses generated from 1999 through 2017 will expire between 2019 and 2037. Net operating losses generated during 2018 do not expire.

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.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 3. Summary of Significant Accounting Policies (continued)

##### 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 interest rate swaps, unrestricted activities of wholly-owned foundations, gain or loss on the extinguishment of debt, loss on deconsolidation, 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 (loss). The performance indicator excludes certain changes in pension obligations and contributions for capital expenditures, distributions, and net assets released from restricted funds.

##### Subsequent Events

For the consolidated financial statements as of and for the year ended December 31, 2018, management has evaluated subsequent events through February 28, 2019, the date that these consolidated financial statements were issued.

##### Reclassifications

Certain amounts in the 2017 consolidated financial statements have been reclassified to conform to the 2018 presentation. Such reclassifications had no effect on previously reported excess of revenues over expenses or net assets.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 3. Summary of Significant Accounting Policies (continued)

##### Recent Accounting Pronouncements Adopted

Effective October 1, 2018, Indiana University Health adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2018-15 *Intangibles – Goodwill and Other, Internal-Use Software (Subtopic 250-40), Customer’s Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That is a Service Contract*, and began capitalizing implementation costs associated with cloud computing arrangements that are classified as services contracts.

Effective January 1, 2018, Indiana University Health retrospectively adopted FASB ASU No. 2017-07, *Compensation – Retirement Benefits (Topic 715)*, and presented all other components of net periodic pension and post retirement costs other than the service cost component as nonoperating (loss) income within the consolidated statements of operations and changes in net assets. As the Indiana University Health pension plans are frozen, no services costs are incurred. Refer to Note 14 for the components of net periodic pension cost recorded within nonoperating income (loss) within the consolidated statements of operations and changes in net assets.

Effective December 31, 2018, Indiana University Health adopted FASB ASU No. 2016-14, *Presentation of Financial Statements of Not-for-Profit Entities (Topic 958)*. This ASU changes certain financial statement requirements for not-for-profit entities in an effort to make the information more meaningful to users and reduced reporting complexity. Indiana University Health adopted the ASU and has adjusted the presentation in these consolidated financial statements accordingly (see Notes 7 and 15). The ASU has been applied retrospectively to all periods presented. The adoption of this ASU did not result in changes to previously reported net assets, other than presentation.

Effective January 1, 2018, Indiana University Health adopted FASB ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, using the full retrospective method of transition. This ASU converged and replaced existing revenue recognition guidance, including industry-specific guidance and requires revenue to be recognized in an amount that reflects the consideration the entity expects to be entitled in an exchange of goods or services. The adoption of this ASU did not result in changes to previously reported revenues, other than presentation.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **3. Summary of Significant Accounting Policies (continued)**

##### **New Accounting Guidance Not Yet Applicable**

In June 2018, the FASB issued ASU No. 2018-08, *Not-for-Profit Entities – Clarifying the Scope and Accounting Guidance for Contributions Received and Contributions Made (Topic 958)*. This ASU provides a more robust framework to determine when a transaction should be accounted for as a contribution or as an exchange transaction and provides additional guidance about how to determine whether a contribution is conditional. This ASU is effective January 1, 2019, and Indiana University Health is evaluating the effect of this ASU on its consolidated financial statements.

In November 2016, the FASB issued ASU 2016-18, *Restricted Cash*. This ASU adds and clarifies guidance in the presentation of changes in restricted cash on the statement of cash flows and requires restricted cash to be included with cash and cash equivalents in the statement of cash flows. The ASU does not provide a definition of restricted cash and is effective January 1, 2019. Indiana University Health is still evaluating the impact of this guidance on the consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*. This ASU adds or clarifies guidance on the classification of certain cash receipts and payments in the statement of cash flows. The ASU is effective for Indiana University Health beginning January 1, 2019 and will result only in presentation changes within the consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, *Leases (Topic 842)*. This ASU requires the rights and obligations arising from the lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. The ASU will require disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. This ASU is effective for Indiana University Health beginning January 1, 2019 and will be applied using a modified retrospective approach. The primary effect of adopting the ASU will be to record right-of-use assets and obligations for current operating leases. Indiana University Health is currently evaluating the effect of adoption on its consolidated financial statements.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **4. Patient Service Revenue, Other Operating Revenue and Uncompensated Care**

The Indiana University Health System provides health care services through inpatient, outpatient, and ambulatory care facilities. The Indiana University Health System recognizes patient service revenue at the amount that reflects the consideration to which the Indiana University Health System expects to be paid for providing patient care. Patient service revenue is recognized as performance obligations based on the nature of the services provided by the Indiana University Health System are satisfied. Performance obligations satisfied over time relate to patients in the Indiana University Health System hospitals who are receiving inpatient acute care services from admission to the point when services are no longer required, which is generally at the time of discharge.

Revenue for performance obligations satisfied over time is recognized based on actual charges incurred in relation to total expected or actual charges. Outpatient services are performance obligations satisfied at a point in time, and revenue is recognized when goods or services are provided. The Indiana University Health System does not believe it is required to provide additional goods or services. Management believes this method provides a fair depiction of the transfer of services over the term of performance obligations, based on the inputs needed to satisfy the obligations.

Because all of its performance obligations relate to contracts with a duration of less than one year, the Indiana University Health System has elected to apply the optional exemption provided in FASB ASC 606-10-50-14(a) and, therefore, is not required to disclose the aggregate amount of the transaction price allocated to performance obligations that are unsatisfied or partially satisfied at the end of the reporting period. The unsatisfied or partially unsatisfied performance obligations referred to above are primarily related to inpatient acute care services at the end of the reporting period. The performance obligations for these contracts are generally completed when the patients are discharged, which generally occurs within days or weeks of the end of the reporting period.

