CONSOLIDATED FINANCIAL STATEMENTS

Indiana University Health, Inc. and Subsidiaries
Years Ended December 31, 2019 and 2018
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, 2019 and 2018

Contents

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Report of Independent Auditors

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

We have audited the accompanying consolidated financial statements of Indiana University Health, Inc. and Subsidiaries, which comprise the consolidated balance sheets as of December 31, 2019 and 2018, 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.

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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, 2019 and 2018, 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 2019, Indiana University Health, Inc. and Subsidiaries changed their method of recognizing leases as a result of the adoption of Accounting Standards Update No. (ASU) 2016-02, *Leases (Topic 842)*. Our opinion is not modified with respect to these matters.

Ernst & Young LLP

March 20, 2020

Indiana University Health, Inc. and Subsidiaries

Consolidated Balance Sheets

(Thousands of Dollars)

	December 31	
	2019	**2018**
Assets		
Current assets:		
Cash and cash equivalents	**$ 223,740**	$ 345,025
Short-term investments	**135,104**	57,591
Current portion of assets limited as to use, including funds held by a trustee for capital expenditure	**273,021**	156,060
Patient accounts receivable	**875,633**	858,270
Other receivables	**155,859**	184,634
Prepaid expenses	**80,033**	58,638
Inventories	**105,486**	101,990
Total current assets	**1,848,876**	1,762,208
Assets limited as to use:		
Board-designated investment funds and other investments	**6,362,587**	5,139,501
Donor-restricted investment funds	**80,679**	90,247
Total assets limited as to use, less current portion	**6,443,266**	5,229,748
Property and equipment:		
Cost of property and equipment in service	**5,633,967**	5,566,805
Less accumulated depreciation	**(3,332,405)**	(3,246,007)
	2,301,562	2,320,798
Construction-in-progress	**316,627**	100,405
Total property and equipment, net	**2,618,189**	2,421,203
Other assets:		
Equity interest in unconsolidated subsidiaries	**28,685**	20,903
Interest in net assets of foundations	**21,302**	22,627
Right-of-use assets	**124,847**	–
Goodwill, intangibles, and other assets	**328,304**	340,635
Total other assets	**503,138**	384,165
Total assets	**$ 11,413,469**	$ 9,797,324

Continued on next page.

Indiana University Health, Inc. and Subsidiaries

Consolidated Balance Sheets (continued)

(Thousands of Dollars)

	December 31	
	2019	**2018**
Liabilities and net assets		
Current liabilities:		
Accounts payable and accrued expenses	**$ 553,387**	$ 492,667
Accrued salaries, wages, and related liabilities	**381,071**	347,550
Accrued health claims	**55,637**	69,898
Estimated third-party payer allowances	**181,706**	105,746
Current portion of lease liabilities	**31,148**	–
Current portion of long-term debt	**51,810**	52,550
Total current liabilities	**1,254,759**	1,068,411
Noncurrent liabilities:		
Long-term debt, less current portion	**1,760,442**	1,529,648
Interest rate swaps	**31,696**	43,700
Accrued pension obligations	**21,438**	15,134
Accrued medical malpractice claims	**64,203**	63,133
Lease liabilities, less current portion	**105,517**	–
Other	**24,521**	35,638
Total noncurrent liabilities	**2,007,817**	1,687,253
Total liabilities	**3,262,576**	2,755,664
Net assets:		
Indiana University Health	**7,757,235**	6,663,366
Noncontrolling interest in subsidiaries	**272,049**	261,563
Total without donor restrictions	**8,029,284**	6,924,929
With donor restrictions	**121,609**	116,731
Total net assets	**8,150,893**	7,041,660
Total liabilities and net assets	**$ 11,413,469**	$ 9,797,324

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)

	Year Ended December 31	
	2019	**2018**
Revenues:		
Patient service revenue	**$ 6,247,880**	$ 5,845,074
Member premium revenue	**205,982**	343,383
Other revenue	**254,191**	239,385
Total operating revenues	**6,708,053**	6,427,842
Expenses:		
Salaries, wages, and benefits	**3,313,376**	3,126,015
Supplies, drugs, purchased services, and other	**2,160,123**	2,023,867
Hospital assessment fee	**169,748**	146,391
Health claims to providers	**92,371**	239,137
Depreciation and amortization	**249,465**	237,297
Interest	**44,295**	43,215
Total operating expenses	**6,029,378**	5,815,922
Operating income	**678,675**	611,920
Nonoperating income (loss):		
Investment income (loss), net	**737,884**	(202,401)
(Losses) gains on interest rate swaps, net	**(9,186)**	12,962
Inherent contribution of acquired entity	**148**	31,935
Contribution to related party	**(145,000)**	–
Debt extinguishment and other	**(18,175)**	(17,856)
Total nonoperating income (loss)	**565,671**	(175,360)
Consolidated excess of revenues over expenses	**1,244,346**	436,560
Less amounts attributable to noncontrolling interest in subsidiaries	**146,499**	140,338
Excess of revenues over expenses attributable to Indiana University Health and subsidiaries	**$ 1,097,847**	$ 296,222

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, 2019		
	Total	**Controlling**	**Noncontrolling**
Without donor restriction:			
Consolidated excess of revenues over expenses	**$ 1,244,346**	**$ 1,097,847**	**$ 146,499**
Change in pension obligations	**(2,386)**	**(2,386)**	**–**
Contributions for capital expenditures	**6,399**	**6,399**	**–**
Distributions to noncontrolling interests	**(136,848)**	**–**	**(136,848)**
Issuance of noncontrolling interests related to joint venture	**120**	**–**	**120**
Change in fair values of interest rate swaps	**(2,393)**	**(2,393)**	**–**
Other	**(4,883)**	**(5,598)**	**715**
	1,104,355	**1,093,869**	**10,486**
With donor restriction:			
Change in beneficial interest in net assets of foundations	**(1,326)**	**(1,326)**	**–**
Contributions	**5,935**	**5,935**	**–**
Investment return	**2,188**	**2,188**	**–**
Change in split interest agreements	**2,848**	**2,848**	**–**
Net assets released from restrictions	**(4,421)**	**(4,421)**	**–**
Other	**(346)**	**(346)**	**–**
	4,878	**4,878**	**–**
Increase in net assets	**1,109,233**	**1,098,747**	**10,486**
Net assets at beginning of year	**7,041,660**	**6,780,097**	**261,563**
Net assets at end of year	**$ 8,150,893**	**$ 7,878,844**	**$ 272,049**

