ENGLOBAL CORP
Form 10-Q
November 19, 2012

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 29, 2012

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission File No. 001-14217

ENGlobal Corporation
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

88-0322261
(I.R.S Employer Identification No.)

654 N. Sam Houston Parkway E., Suite 400, Houston, TX	77060-5914
(Address of principal executive offices)	(Zip code)

(281) 878-1000
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shortened period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes x No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes x No o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer,” and smaller reporting company in Rule 12b-2 of the Exchange Act. (check one):

Large Accelerated Filer	o	Accelerated Filer	o
Non-Accelerated Filer (Do not check if a smaller reporting company)	o	Smaller Reporting Company	x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes o No x

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of the close of business on November 14, 2012.

$0.001 Par Value Common Stock	26,964,339 shares

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QUARTERLY REPORT ON FORM 10-Q
FOR THE PERIOD ENDED SEPTEMBER 29, 2012

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PART I. - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

ENGlobal Corporation
Condensed Consolidated Statements of Operations and Comprehensive Loss
(Unaudited)

	For the Three Months Ended September 29, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 29, 2012	For the Nine Months Ended September 30, 2011
	(amounts in thousands, except loss per share data)			
Operating revenues	$57,482	$60,482	$$ 175,805	$162,961
Operating costs	54,212	53,706	162,455	145,767
Gross profit	3,270	6,776	13,350	17,194
Selling, general and administrative expenses	6,162	6,682	19,301	18,716
Goodwill impairment	14,568	—	14,568	—
Operating income (loss)	(17,460)	94	(20,519)	(1,522)
Other income (expense):				
Other income (expense), net	(98)	(8)	(100)	(68)
Interest expense, net	(643)	(303)	(1,320)	(711)
Loss from continuing operations before income taxes	(18,201)	(217)	(21,939)	(2,301)
Provision (benefit) for federal and state income taxes	412	138	5,606	(460)
Loss from continuing operations	(18,613)	(355)	(27,545)	(1,841)
Loss from discontinued operations, net of taxes	(3,717)	(918)	(4,779)	(1,263)
Net loss	(22,330)	(1,273)	$(32,324)	(3,104)
Other comprehensive income (expense)				
Foreign currency translation adjustment	—	—	(1)	—
Comprehensive loss	$(22,330)	$(1,273)	$(32,325)	$(3,104)
Loss per common share – basic and diluted:				
Net loss from continuing operations	$(0.69)	$(0.01)	$(1.02)	$(0.07)
Net loss from discontinued operations	$(0.14)	$(0.04)	$(0.18)	$(0.05)
Net loss	$(0.83)	$(0.05)	$(1.20)	$(0.12)
Weighted average shares used in computing loss per common share – basic and diluted	26,964	26,620	26,882	26,585

See accompanying notes to unaudited interim condensed consolidated financial statements.

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ENGlobal Corporation
Condensed Consolidated Balance Sheets
(Unaudited)

ASSETS	September 29, 2012	December 31, 2011
	(amounts in thousands, except share amounts)	
Current Assets:		
Cash and cash equivalents	$634	$26
Restricted cash	6,134	2,275
Trade receivables, net of allowances of $2,299 and $1,792	46,949	44,159
Prepaid expenses and other current assets	504	846
Notes receivable	514	514
Costs and estimated earnings in excess of billings on uncompleted contracts	7,632	6,790
Assets held for sale	13,813	19,054
Federal and state income taxes receivable	389	79
Deferred tax asset	—	3,989
Total Current Assets	76,569	77,732
Property and equipment, net	3,241	3,260
Goodwill	2,805	17,373
Other intangible assets, net	2,097	2,835
Long-term trade and notes receivable, net of current portion and allowances	899	899
Deferred tax asset, non-current	—	1,206
Other assets	882	874
Total Assets	$86,493	$104,179

LIABILITIES AND STOCKHOLDERS' EQUITY

Current Liabilities:		
Accounts payable	$9,247	$8,316
Accrued compensation and benefits	13,328	10,400
Current portion of debt	29,406	16,602
Deferred rent	606	635
Billings in excess of costs and estimated earnings on uncompleted contracts	3,986	4,421
Liabilities held for sale	2,862	4,058
Other current liabilities	706	1,247
Total Current Liabilities	60,141	45,679
Commitments and Contingencies (Note 11)		
Stockholders' Equity:		
Common stock - $0.001 par value; 75,000,000 shares authorized; 26,964,339 and 26,882,518 shares outstanding and 27,945,438 and 27,803,617 shares issued at September 29, 2012 and December 31, 2011, respectively	28	28
Additional paid-in capital	38,258	38,081
Retained earnings (deficit)	(9,502)	22,822
Treasury stock - 981,099 shares at September 29, 2012 and December 31, 2011	(2,362)	(2,362)
Accumulated other comprehensive loss	(70)	(69)
Total Stockholders' Equity	26,352	58,500

Total Liabilities and Stockholders' Equity	$86,493	$104,179

See accompanying notes to unaudited interim condensed consolidated financial statements.

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ENGlobal Corporation
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	For the Nine Months Ended September 29, 2012	September 30, 2011
	(amounts in thousands)	
Cash Flows from Operating Activities:		
Net loss	$(32,324)	$(3,104)
Adjustments to reconcile net loss to cash provided by (used in) operating activities:		
Depreciation and amortization	1,452	2,730
Share-based compensation expense	177	307
Deferred income tax expense (benefit)	6,166	(1,047)
Impairment of goodwill	16,965	—
(Gain) loss on disposal of property, plant and equipment	47	(18)
Changes in current assets and liabilities, net of acquisitions:		
Trade accounts and other receivables	(1,467)	(3,300)
Costs and estimated earnings in excess of billings on uncompleted contracts	(704)	(1,693)
Prepaid expenses and other assets	16	482
Accounts payable	770	(210)
Accrued compensation and benefits	3,986	4,289
Billings in excess of costs and estimated earnings on uncompleted contracts	(520)	1,163
Other liabilities	(2,578)	1,876
Income taxes receivable	(264)	(425)
Net cash provided by (used in) operating activities	$(8,278)	$1,050
Cash Flows from Investing Activities:		
Property and equipment acquired	(228)	(452)
Restricted cash	(3,859)	—
Proceeds from sale of other assets	170	65
Net cash used in investing activities	$(3,917)	$(387)
Cash Flows from Financing Activities:		
Borrowings on line of credit	149,872	118,947
Payments on line of credit	(136,818)	(116,358)
Repayments under capital lease	—	(51)
Other long-term debt repayments	(250)	(941)
Net cash provided by financing activities	$12,804	$1,597
Effect of Exchange Rate Changes on Cash	(1)	—
Net change in cash	608	2,260
Cash and cash equivalents, at beginning of period	26	49
Cash and cash equivalents, at end of period	$634	$2,309

See accompanying notes to unaudited interim condensed consolidated financial statements.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

NOTE 1 – BASIS OF PRESENTATION AND CRITICAL ACCOUNTING POLICIES

The condensed consolidated financial statements of ENGlobal Corporation (which may be referred to as "ENGlobal", "the Company," "we," "us," or "our") are prepared in accordance with accounting principles generally accepted in the United States of America. The Company consolidates all of its subsidiaries' financial results, and significant inter-company accounts and transactions have been eliminated in the consolidation.

The condensed consolidated financial statements of the Company included herein are unaudited for the three and nine-month periods ended September 29, 2012 and September 30, 2011, have been prepared from the books and records of the Company pursuant to the rules and regulations of the Securities and Exchange Commission, and in the case of the condensed balance sheet as of December 31, 2011, have been derived from the audited financial statements of the Company. These financial statements reflect all adjustments (consisting of normal recurring adjustments), which are, in the opinion of management, necessary to fairly present the results for the periods presented. Certain information and note disclosures, normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America, have been condensed or omitted pursuant to rules and regulations of the Securities and Exchange Commission. These condensed consolidated financial statements should be read in conjunction with the Company's audited financial statements for the year ended December 31, 2011, included in the Company's Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission. The Company has assessed subsequent events through the date of filing of these condensed consolidated financial statements with the Securities and Exchange Commission and believes that the disclosures made herein are adequate to make the information presented herein not misleading. Certain reclassifications have been made to the 2011 condensed consolidated financial statements to conform the presentation to report discontinued operations. Refer to Note 3.

On January 1, 2012, we changed from a traditional month-end calendar close cycle to a 4-4-5 calendar close methodology. Under this new methodology, each quarter (formerly comprised of 3 calendar months) is comprised of 13 weeks, which includes two 4-week months and one 5-week month. This change in accounting periods has not had a material effect on the comparability to prior periods.

NOTE 2 – LIQUIDITY

The Company has been operating under difficult circumstances in 2012. For the nine-month period ended September 29, 2012, the Company reported a net loss of approximately $32.3 million that included a non-cash charge of approximately $16.9 million relating to a goodwill impairment (see Note 4) and a non-cash charge of approximately $6.2 million relating to a valuation allowance established in connection with the Company's deferred tax assets (see Note 9). During 2012, our net borrowings under our revolving credit facilities have increased approximately $13.0 million to fund our operations. Due to challenging market conditions, our revenues and profitability have declined during 2012. As a result, we have failed to comply with several financial covenants under our credit facilities resulting in defaults (see Note 7). Although we have sold assets and reduced personnel in an attempt to improve our liquidity position, we cannot assure you that we will be successful in obtaining the cure or waiver of the defaults under the respective credit facilities. If we fail to obtain the cure or waiver of the defaults under the facilities after any forbearance period, the lenders may exercise any and all rights and remedies available to them under their respective agreements, including demanding immediate repayment of all amounts then outstanding or initiating foreclosure or insolvency proceedings. In such event and if we are unable to obtain alternative financing, our business will be materially and adversely affected, and we may be forced to sharply curtail or cease our operations. In addition, based on current conditions, it is probable that our independent registered public accounting firm will include an explanatory paragraph with respect to our ability to continue as a going concern in its report on our financial statements for the year ending December 31, 2012.

NOTE 3 - DISCONTINUED OPERATIONS

During the third quarter of 2011, as part of its strategic evaluation of operations, the Company determined that the expected future profitability of the Electrical Services group was not sufficient to support maintaining it as a viable business and that it did not fit within the future strategic plan due to its operational differences. As a result, effective July 1, 2011, the Company initiated a plan to sell the operations of its Electrical Services group. These assets and their related operations have been classified as discontinued operations and accordingly, are presented as discontinued operations in the Company's re-casted consolidated financial statements. The net assets and liabilities related to the discontinued operations are shown on the Condensed Consolidated Balance Sheet as "Assets held for sale" and "Liabilities held for sale," respectively. The results of the discontinued operations are shown on the Condensed Consolidated Statements of Operations as "Loss from discontinued operations, net of taxes".

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

The Company has been unable to sell the Electrical Services group as planned and has decided to dispose of substantially all of the group's remaining assets. During the third quarter of 2012, the Company completed the disposal of the group's remaining assets concurrent with the completion of the last remaining lump sum project. During the third quarter, the Company incurred approximately $0.5 million of costs to complete the remaining lump sum project. Going forward, the Company will have no continuing involvement with these operations after the completion of the remaining lump sum project.

On September 10, 2012, the Company entered into a definitive agreement to sell its Field Solutions segment. The Field Solutions segment includes the Land and Right-of-Way and Inspection divisions, primarily serving pipeline and electric power companies. On November 2, 2012, the Company completed the divestiture of its Land and Right-of-Way division of its Field Solutions segment effective October 26, 2012, and retained the Inspection division pursuant to the terms of the amended definitive agreement. The transaction was valued at approximately $7.5 million, consisting of approximately $4.5 million in working capital at closing to the Company and a $3 million promissory note payable to the Company over four years. The Company is continuing to pursue the sale of the Inspection division and, as such, the Inspection division will continue to be classified as held-for-sale.

The assets and liabilities of the Electrical Services and Field Solutions divisions and their related operations have been classified as discontinued operations and accordingly, are presented as discontinued operations in the Company's re-cast condensed consolidated financial statements. The net assets and liabilities related to the discontinued operations are shown on the Condensed Consolidated Balance Sheet as "Assets held for sale" and "Liabilities held for sale," respectively. The results of the discontinued operations are shown on the Condensed Consolidated Statements of Operations as "Loss from discontinued operations, net of taxes". During the third quarter, the Company incurred or accrued approximately $3.6 million of additional costs (which includes a loss on the sale of the Land and Right-of-Way division of approximately $1.1 million) related to the sale of these divisions. Summarized financial information for the discontinued operations is shown below:

Statement of Operations Data:	For the Three Months Ended September 29, 2012	For the Three Months Ended September 30, 2011	For the Nine Months Ended September 29, 2012	For the Nine Months Ended September 30, 2011
	(amounts in thousands)			
Revenues	$ 14,559	$ 21,598	$ 52,442	$ 75,981
Operating costs	14,227	21,382	49,586	72,995
Operating income (loss)	332	216	2,856	2,986
SG&A	1,650	1,712	3,676	4,888
Goodwill impairment	2,397	—	2,397	—
Other income (expense)	(2)	1	(5)	2
Total income (loss) before taxes	(3,717)	(1,495)	(3,222)	(1,900)
Tax expense (benefit)	—	(577)	1,557	(637)
Net loss	$ (3,717)	$ (918)	$ (4,779)	$ (1,263)

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

Balance Sheet Data:	September 29, 2012		December 31, 2011	
	(amounts in thousands)			
Assets:				
Trade receivables	$	10,929	$	12,252
Cost and estimated earnings in excess of billings on uncompleted contracts		—		138
Deferred tax asset		—		995
Property and equipment, net		111		372
Goodwill and other assets		2,773		5,297
Total assets held for sale	$	13,813	$	19,054
Liabilities:				
Accounts payable	$	316		477
Accrued compensation and benefits		1,818		760
Deferred rent		45		53
Billings in excess of costs and estimated earnings on uncompleted contracts		73		158
Other current liabilities		610		2,610
Total liabilities held for sale	$	2,862	$	4,058

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

NOTE 4 – GOODWILL

Goodwill has an indefinite useful life. Goodwill is not amortized but, instead, tested at least annually for impairment. Because of deteriorating market conditions, our declining financial performance and the decision to sell several of our assets, we made a decision to perform an interim assessment of the carrying value of our goodwill as of September 29, 2012. We reviewed a number of factors on a segment by segment basis, including market conditions, projected cash flows, cost of capital, growth rates and other factors which could significantly impact the reported value of our goodwill. As a result of this review, we recorded a goodwill impairment of approximately $16.9 million as of September 29, 2012. Of this amount, approximately $14.6 million related to continuing operations and approximately $2.4 million relating to discontinued operations. Summarized financial information for goodwill is shown below:

Description of Segment	Balance at December 31, 2011 (amounts in thousands)	Impairments	Balance at September 29, 2012
Engineering and Construction	$ 15,288	$ (14,568)	$ 720
Automation	2,085	—	2,085
Field Solutions*	5,241	(2,397)	2,844
Total	$ 22,614	$ (16,965)	$ 5,649

* Amounts are included in Assets held for sale and Loss from discontinued operations, net of taxes

NOTE 5 – STOCK COMPENSATION PLANS

In April 2012, the Compensation Committee of the Board of Directors approved an increase of 500,000 shares under our 2009 Equity Incentive Plan (the "Equity Plan"), which was subsequently approved by our shareholders. As of November 14, 2012, 502,335 shares of restricted stock have been granted under the Equity Plan, of which 133,115 remain subject to outstanding awards. Unvested restricted stock awards and restricted stock units are included in diluted earnings per share until the shares have been vested. The vested shares are then included in basic earnings per share.

Total share-based compensation expense of approximately $18,000 and $109,000 was recognized during the three-months ended September 29, 2012 and September 30, 2011, respectively. Total share-based compensation expense in the amount of $177,000 and $307,000 was recognized during the nine months ended September 29, 2012 and September 30, 2011, respectively. Share-based compensation expense is reported in selling, general and administrative expense.

Restricted Stock Awards

Restricted stock awards granted to directors are intended to compensate and retain the directors over the one-year service period commencing July 1 of the year of service. These awards vest in quarterly installments beginning September 30 of the year of service, so long as the grantee continues to serve as a director of the Company. Restricted stock awards granted to employees vest in four equal annual installments beginning December 31 in the year granted, so long as the grantee remains employed full-time with the Company as of each vesting date. During 2012, the Company granted restricted stock awards per the following table:

Date Issued	Issued to	Number of Individuals	Number of Shares	Market Price	Fair Value	Grants Forfeited
June 14, 2012	Employee	1	50,336	$ 1.49	$ 75,000	—
June 14, 2012	Director	3	100,671	$ 1.49	$ 150,000	—

The amount of compensation expense related to all restricted stock awards that had not been recognized at September 29, 2012, totaled $173,000. This compensation expense is expected to be recognized over a weighted-average period of approximately 17 months.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

NOTE 6 – CONTRACTS

Costs, estimated earnings and billings on uncompleted contracts consisted of the following at September 29, 2012 and December 31, 2011:

Description		September 29, 2012		December 31, 2011
		(amounts in thousands)		
Costs incurred on uncompleted contracts	$	59,177	$	43,455
Estimated earnings on uncompleted contracts		8,982		5,591
Earned revenues		68,159		49,046
Less: billings to date		64,513		46,677
Net costs and estimated earnings in excess of billings on uncompleted contracts	$	3,646	$	2,369
Costs and estimated earnings in excess of billings on uncompleted contracts	$	7,632	$	6,790
Billings in excess of costs and estimated earnings on uncompleted contracts		(3,986)		(4,421)
Net costs and estimated earnings in excess of billings on uncompleted contracts	$	3,646	$	2,369

Revenue on fixed-price contracts is recorded primarily using the percentage-of-completion (cost-to-cost) method. Under this method, revenue is recognized in the ratio that contract costs incurred bear to total estimated contract costs. Revenue and gross margin on fixed-price contracts are subject to revision throughout the lives of the contracts and any required adjustments are made in the period in which the revisions become known. To manage unknown risks, management may use contingency amounts to increase the estimated costs, therefore, lowering the earned revenues until the risks are better identified and quantified or have been mitigated. Losses on contracts are recorded in full as they are identified.

The Company recognizes service revenue as soon as the services are performed. For clients that we consider higher risk, due to past payment history or history of not providing written work authorizations, we defer revenue recognition until we receive either a written authorization or a payment. The current amount of revenue deferred for these reasons is approximately $0.1 million as of September 29, 2012, compared to $0.3 million as of December 31, 2011. We expect a majority of the deferred revenue amount to be realized by year end 2012.

NOTE 7 – LINE OF CREDIT AND DEBT

The carrying value of debt is composed of the following:

Description:		September 29, 2012		December 31, 2011
Secured debt:		(amounts in thousands)		
Wells Fargo Credit Facility	$	—	$	16,352
PNC Credit Facility		29,406		—
Subordinated and unsecured debt:				
Control Dynamics International, L.P.		—		250
Total debt	$	29,406	$	16,602

The rates applicable to the PNC Credit Facility line of credit and the Wells Fargo Credit Facility line of credit outstanding at September 29, 2012 and December 31, 2011 were 7.0% and 4.125%, respectively. Effective June 20, 2012, upon defaulting on the PNC Credit Facility, the interest rate increased from 5.0% to 7.0% (the default interest rate is 2.0% higher than the applicable facility rate). For the three-month periods ended September 29, 2012 and 2011, the Company recognized interest expense of $0.6 million and $0.3 million, respectively. For the nine-month periods ended September 29, 2012 and 2011, the Company recognized interest expense of $1.3 million and $0.7 million, respectively.

In addition to the terms of the PNC Credit Facility described below, the PNC Credit Facility also contains a subjective acceleration clause (in the form of a material adverse effect clause) and a provision requiring the establishment and utilization of a lock-box account into which all proceeds of collateral are deposited and applied to reduce borrowings outstanding under the PNC Credit Facility. Pursuant to generally accepted accounting principles, the combination of both a subjective acceleration clause and a lock-box arrangement required by the lender results in borrowings outstanding under the PNC Credit Facility being classified as short-term obligations despite the three year term of the agreement.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

PNC Credit Facility

On May 29, 2012, the Company entered into the PNC Credit Facility with PNC Bank, National Association, as administrative agent (the "Agent") for the lenders (the "Lenders") pursuant to which the Lenders agreed to extend credit to the Company in the form of loans (each a "Loan" and collectively, the "Loans") on a revolving basis of up to $35.0 million (the "Commitment"). Capitalized terms used but not otherwise defined herein shall have the meaning given to them in the loan agreement. Set forth below are certain of the material terms of the loan agreement:

Revolving Advances: Each Lender, severally and not jointly, will make revolving advances to the Company in aggregate amounts outstanding at any time equal to such Lender's Commitment Percentage of the lesser of (a) $35.0 million less the maximum undrawn amount on all outstanding letters of credit, or (b) an amount equal to the sum of: (i) up to 85% of Eligible Receivables, plus (ii) up to the lesser of (x) up to 85% of Eligible Extended Term Receivables or (y) $3.0 million, plus (iii) up to the lesser of (x) up to 85% of Eligible Government Receivables or (y) $800,000, plus (iv) up to the lesser of (x) 75% of Eligible Unbilled Receivables or (y) $8.5 million; provided, however, that no more than $800,000 of the amount resulting from the calculation of this part (iv) may be attributable to Eligible Unbilled Receivables owed by Government Customers, plus (v) up to the lesser of (x) up to 50% of Eligible Costs in Excess of Billings or (y) $4.0 million, minus (vi) the Maximum Undrawn Amount of all outstanding letters of credit, minus (vii) such reserves as Agent may deem proper and necessary in the exercise of its discretion. Certain of the percentages and dollar amounts discussed above may be increased or decreased by Agent at any time, so long as such increase or decrease is done is reasonable and done in good faith.

Interest: Any Loans will bear interest at (a) the sum of the Alternate Base Rate (defined as a fluctuating rate equal to the highest of (x) the commercial lending rate of Agent as publicly announced and in effect on such day, (y) the daily federal funds open rate as quoted by ICAP North America, Inc. in effect on such day plus 1/2 of 1%, and (z) the Daily Libor Rate plus 1% (with the Daily LIBOR Rate determined by taking the LIBOR rate published in the Wall Street Journal and dividing it by a number equal to 1 minus the reserve percentage on that day as determined by the Board of Governors of the Federal Reserve), plus the Applicable Margin (defined below) for Domestic Rate Loans or (b) the sum of the Eurodollar Rate (defined as a fluctuating rate determined by Agent by dividing the quoted LIBOR rate (as selected from a variety of sources) by a number equal to 1 minus the reserve percentage on that day as determined by the Board of Governors of the Federal Reserve), plus the Applicable Margin with respect to Eurodollar Rate Loans.

Collateral: All obligations of the Company under the loan agreement are secured by a first priority perfected lien against any and all personal property assets of the Company (other than certain excluded property, including certain accounts receivable related to the Caspian Pipeline Consortium pledged under the Ex-Im Transaction Specific Credit Agreement dated as of July 13, 2011 between ENGlobal US and Wells Fargo Bank, National Association).

Term: All Loans and all other obligations outstanding under the loan agreement shall be payable in full on May 29, 2015, unless otherwise terminated pursuant to the terms of the loan agreement.

Covenants: The loan agreement requires the Company to comply with various financial, affirmative and negative covenants affecting their businesses and operations, including:

- Maintain as of the last day of each applicable period a Tangible Net Worth at least equal to the amount set forth for such period: (a) for each of the fiscal quarters ending June 30, 2012, September 29, 2012 and December 31, 2012, a minimum Tangible Net Worth of 90% of the Tangible Net Worth of the Company on a consolidated basis on the Closing Date, and (b) for the fiscal quarter ending March 31, 2013, and as of the last day of each fiscal quarter thereafter, a minimum Tangible Net Worth equal to that required on December 31 of the immediately preceding fiscal year plus (i) 75% of the Company's after tax net income for such year if such after tax net income is greater than $0, or (ii) $0, if the Company's after tax net income for such year is less than or equal to $0.

- Maintain a Fixed Charge Coverage Ratio of not less than 1.10 to 1.00, measured as of (a) June 30, 2012, for the fiscal quarter then most recently ended, (b) September 29, 2012, for the two fiscal quarter period then most recently ended, (c) December 31, 2012, for the three fiscal quarter then most recently ended, (d) March 31, 2013 and as of the last day of each fiscal quarter thereafter, for the four fiscal quarter period then most recently ended.
- Maintain at all times Average Excess Availability of not less than $3.5 million measured monthly as of the last day of the month.
- Not permit the aggregate amount of all costs and expenses incurred in connection with the Company's performance of its Caspian project obligations to exceed the aggregate amount of cash receipts attributable to the Caspian Contracts by more than the following amounts: (a) for the month ending June 30, 2012, $6.5 million, (b) for the month ending September 29, 2012, $1.0 million, and (c) for the month ending December 31, 2012, $0.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

- The Company will not be party to mergers, acquisitions, consolidations, reorganizations or similar transactions.
- The Company will not sell, lease, transfer or otherwise dispose of any of their properties or assets (subject to certain exceptions set forth in the Loan Agreement).
- The Company will not contract for, purchase or make any expenditure or commitment for capital expenditures in the fiscal year ending December 31, 2012 and in any fiscal year thereafter, in an aggregate amount in excess of $3.5 million.
- The Company will not declare, pay or make any dividend or distribution on any shares of common or preferred stock or use any funds, property or assets to repurchase or otherwise retire any common or preferred stock.

Compliance with Covenants and Fulfillment of Conditions: As of September 29, 2012, the Company was not in compliance with the covenants described below:

- The Company did not provide a foreign good standing certificate for ENGlobal US issued by the Secretary of State or other appropriate official of the State Illinois within 14 days of the closing of the PNC Credit Facility. The Company filed the amended and restated franchise tax filings with the Illinois Secretary of State on July 20, 2012. Since that time, the Company has received and responded to additional information requests from the Illinois Secretary of State. As of the date of this filing, the Company was continuing to work with the Illinois Secretary of State to obtain the foreign good standing certificate.
- The Company did not maintain Tangible Net Worth, as of September 29, 2012, of at least 90% of the Borrowers' Tangible Net Worth as of the closing date of the PNC Credit Facility.
- The Company did not maintain a Fixed Charge Coverage Ratio of not less than 1.10 to 1.00 measured as of September 29, 2012, for the two fiscal quarter periods then most recently ended.
- The Company did not maintain Average Excess Availability of not less than $3.5 million for the fiscal monthly period ended August 25, 2012.

On September 27, 2012, the Company entered into the First Amendment to Revolving Credit and Security Agreement and Forbearance Agreement (the "Forbearance Agreement"), with the Lenders regarding the PNC Credit Facility. Under the terms of the Forbearance Agreement, the Lenders agreed to forbear, during the Forbearance Period (as defined below), from exercising their rights and remedies, under the PNC Credit Facility, with respect to events of default, including those discussed in Note 7. The "Forbearance Period" commenced on the Effective Date and ended on October 31, 2012. On October 30, 2012, the Forbearance Period was extended to November 15, 2012. On November 14, 2012, the Forbearance Period was extended to November 30, 2012 (or earlier should any forebearance default occur).

In addition, under the terms of the Forbearance Agreement, the Company retained, for the duration of the Forbearance Period, a turnaround consultant to provide a turnaround or exit plan, in form and substance satisfactory to the Agent, and services as are reasonably necessary to facilitate the Company's ability to operate in compliance with the terms of the loan agreement.

In addition, under the terms of the Forbearance Agreement, during the Forbearance Period and subject to the other conditions set forth in the loan agreement and the Forbearance Amendment, Lenders may, in their sole and absolute discretion, make revolving advances to the Company in such portions and at the times set forth in the loan agreement, which advances will bear interest at the default rate of interest (currently 7%).

As of the result of covenant violations, including those described above, the Company is currently in default under the terms of the PNC Credit Facility. As of the date of this filing, the Agent has not taken any action with respect to the

Company's defaults and the Company was actively discussing with the Agent the terms under which such defaults may be cured or waived. Although the Company is in active discussions with the Agent, if the Company is not successful in obtaining the cure or waiver of such defaults, at the end of the Forbearance Period, the Agent may exercise any and all rights and remedies available to it, including demanding immediate repayment of all amounts then outstanding or initiating foreclosure or insolvency proceedings. In such event and if we are unable to obtain alternative financing, our business will be materially and adversely affected, and we may be forced to sharply curtail or cease our operations.

Wells Fargo Credit Facility

In December 2009, the Company entered into a credit agreement with Wells Fargo Bank, National Association (“Wells Fargo”) which provided a 28-month, $25 million senior secured revolving credit facility (“Wells Fargo Credit Facility”). On September 30, 2010, the Company entered into an amendment to the Wells Fargo Credit Facility with Wells Fargo which converted our borrowings from a revolving credit facility to an asset based lending agreement. On August 1, 2011, the Company entered into an Amended and Restated Credit Agreement with Wells Fargo that allowed a maximum available principal amount of $35 million under the Wells Fargo Credit Facility. The Wells Fargo Credit Facility, as amended and restated, terminated concurrent with the closing of the PNC Bank Facility on May 29, 2012.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

Ex-Im Bank Facility

In July 2011, with the support of Wells Fargo's Global Banking Group, ENGlobal and the Export-Import Bank of the United States ("Ex-Im Bank") entered into a separate $9.5 million letter of credit facility (the "Ex-Im Bank Facility") to support the Company's Caspian Pipeline Consortium (CPC) project. Under the terms of this agreement, the Company may issue letters of credit to CPC for its performance under the CPC project. The Company is required to collateralize letters of credit outstanding under the Ex-Im Bank Facility with cash or eligible Russian receivables resulting from the CPC project. As of the date of this filing, there was one $9.1 million letter of credit outstanding under this facility. This letter of credit was collateralized by $2.3 million in cash. In the near term, the Company intends to keep the Ex-Im Bank Facility with Wells Fargo until the CPC project has receivables from the Russian portion of the project that are at a sufficient level for borrowing base collateral coverage and this facility is transferred to our new senior lender.

Covenants: The Ex-Im Bank Facility requires the Company to comply with various, financial, affirmative and negative covenants affecting its businesses and operations, including:

- The Company will not be a party to mergers, acquisitions, consolidations, reorganizations or similar transactions.
- The Company will not contract for, purchase or make any expenditure or commitment for capital expenditures in any fiscal year, in an aggregate amount in excess of $3.5 million.
- The Company will not incur any indebtedness except for (a) ENGlobal's liabilities under the PNC Credit Facility, and (b) any other liabilities of ENGlobal not to exceed $1 million in indebtedness in any 12 month period for the unsecured financing of insurance premiums.
- The Company will not declare, pay or make any dividend or distribution on any shares of common or preferred stock or use any funds, property or assets to repurchase or otherwise retire any common or preferred stock.
- The Company will maintain as of the last day of each applicable period a Tangible Net Worth ratio not greater than 2.25 to 1.0.
- The Company will maintain a Fixed Charge Coverage Ratio of not less than 1.75 to 1.00, measured as of each fiscal quarter end commencing September 30, 2011, determined on a rolling 4-quarter basis.

Compliance with Covenants: As of September 29, 2012, the Company was not in compliance with the covenants described below:

- The Company did not maintain a Tangible Net Worth ratio greater than 2.25 to 1.0.
- The Company did not maintain a Fixed Charge Coverage Ratio of not less than 1.75 to 1.00 measured for the rolling four quarter period ended September 29, 2012.

As of the result of covenant violations, including those described above, the Company is currently in default under the terms of the Ex-Im Bank Facility. As of the date of this filing, Wells Fargo had not taken any action with respect to the Company's defaults and the Company was actively discussing with Wells Fargo the terms under which such defaults may be cured or waived. Although the Company is in active discussions with Wells Fargo, if the Company is not successful in obtaining the cure or waiver of such defaults, Wells Fargo may exercise any and all rights and remedies available to it, up to and including terminating the Ex-Im Bank Facility. In such event and if we are unable to obtain an alternative facility, our business will be materially and adversely affected, and we may be forced to sharply curtail or cease our operations.

NOTE 8 – SEGMENT INFORMATION

The Engineering and Construction segment provides services relating to the development, management and execution of projects requiring professional engineering and related project services primarily to the midstream and downstream sectors throughout the United States. Services provided by the Engineering and Construction segment include feasibility studies, engineering, design, procurement and construction management. The Engineering and Construction segment includes the government services group, which provides engineering, design, installation and operation and maintenance of various government, public sector and international facilities. The Automation segment provides services related to the design, fabrication and implementation of process distributed control and analyzer systems, advanced automation, information technology, electrical and heat tracing projects primarily to the upstream and downstream sectors throughout the United States as well as specific projects in the Middle East and Central Asia.

Identifiable assets, revenue, gross profit and operating income for each segment are set forth in the following table. The amount identified as corporate includes those activities that are not allocated to the operating segments and include costs related to business development, executive functions, finance, accounting, health, safety, and environmental, human resources and information technology that are not specifically identifiable with the segments. The Corporate function supports all business segments and therefore cannot be specifically assigned to any specific segment. A significant portion of corporate costs are allocated to each segment based on each segment's revenue.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

Total Assets by Segment	As of September 29, 2012	As of December 31, 2011
	(amounts in thousands)	
Engineering and Construction	$ 37,033	$ 52,108
Automation	28,009	24,080
Field Solutions*	13,103	15,297
Electrical Services*	710	3,757
Corporate	7,638	8,937
Total	$ 86,493	$ 104,179

* All of these assets are included in assets held for sale from discontinued operations as of September 29, 2012 and December 31, 2011.

Statement of Operations Data:	Engineering and Construction	Automation	Corporate	Consolidated
		(amounts in thousands)		
Three months ended September 29, 2012				
Revenue	$ 40,779	$ 16,703	$ —	$ 57,482
Gross profit (loss)	2,638	2,734	(2,102)	3,270
SG&A	2,055	1,096	3,011	6,162
Goodwill impairment	14,568	—	—	14,568
Operating income (loss)	(13,985)	1,638	(5,113)	(17,460)
Other expense				(98)
Interest expense, net				(643)
Tax expense				(412)
Discontinued operations - net of taxes				(3,717)
Net loss				(22,330)
Three months ended September 30, 2011				
Revenue	$ 46,695	$ 13,787	$ —	$ 60,482
Gross profit	4,659	2,117	—	6,776
SG&A	2,009	1,148	3,525	6,682
Operating income (loss)	2,650	969	(3,525)	94
Other expense				(8)
Interest expense, net				(303)
Tax expense				(138)
Discontinued operations - net of taxes				(918)
Net loss				$ (1,273)

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

Statement of Operations Data:	Engineering and Construction	Automation	Corporate	Consolidated
		(amounts in thousands)		
Nine months ended September 29, 2012				
Revenue	$131,161	$44,644	$—	$175,805
Gross profit (loss)	9,874	5,578	(2,102)	13,350
SG&A	6,684	3,186	9,431	19,301
Goodwill impairment	14,568	—	—	14,568
Operating income (loss)	(11,378)	2,392	(11,533)	(20,519)
Other expense				(100)
Interest expense, net				(1,320)
Tax expense				(5,606)
Discontinued operations - net of taxes				(4,779)
Net loss				$(32,324)
Nine months ended September 30, 2011				
Revenue before eliminations	$128,240	$34,949	$—	$163,189
Inter-segment eliminations	(1)	(227)	—	(228)
Revenue	128,239	34,722	—	162,961
Gross profit	12,240	4,954	—	17,194
SG&A	5,702	3,083	9,931	18,716
Operating income (loss)	6,538	1,871	(9,931)	(1,522)
Other expense				(68)
Interest expense, net				(711)
Tax benefit				460
Discontinued operations - net of taxes				(1,263)
Net loss				$(3,104)

NOTE 9 – FEDERAL AND STATE INCOME TAXES

As a result of the valuation allowance recorded against our deferred tax assets as of September 29, 2012, the effective income tax rates for the three and nine month periods ended September 29, 2012 were not meaningful. The effective income tax rates for the three and nine month periods ended September 30, 2011 were 25.6% and 26.1%, respectively.

ASC Topic 825, "Income Taxes" requires all available evidence, both positive and negative, be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. During the quarter, based upon the Company's recent performance, management determined the realization of deferred tax assets is uncertain as the Company is unable to consider tax planning strategies or projections of future taxable income in its evaluation of the realizability of its deferred tax assets as of September 29, 2012. Under these circumstances, deferred tax assets may only be realized through future reversals of taxable temporary differences and carryback of net operating losses to available carryback periods. We have performed such an analysis and a valuation allowance of approximately $10.4 million has been provided against deferred tax assets as of September 29, 2012.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

NOTE 10 – INCOME (LOSS) PER SHARE

Income (loss) per share is computed by dividing net income (loss) from operations attributable to common stock by the weighted average number of common shares outstanding during each period. Income (loss) per share is calculated for both continuing and discontinued operations. Diluted income (loss) per share is computed by adjusting the average number of common shares outstanding for the dilutive effect, if any, of common stock equivalents such as stock options and restricted stock. Diluted net income (loss) per share is the same as basic net income (loss) per share for all periods presented because potential common stock equivalents were anti-dilutive. The Company excluded potentially issuable shares of 593,000 from the computation of diluted income (loss) per share, as the effect of including the shares would have been anti-dilutive for the three month period ended September 30, 2011, and the nine month period ended September 30, 2011. There were no potentially issuable shares in 2012.

NOTE 11 – COMMITMENTS AND CONTINGENCIES

Litigation

In June 2008, ENGlobal filed an action in the United States District Court for the Eastern District of Louisiana; Case Number 08-3601, against South Louisiana Ethanol LLC ("SLE") entitled ENGlobal Engineering, Inc. and ENGlobal Construction Resources, Inc. vs. South Louisiana Ethanol, LLC. The lawsuit seeks to enforce collection of $15.8 million owed to ENGlobal and its affiliates for services performed on an ethanol plant in Louisiana. In August 2009, SLE filed for Chapter 11 protection in the United States Bankruptcy Court for the Eastern District of Louisiana, Case Number 09-12676. Pursuant to the bankruptcy, the plant assets were sold for $6,802,000. On December 6, 2011, the court issued an order allocating proceeds from the sale and authorizing their distribution. Of the total amount, $1,054,418 was allocated to ENGlobal. Of that amount, $845,529 is still being held by the court pending the outcome of continuing litigation regarding the claims of one subcontractor. We estimate the court will render a final decision regarding this matter in the fourth quarter of 2012.

In June 2012, a Contractor filed an action in the United States District Court for Tulsa County, Oklahoma against ENGlobal Construction Resources, Inc dba. ENGlobal Inspection Services. The Contractor alleges that ENGlobal Inspection failed to properly inspect and verify that the nondestructive testing of girth welds on portions of the pipeline system was completed in accordance with state and federal regulations and contract specifications. The Contractor further alleges that ENGlobal Engineering failed to properly manage the work of ENGlobal Inspection to ensure that the work was properly performed, causing the Contractor to incur in excess of $2,500,000 in damages. ENGlobal maintains that the Contractor managed and failed to properly staff the project. The work at issue was not under ENGlobal's scope of work and ENGlobal was not authorized by the Contractor to perform such work. The case is still in discovery. At this time, we express no opinion with respect to the likelihood of an unfavorable outcome, because we have not formed a judgment that an unfavorable outcome is either probable or remote and we express no opinion with respect to an estimate of the amount or range of potential loss if the outcome should be unfavorable. We are still gathering facts on our exposure, discussing coverage with our carriers and have accrued a $600,000 liability associated with this claim. Because this liability was incurred in the Field Solutions segment, it is included in Liabilities held for sale on the Condensed Consolidated Balance Sheets and Income (Loss) from Discontinued Operations on the Condensed Consolidated Statement of Operations.

From time to time, ENGlobal or one or more of its subsidiaries is involved in various legal proceedings or are subject to claims that arise in the ordinary course of business alleging, among other things, claims of breach of contract or negligence in connection with the performance or delivery of goods and/or services. The outcome of any such claims or proceedings cannot be predicted with certainty. We believe, as of the date of this filing, all such active proceedings and claims of substance that have been raised against any subsidiary business entity have been adequately allowed for, or are covered by insurance, such that, if determined adversely to the Company, individually or in the aggregate, they would not have a material adverse effect on our results of operations or financial position.

Insurance

The Company carries a broad range of insurance coverage, including general and business automobile liability, commercial property, professional errors and omissions, workers' compensation insurance, director's and officer's liability insurance and a general umbrella policy. The Company is not aware of any claims in excess of insurance recoveries. ENGlobal is partially self-funded for health insurance claims. Provisions for expected future payments are accrued based on the Company's experience. Specific stop loss levels provide protection for the Company with $200,000 per occurrence. The self-insurance liability, which is included in the Accrued Compensation and Benefits line of the balance sheet, was $1.6 million as of September 29, 2012 and $1.2 million as of December 31, 2011.

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Notes to Unaudited Interim Condensed Consolidated Financial Statements

NOTE 12 – SUBSEQUENT EVENTS

Notice of Delisting

On October 3, 2012, the Company received written notice from The NASDAQ Stock Market LLC ("NASDAQ") indicating that the Company is not in compliance with the $1.00 minimum bid price requirement for continued listing on the NASDAQ Global Select Market. The Company has a grace period of 180 calendar days, or until April 1, 2013, to regain compliance with the minimum bid price requirement. To regain compliance, the closing bid price of the Company's common stock must meet or exceed $1.00 per share for at least ten consecutive business days during this 180-day grace period. If the Company is not in compliance by April 1, 2013, the Company may be afforded a second 180 calendar day grace period if it transfers the listing of its common stock to The NASDAQ Capital Market. To qualify, the Company would be required to meet the continued listing requirement for market value of publicly held shares and all other initial listing standards for The NASDAQ Capital Market, except for the minimum bid price requirement. In addition, the Company would be required to notify NASDAQ of its intent to cure the minimum bid price deficiency by effecting a reverse stock split if necessary.

