



# STATE OF NORTH CAROLINA

**UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM  
ENTERPRISE AND RELATED FUNDS (SYSTEM FUND)**

**CHAPEL HILL, NORTH CAROLINA**

**FINANCIAL STATEMENT AUDIT REPORT**

**FOR THE YEAR ENDED JUNE 30, 2011**

**OFFICE OF THE STATE AUDITOR**

**BETH A. WOOD, CPA**

**STATE AUDITOR**

**UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM  
ENTERPRISE AND RELATED FUNDS (SYSTEM FUND)**

**CHAPEL HILL, NORTH CAROLINA**

**FINANCIAL STATEMENT AUDIT REPORT**

**FOR THE YEAR ENDED JUNE 30, 2011**

**BOARD OF GOVERNORS**

**THE UNIVERSITY OF NORTH CAROLINA**

**THOMAS W. ROSS, PRESIDENT**

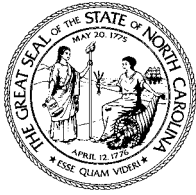
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**Beth A. Wood, CPA**  
State Auditor

STATE OF NORTH CAROLINA  
**Office of the State Auditor**

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**AUDITOR'S TRANSMITTAL**

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The Honorable Beverly E. Perdue, Governor  
The General Assembly of North Carolina  
Board of Directors, University of North Carolina Health Care System

We have completed a financial statement audit of the University of North Carolina Health Care System Enterprise and Related Funds (System Fund) for the year ended June 30, 2011, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

The results of our tests disclosed no deficiencies in internal control over financial reporting that we consider to be material weaknesses in relation to our audit scope or any instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

*North Carolina General Statutes* require the State Auditor to make audit reports available to the public. Copies of audit reports issued by the Office of the State Auditor may be obtained through one of the options listed in the back of this report.

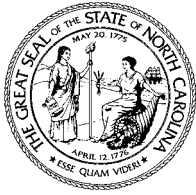
A handwritten signature in cursive script that reads "Beth A. Wood".

Beth A. Wood, CPA  
State Auditor

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**INDEPENDENT AUDITOR'S REPORT**

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Board of Directors  
University of North Carolina Health Care System  
Chapel Hill, North Carolina

We have audited the accompanying basic financial statements of the University of North Carolina Health Care System Enterprise and Related Funds (System Fund), a part of the University of North Carolina Health Care System, which is a part of the multi-campus University of North Carolina System, a component unit of the State of North Carolina, as of and for the year ended June 30, 2011, as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements present only the System Fund and are not intended to present fairly the financial position of the University of North Carolina Health Care System nor the University of North Carolina System, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of North Carolina Health Care System Enterprise and Related Funds as of June 30, 2011, and the changes in its financial position and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

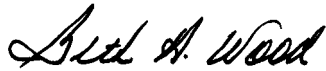
In accordance with *Government Auditing Standards*, we have also issued our report dated February 15, 2012 on our consideration of the System Fund's internal control over financial

## INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

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reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis, as listed in the table of contents, is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.



Beth A. Wood, CPA  
State Auditor

February 15, 2012

**UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM ENTERPRISE  
AND RELATED FUNDS (SYSTEM FUND)  
MANAGEMENT'S DISCUSSION AND ANALYSIS**

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**Introduction**

Management's discussion and analysis provides an overview of the financial activities of the University of North Carolina Health Care System Enterprise and Related Funds (System Fund) for the fiscal year ending June 30, 2011.

The University of North Carolina Health Care System (UNC Health Care) was established November 1, 1998, by *North Carolina General Statute 116-37*. UNC Health Care is governed by a Board of Directors as an affiliated enterprise of the University of North Carolina System. UNC Health Care and UNC Chapel Hill School of Medicine (UNC School of Medicine) are affiliated entities within the University System. The University of North Carolina Physicians & Associates (UNC P&A) is the clinical service component of the UNC School of Medicine and provides a full range of care to patients of UNC Health Care. Rex Healthcare, Inc. (Rex), Chatham Hospital, Inc. (Chatham), and Triangle Physician Network, LLC (TPN) are owned and controlled entities within UNC Health Care, an integrated health care provider.

The entities listed above collectively perform the operating functions of UNC Health Care and the UNC School of Medicine. The System Fund of UNC Health Care, conversely, does not perform revenue generating activities. The System Fund functions as a centralized financial clearinghouse for the integrated health care system.