The Indiana University Health System uses a portfolio approach to account for categories of patient contracts as a collective group, rather than recognizing revenue on an individual contract basis. The portfolios consist of major payer classes for inpatient revenue and outpatient revenue. Based on the historical collection trends and other analysis, the Indiana University Health System believes that revenue recognized by utilizing the portfolio approach approximates the revenue that would have been recognized if an individual contract approach were used.



## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **4. Patient Service Revenue, Other Operating Revenue and Uncompensated Care (continued)**

The Indiana University Health System determines the transaction price, which involves significant estimates and judgment, based on standard charges for goods and services provided, reduced by explicit and implicit price concessions, including contractual adjustments provided to third-party payers, discounts provided to uninsured and underinsured patients in accordance with policy and/or implicit price concessions based on the historical collection experience of patient accounts. The Indiana University Health System determines the transaction price associated with services provided to patients who have third-party payer coverage with Medicare, Medicaid, managed care programs, and other third-party payers based on reimbursement terms per contractual agreements, discount policies, and historical experience. Payment arrangements with those payers include prospectively determined rates per admission or visit, reimbursed costs, discounted charges, per diem rates, and value based payments. Reported costs and/or services provided under certain arrangements are subject to retroactive audit and adjustment. In 2018 and 2017, changes in estimates due to settlements of prior fiscal years' cost reports, Medicaid settlements, and the disposition of other payer audits and settlements were not significant. Future changes in Medicare and Medicaid programs and reduction in funding levels could have an adverse effect on the Indiana University Health System. There were no other significant changes to the judgments used to determine the transaction price in prior periods.

The Indiana University Health System serves Medicaid patients and is subject to reimbursement under various programs. Under the Medicaid Hospital Assessment Fee (HAF) program the Office of Medicaid Policy and Planning (OMPP) collects a fee from eligible hospitals. The fee is used in part to increase reimbursement to eligible hospitals for services provided in both Medicaid fee-for-service and managed care programs, and as the state share of Medicaid Disproportionate Share Hospital (DSH) payments. Separately the upper payment limit (UPL) reimbursement program, now known as the Physician Faculty Access to Care (PFAC) program, was established to pay qualifying providers the difference between what Medicare would have paid and what Medicaid actually paid. The state DSH program 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.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **4. Patient Service Revenue, Other Operating Revenue and Uncompensated Care (continued)**

For the years ended December 31, 2018 and 2017, payments received related to these programs were recorded within patient service revenue in the consolidated statements of operations and changes in net assets, totaling \$473,212 and \$382,886, respectively. During the years ended December 31, 2018 and 2017, assessment fees were recorded within the hospital assessment fee line on the consolidated statements of operations and changes in net assets totaling \$146,391 and \$132,069, respectively.

These revenues are subject to retroactive adjustments due to audits, reviews, change in program administration and rules, and outcome of litigation. These settlements are estimated based on the agreement with the payer and correspondence, which includes an assessment to ensure it is probable that a significant reversal in the amount of cumulative revenue recognition will not occur when the uncertainty associated with the retroactive adjustments is subsequently resolved.

Laws and regulations governing Medicare, Medicaid, and other governmental programs are complex and subject to varying interpretation. The Indiana University Health System believes it is in compliance with applicable laws and regulations governing Medicare, Medicaid, and other governmental programs, as well as contracts that it has with commercial payers and that adequate provisions have been recorded for any adjustments that may result from final settlements.

In support of its mission, the Indiana University Health System provides care to uninsured and underinsured patients. The Indiana University Health System provides charity care to patients who lack financial resources and are deemed to be medically indigent. Under its financial assistance policy, the Indiana University Health System provides medically necessary care to uninsured patients with inadequate financial resources at charitable discounts equivalent to the amounts generally billed, and it provides eligibility for full charity for emergent encounters for uninsured patients who earn less than 200% of the federal poverty level and who meet application criteria. Patients whose liability is deemed catastrophic relative to their annual household income are also eligible for reduced charges. Since the Indiana University Health System does not pursue collection of these amounts, the discounted amounts are not reported as patient service revenue. The Indiana University Health System uses presumptive eligibility screening procedures for free care and recognizes net patient service revenue on services provided to self-pay patients at the discounted rate at the time services are rendered. The estimated cost of charity care, using the consolidated cost to charge ratio, was \$94,886 and \$85,295 in 2018 and 2017, respectively.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Thousands of Dollars)*

**4. Patient Service Revenue, Other Operating Revenue and Uncompensated Care  
 (continued)**

In rare instances, the Indiana University Health System receives payment in advance of the services provided and considers these amounts to represent contract liabilities. Contract liabilities at December 31, 2018 were not significant.

Management has determined that the nature, amount, timing, and uncertainty of revenue and flows are affected by the payers and line of business that render services to patients. The composition of patient service revenue by payer was as follows:

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
Commercial/managed care	<b>\$ 3,385,628</b>	\$ 3,201,523
Medicare	<b>1,419,593</b>	1,325,409
Medicaid	<b>920,769</b>	794,948
Self-pay and other	<b>119,084</b>	128,343
	<b><u>\$ 5,845,074</u></b>	<b><u>\$ 5,450,223</u></b>

The Indiana University Health System's practice is to assign a patient to the primary payer and not reflect other uninsured balances (for example, co-pays and deductibles) as self pay. Therefore, the payers listed above contain patient responsibility components, such as co-pays and deductibles.

One managed care payer represented 31% and 33% of patient service revenue for 2018 and 2017, respectively.