The Company intends to consider available options to resolve the noncompliance with the minimum bid price requirement. No determination regarding the Company's response has been made at this time. There can be no assurance that the Company will be able to regain compliance with the minimum bid price requirement or will otherwise be in compliance with other NASDAQ listing criteria.

Extension of the Forbearance Agreement

On September 27, 2012, the Company entered into the First Amendment to Revolving Credit and Security Agreement and Forbearance Agreement (the "Forbearance Agreement"), with the Lenders regarding the PNC Credit Facility. Under the terms of the Forbearance Agreement, the Lenders agreed to forbear, during the Forbearance Period (as defined below), from exercising their rights and remedies, under the PNC Credit Facility, with respect to events of default, including those discussed in Note 7. The "Forbearance Period" commenced on the Effective Date and ended on October 31, 2012. On October 30, 2012, the Forbearance Period was extended to November 15, 2012. On November 14, 2012, the Forbearance Period was extended to November 30, 2012 (or earlier should any forebearance default occur).

Closing of Sale of the Land and Right of Way Division of the Field Solutions Segment

On November 2, 2012, the Company completed the divestiture of its Land and Right-of-Way division of the Field Solutions segment (effective October 26, 2012). Pursuant to the final agreement, the Company will retain approximately $4.5 million of this division's working capital at the time of closing, in addition to receiving a $3.0 million promissory note payable over four years. Subject to the terms of the final agreement, the purchase price was adjusted based on the net working capital of the division at the time of closing. ENGlobal intends to use the net proceeds from this transaction to reduce outstanding debt. This transaction will result in a loss on sale of these assets of approximately $1.1 million.

As previously reported, the original agreement provided for the sale of substantially all of the assets of both divisions of its Field Solutions segment, the Land and Right-of-Way, and Inspection. However, the Inspection division was not sold as part of the final transaction, and ENGlobal will retain the Tulsa-based business for the foreseeable future, while actively pursuing its sale and reporting its financial position and results of operations as discontinued operations. The Company expects no changes to the personnel of its Inspection operation as a result of this transaction.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Forward-Looking Statements

Certain information contained in this Quarterly Report on Form 10-Q, as well as other written and oral statements made or incorporated by reference from time to time by the Company and its representatives in other reports, filings with the Securities and Exchange Commission, press releases, conferences or otherwise, may be deemed to be forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934. This information includes, without limitation, statements concerning the Company's future financial position and results of operations, planned capital expenditures, business strategy and other plans for future operations, the future mix of revenues and business, customer retention, project reversals, commitments and contingent liabilities, future demand and industry conditions. Although the Company believes that the expectations reflected in such forward-looking statements are reasonable, it can give no assurance that such expectations will prove to have been correct. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Generally, the words "anticipate," "believe," "estimate," "expect," "may" and simi expressions, identify forward-looking statements, which generally are not historical in nature. Actual results could differ materially from the results described in the forward-looking statements due to the risks and uncertainties set forth in this Quarterly Report on Form 10-Q, the specific risk factors identified in the Company's Annual Report on Form 10-K for the year ended December 31, 2011, and those described from time to time in our future reports filed with the Securities and Exchange Commission. The following discussion is qualified in its entirety by, and should be read in conjunction with, the Company's condensed consolidated financial statements, including the notes thereto, included in this Quarterly Report on Form 10-Q and the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

Business Overview

For the three and nine-month periods ended September 29, 2012, the Company reported net losses of approximately $22.3 million and $32.3 million, respectively. Included in the third quarter results were non-cash charges totaling approximately $17.5 million relating to an impairment of goodwill, a litigation accrual and a write-down of the assets of the Field Solutions segment currently classified as held-for-sale.

Accounting standards require companies to evaluate the carrying value of goodwill when there are events or changes in circumstance that indicate a possible impairment. As a result of the Company's continuing losses and its recent decision to sell its Field Solutions segment, the Company concluded that it was appropriate to evaluate the carrying value of its goodwill. As a result of this evaluation, the Company recognized a non-cash goodwill impairment charge of approximately $16.9 million. Of this amount, approximately $14.6 million related to the Engineering and Construction segment and is included in continuing operations and approximately $2.4 million (of which approximately $1.1 million represented the write-down of the assets of the Land and Right-of-Way division of the Field Solutions segment the sale of which closed on November 2, 2012) related to the Field Solutions segment and is included in discontinued operations.

In June 2012, a contractor filed an action against the Company. The contractor alleges that the Company, through the Inspection division of the Field Solutions segment, failed to properly inspect and verify welds on portions of a pipeline system were completed in accordance with state and federal regulations and contract specifications. We are still gathering facts on our exposure, discussing coverage with our carriers and have accrued a $0.6 million liability that is included in discontinued operations.

During the quarter, the Company finished a very difficult project in its Electrical division, which is included in Discontinued Operations. This is the last remaining project in this division and one where the Company underestimated the strict working environment of the project which significantly increased the labor required on the project, the quality of the available labor pool which also increased the labor required on the project and scope of the project. As a result, the Company recorded significant losses from this project. The Company recorded a reserve on this project of $0.5 million during this quarter.

During the quarter, the Company completed a large, fixed price project for one of its customers. During the project, the scope of the project changed significantly resulting in significant increases in the costs. These increases were not passed on to the customer in a timely manner resulting in disputed costs. While the Company is in continuing discussion with its customer and believes it has sufficient grounds to prevail, it has recorded a loss on this project during the quarter of approximately $0.6 million.

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The results for the nine-month period ended September 29, 2012 include the impact of the items discussed above and a non-cash charge of approximately $6.2 million relating to a valuation allowance established in connection with the Company’s deferred tax assets during the second quarter of 2012.

In the first quarter of 2012, we were notified by Wells Fargo Bank that they were no longer willing to support the Company with its credit facility. In response, we began looking for a replacement credit facility to meet our working capital needs, while curtailing unnecessary expenditures. As a result of the uncertainty created by the credit facility transition, we spent valuable time reassuring our customers, vendors and stakeholders. Unfortunately, the internal focus, while necessary, was also counterproductive to our business development. As a result, our sales throughout the second and third quarters have been weaker than expected.

In May 2012, we closed on a new three-year secured revolving credit facility with PNC Bank, N.A. The PNC Credit Facility allows the Company to borrow up to $35 million pursuant to a borrowing base formula based primarily on the Company's eligible accounts receivable. The PNC Credit Facility was used to repay the outstanding indebtedness under the former credit facility with Wells Fargo Bank and to provide ongoing working capital. ENGlobal's existing letter of credit facility with Export-Import Bank of the United States remains in place to support the Company's Caspian Pipeline Consortium (CPC) project. We have failed to comply with all of the covenants of these facilities and are presently in default with respect to both facilities.

On September 27, 2012, the Company entered into the First Amendment to Revolving Credit and Security Agreement and Forbearance Agreement, with the Lenders regarding the PNC Credit Facility. Under the terms of the Forbearance Agreement, the Lenders agreed to forbear, during the Forbearance Period (as defined below), from exercising their rights and remedies, under the PNC Credit Facility, with respect to events of default, including those discussed in Note 7. The Forbearance Period commenced on the Effective Date and ended on October 31, 2012. On October 30, 2012, the Forbearance Period was extended to November 15, 2012. On November 14, 2012, the Forbearance Period was extended to November 30, 2012 (or earlier should any forebearance default occur). After that date, PNC Bank may exercise any and all rights and remedies available to it, including demanding immediate repayment of all amounts then outstanding or initiating foreclosure or insolvency proceedings. In such event and if we are unable to obtain alternative financing, our business will be materially and adversely affected, and we may be forced to sharply curtail or cease our operations.

On October 11, 2012, we announced that our Board of Directors had initiated a process to explore and consider possible strategic alternatives for enhancing shareholder value and supporting the Company's long-term financial strength. The Board of Directors retained Simmons & Company International as its financial advisor during this process. We continue to take actions to streamline our operations, including the divestiture of our Field Solutions segment, the implementation of expense reduction initiatives, and the retention of a management consultant to perform advisory services. We have not made any decision to engage in any specific strategic alternative at this time, and the exploration of strategic alternatives may not result in any specific action or transaction. ENGlobal does not intend to provide updates or make any further comment regarding its exploration and evaluation of strategic alternatives unless and until the Board of Directors has approved a definitive course of action.

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Financial Overview of Continuing Operations

The following financial information sets forth a general overview of our financial condition and results of operations for the three and nine months ended September 29, 2012, compared to the corresponding periods in 2011.

Selected Results of Operations	During the three months ended September 29, 2012		During the nine months ended September 30, 2012	
Revenues	Decreased	5.0 %	Increased	7.9 %
Gross profit	Decreased	51.7 %	Decreased	22.4 %
Selling, general and administrative expense	Decreased	7.8 %	Increased	3.1 %

Selected Balance Sheet Comparisons	As of September 29, 2012	As of December 31, 2011	As of September 30, 2011
		(amounts in thousands)	
Working capital	$ 16,428	$ 32,053	$ 35,175
Total assets*	$ 86,493	$ 104,179	$ 116,283
Accounts receivable (net)	$ 46,949	$ 44,159	$ 46,231
Stockholders' equity	$ 26,352	$ 58,500	$ 62,305

*Includes $13.8 million, $19.1 million, and $22.2 million of assets held for sale from discontinued operations at September 29, 2012, December 31, 2011, and September 30, 2011, respectively.

The Company recognizes service revenue as soon as the services are performed. For clients that we consider higher risk, such as developer clients, clients with a late payment history or history of not providing written work authorizations, we have deferred revenue recognition until we receive either a written authorization or payment. The current amount of revenue deferred for these reasons is approximately $0.1 million. We expect a majority of the deferred revenue amount to be realized by year end.

Revenue on fixed-price contracts is recorded primarily using the percentage-of-completion (cost-to-cost) method. Under this method, revenue is recognized in the ratio that contract costs incurred bear to total estimated contract costs. Revenue and gross margin on fixed-price contracts are subject to revision throughout the lives of the contracts and any required adjustments are made in the period in which the revisions become known. To manage unknown risks, management may use contingency amounts to increase the estimated costs, therefore lowering the earned revenues until the risks are better identified and quantified or have been mitigated. Losses on contracts are recorded in full as they are identified.

Improving our margins on our existing work is an important area of focus. During the recent period of industry-wide decline in demand for the types of services we provide, we reduced our rates significantly, as was required to obtain and retain business. Although the level of demand has increased, pricing in certain geographical markets is still extremely competitive and we have not yet been able to increase our margins to prior levels. We have recently engaged a management consultant to assist us in improving our profit margins.

Early on, the CPC project was hampered by administrative issues related to two major design revisions, which ultimately delayed our portion of the project by several months. In addition, the client’s slow responsiveness on document approvals also contributed to the delay. Over the course of the year, we have worked diligently to understand the client's processes in order to reduce the lag time between the time documents are submitted for and ultimately receive approval. We have been focusing on improving our cash flow position on this project by expediting our client's approval of our work which is a precondition to invoicing for milestones. As a result of these efforts, the project was essentially cash flow neutral as of September 29, 2012. Despite these issues, we believe we have a solid working relationship with the client and we still anticipate completing the project and recognizing approximately $86 million in revenue over the life of the project. We continue to manage our overall billing and client collection processes toward reducing days of sales outstanding to the extent practicable.

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In the course of providing our services, we routinely provide engineering, materials and equipment and may provide construction services on a subcontractor basis. Generally, the materials, equipment and subcontractor costs are passed through to our clients and reimbursed, along with fees, which in total are at margins lower than those of our normal core business. In accordance with industry practice and generally accepted accounting principles, all such costs and fees are included in revenue. The use of subcontractor services can change significantly from project to project; therefore, changes in revenue and gross profit, selling, general and administrative expense and operating income as a percent of revenue may not be indicative of the Company's core business trends.

Selling, general and administrative expense in the segments includes management and staff compensation, office costs such as rents and utilities, depreciation, amortization, travel, bad debt and other expenses generally unrelated to specific contracts, but directly related to the support of a segment's operations. All other selling, general and administrative expense is comprised primarily of business development costs, as well as costs related to the executive, investor relations/governance, finance, corporate accounting, health, safety, and environmental, human resources, legal and information technology departments and other costs generally unrelated to specific projects but which are incurred to support corporate activities and initiatives. We have recently reviewed these expense items and have made some reductions in personnel and departmental expenses. We will continue to review these expenses and seek further reductions where appropriate.

Discontinued Operations

In 2011, as part of its strategic evaluation of operations, the Company determined that the expected future profitability of the Electrical Services group was not sufficient to support maintaining it as a viable business and that it did not fit within the future strategic plan. As a result, effective July 1, 2011, the Company initiated a plan to sell the operations of its Electrical Services group. In addition, on September 10, 2012, we announced an agreement to sell our Field Solutions segment (see Note 3 – "Discontinued Operations"). These assets, liabilities and their related operations have been classified as discontinued operations in the Company's consolidated financial statements.

On November 2, 2012, the Company completed the divestiture of its Land and Right-of-Way division of its Field Solutions segment effective October 26, 2012, and retained the Inspection division pursuant to the terms of the amended agreement. The transaction was valued at approximately $7.5 million, consisting of approximately $4.5 million in working capital at closing to the Company and a $3 million promissory note payable to the Company over four years.

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Results of Continuing Operations– Three Months ended September 29, 2012 versus September 30, 2011

Results of operations for the three months ended September 29, 2012 and September 30, 2011 are summarized below:

For the three months ended September 29, 2012	Engineering and Construction (amounts in thousands)	Automation	Corporate	Consolidated	
Revenue	$ 40,779	$ 16,703	$ —	$ 57,482	100 %
Gross profit (loss)	2,638	2,734	(2,102)	3,270	5.7 %
SG&A	2,055	1,096	3,011	6,162	10.7 %
Goodwill impairment	14,568	—	—	14,568	25.3 %
Operating income (loss)	(13,985)	1,638	(5,113)	(17,460)	(30.3)%
Other income (expense)				(98)	(0.2.)%
Interest expense, net				(643)	(1.1)%
Tax benefit (expense)				(412)	(0.7)%
Net loss from continuing operations				$ (18,613)	(32.3)%
Diluted loss per share from continuing operations				$ (0.69)	
For the three months ended September 30, 2011					
Revenue	$ 46,695	$ 13,787	$ —	$ 60,482	100 %
Gross profit	4,659	2,117	—	6,776	11.2 %
SG&A	2,009	1,148	3,525	6,682	11.0 %
Goodwill impairment	—	—		—	0.0 %
Operating income (loss)	2,650	969	(3,525)	94	0.2 %
Other income (expense)				(8)	(0.0)%
Interest expense, net				(303)	(0.5)%
Tax benefit (expense)				(138)	(0.2)%
Net loss from continuing operations				$ (355)	(0.5)%
Diluted loss per share from continuing operations				$ (0.01)	
Increase (Decrease) in Operating Results					
Revenue before eliminations	$ (5,916)	$ 2,916	$ —	$ (3,000)	(5.0 %)
Gross profit (loss)	(2,021)	617	(2,102)	(3,506)	(5.8)%
SG&A	46	(52)	(514)	(520)	(0.9)%
Goodwill impairment	14,568	—	—	14,568	24.1 %
Operating income (loss)	(16,635)	669	(1,588)	(17,554)	(29.0)%
Other income (expense)				(90)	(0.1)%
Interest expense, net				(340)	(0.6)%
Tax benefit (expense)				(274)	(0.5)%
Net loss from continuing operations				$ (18,258)	(30.2)%

Diluted loss per share from continuing operations	$	(0.68)

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The increases and decreases in operating results comparing the three months ended September 29, 2012 to September 30, 2011 are discussed below:

Revenue:

Our revenue is generally driven by the projects that we are currently working on. These projects vary significantly in size and quantity and primarily serve clients in the upstream, midstream and downstream sectors of the energy industry. Projects are bid and awarded based upon a large number of factors most of which are governed by our customers. Revenue for the three months ended September 29, 2012, as compared to the same period in 2011 decreased approximately $3.0 million. The Automation segment experienced increased revenue, while the Engineering and Construction (“E&C”) segment experienced decreased revenue. The E&C segment decrease is due to a decrease in the in-office revenues for the Gulf Coast Region in the third quarter of 2012. The Automation segment experienced an increase in revenue in both the Fab and Non-Fab divisions.

Gross Profit (Loss):

Gross profit for the three months ended September 29, 2012, as compared to the comparable 2011 period, decreased by approximately $3.5 million, or 5.8%. As a percentage of revenue, gross profit decreased from 11.2% to 5.7% for the three months ended September 29, 2012, as compared to the same period in 2011.

Our gross profit and gross profit margin decreased primarily due to increased direct and variable costs in our E&C Segment, resulting in lower profit margins. We continue to be affected by intense competition and pricing pressures.

Selling, General, and Administrative ("SG&A"):

SG&A expense declined $0.5 million for the three months ended September 29, 2012, as compared to the same period for 2011. As a percentage of revenue, SG&A expense decreased to 10.7% for the three months ended September 29, 2012, from 11.0% for the comparable prior year period. During September 2012, we continued reducing overhead and staff levels in response to reduced activity levels. These staff reductions resulted in severance costs of approximately $0.1 million during the quarter. The declines were the result of reductions in personnel during 2012.

Goodwill Impairment:

A goodwill impairment of $14.6 million was recorded for the three months ended September 29, 2012, due to a determination of erosion in the carrying value associated with the E&C segment. No impairment was recorded for the three months ended September 30, 2011.

Interest Expense, net:

Interest expense increased for the three months ended September 29, 2012, as compared to the same period for 2011, due to higher interest rates and higher levels of borrowing under our former Wells Fargo Credit Facility and current PNC Credit Facility.

Tax Expense:

ASC Topic 825, “Income Taxes” requires all available evidence, both positive and negative, be considered to determine whether, based on the weight of that evidence, a valuation allowance is needed. During the current quarter, based upon the Company's recent performance, management determined the realization of deferred tax assets is uncertain as the Company is unable to consider tax planning strategies or projections of future taxable income in its evaluation of the realizability of its deferred tax assets as of September 29, 2012. Under these circumstances, deferred tax assets may only be realized through future reversals of taxable temporary differences and carryback of net operating losses to available carryback periods. We have performed such an analysis and a valuation allowance of approximately $10.4 million has been provided against deferred tax assets as of September 29, 2012.

Discontinued Operations – Three Months ended September 29, 2012 versus September 30, 2011

The net loss from discontinued operations increased from $0.9 million for the three months ended September 30, 2011 to $3.7 million for the three months ended September 29, 2012. This increase was due primarily to the impairment of goodwill of $2.4 million and a $0.6 million reserve established related to ongoing litigation, partially offset by decreased losses from the Electrical Services segment of $0.2 million. Losses decreased as the Electrical Services segment was wound down throughout 2012. Its operations were significant in 2011 as the Company did not make the decision to discontinue these operations until the end of the third quarter of 2011.

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Results of Operations – Nine Months ended September 29, 2012 versus September 30, 2011

Results of operations for the nine months ended September 29, 2012 and 2011 are summarized below:

For the nine months ended September 29, 2012	Engineering and Construction (amounts in thousands)	Automation	Corporate	Consolidated	
Revenue before eliminations	$ 131,161	$ 44,644	$ —	$ 175,805	100.0 %
Gross profit (loss)	9,874	5,578	(2,102)	13,350	7.6 %
SG&A	6,684	3,186	9,431	19,301	11. 0 %
Goodwill impairment	14,568	—	—	14,568	8.3 %
Operating income (loss)	(11,378)	2,392	(11,533)	(20,519)	(11.7)%
Other income (expense)				(100)	(0. 1)%
Interest expense, net				(1,320)	(0.8)%
Tax benefit (expense)				(5,606)	(3.1)%
Net loss from continuing operations				$ (27,545)	(15.7)%
Diluted loss per share from continuing operations				$ (1.02)	
For the nine months ended September 30, 2011					
Revenue before eliminations	$ 128,240	$ 34,949	$ —	$ 163,189	
Inter-segment eliminations	(1)	(227)	—	(228)	
Revenue	128,239	34,722	—	162,961	100.0 %
Gross profit (loss)	12,240	4,954	—	17,194	10.6 %
SG&A	5,702	3,083	9,931	18,716	11.5 %
Goodwill impairment	—	—	—	—	0.0 %
Operating income (loss)	6,538	1,871	(9,931)	(1,522)	(0.9)%
Other income (expense)				(68)	(0.1)%
Interest expense, net				(711)	(0.4)%
Tax benefit (expense)				460	0.3 %
Net loss from continuing operations				$ (1,841)	(1.1)%
Diluted loss per share from continuing operations				$ (0.07)	
Increase (Decrease) in Operating Results					
Revenue before eliminations	$ 2,921	$ 9,695	$ —	$ 12,616	
Inter-segment eliminations	1	227	—	228	
Revenue	2,922	9,922	—	12,844	7.9 %
Gross profit (loss)	(2,366)	624	(2,102)	(3,844)	(29.9)%
SG&A	982	103	(500)	585	11.9

%

Operating expenses:

Benefits

44,269

38,166

6,103

16.0
%
Operating costs

7,318

7,639

(321
)

(4.2
)%
Depreciation and amortization

355

333

22

6.6
%
Total operating expenses

51,942

46,138

5,804

12.6
 %
Income from operations

2,347

2,362

(15
)

(0.6
)%
Gain on sale of business

270

—

270

100.0
 %
Interest expense

186

192

(6
)

(3.1
)%
Income before income taxes

2,431

2,170

261

12.0
%
Provision for income taxes

1,155

1,023

132

12.9
%
Net income

$
1,276

$
1,147

$
129

11.2
%
Diluted earnings per common share

$
8.44

$
7.36

$

1.08

14.7
%
Benefit ratio (a)

84.5
%

83.0
%

1.5
%
Operating cost ratio (b)

13.6
%

15.9
%

(2.3
)%
Effective tax rate

47.5
%

47.2
%

0.3
%

(a) Represents total benefits expense as a percentage of premiums revenue.

(b) Represents total operating costs, excluding depreciation and amortization, as a percentage of total revenues less investment income.

Summary

Net income was $1.3 billion, or $8.44 per diluted common share, in 2015 compared to $1.1 billion, or $7.36 per diluted common share, in 2014. The completion of the sale of Concentra on June 1, 2015 resulted in an after-tax gain

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of $1.57 per diluted common share in 2015. Excluding the impact of the sale of Concentra, the decrease primarily was due to a decline in Retail segment pretax results, including expense of $0.74 per diluted common share for a premium deficiency reserve for certain of our individual commercial medical products for the 2016 coverage year, and an increase in the effective tax rate as discussed below. These items were partially offset by year-over-year improvement in the Group and Healthcare Services segment pretax results and higher investment income. In addition, 2015 includes expenses of $0.14 per diluted common share for transaction costs associated with the Merger, certain of which are not deductible for tax purposes. Net income for 2014 includes expenses of $0.15 per diluted common share associated with a loss on extinguishment of debt for the redemption of certain senior notes in 2014. Year-over-year comparisons of diluted earnings per common share are also favorably impacted by a lower number of shares used to compute diluted earnings per common share in 2015 reflecting the impact of share repurchases.

Premiums Revenue

Consolidated premiums increased $6.5 billion, or 14.0%, from 2014 to $52.4 billion for 2015 primarily reflecting higher premiums in both the Retail and Group segments. These higher premiums were primarily driven by average membership growth in the Retail segment and an increase in fully-insured group commercial medical per member premiums in the Group segment. Average membership is calculated by summing the ending membership for each month in a period and dividing the result by the number of months in a period. Premiums revenue reflects changes in membership and average per member premiums. Items impacting average per member premiums include changes in premium rates as well as changes in the geographic mix of membership, the mix of product offerings, and the mix of benefit plans selected by our membership.

Services Revenue

Consolidated services revenue decreased $758 million, or 35.0%, from 2014 to $1.4 billion for 2015 primarily due to the completion of the sale of Concentra on June 1, 2015 as well as the loss of certain large group ASO accounts as a result of continued discipline in pricing of services for self-funded accounts amid a highly competitive environment.

Investment Income

Investment income totaled $474 million for 2015, an increase of $97 million, or 25.7%, from 2014, primarily due to higher realized capital gains in 2015 as a result of the repositioning of our portfolio given recent market volatility and anticipated changes to interest rates, with higher average invested balances being substantially offset by lower interest rates.

Benefits Expense

Consolidated benefits expense was $44.3 billion for 2015, an increase of $6.1 billion, or 16.0%, from 2014 primarily due to an increase in the Retail segment mainly driven by higher average Medicare Advantage membership and individual commercial medical on-exchange and off-exchange membership in plans compliant with the Health Care Reform Law. As more fully described herein under the section entitled “Benefits Expense Recognition”, actuarial standards require the use of assumptions based on moderately adverse experience, which generally results in favorable reserve development, or reserves that are considered redundant. We experienced favorable medical claims reserve development related to prior fiscal years of $236 million in 2015 and $518 million in 2014. The decline in prior-period medical claims reserve development year over-year primarily was due to Medicare Advantage and individual commercial medical claims development in the Retail segment as discussed further in the segment results of operations discussion that follows.

The consolidated benefit ratio for 2015 was 84.5%, an increase of 150 basis points from 2014 primarily due to increases in the Retail segment, including the impact of a recognizing a premium deficiency reserve for certain of our individual commercial medical products for the 2016 coverage year, and Group segment ratios as discussed in the segment results of operations discussions that follows. The increase in benefits expense associated with the recognition of the premium deficiency reserve increased the consolidated benefit ratio by approximately 30 basis points in 2015. Favorable prior-period medical claims reserve development decreased the consolidated benefit ratio by approximately 50 basis points in 2015 versus approximately 110 basis points in 2014.

Operating Costs

Our segments incur both direct and shared indirect operating costs. We allocate the indirect costs shared by the segments primarily as a function of revenues. As a result, the profitability of each segment is interdependent.

Consolidated operating costs decreased $321 million, or 4.2%, from 2014 to $7.3 billion in 2015 primarily due to cost management initiatives across all lines of business as well as the completion of the sale of Concentra on June 1, 2015, partially offset by increases in costs mandated by the Health Care Reform Law, including the non-deductible health insurance industry fee.

The consolidated operating cost ratio for 2015 was 13.6%, decreasing 230 basis points from 2014 primarily due to decreases in the operating cost ratios in the Group and Retail segments reflecting cost management initiatives, as well as the completion of the sale of Concentra on June 1, 2015. Concentra carried a higher operating cost ratio.

Depreciation and Amortization

Depreciation and amortization for 2015 totaled $355 million, increasing $22 million, or 6.6% from 2014 reflecting higher depreciation expense from capital expenditures.

Interest Expense

Interest expense was $186 million for 2015 compared to $192 million for 2014, a decrease of $6 million, or 3.1%, primarily reflecting a higher average long-term debt balance due to the issuance of senior notes in September 2014, partially offset by the recognition of a loss on extinguishment of debt of approximately $37 million in October 2014 for the redemption of our $500 million 6.45% senior unsecured notes due June 1, 2016.

Income Taxes

Our effective tax rate during 2015 was 47.5% compared to the effective tax rate of 47.2% in 2014. The increase in the effective tax rate primarily was due to an increase in the non-deductible health insurance industry fee from 2014, substantially offset by the favorable tax effect of the gain on the sale of Concentra. See Note 11 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data for a complete reconciliation of the federal statutory rate to the effective tax rate. Our effective tax rate for 2016 is expected to be approximately 49% to 51%, excluding the impact of any non-deductible transaction costs associated with the Merger.

Retail Segment

	2015	2014	Change Members	Percentage
Membership:				
Medical membership:				
Individual Medicare Advantage	2,753,400	2,427,900	325,500	13.4 %
Group Medicare Advantage	484,100	489,700	(5,600)	(1.1)%
Medicare stand-alone PDP	4,557,900	3,994,000	563,900	14.1 %
Total Retail Medicare	7,795,400	6,911,600	883,800	12.8 %
Individual commercial (a)	1,057,700	1,148,100	(90,400)	(7.9)%
State-based Medicaid	373,700	316,800	56,900	18.0 %
Total Retail medical members	9,226,800	8,376,500	850,300	10.2 %
Individual specialty membership (b)	1,153,100	1,165,800	(12,700)	(1.1)%

(a) Individual commercial medical membership includes Medicare Supplement members.

(b) Specialty products include dental, vision, and other supplemental health and financial protection products. Members included in these products may not be unique to each product since members have the ability to enroll in multiple products.

	2015	2014	Change Dollars	Percentage
	(in millions)			
Premiums and Services Revenue:				
Premiums:				
Individual Medicare Advantage	$29,526	$25,782	$3,744	14.5 %
Group Medicare Advantage	5,588	5,490	98	1.8 %
Medicare stand-alone PDP	3,846	3,404	442	13.0 %
Total Retail Medicare	38,960	34,676	4,284	12.4 %
Individual commercial	4,243	3,265	978	30.0 %
State-based Medicaid	2,341	1,255	1,086	86.5 %
Individual specialty	261	256	5	2.0 %
Total premiums	45,805	39,452	6,353	16.1 %
Services	9	39	(30)	(76.9)%
Total premiums and services revenue	$45,814	$39,491	$6,323	16.0 %
Income before income taxes	$930	$1,339	$(409)	(30.5)%
Benefit ratio	86.7 %	84.9 %		1.8 %
Operating cost ratio	11.2 %	11.6 %		(0.4)%

Pretax Results

- Retail segment pretax income was $930 million in 2015, a decrease of $409 million, or 30.5%, compared to 2014 primarily driven by an increase in the benefit ratio for 2015, including the impact of recognizing a premium deficiency reserve of approximately $176 million for certain of our individual commercial medical products for the 2016 coverage year, partially offset by a decline in the operating cost ratio, Medicare Advantage membership growth, and higher investment income year-over-year.

Enrollment

- Individual Medicare Advantage membership increased 325,500 members, or 13.4%, from December 31, 2014 to December 31, 2015 reflecting net membership additions, particularly for our HMO offerings, for the 2015 plan year.
- Group Medicare Advantage membership decreased 5,600 members, or 1.1%, from December 31, 2014 to December 31, 2015.
- Medicare stand-alone PDP membership increased 563,900 members, or 14.1%, from December 31, 2014 to December 31, 2015 reflecting net membership additions, primarily for our Humana-Walmart plan offering, for the 2015 plan year.
- Individual commercial medical membership decreased 90,400 members, or 7.9%, from December 31, 2014 to December 31, 2015 primarily reflecting the loss of approximately 150,000 members due to termination by CMS for lack of proper eligibility documentation from the member as well as the loss of members who had subscribed to plans that were not compliant with the Health Care Reform Law. These declines were partially offset by an increase in membership in plans that are compliant with the Health Care Reform Law, primarily off-exchange.
- State-based Medicaid membership increased 56,900 members, or 18.0%, from December 31, 2014 to December 31, 2015 primarily driven by the addition of members under our Florida Medicaid contract.
- Individual specialty membership decreased 12,700 members, or 1.1%, from December 31, 2014 to December 31, 2015 primarily driven by a membership decline in supplemental health and financial protection product and vision offerings.

Premiums revenue

- Retail segment premiums increased $6.4 billion, or 16.1%, from 2014 to 2015 primarily due to membership growth across our Medicare Advantage, state-based Medicaid, and Medicare stand-alone PDP lines of business, as well as a heavier percentage of individual commercial medical business in higher premium plans compliant with the Health Care Reform Law. Average Medicare Advantage membership increased 11.8% in 2015.

Benefits expense

- The Retail segment benefit ratio of 86.7% for 2015 increased 180 basis points from 2014 primarily due to higher than expected medical costs as compared to the assumptions used in our pricing, the recognition of a premium deficiency reserve in the fourth quarter of 2015 for certain of our individual commercial medical products for the 2016 coverage year, and unfavorable year-over-year comparisons of prior-period medical claims reserve development as discussed below. In addition, the increase reflects higher benefit ratios associated with a greater number of members from state-based contracts and the impact of the change in estimate for the 2014 net 3Rs receivables in 2015. These items were partially offset by the impact of the increase in the health insurance industry fee included in the pricing of our products. In addition, the 2015 period was favorably impacted by the release of reserves for future policy benefits as individual commercial medical members transitioned to plans compliant with the Health Care Reform Law.

We experienced higher than expected medical costs as compared to the assumptions used in our pricing for 2015 primarily due to lower-than-expected 2015 Medicare Advantage financial claim recovery levels and lower-than-anticipated reductions in inpatient admissions. In addition, medical claims associated with certain individual commercial medical products, in particular products compliant with the Health Care Reform Law, exceeded the assumptions used when we set pricing for 2015. We took a number of actions in 2015 to improve the profitability of our individual commercial medical business in 2016. These actions were subject to regulatory restrictions in certain geographies and included premium increases for the 2016 coverage year related generally to the first half of 2015 claims experience, the discontinuation of certain products as well as exit of certain markets for 2016, network improvements, enhancements to claims and clinical processes and

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administrative cost control. Despite these actions, the deterioration in the second half of 2015 claims experience together with 2016 open enrollment results indicating the retention of many high-utilizing members for 2016 resulted in a probable future loss. As a result of our assessment of the profitability of our individual medical policies compliant with the Health Care Reform Law, in the fourth quarter of 2015, we recorded a provision for probable future losses (premium deficiency reserve) for the 2016 coverage year of $176 million. The increase in benefits expense associated with the recognition of the premium deficiency reserve increased the Retail segment benefit ratio by approximately 40 basis points in 2015.

- The Retail segment’s benefits expense for 2015 included the beneficial effect of $228 million in favorable prior-year medical claims reserve development versus $488 million in 2014. This favorable prior-year medical claims reserve development decreased the Retail segment benefit ratio by approximately 50 basis points in 2015 versus approximately 120 basis points in 2014. The year-over-year decline in prior-period medical claims reserve development primarily was due to the impact of lower financial claim recoveries due in part to our gradual implementation during 2014 of inpatient authorization review prior to admission as opposed to post adjudication, as well as higher than expected flu associated claims from the fourth quarter of 2014 and continued volatility in claims associated with individual commercial medical products.

Operating costs

- The Retail segment operating cost ratio of 11.2% for 2015 decreased 40 basis points from 2014 primarily reflecting administrative cost efficiencies associated with medical membership growth in the segment and other discretionary cost reductions, partially offset by the increase in the non-deductible health insurance industry fee. The non-deductible health insurance industry fee increased the operating cost ratio by approximately 160 basis points in 2015 as compared to 120 basis points in 2014.

Group Segment

	2015	2014	Change Members		Percentage	
Membership:						
Medical membership:						
Fully-insured commercial group	1,178,300	1,235,500	(57,200	)	(4.6	)%
ASO	710,700	1,104,300	(393,600	)	(35.6	)%
Military services	3,074,400	3,090,400	(16,000	)	(0.5	)%
Total group medical members	4,963,400	5,430,200	(466,800	)	(8.6	)%
Group specialty membership (a)	6,068,700	6,502,700	(434,000	)	(6.7	)%

(a) Specialty products include dental, vision, and other voluntary benefit products. Members included in these products may not be unique to each product since members have the ability to enroll in multiple products.

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	2015	2014	Change Dollars	Percentage
	(in millions)			
Premiums and Services Revenue:				
Premiums:				
Fully-insured commercial group	$5,493	$5,339	$154	2.9 %
Group specialty	1,055	1,098	(43)	(3.9)%
Military services	21	19	2	10.5 %
Total premiums	6,569	6,456	113	1.8 %
Services	698	763	(65)	(8.5)%
Total premiums and services revenue	$7,267	$7,219	$48	0.7 %
Income before income taxes	$258	$151	$107	70.9 %
Benefit ratio	80.2 %	79.5 %		0.7 %
Operating cost ratio	24.0 %	26.5 %		(2.5)%

Pretax Results

- Group segment pretax income increased $107 million, or 70.9%, to $258 million in 2015 primarily reflecting improvement in the operating cost ratio partially offset by an increase in the benefit ratio as discussed below.

Enrollment

- Fully-insured commercial group medical membership decreased 57,200 members, or 4.6% from December 31, 2014 reflecting lower membership in both large and small group accounts.
- Group ASO commercial medical membership decreased 393,600 members, or 35.6%, from December 31, 2014 to December 31, 2015 primarily due to the loss of certain large group accounts as a result of continued discipline in pricing of services for self-funded accounts amid a highly competitive environment.
- Group specialty membership decreased 434,000 members, or 6.7%, from December 31, 2014 to December 31, 2015 primarily due to the loss of certain fully-insured group medical accounts that also had specialty coverage.

Premiums revenue

- Group segment premiums increased $113 million, or 1.8%, from 2014 to 2015 primarily due to an increase in fully-insured commercial medical per member premiums partially offset by a net decline in fully-insured commercial medical membership.

Services revenue

- Group segment services revenue decreased $65 million, or 8.5%, from 2014 to 2015 primarily due to a decline in group ASO commercial medical membership.

Benefits expense

- The Group segment benefit ratio increased 70 basis points from 79.5% in 2014 to 80.2% in 2015 primarily reflecting the impact of higher specialty drug costs, net of rebates, as well as higher outpatient costs and lower prior-period medical claims reserve development, partially offset by an increase in the non-deductible health insurance industry fee included in the pricing of our products.
- The Group segment's benefits expense included the beneficial effect of $7 million in favorable prior-year medical claims reserve development versus $29 million in 2014. This favorable prior-year medical claims reserve development decreased the Group segment benefit ratio by approximately 10 basis points in 2015 versus approximately 40 basis points in 2014. The year-over-year decline in favorable prior-period medical

claims reserve development primarily was due to a relatively small number of higher severity claims in the 2015 period associated with prior periods.

Operating costs

- The Group segment operating cost ratio of 24.0% for 2015 decreased 250 basis points from 26.5% for 2014, reflecting a decline in our group ASO commercial medical membership which carries a higher operating cost ratio than our fully-insured commercial medical membership, as well as operating cost efficiencies associated with our fully-insured business. Operating cost efficiencies were the result of both sustainable cost reduction initiatives and discretionary reductions. These declines were partially offset by the impact of an increase in the non-deductible health insurance industry fee. The non-deductible health insurance industry fee increased the operating cost ratio by approximately 140 basis points in 2015 as compared to 100 basis points in 2014.

Healthcare Services Segment

	2015	2014	Change Dollars	Percentage
	(in millions)			
Revenues:				
Services:				
Provider services	$515	$1,147	$(632)	(55.1)%
Home based services	140	107	33	30.8%
Pharmacy solutions	30	99	(69)	(69.7)%
Total services revenues	685	1,353	(668)	(49.4)%
Intersegment revenues:				
Pharmacy solutions	20,551	16,905	3,646	21.6%
Provider services	1,291	1,149	142	12.4%
Home based services	875	585	290	49.6%
Clinical programs	203	208	(5)	(2.4)%
Total intersegment revenues	22,920	18,847	4,073	21.6%
Total services and intersegment revenues	$23,605	$20,200	$3,405	16.9%
Income before income taxes	$981	$738	$243	32.9%
Operating cost ratio	95.2%	95.6%		(0.4)%

Pretax results

- Healthcare Services segment pretax income of $981 million for 2015 increased $243 million, or 32.9%, from 2014 primarily due to higher earnings from our pharmacy solutions and home based services businesses as they serve our growing Medicare membership.

Script Volume

- Humana Pharmacy Solutions® script volumes for the Retail and Group segment membership increased to approximately 398 million in 2015, up 21% versus scripts of approximately 329 million in 2014. The increase primarily reflects growth associated with higher average medical membership for 2015 than in 2014.

Services revenue

- Services revenue decreased $668 million, or 49.4%, from 2014 to $685 million for 2015 primarily due to the completion of the sale of Concentra on June 1, 2015.

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Intersegment revenues

- Intersegment revenues increased $4.1 billion, or 21.6%, from 2014 to $22.9 billion for 2015 primarily due to growth in our Medicare membership which resulted in higher utilization of our Healthcare Services segment businesses.

Operating costs

- The Healthcare Services segment operating cost ratio of 95.2% for 2015 decreased 40 basis points from 95.6% for 2014 primarily due to lower operating costs in our pharmacy business together with discretionary cost reductions across the segment, partially offset by the increasing percentage of pharmacy business associated with lower margin specialty drugs. Improving operating efficiency in the pharmacy business was primarily driven by lower cost of goods associated with increased purchasing scale and lower cost-to-fill primarily due to improvements in technology.