The System Fund assesses, holds, and allocates funds across the entities of UNC Health Care. Initially formed as the Enterprise Fund to facilitate investments in support of the clinical, academic and education missions of UNC Health Care and the UNC School of Medicine, the Enterprise Fund today exists as a sub-account within the System Fund. Since its formation, the System Fund has been used for enabling additional types of transfers between entities of UNC Health Care. As such, the Enterprise Fund, Outreach Fund, Patient Safety Fund, Recruitment Fund, and Shared Administrative Services Fund each function as sub-accounts of the System Fund.

**Using the Financial Statements**

The Governmental Accounting Standards Board (GASB) requires three basic financial statements: the *Statement of Net Assets*, the *Statement of Revenues, Expenses, and Changes in Net Assets*, and the *Statement of Cash Flows*.

The financial statement balances reported are presented in a classified format to aid the reader in understanding the nature of the operations. The *Notes to the Financial Statements* provide information relative to the significant accounting principles applied in the financial statements and further detail concerning the organization and its operations. These disclosures provide information to better understand details, risk, and uncertainty associated with the amounts reported and are considered an integral part of the financial statements.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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The *Statement of Net Assets* provides information relative to the assets, liabilities, and net assets as of the last day of the fiscal year. Assets and liabilities on this Statement are categorized as either current or noncurrent. Current assets are those that are available to pay for expenses in the next fiscal year, and it is anticipated that they will be used to pay for current liabilities. Current liabilities are those payable in the next fiscal year. Net assets on this Statement are categorized as unrestricted. Management estimates are necessary in some instances to determine current or noncurrent categorization. Overall, the *Statement of Net Assets* provides information relative to the financial strength of the System Fund and its ability to meet current and long-term obligations.

The *Statement of Revenues, Expenses, and Changes in Net Assets* provides information relative to the results of the System Fund's operations, nonoperating activities, and other activities affecting net assets, which occurred during the fiscal year. Nonoperating activities include interest income. Other activities include transfers in and transfers out from/to UNC Health Care entities. Overall, the *Statement of Revenues, Expenses, and Changes in Net Assets* provides information relative to the management of the organization's operations and its ability to maintain its financial stability.

The *Statement of Cash Flows* provides information relative to the System Fund's sources and uses of cash for noncapital financing activities and investing activities. The Statement provides a reconciliation of cash balance changes throughout the year and is representative of the activity reported on the *Statement of Revenues, Expenses, and Changes in Net Assets* as adjusted for changes in the beginning and ending balances of noncash accounts on the *Statement of Net Assets*.

### **Comparison of Two-Year Data for 2011 to 2010**

Data for 2011 (Audited) and 2010 (Unaudited) are presented in this report and discussed in the following sections. Discussion in the following sections is pertinent to fiscal year 2011 results and changes relative to ending balances in fiscal year 2010.

### **Analysis of Overall Financial Position and Results of Operations**

#### **Statement of Net Assets**

The sub-accounts of the System Fund collectively hold assets of \$73.4 million. Total assets increased by 15.1% over the prior year. Total liabilities increased by 25.0%. Pre-payments of UNC Hospitals' fiscal year 2012 commitments increased by \$6 million year over year and account for 35.7% of the System Fund assets and 47.3% of the System Fund liabilities as of June 30, 2011. Cash associated with the Enterprise Fund and Shared Administrative Services Fund also increased due to mission support and the timing of the settlement of shared administrative services. While current assets increased overall, noncurrent assets and liabilities decreased due to payments made to the UNC School of Medicine from the Outreach Fund.



## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)**

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### **Statement of Revenues, Expenses, and Changes in Net Assets**

Both transfers in and transfers out increased during fiscal year 2011, compared to fiscal year 2010, due to the assessment and subsequent payment of \$28 million to the UNC School of Medicine that was made in an effort to help fill the gap left by recent budget cuts. This payment was the main driver of the increase in both categories but transfers out of the System Fund ultimately exceeded transfers in to the System Fund by \$1.4 million. This represents the beginning of a planned contraction of fund resources. In total, net assets declined by \$1.4 million.

