BAXTER INTERNATIONAL INC
Form 11-K
June 28, 2016
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# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 11-K

x **ANNUAL REPORT PURSUANT TO SECTION 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the year ended December 31, 2015**

**OR**

¨ **TRANSITION REPORT PURSUANT TO SECTION 15 (d) OF THE SECURITIES EXCHANGE ACT OF 1934**

**For the transition period from _________ to _________**

**Commission file number 1-4448**

A. Full title of the plan and the address of the plan, if different from that of the issuer named below:

**Baxter International Inc. and Subsidiaries**

**Incentive Investment Plan**

B. Name of issuer of the securities held pursuant to the plan and the address of its principal executive office:

**Baxter International Inc.**

**One Baxter Parkway**

**Deerfield, IL 60015**

**(224) 948-2000**

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**Report of Independent Registered Public Accounting Firm**

To the Participants and Administrative Committee of

the Baxter International Inc. and Subsidiaries Incentive Investment Plan

Deerfield, Illinois

We have audited the accompanying statements of net assets available for benefits of the Baxter International Inc. and Subsidiaries Incentive Investment Plan (the Plan) as of December 31, 2015 and 2014, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Plan s management. Our responsibility is to express an opinion on these financial statements based on our 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 audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 2015 and 2014, and the changes in net assets available for benefits for the years then ended in conformity with U.S. generally accepted accounting principles.

The supplemental Schedule H, Line 4i Schedule of Assets (Held at End of Year) as of December 31, 2015 has been subjected to audit procedures performed in conjunction with the audit of the Baxter International Inc. and Subsidiaries Incentive Investment Plan s financial statements. The supplemental schedule is the responsibility of the Plan s management. Our audit procedures included determining whether the information presented in the supplemental schedule reconciles to the financial statements or the underlying accounting and other records, as applicable, and performing procedures to test the completeness and accuracy of the information presented in the supplemental schedule. In forming our opinion on the supplemental schedule, we evaluated whether the supplemental schedule, including its form and content, is presented in conformity with the Department of Labor s Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. In our opinion, the supplemental schedule is fairly stated in all material respects in relation to the financial statements as a whole.

/s/ Crowe Horwath LLP

Oak Brook, Illinois

June 28, 2016

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**Baxter International Inc. and Subsidiaries**

**Incentive Investment Plan**

**Statements of Net Assets Available for Benefits**

**December 31, 2015 and 2014** (in thousands)

| | **2015** | **2014** |
|---|---|---|
| **Assets** | | |
| Investments | | |
| Cash and cash equivalents | $ 46,353 | $ 46,562 |
| Common stock (including securities on loan of $309 in 2015 and $3,364 in 2014) | 442,134 | 507,029 |
| U.S. government and government agency issues (including securities on loan of $10,501 in 2015 and $5,998 in 2014) | 28,483 | 34,634 |
| Corporate and other obligations (including securities on loan of $1,296 in 2015 and $3,257 in 2014) | 29,445 | 39,425 |
| Commingled funds | 920,030 | 1,147,634 |
| Synthetic guaranteed investment contracts | 616,636 | 712,934 |
| Registered investment companies | 15,979 | 16,921 |
| Collateral held on loaned securities | 12,328 | 12,903 |
| Total investments at fair value | 2,111,388 | 2,518,042 |
| Receivables | | |
| Notes receivables from participants | 37,330 | 50,454 |
| Sponsor contributions | 18,157 | 26,743 |
| Accrued interest and dividends | 1,056 | 2,390 |
| Due from brokers for securities sold | 5,127 | 505 |
| Total receivables | 61,670 | 80,092 |
| Total assets | 2,173,058 | 2,598,134 |
| **Liabilities** | | |
| Accounts payable | 8,064 | 5,957 |
| Due to brokers for securities purchased | 10,485 | 7,815 |
| Collateral to be paid on loaned securities | 12,328 | 12,903 |
| Total liabilities | 30,877 | 26,675 |
| Net assets available for benefits, reflecting investments at fair value | 2,142,181 | 2,571,459 |
| Adjustment from fair value to contract value for fully benefit-responsive investment contracts | (22,443) | (41,872) |
| Net assets available for benefits | $ 2,119,738 | $ 2,529,587 |

The accompanying notes are an integral part of these financial statements.