Comparison of Results of Operations for 2014 and 2013

Certain financial data on a consolidated basis and for our segments was as follows for the years ended December 31, 2014 and 2013:

Consolidated

	2014	2013	Change Dollars	Percentage
	(dollars in millions, except per common share results)			
Revenues:				
Premiums:				
Retail	$39,452	$31,922	$7,530	23.6 %
Group	6,456	6,237	219	3.5 %
Other Businesses	51	670	(619)	(92.4)%
Total premiums	45,959	38,829	7,130	18.4 %
Services:				
Retail	39	18	21	116.7 %
Group	763	735	28	3.8 %
Healthcare Services	1,353	1,350	3	0.2 %
Other Businesses	9	6	3	50.0 %
Total services	2,164	2,109	55	2.6 %
Investment income	377	375	2	0.5 %
Total revenues	48,500	41,313	7,187	17.4 %
Operating expenses:				
Benefits	38,166	32,564	5,602	17.2 %
Operating costs	7,639	6,355	1,284	20.2 %
Depreciation and amortization	333	333	—	— %
Total operating expenses	46,138	39,252	6,886	17.5 %
Income from operations	2,362	2,061	301	14.6 %
Interest expense	192	140	52	37.1 %
Income before income taxes	2,170	1,921	249	13.0 %
Provision for income taxes	1,023	690	333	48.3 %
Net income	$1,147	$1,231	$(84)	(6.8)%
Diluted earnings per common share	$7.36	$7.73	$(0.37)	(4.8)%
Benefit ratio (a)	83.0 %	83.9 %		(0.9)%
Operating cost ratio (b)	15.9 %	15.5 %		0.4 %
Effective tax rate	47.2 %	35.9 %		11.3 %

(a) Represents total benefits expense as a percentage of premiums revenue.

(b) Represents total operating costs, excluding depreciation and amortization, as a percentage of total revenues less investment income.

Summary

Net income was $1.1 billion, or $7.36 per diluted common share, in 2014 compared to $1.2 billion, or $7.73 per diluted common share, in 2013. Net income for 2014 includes expenses of $0.15 per diluted common share associated with a loss on extinguishment of debt for the redemption of certain senior notes in 2014 and net income for 2013 includes benefits expense of $0.99 per diluted common share for reserve strengthening associated with our closed-block of long-term care insurance policies included with Other Businesses as discussed in Note 18 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data as well as the benefit of a reduction in benefits expense in 2013 related to a favorable settlement of contract claims with the DoD. Excluding these items, the increase in net income primarily resulted from higher pretax income in our Healthcare Services segment substantially offset by lower pretax income in our Retail and Group segments. In addition, 2014 was favorably impacted by a lower number of shares used to compute diluted earnings per common share reflecting the impact of share repurchases.

Premiums Revenue

Consolidated premiums increased $7.1 billion, or 18.4%, from 2013 to $46.0 billion for 2014 primarily due to increases in both Retail and Group segment premiums mainly driven by higher average individual and group Medicare Advantage membership as well as higher individual commercial medical membership. In addition, year-over-year comparisons to 2013 were negatively impacted by sequestration which became effective April 1, 2013. Premiums revenue for our Other Businesses declined primarily due to the loss of our Puerto Rico Medicaid contracts effective September 30, 2013.

Services Revenue

Consolidated services revenue increased $55 million, or 2.6%, from 2013 to $2.2 billion for 2014 primarily due to an increase in services revenue in our Retail segment due to the acquisition of American Eldercare in September 2013.

Investment Income

Investment income totaled $377 million for 2014, an increase of $2 million from 2013, as higher average invested balances were partially offset by lower interest rates.

Benefits Expense

Consolidated benefits expense was $38.2 billion for 2014, an increase of $5.6 billion, or 17.2%, from 2013 primarily due to increases in both the Retail and Group segments mainly driven by higher average individual and group Medicare Advantage membership as well as higher individual commercial medical membership. We experienced favorable medical claims reserve development related to prior fiscal years of $518 million in 2014 and $474 million in 2013. These increases in favorable medical claims reserve development primarily resulted from increased membership and better than originally expected utilization across most of our major business lines and increased financial recoveries. The increase in financial recoveries primarily resulted from claim audit process enhancements as well as increased volume of claim audits and expanded audit scope. All lines of business benefited from these improvements.

The consolidated benefit ratio for 2014 was 83.0%, a decrease of 90 basis points from 2013 primarily due to reserve strengthening in 2013 associated with our closed-block of long-term care insurance policies included with Other Businesses as discussed above, as well as the loss of our Medicaid contracts in Puerto Rico effective September 30, 2013 which more than offset higher ratios year-over-year in the Retail and Group segments.

Operating Costs

Our segments incur both direct and shared indirect operating costs. We allocate the indirect costs shared by the segments primarily as a function of revenues. As a result, the profitability of each segment is interdependent.

Consolidated operating costs increased $1,284 million, or 20.2%, in 2014 compared to 2013 primarily due to costs mandated by the Health Care Reform Law, including the non-deductible health insurance industry fee, and investments in health care exchanges and state-based contracts, partially offset by operating cost efficiencies.

The consolidated operating cost ratio for 2014 was 15.9%, increasing 40 basis points from 2013 primarily due to increases in the operating cost ratios in our Retail and Group segments due to the same factors impacting consolidated operating costs as described above.

Depreciation and Amortization
Depreciation and amortization for 2014 totaled $333 million, unchanged from 2013.
Interest Expense
Interest expense was $192 million for 2014 compared to $140 million for 2013, an increase of $52 million, or 37.1%. In September 2014, we issued $400 million of 2.625% senior notes due October 1, 2019, $600 million of 3.85% senior notes due October 1, 2024 and $750 million of 4.95% senior notes due October 1, 2044. In October 2014, we redeemed the $500 million 6.45% senior unsecured notes due June 1, 2016, at 100% of the principal amount plus applicable premium for early redemption and accrued and unpaid interest to the redemption date, We recognized a loss on extinguishment of debt of approximately $37 million in October 2014 for the redemption of these notes.
Income Taxes
Our effective tax rate during 2014 was 47.2% compared to the effective tax rate of 35.9% in 2013. The non-deductible nature of the health insurance industry fee levied on the insurance industry beginning in 2014 as mandated by the Health Care Reform Law increased our effective tax rate by approximately 9.4 percentage points for 2014.

Retail Segment

	2014	2013	Change Members	Percentage	
Membership:					
Medical membership:					
Individual Medicare Advantage	2,427,900	2,068,700	359,200	17.4	%
Group Medicare Advantage	489,700	429,100	60,600	14.1	%
Medicare stand-alone PDP	3,994,000	3,275,900	718,100	21.9	%
Total Retail Medicare	6,911,600	5,773,700	1,137,900	19.7	%
Individual commercial (a)	1,148,100	600,100	548,000	91.3	%
State-based Medicaid	316,800	85,500	231,300	270.5	%
Total Retail medical members	8,376,500	6,459,300	1,917,200	29.7	%
Individual specialty membership (b)	1,165,800	1,042,500	123,300	11.8	%

(a) Individual commercial medical membership includes Medicare Supplement members.
Specialty products include dental, vision, and other supplemental health and financial protection products.
(b) Members included in these products may not be unique to each product since members have the ability to enroll in multiple products.

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	2014	2013	Change Dollars	Percentage
	(in millions)			
Premiums and Services Revenue:				
Premiums:				
Individual Medicare Advantage	$25,782	$22,481	$3,301	14.7 %
Group Medicare Advantage	5,490	4,710	780	16.6 %
Medicare stand-alone PDP	3,404	3,033	371	12.2 %
Total Retail Medicare	34,676	30,224	4,452	14.7 %
Individual commercial	3,265	1,160	2,105	181.5 %
State-based Medicaid	1,255	328	927	282.6 %
Individual specialty	256	210	46	21.9 %
Total premiums	39,452	31,922	7,530	23.6 %
Services	39	18	21	116.7 %
Total premiums and services revenue	$39,491	$31,940	$7,551	23.6 %
Income before income taxes	$1,339	$1,490	$(151)	(10.1)%
Benefit ratio	84.9 %	85.1 %		(0.2)%
Operating cost ratio	11.6 %	10.1 %		1.5 %

Pretax Results

- Retail segment pretax income was $1.3 billion in 2014, a decrease of $151 million, or 10.1%, compared to 2013 primarily driven by investment spending for health care exchanges and state-based contracts and higher specialty prescription drug costs associated with a new treatment for Hepatitis C, partially offset by Medicare Advantage and individual commercial medical membership growth as well as increased membership in our clinical programs.

Enrollment

- Individual Medicare Advantage membership increased 359,200 members, or 17.4%, from December 31, 2013 to December 31, 2014 reflecting net membership additions, particularly for our HMO offerings, for the 2014 plan year.
- Fully-insured group Medicare Advantage membership increased 60,600 members, or 14.1%, from December 31, 2013 to December 31, 2014 primarily due to the addition of a new large group account.
- Medicare stand-alone PDP membership increased 718,100 members, or 21.9%, from December 31, 2013 to December 31, 2014 reflecting net membership additions, primarily for our Humana-Walmart plan offering, for the 2014 plan year.
- Individual commercial medical membership increased 548,000 members, or 91.3%, from December 31, 2013 to December 31, 2014 primarily reflecting new sales, both on-exchange and off-exchange, of plans compliant with the Health Care Reform Law.
- State-based Medicaid membership increased 231,300 members, or 270.5%, from December 31, 2013 to December 31, 2014 primarily driven by the addition of members under our Florida Medicaid and Florida Long-Term Support Services contracts as well as 18,300 dual eligible members from state-based contracts in Virginia and Illinois.
- Individual specialty membership increased 123,300 members, or 11.8%, from December 31, 2013 to December 31, 2014 primarily driven by increased membership in dental and vision offerings.

Premiums revenue

- Retail segment premiums increased $7.5 billion, or 23.6%, from 2013 to 2014 primarily due to membership growth across all lines of business, particularly for our Medicare Advantage, individual commercial medical, primarily on the health care exchanges, and state-based Medicaid businesses. Individual Medicare Advantage average membership increased 16.6% in 2014. Individual Medicare Advantage per member premiums decreased approximately 1.7% in 2014 compared to 2013, primarily due to Medicare rate reductions and the impact of sequestration which became effective on April 1, 2013.

Benefits expense

- The Retail segment benefit ratio of 84.9% for 2014 decreased 20 basis points from 2013 primarily due to increased membership in our clinical programs and the inclusion of the health insurance industry fee in the pricing of our products, partially offset by higher specialty prescription drug costs associated with a new treatment for Hepatitis C, higher planned clinical investment spending, and higher benefit ratios associated with members from state-based contracts.
- The Retail segment's benefits expense for 2014 included the beneficial effect of $488 million in favorable prior-year medical claims reserve development versus $428 million in 2013. This favorable prior-year medical claims reserve development decreased the Retail segment benefit ratio by approximately 120 basis points in 2014 versus approximately 130 basis points in 2013.

Operating costs

- The Retail segment operating cost ratio of 11.6% for 2014 increased 150 basis points from 2013 primarily due to the non-deductible health insurance industry fee mandated by the Health Care Reform Law and investment spending for health care exchanges and state-based contracts, partially offset by scale efficiencies from Medicare and individual commercial medical membership growth.

Group Segment

	2014	2013	Change Members	Percentage
Membership:				
Medical membership:				
Fully-insured commercial group	1,235,500	1,237,000	(1,500)	(0.1)%
ASO	1,104,300	1,162,800	(58,500)	(5.0)%
Military services	3,090,400	3,101,800	(11,400)	(0.4)%
Total group medical members	5,430,200	5,501,600	(71,400)	(1.3)%
Group specialty membership (a)	6,502,700	6,780,800	(278,100)	(4.1)%

(a) Specialty products include dental, vision, and voluntary benefit products. Members included in these products may not be unique to each product since members have the ability to enroll in multiple products.

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	2014	2013	Change Dollars	Percentage
	(in millions)			
Premiums and Services Revenue:				
Premiums:				
Fully-insured commercial group	$5,339	$5,117	$222	4.3 %
Group specialty	1,098	1,095	3	0.3 %
Military services	19	25	(6)	(24.0)%
Total premiums	6,456	6,237	219	3.5 %
Services	763	735	28	3.8 %
Total premiums and services revenue	$7,219	$6,972	$247	3.5 %
Income before income taxes	$151	$240	$(89)	(37.1)%
Benefit ratio	79.5 %	77.7 %		1.8 %
Operating cost ratio	26.5 %	26.5 %		— %

Pretax Results

- Group segment pretax income decreased $89 million, or 37.1%, to $151 million in 2014 primarily reflecting higher utilization, mainly due to higher specialty prescription drug costs associated with a new treatment for Hepatitis C, as well as the continuing impact of transitional policy changes which allowed individuals to remain in plans not compliant with the Health Care Reform Law.

Enrollment

- Fully-insured commercial group medical membership decreased 1,500 members, or 0.1% from December 31, 2013 as an increase in small group business membership was generally offset by lower membership in large group accounts. Approximately 65% of our fully-insured commercial group medical membership was in small group accounts at December 31, 2014 compared to 61% at December 31, 2013.
- Group ASO commercial medical membership decreased 58,500 members, or 5.0%, from December 31, 2013 to December 31, 2014 primarily due to continued pricing discipline in a highly competitive environment for self-funded accounts.
- Group specialty membership decreased 278,100 members, or 4.1%, from December 31, 2013 to December 31, 2014 primarily due to declines in dental and vision membership related to our planned discontinuance of certain unprofitable product distribution partnerships.

Premiums revenue

- Group segment premiums increased $219.0 million, or 3.5%, from 2013 to 2014 primarily due to higher fully-insured commercial group medical premiums per member that more than offset a slight decline in total membership for this segment.

Benefits expense

- The Group segment benefit ratio increased 180 basis points from 77.7% in 2013 to 79.5% in 2014 primarily due to higher utilization, mainly due to higher specialty prescription drug costs associated with a new treatment for Hepatitis C, as well as the continuing impact of transitional policy changes, partially offset by the inclusion of the health insurance industry fee and other fees mandated by the Health Care Reform Law in our pricing.
- The Group segment's benefits expense included the beneficial effect of $29 million in favorable prior-year medical claims reserve development versus $42 million in 2013. This favorable prior-year medical claims reserve development decreased the Group segment benefit ratio by approximately 40 basis points in 2014 versus approximately 70 basis points in 2013.

Operating costs

- The Group segment operating cost ratio of 26.5% was unchanged from 2013, reflecting the impact of the non-deductible health insurance industry fee and other fees mandated by the Health Care Reform Law as well as a higher percentage of small group commercial business which carries a higher operating cost ratio than large group business, offset by operating cost efficiencies.

Healthcare Services Segment

	2014	2013	Change Dollars	Percentage
	(in millions)			
Revenues:				
Services:				
Provider services	$1,147	$1,195	$(48)	(4.0)%
Home based services	107	94	13	13.8%
Pharmacy solutions	99	59	40	67.8%
Clinical programs	—	2	(2)	(100.0)%
Total services revenues	1,353	1,350	3	0.2%
Intersegment revenues:				
Pharmacy solutions	16,905	13,079	3,826	29.3%
Provider services	1,149	1,102	47	4.3%
Home based services	585	326	259	79.4%
Clinical programs	208	186	22	11.8%
Total intersegment revenues	18,847	14,693	4,154	28.3%
Total services and intersegment revenues	$20,200	$16,043	$4,157	25.9%
Income before income taxes	$738	$520	$218	41.9%
Operating cost ratio	95.6%	95.8%		(0.2)%

Pretax results

- Healthcare Services segment pretax income of $738 million for 2014 increased $218 million from 2013. The increase is primarily due to a decline in the operating cost ratio in 2014 on a revenue base that reflects growth from our pharmacy solutions and home based services businesses as they serve our growing Medicare membership.

Script Volume

- Humana Pharmacy Solutions® script volumes for the Retail and Group segment membership increased to approximately 329 million in 2014, up 20% versus scripts of approximately 274 million in 2013. The increase primarily reflects growth associated with higher average medical membership for 2014 than in 2013.

Services revenue

- Services revenue for 2014 were relatively unchanged from 2013, increasing $3 million, or 0.2%, to $1.4 billion for 2014.

Intersegment revenues

- Intersegment revenues increased $4.2 billion, or 28.3%, from 2013 to $18.8 billion for 2014 primarily due to growth in our Medicare membership which resulted in higher utilization of our pharmacy solutions and home based services businesses.

Operating costs

- The Healthcare Services segment operating cost ratio of 95.6% for 2014 decreased 20 basis points from 95.8% for 2013 primarily due to an improvement in the ratio for our pharmacy solutions business partially offset by our investment in home based services and other businesses across the segment.

Other Businesses

Our Other Businesses pretax income of $1 million for 2014 compared to a pretax loss of $289 million for 2013. The pretax loss in 2013 included net expense of $243 million for reserve strengthening for our closed-block of long-term care insurance policies further discussed in Note 18 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data. Year-over-year comparisons also reflect the loss of our Medicaid contracts in Puerto Rico effective September 30, 2013.

Liquidity

The Merger Agreement includes customary restrictions on the conduct of our business prior to the completion of the Merger, generally requiring us to conduct our business in the ordinary course and subjecting us to a variety of specified limitations absent Aetna’s prior written consent. Historically, our primary sources of cash have included receipts of premiums, services revenue, and investment and other income, as well as proceeds from the sale or maturity of our investment securities, borrowings, and proceeds from sales of businesses. Our primary uses of cash historically have included disbursements for claims payments, operating costs, interest on borrowings, taxes, purchases of investment securities, acquisitions, capital expenditures, repayments on borrowings, dividends, and share repurchases. Because premiums generally are collected in advance of claim payments by a period of up to several months, our business normally should produce positive cash flows during periods of increasing premiums and enrollment. Conversely, cash flows would be negatively impacted during periods of decreasing premiums and enrollment. From period to period, our cash flows may also be affected by the timing of working capital items including premiums receivable, benefits payable, and other receivables and payables. Our cash flows are impacted by the timing of payments to and receipts from CMS associated with Medicare Part D subsidies for which we do not assume risk. The use of operating cash flows may be limited by regulatory requirements of state departments of insurance (or comparable state regulators) which require, among other items, that our regulated subsidiaries maintain minimum levels of capital and seek approval before paying dividends from the subsidiaries to the parent. Our use of operating cash flows derived from our non-insurance subsidiaries, such as in our Healthcare Services segment, is generally not restricted by state departments of insurance (or comparable state regulators).

The effect of the commercial risk adjustment, risk corridor, and reinsurance provisions of the Health Care Reform Law impact the timing of our operating cash flows, as we build receivables for each coverage year that are expected to be collected in subsequent coverage years. On June 30, 2015 we received notification from CMS of risk adjustment and reinsurance settlement amounts for 2014. During 2015, we collected $392 million net for risk adjustment and reinsurance recoverable settlements associated with the 2014 coverage year. In addition, during 2015, we received our interim settlement associated with our risk corridor receivables for the 2014 coverage year. The interim settlement, representing only 12.6% of risk corridor receivables for the 2014 coverage year, was funded by HHS in accordance with previous guidance, utilizing funds HHS collected from us and other carriers under the 2014 risk corridor program. We collected $25 million net of payments for risk corridor associated with the 2014 coverage year during 2015. HHS provided guidance under the three year risk corridor program that future collections will first be applied to any shortfalls from previous coverage years before application to current year obligations. Risk corridor payables to issuers are obligations of the United States Government under the Health Care Reform law which requires the Secretary of HHS to make full payments to issuers. In the event of a shortfall at the end of the three year program, HHS has asserted it will explore other sources of funding for risk corridor payments, subject to the availability of appropriations. The

remaining net receivable balance associated with the 3Rs was approximately $982 million at December 31, 2015, including $219 million related to the 2014 coverage year, and $679 million at December 31, 2014. Any amounts receivable or payable associated with these risk limiting programs may have an impact on subsidiary liquidity, with any temporary shortfalls funded by the parent company.

For additional information on our liquidity risk, please refer to Item 1A. – Risk Factors in this 2015 Form 10-K.

Cash and cash equivalents increased to $2.6 billion at December 31, 2015 from $1.9 billion at December 31, 2014.

The change in cash and cash equivalents for the years ended December 31, 2015, 2014 and 2013 is summarized as follows:

	2015	2014	2013
	(in millions)		
Net cash provided by operating activities	$868	$1,618	$1,716
Net cash provided by (used in) investing activities	320	(63)	(1,182)
Net cash used in financing activities	(552)	(758)	(702)
Increase (decrease) in cash and cash equivalents	$636	$797	$(168)

Cash Flow from Operating Activities

The change in operating cash flows over the three year period primarily results from the corresponding change in earnings, enrollment activity, and the timing of working capital items as discussed below. The lower operating cash flows in 2015 primarily reflect the effect of significant growth in individual commercial medical and group Medicare Advantage membership in 2014 and changes in the timing of working capital items related to the growth in our pharmacy business. Operating cash flows for 2014 were favorably impacted and conversely operating cash flows for 2015 were negatively impacted from the typical pattern of claim payments that lagged premium receipts related to new membership in 2014. Individual commercial medical added 548,000 new members in 2014 compared to a decline of 90,400 members in 2015. Likewise, group Medicare Advantage added 60,600 new members in 2014 compared to a decline of 5,600 members in 2015. In addition, 2015 and 2014 operating cash flows were impacted by increased receivables associated with the 3Rs.

The most significant drivers of changes in our working capital are typically the timing of payments of benefits expense and receipts for premiums. We illustrate these changes with the following summaries of benefits payable and receivables.

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The detail of benefits payable was as follows at December 31, 2015, 2014 and 2013:

	2015	2014	2013	Change 2015	2014	2013
	(in millions)					
IBNR (1)	$3,730	$3,254	$2,586	$476	$668	$34
Reported claims in process (2)	600	475	381	125	94	66
Premium deficiency reserve (3)	176	—	—	176	—	—
Other benefits payable (4)	470	746	926	(276)	(180)	14
Total benefits payable	$4,976	$4,475	$3,893	501	582	114
Payables from acquisition				—	—	(5)
Change in benefits payable per cash flow statement resulting in cash from operations				$501	$582	$109

(1) IBNR represents an estimate of benefits payable for claims incurred but not reported (IBNR) at the balance sheet date and includes unprocessed claim inventories. The level of IBNR is primarily impacted by membership levels, medical claim trends and the receipt cycle time, which represents the length of time between when a claim is initially incurred and when the claim form is received (i.e. a shorter time span results in a lower IBNR).

(2) Reported claims in process represents the estimated valuation of processed claims that are in the post claim adjudication process, which consists of administrative functions such as audit and check batching and handling, as well as amounts owed to our pharmacy benefit administrator which fluctuate due to bi-weekly payments and the month-end cutoff.

(3) Premium deficiency reserve recognized in 2015 for our individual commercial medical business compliant with the Health Care Reform Law associated with the 2016 coverage year.

(4) Other benefits payable include amounts owed to providers under capitated and risk sharing arrangements.

The increases in benefits payable in 2015 and 2014 largely were due to an increase in IBNR. IBNR increased during 2015 primarily as a result of individual Medicare Advantage membership growth while during 2014 IBNR also increased as a result of individual Medicare Advantage membership growth as well as significant growth in individual commercial medical and group Medicare Advantage membership. As discussed previously, our cash flows are impacted by changes in enrollment. In 2014 (the first year plans compliant with the Health Care Reform Law were effective), membership in new fully-insured individual commercial medical plans compliant with the Health Care Reform Law grew as compared with a decline in membership in these plans in 2015. Similarly, growth in group Medicare Advantage membership in 2014 favorably impacted the 2014 cash flows while a decline in group Medicare Advantage membership in 2015 negatively impacted the 2015 cash flows.

In addition, the increase in benefits payable in 2015 reflects the recognition of a premium deficiency reserve associated with our individual commercial medical products compliant with the Health Care Reform Law for the 2016 coverage year. An increase in the amount of processed but unpaid claims due to our pharmacy benefit administrator, which fluctuates due to month-end cutoff, also contributed to the benefits payable increase in each of 2015 and 2014. These items were partially offset by a decrease in amounts owed to providers under capitated and risk sharing arrangements in both 2015 and 2014, including the disbursement of a portion of our Medicare risk adjustment collections under our contractual obligations associated with our risk sharing arrangements. The increase in benefits payable in 2013 primarily was due to an increase in the amount of processed but unpaid claims due to our pharmacy benefit administrator and an increase in IBNR, primarily as a result of Medicare Advantage membership growth.

The detail of total net receivables was as follows at December 31, 2015, 2014 and 2013:

				Change		
	2015	2014	2013	2015	2014	2013
	(in millions)					
Medicare	$765	$664	$576	$101	$88	$154
Commercial and other	420	381	219	39	162	59
Military services	77	106	87	(29)	19	28
Allowance for doubtful accounts	(101)	(98)	(71)	(3)	(27)	(24)
Total net receivables	$1,161	$1,053	$811	108	242	217
Reconciliation to cash flow statement:						
Provision for doubtful accounts				61	32	37
Change in receivables acquired, held-for-sale, or disposed from sale of business				11	(10)	(3)
Change in receivables per cash flow statement resulting in cash from operations				$180	$264	$251

As disclosed previously, on June 1, 2015, we completed the sale of our wholly owned subsidiary Concentra. Net receivables associated with Concentra were classified as held-for-sale at December 31, 2014 and December 31, 2013 and excluded from the table above for comparative purposes.

Medicare receivables are impacted by revenue growth associated with growth in individual and group Medicare membership and the timing of accruals and related collections associated with the CMS risk-adjustment model.

The increases in commercial and other receivables in each of 2015, 2014, and 2013 primarily are due to growth in the business. Excluding the effect of classifying Concentra receivables as held-for-sale at December 31, 2014, the increase in commercial and other receivables from 2013 to 2014 is primarily due to the commercial risk adjustment provision of the Health Care Reform Law which became effective in 2014.

Military services receivables at December 31, 2015, 2014, and 2013 primarily consist of administrative services only fees owed from the federal government for administrative services provided under our current TRICARE South Region contract.

Many provisions of the Health Care Reform Law became effective in 2014, including the commercial risk adjustment, risk corridor, and reinsurance provisions as well as the non-deductible health insurance industry fee. As discussed previously, the timing of payments and receipts associated with these provisions impact our operating cash flows as we build receivables for each coverage year that are expected to be collected in subsequent coverage years. The net receivable balance associated with the 3Rs was approximately $982 million at December 31, 2015 and $679 million at December 31, 2014, including certain amounts recorded in receivables as noted above. In 2015, we paid the federal government $867 million for the annual health insurance industry fee compared to our payment of $562 million in 2014.

In addition to the timing of payments of benefits expense, receipts for premiums and services revenues, and amounts due under the risk limiting and health insurance industry fee provisions of the Health Care Reform Law, other items impacting operating cash flows primarily resulted from the timing of working capital related to the growth in our pharmacy and payments for the Medicare Part D risk corridor provisions of our contracts with CMS.

Cash Flow from Investing Activities
On June 1, 2015, we completed the sale of Concentra for approximately $1,055 million in cash, excluding approximately $22 million of transaction costs.
Our ongoing capital expenditures primarily relate to our information technology initiatives, support of services in our provider services operations including medical and administrative facility improvements necessary for activities such as the provision of care to members, claims processing, billing and collections, wellness solutions, care coordination, regulatory compliance and customer service. Total capital expenditures, excluding acquisitions, were $523 million in 2015, $528 million in 2014, and $441 million in 2013.
In 2015, we purchased a $284 million note receivable directly from a third-party bank syndicate related to the financing of MCCI Holdings, LLC's business as described in Note 2 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data. The purchase of this note is included with purchases of investment securities in our consolidated statement of cash flows.
Proceeds from sales and maturities of investment securities exceeded purchases by $103 million in 2015 and $411 million in 2014. These net proceeds were used to fund normal working capital needs due to an increase in receivables associated with the 3Rs in addition to the timing of payments to and receipts from CMS associated with Medicare Part D reinsurance subsidies, as discussed below. We reinvested a portion of our operating cash flows in investment securities, primarily investment-grade fixed income securities, totaling $592 million in 2013.
Cash consideration paid for acquisitions, net of cash acquired, was $38 million in 2015, $18 million in 2014, and $187 million in 2013. Acquisitions in 2015 and 2014 included health and wellness related acquisitions. Cash paid for acquisitions in 2013 primarily related to the American Eldercare and other health and wellness related acquisitions.
Cash Flow from Financing Activities
Claims payments were $361 million higher than receipts from CMS associated with Medicare Part D claim subsidies for which we do not assume risk during 2015, $945 million higher during 2014, and $155 million higher during 2013. Our 2014 financing cash flows were negatively impacted by the timing of payments to and receipts from CMS associated with Medicare Part D claim subsidies for which we do not assume risk. We experienced higher specialty prescription drug costs associated with a new treatment for Hepatitis C than were contemplated in our bids which resulted in higher subsidy receivable balances in 2014 that were settled in 2015 under the terms of our contracts with CMS. Our net receivable for CMS subsidies and brand name prescription drug discounts was $2.0 billion at December 31, 2015 compared to $1.7 billion at December 31, 2014. Refer to Note 6 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.
Under our administrative services only TRICARE South Region contract, health care cost payments for which we do not assume risk exceeded reimbursements from the federal government by $4 million in 2015 and were less than reimbursements from the federal government by $5 million in 2013. Reimbursements from the federal government equaled health care cost payments for which we do not assume risk in 2014. Receipts from HHS associated with cost sharing provisions of the Health Care Reform Law for which we do not assume risk were higher than claims payments by $69 million in 2015 and $26 million in 2014. See Note 2 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data for further description.
We repurchased 1.9 million shares for $329 million in 2015, 5.7 million shares for $730 million in 2014 (excludes another $100 million held back pending final settlement of an accelerated stock repurchase plan in March 2015), and 5.8 million shares for $502 million in 2013 under share repurchase plans authorized by the Board of Directors. We also acquired common shares in connection with employee stock plans for an aggregate cost of $56 million in 2015, $42 million in 2014, and $29 million in 2013.
As discussed further below, we paid dividends to stockholders of $172 million in each of 2015 and 2014 and $168 million in 2013.

We entered into a commercial paper program in October 2014. Net proceeds from the issuance of commercial paper were $298 million 2015 and the maximum principal amount outstanding at any one time during 2015 was $414 million. There were no net proceeds from the issuance of commercial paper in 2014 and the maximum principal amount outstanding at any one time during 2014 was $175 million.

In September 2014, we issued $400 million of 2.625% senior notes due October 1, 2019, $600 million of 3.85% senior notes due October 1, 2024 and $750 million of 4.95% senior notes due October 1, 2044. Our net proceeds, reduced for the underwriters' discount and commission and offering expenses, were $1.73 billion. We used a portion of the net proceeds to redeem our $500 million 6.45% senior unsecured notes.

The remainder of the cash used in or provided by financing activities in 2015, 2014, and 2013 primarily resulted from proceeds from stock option exercises and the change in book overdraft.

Future Sources and Uses of Liquidity

Dividends

The following table provides details of dividend payments, excluding dividend equivalent rights, in 2013, 2014, and 2015 under our Board approved quarterly cash dividend policy:

Payment Date	Amount per Share	Total Amount (in millions)
2013	$1.06	$167
2014	$1.10	$170
2015	$1.14	$170

The Merger discussed in Note 2 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data does not impact our ability and intent to continue quarterly dividend payments prior to the closing of the Merger consistent with our historical dividend payments. Under the terms of the Merger Agreement, we have agreed with Aetna that our quarterly dividend will not exceed $0.29 per share prior to the closing of the Merger. Declaration and payment of future quarterly dividends is at the discretion of our Board and may be adjusted as business needs or market conditions change. In addition, under the terms of the Merger Agreement, we have agreed with Aetna to coordinate the declaration and payment of dividends so that our stockholders do not fail to receive a quarterly dividend around the time of the closing of the Merger.

On October 29, 2015, the Board declared a cash dividend of $0.29 per share that was paid on January 29, 2016 to stockholders of record on December 30, 2015, for an aggregate amount of $43 million.

Stock Repurchases

In September 2014, our Board of Directors replaced a previous share repurchase authorization of up to $1 billion (of which $816 million remained unused) with a new current authorization for repurchases of up to $2 billion of our common shares exclusive of shares repurchased in connection with employee stock plans, expiring on December 31, 2016. Under the share repurchase authorization, shares may be purchased from time to time at prevailing prices in the open market, by block purchases, through plans designed to comply with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, or in privately-negotiated transactions (including pursuant to accelerated share repurchase agreements with investment banks), subject to certain regulatory restrictions on volume, pricing, and timing. Pursuant to the Merger Agreement, after July 2, 2015, we are prohibited from repurchasing any of our outstanding securities without the prior written consent of Aetna, other than repurchases of shares of our common stock in connection with the exercise of outstanding stock options or the vesting or settlement of outstanding restricted stock awards. Accordingly, as announced on July 3, 2015, we have suspended our share repurchase program. Our remaining repurchase authorization was $1.04 billion as of July 3, 2015.

Senior Notes

In September 2014, we issued $400 million of 2.625% senior notes due October 1, 2019, $600 million of 3.85% senior notes due October 1, 2024 and $750 million of 4.95% senior notes due October 1, 2044. Our net proceeds, reduced for the underwriters' discount and commission and offering expenses, were $1.73 billion. We used a portion of the net proceeds to redeem the 6.45% senior unsecured notes as discussed below. We previously issued $500 million of 6.45% senior notes due June 1, 2016 that were redeemed in October 2014, $500 million of 7.20% senior notes due June 15, 2018, $300 million of 6.30% senior notes due August 1, 2018, $600 million of 3.15% senior notes due December 1, 2022, $250 million of 8.15% senior notes due June 15, 2038, and $400 million of 4.625% senior notes due December 1, 2042.

In October 2014, we redeemed the $500 million 6.45% senior unsecured notes due June 1, 2016, at 100% of the principal amount plus applicable premium for early redemption and accrued and unpaid interest to the redemption date, for cash totaling approximately $560 million. We recognized a loss on extinguishment of debt of approximately $37 million in October 2014 in connection with the redemption of these notes.

Our senior notes, which are unsecured, may be redeemed at our option at any time at 100% of the principal amount plus accrued interest and a specified make-whole amount. The 7.20% and 8.15% senior notes are subject to an interest rate adjustment if the debt ratings assigned to the notes are downgraded (or subsequently upgraded). In addition, each series of our senior notes (other than the 6.30% senior notes) contain a change of control provision that may require us to purchase the notes under certain circumstances. On July 2, 2015 we entered into a Merger Agreement with Aetna that, when closed, may require redemption of the notes if the notes are downgraded below investment grade by both Standard & Poor’s Rating Services, or S&P and Moody’s Investors Services, Inc., or Moody’s.

Credit Agreement

Our 5-year $1.0 billion unsecured revolving credit agreement expires July 2018. Under the credit agreement, at our option, we can borrow on either a competitive advance basis or a revolving credit basis. The revolving credit portion bears interest at either LIBOR plus a spread or the base rate plus a spread. The LIBOR spread, currently 110 basis points, varies depending on our credit ratings ranging from 90 to 150 basis points. We also pay an annual facility fee regardless of utilization. This facility fee, currently 15 basis points, may fluctuate between 10 and 25 basis points, depending upon our credit ratings. The competitive advance portion of any borrowings will bear interest at market rates prevailing at the time of borrowing on either a fixed rate or a floating rate based on LIBOR, at our option.

The terms of the credit agreement include standard provisions related to conditions of borrowing, including a customary material adverse effect clause which could limit our ability to borrow additional funds. In addition, the credit agreement contains customary restrictive and financial covenants as well as customary events of default, including financial covenants regarding the maintenance of a minimum level of net worth of $8.5 billion at December 31, 2015 and a maximum leverage ratio of 3.0:1. We are in compliance with the financial covenants, with actual net worth of $10.3 billion and an actual leverage ratio of 1.3:1, as measured in accordance with the credit agreement as of December 31, 2015. In addition, the credit agreement includes an uncommitted $250 million incremental loan facility.

At December 31, 2015, we had no borrowings outstanding under the credit agreement and we had outstanding letters of credit of $1 million secured under the credit agreement. No amounts have been drawn on these letters of credit. Accordingly, as of December 31, 2015, we had $999 million of remaining borrowing capacity under the credit agreement, none of which would be restricted by our financial covenant compliance requirement. We have other customary, arms-length relationships, including financial advisory and banking, with some parties to the credit agreement.

Commercial Paper

In October 2014, we entered into a commercial paper program pursuant to which we may issue short-term, unsecured commercial paper notes privately placed on a discount basis through certain broker dealers. Amounts available under the program may be borrowed, repaid and re-borrowed from time to time, with the aggregate face or principal amount outstanding under the program at any time not to exceed $1 billion. The net proceeds of issuances have been and are expected to be used for general corporate purposes. The maximum principal amount outstanding at any one time during the year ended December 31, 2015 was $414 million. There was $299 million outstanding at December 31, 2015.

Liquidity Requirements

We believe our cash balances, investment securities, operating cash flows, and funds available under our credit agreement and our commercial paper program or from other public or private financing sources, taken together, provide adequate resources to fund ongoing operating and regulatory requirements, acquisitions, future expansion opportunities, and capital expenditures for at least the next twelve months, as well as to refinance or repay debt, and repurchase shares.

Adverse changes in our credit rating may increase the rate of interest we pay and may impact the amount of credit available to us in the future. Our investment-grade credit rating at December 31, 2015 was BBB+ according to Standard & Poor's Rating Services, or S&P, and Baa3 according to Moody's Investors Services, Inc., or Moody's. A downgrade by S&P to BB+ or by Moody's to Ba1 triggers an interest rate increase of 25 basis points with respect to $750 million of our senior notes. Successive one notch downgrades increase the interest rate an additional 25 basis points, or annual interest expense by $2 million, up to a maximum 100 basis points, or annual interest expense by $8 million.

In addition, we operate as a holding company in a highly regulated industry. Humana Inc., our parent company, is dependent upon dividends and administrative expense reimbursements from our subsidiaries, most of which are subject to regulatory restrictions. We continue to maintain significant levels of aggregate excess statutory capital and surplus in our state-regulated operating subsidiaries. Cash, cash equivalents, and short-term investments at the parent company increased to $1.6 billion at December 31, 2015 from $1.4 billion at December 31, 2014. This increase primarily reflects proceeds from the sale of Concentra on June 1, 2015, proceeds from issuance of commercial paper and subsidiary dividends to the parent company, partially offset by funding of subsidiary working capital requirements, common stock repurchases, capital expenditures, and payment of stockholder dividends. Our use of operating cash derived from our non-insurance subsidiaries, such as our Healthcare Services segment, is generally not restricted by Departments of Insurance. Our regulated subsidiaries paid dividends to the parent of $493 million in 2015, $927 million in 2014, and $967 million in 2013. Subsidiary dividends in 2015 reflect the impact of losses for our individual commercial medical business compliant with the Health Care Reform Law and the November 5, 2015 revised statutory accounting guidance requiring the exclusion of risk corridor receivables from related statutory surplus described below. Refer to our parent company financial statements and accompanying notes in Schedule I - Parent Company Financial Information. Excluding Puerto Rico subsidiaries, the amount of ordinary dividends that may be paid to our parent company in 2016 is approximately $900 million, in the aggregate. Actual dividends paid may vary due to consideration of excess statutory capital and surplus and expected future surplus requirements related to, for example, premium volume and product mix.

On November 5, 2015, the National Association of Insurance Commissioners, or NAIC, issued statutory accounting guidance for receivables associated with the risk corridor provisions under the Health Care Reform Law, which requires the receivables to be excluded from subsidiary surplus. This accounting guidance required additional capital contributions into certain subsidiaries during 2015. This statutory accounting guidance does not affect our financial statements prepared in accordance with generally accepted accounting principles, under which we have recorded a receivable for risk corridor amounts due to us as an obligation of the United States Government under the Health Care Reform Law. At December 31, 2015, our gross risk corridor receivable for the 2014 and 2015 coverage years in the aggregate was $459 million. We expect to record a risk corridor receivable of approximately $340 million in 2016 for the 2016 coverage year.

Certain regulated subsidiaries recognized premium deficiency reserves for our individual commercial medical policies compliant with the Health Care Reform Law for the 2016 coverage year in the fourth quarter of 2015. Further, the statutory-based premium deficiency excludes the estimated benefit associated with the risk corridor provisions as a reduction in subsidiary surplus in accordance with the previously discussed November 5, 2015 statutory accounting guidance requiring the exclusion of risk corridor amounts from subsidiary surplus. As a result of the statutory-based premium deficiency, we will fund capital contributions into certain regulated subsidiaries of $450 million during the first quarter of 2016.

In 2015, we paid the federal government $867 million for the annual health insurance industry fee and expect to pay a higher amount in 2016 given an increase in market share. The Consolidated Appropriations Act, 2016, enacted on December 18, 2015, included a one-time one year suspension in 2017 of the health insurer fee.

Regulatory Requirements

For a detailed discussion of our regulatory requirements, including aggregate statutory capital and surplus as well as dividends paid from the subsidiaries to the parent, please refer to Note 15 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.

Contractual Obligations

We are contractually obligated to make payments for years subsequent to December 31, 2015 as follows:

	Payments Due by Period				
	Total	Less than 1 Year	1-3 Years	3-5 Years	More than 5 Years
	(in millions)				
Debt	$4,099	$299	$800	$400	$2,600
Interest (1)	2,539	188	342	244	1,765
Operating leases (2)	697	173	286	148	90
Purchase obligations (3)	150	74	74	2	—
Future policy benefits payable and other long-term liabilities (4)	2,578	79	462	204	1,833
Total	$10,063	$813	$1,964	$998	$6,288

(1) Interest includes the estimated contractual interest payments under our debt agreements.