	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)
	330,809	295,052	35,757
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)	–
Restriction reclassification	(1,528)	(1,528)	–
	809	809	–
Increase in net assets	331,618	295,861	35,757
Net assets at beginning of year	6,710,042	6,484,236	225,806
Net assets at end of year	$ 7,041,660	$ 6,780,097	$ 261,563

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	
	2019	**2018**
Operating activities		
Increase in net assets	**$ 1,109,233**	$ 331,618
Adjustments to reconcile increase in net assets to net cash provided by operating activities:		
Change in fair value of interest rate swaps	**9,927**	(16,987)
Change in pension obligation	**2,386**	2,884
Gain in unconsolidated subsidiaries	**(2,025)**	(1,285)
Inherent contribution of acquired entity	**(148)**	(31,935)
Proceeds from issuance of noncontrolling interests related to joint venture	**(120)**	(17,292)
Gain on sale of membership interests	**(7,570)**	(4,572)
Depreciation and amortization	**249,465**	237,297
Amortization of deferred gain on sale of medical office buildings	**(521)**	(740)
Loss on extinguishment of debt	**483**	1,653
Contributions and investment return with donor restrictions	**(9,645)**	(7,158)
Distributions to noncontrolling interests	**136,848**	120,654
Assets limited as to use	**(1,421,863)**	(425,529)
Net changes in operating assets and liabilities:		
Patient accounts receivable	**(17,363)**	17,625
Other assets	**31,319**	(45,006)
Accounts payable, accrued liabilities, and other liabilities	**40,851**	(61,779)
Accrued salaries, wages, and related liabilities	**33,521**	49,475
Estimated third-party payer allowances	**75,960**	18,531
Net cash provided by operating activities	**230,738**	167,454
Investing activities		
Acquisition of subsidiary, net of cash received	**–**	9,243
Proceeds from exercise of put option in joint venture	**–**	19,980
Purchase of property and equipment, net of disposals	**(446,451)**	(295,035)
Net cash used in investing activities	**(446,451)**	(265,812)

Continued on next page.

Indiana University Health, Inc. and Subsidiaries

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

	Year Ended December 31 2019	2018
Financing activities		
Contributions and investment return with donor restrictions	**$ 9,645**	$ 7,158
Repayments on long-term debt	**(446,777)**	(224,976)
Proceeds from issuance of long-term debt	**676,348**	354,301
Proceeds from issuance of noncontrolling interests related to joint venture	**120**	17,292
Termination of swaps	**(21,931)**	(15,127)
Distributions to noncontrolling interests	**(136,848)**	(120,654)
Net cash provided by financing activities	**80,557**	17,994
Decrease in cash and cash equivalents	**(135,156)**	(80,364)
Cash and cash equivalents at beginning of year	**412,449**	492,813
Cash and cash equivalents at end of year	**$ 277,293**	$ 412,449
Reconciliation of cash and cash equivalents to the consolidated balance sheets		
Cash and cash equivalents	**$ 223,740**	$ 345,025
Cash and cash equivalents included in assets limited as to use	**53,553**	67,424
Cash and cash equivalents at end of period	**$ 277,293**	$ 412,449

See accompanying notes to consolidated financial statements.

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; health care diagnostic and treatment services for individuals and families in physician clinics and physician-group practices; personal and home health care; medical management services. The Indiana University Health System is also involved in philanthropic activities through affiliated foundations.

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

1. Organization and Nature of Operations (continued)

Methodist Class (members of which are members of Methodist Health Group, Inc.) and the University Class (members of which are the individuals who are the Trustees of Indiana University).

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

Nature of Operations

The Indiana University Health System operates as an integrated health care delivery system comprising nonprofit and for-profit entities, with coordinated activities and policies designed to meet the mission of the Indiana University Health System. The principal operating activities of the Indiana University Health System are conducted at majority-owned or controlled subsidiaries and consist of the following as of December 31, 2019:

Inpatient, Outpatient, Emergency Health Care Services, Medical Education, and Research

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.

1. Organization and Nature of Operations (continued)

Indianapolis Suburban 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).

West Central Indiana Facilities – Consist of one acute care hospital, and two critical access hospitals located in Lafayette, Monticello, and Frankfort, Indiana. Principal hospital subsidiaries include Indiana University Health Arnett, Inc. (Arnett), Indiana University Health White Memorial Hospital, Inc. (White), and Indiana University Health Frankfort Hospital, Inc. (Frankfort).

East Central Indiana Facilities – Consist of one acute care hospital, and two critical access hospitals located in Muncie, Hartford City, and Portland, Indiana. Principal hospital subsidiaries include Indiana University Health Ball Memorial Hospital, Inc. and subsidiaries (Ball Memorial) including Indiana University Health Blackford Hospital, Inc. (Blackford), as well as Indiana University Health Jay, Inc. (Jay).

South Central Indiana Facilities – Consist of one acute care hospital, and two critical access hospitals located in Bloomington, Bedford, and Paoli, Indiana. Principal hospital subsidiaries include Indiana University Health Bloomington, Inc. and subsidiaries (Bloomington), Indiana University Health Bedford, Inc. (Bedford), and Indiana University Health Paoli, Inc. (Paoli).

Physician Clinics and Group Practice Health Care Services

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.

1. Organization and Nature of Operations (continued)

Personal and Home Health Care Services

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 Management Services

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 & Medicaid Services (CMS).

Philanthropic Activities

Foundations – Consist of three entities that 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 priority community health needs on which Indiana University Health will focus, including improving access to affordable health care; behavioral health (includes drug and substance abuse, as well as mental health); smoking, tobacco use, and exposure to secondhand smoke; social determinants of health; and obesity and diabetes prevention. The costs of providing these programs and services are included in total operating expenses on the accompanying consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies

Principles of Consolidation

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

3. Summary of Significant Accounting Policies (continued)

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 short-term investments and 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.