The Indiana University Health System does not require collateral or other security from its patients, substantially all of whom are residents of the State, for the delivery of health care services. However, consistent with industry practice, the Indiana University Health System routinely obtains assignment of (or is otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans or policies (e.g., Medicare, Medicaid, managed care payers, and commercial insurance policies). As of December 31, 2018 and 2017, 30% and 33% of patient accounts receivable were collectible from government payers. The remaining 70% and 67% of patient accounts receivable in 2018 and 2017, respectively, were collectible from managed care payers, commercial insurance payers, and uninsured and underinsured patients.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 4. Patient Service Revenue, Other Operating Revenue and Uncompensated Care (continued)

Other revenue is recognized at an amount that reflects the consideration to which the Indiana University Health System expects to be entitled in exchange for providing goods and services. The amounts recognized reflect consideration due from customers, third-party payers, and others. Primary categories of other revenue include income from joint ventures, grant revenue, cafeteria revenue, rent and lease revenue, shared professional revenue, and other.

The composition of other revenue by sources is as follows:

	Year Ended December 31	
	2018	2017
Shared health services revenue	\$ 133,601	\$ 131,215
Gain on sale of dialysis business	–	25,285
Gain on sale of MDwise	4,572	68,152
Other	101,212	81,292
	<u>\$ 239,385</u>	<u>\$ 305,944</u>

#### 5. Significant Transactions

##### Fort Wayne

On August 17, 2018, Indiana University Health formed a joint venture, Indiana University Health Fort Wayne, LLC (Fort Wayne), and contributed \$35,708 to be the majority partner, owning 67.37% of the joint venture. Fort Wayne will allow Indiana University Health to enhance and improve the delivery of cost effective, quality health care services in and around the greater Fort Wayne, Indiana area.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **5. Significant Transactions (continued)**

##### **MDwise**

Indiana University Health held 50% membership interests in both MDwise, Inc. and MDwise Medicaid Network, Inc., with Health and Hospital Corporation of Marion County holding the other 50% membership interest. Effective December 29, 2017, all membership interest in MDwise, Inc. and MDwise Medicaid Network, Inc. was sold to Michigan-based McLaren Health Care, resulting in a gain of \$68,152 recognized in other revenue on the consolidated statement of operations and changes in net assets. Indiana University Health recognized an additional gain of \$4,572 during 2018 related to the sale.

Indiana University Health continued to provide care to certain members on a capitated basis through December 31, 2018. Beginning January 1, 2019, Indiana University Health will be reimbursed for these services on a fee for service basis.

##### **LaPorte**

Effective August 10, 2018, Indiana University Health sold its remaining 20% investment in LaPorte Health System to Frankfort Health Partner, Inc. (a subsidiary of Community Health Systems, Inc.) for \$19,980.

##### **Jay**

Effective March 1, 2018, Jay County Hospital, a 25-bed critical access hospital located in Portland, Indiana, transferred substantially all of its assets and liabilities to Indiana University Health Jay, Inc., a newly created nonprofit organization, and Indiana University Health became the sole corporate member. Indiana University Health recorded the assets acquired and the liabilities assumed, measured at fair value as of the date of acquisition, and recognized an inherent contribution of \$31,935 on the consolidated statement of operations and changes in net assets.

##### **Dialysis Business**

On June 1, 2017, Indiana University Health sold two outpatient hemodialysis in-center units in downtown Indianapolis and a home dialysis program to ISD Renal, Inc. a subsidiary of DaVita, Inc. for \$25,763 and recognized a gain of \$25,285 in other revenue on the consolidated statement of operations and changes in net assets.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 5. Significant Transactions (continued)

##### Frankfort

Effective June 1, 2017, Indiana University Health entered into an agreement with Clinton County to lease and operate Frankfort Hospital, a 25-bed county-owned critical access hospital, and the affiliated medical offices located in Clinton County, Indiana with an annual minimum payment of \$1,000.

#### 6. 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 are generally determined by third-party valuation firms and/or 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.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **6. Assets Limited as to Use (continued)**

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. 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, 2018 and 2017, there were \$328,469 and \$434,660, respectively, of unfunded commitments relating to private fund investments, which are expected to be funded over the next five years.

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 \$285,926 at December 31, 2018, and there are no investments in any individual fund greater than 38.36% of that fund's net assets. Changes in the value of these funds are included in nonoperating income (loss) in the accompanying consolidated statements of operations and changes in net assets.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**6. Assets Limited as to Use (continued)**

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

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Assets limited as to use:		
Cash and cash equivalents	\$ 80,983	\$ 130,530
Debt securities:		
Asset backed	157,642	107,600
Bank loans	231,392	238,242
Corporate debt	274,872	253,876
Government and agencies	235,016	152,561
Bond funds	385,670	376,148
Total debt securities	<u>1,284,592</u>	<u>1,128,427</u>
Equity securities:		
Domestic equities	78,925	58,232
Domestic equity funds	880,980	874,683
International equities	98,434	72,751
International equity funds	747,074	765,607
Total equity securities	<u>1,805,413</u>	<u>1,771,273</u>
Commodities	190,794	197,906
Alternatives:		
Hedge funds	1,429,178	1,422,190
Private funds	594,848	373,178
Total alternatives	<u>2,024,026</u>	<u>1,795,368</u>
Less current portion of assets limited as to use	<u>(156,060)</u>	<u>(143,611)</u>
Total assets limited as to use	<u><u>\$ 5,229,748</u></u>	<u><u>\$ 4,879,893</u></u>



Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Thousands of Dollars)*

**6. Assets Limited as to Use (continued)**

Assets limited as to use include funds held by the foundations whose fair values as of December 31, 2018 aggregated \$158,000, of which \$67,753 is considered board-designated investment funds and \$90,247 is considered donor-restricted investment funds. Assets limited as to use include funds held by the foundations whose fair values as of December 31, 2017 aggregated \$188,614, of which \$100,375 is considered board-designated investment funds and \$88,239 is considered donor-restricted investment funds.