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**Baxter International Inc. and Subsidiaries**

**Incentive Investment Plan**

**Statements of Changes in Net Assets Available for Benefits**

**For the Years Ended December 31, 2015 and 2014** (in thousands)

| | 2015 | 2014 |
|---|---|---|
| **Additions to net assets attributed to** | | |
| Investment income | | |
| Net appreciation in fair value of investments | $ 25,871 | $ 121,342 |
| Interest | 20,250 | 22,436 |
| Dividends | 7,880 | 10,973 |
| Net investment income | 54,001 | 154,751 |
| Participant loan interest | 3,383 | 4,099 |
| Contributions | | |
| Sponsor | 61,212 | 73,677 |
| Participant | 103,974 | 107,935 |
| | 165,186 | 181,612 |
| Total additions | 222,570 | 340,462 |
| **Deductions from net assets attributed to** | | |
| Benefits paid | 175,444 | 171,804 |
| Plan expenses | 6,357 | 6,834 |
| Total deductions | 181,801 | 178,638 |
| Increase before transfers | 40,769 | 161,824 |
| **Transfer to Baxalta Incorporated and Subsidiaries Incentive Investment Plan (Refer to Note 1)** | (496,501) | |
| **Transfer from other plan (Refer to Note 11)** | 45,883 | 12,083 |
| **Net (decrease)/increase** | (409,849) | 173,907 |
| **Net assets available for benefits** | | |
| Beginning of year | 2,529,587 | 2,355,680 |
| End of year | $ 2,119,738 | $ 2,529,587 |

The accompanying notes are an integral part of these financial statements.

**Baxter International Inc. and Subsidiaries**

**Incentive Investment Plan**

**Notes to Financial Statements**

**December 31, 2015 and 2014**

**1. General Description of the Plan**

The following description of the Baxter International Inc. and Subsidiaries Incentive Investment Plan (the Plan) is provided for general information purposes only. Participants should refer to the Plan document and summary plan description for more complete information. The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

The Plan is a defined contribution plan the predecessor of which originally became effective on January 1, 1960. The Plan was created for the purpose of providing retirement benefits to United States employees of Baxter International Inc. (the Sponsor or the Company) and its subsidiaries, and to encourage and assist employees in adopting a regular savings program by means of payroll deductions through a plan that qualifies under the United States Internal Revenue Code. Plan participants may authorize the Company to make payroll deductions under the Plan ranging from 1% to 50% of their pre-tax monthly compensation limited to a maximum of $18,000 and $17,500 a year in 2015 and 2014, respectively. Participants who have attained the age of 50 by the end of the year may contribute up to an additional $6,000 and $5,500 per year in catch-up contributions in 2015 and 2014, respectively. Newly hired employees are deemed to have elected to contribute 3% of compensation (increased by 1% per year to a total of 6%) unless they make a contrary election. The Company matches a participant s savings contributions on a dollar for dollar basis up to 3.0% of the participant s compensation, and matches any contributions between 3% and 4% of compensation at the rate of 50 cents for each dollar of a participant s pre-tax contribution, so that the maximum matching contribution for participants who contribute at least 4% of their compensation is 3.5% of compensation. The Company also contributes an additional non-matching 3% of compensation for employees that are not eligible to participate in the Company s U.S. qualified defined benefit pension plan, which includes all new employees hired on or after January 1, 2007, and employees who had less than five years of service on January 1, 2007 and who elected to cease earning additional service in the pension plan and participate in the higher level of Company contributions in the Plan.