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.

3. Summary of Significant Accounting Policies (continued)

Assets Limited as to Use

Assets limited as to use include the following: (i) cash and cash equivalents and designated investment assets, including those funds held by the consolidated foundations, set aside by the Board for future capital improvements, over which the Board retains control and may, in certain circumstances, use for other purposes; (ii) current portion of assets limited as to use includes funds held by a trustee; and (iii) 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) on 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.

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

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

3. Summary of Significant Accounting Policies (continued)

Equity Interest in Unconsolidated Subsidiaries

The Indiana University Health System has joint venture arrangements for health-care-related services in which it owns 50% or less. Where applicable, these arrangements are accounted for using the equity method of accounting. Total equity interest in unconsolidated subsidiaries was $28,685 and $20,903 as of December 31, 2019 and 2018, 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.

Leases

Indiana University Health leases property and equipment under finance and operating leases. Indiana University Health determines whether an arrangement is a lease at inception. For leases with terms greater than 12 months, Indiana University Health records the related right-of-use (ROU) assets and lease liabilities at the present value of lease payments over the term. Leases may include rental escalation clauses and options to extend or terminate the lease that are factored into the determination of lease payments when appropriate. Indiana University Health does not separate lease and non-lease components of contracts. For the purposes of measuring the lease liabilities, Indiana University Health uses a risk-free rate from the U.S. Treasury Constant Maturities Nominal rate based on the period comparable with that of each lease term.

Operating leases are included in ROU assets, current portion of lease liabilities, and lease liabilities, less current portion on the consolidated balance sheet. Operating lease expense is recognized on a straight-line basis over the lease term and is included in supplies, drugs, purchased services, and other on the consolidated statements of operations and changes in net assets.

Finance leases are included in property and equipment, current portion of long-term debt, and long-term debt, less current portion on the consolidated balance sheets. Property and equipment under finance 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 on the accompanying consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies (continued)

Goodwill and Intangible Assets

In connection with business combinations, the Indiana University Health System has recorded goodwill and definite-lived intangible assets on the accompanying consolidated balance sheets. The Indiana University Health System evaluates goodwill for impairment annually or more frequently if events or changes in circumstances suggest that the carrying value of an asset may not be recoverable. The goodwill impairment analysis, performed at the reporting unit level, generally includes estimating the fair value of a reporting unit 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.

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 of goodwill or definite-lived intangible assets during 2019 or 2018. Intangible assets included in goodwill, intangibles, and other assets on the accompanying consolidated balance sheets as of December 31, 2019 and 2018, were $212,835 and $216,140, respectively, which includes goodwill of $196,646 at December 31, 2019 and 2018.

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 on 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, 2019 and 2018, 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) on the consolidated statements of operations and changes in net assets.

3. Summary of Significant Accounting Policies (continued)

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 and the conditions are satisfied. 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.

Noncontrolling Interest in Subsidiaries

The Indiana University Health System recorded $146,499 and $140,338 for the years ended December 31, 2019 and 2018, 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, 2019 and 2018, the surgery center joint ventures accounted for $146,690 and $141,126, respectively, of the excess of revenues over expenses attributable to noncontrolling interest in subsidiaries. The surgery center joint ventures realized operating revenue of $348,916 and $335,672 and operating income of $198,945 and $190,252 in 2019 and 2018, 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 on the accompanying consolidated balance sheets (see Note 17).

3. Summary of Significant Accounting Policies (continued)

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.

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 on 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 and derivative financial instruments are described in Notes 6, 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 on 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 on the accompanying consolidated balance sheets.

3. Summary of Significant Accounting Policies (continued)

Income Taxes

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

The Tax Cuts and Jobs Act (TCJA) was enacted on December 22, 2017. For tax-exempt entities, TCJA requires organizations to 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. Proposed regulations and interim guidance, necessary for implementation, have been issued on most aspects of TCJA. It is expected that proposed regulations will be issued as final regulations by the IRS in 2020. As of and for the year ended December 31, 2019, 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. 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 that, as of December 31, 2019 and 2018, 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, 2019 and 2018, the Indiana University Health System had gross deferred tax assets of $143,157 and $119,965, respectively, primarily relating to net operating loss carryovers. Management determined that a full valuation allowance at December 31, 2019 and 2018, was necessary to reduce the deferred tax assets to the amount that would more likely than not be realized. Based on the weight of the evidence, if it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance to reduce the deferred tax assets is recorded. The change in the valuation allowance for the current year is $23,192. At December 31, 2019, the Indiana University Health System has available net operating loss carryforwards of $575,596. Net operating losses generated from 1999 through 2017 will expire between 2020 and 2037. Net operating losses generated after 2017 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.

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, 2019, management has evaluated subsequent events through March 20, 2020, the date that these consolidated financial statements were issued.

On March 13, 2020, Indiana University Health borrowed $225,000 on its line of credit (see Note 9) and invested the proceeds in a cash equivalent. The line of credit has a variable interest rate and matures on July 3, 2023.

3. Summary of Significant Accounting Policies (continued)

Due to the global viral outbreak caused by Coronavirus Disease 2019 (COVID-19) in 2020, there have been resulting effects in the economy generally and the healthcare industry specifically which could negatively impact the Indiana University Health System's financial condition, including significant capital market volatility, various temporary business closures and event cancellations, and other effects which could result in supply disruptions and/or decisions to defer elective procedures and other medical treatments at the Indiana University Health System as the broader economic impact of COVID-19 develops. The ultimate impact of these matters to the Indiana University Health System and its financial condition is presently unknown.

The accompanying consolidated financial statements as of and for the year ended December 31, 2019 do not reflect the effects of these subsequent events.

Reclassifications

Certain amounts in the 2018 consolidated financial statements have been reclassified to conform to the 2019 presentation. Such reclassifications had no effect on previously reported excess of revenues over expenses or net assets.

Recent Accounting Pronouncements Adopted

Effective January 1, 2019, Indiana University Health adopted Accounting Standards Update No. (ASU) 2018-08, *Not-for-Profit Entities: Topic 958 Clarifying the Scope and the Accounting Guidance for Contributions Received and Contributions Made*. 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. Indiana University Health adopted this guidance on a modified prospective basis, which resulted in no material changes to its presentation of the consolidated financial statements.