### **Discussion of Conditions that May Have a Significant Effect on Net Assets or Revenues, Expenses, and Changes in Net Assets**

UNC Health Care derives the vast majority of its operating revenues from patient care services. Because the System Fund provides no revenue-generating services, it is entirely dependent upon the financial wherewithal of the entities within UNC Health Care. In recent years, the largest entities of UNC Health Care have achieved strong operating performance. Their performance has enabled the investments made through the System Fund in support of the clinical, education, and research programs of UNC P&A and the UNC School of Medicine. These investments have, in turn, yielded positive results as measured by growth in needed services, expansion of the medical school class and increased research funding. Further, UNC Health Care has been able to support the fledgling Triangle Physicians Network during its start-up period and Chatham Hospital despite adverse economic conditions in its primary service area.

The conditions impacting the operating entities of UNC Health Care constitute the greatest risk to the System Fund. National health policy changes are changing the financial outlook for health systems. Adapting to new models requires greater coordination of patient care, major investments in information technology, and an increased focus on wellness. Successfully managing in the future requires tighter integration of administrative functions across the entities of UNC Health Care, caring for patients in lower cost delivery settings, and comprising sufficient scale to spread the cost of major investments across a broad base. UNC Health Care has begun planning for these changes through a health system-wide planning and implementation process.

Payments for professional services continue to pressure the performance of physician providers. The pressure is strongest in academic medicine. Funding from major sources, patient care revenues for clinical services, research revenues for research discovery, and education revenue from State appropriated funds are each under pressure and inadequate to fully cover their costs. At the same time, improvements to the Medicaid payment mechanism will help reduce what have been large and increasing losses.

The private health insurance market has driven important changes in patient coverage and in how/when patients seek care. As premiums have increased in a soft employment market, some employers have dropped employer-provided insurance. For others, the premiums have driven plan-design decisions that have shifted cost to employees or created disincentives for seeking care, particularly for elective procedures. UNC Health Care relies heavily on

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED)

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privately insured patients as indigent and government payers generally do not cover the full cost of care. As this trend continues, UNC Health Care will face increasing pressure to reduce expenses.

Community-based practices face challenges attributable to similar health care financings and broader economic trends. As such, many community physicians have sought employment within health systems. UNC Health Care formed TPN to facilitate employment of community primary care providers. As a start-up, TPN has required cash infusions to develop central administrative infrastructure and deploy electronic medical records in the physician offices. Additionally, primary care practices historically situated within Rex Hospital, Inc. or UNC Hospitals moved into TPN. The losses from these practices are now incurred by TPN. These capital and operating investments will continue in future years.

Physicians newly employed by TPN also have short-term negative cash flow. Acquiring physical assets at fair market value constitute a relatively small investment. More importantly, TPN incurs operating expenses as providers and their support staff begin employment with TPN. Conversely, payments for providing patient care typically lag by several months.

Pressure on the State budget has resulted in sharp cuts to UNC Health Care and the UNC School of Medicine. Relative to the prior year, fiscal year 2012 State appropriated funds to UNC Hospitals were reduced by 50% and to the School of Medicine 20%. While State funding covers a relatively small fraction of total operating expenses, these funds have been important contributors to defraying the cost of providing indigent care and education for our medical students, residents, and sub-specialty residents. Similarly, federal budget cuts may have a significant impact on clinical revenues through cuts in Medicare payments or research revenue as a result of reductions in the National Institutes of Health (NIH) budget.

Economic conditions in the United States and internationally remain weak which, in turn, has depressed asset investment performance for several consecutive years. In fiscal year 2012, legislative changes afforded UNC Health Care additional flexibility. These changes should enable UNC Health Care to improve nonoperating income.

## MANAGEMENT'S DISCUSSION AND ANALYSIS (CONCLUDED)

University of North Carolina Health Care System Enterprise and Related Funds (System Fund)  
 Summary of Condensed Financial Statements Totals  
 For the Fiscal Years Ended June 30, 2011 and 2010