Participants are immediately vested in the elective contributions and matching contribution plus actual earnings thereon. The additional non-matching contributions become fully vested after three years of service. Participants are fully vested in the Company s non-matching contributions account, regardless of years of service with the Company, upon attaining age 65, upon becoming disabled in accordance with the provisions of the Plan or upon dying while employed by the Company. Forfeitures of nonvested accounts are used to reduce future employer contributions.

Participants may borrow from their vested accounts a minimum of $500 up to a maximum equal to the lesser of $50,000 or 50% of their vested account balance. The loans are secured by the balance in the participant s account and bear interest at the prime rate at the last day of the month prior to loan request, plus one percent.

Participants or their beneficiaries may elect lump-sum benefit payments, or benefits may be paid in installments. Shares of Baxter common stock may also be distributed in kind at the participant s election. Subject to certain provisions specified in the Plan agreement, employed participants may withdraw their pre-tax contributions, matching contributions made prior to 2008, vested non-matching contributions and related earnings in cases of financial hardship and in certain other circumstances. In the case of a participant termination by reason of death or disability, the entire vested amount is paid to the person or persons legally entitled thereto.

Each participant s account is credited with the participant s contributions and an allocation of the Company s contributions and Plan earnings, and is charged with his or her withdrawals and an allocation of Plan-related expenses. Allocations are based on participant earnings or account balances, as defined in the Plan document. The net income of the Plan is posted to the participant s accounts on a daily basis. Each participant directs the investment of his or her account to any of the investment options available under the Plan.

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Upon enrollment in the Plan, a participant may direct contributions into any of 17 investment options: Stable Income Fund, Baxter Common Stock Fund, State Street S&P 500 Index Non-Lending Series Fund, State Street International Index Non-Lending Series Fund, State Street Russell Small Cap Index Non-Lending Series Fund, Northern Trust Domestic Mid Cap Fund, State Street Global Advisors Emerging Markets Fund (SSgA Emerging Markets Fund) and ten different Target Date Retirement Funds. However, non-matching contributions may not be invested in the Baxter Common Stock Fund. Participants may not direct contributions to the Self-Managed Fund but can transfer funds into the Self-Managed Fund from other investment options. In addition, certain participants may maintain shares received in connection with Baxter s 1996 spin-off of Allegiance Corporation (Allegiance), which were subsequently converted into common shares of Cardinal Health Inc. (Cardinal) upon Cardinal s acquisition of Allegiance in 1999. These shares are maintained in the Cardinal Health Common Stock Fund. Additionally, certain participants maintain shares in Edwards Lifesciences Corporation. These shares were placed into the Edwards Lifesciences Common Stock Fund in connection with Baxter s 2000 spin-off of its cardiovascular business. Certain participants obtained shares in Baxalta Incorporated (Baxalta), in connection with the spin (as discussed below). These shares were placed into the Baxalta Common Stock Fund in connection with Baxter s 2015 spin-off of its BioScience business. See Note 12 for a discussion of the conversion of the Baxalta Common Stock Fund into the Shire Common Stock Fund in June 2016, in connection with the merger of a wholly-owned subsidiary of Shire plc (Shire) with and into Baxalta, with Baxalta as the surviving company (the Merger). Participants are not able to make contributions or transfer existing account balances to the Cardinal Health Common Stock Fund, Edwards Lifesciences Common Stock Fund or the Shire Common Stock Fund (f/k/a the Baxalta Common Stock Fund), but may make transfers out of these funds at any time. Starting in 2013, participants are no longer able to make contributions to the Composite Fund and General Equity Fund, but may make transfers out of these funds at any time.

On July 1, 2015, Baxter completed the distribution of approximately 80.5% of the outstanding common stock of Baxalta to Baxter stockholders in connection with the separation of its biopharmaceutical business (the spin). The distribution was made to Baxter s stockholders of record as of the close of business on June 17, 2015, who received one share of Baxalta common stock for each Baxter common share held as of such date. The Plan received 2,703,100 shares of Baxalta common stock on July 1, 2015 as a result of the distribution. The distribution was intended to take the form of a tax-free distribution for federal income tax purposes in the United States. As a result of the distribution, Baxalta became an independent public company whose shares traded on the New York Stock Exchange under the symbol BXLT. In 2015, the Plan transferred approximately $497 million of assets to the Baxalta Incorporated and Subsidiaries Incentive Investment Plan in connection with the spin.