Effective January 1, 2019, Indiana University Health adopted 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. Indiana University Health adopted this guidance on a retrospective basis, which resulted in adding cash included in the assets limited as to use in the consolidated statement of cash flows.

3. Summary of Significant Accounting Policies (continued)

Effective January 1, 2019, Indiana University Health adopted ASU 2016-02, *Leases (Topic 842)*, in conjunction with subsequent ASU aimed at providing clarification and transition relief. This ASU requires the rights and obligations arising from lease contracts, including existing and new arrangements, to be recognized as assets and liabilities on the balance sheet. This ASU also requires additional disclosures to help financial statement users better understand the amount, timing, and uncertainty of cash flows arising from leases. Indiana University Health adopted this ASU using a modified retrospective approach. Indiana University Health elected to utilize practical expedients made available, including the package of practical expedients not to reassess whether a contract is or contains a lease, the lease classification, and initial direct costs for any existing leases. Indiana University Health has not elected the practical expedient to use hindsight to determine the lease term for leases at the date of transition. While the adoption of ASU 2016-02 did not have a material impact on the consolidated statements of operations and changes in net assets or the consolidated statements of cash flows, it did have a material impact on the consolidated balance sheet through the recording of the lease liabilities and the related ROU assets for leases in effect at January 1, 2019.

Effective January 1, 2019, Indiana University Health adopted 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 on the statement of cash flows. Indiana University Health adopted this guidance on a retrospective basis, which did not materially impact the presentation of the statement of cash flows.

New Accounting Guidance Not Yet Applicable

In August 2018, the Financial Accounting Standards Board (FASB) issued ASU 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework – Changes to the Disclosure Requirements for Fair Value Measurement*. This ASU removes and modifies certain disclosure requirements on fair value measurements to improve the effectiveness and clarify information required in the disclosures. This ASU is effective for Indiana University Health beginning January 1, 2020. Indiana University Health expects the primary effect of this ASU will be on the disclosures in the notes to the consolidated financial statements, and it will not have a material impact on the consolidated balance sheet or consolidated statement of operations or changes in net assets.

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 Accounting Standards Codification 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.

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 2019 and 2018, 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. 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. 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.

For the years ended December 31, 2019 and 2018, payments received related to these programs were recorded within patient service revenue on the consolidated statements of operations and changes in net assets, totaling $518,647 and $473,212, respectively. During the years ended December 31, 2019 and 2018, assessment fees were recorded within the hospital assessment fee line on the consolidated statements of operations and changes in net assets totaling $169,748 and $146,391, respectively.

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

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 $96,693 and $94,886 in 2019 and 2018, respectively.

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, 2019 and 2018, were not significant.

(Thousands of Dollars)

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

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

	Year Ended December 31	
	2019	**2018**
Commercial/managed care	**$ 3,712,306**	$ 3,385,628
Medicare	**1,418,683**	1,419,593
Medicaid	**985,179**	920,769
Self-pay and other	**131,712**	119,084
	$ 6,247,880	$ 5,845,074

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 payer represented 35% and 36% of patient service revenue for December 31, 2019 and 2018, 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, 2019 and 2018, 29% and 30%, respectively, of patient accounts receivable were collectible from government payers. The remaining 71% and 70% of patient accounts receivable in 2019 and 2018, respectively, was collectible from managed care payers, commercial insurance payers, and uninsured and underinsured patients.

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.

(Thousands of Dollars)

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

The composition of other revenue by sources is as follows:

	Year Ended December 31	
	2019	**2018**
Shared health services revenue	**$ 136,772**	$ 133,601
Other	**117,419**	105,784
	$ 254,191	$ 239,385

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. Growth will include primary care, an outpatient imaging center, laboratory services, and urgent care.

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.

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 other short-term, liquid investments: the carrying amounts reported on 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 that 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.

6. Assets Limited as to Use (continued)

In the case of private funds, capital is returned as monetization events occur that 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, 2019 and 2018, there were $557,795 and $328,469, 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.

(Thousands of Dollars)

6. Assets Limited as to Use (continued)

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

	December 31	
	2019	**2018**
Assets limited as to use:		
Cash	**$ 53,553**	$ 67,424
Short-term, liquid investments	**122,855**	13,559
Debt securities:		
Asset backed	**199,401**	157,642
Bank loans	**351,801**	231,392
Corporate debt	**310,894**	274,872
Government and agencies	**416,598**	235,016
Bond funds	**492,352**	385,670
Total debt securities	**1,771,046**	1,284,592
Equity securities:		
Domestic equities	**82,309**	78,925
Domestic equity funds	**1,273,229**	880,980
International equities	**87,538**	98,434
International equity funds	**895,996**	747,074
Total equity securities	**2,339,072**	1,805,413
Commodities	**223,335**	190,794
Alternatives:		
Hedge funds	**1,574,752**	1,429,178
Private funds	**631,674**	594,848
Total alternatives	**2,206,426**	2,024,026
Less current portion of assets limited as to use	**(273,021)**	(156,060)
Total assets limited as to use	**$ 6,443,266**	$ 5,229,748

(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, 2019, aggregated to $195,809, of which $115,130 is considered Board-designated investment funds and $80,679 is considered donor-restricted investment funds. Assets limited as to use include funds held by the foundations whose fair values as of December 31, 2018, aggregated to $158,000, of which $67,753 is considered Board-designated investment funds and $90,247 is considered donor-restricted investment funds.

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

	Year Ended December 31	
	2019	**2018**
Investment income (loss):		
Interest and dividend income	**$ 122,546**	$ 98,248
Investment management and administrative fees	**(10,562)**	(10,432)
Realized gains on sale of investments, net	**77,747**	8,622
Unrealized gains (losses) on investments	**446,927**	(269,021)
Unrealized equity gains (losses) on alternative investments	**101,226**	(29,818)
	$ 737,884	$ (202,401)

(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, 2019 and 2018. The Indiana University Health System defines general expenditures as the normal expenditures related to operations of the Indiana University Health System, excluding capital expenditures.