Table 1

	FY11	(Unaudited) FY10	Change
<b>STATEMENT OF NET ASSETS</b>			
Current Assets	\$ 69,425,766	\$ 57,802,179	\$ 11,623,587
Noncurrent Assets	4,000,000	6,000,000	(2,000,000)
<b>TOTAL ASSETS</b>	<b>73,425,766</b>	<b>63,802,179</b>	<b>9,623,587</b>
Current Liabilities	51,294,268	38,235,260	13,059,008
Noncurrent Liabilities	4,000,000	6,000,000	(2,000,000)
<b>TOTAL LIABILITIES</b>	<b>55,294,268</b>	<b>44,235,260</b>	<b>11,059,008</b>
Unrestricted Net Assets	<u>\$ 18,131,498</u>	<u>\$ 19,566,919</u>	<u>\$ (1,435,421)</u>
<b>STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS</b>			
Revenues	\$ 0	\$ 0	\$ 0
Expenses			
Nonoperating Revenues	412,724	274,660	138,064
Transfers In	138,112,605	121,716,311	16,396,294
Transfers Out	139,960,750	111,812,055	28,148,695
<b>INCREASE (DECREASE) IN NET ASSETS</b>	<b>(1,435,421)</b>	<b>10,178,916</b>	<b>(11,614,337)</b>
<b>NET ASSETS - BEGINNING OF YEAR</b>	<b>19,566,919</b>	<b>9,388,003</b>	<b>10,178,916</b>
<b>NET ASSETS - END OF YEAR</b>	<u><b>\$ 18,131,498</b></u>	<u><b>\$ 19,566,919</b></u>	<u><b>\$ (1,435,421)</b></u>

**University of North Carolina Health Care System Enterprise  
and Related Funds (System Fund)  
Statement of Net Assets  
June 30, 2011**

**Exhibit A-1**

**ASSETS**

Current Assets:

Cash and Cash Equivalents:

Undesignated Funds (Note 2)	\$ 2,138,481
Designated for UNC Physicians & Associates Program Support (Note 2)	26,200,000
Designated for UNC Physicians & Associates Mission Support (Note 2)	13,563,071
Designated for Shared Administrative Services (Note 2)	13,002,020
Designated for UNC Faculty Recruitment (Note 2)	7,000,000
Designated for Graduate Medical Education Support (Note 2)	<u>2,000,000</u>
Cash and Cash Equivalents Total	63,903,572
Due from UNC Health Care Entities (Note 3)	<u>5,522,194</u>
Total Current Assets	<u>69,425,766</u>

Noncurrent Assets:

Cash and Cash Equivalents:

Designated for Graduate Medical Education Support (Note 2)	<u>4,000,000</u>
Total Assets	<u>73,425,766</u>

**LIABILITIES**

Current Liabilities:

Due to UNC Health Care Entities (Note 4)	25,094,268
Assessments Paid in Advance	<u>26,200,000</u>
Total Current Liabilities	<u>51,294,268</u>

Noncurrent Liabilities:

Due to UNC Health Care Entities (Note 4)	<u>4,000,000</u>
Total Liabilities	<u>55,294,268</u>

**NET ASSETS**

Unrestricted	<u><u>\$ 18,131,498</u></u>
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The accompanying notes to the financial statements are an integral part of this statement.

***University of North Carolina Health Care System Enterprise  
and Related Funds (System Fund)  
Statement of Revenues, Expenses, and Changes in Net Assets  
For the Fiscal Year Ended June 30, 2011***

***Exhibit A-2***

<b>REVENUES</b>	
Operating Revenues	\$ 0
<b>EXPENSES</b>	
Operating Expenses	
<b>NONOPERATING REVENUES</b>	
Interest Income	412,724
<b>TRANSFERS IN</b>	
Regular Assessments (Note 5)	33,713,940
Special Assessments (Note 5)	43,980,926
Mission Support Assessments (Note 5)	15,605,799
Shared Administrative Services Assessments (Note 5)	<u>44,811,940</u>
Total Transfers In	<u>138,112,605</u>
<b>TRANSFERS OUT</b>	
Program Support (Note 6)	82,050,561
Shared Administrative Services (Note 6)	44,066,800
Mission Support (Note 6)	<u>13,843,389</u>
Total Transfers Out	<u>139,960,750</u>
Decrease in Net Assets	(1,435,421)
<b>NET ASSETS</b>	
Net Assets - July 1, 2010	<u>19,566,919</u>
Net Assets - June 30, 2011	<u>\$ 18,131,498</u>

The accompanying notes to the financial statements are an integral part of this statement.