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

	<b>Year Ended December 31</b>	
	<b>2018</b>	<b>2017</b>
Investment income:		
Interest and dividend income	\$ 98,248	\$ 75,568
Investment management and administrative fees	(10,432)	(10,118)
Realized gains on sale of investments, net	8,622	66,193
Unrealized (losses) gains on investments	(269,021)	298,720
Unrealized equity (losses) gains on alternative investments	(29,818)	74,552
	<u>\$ (202,401)</u>	<u>\$ 504,915</u>

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 7. Financial Assets and Liquidity Reserves

The table below represents financial assets and liquidity resources available for general expenditures within one year as of December 31, 2018 and 2017. The Indiana University Health System defines general expenditures as the normal expenditures related to operations of the Indiana University Health System, excluding capital expenditures.

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Financial assets:		
Cash and cash equivalents	\$ 345,025	\$ 414,674
Short-term investments	57,591	5,081
Patient accounts receivable	858,270	870,252
Other receivables	184,634	156,281
Assets limited as to use	5,385,808	5,023,504
Total financial assets	<b>6,831,328</b>	6,469,792
Liquidity resource:		
Unused bank lines of credit	<b>226,000</b>	55,000
Less amounts not available within one year or not designated for general expenditures:		
Alternative investments	<b>(751,100)</b>	(528,745)
Other	<b>(168,027)</b>	(195,658)
Financial assets not available for use within one year	<b>(919,127)</b>	(724,403)
Financial assets and liquidity resources available for general expenditures within one year	<b>\$ 6,138,201</b>	\$ 5,800,389

The Indiana University Health System has certain board-designated assets limited as to use which are available for general expenditures within one year in the normal course of operations. Indiana University Health System maintains a liquidity pool with a target range of \$350,000 to \$550,000, which is comprised of zero to three years fixed-income securities and cash equivalents. Alternative investments not available within one year consist of the private funds due to their nature, as well as a portion of the hedge funds based on contractual restrictions which prevent redemption of all or portions of such funds within a year. Additionally, the “Other” category above includes board-designated investments within the general liability captive insurance program, foundation assets not available within one year or for general expenditures, and other restricted cash.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 8. Property and Equipment

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

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Land and improvements	\$ 242,460	\$ 238,098
Buildings and improvements	3,213,855	3,154,153
Equipment	2,110,490	2,144,482
	<u>\$ 5,566,805</u>	<u>\$ 5,536,733</u>

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.

Construction-in-progress for assets currently under development was \$100,405 and \$69,775 at December 31, 2018 and 2017, respectively, and includes commitments for the construction, refurbishment, and replacement of facilities and equipment.

Firm commitments for construction-in-progress totaled \$242,323 at December 31, 2018.

Certain buildings, equipment, and software are accounted for as capital leases expiring in various years through 2022 and are included in property and equipment. Amortization of assets under capital leases is included in depreciation expense (see Note 9).

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 9. 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: (i) the Indiana University Health Obligated Group includes Indiana University Health (entity that includes divisions such as the Downtown Indianapolis Hospitals of the Academic Health Center, Saxony, and Morgan) as the sole member and (ii) the Rehabilitation Hospital of Indiana Obligated Group includes RHI as the sole member. 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 MTI. 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, 2018, the Indiana University Health System was in compliance with all financial covenants.

##### Issuance, Modification, and Extinguishment of Debt

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.

On April 17, 2018, Indiana University Health issued \$354,000 in par value of Series 2018A taxable, fixed-rate bonds. A portion of the proceeds was used to advance refund \$60,500 in par amount of the Indiana Finance Authority Hospital Revenue Bonds, Series 2011N (Indiana University Health Obligated Group), to refinance all of the Indiana Finance Authority Hospital Revenue Bonds, Series 2015C (Indiana University Health Obligated Group) in the amount of \$50,000, and to repay the balance on Indiana University Health's revolving commercial bank line of credit in the amount of \$50,000. Remaining proceeds were used to finance the termination payments related to certain interest rate swaps and for general corporate purposes.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Thousands of Dollars)*

#### **9. Debt (continued)**

On October 12, 2017, through the Indiana Finance Authority, Indiana University Health amended its 2011 Series H & I tax exempt, variable-rate, direct-purchase bonds changing both the variable rate and principal repayment schedule. Indiana University Health sold the bonds to a new direct purchaser with the expiration date of the direct-purchase agreement being the same date as the final maturity of the bonds.

As of December 31, 2018 and 2017, the Indiana University Health System maintained several lines of credit totaling \$226,000 and \$105,000, respectively. As of December 31, 2018, no amounts are drawn on the lines of credit. As of December 31, 2017, the total balance drawn on the lines of credit was \$50,000, which was included in the current portion of long-term debt, as the line of credit associated with the drawn balance had an expiration date of June 30, 2018. The balance on the line was repaid in April 2018 in conjunction with the issuance of the Series 2018A bonds.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**9. Debt (continued)**

Long-term debt consists of the following:

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
<b>Indiana University Health Obligated Group</b>		
Fixed-Rate, Taxable Bonds, Series 2018A, payable in a single principal installment at maturity in 2048, with an interest rate of 3.97% at December 31, 2018	\$ 354,000	\$ –
Indiana Finance Authority:		
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2016A Serial Bonds, payable in varying principal installments through 2025, with an interest rate of 5.00% at December 31, 2018	141,435	150,020
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, 2018	287,395	287,395
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2014A Serial Bonds, payable in varying principal installments through 2030, with an interest rate of 5.00% at December 31, 2018	52,185	58,230
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2011N Serial Bonds, payable in varying principal installments through 2021, with interest rates ranging from 3.50% to 5.00% at December 31, 2018	45,710	122,935
Variable-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2011A, B, C, D, E, H, I, L, and M, Series 2015B, and Series 2016B and C, payable in varying principal installments through 2046, with variable interest rates ranging from 1.63% to 2.26% at December 31, 2018	634,970	698,470
Variable Rate Commercial Bank Revolving Line of Credit, maturing in 2023	–	50,000
<b>Rehabilitation Hospital of Indiana Obligated Group</b>		
Indiana Finance Authority: Fixed-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2011A, payable in varying principal installments through 2031, with an interest rate of 2.22% at December 31, 2018	12,260	13,000
<b>Other debt</b>		
Capital lease obligations	2,139	3,023
Other	8,149	11,581
Total long-term debt	<b>1,538,243</b>	1,394,654
Unamortized premium, net of unamortized discount	51,671	62,451
Unamortized bond issuance costs	(7,716)	(5,885)
Less current portion	(52,550)	(100,105)
Long-term debt, less current portion	<b>\$ 1,529,648</b>	<b>\$ 1,351,115</b>