	December 31	
	2019	**2018**
Financial assets:		
Cash and cash equivalents	**$ 223,740**	$ 345,025
Short-term investments	**135,104**	57,591
Patient accounts receivable	**875,633**	858,270
Other receivables	**155,859**	184,634
Assets limited as to use	**6,716,287**	5,385,808
Total financial assets	**8,106,623**	6,831,328
Liquidity resource:		
Unused bank lines of credit	**226,000**	226,000
Less amounts not available within one year or not designated for general expenditures:		
Alternative investments	**(805,304)**	(751,100)
Other	**(204,366)**	(168,027)
Financial assets not available for use within one year	**(1,009,670)**	(919,127)
Financial assets and liquidity resources available for general expenditures within one year	**$ 7,322,953**	$ 6,138,201

The Indiana University Health System has certain Board-designated assets limited as to use that are available for general expenditures within one year in the normal course of operations. The Indiana University Health System maintains a liquidity pool with a target range of $350,000 to $550,000, which comprises fixed-income securities with maturities ranging from zero to three years and cash equivalents and is reflected in cash and cash equivalents, short-term investments, and assets limited as to use on the consolidated balance sheets. Alternative investments not

(Thousands of Dollars)

7. Financial Assets and Liquidity Reserves (continued)

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 that 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.

8. Property and Equipment

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

	December 31	
	2019	**2018**
Land and improvements	**$ 279,485**	$ 242,460
Buildings and improvements	**3,153,397**	3,213,855
Equipment	**2,201,085**	2,110,490
	$ 5,633,967	$ 5,566,805

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 and improvements; 15–40 years for buildings and improvements; and 3–10 years for equipment, including software developed for internal use.

The Indiana University Health System has several approved large capital projects within construction-in-progress, and proceeds of the Series 2019A and 2019B bonds (see Note 9) have been or will be drawn upon for certain portions of the related expenditures. The projects include renovations to Riley Hospital in order to integrate maternity and neonatal services; construction of a cancer care facility at North; construction of a regional health campus and replacement hospital in Bloomington; an expansion and renovation of West; and a replacement hospital at Frankfort.

8. Property and Equipment (continued)

Construction-in-progress for assets currently under development was $316,627 and $100,405 at December 31, 2019 and 2018, respectively, and includes incurred costs for these projects and the construction, refurbishment, and replacement of other facilities and equipment. Firm commitments for future construction-in-progress spending totaled $406,199 at December 31, 2019.

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. All Obligations Outstanding under the Indiana University Health Obligated Group MTI are secured by security interests in the Gross Receivables of the Obligated Group Members (capitalized terms in this sentence not otherwise defined herein have the meanings assigned to them in the Indiana University Health Obligated Group MTI). As of December 31, 2019, 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 or standby bond purchase 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. 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.

9. Debt (continued)

On July 2, 2019, through the Indiana Finance Authority, Indiana University Health issued $133,610 in par value of Series 2019A tax-exempt, fixed-rate bonds at a premium of $10,876; $109,070 in par value of Series 2019B tax-exempt, fixed-rate mandatory tender bonds at a premium of $2,558; and $102,615 in par value of Series 2019C tax-exempt, fixed-rate bonds at a premium of $11,590. On the same day, IU Health also issued $39,408 in additional par value of Series 2018A taxable, fixed-rate bonds at a premium of $3,730, which additional bonds have been consolidated with the existing Series 2018A bonds. Also on the same day, Indiana University Health effectuated the conversion and public remarketing of the following bonds: (i) $20,090 at par of Series 2011H bonds as tax-exempt, fixed-rate mandatory tender bonds; (ii) $20,090 at par of Series 2011I bonds as tax-exempt, fixed-rate mandatory tender bonds; (iii) $58,225 at par of Series 2011L bonds as tax-exempt, floating-rate notes; (iv) $49,565 at par of Series 2011M bonds as tax-exempt, floating-rate notes; and (v) $143,675 at par of Series 2015B bonds as tax-exempt, fixed-rate mandatory tender bonds.

Proceeds of the Series 2019A and 2019B bonds have been or will be used for certain capital expenditures and to pay certain expenses incurred in connection with their issuance. The remaining proceeds in the amount of $92,924 are recorded in current portion of assets limited as to use, including funds held by a trustee for capital expenditure. Proceeds of the Series 2019C bonds were used (i) to refund (on a current basis) the following bonds: (a) $9,065 in par of Series 2011A bonds, (b) $10,290 in par of Series 2011B bonds, (c) $10,020 in par of Series 2011C bonds, (d) $5,040 in par of Series 2011D bonds, (e) $9,860 in par of Series 2011E bonds, (f) $34,845 in par of Series 2011H bonds, and (g) $34,845 in par of Series 2011I bonds and (ii) to pay certain expenses incurred in connection with their issuance. Proceeds of the additional Series 2018A bonds have been or will be used to finance partial termination payments related to certain interest rate swaps, to finance certain capital expenditures, and to pay certain expenses incurred in connection with their issuance; the issuance of the Series 2019A, 2019B, and 2019C bonds; and the conversion and remarketing of the Series 2011H, 2011I, 2011L, 2011M, and 2015B bonds.

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.

(Thousands of Dollars)

9. Debt (continued)

As of December 31, 2019 and 2018, the Indiana University Health System maintained several lines of credit totaling $226,000. As of December 31, 2019 and 2018, no amounts are drawn on the lines of credit.