***University of North Carolina Health Care System Enterprise  
and Related Funds (System Fund)  
Statement of Cash Flows  
For the Fiscal Year Ended June 30, 2011***

***Exhibit A-3***

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Transfers In from Entities	\$ 161,262,139
Transfers Out to Entities	<u>(135,101,742)</u>
Net Cash Provided by Noncapital Financing Activities	<u>26,160,397</u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

Interest Income	<u>412,724</u>
Net Increase in Cash and Cash Equivalents	26,573,121
Cash and Cash Equivalents - July 1, 2010	<u>41,330,451</u>
Cash and Cash Equivalents - June 30, 2011	<u><u>\$ 67,903,572</u></u>

**RECONCILIATION OF CASH AND CASH EQUIVALENTS**

Current Assets:	
Cash and Cash Equivalents	\$ 63,903,572
Noncurrent Assets:	
Cash and Cash Equivalents	<u>4,000,000</u>
Total Cash and Cash Equivalents - June 30, 2011	<u><u>\$ 67,903,572</u></u>

The accompanying notes to the financial statements are an integral part of this statement.

**UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM ENTERPRISE  
AND RELATED FUNDS (SYSTEM FUND)  
NOTES TO THE FINANCIAL STATEMENTS  
JUNE 30, 2011**

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**NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES**

- A. Organization** - The University of North Carolina Health Care System (UNC Health Care) was established November 1, 1998 by *North Carolina General Statute 116-37*. UNC Health Care was established by the North Carolina General Assembly to provide patient care, facilitate the education of physicians and other health care providers, conduct research collaboratively with the health sciences schools of the University of North Carolina at Chapel Hill (UNC-CH), and render other services designed to promote the health and well-being of the citizens of North Carolina.

UNC Health Care is governed by a Board of Directors (Board) as an affiliated enterprise of the University of North Carolina (UNC) System. UNC Health Care and UNC-CH are affiliated entities within the University System. The University of North Carolina Physicians & Associates (UNC P&A) is the clinical service component of the UNC School of Medicine and provides a full range of care to patients of UNC Health Care. Rex Healthcare, Inc. (Rex), Chatham Hospital, Inc. (Chatham), and Triangle Physician Network, LLC (TPN) are owned and controlled entities within UNC Health Care, an integrated health care provider.

The Board's vision for UNC Health Care is to be the nation's leading public academic health care system. The Board authorized the creation of the UNC Health Care System Enterprise and Related Funds (System Fund) to enable fund transfers among entities in the health system in support of the articulated vision and statutory missions.

The System Fund assesses, holds, and allocates funds across the entities of UNC Health Care. Initially formed as the Enterprise Fund to facilitate investments in support of the clinical, academic and education missions of UNC Health Care and the UNC School of Medicine, the Enterprise Fund today exists as a sub-account within the System Fund.

Since its formation, the System Fund has broadened its scope to include five distinct funds. These funds function as sub-accounts and collectively constitute the System Fund. These funds are as follows:

**The Enterprise Fund** - The Enterprise Fund provides support for the teaching, research and clinical missions of UNC Health Care and the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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UNC School of Medicine. It is funded by assessments against revenues of UNC Hospitals, UNC School of Medicine, UNC P&A, and Rex, made at least annually<sup>1</sup>. Assessments to the constituent entities are determined on an annual basis or more often as necessary. UNC Hospitals and UNC P&A make additional mission support contributions to the Enterprise Fund if they have met required organizational goals. The overwhelming majority of transfers from the Enterprise Fund are made to the clinical departments of the UNC School of Medicine and UNC P&A for their teaching, research, and clinical programs.

**The Outreach Fund** - The Outreach Fund was initially invested in innovative projects designed to improve the health of the community with particular focus on geriatrics and other underserved constituencies. The initial funds were formed by a one-time contribution from UNC Hospitals. These funds were fully expended by the end of fiscal year 2009. The Outreach Fund was subsequently re-chartered in fiscal year 2010 by a transfer from the Enterprise Fund in the amount of \$10,000,000. These funds are being expended at a rate of \$2 million per year to offset expenses incurred by clinical departments for graduate medical education (GME). These funds will be fully expended by the end of fiscal year 2014.

**The Recruitment Fund** - The Recruitment Fund was established through a special assessment at the end of fiscal year 2010 in the amount of \$7,000,000, to enable critical faculty recruitments to the UNC School of Medicine. The Recruitment Fund is designed to provide salary support for recruitments deemed critical to the missions of the UNC School of Medicine. It was formed by contributions from UNC Hospitals, UNC P&A, and several UNC School of Medicine clinical departments in response to a crisis in UNC Health Care's cardiac surgery program. These funds are set aside to enable UNC Hospitals, UNC P&A, and the UNC School of Medicine to collaboratively recruit faculty physicians to better serve the people of North Carolina. No funds were expended from the Recruitment Fund in fiscal year 2011.