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**9. Debt (continued)**

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

	<b>Indiana University Health Obligated Group MTI Debt</b>	<b>RHI Obligated Group MTI Debt</b>	<b>Other</b>	<b>Total</b>
Year ending December 31:				
2019	\$ 47,360	\$ 789	\$ 4,401	\$ 52,550
2020	50,295	840	3,667	54,802
2021	54,945	890	1,071	56,906
2022	53,650	905	835	55,390
2023	56,495	920	381	57,796
Thereafter	1,252,883	7,916	–	1,260,799
	<u>\$ 1,515,628</u>	<u>\$ 12,260</u>	<u>\$ 10,355</u>	<u>\$ 1,538,243</u>

Total interest paid on long-term debt for the years ended December 31, 2018 and 2017 aggregated \$50,014 and \$41,820, respectively.

**10. 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, 2018:

<b>Notional Amount</b>	<b>Effective Date</b>	<b>Maturity Date</b>	<b>Rate Received<sup>A</sup></b>	<b>Rate Paid</b>
\$ 54,075	6/23/2011	3/1/2036	62.30% LIBOR plus 0.24%	2.68%
63,950	11/15/2005	2/15/2030	62.30% LIBOR plus 0.24%	3.35%
64,225	6/20/2011	2/15/2030	62.30% LIBOR plus 0.24%	3.35%
17,098	6/16/2011	3/01/2033	LIBOR	4.92%
68,390	6/16/2011	3/01/2033	LIBOR	4.92%
3,400	1/27/2006	11/02/2020	SIFMA	3.98%

(A) In the tables above and below, LIBOR represents London Interbank Offered Rate and SIFMA represents Securities Industry and Financial Markets Association

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 10. Derivative Financial Instruments (continued)

After giving effect to the above derivative transactions, the Indiana University Health System's variable-rate debt was approximately 23.0% and 24.4% of total debt outstanding as of December 31, 2018 and 2017, 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, 2018 as follows:

Notional Amount	Effective Date	Maturity Date	Swap Type	Rate Received	Rate Paid
\$ 140,446	3/10/2021	2/15/2033	Forward starting basis	75.00% three-month LIBOR minus 0.05%	SIFMA
309,200	3/10/2021	1/7/2033	Forward starting basis	75.00% three-month LIBOR minus 0.04%	SIFMA
309,200	1/7/2020	1/7/2033	Forward starting basis	75.00% one-month LIBOR	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, 2018, the fair value of interest rate swaps was a liability of \$43,700, which is net of CVA of \$2,475. As of December 31, 2017, the fair value of interest rate swaps was a liability of \$75,813, which is net of CVA of \$3,536. The fair values of the swaps have been included with noncurrent liabilities in the accompanying consolidated balance sheets.

As of December 31, 2018, interest rate swaps had a total notional amount of \$1,029,984, including \$271,138 of fixed-pay swaps and \$758,846 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. As of December 31, 2018, all interest rate swaps were subject to credit-risk-related contingent features. As of December 31, 2017, interest rate swaps in a liability position with aggregate market value of \$63,996 were subject to credit-risk-related contingent features. No collateral was posted as of December 31, 2018 or 2017.



## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 10. Derivative Financial Instruments (continued)

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

	Year Ended December 31	
	2018	2017
Gains on interest rate swaps, net:		
Unrealized gains on interest rate swaps	\$ 32,114	\$ 16,427
Realized losses on interest rate swaps	(19,152)	(10,707)
	<u>\$ 12,962</u>	<u>\$ 5,720</u>

During April 2018, Indiana University Health terminated four fixed-pay interest rate swaps in the aggregate notional amount of \$103,850 for a one-time cash payment (outflow) of \$15,127, after which no payments or other amounts are owed to either party with respect to these swaps.

#### 11. Fair Value Measurements

The accounting guidance for the application of fair value provides, among other matters, for the following: (i) 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, (ii) 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, (iii) requires consideration of nonperformance risk when valuing liabilities, and (iv) 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.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### 11. Fair Value Measurements (continued)

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.
- 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.
- Net Asset Value (NAV) – Indiana University Health invests in funds for which the NAV per share represents the fair value of the investment held. Risks and redemption restrictions for these investments are similar to the alternative investments (see Note 6). Management opted to use the NAV per share, or its equivalent, as a practical expedient for the fair value of the interest in certain funds. Valuations provided by the respective fund's management consider variables, such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**11. Fair Value Measurements (continued)**

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, 2018 and 2017. 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.