(2) We lease facilities, computer hardware, and other furniture and equipment under long-term operating leases that are noncancelable and expire on various dates through 2026. We sublease facilities or partial facilities to third party tenants for space not used in our operations which partially mitigates our operating lease commitments. An operating lease is a type of off-balance sheet arrangement. Assuming we acquired the asset, rather than leased such asset, we would have recognized a liability for the financing of these assets. See also Note 16 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.

(3) Purchase obligations include agreements to purchase services, primarily information technology related services, or to make improvements to real estate, in each case that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum levels of service to be purchased; fixed, minimum or variable price provisions; and the appropriate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty.

(4) Includes future policy benefits payable ceded to third parties through 100% coinsurance agreements as more fully described in Note 19 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data. We expect the assuming reinsurance carriers to fund these obligations and reflected these amounts as reinsurance recoverables included in other long-term assets on our consolidated balance sheet. Amounts payable in less than one year are included in trade accounts payable and accrued expenses in the consolidated balance sheet.

Off-Balance Sheet Arrangements

As of December 31, 2015, we were not involved in any special purpose entity, or SPE, transactions. For a detailed discussion off-balance sheet arrangements, please refer to Note 16 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.

Guarantees and Indemnifications
For a detailed discussion our guarantees and indemnifications, please refer to Note 16 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.
Government Contracts
For a detailed discussion of our government contracts, including our Medicare, Military, and Medicaid contracts, please refer to Note 16 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.

Critical Accounting Policies and Estimates
The discussion and analysis of our financial condition and results of operations is based upon our consolidated financial statements and accompanying notes, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements and accompanying notes requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. We continuously evaluate our estimates and those critical accounting policies primarily related to benefits expense and revenue recognition as well as accounting for impairments related to our investment securities, goodwill, and long-lived assets. These estimates are based on knowledge of current events and anticipated future events and, accordingly, actual results ultimately may differ from those estimates. We believe the following critical accounting policies involve the most significant judgments and estimates used in the preparation of our consolidated financial statements.
Benefits Expense Recognition
Benefits expense is recognized in the period in which services are provided and includes an estimate of the cost of services which have been incurred but not yet reported, or IBNR. IBNR represents a substantial portion of our benefits payable as follows:

	December 31, 2015	Percentage of Total		December 31, 2014	Percentage of Total	
	(dollars in millions)					
IBNR	$3,730	75.0	%	$3,254	72.7	%
Reported claims in process	600	12.1	%	475	10.6	%
Premium deficiency reserve	176	3.5	%	—	—	%
Other benefits payable	470	9.4	%	746	16.7	%
Total benefits payable	$4,976	100.0	%	$4,475	100.0	%

Our reserving practice is to consistently recognize the actuarial best point estimate within a level of confidence required by actuarial standards. Actuarial standards of practice generally require a level of confidence such that the liabilities established for IBNR have a greater probability of being adequate versus being insufficient, or such that the liabilities established for IBNR are sufficient to cover obligations under an assumption of moderately adverse conditions. Adverse conditions are situations in which the actual claims are expected to be higher than the otherwise estimated value of such claims at the time of the estimate. Therefore, in many situations, the claim amounts ultimately settled will be less than the estimate that satisfies the actuarial standards of practice.
We develop our estimate for IBNR using actuarial methodologies and assumptions, primarily based upon historical claim experience. Depending on the period for which incurred claims are estimated, we apply a different method in determining our estimate. For periods prior to the most recent two months, the key assumption used in estimating our IBNR is that the completion factor pattern remains consistent over a rolling 12-month period after adjusting for known changes in claim inventory levels and known changes in claim payment processes. Completion factors result from the calculation of the percentage of claims incurred during a given period that have historically been adjudicated as of the reporting period. For the most recent two months, the incurred claims are estimated primarily from a trend analysis

based upon per member per month claims trends developed from our historical experience in the preceding months, adjusted for known changes in estimates of recent hospital and drug utilization data, provider contracting changes, changes in benefit levels, changes in member cost sharing, changes in medical management processes, product mix, and weekday seasonality.

The completion factor method is used for the months of incurred claims prior to the most recent two months because the historical percentage of claims processed for those months is at a level sufficient to produce a consistently reliable result. Conversely, for the most recent two months of incurred claims, the volume of claims processed historically is not at a level sufficient to produce a reliable result, which therefore requires us to examine historical trend patterns as the primary method of evaluation. Changes in claim processes, including recoveries of overpayments, receipt cycle times, claim inventory levels, outsourcing, system conversions, and processing disruptions due to weather or other events affect views regarding the reasonable choice of completion factors. Claim payments to providers for services rendered are often net of overpayment recoveries for claims paid previously, as contractually allowed. Claim overpayment recoveries can result from many different factors, including retroactive enrollment activity, audits of provider billings, and/or payment errors. Changes in patterns of claim overpayment recoveries can be unpredictable and result in completion factor volatility, as they often impact older dates of service. The receipt cycle time measures the average length of time between when a medical claim was initially incurred and when the claim form was received. Increases in electronic claim submissions from providers decrease the receipt cycle time. If claims are submitted or processed on a faster (slower) pace than prior periods, the actual claim may be more (less) complete than originally estimated using our completion factors, which may result in reserves that are higher (lower) than required.

Medical cost trends potentially are more volatile than other segments of the economy. The drivers of medical cost trends include increases in the utilization of hospital facilities, physician services, new higher priced technologies and medical procedures, and new prescription drugs and therapies, as well as the inflationary effect on the cost per unit of each of these expense components. Other external factors such as government-mandated benefits or other regulatory changes, the tort liability system, increases in medical services capacity, direct to consumer advertising for prescription drugs and medical services, an aging population, lifestyle changes including diet and smoking, catastrophes, and epidemics also may impact medical cost trends. Internal factors such as system conversions, claims processing cycle times, changes in medical management practices and changes in provider contracts also may impact our ability to accurately predict estimates of historical completion factors or medical cost trends. All of these factors are considered in estimating IBNR and in estimating the per member per month claims trend for purposes of determining the reserve for the most recent two months. Additionally, we continually prepare and review follow-up studies to assess the reasonableness of the estimates generated by our process and methods over time. The results of these studies are also considered in determining the reserve for the most recent two months. Each of these factors requires significant judgment by management.

The completion and claims per member per month trend factors are the most significant factors impacting the IBNR estimate. The portion of IBNR estimated using completion factors for claims incurred prior to the most recent two months is generally less variable than the portion of IBNR estimated using trend factors. The following table illustrates the sensitivity of these factors assuming moderate adverse experience and the estimated potential impact on our operating results caused by reasonably likely changes in these factors based on December 31, 2015 data:

Completion Factor (a):		Claims Trend Factor (b):	
Factor Change (c)	Decrease in Benefits Payable	Factor Change (c)	Decrease in Benefits Payable
(dollars in millions)			
0.60%	$(181)	(2.75)%	$(298)
0.50%	$(151)	(2.50)%	$(271)
0.40%	$(120)	(2.25)%	$(244)
0.30%	$(90)	(2.00)%	$(217)
0.20%	$(60)	(1.75)%	$(190)
0.10%	$(30)	(1.50)%	$(162)
—%	$—	(1.25)%	$(135)

(a) Reflects estimated potential changes in benefits payable at December 31, 2015 caused by changes in completion factors for incurred months prior to the most recent two months.

(b) Reflects estimated potential changes in benefits payable at December 31, 2015 caused by changes in annualized claims trend used for the estimation of per member per month incurred claims for the most recent two months.

(c) The factor change indicated represents the percentage point change.

The following table provides a historical perspective regarding the accrual and payment of our benefits payable, excluding military services. Components of the total incurred claims for each year include amounts accrued for current year estimated benefits expense as well as adjustments to prior year estimated accruals.

	2015	2014	2013
	(in millions)		
Balances at January 1	$4,475	$3,893	$3,775
Less: Reinsurance recoverables	(78)	—	—
Balances at January 1, net	4,397	3,893	3,775
Acquisitions	—	—	5
Incurred related to:			
Current year	44,397	38,641	32,711
Prior years	(236)	(518)	(474)
Total incurred	44,161	38,123	32,237
Paid related to:			
Current year	(39,802)	(34,357)	(29,103)
Prior years	(4,041)	(3,262)	(3,021)
Total paid	(43,843)	(37,619)	(32,124)
Premium deficiency reserve	176	—	—
Reinsurance recoverable	85	78	—
Balances at December 31	$4,976	$4,475	$3,893

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The following table summarizes the changes in estimate for incurred claims related to prior years attributable to our key assumptions. As previously described, our key assumptions consist of trend and completion factors estimated using an assumption of moderately adverse conditions. The amounts below represent the difference between our original estimates and the actual benefits expense ultimately incurred as determined from subsequent claim payments.

	Favorable Development by Changes in Key Assumptions					
	2015		2014		2013	
	Amount	Factor Change (a)	Amount	Factor Change (a)	Amount	Factor Change (a)
	(dollars in millions)					
Trend factors	$(145)	(1.5)%	$(266)	(3.7)%	$(233)	(3.4)%
Completion factors	(91)	0.4%	(252)	1.2%	(241)	1.2%
Total	$(236)		$(518)		$(474)	

(a) The factor change indicated represents the percentage point change.

As previously discussed, our reserving practice is to consistently recognize the actuarial best estimate of our ultimate liability for claims. Actuarial standards require the use of assumptions based on moderately adverse experience, which generally results in favorable reserve development, or reserves that are considered redundant. We experienced favorable medical claims reserve development related to prior fiscal years of $236 million in 2015, $518 million in 2014, and $474 million in 2013. The table below details our favorable medical claims reserve development related to prior fiscal years by segment for 2015, 2014, and 2013.

	Favorable Medical Claims Reserve Development			Change	
	2015	2014	2013	2015	2014
	(in millions)				
Retail Segment	$(228)	$(488)	$(428)	$260	$(60)
Group Segment	(7)	(29)	(42)	22	13
Other Businesses	(1)	(1)	(4)	—	3
Total	$(236)	$(518)	$(474)	$282	$(44)

The favorable medical claims reserve development for 2015, 2014, and 2013 primarily reflects the consistent application of trend and completion factors estimated using an assumption of moderately adverse conditions. The decline in favorable prior period development in 2015 primarily was due to the impact of lower financial claim recoveries due in part to our gradual implementation during 2014 of inpatient authorization review prior to admission as opposed to post adjudication, as well as higher than expected flu associated claims from the fourth quarter of 2014 and continued volatility in claims associated with individual commercial medical products. The higher favorable prior period development during 2014 and 2013 resulted from increased membership, better than originally expected utilization across most of our major business lines and increased financial recoveries. The increase in financial recoveries primarily resulted from claim audit process enhancements as well as increased volume of claim audits and expanded audit scope. All lines of business benefited from these improvements.

We continually adjust our historical trend and completion factor experience with our knowledge of recent events that may impact current trends and completion factors when establishing our reserves. Because our reserving practice is to consistently recognize the actuarial best point estimate using an assumption of moderately adverse conditions as required by actuarial standards, there is a reasonable possibility that variances between actual trend and completion factors and those assumed in our December 31, 2015 estimates would fall towards the middle of the ranges previously presented in our sensitivity table.

Benefits expense excluded from the previous table was as follows for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
	(in millions)		
Premium deficiency reserve for short-duration policies	$176	$—	$—
Military services	12	11	(27)
Future policy benefits	(80)	32	354
Total	$108	$43	$327

In the fourth quarter of 2015, we recognized a premium deficiency reserve for our individual commercial medical business compliant with the Health Care Reform Law associated with the 2016 coverage year as discussed in more detail in Note 7 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.

Military services benefits expense for 2015 and 2014 reflect expenses associated with our contracts with the Veterans Administration. Military services benefits expense for 2013 reflects the beneficial effect of a favorable settlement of contract claims with the DoD partially offset by expenses associated with our contracts with the Veterans Administration.

Certain health policies sold to individuals prior to 2014 (the first year plans compliant with the Health Care Reform Law were effective) are accounted for as long-duration as more fully described below. The reduction in future policy benefits in 2015 reflects the release of reserves as individual commercial medical members transition to plans compliant with the Health Care Reform Law.

Future policy benefits payable of $2.2 billion and $2.3 billion at December 31, 2015 and 2014, respectively, represent liabilities for long-duration insurance policies including long-term care insurance, life insurance, annuities, and certain health and other supplemental policies sold to individuals for which some of the premium received in the earlier years is intended to pay anticipated benefits to be incurred in future years. At policy issuance, these reserves are recognized on a net level premium method based on premium rate increase, interest rate, mortality, morbidity, persistency (the percentage of policies remaining in-force), and maintenance expense assumptions. Interest rates are based on our expected net investment returns on the investment portfolio supporting the reserves for these blocks of business. Mortality, a measure of expected death, and morbidity, a measure of health status, assumptions are based on published actuarial tables, modified based upon actual experience. The assumptions used to determine the liability for future policy benefits are established and locked in at the time each contract is issued and only change if our expected future experience deteriorates to the point that the level of the liability, together with the present value of future gross premiums, are not adequate to provide for future expected policy benefits and maintenance costs (i.e. the loss recognition date). Because these policies have long-term claim payout periods, there is a greater risk of significant variability in claims costs, either positive or negative. We perform loss recognition tests at least annually in the fourth quarter, and more frequently if adverse events or changes in circumstances indicate that the level of the liability, together with the present value of future gross premiums, may not be adequate to provide for future expected policy benefits and maintenance costs.

Future policy benefits payable include $1.5 billion at December 31, 2015 and 2014 associated with a non-strategic closed block of long-term care insurance policies acquired in connection with the 2007 acquisition of KMG. Approximately 31,800 policies remain in force as of December 31, 2015. No new policies have been written since 2005 under this closed block. Future policy benefits payable includes amounts charged to accumulated other comprehensive income for an additional liability that would exist on our closed-block of long-term care insurance policies if unrealized gains on the sale of the investments backing such products had been realized and the proceeds reinvested at then current yields. There was no additional liability at December 31, 2015 and $123 million of additional liability at December 31, 2014. Amounts charged to accumulated other comprehensive income are net of applicable deferred taxes.

Long-term care insurance policies provide nursing home and home health coverage for which premiums are collected many years in advance of benefits paid, if any. Therefore, our actual claims experience will emerge many years after assumptions have been established. The risk of a deviation of the actual interest, morbidity, mortality, and maintenance expense assumptions from those assumed in our reserves are particularly significant to our closed block of long-term care insurance policies. A prolonged period during which interest rates remain at levels lower than those anticipated in our reserving would result in shortfalls in investment income on assets supporting our obligation under long term care policies because the long duration of the policy obligations exceeds the duration of the supporting investment assets. Further, we monitor the loss experience of these long-term care insurance policies and, when necessary, apply for premium rate increases through a regulatory filing and approval process in the jurisdictions in which such products were sold. To the extent premium rate increases, interest rates, and/or loss experience vary from our loss recognition date assumptions, future material adjustments to reserves could be required.

During 2013, we recorded a loss for a premium deficiency. The premium deficiency was based on current and anticipated experience that had deteriorated from our locked-in assumptions from the previous December 31, 2010 loss recognition date, particularly as they related to emerging experience due to an increase in life expectancies and utilization of home health care services. Based on this deterioration, and combined with lower interest rates, we determined that our existing future policy benefits payable, together with the present value of future gross premiums, associated with our closed block of long-term care insurance policies were not adequate to provide for future policy benefits and maintenance costs under these policies; therefore we unlocked and modified our assumptions based on current expectations. Accordingly, during 2013 we recorded $243 million of additional benefits expense, with a corresponding increase in future policy benefits payable of $350 million partially offset by a related reinsurance recoverable of $107 million included in other long-term assets.

For our closed block of long-term care policies, actuarial assumptions used to estimate reserves are inherently uncertain due to the potential changes in trends in mortality, morbidity, persistency and interest rates as well as premium rate increases. As a result, our long term care reserves may be subject to material increases if these trends develop adversely to our expectations. The estimated increase in reserves and additional benefit expense from hypothetically modeling adverse variations in our actuarial assumptions, in the aggregate, could be up to $400 million, net of reinsurance. Although such hypothetical revisions are not currently appropriate, we believe they could occur based on past variances in experience and our expectation of the ranges of future experience that could reasonably occur, and any such revision could be material. Generally accepted accounting principles do not allow us to unlock our assumptions for favorable items.

In addition, future policy benefits payable includes amounts of $205 million at December 31, 2015, $210 million at December 31, 2014, and $215 million at December 31, 2013 which are subject to 100% coinsurance agreements as more fully described in Note 19 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data, and as such are offset by a related reinsurance recoverable included in other long-term assets.

Revenue Recognition

We generally establish one-year commercial membership contracts with employer groups, subject to cancellation by the employer group on 30-day written notice. Our Medicare contracts with CMS renew annually. Our military services contracts with the federal government and our contracts with various state Medicaid programs generally are multi-year contracts subject to annual renewal provisions.

Our commercial contracts establish rates on a per employee basis for each month of coverage based on the type of coverage purchased (single to family coverage options). Our Medicare and Medicaid contracts also establish monthly rates per member. However, our Medicare contracts also have additional provisions as outlined in the following separate section.

Premiums revenue and administrative services only, or ASO, fees are estimated by multiplying the membership covered under the various contracts by the contractual rates. In addition, we adjust revenues for estimated changes in an employer's enrollment and individuals that ultimately may fail to pay, and for estimated rebates under the minimum benefit ratios required under the Health Care Reform Law. Enrollment changes not yet processed or not yet reported by an employer group or the government, also known as retroactive membership adjustments, are estimated based on

available data and historical trends. We routinely monitor the collectibility of specific accounts, the aging of receivables, historical retroactivity trends, estimated rebates, as well as prevailing and anticipated economic conditions, and reflect any required adjustments in the current period's revenue.

We bill and collect premium from employer groups and members in our Medicare and other individual products monthly. We receive monthly premiums from the federal government and various states according to government specified payment rates and various contractual terms. Changes in revenues from for our Medicare and individual commercial medical products resulting from the periodic changes in risk-adjustment scores derived from medical diagnoses for our membership are recognized when the amounts become determinable and the collectibility is reasonably assured.

Medicare Risk-Adjustment Provisions

CMS utilizes a risk-adjustment model which apportions premiums paid to Medicare Advantage plans according to health severity. The risk-adjustment model pays more for enrollees with predictably higher costs. Under the risk-adjustment methodology, all Medicare Advantage plans must collect and submit the necessary diagnosis code information from hospital inpatient, hospital outpatient, and physician providers to CMS within prescribed deadlines. The CMS risk-adjustment model uses this diagnosis data to calculate the risk-adjusted premium payment to Medicare Advantage plans. Rates paid to Medicare Advantage plans are established under an actuarial bid model, including a process that bases our payments on a comparison of our beneficiaries' risk scores, derived from medical diagnoses, to those enrolled in the government's Medicare FFS program. We generally rely on providers, including certain providers in our network who are our employees, to code their claim submissions with appropriate diagnoses, which we send to CMS as the basis for our payment received from CMS under the actuarial risk-adjustment model. We also rely on providers to appropriately document all medical data, including the diagnosis data submitted with claims. We estimate risk-adjustment revenues based on medical diagnoses for our membership. The risk-adjustment model is more fully described in Item 1. – Business under the section titled "Individual Medicare."

Investment Securities

Investment securities totaled \$9.1 billion, or 37% of total assets at December 31, 2015, and \$9.5 billion, or 41% of total assets at December 31, 2014. Debt securities, detailed below, comprised this entire investment portfolio at December 31, 2015 and 2014. The fair value of debt securities were as follows at December 31, 2015 and 2014:

	December 31, 2015	Percentage of Total		December 31, 2014	Percentage of Total	
	(dollars in millions)					
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	$332	3.6	%	$374	3.9	%
Mortgage-backed securities	1,891	20.8	%	1,498	15.7	%
Tax-exempt municipal securities	2,668	29.3	%	3,068	32.1	%
Mortgage-backed securities:						
Residential	13	0.1	%	17	0.2	%
Commercial	985	10.8	%	843	8.8	%
Asset-backed securities	263	2.9	%	29	0.3	%
Corporate debt securities	2,958	32.5	%	3,718	39.0	%
Total debt securities	$9,110	100.0	%	$9,547	100.0	%

Approximately 98% of our debt securities were investment-grade quality, with a weighted average credit rating of AA by S&P at December 31, 2015. Most of the debt securities that were below investment-grade were rated BB, the higher end of the below investment-grade rating scale. Our investment policy limits investments in a single issuer and requires diversification among various asset types.

Tax-exempt municipal securities included pre-refunded bonds of $178 million at December 31, 2015 and $199 million at December 31, 2014. These pre-refunded bonds were secured by an escrow fund consisting of U.S. government obligations sufficient to pay off all amounts outstanding at maturity. The ratings of these pre-refunded bonds generally assume the rating of the government obligations at the time the fund is established. Tax-exempt municipal securities that were not pre-refunded were diversified among general obligation bonds of U.S. states and local municipalities as well as special revenue bonds. General obligation bonds, which are backed by the taxing power and full faith of the issuer, accounted for $1.0 billion of these municipals in the portfolio. Special revenue bonds, issued by a municipality to finance a specific public works project such as utilities, water and sewer, transportation, or education, and supported by the revenues of that project, accounted for $1.4 billion of these municipals. Our general obligation bonds are diversified across the U.S. with no individual state exceeding 11%. In addition, certain monoline insurers guarantee the timely repayment of bond principal and interest when a bond issuer defaults and generally provide credit enhancement for bond issues related to our tax-exempt municipal securities. We have no direct exposure to these monoline insurers. We owned $173 million and $484 million at December 31, 2015 and 2014, respectively, of tax-exempt securities guaranteed by monoline insurers. The equivalent weighted average S&P credit rating of these tax-exempt securities without the guarantee from the monoline insurer was AA.

Our direct exposure to subprime mortgage lending is limited to investment in residential mortgage-backed securities and asset-backed securities backed by home equity loans. The fair value of securities backed by Alt-A and subprime loans was $1 million at December 31, 2015 and 2014. There are no collateralized debt obligations or structured investment vehicles in our investment portfolio. The percentage of corporate securities associated with the financial services industry was 25% at December 31, 2015 and 21% at December 31, 2014.

Gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows at December 31, 2015:

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
December 31, 2015						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	$195	$(1)	$14	$—	$209	$(1)
Mortgage-backed securities	1,484	(20)	86	(3)	1,570	(23)
Tax-exempt municipal securities	843	(3)	52	(1)	895	(4)
Mortgage-backed securities:						
Residential	2	—	4	—	6	—
Commercial	626	(13)	265	(28)	891	(41)
Asset-backed securities	258	(2)	—	—	258	(2)
Corporate debt securities	918	(45)	63	(10)	981	(55)
Total debt securities	$4,326	$(84)	$484	$(42)	$4,810	$(126)

Under the other-than-temporary impairment model for debt securities held, we recognize an impairment loss in income in an amount equal to the full difference between the amortized cost basis and the fair value when we have the intent to sell the debt security or it is more likely than not we will be required to sell the debt security before recovery of our amortized cost basis. However, if we do not intend to sell the debt security, we evaluate the expected cash flows to be received as compared to amortized cost and determine if a credit loss has occurred. In the event of a credit loss, only the amount of the impairment associated with the credit loss is recognized currently in income with the remainder of the loss recognized in other comprehensive income.

When we do not intend to sell a security in an unrealized loss position, potential other-than-temporary impairment is considered using a variety of factors, including the length of time and extent to which the fair value has been less than cost; adverse conditions specifically related to the industry, geographic area or financial condition of the issuer or underlying collateral of a security; payment structure of the security; changes in credit rating of the security by the rating agencies; the volatility of the fair value changes; and changes in fair value of the security after the balance sheet date. For debt securities, we take into account expectations of relevant market and economic data. For example, with respect to mortgage and asset-backed securities, such data includes underlying loan level data and structural features such as seniority and other forms of credit enhancements. A decline in fair value is considered other-than-temporary when we do not expect to recover the entire amortized cost basis of the security. We estimate the amount of the credit loss component of a debt security as the difference between the amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate of future cash flows discounted at the implicit interest rate at the date of purchase. The risks inherent in assessing the impairment of an investment include the risk that market factors may differ from our expectations, facts and circumstances factored into our assessment may change with the passage of time, or we may decide to subsequently sell the investment. The determination of whether a decline in the value of an investment is other than temporary requires us to exercise significant diligence and judgment. The discovery of new information and the passage of time can significantly change these judgments. The status of the general economic environment and significant changes in the national securities markets influence the determination of fair value and the assessment of investment impairment. There is a continuing risk that declines in fair value may occur and additional material realized losses from sales or other-than-temporary impairments may be recorded in future periods.

The recoverability of our non-agency residential and commercial mortgage-backed securities is supported by factors such as seniority, underlying collateral characteristics and credit enhancements. These residential and commercial mortgage-backed securities at December 31, 2015 primarily were composed of senior tranches having high credit support, with over 99% of the collateral consisting of prime loans. The weighted average credit rating of all commercial mortgage-backed securities was AA+ at December 31, 2015.

All issuers of securities we own that were trading at an unrealized loss at December 31, 2015 remain current on all contractual payments. After taking into account these and other factors previously described, we believe these unrealized losses primarily were caused by an increase in market interest rates in the current markets than when the securities were purchased. At December 31, 2015, we did not intend to sell the securities with an unrealized loss position in accumulated other comprehensive income, and it is not likely that we will be required to sell these securities before recovery of their amortized cost basis. As a result, we believe that the securities with an unrealized loss were not other-than-temporarily impaired at December 31, 2015. There were no material other-than-temporary impairments in 2015, 2014, or 2013.

Goodwill and Long-lived Assets

At December 31, 2015, goodwill and other long-lived assets represented 20% of total assets and 48% of total stockholders’ equity, compared to 24% and 59%, respectively, at December 31, 2014.

We are required to test at least annually for impairment at a level of reporting referred to as the reporting unit, and more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. A reporting unit either is our operating segments or one level below the operating segments, referred to as a component, which comprise our reportable segments. A component is considered a reporting unit if the component constitutes a business for which discrete financial information is available that is regularly reviewed by management. We are required to aggregate the components of an operating segment into one reporting unit if they have similar economic characteristics. Goodwill is assigned to the reporting unit that is expected to benefit from a specific acquisition. The carrying amount of goodwill for our reportable segments has been retrospectively adjusted to conform to the 2015 segment change discussed in Note 2 to the consolidated financial statements included in Item 8. – Financial Statements and Supplementary Data.

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We use a two-step process to review goodwill for impairment. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. Our strategy, long-range business plan, and annual planning process support our goodwill impairment tests. These tests are performed, at a minimum, annually in the fourth quarter, and are based on an evaluation of future discounted cash flows. We rely on this discounted cash flow analysis to determine fair value. However outcomes from the discounted cash flow analysis are compared to other market approach valuation methodologies for reasonableness. We use discount rates that correspond to a market-based weighted-average cost of capital and terminal growth rates that correspond to long-term growth prospects, consistent with the long-term inflation rate. Key assumptions in our cash flow projections, including changes in membership, premium yields, medical and operating cost trends, and certain government contract extensions, are consistent with those utilized in our long-range business plan and annual planning process. If these assumptions differ from actual, including the impact of the Health Care Reform Law, the estimates underlying our goodwill impairment tests could be adversely affected. Goodwill impairment tests completed in each of the last three years did not result in an impairment loss. The fair value of our reporting units with significant goodwill exceeded carrying amounts by a substantial margin. A 100 basis point increase in the discount rate would not have a significant impact on the amount of margin for any of our reporting units with significant goodwill, with the exception of our provider services reporting unit in our Healthcare Services segment. The provider services reporting unit would decline to approximately 10% margin after factoring in a 100 basis point increase in the discount rate.

Long-lived assets consist of property and equipment and other finite-lived intangible assets. These assets are depreciated or amortized over their estimated useful life, and are subject to impairment reviews. We periodically review long-lived assets whenever adverse events or changes in circumstances indicate the carrying value of the asset may not be recoverable. In assessing recoverability, we must make assumptions regarding estimated future cash flows and other factors to determine if an impairment loss may exist, and, if so, estimate fair value. We also must estimate and make assumptions regarding the useful life we assign to our long-lived assets. If these estimates or their related assumptions change in the future, we may be required to record impairment losses or change the useful life, including accelerating depreciation or amortization for these assets. There were no material impairment losses in the last three years.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our earnings and financial position are exposed to financial market risk, including those resulting from changes in interest rates.

The level of our pretax earnings is subject to market risk due to changes in interest rates and the resulting impact on investment income and interest expense. Prior to 2009, under interest rate swap agreements, we exchanged the fixed interest rate under all of our senior notes for a variable interest rate based on LIBOR using interest rate swap agreements. We terminated all of our interest rate swap agreements in 2008. We may re-enter into interest rate swap agreements in the future depending on market conditions and other factors. Amounts borrowed under the revolving credit portion of our $1.0 billion unsecured revolving credit agreement bear interest at either LIBOR plus a spread or the base rate plus a spread. There were no borrowings outstanding under our credit agreement at December 31, 2015 or December 31, 2014.

Interest rate risk also represents a market risk factor affecting our consolidated financial position due to our significant investment portfolio, consisting primarily of fixed maturity securities of investment-grade quality with a weighted average S&P credit rating of AA at December 31, 2015. Our net unrealized position decreased $383 million from a net unrealized gain position of $475 million at December 31, 2014 to a net unrealized gain position of $92 million at December 31, 2015. At December 31, 2015, we had gross unrealized losses of $126 million on our investment portfolio primarily due to an increase in market interest rates since the time the securities were purchased. There were no material other-than-temporary impairments during 2015. While we believe that these impairments are temporary and we currently do not have the intent to sell such securities, given the current market conditions and the significant judgments involved, there is a continuing risk that future declines in fair value may occur and material realized losses from sales or other-than-temporary impairments may be recorded in future periods.

Duration is the time-weighted average of the present value of the bond portfolio’s cash flow. Duration is indicative of the relationship between changes in fair value and changes in interest rates, providing a general indication of the

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sensitivity of the fair values of our fixed maturity securities to changes in interest rates. However, actual fair values may differ significantly from estimates based on duration. The average duration of our investment portfolio, including cash and cash equivalents, was approximately 4.1 years as of December 31, 2015 and 4.1 years as of December 31, 2014. Based on the duration including cash equivalents, a 1% increase in interest rates would generally decrease the fair value of our securities by approximately $459 million.

We have also evaluated the impact on our investment income and interest expense resulting from a hypothetical change in interest rates of 100, 200, and 300 basis points over the next twelve-month period, as reflected in the following table. The evaluation was based on our investment portfolio and our outstanding indebtedness at December 31, 2015 and 2014. Our investment portfolio consists of cash, cash equivalents, and investment securities. The modeling technique used to calculate the pro forma net change in pretax earnings considered the cash flows related to fixed income investments and debt, which are subject to interest rate changes during a prospective twelve-month period. This evaluation measures parallel shifts in interest rates and may not account for certain unpredictable events that may affect interest income, including unexpected changes of cash flows into and out of the portfolio, changes in the asset allocation, including shifts between taxable and tax-exempt securities, and spread changes specific to various investment categories. In the past ten years, changes in 3 month LIBOR rates during the year have exceeded 300 basis points once, have not changed between 200 and 300 basis points, have changed between 100 and 200 basis points two times, and have changed by less than 100 basis points seven times.

	Increase (decrease) in pretax earnings given an interest rate decrease of X basis points			Increase (decrease) in pretax earnings given an interest rate increase of X basis points		
	(300)	(200)	(100)	100	200	300
	(in millions)					
As of December 31, 2015						
Investment income (a)	$(33)	$(27)	$(21)	$41	$82	$124
Interest expense (b)	3	3	3	(3)	(6)	(9)
Pretax	$(30)	$(24)	$(18)	$38	$76	$115
As of December 31, 2014						
Investment income (a)	$(20)	$(15)	$(9)	$42	$85	$128
Interest expense (b)	—	—	—	—	—	—
Pretax	$(20)	$(15)	$(9)	$42	$85	$128

(a) As of December 31, 2015 and 2014, some of our investments had interest rates below 3% so the assumed hypothetical change in pretax earnings does not reflect the full 3% point reduction.

(b) The interest rate under our senior notes is fixed. There were no borrowings outstanding under the credit agreement at December 31, 2015 or December 31, 2014. There was $299 million outstanding under our commercial paper program at December 31, 2015. As of December 31, 2015, our interest rate under our commercial paper program was less than 1% so the assumed hypothetical change in pretax earnings does not reflect the full 1% point reduction. There were no borrowings outstanding under our commercial paper program at December 31, 2014.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA
Humana Inc.
CONSOLIDATED BALANCE SHEETS

	December 31, 2015	2014
	(in millions, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$2,571	$1,935
Investment securities	7,267	7,598
Receivables, less allowance for doubtful accounts of $101 in 2015 and $98 in 2014	1,161	1,053
Other current assets	4,712	4,007
Assets held-for-sale	—	943
Total current assets	15,711	15,536
Property and equipment, net	1,384	1,228
Long-term investment securities	1,843	1,949
Goodwill	3,265	3,231
Other long-term assets	2,502	1,583
Total assets	$24,705	$23,527
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Benefits payable	$4,976	$4,475
Trade accounts payable and accrued expenses	2,212	2,095
Book overdraft	301	334
Unearned revenues	364	361
Short-term borrowings	299	—
Liabilities held-for-sale	—	206
Total current liabilities	8,152	7,471
Long-term debt	3,821	3,825
Future policy benefits payable	2,151	2,349
Other long-term liabilities	235	236
Total liabilities	14,359	13,881
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, $1 par; 10,000,000 shares authorized; none issued	—	—
Common stock, $0.16 2/3 par; 300,000,000 shares authorized; 198,372,059 shares issued at December 31, 2015 and 197,951,551 shares issued at December 31, 2014	33	33
Capital in excess of par value	2,530	2,330
Retained earnings	11,017	9,916
Accumulated other comprehensive income	58	223
Treasury stock, at cost, 50,084,043 shares at December 31, 2015 and 48,347,541 shares at December 31, 2014	(3,292)	(2,856)
Total stockholders' equity	10,346	9,646
Total liabilities and stockholders' equity	$24,705	$23,527

The accompanying notes are an integral part of the consolidated financial statements.

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Humana Inc.
CONSOLIDATED STATEMENTS OF INCOME

	For the year ended December 31,		
	2015	2014	2013
	(in millions, except per share results)		
Revenues:			
Premiums	$52,409	$45,959	$38,829
Services	1,406	2,164	2,109
Investment income	474	377	375
Total revenues	54,289	48,500	41,313
Operating expenses:			
Benefits	44,269	38,166	32,564
Operating costs	7,318	7,639	6,355
Depreciation and amortization	355	333	333
Total operating expenses	51,942	46,138	39,252
Income from operations	2,347	2,362	2,061
Gain on sale of business	270	—	—
Interest expense	186	192	140
Income before income taxes	2,431	2,170	1,921
Provision for income taxes	1,155	1,023	690
Net income	$1,276	$1,147	$1,231
Basic earnings per common share	$8.54	$7.44	$7.81
Diluted earnings per common share	$8.44	$7.36	$7.73
Dividends declared per common share	$1.15	$1.11	$1.07

The accompanying notes are an integral part of the consolidated financial statements.

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Humana Inc.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

	For the year ended December 31,		
	2015	2014	2013
	(in millions)		
Net income	$1,276	$1,147	$1,231
Other comprehensive (loss) income:			
Change in gross unrealized investment gains/losses	(114)	122	(338)
Effect of income taxes	42	(44)	124
Total change in unrealized investment gains/losses, net of tax	(72)	78	(214)
Reclassification adjustment for net realized gains included in investment income	(146)	(20)	(22)
Effect of income taxes	53	7	8
Total reclassification adjustment, net of tax	(93)	(13)	(14)
Other comprehensive (loss) income, net of tax	(165)	65	(228)
Comprehensive income	$1,111	$1,212	$1,003

The accompanying notes are an integral part of the consolidated financial statements.

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Humana Inc.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	Common Stock		Capital In Excess of Par Value	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Treasury Stock	Total Stockholders' Equity
	Issued Shares	Amount					
	(dollars in millions, share amounts in thousands)						
Balances, January 1, 2013	194,471	$32	$2,101	$7,881	$386	$(1,553)	$8,847
Net income				1,231			1,231
Other comprehensive income					(228)		(228)
Common stock repurchases						(531)	(531)
Dividends and dividend equivalents			—	(170)			(170)
Stock-based compensation			92				92
Restricted stock unit vesting	563	—					—
Stock option exercises	1,242	1	66				67
Stock option and restricted stock tax benefit			8				8
Balances, December 31, 2013	196,276	33	2,267	8,942	158	(2,084)	9,316
Net income				1,147			1,147
Other comprehensive loss					65		65
Common stock repurchases			(100)			(772)	(872)
Dividends and dividend equivalents			—	(173)			(173)
Stock-based compensation			98				98
Restricted stock unit vesting	966	—					—
Stock option exercises	710	—	52				52
Stock option and restricted stock tax benefit			13				13
Balances, December 31, 2014	197,952	33	2,330	9,916	223	(2,856)	9,646
Net income				1,276			1,276

Other comprehensive income					(165)		(165)
Common stock repurchases			100			(485)	(385)
Dividends and dividend equivalents			—	(175)			(175)
Stock-based compensation			109				109
Restricted stock unit vesting	159	—	(49)			49	—
Stock option exercises	261	—	23				23
Stock option and restricted stock tax benefit			17				17
Balances, December 31, 2015	198,372	$33	$2,530	$11,017	$58	$(3,292)	$10,346

The accompanying notes are an integral part of the consolidated financial statements.

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Humana Inc.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the year ended December 31,		
	2015	2014	2013
	(in millions)		
Cash flows from operating activities			
Net income	$1,276	$1,147	$1,231
Adjustments to reconcile net income to net cash provided by operating activities:			
Gain on sale of business	(270)	—	—
Depreciation	354	328	309
Amortization	93	121	117
Stock-based compensation	109	98	92
Net realized capital gains	(146)	(20)	(22)
(Benefit) provision for deferred income taxes	(2)	(64)	42
Provision for doubtful accounts	61	32	37
Changes in operating assets and liabilities, net of effect of businesses acquired and dispositions:			
Receivables	(180)	(264)	(251)
Other assets	(872)	(952)	(330)
Benefits payable	501	582	109
Other liabilities	(129)	413	313
Unearned revenues	3	155	(24)
Other	70	42	93
Net cash provided by operating activities	868	1,618	1,716
Cash flows from investing activities			
Acquisitions, net of cash acquired	(38)	(18)	(187)
Proceeds from sale of business	1,061	72	34
Purchases of property and equipment	(523)	(528)	(441)
Proceeds from sales of property and equipment	1	—	4
Purchases of investment securities	(6,739)	(2,883)	(3,261)
Maturities of investment securities	1,065	885	1,077
Proceeds from sales of investment securities	5,493	2,409	1,592
Net cash provided by (used in) investing activities	320	(63)	(1,182)
Cash flows from financing activities			
Receipts (withdrawals) from contract deposits, net	(296)	(919)	(150)
Proceeds from issuance of senior notes, net	—	1,733	—
Proceeds from issuance of commercial paper, net	298	—	—
Repayment of long-term debt	—	(500)	—
Common stock repurchases	(385)	(872)	(531)
Dividends paid	(172)	(172)	(168)
Excess tax benefit from stock-based compensation	15	12	8
Change in book overdraft	(33)	(69)	79
Proceeds from stock option exercises and other, net	21	29	60

Net cash used in financing activities	(552)	(758)	(702)
Increase (decrease) in cash and cash equivalents	636	797	(168)
Cash and cash equivalents at beginning of year	1,935	1,138	1,306
Cash and cash equivalents at end of year	$2,571	$1,935	$1,138
Supplemental cash flow disclosures:			
Interest payments	$187	$143	$146
Income tax payments, net	$1,179	$1,030	$734
Details of businesses acquired in purchase transactions:			
Fair value of assets acquired, net of cash acquired	$38	$18	$196
Less: Fair value of liabilities assumed	—	—	(9)
Cash paid for acquired businesses, net of cash acquired	$38	$18	$187

The accompanying notes are an integral part of the consolidated financial statements.

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Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. REPORTING ENTITY

Nature of Operations

Humana Inc., headquartered in Louisville, Kentucky, is a leading health and well-being company focused on making it easy for people to achieve their best health with clinical excellence through coordinated care. Our strategy integrates care delivery, the member experience, and clinical and consumer insights to encourage engagement, behavior change, proactive clinical outreach and wellness for the millions of people we serve across the country. References throughout these notes to consolidated financial statements to “we,” “us,” “our,” “Company,” and “Humana,” mean Humana Inc. and its subsidiaries. We derived approximately 73% of our total premiums and services revenue from contracts with the federal government in 2015, including 14% related to our federal government contracts with the Centers for Medicare and Medicaid Services, or CMS, to provide health insurance coverage for individual Medicare Advantage members in Florida. CMS is the federal government’s agency responsible for administering the Medicare program.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

Our financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America. Our consolidated financial statements include the accounts of Humana Inc. and subsidiaries that the Company controls, including variable interest entities associated with medical practices for which we are the primary beneficiary. We do not own many of our medical practices but instead enter into exclusive management agreements with the affiliated Professional Associations, or P.A.s, that operate these medical practices. Based upon the provisions of these agreements, these affiliated P.A.s are variable interest entities and we are the primary beneficiary, and accordingly we consolidated the affiliated P.A.s. All significant intercompany balances and transactions have been eliminated.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. The areas involving the most significant use of estimates are the estimation of benefits payable, future policy benefits payable, the impact of risk adjustment provisions related to our Medicare contracts, the valuation and related impairment recognition of investment securities, and the valuation and related impairment recognition of long-lived assets, including goodwill. These estimates are based on knowledge of current events and anticipated future events, and accordingly, actual results may ultimately differ materially from those estimates.