Long-term debt consists of the following:

	December 31	
	2019	**2018**
Indiana University Health Obligated Group		
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, 2019	**$ 393,408**	$ 354,000
Indiana Finance Authority:		
Fixed-Rate, Tax-Exempt Health System Revenue Bonds, Series 2019A, payable in varying principal installments in 2047 and 2049, with an interest rate of 4.00% at December 31, 2019	**133,610**	–
Fixed-Rate, Tax-Exempt Health System Revenue Bonds, Series 2019B, payable in varying principal installments in 2057 and 2058 and subject to mandatory tender and remarketing in 2025, with an interest rate of 2.25% at December 31, 2019	**109,070**	–
Fixed-Rate, Tax-Exempt Health System Revenue Bonds, Series 2019C, payable in varying principal installments through 2024, with an interest rate of 5.00% at December 31, 2019	**99,025**	–
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2016A Bonds, payable in varying principal installments through 2025, with an interest rate of 5.00% at December 31, 2019	**132,625**	141,435
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2015A Bonds, payable in varying principal installments through 2040, with interest rates ranging from 4.00% to 5.00% at December 31, 2019	**287,395**	287,395
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2014A Bonds, payable in varying principal installments through 2030, with an interest rate of 5.00% at December 31, 2019	**48,575**	52,185
Fixed-Rate, Tax-Exempt Hospital Revenue Refunding Bonds, Series 2011N Bonds, payable in varying principal installments through 2021, with interest rates ranging from 3.50% to 5.00% at December 31, 2019	**28,320**	45,710
Fixed-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2011H and I and Series 2015B, payable in varying principal installments through 2042 and subject to mandatory tender and remarketing in 2022, with an interest rate of 1.65% at December 31, 2019	**183,855**	263,135
Variable-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2011L and M, payable in varying principal installments through 2046 and subject to mandatory tender and remarketing in 2021, with an interest rate of 1.89% at December 31, 2019	**107,790**	107,790
Variable-Rate, Tax-Exempt Hospital Revenue Bonds, Series 2011A, B, C, D, E, and Series 2016B and C, payable in varying principal installments through 2036, with variable interest rates ranging between 1.63% and 1.68% at December 31, 2019	**211,810**	264,045

(Thousands of Dollars)

9. Debt (continued)

	December 31 2019	December 31 2018
Rehabilitation Hospital of Indiana Obligated Group		
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, 2019	**$ 11,475**	$ 12,260
Other debt		
Finance lease obligations	**1,392**	2,139
Other	**2,496**	8,149
Total long-term debt	**1,750,846**	1,538,243
Unamortized premium, net of unamortized discount	**71,322**	51,671
Unamortized bond issuance costs	**(9,916)**	(7,716)
Less current portion	**(51,810)**	(52,550)
Long-term debt, less current portion	**$ 1,760,442**	$ 1,529,648

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

	Indiana University Health Obligated Group MTI Debt	RHI Obligated Group MTI Debt	Other	Total
Year ending December 31:				
2020	$ 49,430	$ 840	$ 1,540	$ 51,810
2021	52,140	890	1,170	54,200
2022	54,670	905	868	56,443
2023	52,885	920	380	54,185
2024	50,735	940	–	51,675
Thereafter	1,475,553	6,980	–	1,482,533
	$ 1,735,413	$ 11,475	$ 3,958	$ 1,750,846

Total interest paid on long-term debt for the years ended December 31, 2019 and 2018, aggregated $54,077 and $50,014, respectively.

(Thousands of Dollars)

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 and maximum future notional amounts, remain in place as of December 31, 2019:

Current Notional Amount	Maximum Future Notional Amount	Effective Date	Maturity Date	Rate Received[A]	Rate Paid
$ –	$ 39,705	3/03/2022	3/01/2036	62.30% LIBOR plus 0.24%	2.68%
–	54,900	2/18/2022	2/15/2030	62.30% LIBOR plus 0.24%	3.35%
–	55,200	2/22/2022	2/15/2030	62.30% LIBOR plus 0.24%	3.35%
–	12,230	3/10/2022	3/01/2033	LIBOR	4.92%
–	48,920	3/10/2022	3/01/2033	LIBOR	4.92%
1,800	1,800	1/27/2006	11/02/2020	SIFMA Municipal Swap Index	3.98%

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

After giving effect to the above derivative transactions, the Indiana University Health System's variable-rate debt was approximately 17.5% and 23.0% of total debt outstanding as of December 31, 2019 and 2018, 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, 2019, as follows:

Current Notional Amount	Maximum Future Notional Amount	Effective Date	Maturity Date	Swap Type	Rate Received	Rate Paid
$ –	$ 309,200	1/07/2020	1/07/2033	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, 2019, the fair value of interest rate swaps was a liability of $31,696, which is net of CVA of $541. As of December 31, 2018, the fair value

(Thousands of Dollars)

10. Derivative Financial Instruments (continued)

of interest rate swaps was a liability of $43,700, which is net of CVA of $2,475. The fair values of the swaps have been included with noncurrent liabilities on the accompanying consolidated balance sheets.

As of December 31, 2019, interest rate swaps had a total current notional amount of $1,800, comprising $1,800 of fixed-pay swaps and maximum future notional amount of $521,955, comprising $212,755 of fixed-pay swaps and $309,200 of 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, 2019 and 2018, all interest rate swaps were subject to credit-risk-related contingent features. No collateral was posted as of December 31, 2019 or 2018.

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

	Year Ended December 31	
	2019	**2018**
(Losses) gains on interest rate swaps, net:		
Unrealized (losses) gains on interest rate swaps	**$ (9,927)**	$ 16,987
Change in unrealized gains due to swap terminations	**21,931**	15,127
Realized losses on interest rate swaps	**(21,190)**	(19,152)
	$ (9,186)	$ 12,962

During June 2019, Indiana University Health partially terminated each of its five fixed-pay interest rate swaps for a one-time cash payment (outflow) of $17,767, paid in July 2019. Pursuant to these partial terminations and subsequent to this one-time payment, no payments or other amounts will be owed to either party with respect to these swaps until March 2022 and future contractual notional amounts were reduced.

10. Derivative Financial Instruments (continued)

During March 2019, Indiana University Health partially terminated a basis swap with a future notional amount of $309,200 and a maturity date of January 7, 2033. No payment was due related to this partial termination, which resulted in an amended effective date of June 10, 2024, without any other modifications to the contractual terms. Also during March 2019, Indiana University Health partially terminated a basis swap with a notional amount of $140,446. No payment was due related to this partial termination, which resulted in an amended effective date of June 10, 2024, and a notional amount of $98,901 without any other modifications to the contractual terms. During July 2019, Indiana University Health fully terminated the remaining $98,901 notional amount basis swap for a one-time cash payment (outflow) of $255. During November 2019, Indiana University Health fully terminated the remainder of the basis swap with a future notional amount of $309,200 and a maturity date of January 7, 2033, for a one-time cash payment (outflow) of $3,909.

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 a 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.