	December 31, 2018						Equity Method	Carrying Value
	Level 1	Level 2	Level 3	NAV	Fair Value			
<b>Assets</b>								
Cash and cash equivalents	\$ 345,025	\$ -	\$ -	\$ -	\$ 345,025	\$ -	\$ 345,025	
Short-term investments:								
Debt securities:								
Asset backed	-	565	-	-	565	-	565	
Corporate debt	-	23,363	-	-	23,363	-	23,363	
Government and agencies	33,663	-	-	-	33,663	-	33,663	
Assets limited as to use:								
Cash and cash equivalents	80,983	-	-	-	80,983	-	80,983	
Debt securities:								
Asset backed	-	156,644	998	-	157,642	-	157,642	
Bank loans	-	230,812	580	-	231,392	-	231,392	
Corporate debt	-	274,493	379	-	274,872	-	274,872	
Government and agencies	235,016	-	-	-	235,016	-	235,016	
Bond funds	135,562	-	-	250,108	385,670	-	385,670	
Equity securities:								
Domestic equities	78,925	-	-	-	78,925	-	78,925	
Domestic equity funds	158,735	-	-	722,245	880,980	-	880,980	
International equities	98,434	-	-	-	98,434	-	98,434	
International equity funds	168,304	-	-	578,770	747,074	-	747,074	
Commodities	190,794	-	-	-	190,794	-	190,794	
Alternatives:								
Hedge funds	-	-	-	-	-	1,429,178	1,429,178	
Private funds	-	-	-	-	-	594,848	594,848	
Beneficial interests in charitable remainder and perpetual trusts	-	13,013	-	-	13,013	-	13,013	
<b>Total cash and investments</b>	<b>\$ 1,525,441</b>	<b>\$ 698,890</b>	<b>\$ 1,957</b>	<b>\$ 1,551,123</b>	<b>\$ 3,777,411</b>	<b>\$ 2,024,026</b>	<b>\$ 5,801,437</b>	
<b>Liabilities</b>								
Interest rate swaps	\$ -	\$ 43,700	\$ -	\$ -	\$ 43,700	\$ -	\$ 43,700	
<b>Total liabilities measured at fair value on a recurring basis</b>	<b>\$ -</b>	<b>\$ 43,700</b>	<b>\$ -</b>	<b>\$ -</b>	<b>\$ 43,700</b>	<b>\$ -</b>	<b>\$ 43,700</b>	

# Indiana University Health, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

### 11. Fair Value Measurements (continued)

	December 31, 2017						Equity Method	Carrying Value
	Level 1	Level 2	Level 3	NAV	Fair Value			
<b>Assets</b>								
Cash and cash equivalents	\$ 414,674	\$ –	\$ –	\$ –	\$ 414,674	\$ –	\$ 414,674	
Short-term investments:								
Corporate debt	–	5,081	–	–	5,081	–	5,081	
Assets limited as to use:								
Cash and cash equivalents	130,530	–	–	–	130,530	–	130,530	
Debt securities:								
Asset backed	–	106,700	900	–	107,600	–	107,600	
Bank loans	–	224,414	13,828	–	238,242	–	238,242	
Corporate debt	–	253,852	24	–	253,876	–	253,876	
Government and agencies	152,561	–	–	–	152,561	–	152,561	
Bond funds	163,075	–	–	213,073	376,148	–	376,148	
Equity securities:								
Domestic equities	58,232	–	–	–	58,232	–	58,232	
Domestic equity funds	215,690	–	–	658,993	874,683	–	874,683	
International equities	72,751	–	–	–	72,751	–	72,751	
International equity funds	210,022	–	–	555,585	765,607	–	765,607	
Commodities	197,906	–	–	–	197,906	–	197,906	
Alternatives:								
Hedge Funds	–	–	–	–	–	1,422,190	1,422,190	
Private Funds	–	–	–	–	–	373,178	373,178	
Beneficial interests in charitable remainder and perpetual trusts	–	10,307	–	–	10,307	–	10,307	
<b>Total cash and investments</b>	<b>\$ 1,615,441</b>	<b>\$ 600,354</b>	<b>\$ 14,752</b>	<b>\$ 1,427,651</b>	<b>\$ 3,658,198</b>	<b>\$ 1,795,368</b>	<b>\$ 5,453,566</b>	
<b>Liabilities</b>								
Interest rate swaps	\$ –	\$ 75,813	\$ –	\$ –	\$ 75,813	\$ –	\$ 75,813	
<b>Total liabilities measured at fair value on a recurring basis</b>	<b>\$ –</b>	<b>\$ 75,813</b>	<b>\$ –</b>	<b>\$ –</b>	<b>\$ 75,813</b>	<b>\$ –</b>	<b>\$ 75,813</b>	

The fair value of cash and cash equivalents 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 Level 3 trading securities is based on historical costs provided by a third-party valuation firm.

The beneficial interests in charitable remainder and perpetual trusts are shown within other assets in the accompanying consolidated balance sheets.

There were no material transfers between Level 3 investments in 2018 or 2017.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **11. Fair Value Measurements (continued)**

The fair values of the interest rate swap contracts are determined based on the present value of expected future cash flows using discount rates appropriate with the risks involved. The valuations reflect a CVA (see Note 10) to the LIBOR discount curve in order to reflect the credit value adjustment for nonperformance risk. The Indiana University Health System credit spread adjustment is derived from other comparably rated entities' bonds priced in the market. Generally, swaps are transferred between Level 2 and Level 3 when the CVA exceeds 10% of the gross valuation of the swap. Transfers are recorded at the end of the reporting period. Due to the volatility of the capital markets, there is a reasonable possibility of changes in fair value and additional gains (losses) in the near term subsequent to December 31, 2018.

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.
- 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).
- To the extent that the spread between the swap curves discussed above expands or compresses.

#### **12. 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 consolidated financial condition, results of operations, or cash flows.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**12. Commitments and Contingencies (continued)**

**Leases**

Buildings and medical and office equipment are leased under noncancelable operating and capital leases. Future minimum lease payments as of December 31, 2018 are as follows:

	<b>Operating Leases</b>	<b>Capital Leases</b>
Year ending December 31:		
2019	\$ 35,261	\$ 1,135
2020	28,457	909
2021	21,951	372
2022	16,828	61
2023	13,123	–
Thereafter	31,954	–
Total minimum lease payments	<u>\$ 147,574</u>	2,477
Less amount representing interest		(338)
Present value of net minimum lease payments		<u>\$ 2,139</u>

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 \$59,070 and \$57,181 for the years ended December 31, 2018 and 2017, respectively.