Certain amounts have been reclassified to conform to the current year presentation, including business segment reclassifications discussed below and the reclassification of Concentra Inc. assets and liabilities as held-for-sale in our December 31, 2014 balance sheet for comparative purposes. Refer to Note 3 for a discussion of the sale of Concentra in June 2015.

Aetna Merger

On July 2, 2015, we entered into an Agreement and Plan of Merger, which we refer to in this report as the Merger Agreement, with Aetna Inc. and certain wholly owned subsidiaries of Aetna Inc., which we refer to collectively as Aetna, which sets forth the terms and conditions under which we will merge with, and become a wholly owned subsidiary of Aetna, a transaction we refer to in this report as the Merger. Under the terms of the Merger Agreement, at the closing of the Merger, each outstanding share of our common stock will be converted into the right to receive (i) 0.8375 of a share of Aetna common stock and (ii) $125 in cash. The total transaction was estimated at approximately $37 billion including the assumption of Humana debt, based on the closing price of Aetna common shares on July 2, 2015. The Merger Agreement includes customary restrictions on the conduct of our business prior to the completion of the Merger, generally requiring us to conduct our business in the ordinary course and subjecting us to a variety of customary specified limitations absent Aetna’s prior written consent, including, for example, limitations on dividends (we agreed that our

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quarterly dividend will not exceed $0.29 per share) and repurchases of our securities (we agreed to suspend our share repurchase program), restrictions on our ability to enter into material contracts, and negotiated thresholds for capital expenditures, capital contributions, acquisitions and divestitures of businesses.

On October 19, 2015, our stockholders approved the adoption of the Merger Agreement at a special stockholder meeting. Also on October 19, 2015, the holders of Aetna outstanding shares approved the issuance of Aetna common stock in the Merger at a special meeting of Aetna shareholders.

The Merger is subject to customary closing conditions, including, among other things, (i) the expiration or termination of the applicable waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, and the receipt of necessary approvals under state insurance and healthcare laws and regulations and pursuant to certain licenses of certain of Humana's subsidiaries, (ii) the absence of legal restraints and prohibitions on the consummation of the Merger, (iii) listing of the Aetna common stock to be issued in the Merger on the New York Stock Exchange, (iv) subject to the relevant standards set forth in the Merger Agreement, the accuracy of the representations and warranties made by each party, (v) material compliance by each party with its covenants in the Merger Agreement, and (vi) no "Company Material Adverse Effect" with respect to us and no "Parent Material Adverse Effect" with respect to Aetna, in each case since the execution of and as defined in the Merger Agreement. In addition, Aetna's obligation to consummate the Merger is subject to (a) the condition that the required regulatory approvals do not impose any condition that, individually or in the aggregate, would reasonably be expected to have a "Regulatory Material Adverse Effect" (as such term is defined in the Merger Agreement), and (b) CMS has not imposed any sanctions with respect to our Medicare Advantage, or MA, business that, individually or in the aggregate, is or would reasonably be expected to be material and adverse to us and our subsidiaries, taken as a whole. The Merger is currently expected to close in the second half of 2016.

Business Segment Reclassifications

On January 1, 2015, we realigned certain of our businesses among our reportable segments to correspond with internal management reporting changes and renamed our Employer Group segment to the Group segment. Our three reportable segments remain Retail, Group, and Healthcare Services. The more significant realignments included reclassifying Medicare benefits offered to groups to the Retail segment from the Group segment, bringing all of our Medicare offerings, which are now managed collectively, together in one segment, recognizing that in some instances we market directly to individuals that are part of a group Medicare account. In addition, we realigned our military services business, primarily consisting of our TRICARE South Region contract previously included in the Other Businesses category, to our Group segment as we consider this contract with the government to be a group account. Prior period segment financial information has been recast to conform to the 2015 presentation. See Note 17 for segment financial information and Note 9 for goodwill information by segment.

Health Care Reform

The Patient Protection and Affordable Care Act and The Health Care and Education Reconciliation Act of 2010 (which we collectively refer to as the Health Care Reform Law) enacted significant reforms to various aspects of the U.S. health insurance industry. Certain of these reforms became effective January 1, 2014, including an annual insurance industry premium-based fee and the establishment of federally-facilitated or state-based exchanges coupled with three premium stabilization programs, as described more fully below.

The Health Care Reform Law imposes an annual premium-based fee on health insurers for each calendar year beginning on or after January 1, 2014 which is not deductible for tax purposes. We are required to estimate a liability for the health insurer fee and record it in full once qualifying insurance coverage is provided in the applicable calendar year in which the fee is payable with a corresponding deferred cost that is amortized ratably to expense over the same calendar year. We record the liability for the health insurer fee in trade accounts payable and accrued expenses and record the deferred cost in other current assets in our consolidated financial statements. We pay the health insurer fee in September of each year. The Consolidated Appropriations Act, 2016, enacted on December 18, 2015, included a one-time one year suspension in 2017 of the health insurer fee. See Note 7 for detail regarding amounts paid for the annual health insurer fee.

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The Health Care Reform Law also establishes risk spreading premium stabilization programs effective January 1, 2014. The risk spreading programs are applicable to certain of our commercial medical insurance products. In the aggregate, our commercial medical insurance products represented approximately 18% of our total premiums and services revenue for the year ended December 31, 2015, a subset of which is subject to these programs. These programs, commonly referred to as the 3Rs, include a permanent risk adjustment program, a transitional reinsurance program, and a temporary risk corridors program designed to more evenly spread the financial risk borne by issuers and to mitigate the risk that issuers would have mispriced products. The transitional reinsurance and temporary risk corridors programs are for years 2014 through 2016, with potential for additional reinsurance recoveries through 2018 to the extent funds are available. Policies issued prior to March 23, 2010 are considered grandfathered policies and are exempt from the 3Rs. Certain states have allowed non-grandfathered policies issued prior to January 1, 2014 to extend the date of required transition to policies compliant with the Health Care Reform Law to as late as 2017. Accordingly, such policies are exempt from the 3Rs until they transition to policies compliant with the Health Care Reform Law.
The permanent risk adjustment program adjusts the premiums that commercial individual and small group health insurance issuers receive based on the demographic factors and health status of each member as derived from current year medical diagnosis as reported throughout the year. This program transfers funds from lower risk plans to higher risk plans within similar plans in the same state. The risk adjustment program is applicable to commercial individual and small group health plans (except certain exempt and grandfathered plans as discussed above) operating both inside and outside of the health insurance exchanges established under the Health Care Reform Law. Under the risk adjustment program, a risk score is assigned to each covered member to determine an average risk score at the individual and small group level by legal entity in a particular market in a state. Additionally, an average risk score is determined for the entire subject population for each market in each state. Settlements are determined on a net basis by legal entity and state. Each health insurance issuer's average risk score is compared to the state's average risk score. Plans with an average risk score below the state average will pay into a pool and health insurance issuers with an average risk score that is greater than the state average risk score will receive money from that pool. We generally rely on providers, including certain network providers who are our employees, to appropriately document all medical data, including the diagnosis codes submitted with claims, as the basis for our risk scores under the program. Our estimate of amounts receivable and/or payable under the risk adjustment program is based on our estimate of both our own and the state average risk scores. Assumptions used in these estimates include but are not limited to published third party studies and other publicly available data including regulatory plan filings, geographic considerations including our historical experience in markets we have participated in over a long period of time, member demographics (including age and gender for our members and other health insurance issuers), our pricing model, sales data for each metal tier (different metal tiers yield different risk scores), and the mix of previously underwritten membership as compared to new members in plans compliant with the Health Care Reform Law. We refine our estimates as new information becomes available, including additional data released by the Department of Health and Human Services, or HHS, regarding estimates of state average risk scores. Risk adjustment is subject to audit by HHS beginning with the 2015 coverage year, however, there will be no payments associated with these audits for 2015, the pilot year for the audits.
The temporary risk corridor program applies to individual and small group Qualified Health Plans (or substantially equivalent plans), or QHPs, as defined by HHS, operating both inside and outside of the exchanges. Accordingly, plans subject to risk adjustment that are not QHPs, including our small group health plans, were not subject to the risk corridor program in 2014 or 2015. The risk corridor provisions limit issuer gains and losses by comparing allowable medical costs to a target amount, each defined/prescribed by HHS, and sharing the risk for allowable costs with the federal government. Allowable medical costs are adjusted for risk adjustment settlements, transitional reinsurance recoveries, and cost sharing reductions received from HHS. Variances from the target exceeding certain thresholds may result in HHS making additional payments to us or require us to refund HHS a portion of the premiums we

received.

We estimate and recognize adjustments to premiums revenue for the risk adjustment and risk corridor provisions by projecting our ultimate premium for the calendar year separately for individual and group plans by state and legal entity. Estimated calendar year settlement amounts are recognized ratably during the year and are revised each period to reflect current experience, including changes in risk scores derived from medical diagnoses submitted by providers. We record receivables or payables at the individual or group level within each state and legal entity and classify the amounts as current or long-term in our consolidated balance sheets based on the timing of expected settlement.

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The transitional reinsurance program requires us to make reinsurance contributions for calendar years 2014 through 2016 to a state or HHS established reinsurance entity based on a national contribution rate per covered member as determined by HHS. While all commercial medical plans, including self-funded plans, are required to fund the reinsurance entity, only fully-insured non-grandfathered plans compliant with the Health Care Reform Law in the individual commercial market will be eligible for recoveries if individual claims exceed a specified threshold. Accordingly, we account for transitional reinsurance contributions associated with all commercial medical health plans other than these non-grandfathered individual plans as an assessment in operating costs in our consolidated statements of income. We account for contributions made by individual commercial plans compliant with the Health Care Reform Law, which are subject to recoveries, as ceded premiums (a reduction of premiums) and similarly we account for any recoveries as ceded benefits (a reduction of benefits expense) in our consolidated statements of income.

We are required to remit payment for our per member reinsurance contribution, exclusive of the portion payable to the U.S. Treasury, by January 15 of the year following the coverage year, or January 15, 2016 for the 2015 coverage year. The portion of the reinsurance contribution due to the U.S. Treasury must be paid by November 15 of the year following the coverage year, or November 15, 2016 for the 2015 coverage year. Risk adjustment calculations will be completed and HHS will notify us of recoveries due or payments owed to/from us under the risk adjustment and reinsurance programs by June 30 of the year following the coverage year. Following this notification, risk corridor calculations are then due by July 31 of the year following the coverage year. Payments due to HHS under the risk adjustment and risk corridor programs must be remitted within 30 days of notification for each program and will be collected prior to the distribution of recoveries by HHS under each program. Payment and recovery amounts associated with reinsurance and risk adjustment will generally be settled with HHS annually in the year following the coverage year. Accordingly, for the 2015 coverage year, we expect to receive recoveries and/or pay amounts due under these programs in 2016. The risk corridor program is a three year program. We are required to pay gross risk corridor payables in the second half of the year following the coverage year. Interim settlements of risk corridor receivables in the year following the coverage year are limited to risk corridor amounts collected by HHS and available for distribution in the year following the coverage year. HHS guidance provides that risk corridor collections over the life of the three year program will first be applied to any shortfalls from previous coverage years before application to current year obligations. Risk corridor payables to issuers are obligations of the United States Government under the Health Care Reform law which requires the Secretary of HHS to make full payments to issuers. In the event of a shortfall at the end of the three year program, HHS has asserted it will explore other sources of funding for risk corridor payments, subject to the availability of appropriations.

See Note 7 for detail regarding amounts recorded to the consolidated balance sheets related to the 3Rs.

In addition to the provisions discussed above, beginning in 2014, HHS pays us a portion of the health care costs for low-income individual members for which we assume no risk in accordance with the Health Care Reform Law. We account for these subsidies as a deposit in our consolidated balance sheets and as a financing activity in our consolidated statements of cash flows. We do not recognize premiums revenue or benefits expense for these subsidies. Receipt and payment activity is accumulated at the state and legal entity level and recorded in our consolidated balance sheet in other current assets or trade accounts payable and accrued expenses depending on the state and legal entity balance at the end of the reporting period. We will be notified of final settlement amounts by June 30 of the year following the coverage year. Receipts from HHS associated with cost sharing subsidies for which we do not assume risk were approximately $478 million, exceeding payments of $409 million by $69 million for the year ended December 31, 2015. For the year ended December 31, 2014, receipts from HHS associated with cost sharing subsidies for which we do not assume risk were approximately $281 million, exceeding payments of $255 million by $26 million. The program began in 2014, and as such, there were no receipts or payments from HHS for cost sharing subsidies in 2013.

Cash and Cash Equivalents

Cash and cash equivalents include cash, time deposits, money market funds, commercial paper, other money market instruments, and certain U.S. Government securities with an original maturity of three months or less. Carrying value approximates fair value due to the short-term maturity of the investments.

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Investment Securities

Investment securities, which consist entirely of debt securities, have been categorized as available for sale and, as a result, are stated at fair value. Investment securities available for current operations are classified as current assets. Investment securities available for our long-term insurance products and professional liability funding requirements, as well as restricted statutory deposits, are classified as long-term assets. For the purpose of determining gross realized gains and losses, which are included as a component of investment income in the consolidated statements of income, the cost of investment securities sold is based upon specific identification. Unrealized holding gains and losses, net of applicable deferred taxes, are included as a component of stockholders' equity and comprehensive income until realized from a sale or other-than-temporary impairment.

Under the other-than-temporary impairment model for debt securities held, we recognize an impairment loss in income in an amount equal to the full difference between the amortized cost basis and the fair value when we have the intent to sell the debt security or it is more likely than not we will be required to sell the debt security before recovery of our amortized cost basis. However, if we do not intend to sell the debt security, we evaluate the expected cash flows to be received as compared to amortized cost and determine if a credit loss has occurred. In the event of a credit loss, only the amount of the impairment associated with the credit loss is recognized currently in income with the remainder of the loss recognized in other comprehensive income.

When we do not intend to sell a security in an unrealized loss position, potential other-than-temporary impairment is considered using a variety of factors, including the length of time and extent to which the fair value has been less than cost; adverse conditions specifically related to the industry, geographic area or financial condition of the issuer or underlying collateral of a security; payment structure of the security; changes in credit rating of the security by the rating agencies; the volatility of the fair value changes; and changes in fair value of the security after the balance sheet date. For debt securities, we take into account expectations of relevant market and economic data. For example, with respect to mortgage and asset-backed securities, such data includes underlying loan level data and structural features such as seniority and other forms of credit enhancements. A decline in fair value is considered other-than-temporary when we do not expect to recover the entire amortized cost basis of the security. We estimate the amount of the credit loss component of a debt security as the difference between the amortized cost and the present value of the expected cash flows of the security. The present value is determined using the best estimate of future cash flows discounted at the implicit interest rate at the date of purchase.

Receivables and Revenue Recognition

We generally establish one-year commercial membership contracts with employer groups, subject to cancellation by the employer group on 30-day written notice. Our Medicare contracts with CMS renew annually. Our military services contracts with the federal government and our contracts with various state Medicaid programs generally are multi-year contracts subject to annual renewal provisions. Individual polices are subject to the requirements of the Health Care Reform Law as discussed previously.

Premiums Revenue

We bill and collect premium from employer groups and members in our Medicare and other individual products monthly. We receive monthly premiums from the federal government and various states according to government specified payment rates and various contractual terms. Changes in revenues for our Medicare and individual commercial medical products resulting from the periodic changes in risk-adjustment scores derived from medical diagnoses for our membership and changes in risk corridor estimates are recognized when the amounts become determinable and the collectibility is reasonably assured.

Premiums revenue is estimated by multiplying the membership covered under the various contracts by the contractual rates. Premiums revenue is recognized as income in the period members are entitled to receive services, and is net of estimated uncollectible amounts, retroactive membership adjustments, and adjustments to recognize rebates under the minimum benefit ratios required under the Health Care Reform Law. We estimate policyholder rebates by projecting calendar year minimum benefit ratios for the individual, small group, and large group markets, as defined by the Health Care Reform Law using a methodology prescribed by HHS, separately by state and legal entity. Beginning

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in 2014, Medicare Advantage products were also subject to minimum benefit ratio requirements under the Health Care Reform Law. Estimated calendar year rebates recognized ratably during the year are revised each period to reflect current experience. Retroactive membership adjustments result from enrollment changes not yet processed, or not yet reported by an employer group or the government. We routinely monitor the collectibility of specific accounts, the aging of receivables, historical retroactivity trends, estimated rebates, as well as prevailing and anticipated economic conditions, and reflect any required adjustments in current operations. Premiums received prior to the service period are recorded as unearned revenues.

Medicare Part D

We cover prescription drug benefits in accordance with Medicare Part D under multiple contracts with CMS. The payments we receive monthly from CMS and members, which are determined from our annual bid, represent amounts for providing prescription drug insurance coverage. We recognize premiums revenue for providing this insurance coverage ratably over the term of our annual contract. Our CMS payment is subject to risk sharing through the Medicare Part D risk corridor provisions. In addition, receipts for reinsurance and low-income cost subsidies as well as receipts for certain discounts on brand name prescription drugs in the coverage gap represent payments for prescription drug costs for which we are not at risk.

The risk corridor provisions compare costs targeted in our bids to actual prescription drug costs, limited to actual costs that would have been incurred under the standard coverage as defined by CMS. Variances exceeding certain thresholds may result in CMS making additional payments to us or require us to refund to CMS a portion of the premiums we received. As risk corridor provisions are considered in our overall annual bid process, we estimate and recognize an adjustment to premiums revenue related to these provisions based upon pharmacy claims experience. We record a receivable or payable at the contract level and classify the amount as current or long-term in our consolidated balance sheets based on the timing of expected settlement.

Reinsurance and low-income cost subsidies represent funding from CMS in connection with the Medicare Part D program for which we assume no risk. Reinsurance subsidies represent funding from CMS for its portion of prescription drug costs which exceed the member's out-of-pocket threshold, or the catastrophic coverage level. Low-income cost subsidies represent funding from CMS for all or a portion of the deductible, the coinsurance and co-payment amounts above the out-of-pocket threshold for low-income beneficiaries. Monthly prospective payments from CMS for reinsurance and low-income cost subsidies are based on assumptions submitted with our annual bid. A reconciliation and related settlement of CMS's prospective subsidies against actual prescription drug costs we paid is made after the end of the year. The Health Care Reform Law mandates consumer discounts of 50% on brand name prescription drugs for Part D plan participants in the coverage gap. These discounts are funded by CMS and pharmaceutical manufacturers while we administer the application of these funds. We account for these subsidies and discounts as a deposit in our consolidated balance sheets and as a financing activity under receipts (withdrawals) from contract deposits in our consolidated statements of cash flows. For 2015, subsidy and discount payments of $8.9 billion exceeded reimbursements of $8.6 billion by $361 million. For 2014, subsidy and discount payments of $6.7 billion exceeded reimbursements of $5.8 billion by $945 million. For 2013, subsidy and discount payments of $4.8 billion exceeded reimbursements of $4.6 billion by $154 million. We do not recognize premiums revenue or benefit expenses for these subsidies or discounts. Receipt and payment activity is accumulated at the contract level and recorded in our consolidated balance sheets in other current assets or trade accounts payable and accrued expenses depending on the contract balance at the end of the reporting period.

Settlement of the reinsurance and low-income cost subsidies as well as the risk corridor payment is based on a reconciliation made approximately 9 months after the close of each calendar year. Settlement with CMS for brand name prescription drug discounts is based on a reconciliation made approximately 14 to 18 months after the close of each calendar year. We continue to revise our estimates with respect to the risk corridor provisions based on subsequent period pharmacy claims data. See Note 6 for detail regarding amounts recorded to our consolidated balance sheets related to the risk corridor settlement and subsidies from CMS.

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Services Revenue
Patient services revenue
Patient services include injury and illness care and related services as well as other healthcare services related to employer needs or as required by law. Patient services revenues are recognized in the period services are provided to the customer when the sales price is fixed or determinable, and are net of contractual allowances.
Administrative services fees
Administrative services fees cover the processing of claims, offering access to our provider networks and clinical programs, and responding to customer service inquiries from members of self-funded groups. Revenues from providing administration services, also known as administrative services only, or ASO, are recognized in the period services are performed and are net of estimated uncollectible amounts. ASO fees are estimated by multiplying the membership covered under the various contracts by the contractual rates. Under ASO contracts, self-funded employers retain the risk of financing substantially all of the cost of health benefits. However, many ASO customers purchase stop loss insurance coverage from us to cover catastrophic claims or to limit aggregate annual costs. Accordingly, we have recorded premiums revenue and benefits expense related to these stop loss insurance contracts. We routinely monitor the collectibility of specific accounts, the aging of receivables, as well as prevailing and anticipated economic conditions, and reflect any required adjustments in current operations. ASO fees received prior to the service period are recorded as unearned revenues.
Under our current TRICARE South Region contract with the Department of Defense, we provide administrative services, including offering access to our provider networks and clinical programs, claim processing, customer service, enrollment, and other services, while the federal government retains all of the risk of the cost of health benefits. We account for revenues under the current contract net of estimated health care costs similar to an administrative services fee only agreement. The current contract includes fixed administrative services fees and incentive fees and penalties. Administrative services fees are recognized as services are performed.
Our TRICARE members are served by both in-network and out-of-network providers in accordance with the current contract. We pay health care costs related to these services to the providers and are subsequently reimbursed by the DoD for such payments. We account for the payments of the federal government’s claims and the related reimbursements under deposit accounting in our consolidated balance sheets and as a financing activity under receipts (withdrawals) from contract deposits in our consolidated statements of cash flows. For 2015, health care cost reimbursements and payments were each approximately $3.3 billion, with payments exceeding reimbursements by $4 million for the year. For 2014, health care cost reimbursements and payments were each $3.2 billion. For 2013, health care cost reimbursements and payments were each approximately $3.2 billion, with reimbursements exceeding payments by $5 million for the year.
Receivables
Receivables, including premium receivables, patient services revenue receivables, and ASO fee receivables, are shown net of allowances for estimated uncollectible accounts, retroactive membership adjustments, and contractual allowances.
Policy Acquisition Costs
Policy acquisition costs are those costs that relate directly to the successful acquisition of new and renewal insurance policies. Such costs include commissions, costs of policy issuance and underwriting, and other costs we incur to acquire new business or renew existing business. We expense policy acquisition costs related to our employer-group prepaid health services policies as incurred. These short-duration employer-group prepaid health services policies typically have a 1-year term and may be cancelled upon 30 days notice by the employer group.
Life insurance, annuities, and certain health and other supplemental policies sold to individuals are accounted for as long-duration insurance products because they are expected to remain in force for an extended period beyond one year

and premium received in the earlier years is intended to pay anticipated benefits to be incurred in future years. As

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a result, we defer policy acquisition costs, primarily consisting of commissions, and amortize them over the estimated life of the policies in proportion to premiums earned. Deferred acquisition costs are reviewed to determine if they are recoverable from future income. See Note 18.

Beginning in 2014, health policies sold to individuals that conform to the Health Care Reform Law are accounted for under a short-duration model and accordingly policy acquisition costs are expensed as incurred because premiums received in the current year are intended to pay anticipated benefits in that year. In addition, as previously underwritten members transition to plans compliant with the Health Care Reform Law, it results in policy lapses and the recognition of previously deferred acquisition costs.

Long-Lived Assets

Property and equipment is recorded at cost. Gains and losses on sales or disposals of property and equipment are included in operating costs. Certain costs related to the development or purchase of internal-use software are capitalized. Depreciation is computed using the straight-line method over estimated useful lives ranging from 3 to 10 years for equipment, 3 to 7 years for computer software, and 20 to 40 years for buildings. Improvements to leased facilities are depreciated over the shorter of the remaining lease term or the anticipated life of the improvement.

We periodically review long-lived assets, including property and equipment and other intangible assets, for impairment whenever adverse events or changes in circumstances indicate the carrying value of the asset may not be recoverable. Losses are recognized for a long-lived asset to be held and used in our operations when the undiscounted future cash flows expected to result from the use of the asset are less than its carrying value. We recognize an impairment loss based on the excess of the carrying value over the fair value of the asset. A long-lived asset held for sale is reported at the lower of the carrying amount or fair value less costs to sell. Depreciation expense is not recognized on assets held for sale. Losses are recognized for a long-lived asset to be abandoned when the asset ceases to be used. In addition, we periodically review the estimated lives of all long-lived assets for reasonableness.

Goodwill and Other Intangible Assets

Goodwill represents the unamortized excess of cost over the fair value of the net tangible and other intangible assets acquired. We are required to test at least annually for impairment at a level of reporting referred to as the reporting unit, and more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. A reporting unit either is our operating segments or one level below the operating segments, referred to as a component, which comprise our reportable segments. A component is considered a reporting unit if the component constitutes a business for which discrete financial information is available that is regularly reviewed by management. We aggregate the components of an operating segment into one reporting unit if they have similar economic characteristics. Goodwill is assigned to the reporting unit that is expected to benefit from a specific acquisition.

We use a two-step process to review goodwill for impairment. The first step is a screen for potential impairment, and the second step measures the amount of impairment, if any. Impairment tests are performed, at a minimum, in the fourth quarter of each year supported by our long-range business plan and annual planning process. We rely on an evaluation of future discounted cash flows to determine fair value of our reporting units. Impairment tests completed for 2015, 2014, and 2013 did not result in an impairment loss.

Other intangible assets primarily relate to acquired customer contracts/relationships and are included with other long-term assets in the consolidated balance sheets. Other intangible assets are amortized over the useful life, based upon the pattern of future cash flows attributable to the asset. This sometimes results in an accelerated method of amortization for customer contracts because the asset tends to dissipate at a more rapid rate in earlier periods. Other than customer contracts, other intangible assets generally are amortized using the straight-line method. We review other finite-lived intangible assets for impairment under our long-lived asset policy.

Benefits Payable and Benefits Expense Recognition

Benefits expense includes claim payments, capitation payments, pharmacy costs net of rebates, allocations of certain centralized expenses and various other costs incurred to provide health insurance coverage to members, as well as estimates of future payments to hospitals and others for medical care and other supplemental benefits provided on

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or prior to the balance sheet date. Capitation payments represent monthly contractual fees disbursed to primary care and other providers who are responsible for providing medical care to members. Pharmacy costs represent payments for members' prescription drug benefits, net of rebates from drug manufacturers. Receivables for such pharmacy rebates are included in other current assets in our consolidated balance sheets. Other supplemental benefits include dental, vision, and other supplemental health and financial protection products.

We estimate the costs of our benefits expense payments using actuarial methods and assumptions based upon claim payment patterns, medical cost inflation, historical developments such as claim inventory levels and claim receipt patterns, and other relevant factors, and record benefit reserves for future payments. We continually review estimates of future payments relating to claims costs for services incurred in the current and prior periods and make necessary adjustments to our reserves.

We reassess the profitability of our contracts for providing insurance coverage to our members when current operating results or forecasts indicate probable future losses. We establish a premium deficiency reserve in current operations to the extent that the sum of expected future costs, claim adjustment expenses, and maintenance costs exceeds related future premiums under contracts without consideration of investment income. For purposes of determining premium deficiencies, contracts are grouped in a manner consistent with our method of acquiring, servicing, and measuring the profitability of such contracts. Losses recognized as a premium deficiency result in a beneficial effect in subsequent periods as operating losses under these contracts are charged to the liability previously established. Because the majority of our member contracts renew annually, we would not record a material premium deficiency reserve, except when unanticipated adverse events or changes in circumstances indicate otherwise. In the fourth quarter of 2015, we recognized a premium deficiency reserve for our individual commercial medical business compliant with the Health Care Reform Law associated with the 2016 coverage year as discussed in more detail in Note 7.

We believe our benefits payable are adequate to cover future claims payments required. However, such estimates are based on knowledge of current events and anticipated future events. Therefore, the actual liability could differ materially from the amounts provided.

Future policy benefits payable

Future policy benefits payable include liabilities for long-duration insurance policies including long-term care, life insurance, annuities, and certain health and other supplemental policies sold to individuals for which some of the premium received in the earlier years is intended to pay anticipated benefits to be incurred in future years. At policy issuance, these reserves are recognized on a net level premium method based on interest rates, mortality, morbidity, and maintenance expense assumptions. Interest rates are based on our expected net investment returns on the investment portfolio supporting the reserves for these blocks of business. Mortality, a measure of expected death, and morbidity, a measure of health status, assumptions are based on published actuarial tables, modified based upon actual experience. Changes in estimates of these reserves are recognized as an adjustment to benefits expense in the period the changes occur. We perform loss recognition tests at least annually in the fourth quarter, and more frequently if adverse events or changes in circumstances indicate that the level of the liability, together with the present value of future gross premiums, may not be adequate to provide for future expected policy benefits and maintenance costs. We adjust future policy benefits payable for the additional liability that would have been recorded if investment securities backing the liability had been sold at their stated aggregate fair value and the proceeds reinvested at current yields. We include the impact of this adjustment, if any, net of applicable deferred taxes, with the change in unrealized investment gain (loss) in accumulated other comprehensive income in stockholders' equity. As discussed previously, beginning in 2014, health policies sold to individuals that conform to the Health Care Reform Law are accounted for under a short-duration model under which policy reserves are not established because premiums received in the current year are intended to pay anticipated benefits in that year. In addition, as previously underwritten members transition to plans compliant with the Health Care Reform Law, it results in policy lapses and the release of reserves for future policy benefits.

Book Overdraft

Under our cash management system, checks issued but not yet presented to banks that would result in negative bank balances when presented are classified as a current liability in the consolidated balance sheets. Changes in book overdrafts from period to period are reported in the consolidated statement of cash flows as a financing activity.

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Income Taxes
We recognize an asset or liability for the deferred tax consequences of temporary differences between the tax bases of assets or liabilities and their reported amounts in the consolidated financial statements. These temporary differences will result in taxable or deductible amounts in future years when the reported amounts of the assets or liabilities are recovered or settled. We also recognize the future tax benefits such as net operating and capital loss carryforwards as deferred tax assets. A valuation allowance is provided against these deferred tax assets if it is more likely than not that some portion or all of the deferred tax assets will not be realized. Future years' tax expense may be increased or decreased by adjustments to the valuation allowance or to the estimated accrual for income taxes.
We record tax benefits when it is more likely than not that the tax return position taken with respect to a particular transaction will be sustained. A liability, if recorded, is not considered resolved until the statute of limitations for the relevant taxing authority to examine and challenge the tax position has expired, or the tax position is ultimately settled through examination, negotiation, or litigation. We classify interest and penalties associated with uncertain tax positions in our provision for income taxes.
Derivative Financial Instruments
On October 29, 2012, we acquired a noncontrolling equity interest in MCCI Holdings, LLC, or MCCI, a privately held Medical Services Organization, or MSO, headquartered in Miami, Florida, that primarily coordinates medical care for Medicare Advantage beneficiaries in Florida, Texas and Georgia. Our agreement with MCCI includes a put option that would allow the controlling interest holder to put their interest to us beginning in 2018 as well as a call option that would allow us to purchase the controlling interest beginning in 2021. Accordingly, we recorded, at fair value, a liability and an asset associated with the put and call, respectively. Changes in the fair value of the liability and asset during the years ended December 31, 2015, 2014, and 2013 were not material to our results of operations, financial condition, or cash flows.
At times, we may use interest-rate swap agreements to manage our exposure to interest rate risk. The differential between fixed and variable rates to be paid or received is accrued and recognized over the life of the agreements as adjustments to interest expense in the consolidated statements of income. We were not party to any interest-rate swap agreements in 2015, 2014, or 2013.
Related Party
As noted above, MCCI is a related party to Humana. In December 2015, we purchased a note receivable directly from a third-party bank syndicate related to the financing of MCCI's business and extended the exercise date of the put option to 2018 and the call option to 2021 as previously discussed. The $284 million note receivable bears interest at 10% annually, payable in quarterly installments, and matures in December 2020. We have also entered into a revolving note agreement providing a line of credit up to $55 million under which no amounts have been drawn. The note receivable is included with other long-term assets in our consolidated balance sheet and with purchases of investment securities in our consolidated statement of cash flows. The related interest income is included in investment income in our consolidated statement of income. MCCI provides services to Humana Medicare Advantage members under capitation contracts with our health plans. Under these capitation agreements with Humana, MCCI assumes the financial risk associated with these Medicare Advantage members. We also advanced MCCI $9 million, with repayment terms tied to the performance under the capitation agreements. We recognized benefits expense of approximately $1.0 billion in 2015, $962 million in 2014 and $873 million in 2013 under these capitation agreements with MCCI.
Stock-Based Compensation
We generally recognize stock-based compensation expense, as determined on the date of grant at fair value, on a straight-line basis over the period during which an employee is required to provide service in exchange for the award (the vesting period). In addition, for awards with both time and performance-based conditions, we generally recognize

compensation expense on a straight line basis over the vesting period when it is probable that the performance condition will be achieved. However, prior to July 2, 2015, for awards granted to retirement eligible employees, compensation expense is recognized on a straight-line basis over the shorter of the requisite service period or the period from the date

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of grant to an employee's eligible retirement date. For awards granted on or after July 2, 2015 to retirement eligible employees, we recognize expense on a straight-line basis over the service period (the vesting period). We estimate expected forfeitures and recognize compensation expense only for those awards which are expected to vest. We estimate the grant-date fair value of stock options using the Black-Scholes option-pricing model. In addition, we report certain tax effects of stock-based compensation as a financing activity rather than an operating activity in the consolidated statement of cash flows. Additional detail regarding our stock-based compensation plans is included in Note 13.

Earnings Per Common Share

We compute basic earnings per common share on the basis of the weighted-average number of unrestricted common shares outstanding. Diluted earnings per common share is computed on the basis of the weighted-average number of unrestricted common shares outstanding plus the dilutive effect of outstanding employee stock options and restricted shares, or units, using the treasury stock method.

Fair Value

Assets and liabilities measured at fair value are categorized into a fair value hierarchy based on whether the inputs to valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect our own assumptions about the assumptions market participants would use. The fair value hierarchy includes three levels of inputs that may be used to measure fair value as described below.

Level 1 – Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt securities that are traded in an active exchange market.

Level 2 – Observable inputs other than Level 1 prices such as quoted prices in active markets for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted prices that are traded less frequently than exchange-traded instruments as well as debt securities whose value is determined using a pricing model with inputs that are observable in the market or can be derived principally from or corroborated by observable market data.

Level 3 – Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. Level 3 includes assets and liabilities whose value is determined using pricing models, discounted cash flow methodologies, or similar techniques reflecting our own assumptions about the assumptions market participants would use as well as those requiring significant management judgment.

Fair value of actively traded debt securities are based on quoted market prices. Fair value of other debt securities are based on quoted market prices of identical or similar securities or based on observable inputs like interest rates generally using a market valuation approach, or, less frequently, an income valuation approach and are generally classified as Level 2. We obtain at least one price for each security from a third party pricing service. These prices are generally derived from recently reported trades for identical or similar securities, including adjustments through the reporting date based upon observable market information. When quoted prices are not available, the third party pricing service may use quoted market prices of comparable securities or discounted cash flow analyses, incorporating inputs that are currently observable in the markets for similar securities. Inputs that are often used in the valuation methodologies include benchmark yields, reported trades, credit spreads, broker quotes, default rates, and prepayment speeds. We are responsible for the determination of fair value and as such we perform analysis on the prices received from the third party pricing service to determine whether the prices are reasonable estimates of fair value. Our analysis includes a review of monthly price fluctuations as well as a quarterly comparison of the prices received from the pricing service to prices reported by our third party investment advisor. In addition, on a quarterly basis we examine the underlying inputs and assumptions for a sample of individual securities across asset classes, credit rating levels, and various durations.

Fair value of privately held debt securities, as well as auction rate securities, are estimated using a variety of valuation methodologies, including both market and income approaches, where an observable quoted market does not

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

exist and are generally classified as Level 3. For privately-held debt securities, such methodologies include reviewing the value ascribed to the most recent financing, comparing the security with securities of publicly-traded companies in similar lines of business, and reviewing the underlying financial performance including estimating discounted cash flows. Auction rate securities are debt instruments with interest rates that reset through periodic short-term auctions. From time to time, liquidity issues in the credit markets have led to failed auctions. Given the liquidity issues, fair value could not be estimated based on observable market prices, and as such, unobservable inputs were used. For auction rate securities, valuation methodologies include consideration of the quality of the sector and issuer, underlying collateral, underlying final maturity dates, and liquidity.

Recently Issued Accounting Pronouncements

In January 2016, the Financial Accounting Standards Board, or FASB, issued new guidance related to classification and measurement of financial instruments which requires equity securities that are not accounted for using the equity method or that do not result in consolidation, to be accounted for at fair value with changes in fair value recognized through net income. The new guidance is effective for us beginning with annual and interim periods in 2018 with early adoption permitted under certain circumstances. We are currently evaluating the impact, if any, on our results of operations, financial position, and cash flows.

In November 2015, the FASB issued new guidance related to accounting for income taxes which changes the balance sheet classification of deferred taxes, requiring deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. The new guidance is effective for us beginning with annual and interim periods in 2017, with early adoption permitted. We elected to early adopt the guidance and have classified all deferred tax liabilities and assets as noncurrent in our consolidated balance sheet at December 31, 2015 to simplify their presentation. Prior periods were not retrospectively adjusted. The adoption of the new guidance did not have any impact on our results of operations or cash flows.

In May 2015, the FASB issued new guidance requiring insurance entities to provide additional disclosures about claim liabilities including paid claims development information by accident year and claim frequency data and related methodologies. The guidance is effective for us beginning with the 2016 annual reporting period and interim periods beginning in 2017. We are currently evaluating the impact the new guidance will have on our disclosures.

In April 2015, the FASB issued new guidance to help entities determine whether a cloud computing arrangement contains a software license that should be accounted for as internal-use software or as a service contract. The guidance is effective for us beginning with interim and annual reporting periods in 2016, with early adoption permitted. Upon adoption, an entity has the option to apply the provisions either prospectively to all arrangements entered into or materially modified, or retrospectively. We are currently evaluating the impact, if any, on our results of operations, financial position, and cash flows.

In March 2015, the FASB issued new guidance which changes the presentation of debt issuance costs from an asset to a direct reduction of the related debt liability. The new guidance is effective for us beginning with annual and interim periods in 2016 with early adoption permitted. The adoption of the new guidance will not have a material impact on our results of operations, financial condition, or cash flows.

In February 2015, the FASB issued an amendment to current consolidation guidance that modifies the evaluation of whether limited partnerships and similar legal entities are variable interest entities or voting interest entities, eliminating the presumption that a general partner should consolidate a limited partnership, and affects the consolidation analysis of reporting entities that are involved with variable interest entities. The new guidance is effective for us beginning with interim and annual reporting periods in 2016, with early adoption permitted. All legal entities are subject to reevaluation under the revised consolidation model. We are currently evaluating the impact, if any, on our results of operations, financial position, and cash flows.

In May 2014, the FASB issued new guidance that amends the accounting for revenue recognition. The amendments are intended to provide a more robust framework for addressing revenue issues, improve comparability of revenue recognition practices, and improve disclosure requirements. Insurance contracts are not included in the scope of this new guidance. In July 2015, the FASB decided to defer the effective date provided in the new revenue guidance by

one year. Giving effect to this deferral, the new guidance is effective for us beginning with annual and interim periods in 2018. We are currently evaluating the impact on our results of operations, financial condition, and cash flows.
There are no other recently issued accounting standards that apply to us or that are expected to have a material impact on our results of operations, financial condition, or cash flows.

3. ACQUISITIONS AND DIVESTITURES

On June 1, 2015, we completed the sale of our wholly owned subsidiary, Concentra Inc., or Concentra, to MJ Acquisition Corporation, a joint venture between Select Medical Holdings Corporation and Welsh, Carson, Anderson & Stowe XII, L.P., a private equity fund, for approximately $1,055 million in cash, excluding approximately $22 million of transaction costs. In connection with the sale, we recognized a pre-tax gain, net of transaction costs, of $270 million which is reported as gain on sale of business in the accompanying condensed consolidated statements of income for the year ended December 31, 2015.

In March 2015, we classified Concentra as held-for-sale and aggregated Concentra's assets and liabilities separately on the balance sheet, including a reclassification of the December 31, 2014 balance sheet for comparative purposes. The assets and liabilities of Concentra that were disposed of on June 1, 2015 and classified as held-for-sale as of December 31, 2014 were as follows:

	June 1, 2015	December 31, 2014
Assets	(in millions)	
Receivables, net	$130	$115
Property and equipment, net	197	191
Goodwill	480	480
Other intangible assets, net	124	132
Other assets	27	25
Total assets disposed/held-for-sale	$958	$943
Liabilities		
Trade accounts payable and accrued expenses	81	90
Other liabilities	114	116
Total liabilities disposed/held-for-sale	$195	$206
Net assets disposed	$763	$737

For the year ended December 31, 2015, the accompanying condensed consolidated statements of income include revenues related to Concentra of $411 million in 2015, $998 million in 2014, and $981 million in 2013.