## 2. Summary of Significant Accounting Policies

Basis of Accounting

The accompanying financial statements of the Plan have been prepared on the accrual basis of accounting. Accordingly, investment income is recognized when earned and expenses are recognized when incurred.

New Accounting Standards

In May 2015, the Financial Accounting Standards Board ( FASB ) issued updated guidance which removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share ( NAV ) practical expedient ( ASU 2015-07 ). ASU 2015-07 also removes the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the NAV practical expedient. ASU 2015-07 is effective for annual reporting periods beginning after December 15, 2016. The Plan Sponsor has chosen not to early adopt this standard and is currently evaluating the impact of this standard on the Plan s financial statements.

In July 2015, the FASB issued new guidance impacting benefit plan accounting and reporting ( ASU 2015-12 ). ASU 2015-12 requires an employee benefit plan to use contract value as the only measurement amount for fully benefit-responsive investment contracts. It also simplifies and increases the effectiveness of plan investment disclosure requirements for employee benefit plans, and provides employee benefit plans with a measurement-date practical expedient for asset fair value. ASU 2015-12 is effective for fiscal years beginning after December 15, 2015. The Plan Sponsor has chosen not to early adopt this standard and is currently evaluating the impact of this standard on the Plan s financial statements.

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**Baxter International Inc. and Subsidiaries**

**Incentive Investment Plan**

**Notes to Financial Statements**

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Valuation of Investments and Collateral

The fair value of Plan investments and collateral is determined as follows:

| | |
|---|---|
| Cash and cash equivalents | These largely consist of a short-term investment fund and a money market fund, the fair value of which is based on the net asset value. The investment objectives for these funds are to provide safety for principal, daily liquidity and a competitive yield by investing in high quality instruments. |
| Common stock | Value based on closing prices on the valuation date in an active market on national securities exchanges. |
| U.S. government and government agency issues | Value based on reputable pricing vendors that typically use pricing matrices or models. |
| Corporate and other obligations | Value based on reputable pricing vendors that typically use pricing matrices or models. |
| Commingled funds | Value based on net asset values reported by the fund managers as of the Plan s financial statement dates and recent transaction prices. The investment objectives of certain funds are to track the performances of the S&P 500, Europe, Australasia and the Far East (EAFE), or Russell 2000 indexes. In addition, these funds include target date retirement funds, whose objective is to provide investors, who have a specific date in mind for retirement with a portfolio of investments. The underlying investments for all funds vary, with some holding diversified portfolios of domestic stocks, government agency and corporate bonds, and others holding collective investment funds. Each fund provides for daily redemptions by the Plan at reported net asset values per share, with no advance notice requirement. |
| Registered investment companies | Value based upon the closing price from a national security exchange on the valuation date. |
| Synthetic guaranteed investment contracts | Value based on the fair value of the underlying securities in the contract on the valuation date plus the fair value of the wrapper contracts, which is calculated using a replacement cost approach. The underlying securities are valued based upon the methodologies described above. In addition, this investment includes an individual separate account with Metropolitan Life Insurance Company (MetLife). The value of this separate account is based upon the unit value provided by MetLife as of the Plan s financial statement date plus the fair value of the wrapper contracts, which is calculated using a replacement cost |

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| | |
|---|---|
| | approach. The underlying securities primarily of the account, managed by a sub-advisor of the insurance company, consist of fixed income securities. See below for more information. |
| Collateral held on loaned securities | Value based upon the net asset value per unit of the short-term investment funds where the collateral is invested. Refer to Note 7 for more information on the securities lending program. |
| Collateral to be paid on loaned securities | Value based on the fair value of the underlying securities loaned on the valuation date, plus an incremental margin. |

Income Recognition

Plan investment return includes dividend and interest income, gains and losses on sales of investments and unrealized depreciation or appreciation of investments. Purchases and sales of investments are recorded on a trade date basis. Dividends are recorded on the ex-dividend date. Interest is earned on an accrual basis.