**13. Medical Malpractice**

The Indiana University Health System’s medical malpractice coverage is provided through the Indiana University Health Risk Retention Group, Inc. (IUHRRG), a 97%-owned subsidiary. The program of medical malpractice coverage considers the per claim limitation of liability prescribed by the Indiana Medical Malpractice Act (the Act), which limits the amount of individual claims to: (i) for acts of negligence prior to June 30, 2017, \$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 and

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Thousands of Dollars)*

#### **13. Medical Malpractice (continued)**

(ii) for acts of negligence from July 1, 2017 to June 30, 2019, \$1,650 and annual aggregate claims to \$12,000 of which up to \$1,250 would be paid by the Fund and \$400 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 for acts of negligence occurring prior to June 30, 2017, and \$400 per occurrence and \$12,000 in the annual aggregate for acts of negligence occurring from July 1, 2017 to June 30, 2019. The Indiana University Health System's medical malpractice program includes coverage offered by IUHRRG and reinsured by Indiana University Health Assurance SPC, Ltd., 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.

#### **14. 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 \$135,240 and \$108,435 in 2018 and 2017, respectively (net of forfeitures of \$988 and \$778 in 2018 and 2017, respectively).

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Thousands of Dollars)*

#### **14. Retirement Plans (continued)**

##### **Defined Benefit Plans**

Defined benefit pension plans previously sponsored by Indiana University Health, Ball Memorial, and Bloomington have been curtailed with benefits frozen and no new participants allowed. On December 4, 2018, Indiana University Health became a single sponsor defined benefit plan after merging the plans previously sponsored by Ball Memorial and Bloomington into its existing plan.

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 net assets without donor restriction.



Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Thousands of Dollars)*

**14. Retirement Plans (continued)**

The following table sets forth the funded status of the defined benefit pension plans and amounts recognized in the consolidated financial statements.

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Accumulated benefit obligation	<b>\$ 380,473</b>	\$ 420,996
Changes in benefit obligation of the plans:		
Benefit obligation at beginning of year	<b>\$ 420,996</b>	\$ 458,186
Interest cost	<b>13,608</b>	16,000
Actuarial (loss) gain	<b>(28,710)</b>	26,072
Benefits paid	<b>(25,421)</b>	(47,095)
Annuity premium	–	(32,167)
Benefit obligation at end of year	<b>\$ 380,473</b>	\$ 420,996
Changes in assets of the plans:		
Fair value of assets at beginning of year	<b>\$ 410,862</b>	\$ 358,064
Actual return on assets	<b>(20,837)</b>	41,976
Employer contributions	<b>735</b>	90,523
Assets to revert back to employer	–	(439)
Benefits paid	<b>(25,421)</b>	(47,095)
Annuity premium	–	(32,167)
Fair value of assets at end of year	<b>\$ 365,339</b>	\$ 410,862
Unfunded status at December 31	<b>\$ (15,134)</b>	\$ (10,134)
Included in net assets without donor restriction is the following item not yet recognized as a component of net periodic pension cost:		
Net actuarial loss	<b>\$ 132,121</b>	\$ 129,237
	<b>\$ 132,121</b>	\$ 129,237

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Thousands of Dollars)*

**14. Retirement Plans (continued)**

The following is a summary of the components of net period pension cost recorded in debt extinguishment and other within the consolidated statement of operations and changes in net assets for the years ended:

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Net actuarial gain	\$ 8,008	\$ 3,612
Amortization of net actuarial loss	(3,622)	(3,592)
Net loss due to settlement	(1,502)	(1,118)
	<u>\$ 2,884</u>	<u>\$ (1,098)</u>

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Components of net pension benefit cost:		
Interest cost	\$ 13,608	\$ 16,000
Expected return on assets	(15,878)	(18,350)
Amortization of unrecognized net loss	3,622	3,592
Settlement expense	1,502	(49)
Net periodic pension cost	<u>\$ 2,854</u>	<u>\$ 1,193</u>

	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Weighted average actuarial assumptions to determine benefit cost:		
Discount rate for net periodic pension cost	3.67%	4.12%
Discount rate for benefit obligations	4.36	3.67
Expected rate of return on plan assets	4.00	4.00

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
*(Thousands of Dollars)*

**14. Retirement Plans (continued)**

Expected future benefit payments:	
2019	\$ 25,652
2020	25,276
2021	25,318
2022	25,570
2023	25,222
2024–28	124,503

Expected amortization of amounts in net assets without donor restriction is expected to increase net periodic pension costs by \$3,622 during the year ending December 31, 2019. There are no required contributions for 2019.

The plan's 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 duration-oriented assets vs. growth-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:

<b>Asset category</b>	<b>December 31</b>	
	<b>2018</b>	<b>2017</b>
Cash and cash equivalents	<b>0%</b>	1%
Debt securities	<b>89</b>	88
Equity securities	<b>11</b>	9
Alternatives	<b>0</b>	2
	<b>100%</b>	100%

The allocation strategy for the group trust in which the plans participate is currently composed of approximately 10% of growth-oriented investments and 90% of duration-oriented investments. The largest component of these growth-oriented assets is public equity securities that are diversified and invested in U.S. companies.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**14. Retirement Plans (continued)**

The following tables present the plan's financial instruments, measured at fair value on a recurring basis within the fair value hierarchy as disclosed in Note 11:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>NAV</u>	<u>Total</u>
<b>December 31, 2018</b>					
<b>Assets</b>					
Cash and cash equivalents	\$ 714	\$ -	\$ -	\$ -	\$ 714
Debt securities:					
Asset backed	-	5,680	-	-	5,680
Bank loans	-	1,277	-	-	1,277
Corporate debt	-	37,783	-	-	37,783
Government and agencies	86,286	-	-	-	86,286
Bond funds	-	-	-	192,543	192,543
Equity securities:					
Domestic equity funds	-	-	-	40,316	40,316
Alternatives:					
Hedge funds	-	-	-	740	740
Total plan assets at fair value	<u>\$ 87,000</u>	<u>\$ 44,740</u>	<u>\$ -</u>	<u>\$ 233,599</u>	<u>\$ 365,339</u>