On September 6, 2013, we acquired American Eldercare Inc., or American Eldercare, the largest provider of nursing home diversion services in the state of Florida, serving frail and elderly individuals in home and community-based settings. American Eldercare complements our core capabilities and strength in serving seniors and disabled individuals with a unique focus on individualized and integrated care, and has contracts to provide Medicaid long-term support services across the entire state of Florida. The enrollment effective dates for the various regions ranged from August 2013 to March 2014. The allocation of the purchase price resulted in goodwill of $76 million and other intangible assets of $75 million. The goodwill was assigned to the Retail segment. The other intangible assets, which primarily consist of customer contracts and technology, have a weighted average useful life of 9.3 years. Goodwill and other intangible assets are amortizable as deductible expenses for tax purposes.

The results of operations and financial condition of American Eldercare has been included in our consolidated statements of income and consolidated balance sheets from the acquisition date. In addition, during 2015, 2014 and

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2013, we acquired other health and wellness and technology related businesses which, individually or in the aggregate, have not had a material impact on our results of operations, financial condition, or cash flows. The results of operations and financial condition of these businesses have been included in our condensed consolidated statements of income and condensed consolidated balance sheets from the respective acquisition dates. Acquisition-related costs recognized in each of 2015, 2014, and 2013 were not material to our results of operations. The pro forma financial information assuming the acquisitions had occurred as of the beginning of the calendar year prior to the year of acquisition, as well as the revenues and earnings generated during the year of acquisition, were not material for disclosure purposes.

4. INVESTMENT SECURITIES

Investment securities classified as current and long-term were as follows at December 31, 2015 and 2014, respectively:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
	(in millions)			
December 31, 2015				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	$331	$2	$(1)	$332
Mortgage-backed securities	1,902	12	(23)	1,891
Tax-exempt municipal securities	2,611	61	(4)	2,668
Mortgage-backed securities:				
Residential	13	—	—	13
Commercial	1,024	2	(41)	985
Asset-backed securities	264	1	(2)	263
Corporate debt securities	2,873	140	(55)	2,958
Total debt securities	$9,018	$218	$(126)	$9,110
December 31, 2014				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	$365	$10	$(1)	$374
Mortgage-backed securities	1,453	50	(5)	1,498
Tax-exempt municipal securities	2,931	140	(3)	3,068
Mortgage-backed securities:				
Residential	17	—	—	17
Commercial	846	16	(19)	843
Asset-backed securities	28	1	—	29
Corporate debt securities	3,432	299	(13)	3,718
Total debt securities	$9,072	$516	$(41)	$9,547

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Gross unrealized losses and fair values aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position were as follows at December 31, 2015 and 2014, respectively:

	Less than 12 months		12 months or more		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(in millions)					
December 31, 2015						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	$195	$(1)	$14	$—	$209	$(1)
Mortgage-backed securities	1,484	(20)	86	(3)	1,570	(23)
Tax-exempt municipal securities	843	(3)	52	(1)	895	(4)
Mortgage-backed securities:						
Residential	2	—	4	—	6	—
Commercial	626	(13)	265	(28)	891	(41)
Asset-backed securities	258	(2)	—	—	258	(2)
Corporate debt securities	918	(45)	63	(10)	981	(55)
Total debt securities	$4,326	$(84)	$484	$(42)	$4,810	$(126)
December 31, 2014						
U.S. Treasury and other U.S. government corporations and agencies:						
U.S. Treasury and agency obligations	$79	$—	$80	$(1)	$159	$(1)
Mortgage-backed securities	22	—	320	(5)	342	(5)
Tax-exempt municipal securities	131	(1)	118	(2)	249	(3)
Mortgage-backed securities:						
Residential	1	—	4	—	5	—
Commercial	31	(1)	267	(18)	298	(19)
Asset-backed securities	13	—	—	—	13	—
Corporate debt securities	219	(6)	128	(7)	347	(13)
Total debt securities	$496	$(8)	$917	$(33)	$1,413	$(41)

Approximately 98% of our debt securities were investment-grade quality, with a weighted average credit rating of AA by S&P at December 31, 2015. Most of the debt securities that were below investment-grade were rated BB, the higher end of the below investment-grade rating scale. At December 31, 2015, 7% of our tax-exempt municipal securities were pre-refunded, generally with U.S. government and agency securities. Tax-exempt municipal securities that were not pre-refunded were diversified among general obligation bonds of U.S. states and local municipalities as well as special revenue bonds. General obligation bonds, which are backed by the taxing power and full faith of the issuer, accounted for 42% of the tax-exempt municipals that were not pre-refunded in the portfolio. Special revenue bonds, issued by a municipality to finance a specific public works project such as utilities, water and sewer, transportation, or education, and supported by the revenues of that project, accounted for the remaining 58% of these municipals. Our general obligation bonds are diversified across the United States with no individual state exceeding 11%. In addition, 6% of our tax-exempt securities were insured by bond insurers and had an equivalent weighted average S&P credit rating of AA exclusive of the bond insurers' guarantee. Our investment policy limits investments in a single issuer and requires diversification among various asset types.

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Residential mortgage back securities comprised approximately 98% of our agency mortgage-backed securities at December 31, 2015 and 99% at December 31, 2014.

The recoverability of our non-agency residential and commercial mortgage-backed securities is supported by factors such as seniority, underlying collateral characteristics and credit enhancements. These residential and commercial mortgage-backed securities at December 31, 2015 primarily were composed of senior tranches having high credit support, with over 99% of the collateral consisting of prime loans. The weighted average credit rating of all commercial mortgage-backed securities was AA+ at December 31, 2015.

The percentage of corporate securities associated with the financial services industry was 25% at December 31, 2015 and 21% at December 31, 2014.

Our unrealized loss from all securities was generated from approximately 690 positions out of a total of approximately 2,000 positions at December 31, 2015. All issuers of securities we own that were trading at an unrealized loss at December 31, 2015 remain current on all contractual payments. After taking into account these and other factors previously described, we believe these unrealized losses primarily were caused by an increase in market interest rates in the current markets than when the securities were purchased. At December 31, 2015, we did not intend to sell the securities with an unrealized loss position in accumulated other comprehensive income, and it is not likely that we will be required to sell these securities before recovery of their amortized cost basis. As a result, we believe that the securities with an unrealized loss were not other-than-temporarily impaired at December 31, 2015.

The detail of realized gains (losses) related to investment securities and included within investment income was as follows for the years ended December 31, 2015, 2014, and 2013:

	2015	2014	2013
	(in millions)		
Gross realized gains	$179	$29	$33
Gross realized losses	(33)	(9)	(11)
Net realized capital gains	$146	$20	$22

There were no material other-than-temporary impairments in 2015, 2014, or 2013.

The contractual maturities of debt securities available for sale at December 31, 2015, regardless of their balance sheet classification, are shown below. Expected maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
	(in millions)	
Due within one year	$438	$439
Due after one year through five years	1,829	1,871
Due after five years through ten years	1,244	1,264
Due after ten years	2,304	2,384
Mortgage and asset-backed securities	3,203	3,152
Total debt securities	$9,018	$9,110

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5. FAIR VALUE
Financial Assets
The following table summarizes our fair value measurements at December 31, 2015 and 2014, respectively, for financial assets measured at fair value on a recurring basis:

	Fair Value	Fair Value Measurements Using		
		Quoted Prices in Active Markets (Level 1)	Other Observable Inputs (Level 2)	Unobservable Inputs (Level 3)
	(in millions)			
December 31, 2015				
Cash equivalents	$2,229	$2,229	$—	$—
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	332	—	332	—
Mortgage-backed securities	1,891	—	1,891	—
Tax-exempt municipal securities	2,668	—	2,663	5
Mortgage-backed securities:				
Residential	13	—	13	—
Commercial	985	—	985	—
Asset-backed securities	263	—	263	—
Corporate debt securities	2,958	—	2,952	6
Total debt securities	9,110	—	9,099	11
Total invested assets	$11,339	$2,229	$9,099	$11
December 31, 2014				
Cash equivalents	$1,712	$1,712	$—	$—
Debt securities:				
U.S. Treasury and other U.S. government corporations and agencies:				
U.S. Treasury and agency obligations	374	—	374	—
Mortgage-backed securities	1,498	—	1,498	—
Tax-exempt municipal securities	3,068	—	3,060	8
Mortgage-backed securities:				
Residential	17	—	17	—
Commercial	843	—	843	—
Asset-backed securities	29	—	28	1
Corporate debt securities	3,718	—	3,695	23
Total debt securities	9,547	—	9,515	32
Total invested assets	$11,259	$1,712	$9,515	$32

There were no material transfers between Level 1 and Level 2 during 2015 or 2014.

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Our Level 3 assets had a fair value of $11 million at December 31, 2015, or 0.1% of our total invested assets. During the years ended December 31, 2015, 2014, and 2013, the changes in the fair value of the assets measured using significant unobservable inputs (Level 3) were comprised of the following:

	For the years ended December 31,								
	2015			2014			2013		
	Private Placements	Auction Rate Securities	Total	Private Placements	Auction Rate Securities	Total	Private Placements	Auction Rate Securities	Total
	(in millions)								
Beginning balance at January 1	$24	$8	$32	$24	$13	$37	$25	$13	$38
Total gains or losses:									
Realized in earnings	(1)	—	(1)	—	—	—	—	—	—
Unrealized in other comprehensive income	—	—	—	—	—	—	—	—	—
Purchases	—	—	—	—	—	—	—	—	—
Sales	(17)	(3)	(20)	—	(5)	(5)	—	—	—
Settlements	—	—	—	—	—	—	(1)	—	(1)
Balance at December 31	$6	$5	$11	$24	$8	$32	$24	$13	$37

Financial Liabilities
Our long-term debt, recorded at carrying value in our consolidated balance sheets, was $3,821 million at December 31, 2015 and $3,825 million at December 31, 2014. The fair value of our long-term debt was $3,986 million at December 31, 2015 and $4,102 million at December 31, 2014. The fair value of our long-term debt is determined based on Level 2 inputs, including quoted market prices for the same or similar debt, or if no quoted market prices are available, on the current prices estimated to be available to us for debt with similar terms and remaining maturities.
Due to the short-term nature, carrying value approximates fair value for our commercial paper borrowings.
Assets and Liabilities Measured at Fair Value on a Nonrecurring Basis
As disclosed in Note 3, we completed our acquisition of American Eldercare and other companies during 2015, 2014, and 2013. The values of net tangible assets acquired and the resulting goodwill and other intangible assets were recorded at fair value using Level 3 inputs. The majority of the related tangible assets acquired and liabilities assumed were recorded at their carrying values as of the respective dates of acquisition, as their carrying values approximated their fair values due to their short-term nature. The fair values of goodwill and other intangible assets acquired in these acquisitions were internally estimated primarily based on the income approach. The income approach estimates fair value based on the present value of the cash flows that the assets are expected to generate in the future. We developed internal estimates for the expected cash flows and discount rates in the present value calculations. Other than assets acquired and liabilities assumed in these acquisitions, there were no material assets or liabilities measured at fair value on a nonrecurring basis during 2015, 2014, or 2013.

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6. MEDICARE PART D
As discussed in Note 2, we cover prescription drug benefits in accordance with Medicare Part D under multiple contracts with CMS. The accompanying consolidated balance sheets include the following amounts associated with Medicare Part D as of December 31, 2015 and 2014. CMS subsidies/discounts in the table below include the reinsurance and low-income cost subsidies funded by CMS for which we assume no risk as well as brand name prescription drug discounts for Part D plan participants in the coverage gap funded by CMS and pharmaceutical manufacturers.

	2015		2014	
	Risk Corridor Settlement	CMS Subsidies/ Discounts	Risk Corridor Settlement	CMS Subsidies/ Discounts
	(in millions)			
Other current assets	$25	$2,082	$105	$1,690
Trade accounts payable and accrued expenses	(47)	(63)	(36)	(32)
Net current (liability) asset	$(22)	$2,019	$69	$1,658

7. HEALTH CARE REFORM
Operating results for our individual commercial medical business compliant with the Health Care Reform Law have been challenged primarily due to unanticipated modifications in the program subsequent to the passing of the Health Care Reform Law, resulting in higher covered population morbidity and the ensuing enrollment and claims issues causing volatility in claims experience. We took a number of actions in 2015 to improve the profitability of our individual commercial medical business in 2016. These actions were subject to regulatory restrictions in certain geographies and included premium increases for the 2016 coverage year related generally to the first half of 2015 claims experience, the discontinuation of certain products as well as exit of certain markets for 2016, network improvements, enhancements to claims and clinical processes and administrative cost control. Despite these actions, the deterioration in the second half of 2015 claims experience together with 2016 open enrollment results indicating the retention of many high-utilizing members for 2016 resulted in a probable future loss. As a result of our assessment of the profitability of our individual medical policies compliant with the Health Care Reform Law, in the fourth quarter of 2015, we recorded a provision for probable future losses (premium deficiency reserve) for the 2016 coverage year of $176 million in benefits payable in our consolidated balance sheet with a corresponding increase in benefits expense in our consolidated statement of income. The premium deficiency reserve includes the estimated benefit of approximately $340 million associated with risk corridor provisions expected for the 2016 coverage year.
On June 30, 2015 we received notification from CMS of risk adjustment and reinsurance settlement amounts for 2014. We revised our 2014 coverage year estimates to reflect actual amounts and also made a corresponding adjustment to our risk corridor estimate based on these results. The change in estimate for risk adjustment was substantially offset by the corresponding change in estimate for risk corridor, both of which are reflected as changes in premiums revenue in our consolidated statements of income. The change in estimate related to the 3Rs for the 2014 coverage year was a decline in the estimated net receivable of approximately $43 million for the year ended December 31, 2015. In addition, we revised our 3Rs estimates for the 2015 coverage year based on the data from CMS for 2014.
During the year ended December 31, 2015, we paid $186 million in risk adjustment charges and $1 million in risk corridor charges associated with the 2014 coverage year. We received payments of $521 million for reinsurance recoverables, $57 million for risk adjustment settlements, and $26 million for risk corridor settlements associated with the 2014 coverage year during the year ended December 31, 2015. We expect to collect the remaining risk adjustment receivable for the 2014 coverage year of approximately $4 million in 2016.

During 2015, we received our interim settlement associated with our risk corridor receivables for the 2014 coverage year. The interim settlement, representing only 12.6% of risk corridor receivables for the 2014 coverage year, was funded by HHS in accordance with previous guidance, utilizing funds HHS collected from us and other carriers under the 2014 risk corridor program. As discussed in Note 2, HHS provided guidance under the three year risk corridor program that future collections will first be applied to any shortfalls from previous coverage years before application

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to current year obligations. Risk corridor payables to issuers are obligations of the United States Government under the Health Care Reform law which requires the Secretary of HHS to make full payments to issuers. In the event of a shortfall at the end of the three year program, HHS has asserted it will explore other sources of funding for risk corridor payments, subject to the availability of appropriations. Based on the notice from CMS and collections in the fourth quarter of 2015, we classified our remaining gross risk corridor receivables for both the 2014 and 2015 coverage years as long-term because settlement is expected to exceed 12 months at December 31, 2015.

The accompanying consolidated balance sheets include the following amounts associated with the 3Rs at December 31, 2015 and December 31, 2014. Amounts classified as long-term represent settlements that we expect to exceed 12 months at December 31, 2015.

	2015 Risk Adjustment Settlement	Reinsurance Recoverables	Risk Corridor Settlement	2014 Risk Adjustment Settlement	Reinsurance Recoverables	Risk Corridor Settlement
	(in millions)					
2014 Coverage Year						
Premiums receivable	$4	$ —	$—	$131	$ —	$—
Other current assets	—	—	—	—	586	55
Trade accounts payable and accrued expenses	—	—	—	(89)	—	(4)
Net current asset	4	—	—	42	586	51
Other long-term assets	—	—	215	—	—	—
Other long-term liabilities	—	—	—	—	—	—
Net long-term asset	—	—	215	—	—	—
Total 2014 coverage year net asset	4	—	215	42	586	51
2015 Coverage Year						
Premiums receivable	122	—	—	—	—	—
Other current assets	—	610	—	—	—	—
Trade accounts payable and accrued expenses	(223)	—	—	—	—	—
Net current (liability) asset	(101)	610	—	—	—	—
Other long-term assets	10	—	244	—	—	—
Other long-term liabilities	—	—	—	—	—	—
Net long-term asset	10	—	244	—	—	—
Total 2015 coverage year net (liability) asset	(91)	610	244	—	—	—
Total net (liability) asset	$(87)	$ 610	$459	$42	$ 586	$51

In 2015, we paid the federal government $867 million for the annual health insurance industry fee attributed to calendar year 2015, in accordance with the Health Care Reform Law. In 2014, we paid the federal government $562 million for the annual health insurance industry fee attributed to calendar year 2014. This fee is not deductible for tax purposes.

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8. PROPERTY AND EQUIPMENT, NET

Property and equipment was comprised of the following at December 31, 2015 and 2014, excluding Concentra amounts classified as held-for-sale at December 31, 2014 for comparative purposes. Net property and equipment associated with Concentra and classified as held-for sale at December 31, 2014 was $191 million.

	2015	2014
	(in millions)	
Land	$20	$18
Buildings and leasehold improvements	633	602
Equipment	645	631
Computer software	1,424	1,656
	2,722	2,907
Accumulated depreciation	(1,338)	(1,679)
Property and equipment, net	$1,384	$1,228

Depreciation expense was $354 million in 2015, $328 million in 2014, and $309 million in 2013, including amortization expense for capitalized internally developed and purchased software of $220 million in 2015, $191 million in 2014, and $172 million in 2013.

9. GOODWILL AND OTHER INTANGIBLE ASSETS

The carrying amounts of goodwill for our reportable segments have been retrospectively adjusted as of January 1, 2014 to conform to the 2015 segment change discussed in Note 2. Changes in the carrying amount of goodwill for our reportable segments for the years ended December 31, 2015 and 2014 were as follows:

	Retail	Group	Healthcare Services	Total
	(in millions)			
Balance at January 1, 2014	$1,069	$385	$1,799	$3,253
Acquisitions	—	—	19	19
Dispositions	—	—	(40)	(40)
Subsequent payments/adjustments	—	—	(1)	(1)
Balance at December 31, 2014	1,069	385	1,777	3,231
Acquisitions	—	—	35	35
Dispositions	—	—	(1)	(1)
Balance at December 31, 2015	$1,069	$385	$1,811	$3,265

Healthcare Services segment goodwill of $480 million associated with the sale of Concentra was reclassified to assets held-for-sale as of January 1, 2014 for comparative purposes and excluded from the table above. This $480 million of goodwill was disposed of on June 1, 2015 with the completion of the sale of Concentra.

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The following table presents details of our other intangible assets included in other long-term assets in the accompanying consolidated balance sheets at December 31, 2015 and 2014 and excludes Concentra amounts classified as held-for-sale as of December 31, 2014 for comparative purposes. Net other intangible assets associated with Concentra and classified as held-for-sale at December 31, 2014 were $132 million.

	Weighted Average Life	2015 Cost	2015 Accumulated Amortization	2015 Net	2014 Cost	2014 Accumulated Amortization	2014 Net
		(in millions)					
Other intangible assets:							
Customer contracts/relationships	9.8 years	$566	$292	$274	$657	$326	$331
Trade names and technology	8.3 years	104	54	50	115	50	65
Provider contracts	14.6 years	51	24	27	52	21	31
Noncompetes and other	8.2 years	32	26	6	41	28	13
Total other intangible assets	9.8 years	$753	$396	$357	$865	$425	$440

Amortization expense for other intangible assets was approximately $93 million in 2015, $121 million in 2014, and $117 million in 2013. The following table presents our estimate of amortization expense for each of the five next succeeding fiscal years:

	(in millions)
For the years ending December 31,:	
2016	$78
2017	71
2018	62
2019	51
2020	47

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10. BENEFITS PAYABLE
Activity in benefits payable, excluding military services, was as follows for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
	(in millions)		
Balances at January 1	$4,475	$3,893	$3,775
Less: Reinsurance recoverables	(78)	—	—
Balances at January 1, net	4,397	3,893	3,775
Acquisitions	—	—	5
Incurred related to:			
Current year	44,397	38,641	32,711
Prior years	(236)	(518)	(474)
Total incurred	44,161	38,123	32,237
Paid related to:			
Current year	(39,802)	(34,357)	(29,103)
Prior years	(4,041)	(3,262)	(3,021)
Total paid	(43,843)	(37,619)	(32,124)
Premium deficiency reserve	176	—	—
Reinsurance recoverable	85	78	—
Balances at December 31	$4,976	$4,475	$3,893

Amounts incurred related to prior years vary from previously estimated liabilities as the claims ultimately are settled. Negative amounts reported for incurred related to prior years result from claims being ultimately settled for amounts less than originally estimated (favorable development).
Actuarial standards require the use of assumptions based on moderately adverse experience, which generally results in favorable reserve development, or reserves that are considered redundant. We experienced favorable medical claims reserve development related to prior fiscal years of $236 million in 2015, $518 million in 2014, and $474 million in 2013. The favorable medical claims reserve development for 2015, 2014, and 2013 primarily reflects the consistent application of trend and completion factors estimated using an assumption of moderately adverse conditions. The decline in favorable prior period development in 2015 primarily was due to the impact of lower financial claim recoveries due in part to our gradual implementation during 2014 of inpatient authorization review prior to admission as opposed to post adjudication, as well as higher than expected flu associated claims from the fourth quarter of 2014 and continued volatility in claims associated with individual commercial medical products. The higher favorable prior period development during 2014 and 2013 resulted from increased membership, better than originally expected utilization across most of our major business lines and increased financial recoveries. The increase in financial recoveries primarily resulted from claim audit process enhancements as well as increased volume of claim audits and expanded audit scope. All lines of business benefited from these improvements.

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Benefits expense excluded from the previous table was as follows for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
	(in millions)		
Premium deficiency reserve for short-duration policies	$176	$—	$—
Military services	12	11	(27)
Future policy benefits	(80)	32	354
Total	$108	$43	$327

In the fourth quarter of 2015, we recognized a premium deficiency reserve for our individual commercial medical business compliant with the Health Care Reform Law associated with the 2016 coverage year as discussed in more detail in Note 7.

Military services benefits expense for 2015 and 2014 reflect expenses associated with our contracts with the Veterans Administration. Military services benefits expense for 2013 reflects the beneficial effect of a favorable settlement of contract claims with the DoD partially offset by expenses associated with our contracts with the Veterans Administration.

The decrease in benefits expense associated with future policy benefits payable in 2015 primarily reflects the release of reserves as individual commercial medical members transitioned to plans compliant with the Health Care Reform Law. The higher benefits expense associated with future policy benefits payable during 2013 relates to reserve strengthening for our closed block of long-term care insurance policies acquired in connection with the 2007 KMG America Corporation, or KMG, acquisition more fully described in Note 18.

11. INCOME TAXES

The provision for income taxes consisted of the following for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
	(in millions)		
Current provision:			
Federal	$1,067	$1,006	$595
States and Puerto Rico	90	81	53
Total current provision	1,157	1,087	648
Deferred (benefit) provision	(2)	(64)	42
Provision for income taxes	$1,155	$1,023	$690

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The provision for income taxes was different from the amount computed using the federal statutory rate for the years ended December 31, 2015, 2014 and 2013 due to the following:

	2015	2014	2013
	(in millions)		
Income tax provision at federal statutory rate	$851	$759	$672
States, net of federal benefit, and Puerto Rico	44	48	32
Tax exempt investment income	(24)	(27)	(26)
Health insurer fee	314	204	—
Nondeductible executive compensation	18	22	6
Concentra sale	(67)	—	—
Other, net	19	17	6
Provision for income taxes	$1,155	$1,023	$690

The provision for income taxes for 2015, 2014, and 2013 reflects an $18 million, $22 million, and $6 million, respectively, estimated impact from limitations on the deductibility of annual compensation in excess of $500,000 per employee as mandated by the Health Care Reform Law. As of December 31, 2015, we do not have material uncertain tax positions reflected in our consolidated balance sheet.

Deferred income tax balances reflect the impact of temporary differences between the tax bases of assets or liabilities and their reported amounts in our consolidated financial statements, and are stated at enacted tax rates expected to be in effect when the reported amounts are actually recovered or settled. Principal components of our net deferred tax balances at December 31, 2015 and 2014 were as follows, excluding Concentra amounts classified as held-for-sale at December 31, 2014 for comparative purposes. The net deferred tax liability associated with Concentra and classified as held-for sale at December 31, 2014 was $55 million.

	Assets (Liabilities)	
	2015	2014
	(in millions)	
Future policy benefits payable	$200	$320
Compensation and other accrued expenses	130	168
Benefits payable	267	138
Net operating loss carryforward	47	52
Deferred acquisition costs	64	57
Unearned revenues	22	21
Other	13	17
Total deferred income tax assets	743	773
Valuation allowance	(42)	(48)
Total deferred income tax assets, net of valuation allowance	701	725
Depreciable property and intangible assets	(363)	(346)
Investment securities	(37)	(168)
Prepaid expenses	(45)	(55)
Total deferred income tax liabilities	(445)	(569)
Total net deferred income tax assets	$256	$156
Amounts recognized in the consolidated balance sheets:		
Other current assets	$—	$79
Other long-term assets	256	77
Total net deferred income tax assets	$256	$156

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In November 2015, the FASB issued new guidance related to accounting for income taxes which changes the balance sheet classification of deferred taxes, requiring deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. We elected to early adopt the guidance and have classified all deferred tax liabilities and assets as noncurrent in our consolidated balance sheet at December 31, 2015 to simplify their presentation. Prior periods were not retrospectively adjusted. If we had retrospectively adjusted our consolidated balance sheet, our other current assets would have declined by $79 million and, similarly, our other long-term assets would have increased by $79 million at December 31, 2014.

At December 31, 2015, we had approximately $126 million of net operating losses to carry forward related to prior acquisitions and our Puerto Rico subsidiaries. These net operating loss carryforwards, if not used to offset future taxable income, will expire from 2016 through 2033. Due to limitations and uncertainty regarding our ability to use some of the carryforwards, a valuation allowance was established on $105 million of these net operating loss carryforwards and $7 million of other items related to Puerto Rico. For the remainder of the net operating loss carryforwards and other cumulative temporary differences, based on our historical record of producing taxable income and profitability, we have concluded that future operating income will be sufficient to give rise to tax expense to recover all deferred tax assets.

We provide for income taxes on the undistributed earnings of our Puerto Rico operations using that jurisdiction’s tax rate, which has been lower historically than the U.S. statutory tax rate. Permanent investment of these earnings has resulted in cumulative unrecognized deferred tax liabilities of approximately $30 million as of December 31, 2015.

We file income tax returns in the United States and certain foreign jurisdictions. The U.S. Internal Revenue Service, or IRS, has completed its examinations of our consolidated income tax returns for 2013 and prior years. Our 2014 tax return is in the post-filing review period under the Compliance Assurance Process (CAP). Our 2015 tax return is under advance review by the IRS under CAP. With few exceptions, which are immaterial in the aggregate, we no longer are subject to state, local and foreign tax examinations for years before 2012. As of December 31, 2015, we are not aware of any material adjustments that may be proposed.

12. DEBT

The carrying value of long-term debt outstanding was as follows at December 31, 2015 and 2014:

	2015	2014
	(in millions)	
Long-term debt:		
Senior notes:		
$500 million, 7.20% due June 15, 2018	$503	$504
$300 million, 6.30% due August 1, 2018	309	312
$400 million, 2.625% due October 1, 2019	400	400
$600 million, 3.15% due December 1, 2022	598	598
$600 million, 3.85% due October 1, 2024	599	599
$250 million, 8.15% due June 15, 2038	266	266
$400 million, 4.625% due December 1, 2042	400	400
$750 million, 4.95% due October 1, 2044	746	746
Total long-term debt	$3,821	$3,825

Senior Notes

In September 2014, we issued $400 million of 2.625% senior notes due October 1, 2019, $600 million of 3.85% senior notes due October 1, 2024 and $750 million of 4.95% senior notes due October 1, 2044. Our net proceeds, reduced for the underwriters' discount and commission and offering expenses, were $1.73 billion. We used a portion of the net proceeds to redeem the $500 million 6.45% senior unsecured notes as discussed below.

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In October 2014, we redeemed the $500 million 6.45% senior unsecured notes due June 1, 2016, at 100% of the principal amount plus applicable premium for early redemption and accrued and unpaid interest to the redemption date, for cash totaling approximately $560 million. We recognized a loss on extinguishment of debt of approximately $37 million in October 2014 for the redemption of these notes.

Our senior notes, which are unsecured, may be redeemed at our option at any time at 100% of the principal amount plus accrued interest and a specified make-whole amount. The 7.20% and 8.15% senior notes are subject to an interest rate adjustment if the debt ratings assigned to the notes are downgraded (or subsequently upgraded). In addition, our senior notes (other than the 6.30% senior notes) contain a change of control provision that may require us to purchase the notes under certain circumstances. On July 2, 2015 we entered into a Merger Agreement with Aetna that, when closed, may require redemption of the notes if the notes are downgraded below investment grade by both Standard & Poor's Rating Services, or S&P and Moody's Investors Services, Inc., or Moody's.

Prior to 2009, we were parties to interest-rate swap agreements that exchanged the fixed interest rate under our senior notes for a variable interest rate based on LIBOR. As a result, the carrying value of the senior notes was adjusted to reflect changes in value caused by an increase or decrease in interest rates. During 2008, we terminated all of our swap agreements. The cumulative adjustment to the carrying value of our senior notes was $103 million as of the termination date which is being amortized as a reduction to interest expense over the remaining term of the senior notes. In October 2014, the redemption of our 6.45% senior notes reduced the unamortized carrying value adjustment by $12 million. The unamortized carrying value adjustment was $28 million as of December 31, 2015 and $32 million as of December 31, 2014.

Credit Agreement

Our 5-year $1.0 billion unsecured revolving credit agreement expires July 2018. Under the credit agreement, at our option, we can borrow on either a competitive advance basis or a revolving credit basis. The revolving credit portion bears interest at either LIBOR plus a spread or the base rate plus a spread. The LIBOR spread, currently 110 basis points, varies depending on our credit ratings ranging from 90 to 150 basis points. We also pay an annual facility fee regardless of utilization. This facility fee, currently 15 basis points, may fluctuate between 10 and 25 basis points, depending upon our credit ratings. The competitive advance portion of any borrowings will bear interest at market rates prevailing at the time of borrowing on either a fixed rate or a floating rate based on LIBOR, at our option.

The terms of the credit agreement include standard provisions related to conditions of borrowing, including a customary material adverse effect clause which could limit our ability to borrow additional funds. In addition, the credit agreement contains customary restrictive and financial covenants as well as customary events of default, including financial covenants regarding the maintenance of a minimum level of net worth of $8.5 billion at December 31, 2015 and a maximum leverage ratio of 3.0:1. We are in compliance with the financial covenants, with actual net worth of $10.3 billion and an actual leverage ratio of 1.3:1, as measured in accordance with the credit agreement as of December 31, 2015. In addition, the credit agreement includes an uncommitted $250 million incremental loan facility.

At December 31, 2015, we had no borrowings outstanding under the credit agreement and we had outstanding letters of credit of $1 million secured under the credit agreement. No amounts have been drawn on these letters of credit. Accordingly, as of December 31, 2015, we had $999 million of remaining borrowing capacity under the credit agreement, none of which would be restricted by our financial covenant compliance requirement. We have other customary, arms-length relationships, including financial advisory and banking, with some parties to the credit agreement.

Commercial Paper

In October 2014, we entered into a commercial paper program pursuant to which we may issue short-term, unsecured commercial paper notes privately placed on a discount basis through certain broker dealers. Amounts available under the program may be borrowed, repaid and re-borrowed from time to time, with the aggregate face or principal amount outstanding under the program at any time not to exceed $1 billion. The net proceeds of issuances have been and are expected to be used for general corporate purposes. The maximum principal amount outstanding at any one time during

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the year ended December 31, 2015 was $414 million, with $299 million outstanding at December 31, 2015. There were no outstanding borrowings at December 31, 2014.

13. EMPLOYEE BENEFIT PLANS

Employee Savings Plan

We have defined contribution retirement savings plans covering eligible employees which include matching contributions based on the amount of our employees' contributions to the plans. The cost of these plans amounted to approximately $188 million in 2015, $176 million in 2014, and $155 million in 2013. The Company's cash match is invested pursuant to the participant's contribution direction. Based on the closing price of our common stock of $178.51 on December 31, 2015, approximately 13% of the retirement and savings plan's assets were invested in our common stock, or approximately 2.5 million shares, representing 2% of the shares outstanding as of December 31, 2015. At December 31, 2015, approximately 3.4 million shares of our common stock were reserved for issuance under our defined contribution retirement savings plans.

Stock-Based Compensation

We have plans under which options to purchase our common stock and restricted stock units have been granted to executive officers, directors and key employees. For awards granted prior to July 2, 2015, our equity award agreements generally contain provisions whereby the awards automatically accelerate and vest upon change in control, including those granted to retirement-eligible participants described below. The Merger discussed in Note 2 qualifies as a change in control event under our equity award agreements. Awards granted on or after July 2, 2015 would generally require both a change in control and termination of employment within 2 years of the date of the change in control to accelerate the vesting, including those granted to retirement-eligible participants.

The terms and vesting schedules for stock-based awards vary by type of grant. Generally, the awards vest upon time-based conditions. We have also granted awards to certain employees that vest upon a combination of time and performance-based conditions. The stock awards of retirement-eligible participants granted prior to July 2, 2015 generally will continue to fully vest on the originally scheduled vest date upon retirement from the Company. For stock awards of retirement-eligible employees granted on or after July 2, 2015, awards are generally earned ratably over the service period for each tranche. Accordingly, upon retirement the earned portion of the current tranche will continue to vest on the originally scheduled vest date and any remaining unearned portion of the award will be forfeited. Our equity award program includes a retirement provision that generally treats employees with a combination of age and years of services with the Company totaling 65 or greater, with a minimum required age of 55 and a minimum requirement of 5 years of service, as retirement-eligible. Upon exercise, stock-based compensation awards are settled with authorized but unissued company stock or treasury stock.

The compensation expense that has been charged against income for these plans was as follows for the years ended December 31, 2015, 2014, and 2013:

	2015	2014	2013
	(in millions)		
Stock-based compensation expense by type:			
Restricted stock	$99	$91	$84
Stock options	10	7	8
Total stock-based compensation expense	109	98	92
Tax benefit recognized	(26)	(22)	(22)
Stock-based compensation expense, net of tax	$83	$76	$70

The tax benefit recognized in our consolidated financial statements is based on the amount of compensation expense recorded for book purposes, subject to limitations on the deductibility of annual compensation in excess of $500,000 per employee as mandated by the Health Care Reform Law. The actual tax benefit realized in our tax return is based

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on the intrinsic value, or the excess of the market value over the exercise or purchase price, of stock options exercised and restricted stock vested during the period, subject to limitations on the deductibility of annual compensation in excess of $500,000 per employee as mandated by the Health Care Reform Law. The actual tax benefit realized for the deductions taken on our tax returns from option exercises and restricted stock vesting totaled $34 million in 2015, $30 million in 2014, and $20 million in 2013. There was no capitalized stock-based compensation expense during these years.

At December 31, 2015, there were 18.1 million shares reserved for stock award plans. These reserved shares included giving effect to, under the 2011 Plan, 8.7 million shares of common stock available for future grants assuming all stock options were granted or 3.8 million shares available for future grants assuming all restricted stock were granted. Shares may be issued from authorized but unissued company stock or treasury stock.

Restricted Stock

Restricted stock is granted with a fair value equal to the market price of our common stock on the date of grant and generally vests three years from the date of grant. Restricted stock granted on or after July 2, 2015, generally vests in equal annual tranches over a three year period from the date of grant. Certain of our restricted stock units also include performance-based conditions generally associated with strategic membership growth and return on invested capital. Restricted stock units have forfeitable dividend equivalent rights equal to the dividend paid on common stock. The weighted-average grant date fair value of our restricted stock was $165.26 in 2015, $103.57 in 2014, and $73.50 in 2013. Activity for our restricted stock was as follows for the year ended December 31, 2015:

	Shares	Weighted-Average Grant-Date Fair Value
	(shares in thousands)	
Nonvested restricted stock at December 31, 2014	3,635	$85.52
Granted	837	165.26
Vested	(919)	84.95
Forfeited	(188)	98.92
Nonvested restricted stock at December 31, 2015	3,365	$104.58

Approximately 30% of the nonvested restricted stock at December 31, 2015 included performance-based conditions. The fair value of shares vested was $153 million during 2015, $99 million during 2014, and $52 million during 2013. Total compensation expense not yet recognized related to nonvested restricted stock was $88 million at December 31, 2015. We expect to recognize this compensation expense over a weighted-average period of approximately 1.4 years. There are no other contractual terms covering restricted stock once vested.

Stock Options

Stock options are granted with an exercise price equal to the fair market value of the underlying common stock on the date of grant. Our stock plans, as approved by the Board of Directors and stockholders, define fair market value as the average of the highest and lowest stock prices reported on the composite tape by the New York Stock Exchange on a given date. Exercise provisions vary, but most options vest in whole or in part 1 to 3 years after grant and expire 7 years after grant.

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The weighted-average fair value of each option granted during 2015, 2014, and 2013 is provided below. The fair value was estimated on the date of grant using the Black-Scholes pricing model with the weighted-average assumptions indicated below:

	2015	2014	2013
Weighted-average fair value at grant date	$36.91	$22.45	$21.80
Expected option life (years)	4.2 years	4.3 years	4.4 years
Expected volatility	27.4 %	27.6 %	38.8 %
Risk-free interest rate at grant date	1.4 %	1.3 %	0.8 %
Dividend yield	0.7 %	1.1 %	1.5 %

When valuing employee stock options, we stratify the employee population into three homogenous groups that historically have exhibited similar exercise behaviors. These groups are executive officers, directors, and all other employees. We value the stock options based on the unique assumptions for each of these employee groups.
We calculate the expected term for our employee stock options based on historical employee exercise behavior and base the risk-free interest rate on a traded zero-coupon U.S. Treasury bond with a term substantially equal to the option's expected term.
The volatility used to value employee stock options is based on historical volatility. We calculate historical volatility using a simple-average calculation methodology based on daily price intervals as measured over the expected term of the option.
Activity for our option plans was as follows for the year ended December 31, 2015:

	Shares Under Option (shares in thousands)	Weighted-Average Exercise Price
Options outstanding at December 31, 2014	768	$82.45
Granted	377	164.80
Exercised	(304)	76.25
Forfeited	(6)	83.58
Options outstanding at December 31, 2015	835	$121.89
Options exercisable at December 31, 2015	203	$78.30

As of December 31, 2015, outstanding stock options, substantially all of which are expected to vest, had an aggregate intrinsic value of $48 million, and a weighted-average remaining contractual term of 5.0 years. As of December 31, 2015, exercisable stock options had an aggregate intrinsic value of $20 million, and a weighted-average remaining contractual term of 3.5 years. The total intrinsic value of stock options exercised during 2015 was $28 million, compared with $32 million during 2014 and $39 million during 2013. Cash received from stock option exercises totaled $23 million in 2015, $52 million in 2014, and $67 million in 2013.
Total compensation expense not yet recognized related to nonvested options was $10 million at December 31, 2015. We expect to recognize this compensation expense over a weighted-average period of approximately 1.9 years.

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14. EARNINGS PER COMMON SHARE COMPUTATION

Detail supporting the computation of basic and diluted earnings per common share was as follows for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
	(dollars in millions, except per common share results, number of shares/options in thousands)		
Net income available for common stockholders	$1,276	$1,147	$1,231
Weighted-average outstanding shares of common stock used to compute basic earnings per common share	149,455	154,187	157,503
Dilutive effect of:			
Employee stock options	192	230	322
Restricted stock	1,495	1,457	1,326
Shares used to compute diluted earnings per common share	151,142	155,874	159,151
Basic earnings per common share	$8.54	$7.44	$7.81
Diluted earnings per common share	$8.44	$7.36	$7.73
Number of antidilutive stock options and restricted stock awards excluded from computation	415	320	704

15. STOCKHOLDERS' EQUITY

Dividends

The following table provides details of dividend payments, excluding dividend equivalent rights, in 2013, 2014, and 2015 under our Board approved quarterly cash dividend policy:

Payment Date	Amount per Share	Total Amount (in millions)
2013	$1.06	$167
2014	$1.10	$170
2015	$1.14	$170

The Merger Agreement discussed in Note 2 does not impact our ability and intent to continue quarterly dividend payments prior to the closing of the Merger consistent with our historical dividend payments. Under the terms of the Merger Agreement, we have agreed with Aetna that our quarterly dividend will not exceed $0.29 per share prior to the closing of the Merger. Declaration and payment of future quarterly dividends is at the discretion of our Board and may be adjusted as business needs or market conditions change. In addition, under the terms of the Merger Agreement, we have agreed with Aetna to coordinate the declaration and payment of dividends so that our stockholders do not fail to receive a quarterly dividend around the time of the closing of the Merger.

On October 29, 2015, the Board declared a cash dividend of $0.29 per share that was paid on January 29, 2016 to stockholders of record on December 30, 2015, for an aggregate amount of $43 million.