The financial statements reflect the net depreciation or appreciation in the fair value of the Plan s investments. This net depreciation or appreciation consists of realized gains and losses calculated as the difference between proceeds from a sales transaction and cost determined on a moving average basis, and unrealized gains and losses calculated as the change in the fair value between beginning of the year (or purchase date if later) and the end of the year.

Synthetic Guaranteed Investment Contracts

The Plan holds synthetic guaranteed investment contracts (GICs) as part of the Stable Income Fund. The synthetic GICs provide for a fixed return on principal over a specified time through fully benefit-responsive contracts issued by Transamerica, Prudential and MetLife. During 2014, the GIC with Bank of America was terminated and the Plan entered into a new GIC with Prudential. The portfolio of assets underlying the synthetic GICs primarily includes cash and cash equivalents, U.S. government and government agency issues, and corporate and other obligations.

The fair value of the synthetic GICs equals the total of the fair value of the underlying assets plus the fair value of the wrapper contracts. The fair value of the wrapper contracts is computed using a replacement cost approach that incorporates a comparison of the current fee rate on similar wrapper contracts to the fee being paid by the Plan. Using this approach, the fair values of the wrapper contracts were a loss of $391 thousand and a loss of $449 thousand at December 31, 2015 and 2014, respectively.

While Plan investments are presented at fair value in the Statements of Net Assets Available for Benefits, any material difference between the fair value of the Plan s direct and indirect interests in fully benefit-responsive investment contracts and their contract value is presented as an adjustment line in the Statements of Net Assets Available for Benefits, because contract value is the relevant measurement attribute for that portion of the Plan s net assets available for benefits. Contract value represents contributions, plus earnings, less participant withdrawals and administrative expenses. The wrapper contracts used by the Plan are fully benefit-responsive because the wrapper contract issuers are contractually obligated to make up any shortfall in the event that the underlying asset portfolio has been liquidated and is inadequate to cover participant withdrawals and transfers at contract value. There are currently no reserves against contract values for credit risk of the contract issuers or any other risk. The contract value for the synthetic GICs was $594.2 million and $671.1 million at December 31, 2015 and 2014, respectively.

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The crediting interest rate, which is reset quarterly, can never fall below zero. The crediting rate formula smoothes the impact of interest rate changes on participant returns by amortizing any difference between market value and book value over a period of years equal to the duration of the portfolio benchmark. The average yield on the synthetic GICs was approximately 2.3% and 1.9% at December 31, 2015 and 2014, respectively. The average interest rate credited to participants on the synthetic GICs was approximately 2.7% and 2.8% for the years ended December 31, 2015 and 2014. The credit ratings for Transamerica, Prudential and MetLife were AA- at both December 31, 2015 and 2014.

Events that lead to market value withdrawals that exceed 15 percent of the contract value of the GIC s of Prudential and Transamerica or 10 percent of the contract value of the GIC of MetLife would limit the ability of the Plan to transact at contract value with participants. These events include restructurings, early retirement plans, divestitures, bankruptcies, or legal, tax or regulatory changes. The Plan sponsor believes that the occurrence of any such event is remote. The spin did not constitute such an event under the GIC s.

The wrapper providers can only terminate at a value different than contract value under an event of default (that was not remedied) such as failure to follow the terms of the contract. If a wrapper provider would like to exit the contract for another reason, the Plan can maintain the contract through an extended termination process designed to ensure continued benefit-responsive treatment for withdrawals.

Notes Receivables from Participants

Participant loans are reported at their unpaid principal balance plus any accrued but unpaid interest, with no allowance for credit losses, as repayments of principal and interest are received through payroll deductions and the notes are collateralized by the participant s account balances.