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**14. Retirement Plans (continued)**

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>NAV</b>	<b>Total</b>
<b>December 31, 2017</b>					
<b>Assets</b>					
Cash and cash equivalents	\$ 5,386	\$ –	\$ –	\$ –	\$ 5,386
Debt securities:					
Asset backed	–	602	–	–	602
Bank loans	–	1,191	–	–	1,191
Corporate debt	–	33,883	–	–	33,883
Government and agencies	113,193	–	–	–	113,193
Bond funds	–	–	–	214,124	214,124
Equity securities:					
Domestic equity funds	3,977	–	–	31,496	35,473
Alternatives:					
Hedge funds	–	–	–	7,010	7,010
Total plan assets at fair value	<u>\$ 122,556</u>	<u>\$ 35,676</u>	<u>\$ –</u>	<u>\$ 252,630</u>	<u>\$ 410,862</u>

The calculation of the fair value of each level of investment is described in Note 11.

The plans invest in hedged funds for which the NAV per share represents the fair value of the investment held. Risks and redemption restrictions for these investments are similar to the alternative investments (see Note 6). Management opted to use the NAV per share, or its equivalent, as a practical expedient for the fair value of the plan's interest in certain funds. Valuations provided by the respective fund's management consider variables, such as the financial performance of underlying investments, recent sales prices of underlying investments, and other pertinent information.

Indiana University Health, Inc. and Subsidiaries

Notes to Consolidated Financial Statements (continued)  
(Thousands of Dollars)

**15. Functional Expenses**

The tables below present expenses by both their nature and function for the years ending December 31, 2018 and 2017.

	<b>Health Services</b>	<b>Insurance Services</b>	<b>General &amp; Administrative</b>	<b>Total</b>
Year ended December 31, 2018:				
Salaries, wages, and benefits	\$ 3,004,151	\$ 19,890	\$ 101,974	\$ 3,126,015
Supplies, drugs, purchased services, and other	1,844,206	56,631	123,030	2,023,867
Hospital assessment fee	146,391	–	–	146,391
Health claims to providers	–	239,137	–	239,137
Depreciation and amortization	228,805	–	8,492	237,297
Interest	43,215	–	–	43,215
	<b>\$ 5,266,768</b>	<b>\$ 315,658</b>	<b>\$ 233,496</b>	<b>\$ 5,815,922</b>

	<b>Health Services</b>	<b>Insurance Services</b>	<b>General &amp; Administrative</b>	<b>Total</b>
Year ended December 31, 2017:				
Salaries, wages, and benefits	\$ 2,786,665	\$ 21,844	\$ 103,487	\$ 2,911,996
Supplies, drugs, purchased services, and other	1,762,476	92,847	113,787	1,969,110
Hospital assessment fee	132,069	–	–	132,069
Health claims to providers	–	474,623	–	474,623
Depreciation and amortization	221,917	–	9,092	231,009
Interest	34,470	–	–	34,470
	<b>\$ 4,937,597</b>	<b>\$ 589,314</b>	<b>\$ 226,366</b>	<b>\$ 5,753,277</b>

The consolidated financial statements report certain categories of expenses that are attributable to more than one supporting function. Therefore, these expenses require allocation on a reasonable basis that is consistently applied. The expenses that are allocated include salaries, wages, and benefits, which are allocated on a per full-time equivalent basis.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **16. 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 \$45,184 and \$43,851 in 2018 and 2017, respectively, and have been reported within 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 \$42,983 and \$48,335, net of offsetting funds from the School of Medicine, for the years ended December 31, 2018 and 2017, respectively, and have been reported within salaries, wages, and benefits and 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 2018 and 2017, Indiana University Health expensed \$57,731 and \$56,752, respectively, within 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 ended December 31, 2016, certain basic, clinical, and translational research programs of the School of Medicine. The total commitment aggregated \$75,000. In 2017, a new five-year term of \$55,000 was agreed upon effective July 1, 2017 through June 30, 2022. For the years ended December 31, 2018 and 2017, the Indiana University Health System expensed \$11,000 and \$5,000, respectively, under these agreements within supplies, drugs, purchased services, and other expenses in the accompanying consolidated statements of operations and changes in net assets, of which \$25,652 and \$32,875 was accrued related to these agreements within accounts payable and accrued expenses at December 31, 2018 and 2017, respectively.

## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued) (Thousands of Dollars)

#### **16. Related-Party Transactions (continued)**

##### **Other Foundations**

Bloomington Hospital Foundation, Inc. and Tipton are tax-exempt organizations under Section 501(c)(3) of the IRC; these foundations hold funds solely on behalf of Bloomington and Tipton, 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 \$22,524 and \$21,654 at December 31, 2018 and 2017, respectively, are included with other assets and net assets, respectively, 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.

#### **17. 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.

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.



## Indiana University Health, Inc. and Subsidiaries

### Notes to Consolidated Financial Statements (continued)

*(Thousands of Dollars)*

#### **17. Health Care Legislation and Regulation (continued)**

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, the CMS approved the Healthy Indiana Plan 2.0, which was Indiana's response to expanding its Medicaid program. The State of Indiana's request for renewal of the Healthy Indiana Plan 2.0 waiver by CMS was approved in late January of 2018 for an additional three years, meaning that the state will continue to engage eligible adults in its signature health program through at least the year 2020. Changes to existing Medicare and Medicaid coverage and payments have also occurred as a result of this legislation. Congress continues to debate the future of the Affordable Care Act, but the specific impact of any changes or new legislation on the Indiana University Health System is not determinable at this time.

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