Stock Repurchases

In September 2014, our Board of Directors replaced a previous share repurchase authorization of up to $1 billion (of which $816 million remained unused) with a new current authorization for repurchases of up to $2 billion of our common shares exclusive of shares repurchased in connection with employee stock plans, expiring on December 31, 2016. Under the share repurchase authorization, shares may be purchased from time to time at prevailing prices in the

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open market, by block purchases, through plans designed to comply with Rule 10b5-1 under the Securities Exchange Act of 1934, as amended, or in privately-negotiated transactions (including pursuant to accelerated share repurchase agreements with investment banks), subject to certain regulatory restrictions on volume, pricing, and timing. Pursuant to the Merger Agreement, after July 2, 2015, we are prohibited from repurchasing any of our outstanding securities without the prior written consent of Aetna, other than repurchases of shares of our common stock in connection with the exercise of outstanding stock options or the vesting or settlement of outstanding restricted stock awards. Accordingly, as announced on July 3, 2015, we have suspended our share repurchase program. Our remaining repurchase authorization was $1.04 billion as of July 3, 2015.

Excluding shares acquired in connection with employee stock plans as well as 0.36 million shares received in March 2015 upon final settlement of our accelerated share repurchase agreement, or ASR Agreement, described below for which no cash was paid during the period, share repurchases were as follows during the years ended December 31, 2015, 2014 and 2013:

		Year Ended December 31,					
		2015		2014		2013	
Authorization Date	Purchase Not to Exceed	Shares	Cost	Shares	Cost	Shares	Cost
	(in millions)						
September 2014	$2,000	1.85	$329	4.10	$635 (a)	—	$—
April 2014	1,000	—	—	1.50	184	—	—
April 2013	1,000	—	—	0.10	11	4.55	420
April 2012	1,000	—	—	—	—	1.22	82
Total repurchases		1.85	$329	5.70	$830	5.77	$502

(a) Includes $100 million held back by Goldman Sachs pending final settlement of the ASR Agreement in March 2015 at which time we received an additional 0.36 million shares which are excluded from the table above.

On November 7, 2014, we announced that we had entered into an accelerated share repurchase agreement, or ASR Agreement, with Goldman, Sachs & Co., or Goldman Sachs, to repurchase $500 million of our common stock as part of the $2 billion share repurchase program authorized in September 2014. Under the ASR Agreement, on November 10, 2014, we made a payment of $500 million to Goldman Sachs from available cash on hand and received an initial delivery of 3.06 million shares of our common stock from Goldman Sachs based on the then current market price of Humana common stock. The payment to Goldman Sachs was recorded as a reduction to stockholders' equity, consisting of a $400 million increase in treasury stock, which reflected the value of the initial 3.06 million shares received upon initial settlement, and a $100 million decrease in capital in excess of par value, which reflected the value of stock held back by Goldman Sachs pending final settlement of the ASR Agreement. Upon settlement of the ASR on March 13, 2015, we received an additional 0.36 million shares as determined by the average daily volume weighted-average share price of our common stock during the term of the ASR Agreement of $146.21, bringing the total shares received under this program to 3.42 million. In addition, upon settlement we reclassified the $100 million value of stock initially held back by Goldman Sachs from capital in excess of par value to treasury stock.

In connection with employee stock plans, we acquired 0.3 million common shares for $56 million in 2015, 0.4 million common shares for $42 million in 2014, and 0.3 million common shares for $29 million in 2013.

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Regulatory Requirements
Certain of our subsidiaries operate in states that regulate the payment of dividends, loans, or other cash transfers to Humana Inc., our parent company, and require minimum levels of equity as well as limit investments to approved securities. The amount of dividends that may be paid to Humana Inc. by these subsidiaries, without prior approval by state regulatory authorities, or ordinary dividends, is limited based on the entity's level of statutory income and statutory capital and surplus. In most states, prior notification is provided before paying a dividend even if approval is not required.
Although minimum required levels of equity are largely based on premium volume, product mix, and the quality of assets held, minimum requirements vary significantly at the state level. Our state regulated insurances subsidiaries had aggregate statutory capital and surplus of approximately $6.6 billion and $6.0 billion as of December 31, 2015 and 2014, respectively, which exceeded aggregate minimum regulatory requirements of $4.6 billion and $4.1 billion, respectively. Subsidiary dividends are subject to state regulatory approval, the amount and timing of which could be reduced or delayed. Excluding Puerto Rico subsidiaries, the amount of ordinary dividends that may be paid to our parent company in 2016 is approximately $900 million in the aggregate. This compares to dividends that were paid to our parent company in 2015 of approximately $493 million. Actual dividends paid may vary due to consideration of excess statutory capital and surplus and expected future surplus requirements related to, for example, premium volume and product mix.
16. COMMITMENTS, GUARANTEES AND CONTINGENCIES
Leases
We lease facilities, computer hardware, and other furniture and equipment under long-term operating leases that are noncancelable and expire on various dates through 2026. We sublease facilities or partial facilities to third party tenants for space not used in our operations. Rent with scheduled escalation terms are accounted for on a straight-line basis over the lease term. Rent expense and sublease rental income, which are recorded net as an operating cost, for all operating leases were as follows for the years ended December 31, 2015, 2014 and 2013:

	2015	2014	2013
	(in millions)		
Rent expense	$201	$226	$227
Sublease rental income	(25)	(14)	(11)
Net rent expense	$176	$212	$216

Future annual minimum payments due subsequent to December 31, 2015 under all of our noncancelable operating leases with initial terms in excess of one year are as follows:

	Minimum Lease Payments	Sublease Rental Receipts	Net Lease Commitments
	(in millions)		
For the years ending December 31,:			
2016	$173	$(16)	$157
2017	159	(16)	143
2018	127	(14)	113
2019	94	(11)	83
2020	54	(7)	47
Thereafter	90	(45)	45
Total	$697	$(109)	$588

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Purchase Obligations
We have agreements to purchase services, primarily information technology related services, or to make improvements to real estate, in each case that are enforceable and legally binding on us and that specify all significant terms, including: fixed or minimum levels of service to be purchased; fixed, minimum or variable price provisions; and the appropriate timing of the transaction. We have purchase obligation commitments of $74 million in 2016, $44 million in 2017, $30 million in 2018, $1 million in 2019, and $1 million thereafter. Purchase obligations exclude agreements that are cancelable without penalty.
Off-Balance Sheet Arrangements
As part of our ongoing business, we do not participate or knowingly seek to participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of December 31, 2015, we were not involved in any SPE transactions.
Guarantees and Indemnifications
Through indemnity agreements approved by the state regulatory authorities, certain of our regulated subsidiaries generally are guaranteed by Humana Inc., our parent company, in the event of insolvency for (1) member coverage for which premium payment has been made prior to insolvency; (2) benefits for members then hospitalized until discharged; and (3) payment to providers for services rendered prior to insolvency. Our parent also has guaranteed the obligations of our military services subsidiaries.
In the ordinary course of business, we enter into contractual arrangements under which we may agree to indemnify a third party to such arrangement from any losses incurred relating to the services they perform on behalf of us, or for losses arising from certain events as defined within the particular contract, which may include, for example, litigation or claims relating to past performance. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.
Government Contracts
Our Medicare products, which accounted for approximately 72% of our total premiums and services revenue for the year ended December 31, 2015, primarily consisted of products covered under the Medicare Advantage and Medicare Part D Prescription Drug Plan contracts with the federal government. These contracts are renewed generally for a calendar year term unless CMS notifies us of its decision not to renew by May 1 of the calendar year in which the contract would end, or we notify CMS of our decision not to renew by the first Monday in June of the calendar year in which the contract would end. All material contracts between Humana and CMS relating to our Medicare products have been renewed for 2016, and all of our product offerings filed with CMS for 2016 have been approved.
CMS uses a risk-adjustment model which apportions premiums paid to Medicare Advantage, or MA, plans according to health severity of covered members. The risk-adjustment model pays more for enrollees with predictably higher costs. Under this model, rates paid to MA plans are based on actuarially determined bids, which include a process whereby our prospective payments are based on a comparison of our beneficiaries' risk scores, derived from medical diagnoses, to those enrolled in the government's traditional fee-for-service Medicare program (referred to as "Medicare FFS"). Under the risk-adjustment methodology, all MA plans must collect and submit the necessary diagnosis code information from hospital inpatient, hospital outpatient, and physician providers to CMS within prescribed deadlines. The CMS risk-adjustment model uses the diagnosis data to calculate the risk-adjusted premium payment to MA plans, which CMS adjusts for coding pattern differences between the health plans and the government fee-for-service program. We generally rely on providers, including certain providers in our network who are our employees, to code their claim submissions with appropriate diagnoses, which we send to CMS as the basis for our payment received from CMS under the actuarial risk-adjustment model. We also rely on these providers to document appropriately all

medical data, including the diagnosis data submitted with claims. In addition, we conduct medical record reviews as part of our data

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and payment accuracy compliance efforts, to more accurately reflect diagnosis conditions under the risk adjustment model. These compliance efforts include the internal contract level audits described in more detail below.

CMS is continuing to perform audits of various companies' selected MA contracts related to this risk adjustment diagnosis data. We refer to these audits as Risk-Adjustment Data Validation Audits, or RADV audits. RADV audits review medical records in an attempt to validate provider medical record documentation and coding practices which influence the calculation of premium payments to MA plans.

In 2012, CMS released a "Notice of Final Payment Error Calculation Methodology for Part C Medicare Advantage Risk Adjustment Data Validation (RADV) Contract-Level Audits." The payment error calculation methodology provides that, in calculating the economic impact of audit results for an MA contract, if any, the results of the audit sample will be extrapolated to the entire MA contract based upon a comparison to "benchmark" audit data in Medicare FFS (which we refer to as the "FFS Adjuster"). This comparison to the FFS Adjuster is necessary to determine the economic impact, if any, of audit results because the government program data set, including any attendant errors that are present in that data set, provides the basis for MA plans' risk adjustment to payment rates. CMS already makes other adjustments to payment rates based on a comparison of coding pattern differences between MA plans and Medicare FFS data (such as for frequency of coding for certain diagnoses in MA plan data versus the government program data set).

The final methodology, including the first application of extrapolated audit results to determine audit settlements, is expected to be applied to RADV contract level audits currently being conducted for contract year 2011 in which two of our Medicare Advantage plans are being audited. Per CMS guidance, selected MA contracts will be notified of an audit at some point after the close of the final reconciliation for the payment year being audited. The final reconciliation occurs in August of the calendar year following the payment year. We were notified on September 15, 2015, that five of our Medicare Advantage contracts have been selected for audit for contract year 2012.

Estimated audit settlements are recorded as a reduction of premiums revenue in our consolidated statements of income, based upon available information. We perform internal contract level audits based on the RADV audit methodology prescribed by CMS. Included in these internal contract level audits is an audit of our Private Fee-For-Service business which we used to represent a proxy of the FFS Adjuster which has not yet been released. We based our accrual of estimated audit settlements for each contract year on the results of these internal contract level audits and update our estimates as each audit is completed. Estimates derived from these results were not material to our results of operations, financial position, or cash flows. However, as indicated, we are awaiting additional guidance from CMS regarding the FFS Adjuster. Accordingly, we cannot determine whether such RADV audits will have a material adverse effect on our results of operations, financial position, or cash flows.

In addition, CMS' comments in formalized guidance regarding "overpayments" to MA plans appear to be inconsistent with CMS' prior RADV audit guidance. These statements, contained in the preamble to CMS' final rule release regarding Medicare Advantage and Part D prescription drug benefit program regulations for Contract Year 2015, appear to equate each Medicare Advantage risk adjustment data error with an "overpayment" without reconciliation to the principles underlying the FFS Adjuster referenced above. We will continue to work with CMS to ensure that MA plans are paid accurately and that payment model principles are in accordance with the requirements of the Social Security Act, which, if not implemented correctly could have a material adverse effect on our results of operations, financial position, or cash flows.

At December 31, 2015, our military services business, which accounted for approximately 1% of our total premiums and services revenue for the year ended December 31, 2015, primarily consisted of the TRICARE South Region contract. The current 5-year South Region contract, which expires March 31, 2017, is subject to annual renewals on April 1 of each year during its term at the government's option. On January 22, 2016, we received notice from the Defense Health Agency, or DHA, of its intent to exercise its option to extend the TRICARE South Region contract through March 31, 2017. On April 24, 2015, a request for proposal was issued for the next generation of TRICARE contracts for the period beginning April 1, 2017. The request for proposal provides for the consolidation of three regions into two - East and West. The current North Region and South Region are to be combined to form the East Region. We responded to the request for proposal on July 22, 2015. On January 15, 2016, we received a request for Final Proposal Revisions that we responded to on February 16, 2016.

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Our state-based Medicaid business accounted for approximately 4% of our total premiums and services revenue for the year ended December 31, 2015. In addition to our state-based Temporary Assistance for Needy Families, or TANF, Medicaid contracts in Florida and Kentucky, we have contracts in Illinois and Virginia for stand-alone dual eligible demonstration programs serving individuals dually eligible for both the federal Medicare program and the applicable state-based Medicaid program as well as an Integrated Care Program, or ICP, Medicaid contract in Illinois. We began serving members in Illinois in the first quarter of 2014 and in Virginia in the second quarter of 2014. In addition, we began serving members in Long-Term Support Services (LTSS) regions in Florida at various effective dates ranging from the second half of 2013 through the first quarter of 2014.

The loss of any of the contracts above or significant changes in these programs as a result of legislative or regulatory action, including reductions in premium payments to us, regulatory restrictions on profitability, including by comparison of our Medicare Advantage profitability to our non-Medicare Advantage business profitability and a requirement that they remain within certain ranges of each other, or increases in member benefits without corresponding increases in premium payments to us, may have a material adverse effect on our results of operations, financial position, and cash flows.

Legal Proceedings and Certain Regulatory Matters

Florida Matters

On January 6, 2012, the Civil Division of the United States Attorney's Office for the Southern District of Florida advised us that it is seeking documents and information from us and several of our affiliates relating to several matters including the coding of medical claims by one or more South Florida medical providers, and loans to physician practices. On May 1, 2014, the U.S. Attorney's Office filed a Notice of Non-Intervention in connection with a civil qui tam suit related to one of these matters captioned United States of America ex rel. Olivia Graves v. Plaza Medical Centers, et al., and the Court ordered the complaint unsealed. Subsequently, the individual plaintiff amended the complaint and served the Company, opting to continue to pursue the action. The individual plaintiff has filed a third amended complaint which we answered on October 16, 2015. The Court has ordered trial to commence on October 3, 2016 if the matter is not resolved prior to trial. We continue to cooperate with and respond to information requests from the U.S. Attorney's office. These matters could result in additional qui tam litigation.

As previously disclosed, the Civil Division of the United States Department of Justice had provided us with an information request, separate from but related to the Plaza Medical matter, concerning our Medicare Part C risk adjustment practices. The request relates to our oversight and submission of risk adjustment data generated by providers in our Medicare Advantage network, including the providers identified in the Plaza Medical matter, as well as to our business and compliance practices related to risk adjustment data generated by our providers and by us, including medical record reviews conducted as part of our data and payment accuracy compliance efforts, the use of health and well-being assessments, and our fraud detection efforts. We believe that this request for information is in connection with a wider review of Medicare Risk Adjustment generally that includes a number of Medicare Advantage plans, providers and vendors. We continue to cooperate with and voluntarily respond to the information requests from the Department of Justice and the U.S. Attorney's Office. These matters are expected to result in additional qui tam litigation.

On June 16, 2015, the U.S. Attorney's Office filed a Declination Notice, indicating its intent not to intervene, in connection with a civil qui tam suit captioned U.S. ex rel. Ramsey-Ledesma v. Censeo, et al., and the Court ordered the complaint unsealed. Subsequently, the individual plaintiff filed a second amended complaint and served the Company, opting to continue to pursue the action. The plaintiff's second amended complaint names several other defendants, including CenseoHealth. On January 8, 2016, we and the other defendants each filed a motion to dismiss the second amended complaint.

Litigation Related to the Merger

In connection with the Merger, three putative class action complaints were filed by purported Humana stockholders challenging the Merger, two in the Circuit Court of Jefferson County, Kentucky and one in the Court of Chancery of the State of Delaware. The complaints are captioned Solak v. Broussard et al., Civ. Act. No. 15CI03374 (Kentucky

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state court), Litwin v. Broussard et al., Civ. Act. No. 15CI04054 (Kentucky state court) and Scott v. Humana Inc. et al., C.A. No. 11323-VCL (Delaware state court). The complaints name as defendants each member of Humana's board of directors, Aetna, and, in the case of the Delaware complaint, Humana. The complaints generally allege, among other things, that the individual members of our board of directors breached their fiduciary duties owed to our stockholders by entering into the Merger Agreement, approving the mergers as contemplated by the Merger Agreement, and failing to take steps to maximize the value of Humana to our stockholders, and that Aetna, and, in the case of the Delaware complaint, Humana aided and abetted such breaches of fiduciary duties. In addition, the complaints allege that the merger undervalues Humana, that the process leading up to the execution of the Merger Agreement was flawed, that the members of our board of directors improperly placed their own financial interests ahead of those of our stockholders, and that certain provisions of the Merger Agreement improperly favor Aetna and impede a potential alternative transaction. Among other remedies, the complaints seek equitable relief rescinding the Merger Agreement and enjoining the defendants from completing the mergers as well as costs and attorneys' fees. We refer to all these cases collectively in this report as the Merger Litigation. On August 20, 2015, the parties in the Kentucky state cases filed a stipulation and proposed order with the court to consolidate these cases into a single action captioned In re Humana Inc. Shareholder Litigation, Civ. Act. No. 15CI03374.

On October 9, 2015, solely to avoid the costs, risks, and uncertainties inherent in litigation, and without admitting any liability or wrongdoing, we and the other named defendants in the Merger Litigation signed a memorandum of understanding, which we refer to as the MOU, to settle the Merger Litigation. Subject to court approval and further definitive documentation in a stipulation of settlement that will be subject to customary conditions, the MOU resolved the claims brought in the Merger Litigation and provided that we would make certain additional disclosures related to the proposed mergers. The MOU further provided for, among other things, dismissal of the Merger Litigation with prejudice and a release and settlement by the purported class of our stockholders of all claims against the defendants and their affiliates and agents in connection with the Merger Agreement and transactions and disclosures related to the Merger Agreement. The asserted claims will not be released until such stipulation of settlement receives court approval. The foregoing terms and conditions will be defined by the stipulation of settlement, and class members will receive a separate notice describing the settlement terms and their rights in connection with the approval of the settlement. In connection with the settlement, the parties contemplate that plaintiffs' counsel will file a petition for an award of attorneys' fees and expenses. We will pay or cause to be paid any court awarded attorneys' fees and expenses. There can be no assurance that the parties will ultimately enter into a stipulation of settlement or that a court will approve such settlement even if the parties were to enter into such stipulation. In such event, the proposed settlement as contemplated by the MOU may be terminated. Because the MOU contemplates that the Kentucky court will be asked to approve the settlement, the plaintiffs have already withdrawn the Delaware case.

Other Lawsuits and Regulatory Matters

Our current and past business practices are subject to review or other investigations by various state insurance and health care regulatory authorities and other state and federal regulatory authorities. These authorities regularly scrutinize the business practices of health insurance, health care delivery and benefits companies. These reviews focus on numerous facets of our business, including claims payment practices, statutory capital requirements, provider contracting, risk adjustment, competitive practices, commission payments, privacy issues, utilization management practices, pharmacy benefits, access to care, and sales practices, among others. Some of these reviews have historically resulted in fines imposed on us and some have required changes to some of our practices. We continue to be subject to these reviews, which could result in additional fines or other sanctions being imposed on us or additional changes in some of our practices.

We also are involved in various other lawsuits that arise, for the most part, in the ordinary course of our business operations, certain of which may be styled as class-action lawsuits. Among other matters, this litigation may include employment matters, claims of medical malpractice, bad faith, nonacceptance or termination of providers, anticompetitive practices, improper rate setting, provider contract rate disputes, failure to disclose network discounts and various other provider arrangements, general contractual matters, intellectual property matters, and challenges to subrogation practices. For example, a number of hospitals and other providers have asserted that, under their network provider contracts, we are not entitled to reduce Medicare Advantage payments to these providers in connection with changes in Medicare payment systems and in accordance with the Balanced Budget and Emergency Deficit Control

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Act of 1985, as amended (commonly referred to as “sequestration”). Those challenges have led and could lead to arbitration demands or other litigation. Also, under state guaranty assessment laws, including those related to state cooperative failures in the industry, we may be assessed (up to prescribed limits) for certain obligations to the policyholders and claimants of insolvent insurance companies that write the same line or lines of business as we do. As a government contractor, we may also be subject to qui tam litigation brought by individuals who seek to sue on behalf of the government, alleging that the government contractor submitted false claims to the government including, among other allegations, those resulting from coding and review practices under the Medicare risk adjustment model. Qui tam litigation is filed under seal to allow the government an opportunity to investigate and to decide if it wishes to intervene and assume control of the litigation. If the government does not intervene, the lawsuit is unsealed, and the individual may continue to prosecute the action on his or her own, on behalf of the government. We also are subject to other allegations of non-performance of contractual obligations to providers, members, and others, including failure to properly pay claims, improper policy terminations, challenges to our implementation of the Medicare Part D prescription drug program and other litigation.

A limited number of the claims asserted against us are subject to insurance coverage. Personal injury claims, claims for extracontractual damages, care delivery malpractice, and claims arising from medical benefit denials are covered by insurance from our wholly owned captive insurance subsidiary and excess carriers, except to the extent that claimants seek punitive damages, which may not be covered by insurance in certain states in which insurance coverage for punitive damages is not permitted. In addition, insurance coverage for all or certain forms of liability has become increasingly costly and may become unavailable or prohibitively expensive in the future.

We record accruals for the contingencies discussed in the sections above to the extent that we conclude it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. No estimate of the possible loss or range of loss in excess of amounts accrued, if any, can be made at this time regarding the matters specifically described above because of the inherently unpredictable nature of legal proceedings, which also may be exacerbated by various factors, including: (i) the damages sought in the proceedings are unsubstantiated or indeterminate; (ii) discovery is not complete; (iii) the proceeding is in its early stages; (iv) the matters present legal uncertainties; (v) there are significant facts in dispute; (vi) there are a large number of parties (including where it is uncertain how liability, if any, will be shared among multiple defendants); or (vii) there is a wide range of potential outcomes.

The outcome of any current or future litigation or governmental or internal investigations, including the matters described above, cannot be accurately predicted, nor can we predict any resulting judgments, penalties, fines or other sanctions that may be imposed at the discretion of federal or state regulatory authorities or as a result of actions by third parties. Nevertheless, it is reasonably possible that any such outcome of litigation, judgments, penalties, fines or other sanctions could be substantial, and the outcome of these matters may have a material adverse effect on our results of operations, financial position, and cash flows, and may also affect our reputation.

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17. SEGMENT INFORMATION

On January 1, 2015, we realigned certain of our businesses among our reportable segments to correspond with internal management reporting changes and renamed our Employer Group segment to the Group segment. Our three reportable segments remain Retail, Group, and Healthcare Services. The more significant realignments included reclassifying Medicare benefits offered to groups to the Retail segment from the Group segment, bringing all of our Medicare offerings, which are now managed collectively, together in one segment, recognizing that in some instances we market directly to individuals that are part of a group Medicare account. In addition, we realigned our military services business, primarily consisting of our TRICARE South Region contract previously included in the Other Businesses category, to our Group segment as we consider this contract with the government to be a group account. Prior period segment financial information has been recast to conform to the 2015 presentation.

We manage our business with three reportable segments: Retail, Group, and Healthcare Services. In addition, the Other Businesses category includes businesses that are not individually reportable because they do not meet the quantitative thresholds required by generally accepted accounting principles. These segments are based on a combination of the type of health plan customer and adjacent businesses centered on well-being solutions for our health plans and other customers, as described below. These segment groupings are consistent with information used by our Chief Executive Officer to assess performance and allocate resources.

The Retail segment consists of Medicare benefits, marketed to individuals or directly via group accounts, as well as individual commercial fully-insured medical and specialty health insurance benefits, including dental, vision, and other supplemental health and financial protection products. In addition, the Retail segment also includes our contract with CMS to administer the LI-NET prescription drug plan program and contracts with various states to provide Medicaid, dual eligible, and Long-Term Support Services benefits, collectively our state-based contracts. The Group segment consists of employer group commercial fully-insured medical and specialty health insurance benefits, including dental, vision, and other supplemental health and voluntary insurance benefits, as well as administrative services only, or ASO products. In addition, our Group segment includes our health and wellness products (primarily marketed to employer groups) and military services business, primarily our TRICARE South Region contract. The Healthcare Services segment includes services offered to our health plan members as well as to third parties, including pharmacy solutions, provider services, home based services, and clinical programs, as well as services and capabilities to advance population health. We will continue to report under the category of Other Businesses those businesses which do not align with the reportable segments described above, primarily our closed-block long-term care insurance policies.

Our Healthcare Services intersegment revenues primarily relate to managing prescription drug coverage for members of our other segments through Humana Pharmacy Solutions®, or HPS, and includes the operations of Humana Pharmacy, Inc., our mail order pharmacy business. These revenues consist of the prescription price (ingredient cost plus dispensing fee), including the portion to be settled with the member (co-share) or with the government (subsidies), plus any associated administrative fees. Services revenues related to the distribution of prescriptions by third party retail pharmacies in our networks are recognized when the claim is processed and product revenues from dispensing prescriptions from our mail order pharmacies are recorded when the prescription or product is shipped. Our pharmacy operations, which are responsible for designing pharmacy benefits, including defining member co-share responsibilities, determining formulary listings, contracting with retail pharmacies, confirming member eligibility, reviewing drug utilization, and processing claims, act as a principal in the arrangement on behalf of members in our other segments. As principal, our Healthcare Services segment reports revenues on a gross basis including co-share amounts from members collected by third party retail pharmacies at the point of service.

In addition, our Healthcare Services intersegment revenues include revenues earned by certain owned providers derived from risk-based and non risk-based managed care agreements with our health plans. Under risk based agreements, the provider receives a monthly capitated fee that varies depending on the demographics and health status of the member, for each member assigned to these owned providers by our health plans. The owned provider assumes the economic risk of funding the assigned members' healthcare services. Under non risk-based agreements, our health plans retain the economic risk of funding the assigned members' healthcare services. Our Healthcare Services segment reports provider services revenues associated with risk-based agreements on a gross basis, whereby capitation fee

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revenue is recognized in the period in which the assigned members are entitled to receive healthcare services. Provider services revenues associated with non risk-based agreements are presented net of associated healthcare costs.
We present our consolidated results of operations from the perspective of the health plans. As a result, the cost of providing benefits to our members, whether provided via a third party provider or internally through a stand-alone subsidiary, is classified as benefits expense and excludes the portion of the cost for which the health plans do not bear responsibility, including member co-share amounts and government subsidies of $12.3 billion in 2015, $9.7 billion in 2014, and $7.3 billion in 2013. In addition, depreciation and amortization expense associated with certain businesses in our Healthcare Services segment delivering benefits to our members, primarily associated with our provider services and pharmacy operations, are included with benefits expense. The amount of this expense was $92 million in 2015, $116 million in 2014, and $93 million in 2013.
Other than those described previously, the accounting policies of each segment are the same and are described in Note 2. Transactions between reportable segments primarily consist of sales of services rendered by our Healthcare Services segment, primarily pharmacy, provider, and home based services as well as clinical programs, to our Retail and Group customers. Intersegment sales and expenses are recorded at fair value and eliminated in consolidation. Members served by our segments often use the same provider networks, enabling us in some instances to obtain more favorable contract terms with providers. Our segments also share indirect costs and assets. As a result, the profitability of each segment is interdependent. We allocate most operating expenses to our segments. Assets and certain corporate income and expenses are not allocated to the segments, including the portion of investment income not supporting segment operations, interest expense on corporate debt, and certain other corporate expenses. These items are managed at a corporate level. These corporate amounts are reported separately from our reportable segments and are included with intersegment eliminations in the tables presenting segment results below.

Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Our segment results were as follows for the years ended December 31, 2015, 2014, and 2013:

	Retail	Group	Healthcare Services	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)					
2015						
Revenues—external customers						
Premiums:						
Individual Medicare Advantage	$29,526	$—	$—	$—	$—	$29,526
Group Medicare Advantage	5,588	—	—	—	—	5,588
Medicare stand-alone PDP	3,846	—	—	—	—	3,846
Total Medicare	38,960	—	—	—	—	38,960
Fully-insured	4,243	5,493	—	—	—	9,736
Specialty	261	1,055	—	—	—	1,316
Medicaid and other	2,341	21	—	35	—	2,397
Total premiums	45,805	6,569	—	35	—	52,409
Services revenue:						
Provider	—	40	655	—	—	695
ASO and other	9	658	—	14	—	681
Pharmacy	—	—	30	—	—	30
Total services revenue	9	698	685	14	—	1,406
Total revenues—external customers	45,814	7,267	685	49	—	53,815
Intersegment revenues						
Services	—	93	17,997	—	(18,090)	—
Products	—	—	4,923	—	(4,923)	—
Total intersegment revenues	—	93	22,920	—	(23,013)	—
Investment income	134	26	—	76	238	474
Total revenues	45,948	7,386	23,605	125	(22,775)	54,289
Operating expenses:						
Benefits	39,708	5,266	—	87	(792)	44,269
Operating costs	5,118	1,769	22,481	14	(22,064)	7,318
Depreciation and amortization	192	93	143	—	(73)	355
Total operating expenses	45,018	7,128	22,624	101	(22,929)	51,942
Income from operations	930	258	981	24	154	2,347
Gain on sale of business	—	—	—	—	270	270
Interest expense	—	—	—	—	186	186
Income before income taxes	$930	$258	$981	$24	$238	$2,431

Premium and services revenues derived from our contracts with the federal government, as a percentage of our total premium and services revenues, was approximately 73% for 2015, compared to 73% for 2014, and 75% for 2013.
Benefits expense for the Retail segment for 2015 includes $176 million for a provision for probable future losses (premium deficiency) for individual commercial medical business compliant with the Health Care Reform Law for the 2016 coverage year as discussed more fully in Note 7.

Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Retail	Group	Healthcare Services	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)					
2014						
Revenues—external customers						
Premiums:						
Individual Medicare Advantage	$25,782	$—	$—	$—	$—	$25,782
Group Medicare Advantage	5,490	—	—	—	—	5,490
Medicare stand-alone PDP	3,404	—	—	—	—	3,404
Total Medicare	34,676	—	—	—	—	34,676
Fully-insured	3,265	5,339	—	—	—	8,604
Specialty	256	1,098	—	—	—	1,354
Medicaid and other	1,255	19	—	51	—	1,325
Total premiums	39,452	6,456	—	51	—	45,959
Services revenue:						
Provider	—	23	1,254	—	—	1,277
ASO and other	39	740	—	9	—	788
Pharmacy	—	—	99	—	—	99
Total services revenue	39	763	1,353	9	—	2,164
Total revenues—external customers	39,491	7,219	1,353	60	—	48,123
Intersegment revenues						
Services	—	78	15,098	—	(15,176)	—
Products	—	—	3,749	—	(3,749)	—
Total intersegment revenues	—	78	18,847	—	(18,925)	—
Investment income	97	23	—	60	197	377
Total revenues	39,588	7,320	20,200	120	(18,728)	48,500
Operating expenses:						
Benefits	33,508	5,130	—	102	(574)	38,166
Operating costs	4,576	1,936	19,307	17	(18,197)	7,639
Depreciation and amortization	165	103	155	—	(90)	333
Total operating expenses	38,249	7,169	19,462	119	(18,861)	46,138
Income from operations	1,339	151	738	1	133	2,362
Interest expense	—	—	—	—	192	192
Income (loss) before income taxes	$1,339	$151	$738	$1	$(59)	$2,170

Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

	Retail	Group	Healthcare Services	Other Businesses	Eliminations/ Corporate	Consolidated
	(in millions)					
2013						
Revenues—external customers						
Premiums:						
Individual Medicare Advantage	$22,481	$—	$—	$—	$—	$22,481
Group Medicare Advantage	4,710	—	—	—	—	4,710
Medicare stand-alone PDP	3,033	—	—	—	—	3,033
Total Medicare	30,224	—	—	—	—	30,224
Fully-insured	1,160	5,117	—	—	—	6,277
Specialty	210	1,095	—	—	—	1,305
Medicaid and other	328	25	—	670	—	1,023
Total premiums	31,922	6,237	—	670	—	38,829
Services revenue:						
Provider	—	21	1,291	—	—	1,312
ASO and other	18	714	—	6	—	738
Pharmacy	—	—	59	—	—	59
Total services revenue	18	735	1,350	6	—	2,109
Total revenues—external customers	31,940	6,972	1,350	676	—	40,938
Intersegment revenues						
Services	—	51	11,890	—	(11,941)	—
Products	—	—	2,803	—	(2,803)	—
Total intersegment revenues	—	51	14,693	—	(14,744)	—
Investment income	92	24	—	59	200	375
Total revenues	32,032	7,047	16,043	735	(14,544)	41,313
Operating expenses:						
Benefits	27,164	4,847	—	962	(409)	32,564
Operating costs	3,232	1,860	15,372	56	(14,165)	6,355
Depreciation and amortization	146	100	151	6	(70)	333
Total operating expenses	30,542	6,807	15,523	1,024	(14,644)	39,252
Income (loss) from operations	1,490	240	520	(289)	100	2,061
Interest expense	—	—	—	—	140	140
Income (loss) before income taxes	$1,490	$240	$520	$(289)	$(40)	$1,921

Benefits expense for Other Businesses for 2013 includes $243 million for reserve strengthening associated with our closed block of long-term care insurance policies as discussed more fully in Note 18.

Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

18. EXPENSES ASSOCIATED WITH LONG-DURATION INSURANCE PRODUCTS

Premiums associated with our long-duration insurance products accounted for approximately 1% of our consolidated premiums and services revenue for the year ended December 31, 2015. We use long-duration accounting for products such as long-term care, life insurance, annuities, and certain health and other supplemental policies sold to individuals because they are expected to remain in force for an extended period beyond one year and because premium received in the earlier years is intended to pay anticipated benefits to be incurred in future years. As a result, we defer policy acquisition costs, primarily consisting of commissions, and amortize them over the estimated life of the policies in proportion to premiums earned.

In addition, we establish reserves for future policy benefits in recognition of the fact that some of the premium received in the earlier years is intended to pay anticipated benefits to be incurred in future years. At policy issuance, these reserves are recognized on a net level premium method based on premium rate increase, interest rate, mortality, morbidity, persistency (the percentage of policies remaining in-force), and maintenance expense assumptions. The assumptions used to determine the liability for future policy benefits are established and locked in at the time each contract is issued and only change if our expected future experience deteriorates to the point that the level of the liability, together with the present value of future gross premiums, are not adequate to provide for future expected policy benefits and maintenance costs (i.e. the loss recognition date). As discussed in Note 2, beginning in 2014, health policies sold to individuals that conform to the Health Care Reform Law are accounted for under a short-duration model because premiums received in the current year are intended to pay anticipated benefits in that year.

The table below presents deferred acquisition costs and future policy benefits payable associated with our long-duration insurance products for the years ended December 31, 2015 and 2014.

	2015		2014	
	Deferred acquisition costs	Future policy benefits payable	Deferred acquisition costs	Future policy benefits payable
	(in millions)			
Other long-term assets	$135	$—	$167	$—
Trade accounts payable and accrued expenses	—	(64)	—	(68)
Long-term liabilities	—	(2,151)	—	(2,349)
Total asset (liability)	$135	$(2,215)	$167	$(2,417)

In addition, future policy benefits payable include amounts of $205 million at December 31, 2015 and $210 million at December 31, 2014 which are subject to 100% coinsurance agreements as more fully described in Note 19.

In 2015, we recorded a net reduction in benefits expense of $80 million associated with future policy benefits primarily due to the release of reserves as individual commercial medical members transitioned to plans compliant with the Health Care Reform Law. Benefits expense associated with future policy benefits payable was $32 million in 2014 and $354 million in 2013. Benefits expense for 2013 included net charges of $243 million associated with our closed block of long-term care insurance policies discussed further below. Amortization of deferred acquisition costs included in operating costs was $63 million in 2015, $39 million in 2014, and $55 million in 2013. The increase in amortization in 2015 primarily reflects the effect of existing previously underwritten members transitioning to policies compliant with the Health Care Reform Law with us and other carriers.

Future policy benefits payable include $1.5 billion at December 31, 2015 and 2014 associated with a non-strategic closed block of long-term care insurance policies acquired in connection with the 2007 acquisition of KMG. Future policy benefits payable includes amounts charged to accumulated other comprehensive income for an additional liability that would exist on our closed-block of long-term care insurance policies if unrealized gains on the sale of the investments backing such products had been realized and the proceeds reinvested at then current yields. There was no additional liability at December 31, 2015 and $123 million of additional liability at December 31, 2014. Amounts charged to accumulated other comprehensive income are net of applicable deferred taxes.

Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

Long-term care insurance policies provide nursing home and home health coverage for which premiums are collected many years in advance of benefits paid, if any. Therefore, our actual claims experience will emerge many years after assumptions have been established. The risk of a deviation of the actual premium rate increase, interest, morbidity, mortality, persistency, and maintenance expense assumptions from those assumed in our reserves are particularly significant to our closed block of long-term care insurance policies. We monitor the loss experience of these long-term care insurance policies and, when necessary, apply for premium rate increases through a regulatory filing and approval process in the jurisdictions in which such products were sold. To the extent premium rate increases, interest rates, and/or loss experience vary from our loss recognition date assumptions, material future adjustments to reserves could be required.

During 2013, we recorded a loss for a premium deficiency. The premium deficiency was based on current and anticipated experience that had deteriorated from our locked-in assumptions from the previous December 31, 2010 loss recognition date, particularly as they related to emerging experience due to an increase in life expectancies and utilization of home health care services. Based on this deterioration, and combined with lower interest rates, we determined that our existing future policy benefits payable, together with the present value of future gross premiums, associated with our closed block of long-term care insurance policies were not adequate to provide for future policy benefits and maintenance costs under these policies; therefore we unlocked and modified our assumptions based on current expectations. Accordingly, during 2013 we recorded $243 million of additional benefits expense, with a corresponding increase in future policy benefits payable of $350 million partially offset by a related reinsurance recoverable of $107 million included in other long-term assets.

Deferred acquisition costs included $26 million and $59 million associated with our individual commercial medical policies at December 31, 2015 and December 31, 2014, respectively. Future policy benefits payable associated with our individual commercial medical policies were $180 million at December 31, 2015 and $297 million at December 31, 2014. The decline in deferred acquisition costs and future policy benefits payable primarily reflects the effect of existing previously underwritten members transitioning to policies compliant with the Health Care Reform Law with us and other carriers.

19. REINSURANCE

Certain blocks of insurance assumed in acquisitions, primarily life, long-term care, and annuities in run-off status, are subject to reinsurance where some or all of the underwriting risk related to these policies has been ceded to a third party. In addition, a large portion of our reinsurance takes the form of 100% coinsurance agreements where, in addition to all of the underwriting risk, all administrative responsibilities, including premium collections and claim payment, have also been ceded to a third party. We acquired these policies and related reinsurance agreements with the purchase of stock of companies in which the policies were originally written. We acquired these companies for business reasons unrelated to these particular policies, including the companies' other products and licenses necessary to fulfill strategic plans.

A reinsurance agreement between two entities transfers the underwriting risk of policyholder liabilities to a reinsurer while the primary insurer retains the contractual relationship with the ultimate insured. As such, these reinsurance agreements do not completely relieve us of our potential liability to the ultimate insured. However, given the transfer of underwriting risk, our potential liability is limited to the credit exposure which exists should the reinsurer be unable to meet its obligations assumed under these reinsurance agreements.

Reinsurance recoverables represent the portion of future policy benefits payable and benefits payable that are covered by reinsurance. Amounts recoverable from reinsurers are estimated in a manner consistent with the methods used to determine future policy benefits payable as detailed in Note 2. Excluding reinsurance associated with the Health Care Reform Law discussed in Note 2, reinsurance recoverables, included in other current and long-term assets, were $668 million at December 31, 2015 and $646 million at December 31, 2014. The percentage of these reinsurance recoverables resulting from 100% coinsurance agreements was approximately 43% at December 31, 2015 and approximately 45% at December 31, 2014. Premiums ceded were $821 million in 2015, $357 million in 2014 and $33 million in 2013. Benefits ceded were $666 million in 2015, $272 million in 2014, and $70 million in 2013. Ceded premium and benefits reflect a July 1, 2014 amendment ceding all risk under a Medicaid contract to a third party reinsurer.