Payment of Benefits and Fees

Benefits are recorded when paid. Loan origination fees associated with notes receivable from participants and the Plan s record keeping and trustee fees are paid by the Plan and are reflected in the financial statements as Plan expenses. Investment management fees are charged to the Plan as a reduction of investment return and included in the investment income (loss) reported by the Plan. All other expenses of the Plan are paid by the Company.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and related notes to the financial statements. Changes in such estimates may affect amounts reported in future periods.

Other

Due from broker for securities sold represent the net cash value of security trades initiated but not yet settled at each respective year-end.

Risks and Uncertainties

The Plan provides for various investment options which invest in any combination of registered investment companies, U.S. government and government agency issues, corporate and other obligations, common stock, commingled funds, synthetic guaranteed investment contracts and short-term investments. Investment securities are exposed to various risks, such as interest rate, market, liquidity and credit risks. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term could materially affect participants account balances and the amounts reported in the Statements of Net Assets Available for Benefits and the Statements of Changes in Net Assets Available for Benefits. Individual participants accounts bear the risk of loss resulting from fluctuations in investment values.

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Investments underlying the Plan s synthetic GICs include securities with contractual cash flows, such as asset-backed securities, collateralized mortgage obligations and commercial mortgage-backed securities, including securities backed by subprime mortgage loans (corporate and other obligations). The value, liquidity and related income of these securities are sensitive to changes in economic conditions, including real estate values, delinquencies and/or defaults and may be adversely affected by shifts in the market s perception of the issuers and changes in interest rates.

**3. Eligibility Requirements**

Employees become eligible to participate in the Plan as of the first day of the month following the completion of thirty days of employment. Eligible employees are those who meet the following requirements:

A. U.S. employees of Baxter or its subsidiaries which have adopted the Plan;

B. U.S. employees not covered by a collective bargaining agreement unless the agreement provides for coverage under the Plan; and

C. U.S. employees who are not leased employees.

**4. Administration of the Plan**

State Street Bank and Trust Company (the Trustee) serves as trustee and Voya Institutional Plan Services, LLC, formerly ING Institutional Plan Services, LLC, serves as recordkeeper for the Plan.

The Administrative Committee administers the Plan. The Investment Committee has authority, responsibility and control over the management of the assets of the Plan. Members of both committees are appointed by the Board of Directors of Baxter and are employees of Baxter.

Substantially all investment manager, trustee and administrative fees incurred in the administration of the Plan were paid from the assets of the Plan.

**5. Fair Value Measurements**

The fair value hierarchy under the accounting standard for fair value measurements consists of the following three levels:

Level 1 - Quoted prices in active markets that the Plan has the ability to access for identical assets or liabilities;

Level 2 - Quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model-based valuations in which all significant inputs are observable in the market; and

Level 3 - Valuations using significant inputs that are unobservable in the market and include the use of judgment by the Plan s management about the assumptions market participants would use in pricing the asset or liability.

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The following tables summarize the bases used to measure the Plan s financial instruments and liabilities that are carried at fair value on a recurring basis.

| | | Basis of Fair Value Measurement | | |
|---|---|---|---|---|
| | | Quoted Prices in Active Markets for Identical Assets | Significant Other Observable Inputs | Significant Unobservable Inputs |
| **(in thousands)** | **Balance at December 31, 2015** | **(Level 1)** | **(Level 2)** | **(Level 3)** |
| **Assets** | | | | |
| Cash and cash equivalents | $ 46,353 | $ | $ 46,353 | $ |
| Common stock: | | | | |
| Healthcare | 236,252 | 236,252 | | |
| Consumer products | 72,615 | 72,615 | | |
| Information technology | 81,102 | 81,102 | | |
| Financial services | 13,437 | 13,437 | | |
| Industrial services and materials | 11,958 | 11,958 | | |
| Energy | 4,437 | 4,437 | | |
| Other | 22,333 | | | |