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.

11. Fair Value Measurements (continued)

- 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.

- 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.

(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, 2019 and 2018. 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, 2019						
	Level 1	Level 2	Level 3	NAV	Fair Value	Equity Method	Carrying Value
Assets							
Cash and cash equivalents	$ 223,740	$ –	$ –	$ –	$ 223,740	$ –	$ 223,740
Short-term investments:							
Debt securities:							
Asset backed	–	8,984	–	–	8,984	–	8,984
Corporate debt	–	77,630	–	–	77,630	–	77,630
Government and agencies	48,490	–	–	–	48,490	–	48,490
Assets limited as to use:							
Cash	53,553	–	–	–	53,553	–	53,553
Short-term, liquid investments	122,855	–	–	–	122,855	–	122,855
Debt securities:							
Asset backed	–	198,550	851	–	199,401	–	199,401
Bank loans	–	350,015	1,786	–	351,801	–	351,801
Corporate debt	–	310,389	506	–	310,895	–	310,895
Government and agencies	416,598	–	–	–	416,598	–	416,598
Bond funds	204,912	–	–	287,440	492,352	–	492,352
Equity securities:							
Domestic equities	82,309	–	–	–	82,309	–	82,309
Domestic equity funds	215,408	–	–	1,057,821	1,273,229	–	1,273,229
International equities	87,538	–	–	–	87,538	–	87,538
International equity funds	195,296	–	–	700,700	895,996	–	895,996
Commodities	223,335	–	–	–	223,335	–	223,335
Alternatives:							
Hedge funds	–	–	–	–	–	1,574,752	1,574,752
Private funds	–	–	–	–	–	631,674	631,674
Beneficial interests in charitable remainder and perpetual trusts	–	16,033	–	–	16,033	–	16,033
Total cash and investments	$ 1,874,034	$ 961,601	$ 3,143	$ 2,045,961	$ 4,884,739	$ 2,206,426	$ 7,091,165
Liabilities							
Interest rate swaps	$ –	$ 31,696	$ –	$ –	$ 31,696	$ –	$ 31,696
Total liabilities measured at fair value on a recurring basis	$ –	$ 31,696	$ –	$ –	$ 31,696	$ –	$ 31,696

(Thousands of Dollars)

11. Fair Value Measurements (continued)

	December 31, 2018						
	Level 1	Level 2	Level 3	NAV	Fair Value	Equity Method	Carrying Value
Assets							
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	67,424	–	–	–	67,424	–	67,424
Short-term, liquid investments	13,559	–	–	–	13,559	–	13,559
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
Total cash and investments	$ 1,525,441	$ 698,890	$ 1,957	$ 1,551,123	$ 3,777,411	$ 2,024,026	$ 5,801,437
Liabilities							
Interest rate swaps	$ –	$ 43,700	$ –	$ –	$ 43,700	$ –	$ 43,700
Total liabilities measured at fair value on a recurring basis	$ –	$ 43,700	$ –	$ –	$ 43,700	$ –	$ 43,700

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 on the accompanying consolidated balance sheets.

11. Fair Value Measurements (continued)

There were no material transfers between Level 3 investments in 2019 or 2018.

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, 2019.

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.

(Thousands of Dollars)

13. Leases

Indiana University Health has operating and finance leases for medical offices, administrative offices, and certain equipment. The leases have remaining lease terms of 1 year to 15 years, some of which may include options to extend.

Rent and lease expense, included in supplies, drugs, purchased services, and other expenses on the accompanying consolidated statements of operations and changes in net assets, amounted to $61,593 and $59,070 for the years ended December 31, 2019 and 2018, respectively.

Other information related to leases was as follows for the year ended December 31, 2019:

Supplemental cash flow information	
Cash paid for amounts included in the measurement of lease liabilities:	
Operating cash flows from operating leases	$ 42,261
Operating cash flows from finance leases	210
Financing cash flows from finance leases	923
Right-of-use assets obtained in exchange for lease obligations:	
Operating leases	$ 124,847
Finance leases	1,231
Weighted average remaining lease term (in years)	
Operating leases	6.05
Finance leases	1.74
Weighted average discount rate	
Operating leases	2.86%
Finance leases	4.94

(Thousands of Dollars)

13. Leases (continued)

Future minimum lease payments under noncancelable leases as of December 31, 2019, were as follows:

	Operating	Finance
2020	$ 36,548	$ 985
2021	28,977	446
2022	23,977	99
2023	18,859	2
2024	11,606	–
Thereafter	31,307	–
Total future minimum lease payments	151,274	1,532
Less imputed interest	14,610	140
Net present value of minimum lease payments	$ 136,664	$ 1,392

As of December 31, 2019, Indiana University Health reviewed leases which had been signed in 2019 with commencement dates in later years. None of these agreements were deemed material for disclosure.

14. 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 as follows; (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; (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; and (iii) for acts of negligence from July 1, 2019, and forward, $1,800 and annual aggregate claims to $15,000 of which up to $1,300 would be paid by the Fund and $500 by the Indiana University Health System for each occurrence of

14. Medical Malpractice (continued)

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; $400 per occurrence and $12,000 in the annual aggregate for acts of negligence occurring from July 1, 2017 to June 30, 2019; and $500 per occurrence and $15,000 in the annual aggregate for acts of negligence occurring from July 1, 2019, forward. 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 on the accompanying consolidated balance sheets.

15. 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 $142,087 and $135,240 in 2019 and 2018, respectively (net of forfeitures of $1,464 and $988 in 2019 and 2018, respectively).

Defined Benefit Plans

On December 4, 2018, Indiana University Health became a single defined benefit plan sponsor (the Plan) after merging the plans previously sponsored by Ball Memorial and Bloomington into its existing plan. The Plan was curtailed with benefits frozen and no new participants. On June 1, 2019, the Plan was terminated and is expected to be liquidated in 2020.

(Thousands of Dollars)

15. Retirement Plans (continued)

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.