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Humana Inc.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued)

We evaluate the financial condition of these reinsurers on a regular basis. These reinsurers are well-known and well-established, as evidenced by the strong financial ratings at December 31, 2015 presented below:

Reinsurer	Total Recoverable (in millions)	A.M. Best Rating at December 31, 2015
Protective Life Insurance Company	$184	A+ (superior)
Munich American Reassurance Company	155	A+ (superior
Employers Reassurance Corporation	91	A- (excellent)
General Re Life Corporation	90	A++ (superior)
All others	148	A+ to B++ (superior to good)
	$668	

The all other category represents 18 reinsurers with individual balances less than $85 million. Three of these reinsurers with recoverables of $104 million are subject to trust or funds withheld accounts, requiring amounts at least equal to the total recoverable from each of these reinsurers.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of Humana Inc.:

In our opinion, the consolidated balance sheets and the related consolidated statements of income, of comprehensive income, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Humana Inc. and its subsidiaries at December 31, 2015 and 2014, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2015 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedules listed in the index appearing under Item 15(a)(2) present fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2015, based on criteria established in Internal Control - Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedules, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedules, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP
Louisville, Kentucky
February 18, 2016

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Humana Inc.
QUARTERLY FINANCIAL INFORMATION
(Unaudited)
A summary of our quarterly unaudited results of operations for the years ended December 31, 2015 and 2014 follows:

	2015			
	First	Second	Third	Fourth (2)
	(in millions, except per share results)			
Total revenues	$13,833	$13,732	$13,363	$13,361
Income before income taxes	744	793	648	246
Net income	430	431	314	101
Basic earnings per common share	$2.86	$2.88	$2.11	$0.68
Diluted earnings per common share (1)	$2.82	$2.85	$2.09	$0.67

	2014			
	First	Second	Third	Fourth
	(in millions, except per share results)			
Total revenues	$11,712	$12,222	$12,238	$12,328
Income before income taxes	686	646	551	287
Net income	368	344	290	145
Basic earnings per common share	$2.37	$2.22	$1.87	$0.96
Diluted earnings per common share (1)	$2.35	$2.19	$1.85	$0.94

(1) The calculation of diluted earnings per common share is based on the weighted average shares outstanding during each quarter and, accordingly, the sum may not equal the total for the year.

(2) The fourth quarter of 2015 includes an expense of $176 million ($112 million after tax, or $0.74 per diluted common share) for a premium deficiency reserve associated with our individual commercial medical policies compliant with the Health Care Reform Law associated with the 2016 coverage year.

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Not applicable.

ITEM 9A. CONTROLS AND PROCEDURES

Management's Responsibility for Financial Statements and Other Information

We are responsible for the preparation and integrity of the consolidated financial statements appearing in our Annual Report. The consolidated financial statements were prepared in conformity with accounting principles generally accepted in the United States and include amounts based on our estimates and judgments. All other financial information in this report has been presented on a basis consistent with the information included in the financial statements.

Our control environment is the foundation for our system of internal control over financial reporting and is embodied in our Code of Ethics and Business Conduct, which we currently refer to as the Humana Inc. Ethics Every Day. It sets the tone of our organization and includes factors such as integrity and ethical values. Our internal control over financial reporting is supported by formal policies and procedures which are reviewed, modified and improved as changes occur in business conditions and operations.

The Audit Committee of the Board of Directors, which is composed solely of independent outside directors, meets periodically with members of management, the internal auditors and our independent registered public accounting firm to review and discuss internal controls over financial reporting and accounting and financial reporting matters. Our independent registered public accounting firm and internal auditors report to the Audit Committee and accordingly have full and free access to the Audit Committee at any time.

Evaluation of Disclosure Controls and Procedures

We have established disclosure controls and procedures to ensure that material information relating to the Company, including its consolidated subsidiaries, is made known to members of senior management and the Board of Directors. Based on our evaluation as of December 31, 2015, we as the principal executive officer and the principal financial officer and the principal accounting officer of the Company have concluded that the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934) are effective to ensure that the information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported as specified in Securities and Exchange Commission rules and forms.

Management's Report on Internal Control Over Financial Reporting

We are responsible for establishing and maintaining effective internal control over financial reporting as defined in Rule 13a-15(f) under the Securities Exchange Act of 1934. The Company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate or that the degree of compliance with the policies or procedures may deteriorate.

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We assessed the effectiveness of the Company's internal control over financial reporting as of December 31, 2015. In making this assessment, we used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control – Integrated Framework (2013). Based on our assessment, we determined that, as of December 31, 2015, the Company's internal control over financial reporting was effective based on those criteria.

The effectiveness of our internal control over financial reporting as of December 31, 2015 has been audited by PricewaterhouseCoopers LLP, our independent registered public accounting firm, who also audited the Company's consolidated financial statements included in our Annual Report on Form 10-K, as stated in their report which appears on page 136.

Changes in Internal Control over Financial Reporting

There have been no changes in the Company's internal control over financial reporting during the quarter ended December 31, 2015 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

Bruce D. Broussard
President and Chief Executive Officer (Principal Executive Officer)
Brian A. Kane
Senior Vice President and Chief Financial Officer (Principal Financial Officer)
Cynthia H. Zipperle
Vice President, Chief Accounting Officer and Controller (Principal Accounting Officer)

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors

The information required by this Item is herein incorporated by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the caption "Proposal One: Election of Directors" in such Proxy Statement.

Executive Officers of the Registrant

Set forth below are names and ages of all of our current executive officers as of February 1, 2016, their positions, and the date first elected an officer:

Name	Age	Position	First Elected Officer	
Bruce D. Broussard	53	President and Chief Executive Officer, Director	12/11	(1)
James E. Murray	62	Executive Vice President and Chief Operating Officer	08/90	(2)
Roy A. Beveridge, M.D.	58	Senior Vice President and Chief Medical Officer	06/13	(3)
Jody L. Bilney	54	Senior Vice President and Chief Consumer Officer	04/13	(4)
Christopher H. Hunter	47	Senior Vice President and Chief Strategy Officer	01/14	(5)
Timothy S. Huval	49	Senior Vice President and Chief Human Resources Officer	12/12	(6)
Brian A. Kane	43	Senior Vice President and Chief Financial Officer	06/14	(7)
Christopher Kay	50	Senior Vice President and Chief Innovation Officer	03/14	(8)
Brian P. LeClaire	55	Senior Vice President and Chief Information Officer	08/11	(9)
Heidi S. Margulis	62	Senior Vice President – Corporate Affairs	12/95	(10)
Christopher M. Todoroff	53	Senior Vice President and General Counsel	08/08	(11)
Cynthia H. Zipperle	53	Vice President, Chief Accounting Officer and Controller	12/14	(12)

(1) Mr. Broussard currently serves as Director, President and Chief Executive Officer (Principal Executive Officer), having held these positions since January 1, 2013. Mr. Broussard was elected President upon joining the Company in December 2011 and served in that capacity through December 2012. Prior to joining the Company, Mr. Broussard was Chief Executive Officer of McKesson Specialty/US Oncology, Inc. US Oncology was purchased by McKesson in December 2010. At US Oncology, Mr. Broussard served in a number of senior executive roles, including Chief Financial Officer, Chief Executive Officer, and Chairman of the Board.

(2) Mr. Murray currently serves as Executive Vice President and Chief Operating Officer, having held this position since December 2011. Mr. Murray has held the position of Chief Operating Officer since February 2006, and was

the Chief Operating Officer – Market and Business Segment Operations from September 2002 to February 2006. Mr. Murray joined the Company in December 1989.

(3) Dr. Beveridge currently serves as Senior Vice President and Chief Medical Officer, having held this position since joining the Company in June 2013. Prior to joining the Company, Dr. Beveridge served as Chief Medical Officer for McKesson Specialty Health from December 2010 until June 2013. Prior to McKesson's acquisition

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of US Oncology, Dr. Beveridge served as the Executive Vice President and Medical Director at US Oncology from September 2009 through December 2010.

(4) Ms. Bilney currently serves as Senior Vice President and Chief Consumer Officer, having held this position since joining the Company in April 2013. Prior to joining the Company, Ms. Bilney served as Executive Vice President and Chief Brand Officer for Bloomin' Brands, Inc. from 2006 until April 2013.

(5) Mr. Hunter currently serves as Senior Vice President and Chief Strategy Officer, having held this position since joining the Company in January 2014. Prior to joining the Company, Mr. Hunter served as President of Provider Markets at The TriZetto Group, Inc. from July 2012 until December 2013, and as Senior Vice President, Emerging Markets at BlueCross BlueShield of Tennessee from 2009 through July 2012. While at BlueCross BlueShield of Tennessee, Mr. Hunter was simultaneously President and Chief Executive Officer of Onlife Health, a national health and wellness subsidiary of BlueCross BlueShield of Tennessee.

(6) Mr. Huval currently serves as Senior Vice President and Chief Human Resources Officer, having been elected to this position in December 2012. Prior to joining the Company, Mr. Huval spent 10 years at Bank of America in multiple senior-level roles, including Human Resources executive and Chief Information Officer for Global Wealth & Investment Management, as well as Human Resources executive for both Global Treasury Services and Technology & Global Operations.

(7) Mr. Kane currently serves as Senior Vice President and Chief Financial Officer, having been elected to this position in June 2014. Prior to joining the Company, Mr. Kane spent nearly 17 years at Goldman, Sachs & Co. As a managing director, he was responsible for client relationships as well as for leading strategic and financing transactions for a number of companies in multiple industries.

(8) Mr. Kay currently serves of Senior Vice President and Chief Innovation Officer, having been elected to this position in March 2014. Prior to joining the Company, Mr. Kay was most recently Managing Director and CEO of Citi Ventures, Citigroup's global corporate venturing arm. Prior to joining Citi in 2007, Mr. Kay held several leadership positions at Target over a 12-year period.

(9) Mr. LeClaire currently serves as Senior Vice President and Chief Information Officer, having held this position since January 2014. Prior to that, he served as Senior Vice President and Chief Service and Information Officer from August 2011 to January 2014, and as Chief Technology Officer from 2002 to August 2011. Mr. LeClaire joined the Company in August 1999.

(10) Ms. Margulis currently serves as Senior Vice President – Corporate Affairs, having held this position since January 2000. Ms. Margulis joined the Company in November 1985.

(11) Mr. Todoroff currently serves as Senior Vice President and General Counsel, having held this position since August 2008. Prior to joining the Company, Mr. Todoroff served as Vice President, Senior Corporate Counsel and Corporate Secretary for Aetna Inc. from 2006 through July 2008. Mr. Todoroff joined Aetna's Legal Department in 1995 and held various positions of increasing responsibility.

(12) Mrs. Zipperle currently serves as Vice President, Chief Accounting Officer and Controller, having held this position since December 2014. Mrs. Zipperle previously served as the Vice President - Finance from January 2013 until her election to her current role, and as the Assistant Controller from January 1998 until January 2013.

Executive officers are elected annually by our Board of Directors and serve until their successors are elected or until resignation or removal. There are no family relationships among any of our executive officers.

Section 16(a) Beneficial Ownership Reporting Compliance

The information required by this Item is herein incorporated by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the caption "Section 16(a) Beneficial Ownership Reporting Compliance" of such Proxy Statement.

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Code of Conduct for Chief Executive Officer and Senior Financial Officers

We have adopted a Code of Conduct for the Chief Executive Officer and Senior Financial Officers, violations of which should be reported to the Audit Committee. The code may be viewed through the Investor Relations section of our web site at www.humana.com. Any amendment to or waiver of the application of the Code of Conduct for the Chief Executive Officer and Senior Financial Officers will be promptly disclosed through the Investor Relations section of our web site at www.humana.com.

Code of Business Conduct and Ethics

Since 1995, we have operated under an omnibus Code of Ethics and Business Conduct, currently known as the Humana Inc. Ethics Every Day. All employees and directors are required to annually affirm in writing their acceptance of the code. The Humana Inc. Ethics Every Day was adopted by our Board of Directors in June 2014, replacing a previous iteration of our Code of Ethics and Business Conduct – the Humana Inc. Principles of Business Ethics – as the document to comply with the New York Stock Exchange Corporate Governance Standard 303A.10. The Humana Inc. Ethics Every Day is available on our web site at www.humana.com. Any waiver of the application of the Humana Inc. Principles of Business Ethics to directors or executive officers must be made by the Board of Directors and will be promptly disclosed on our web site at www.humana.com.

Corporate Governance Items

We have made available free of charge on or through the Investor Relations section of our web site at www.humana.com our annual reports on Form 10-K, quarterly reports on Form 10-Q, proxy statements, and all of our other reports, and, if applicable, amendments to those reports filed or furnished pursuant to Section 13(a) of the Exchange Act, as soon as reasonably practicable after we electronically file such material with, or furnish it to, the SEC. Also available on our Internet web site is information about our corporate governance, including:

- a determination of independence for each member of our Board of Directors;
- the name, membership, role, and charter of each of the various committees of our Board of Directors;
- the name(s) of the directors designated as a financial expert under rules and regulations promulgated by the SEC;
- the responsibility of the Company’s Lead Independent Director, if applicable, to convene, set the agenda for, and lead executive sessions of the non-management directors;
- the pre-approval process of non-audit services provided by our independent accountants;
- our by-laws and Certificate of Incorporation;
- our Majority Vote policy;
- our Related Persons Transaction Policy;
- the process by which interested parties can communicate with directors;
- the process by which stockholders can make director nominations (pursuant to our By-laws);
- our Corporate Governance Guidelines;
- our Policy Regarding Transactions in Company Securities, Inside Information and Confidentiality;
- Stock Ownership Guidelines for directors and for executive officers;
- the Humana Inc. Ethics Every Day and any waivers thereto; and
- the Code of Conduct for the Chief Executive Officer and Senior Financial Officers and any waivers thereto.

Additional information about these items can be found in, and is incorporated by reference to, our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016.

Material Changes to the Procedures by which Security Holders May Recommend Nominees to the Registrant’s Board of Directors

None.

Audit Committee Financial Expert

The information required by this Item is herein incorporated by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the caption “Corporate Governance – Audit Committee” of such Proxy Statement.

Audit Committee Composition and Independence

The information required by this Item is herein incorporated by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the caption “Corporate Governance – Committee Membership and Attendance” of such Proxy Statement.

ITEM 11. EXECUTIVE COMPENSATION

Additional information required by this Item is incorporated herein by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the captions “Corporate Governance – Organization & Compensation Committee – Compensation Committee Interlocks and Insider Participation,” “Director Compensation,” “Compensation Discussion and Analysis,” “Organization & Compensation Committee Report,” and “Executive Compensation” of such Proxy Statement.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Equity compensation plan information

We maintain plans under which options to purchase our common stock and awards of restricted stock may be made to officers, directors, key employees, and consultants. Stock options are granted with an exercise price equal to the fair market value of the underlying common stock on the date of grant. Our stock plans, as approved by the Board of Directors and stockholders, define fair market value as the average of the highest and lowest stock prices reported on the composite tape by the New York Stock Exchange on a given date. Exercise provisions vary, but most options vest in whole or in part 1 to 3 years after grant and expire up to 7 years after grant.

Information concerning stock option awards and the number of securities remaining available for future issuance under our equity compensation plans in effect as of December 31, 2015 follows:

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column(a))	
Equity compensation plans approved by security holders (1)	835,123	$ 121.889	8,734,399	(2)(3)
Equity compensation plans not approved by security holders	—	—	—	
Total	835,123	$ 121.889	8,734,399	

(1) The above table does not include awards of shares of restricted stock or restricted stock units. For information concerning these awards, see Note 13.

(2) The Humana Inc. 2011 Stock Incentive Plan was approved by stockholders at the Annual Meeting held on April 21, 2011. On July 5, 2011, 18.5 million shares were registered with the Securities and Exchange Commission on Form S-8.

(3) Of the number listed above, 3,814,148 can be issued as restricted stock at December 31, 2015 (giving effect to the provision that one restricted share is equivalent to 2.29 stock options in the 2011 Plan).

The information under the captions “Security Ownership of Certain Beneficial Owners of Company Common Stock” and “Security Ownership of Directors and Executive Officers” in our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016, is herein incorporated by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE
The information required by this Item is herein incorporated by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the captions “Certain Transactions with Management and Others” and “Corporate Governance – Independent Directors” of such Proxy Statement.

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES
The information required by this Item is herein incorporated by reference from our Proxy Statement for the Annual Meeting of Stockholders scheduled to be held on April 21, 2016 appearing under the caption “Audit Committee Report” of such Proxy Statement.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) The financial statements, financial statement schedules and exhibits set forth below are filed as part of this report.

(1) Financial Statements – The response to this portion of Item 15 is submitted as Item 8 of Part II of this report.

(2) The following Consolidated Financial Statement Schedules are included herein:

Schedule I	Parent Company Financial Information
Schedule II	Valuation and Qualifying Accounts

All other schedules have been omitted because they are not applicable.

(3) Exhibits:

2.1 Agreement and Plan of Merger, dated as of July 2, 2015 among Aetna Inc., Echo Merger Sub, Inc., Echo Merger Sub, LLC and Humana Inc. (incorporated herein by reference to Exhibit 2.1 to Humana Inc.'s Current Report on Form 8-K filed on July 7, 2015).

3(a) Restated Certificate of Incorporation of Humana Inc. filed with the Secretary of State of Delaware on November 9, 1989, as restated to incorporate the amendment of January 9, 1992, and the correction of March 23, 1992 (incorporated herein by reference to Exhibit 4(i) to Humana Inc.'s Post-Effective Amendment No.1 to the Registration Statement on Form S-8 (Reg. No. 33-49305) filed February 2, 1994).

(b) By-Laws of Humana Inc., as amended on January 4, 2007 (incorporated herein by reference to Exhibit 3 to Humana Inc.'s Annual Report on Form 10-K for the year ended December 31, 2006).

4(a) Indenture, dated as of August 5, 2003, by and between Humana Inc. and The Bank of New York, as trustee (incorporated herein by reference to Exhibit 4.1 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).

(b) First Supplemental Indenture, dated as of August 5, 2003, by and between Humana Inc. and The Bank of New York, as trustee (incorporated herein by reference to Exhibit 4.2 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2003).

(c) Second Supplemental Indenture, dated as of May 31, 2006, by and between Humana Inc. and The Bank of New York Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.1 to Humana Inc.'s Current Report on Form 8-K filed on May 31, 2006).

(d) Third Supplemental Indenture, dated as of June 5, 2008, by and between Humana Inc. and The Bank of New York Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.1 to Humana Inc.'s Current Report on Form 8-K filed on June 5, 2008).

(e)	Fourth Supplemental Indenture, dated as of June 5, 2008, by and between Humana Inc. and The Bank of New York Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.3 to Humana Inc.'s Current Report on Form 8-K filed on June 5, 2008).
(f)	Indenture, dated as of March 30, 2006, by and between Humana Inc. and The Bank of New York Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.2 to Humana Inc.'s Registration Statement on Form S-3 filed on March 31, 2006).
(g)	There are no instruments defining the rights of holders with respect to long-term debt in excess of 10 percent of the total assets of Humana Inc. on a consolidated basis. Other long-term indebtedness of Humana Inc. is described herein in Note 12 to Consolidated Financial Statements. Humana Inc. agrees to furnish copies of all such instruments defining the rights of the holders of such indebtedness not otherwise filed as an Exhibit to this Annual Report on Form 10-K to the Commission upon request.

(h)	Fifth Supplemental Indenture, dated as of December 10, 2012, by and between Humana Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.1 to Humana Inc.'s Current Report on Form 8-K filed on December 10, 2012).
(i)	Sixth Supplemental Indenture, dated as of December 10, 2012, by and between Humana Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.3 to Humana Inc.'s Current Report on Form 8-K filed on December 10, 2012).
(j)	Seventh Supplemental Indenture, dated as of September 19, 2014, by and between Humana Inc. and The Bank of New York, Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.2 to Humana Inc.'s Current Report on Form 8-K filed on September 19, 2014).
(k)	Eighth Supplemental Indenture, dated as of September 19, 2014, by and between Humana Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.4 to Humana Inc.'s Current Report on Form 8-K filed on September 19, 2014).
(l)	Ninth Supplemental Indenture, dated as of September 19, 2014, by and between Humana Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee (incorporated herein by reference to Exhibit 4.6 to Humana Inc.'s Current Report on Form 8-K filed on September 19, 2014).
10(a)*†	Form of Company's Restricted Stock Unit Agreement and Agreement not to Compete or Solicit under the 2011 Stock Incentive Plan (with retirement provisions)
(b)*†	Form of Company's Restricted Stock Unit Agreement and Agreement not to Compete or Solicit under the 2011 Stock Incentive Plan (without retirement provisions).
(c)*	Humana Inc. Amended and Restated 2003 Stock Incentive Plan (incorporated herein by reference to Appendix A to Humana Inc.'s Proxy Statement with respect to the Annual Meeting of Stockholders held on April 27, 2006).
(d)*	Humana Inc. Executive Management Incentive Compensation Plan, as amended and restated February 1, 2008 (incorporated herein by reference to Appendix A to Humana Inc.'s Proxy Statement with respect to the Annual Meeting of Stockholders held on April 24, 2008).
(e)*	Form of Change of Control Agreement (incorporated herein by reference to Exhibit 10.2 to Humana Inc.'s current report on Form 8-K filed on February 24, 2014).
(f)*	Trust under Humana Inc. Deferred Compensation Plans (incorporated herein by reference to Exhibit 10(p) to Humana Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1999).
(g)*	The Humana Inc. Deferred Compensation Plan for Non-Employee Directors (as amended on October 18, 2012) (incorporated herein by reference to Exhibit 10(m) to Humana Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2012).

(h)*	Severance policy as amended and restated on October 23, 2007 (incorporated herein by reference to Exhibit 10(r) to Humana Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2007).
(i)*	Humana Inc. Deferred Compensation Plan (incorporated herein by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-8 (Reg. No. 333-171616), filed on January 7, 2011).
(j)*	Humana Retirement Equalization Plan, as amended and restated as of January 1, 2011 (incorporated herein by reference to Exhibit 10(p) to Humana Inc.'s Annual Report on Form 10-K filed on February 17, 2011).
(k)*	Letter agreement with Humana Inc. officers concerning health insurance availability (incorporated herein by reference to Exhibit 10(mm) to Humana Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 1994).
(l)*	Executive Long-Term Disability Program (incorporated herein by reference to Exhibit 10(a) to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2004).

(m)*	Indemnity Agreement (incorporated herein by reference to Appendix B to Humana Inc.'s Proxy Statement with respect to the Annual Meeting of Stockholders held on January 8, 1987).
(n)* **	Form of Company's Restricted Stock Unit Agreement with Time/Performance Vesting and Agreement not to Compete or Solicit, under the 2011 Stock Incentive Plan (incorporated herein by reference to Exhibit 10(t) to Humana Inc.'s Annual Report on Form 10-K/A filed on January 30, 2014).
(o)*†	Form of Company's Restricted Stock Unit Agreement and Agreement not to Solicit under the 2011 Stock Incentive Plan (with retirement provisions).
(p)*	Summary of the Company's Financial Planning Program for our executive officers (incorporated herein by reference to Exhibit 10(v) to Humana's Inc.'s Annual Report on Form 10-K filed on February 22, 2013.
(q)*†	Form of Company's Restricted Stock Unit Agreement and Agreement not to Solicit under the 2011 Stock Incentive Plan (without retirement provisions).
(r)	Five-Year Credit Agreement, dated as of July 9, 2013 (incorporated herein by reference to Exhibit 10 to Humana Inc.'s Current Report on Form 8-K filed on July 10, 2013).
(s)	Form of CMS Coordinated Care Plan Agreement (incorporated herein by reference to Exhibit 10.1 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
(t)	Form of CMS Private Fee for Service Agreement (incorporated herein by reference to Exhibit 10.2 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
(u)	Addendum to Agreement Providing for the Operation of a Medicare Voluntary Prescription Drug Plan (incorporated herein by reference to Exhibit 10.3 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
(v)	Addendum to Agreement Providing for the Operation of an Employer/Union-only Group Medicare Advantage Prescription Drug Plan (incorporated herein by reference to Exhibit 10.4 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
(w)	Addendum to Agreement Providing for the Operation of an Employer/Union-only Group Medicare Advantage-Only Plan (incorporated herein by reference to Exhibit 10.5 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
(x)	Addendum to Agreement Providing for the Operation of a Medicare Advantage Regional Coordinated Care Plan (incorporated herein by reference to Exhibit 10.6 to Humana Inc.'s Quarterly Report on Form 10-Q for the quarter ended September 30, 2005).
(y)	Explanatory Note regarding Medicare Prescription Drug Plan Contracts between Humana and CMS (incorporated herein by reference to Exhibit 10(nn) to Humana Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2005).

(z)*	Humana Inc. 2011 Stock Incentive Plan (incorporated herein by reference to Appendix A to Humana Inc.'s Proxy Statement with respect to the Annual Meeting of Stockholders held on April 21, 2011).
(aa)*	Form of Company's Stock Option Agreement under the 2011 Stock Incentive Plan (Non-Qualified Stock Options with Non-Compete/Non-Solicit) (incorporated herein by reference to Exhibit 10(oo) to Humana Inc.'s Annual Report on Form 10-K filed on February 24, 2012).
(bb)*	Form of Company's Stock Option Agreement under the 2011 Stock Incentive Plan (Incentive Stock Options with Non-Compete/Non-Solicit) (incorporated herein by reference to Exhibit 10(pp) to Humana Inc.'s Annual Report on Form 10-K filed on February 24, 2012).
(cc)*	Form of Company's Restricted Stock Unit Agreement and Agreement not to Compete or Solicit under the 2011 Stock Incentive Plan (incorporated herein by reference to Exhibit 10(rr) to Humana Inc.'s Annual Report on Form 10-K filed on February 24, 2012).

(dd)*	Amended and Restated Employment Agreement, dated as of February 27, 2014, by and between Humana Inc. and Bruce D. Broussard (incorporated herein by reference to Exhibit 10.1 to Humana Inc.'s current report on Form 8-K filed on February 28, 2014).
(ee)*	Amendment to the Amended and Restated Employment Agreement between Humana Inc. and Bruce D. Broussard, dated July 2, 2015 (incorporated herein by reference to Exhibit 10.1 to Humana Inc.'s current report on Form 8-K filed on July 9, 2015).
(ff)**	Agreement between the United States Department of Defense and Humana Military Healthcare Services, Inc., a wholly owned subsidiary of Humana Inc., dated as March 3, 2011 (incorporated herein by reference to Exhibit 10(mm) to Humana Inc.'s Annual Report on Form 10-K filed on February 24, 2012).
(gg)*	Form of Amendment to Change of Control Agreement between Humana Inc. and various executive officers (incorporated herein by reference to Exhibit 10.1 to Humana Inc.'s current report on Form 8-K filed on February 24, 2014).
(hh)	Form of Commercial Paper Dealer Agreement between Humana Inc., as Issuer, and the Dealer party thereto (incorporated herein by reference to Exhibit 10.1 to Humana Inc.'s current report on Form 8-K filed on October 6, 2014).
(ii)	Master Confirmation by and between Humana Inc. and Goldman, Sachs & Co., dated November 7, 2014 (incorporated herein by reference to Humana Inc.'s current report on Form 8-K filed on November 10, 2014).
(jj)*†	Form of Company's Stock Option Agreement under the 2011 Stock Incentive Plan (Incentive Stock Options).
(kk)*†	Form of Company's Stock Option Agreement under the 2011 Stock Incentive Plan (Non-Qualified Stock Options with Non-Compete/Non-Solicit).
12 †	Computation of ratio of earnings to fixed charges.
14	Code of Conduct for Chief Executive Officer & Senior Financial Officers (incorporated herein by reference to Exhibit 14 to Humana Inc.'s Annual Report on Form 10-K for the fiscal year ended December 31, 2003).
21 †	List of subsidiaries.
23 †	Consent of PricewaterhouseCoopers LLP.
31.1 †	CEO certification pursuant to Rule 13a-14(a)/15d-14(a).
31.2 †	CFO certification pursuant to Rule 13a-14(a)/15d-14(a).
32 †	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes – Oxley Act of 2002.

101	The following materials from Humana Inc.'s Annual Report on Form 10-K formatted in XBRL (Extensible Business Reporting Language): (i) the Consolidated Balance Sheets at December 31, 2015 and 2014; (ii) the Consolidated Statements of Income for the years ended December 31, 2015, 2014 and 2013; (iii) the Consolidated Statements of Comprehensive Income for the years ended December 31, 2015, 2014 and 2013; (iv) the Consolidated Statements of Stockholders' Equity as of December 31, 2015, 2014, and 2013; (v) the Consolidated Statements of Cash Flows for the years ended December 31, 2015, 2014 and 2013; and (vi) Notes to Consolidated Financial Statements.

*Exhibits 10(a) through and including 10(q) and 10(z) through and including 10(ee),10(gg),10(jj) and 10(ii) are compensatory plans or management contracts.
**Pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, as amended, confidential portions of this exhibit have been omitted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.
†Submitted electronically with this report.

Humana Inc.
SCHEDULE I—PARENT COMPANY FINANCIAL INFORMATION
CONDENSED BALANCE SHEETS

	December 31, 2015	2014
	(in millions, except share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	$1,389	$1,211
Investment securities	256	201
Receivable from operating subsidiaries	1,124	873
Other current assets	224	180
Total current assets	2,993	2,465
Property and equipment, net	1,011	885
Investments in subsidiaries	14,276	13,983
Other long-term assets	437	114
Total assets	$18,717	$17,447
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Payable to operating subsidiaries	$3,322	$3,130
Current portion of notes payable to operating subsidiaries	28	28
Book overdraft	38	54
Short-term borrowings	299	—
Other current liabilities	572	562
Total current liabilities	4,259	3,774
Long-term debt	3,821	3,825
Notes payable to operating subsidiaries	9	9
Other long-term liabilities	282	193
Total liabilities	8,371	7,801
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $1 par; 10,000,000 shares authorized; none issued	—	—
Common stock, $0.16 2/3 par; 300,000,000 shares authorized; 198,372,059 shares issued at December 31, 2015 and 197,951,551 shares issued at December 31, 2014	33	33
Capital in excess of par value	2,530	2,330
Retained earnings	11,017	9,916
Accumulated other comprehensive income	58	223
Treasury stock, at cost, 50,084,043 shares at December 31, 2015 and 48,347,541 shares at December 31, 2014	(3,292)	(2,856)
Total stockholders' equity	10,346	9,646
Total liabilities and stockholders' equity	$18,717	$17,447

See accompanying notes to the parent company financial statements.

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Humana Inc.
SCHEDULE I—PARENT COMPANY FINANCIAL INFORMATION
CONDENSED STATEMENTS OF INCOME

	For the year ended December 31,		
	2015	2014	2013
	(in millions)		
Revenues:			
Management fees charged to operating subsidiaries	$1,469	$1,509	$1,370
Investment and other income, net	5	4	3
	1,474	1,513	1,373
Expenses:			
Operating costs	1,370	1,434	1,366
Depreciation	252	212	193
Interest	186	192	141
	1,808	1,838	1,700
Loss before gain on sale of business, income taxes and equity in net earnings of subsidiaries	(334)	(325)	(327)
Gain on sale of business	270	—	—
Loss before income taxes and equity in net earnings of subsidiaries	(64)	(325)	(327)
Benefit for income taxes	(70)	(81)	(107)
Income (loss) before equity in net earnings of subsidiaries	6	(244)	(220)
Equity in net earnings of subsidiaries	1,270	1,391	1,451
Net income	$1,276	$1,147	$1,231

See accompanying notes to the parent company financial statements.

Humana Inc.
SCHEDULE I—PARENT COMPANY FINANCIAL INFORMATION
CONDENSED STATEMENTS OF COMPREHENSIVE INCOME

	For the year ended December 31,		
	2015	2014	2013
	(in millions)		
Net income	$1,276	$1,147	$1,231
Other comprehensive (loss) income:			
Change in gross unrealized investment gains/losses	(114)	122	(338)
Effect of income taxes	42	(44)	124
Total change in unrealized investment gains/losses, net of tax	(72)	78	(214)
Reclassification adjustment for net realized gains included in investment income	(146)	(20)	(22)
Effect of income taxes	53	7	8
Total reclassification adjustment, net of tax	(93)	(13)	(14)
Other comprehensive (loss) income, net of tax	(165)	65	(228)
Comprehensive income	$1,111	$1,212	$1,003

See accompanying notes to the parent company financial statements.

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Humana Inc.
SCHEDULE I—PARENT COMPANY FINANCIAL INFORMATION
CONDENSED STATEMENTS OF CASH FLOWS

	For the year ended December 31,		
	2015	2014	2013
	(in millions)		
Net cash provided by operating activities	$953	$1,499	$1,554
Cash flows from investing activities:			
Proceeds from sale of business	1,055	—	—
Acquisitions	—	—	—
Capital contributions to operating subsidiaries	(833)	(442)	(521)
Purchases of investment securities	(507)	(629)	(320)
Proceeds from sale of investment securities	18	606	35
Maturities of investment securities	108	149	104
Purchases of property and equipment, net	(378)	(380)	(223)
Net cash used in investing activities	(537)	(696)	(925)
Cash flows from financing activities:			
Proceeds from issuance of senior notes, net	—	1,733	—
Proceeds from issuance of commercial paper, net	298	—	—
Repayment of long-term debt	—	(500)	—
Change in book overdraft	(16)	(5)	7
Common stock repurchases	(385)	(872)	(531)
Dividends paid	(172)	(172)	(168)
Tax benefit from stock-based compensation	15	12	8
Proceeds from stock option exercises and other	22	51	65
Net cash (used in) provided by financing activities	(238)	247	(619)
Increase in cash and cash equivalents	178	1,050	10
Cash and cash equivalents at beginning of year	1,211	161	151
Cash and cash equivalents at end of year	$1,389	$1,211	$161

See accompanying notes to the parent company financial statements.

Humana Inc.
SCHEDULE I—PARENT COMPANY FINANCIAL INFORMATION
NOTES TO CONDENSED FINANCIAL STATEMENTS

1. BASIS OF PRESENTATION

Parent company financial information has been derived from our consolidated financial statements and excludes the accounts of all operating subsidiaries. This information should be read in conjunction with our consolidated financial statements.

Related Party

Refer to Note 2 of the notes to consolidated financial statements in this Annual Report on Form 10-K for a description of our related party transactions. A related party note receivable in the amount of $284 million is included with other long-term assets in our condensed balance sheet at December 31, 2015 and with purchases of investment securities in our condensed statement of cash flows. The related interest income is included in investment income in our consolidated statement of income.

2. TRANSACTIONS WITH SUBSIDIARIES

Management Fee

Through intercompany service agreements approved, if required, by state regulatory authorities, Humana Inc., our parent company, charges a management fee for reimbursement of certain centralized services provided to its subsidiaries including information systems, disbursement, investment and cash administration, marketing, legal, finance, and medical and executive management oversight.

Dividends

Cash dividends received from subsidiaries and included as a component of net cash provided by operating activities were $493 million in 2015, $927 million in 2014, and $967 million in 2013. Subsidiary dividends in 2015 reflect the impact of losses for our individual commercial medical business compliant with the Health Care Reform Law and the November 5, 2015 revised statutory accounting guidance requiring the exclusion of risk corridor receivables from related statutory surplus discussed in Note 3 below.

Guarantee

Through indemnity agreements approved by state regulatory authorities, certain of our regulated subsidiaries generally are guaranteed by our parent company in the event of insolvency for: (1) member coverage for which premium payment has been made prior to insolvency; (2) benefits for members then hospitalized until discharged; and (3) payment to providers for services rendered prior to insolvency. Our parent has also guaranteed the obligations of our military services subsidiaries.

Notes Receivables from Operating Subsidiaries

We funded certain subsidiaries with surplus note agreements. These notes are generally non-interest bearing and may not be entered into or repaid without the prior approval of the applicable Departments of Insurance or other state regulatory authorities.

Notes Payable to Operating Subsidiaries

We borrowed funds from certain subsidiaries with notes generally collateralized by real estate. These notes, which have various payment and maturity terms, bear interest ranging from 1.51% to 6.65% and are payable in 2016 and 2019. We recorded interest expense of $1 million related to these notes for each of the years ended December 31, 2015, 2014 and 2013.

Humana Inc.
SCHEDULE I—PARENT COMPANY FINANCIAL INFORMATION
NOTES TO CONDENSED FINANCIAL STATEMENTS—(Continued)

3. REGULATORY REQUIREMENTS

Certain of our insurance subsidiaries operate in states that regulate the payment of dividends, loans, or other cash transfers to Humana Inc., our parent company, and require minimum levels of equity as well as limit investments to approved securities. The amount of dividends that may be paid to Humana Inc. by these insurance subsidiaries, without prior approval by state regulatory authorities, or ordinary dividends, is limited based on the entity's level of statutory income and statutory capital and surplus. In most states, prior notification is provided before paying a dividend even if approval is not required.

Although minimum required levels of equity are largely based on premium volume, product mix, and the quality of assets held, minimum requirements vary significantly at the state level. Our state regulated insurances subsidiaries had aggregate statutory capital and surplus of approximately $6.6 billion and $6.0 billion as of December 31, 2015 and 2014, respectively, which exceeded aggregate minimum regulatory requirements of $4.6 billion and $4.1 billion, respectively. Subsidiary dividends are subject to state regulatory approval, the amount and timing of which could be reduced or delayed. Excluding Puerto Rico subsidiaries, the amount of ordinary dividends that may be paid to our parent company in 2016 is approximately $900 million in the aggregate. This compares to dividends that were paid to our parent company in 2015 of approximately $493 million. Actual dividends paid may vary due to consideration of excess statutory capital and surplus and expected future surplus requirements related to, for example, premium volume and product mix.

On November 5, 2015, the National Association of Insurance Commissioners, or NAIC, issued statutory accounting guidance for receivables associated with the risk corridor provisions under the Health Care Reform Law, which requires the receivables to be excluded from subsidiary surplus. This accounting guidance required additional capital contributions into certain subsidiaries during 2015.

Certain regulated subsidiaries recognized premium deficiency reserves for our individual commercial medical policies compliant with the Health Care Reform Law for the 2016 coverage year in the fourth quarter of 2015. Further, the statutory-based premium deficiency excludes the estimated benefit associated with the risk corridor provisions as a reduction in subsidiary surplus in accordance with the previously discussed November 5, 2015 statutory accounting guidance requiring the exclusion of risk corridor amounts from subsidiary surplus. As a result of the statutory-based premium deficiency, we will fund capital contributions into certain regulated subsidiaries of $450 million during the first quarter of 2016.

Our use of operating cash flows derived from our non-insurance subsidiaries, such as in our Healthcare Services segment, is generally not restricted by state departments of insurance (or comparable state regulators).

4. ACQUISITIONS AND DIVESTITURES

Refer to Note 3 of the notes to consolidated financial statements in this Annual Report on Form 10-K for a description of certain acquisitions and divestitures. On June 1, 2015, we completed the sale of our wholly owned subsidiary, Concentra Inc. During 2015, 2014 and 2013, we funded certain non-regulated subsidiary acquisitions, including the acquisition of American Eldercare Inc., with contributions from Humana Inc., our parent company, included in capital contributions in the condensed statement of cash flows.

5. INCOME TAXES

Refer to Note 11 of the notes to consolidated financial statements included in this Annual Report on Form 10-K for a description of income taxes.

6. DEBT

Refer to Note 12 of the notes to consolidated financial statements included in this Annual Report on Form 10-K for a description of debt.

7. STOCKHOLDER'S EQUITY

Refer to Note 15 of the notes to consolidated financial statements included in this Annual Report on Form 10-K for a description of stockholders' equity, including stock repurchases and stockholder dividends.

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Humana Inc.
SCHEDULE II—VALUATION AND QUALIFYING ACCOUNTS
For the Years Ended December 31, 2015, 2014, and 2013
(in millions)

	Balance at Beginning of Period	Acquired/(Disposed) Balances	Additions Charged (Credited) to Costs and Expenses	Charged to Other Accounts (1)	Deductions or Write-offs	Balance at End of Period
Allowance for loss on receivables:						
2015	$137	$ (39)	$61	$(7)	$(51)	$101
2014	118	—	32	28	(41)	137
2013	94	—	37	18	(31)	118
Deferred tax asset valuation allowance:						
2015	(48)	—	6	—	—	(42)
2014	(28)	—	(20)	—	—	(48)
2013	(28)	—	—	—	—	(28)

(1) Represents changes in retroactive membership adjustments to premiums revenue and contractual allowances adjustments to services revenue as more fully described in Note 2 to the consolidated financial statements included in this annual report on Form 10-K.

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SIGNATURES

Pursuant to the requirements of Sections 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned, thereto duly authorized.

HUMANA INC.

By: /s/ BRIAN A. KANE
Brian A. Kane
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: February 18, 2016

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Company and in the capacities and on the date indicated.

Signature	Title	Date
/s/ BRIAN A. KANE Brian A. Kane	Senior Vice President and Chief Financial Officer (Principal Financial Officer)	February 18, 2016
/s/ CYNTHIA H. ZIPPERLE Cynthia H. Zipperle	Vice President, Chief Accounting Officer and Controller (Principal Accounting Officer)	February 18, 2016
/s/ BRUCE D. BROUSSARD Bruce D. Broussard	President and Chief Executive Officer, Director (Principal Executive Officer)	February 18, 2016
/s/ KURT J. HILZINGER Kurt J. Hilzinger	Chairman of the Board	February 18, 2016
/s/ FRANK A. D’AMELIO Frank A. D’Amelio	Director	February 18, 2016
/s/ W. ROY DUNBAR W. Roy Dunbar	Director	February 18, 2016
/s/ DAVID A. JONES, JR. David A. Jones, Jr.	Director	February 18, 2016
/s/ WILLIAM J. MCDONALD William J. McDonald	Director	February 18, 2016
/s/ WILLIAM E. MITCHELL William E. Mitchell	Director	February 18, 2016
/s/ DAVID B. NASH, M.D.	Director	February 18, 2016

David B. Nash, M.D.

/s/ JAMES J. O'BRIEN James J. O'Brien	Director	February 18, 2016
/s/ MARISSA T. PETERSON Marissa T. Peterson	Director	February 18, 2016

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