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

	December 31	
	2019	**2018**
Accumulated benefit obligation	**$ 433,321**	$ 380,473
Changes in benefit obligation of the plans:		
Benefit obligation at beginning of year	**$ 380,473**	$ 420,996
Interest cost	**14,762**	13,608
Actuarial loss (gain)	**70,720**	(28,710)
Benefits paid	**(32,634)**	(25,421)
Benefit obligation at end of year	**433,321**	380,473
Changes in assets of the plans:		
Fair value of assets at beginning of year	**365,339**	410,862
Actual return on assets	**78,443**	(20,837)
Employer contributions	**735**	735
Benefits paid	**(32,634)**	(25,421)
Fair value of assets at end of year	**411,883**	365,339
Unfunded status at December 31	**$ (21,438)**	$ (15,134)
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	**$ 134,507**	$ 132,121

(Thousands of Dollars)

15. Retirement Plans (continued)

	December 31 2019	December 31 2018
Net actuarial loss	**$ 6,333**	$ 8,008
Amortization of net actuarial loss	**(3,947)**	(3,622)
Settlement expense	**–**	(1,502)
	$ 2,386	$ 2,884

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:

	December 31 2019	December 31 2018
Components of net periodic pension cost:		
Interest cost	**$ 14,762**	$ 13,608
Expected return on assets	**(14,057)**	(15,878)
Amortization of net actuarial loss	**3,947**	3,622
Settlement expense	**–**	1,502
Net periodic pension cost	**$ 4,652**	$ 2,854

	December 31 2019	December 31 2018
Weighted average actuarial assumptions to determine benefit cost:		
Discount rate for net periodic pension cost	**4.36%**	3.67%
Discount rate for benefit obligations	**2.98**	4.36
Expected rate of return on plan assets	**4.00**	4.00

(Thousands of Dollars)

15. Retirement Plans (continued)

Expected future benefit payments:	
2020	$ 431,735
2021	735
2022	735
2023	689
2024	678
2025–29	2,682

Expected amortization of amounts in net assets without donor restriction is expected to increase net periodic pension costs by $3,947 during the year ending December 31, 2020. Required contributions for 2020 are expected to be $15,000.

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 plan, by asset category, are as follows:

	December 31	
	2019	**2018**
Asset category		
Cash and cash equivalents	**27%**	–%
Debt securities	**73**	89
Equity securities	**–**	11
	100%	100%

The allocation strategy for the group trust in which the plan participate is aligned with the plan liquidation in 2020.

(Thousands of Dollars)

15. 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:

	Level 1	Level 2	Level 3	NAV	Total
December 31, 2019					
Assets					
Cash and cash equivalents	**$ 111,459**	**$ –**	**$ –**	**$ –**	**$ 111,459**
Debt securities:					
Corporate debt	**–**	**243,299**	**–**	**–**	**243,299**
Government and agencies	**56,701**	**–**	**–**	**–**	**56,701**
Alternatives:					
Hedge funds	**–**	**–**	**–**	**424**	**424**
Total plan assets at fair value	**$ 168,160**	**$ 243,299**	**$ –**	**$ 424**	**$ 411,883**

	Level 1	Level 2	Level 3	NAV	Total
December 31, 2018					
Assets					
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	$ 87,000	$ 44,740	$ –	$ 233,599	$ 365,339

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

(Thousands of Dollars)

15. Retirement Plans (continued)

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.

16. Functional Expenses

The tables below present expenses by both their nature and function for the years ended December 31.

	Health Services	Insurance Services	General and Administrative	Total
2019:				
Salaries, wages, and benefits	**$ 3,151,296**	**$ 28,761**	**$ 133,319**	**$ 3,313,376**
Supplies, drugs, purchased services, and other	**1,957,083**	**57,726**	**145,314**	**2,160,123**
Hospital assessment fee	**169,748**	**–**	**–**	**169,748**
Health claims to providers	**–**	**92,371**	**–**	**92,371**
Depreciation and amortization	**241,455**	**–**	**8,010**	**249,465**
Interest	**44,295**	**–**	**–**	**44,295**
	$ 5,563,877	**$ 178,858**	**$ 286,643**	**$ 6,029,378**

	Health Services	Insurance Services	General and Administrative	Total
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
	$ 5,266,768	$ 315,658	$ 233,496	$ 5,815,922

16. Functional Expenses (continued)

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.

17. 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 $46,508 and $45,184 in 2019 and 2018, respectively, and have been reported within salaries, wages, and benefits expense on 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 $49,287 and $42,983, net of offsetting funds from the School of Medicine, for the years ended December 31, 2019 and 2018, respectively, and have been reported within salaries, wages, and benefits and supplies, drugs, purchased services, and other expenses on 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 2019 and 2018, Indiana University Health expensed $62,963 and $57,731, respectively, within supplies, drugs, purchased services, and other expenses on 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, 2019 and 2018, the Indiana University Health System expensed $11,000 in each

17. Related-Party Transactions (continued)

year under these agreements within supplies, drugs, purchased services, and other expenses on the accompanying consolidated statements of operations and changes in net assets, of which $26,942 and $25,652 was accrued related to these agreements within accounts payable and accrued expenses at December 31, 2019 and 2018, respectively.

In December 2019, the Indiana University Health Board approved an unrestricted contribution of $145,000 to Indiana University for costs associated with a new medical and education research building. The unrestricted contribution was made in December 2019 and is reflected in contribution to related party on the consolidated statement of operations and changes in net assets.

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 $21,206 and $22,524 at December 31, 2019 and 2018, respectively, are included within interests in net assets of foundations on 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 net assets with donor restrictions.

18. 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 in the consolidated financial statements of the Indiana University Health System; however, compliance with such laws and regulations can be subject to future government review and interpretation, as well as regulatory actions unknown or unasserted at this time.

The Affordable Care Act and its associated legislation are designed, in part, to expand access to coverage to substantively all U.S. citizens through a combination of states' expansion of their Medicaid programs and the health insurance marketplace. For Indiana, 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 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. Indiana is also among a handful of states that have instituted work requirements for their Medicaid expansion populations, a program feature that is currently under judicial review for a number of states, including Indiana. As a result, in late October 2019, Indiana Medicaid opted to postpone plans to terminate Medicaid benefits scheduled to go into effect on January 1, 2020, for those enrollees who had not met the new work requirements. While the debate regarding the Affordable Care Act appears to have shifted from Congress to the courts, 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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