**The Patient Safety Fund** - The Patient Safety Fund (Performance Improvement and Patient Safety Innovations Fund or PIPSIF) is funded through savings realized in the Liability & Insurance Trust Fund (LITF). These savings were realized from efforts to improve clinical outcomes and patient safety. The Patient Safety Fund enables UNC Health Care to designate resources specifically intended to improve patient care and further reduce potential harm to patients.

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<sup>1</sup> Chatham and TPN's current fiscal positions prevent an assessment. Additionally, Chatham's existing bond covenants specifically prohibit an assessment.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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**The Shared Administrative Services Fund** - The Shared Administrative Services Fund is used to assess and allocate administrative expenses for UNC Health Care's centralized services. These services (including but not limited to information technology, human resources, finance, strategic planning, risk management, etc.) are provided more efficiently and effectively on a consolidated basis.

- B. Financial Reporting Entity** - The concept underlying the definition of the financial reporting entity is that elected officials are accountable to their constituents for their actions. As required by accounting principles generally accepted in the United States of America (GAAP), the financial reporting entity includes both the primary government and all of its component units. An organization other than a primary government serves as a nucleus for a reporting entity when it issues separate financial statements. The System Fund is a part of UNC Health Care, an affiliated enterprise of the multi-campus University of North Carolina System. The University of North Carolina System is a component unit of the State of North Carolina and an integral part of the State's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the System Fund, for which the UNC Health Care Board is responsible. *G.S. 116-37* grants authority and responsibility to meet patient-care, educational, research, and public service goals of UNC Health Care.

- C. Basis of Presentation** - The accompanying financial statements are presented in accordance with GAAP as prescribed by the Governmental Accounting Standards Board (GASB).

Pursuant to the provisions of GASB Statement No. 34, *Basic Financial Statements - and Management's Discussion and Analysis - for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements - and Management's Discussion and Analysis - for Public Colleges and Universities*, UNC Health Care is considered to be a single business type activity that qualifies for reporting in a single column. Since the System Fund is a component of UNC Health Care, it is also presented in a single column.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the System Fund does not apply Financial Accounting Standards Board (FASB) pronouncements issued after November 30, 1989, unless the GASB amends its pronouncements to specifically adopt FASB pronouncements issued after that date.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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- D. Basis of Accounting** - The financial statements of the System Fund have been prepared using the economic resource measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred, regardless of the timing of the cash flows.

Nonexchange transactions, in which the System Fund receives (or gives) value without directly giving (or receiving) equal value in exchange includes assessments, mission support, and contributions.

- E. Cash and Cash Equivalents** - This classification includes deposits held by the State Treasurer in the Short-Term Investment Fund. The Short-Term Investment Fund maintained by the State Treasurer has the general characteristics of a demand deposit account in that participants may deposit and withdraw cash at any time without prior notice or penalty.

- F. Net Assets** - The System Fund's net assets are classified as unrestricted. Unrestricted net assets include resources derived from assessments, mission support, shared administrative services, and interest income.

- G. Transfers In and Transfers Out** - The System Fund supports UNC Health Care and UNC School of Medicine clinical, research, and teaching initiatives based on recommendations by the management team, ultimately approved by the Chief Executive Officer. The transfers in and transfers out reported for the System Fund supporting these initiatives result from the following:

**Regular Assessments** - Ongoing funding needs which are estimated annually based on requests submitted, reviewed and approved, and paid for by monies transferred from UNC Hospitals, UNC P&A, UNC School of Medicine, and Rex. Funding amounts required and the corresponding assessments are determined annually but may be revised throughout the year as necessary.

**Special Assessments** - Funding needs that arise during the year that were not identified during the annual budgeting process are approved as needed by the Chief Executive Officer of UNC Health Care.

**Mission Support Assessments and Transfers Out** – UNC Hospitals and UNC P&A are entities of UNC Health Care with highly interdependent activities. Mission Support aligns incentives by creating shared organizational goals. The level of support increases with better performance on quality, research, education, patient satisfaction, employee satisfaction and financial metrics. This approach impels employees across the enterprise to improve in our research, education and clinical missions.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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UNC Hospitals and UNC P&A make additional payments to the System Fund if a specific set of pre-determined organizational goals are achieved. Mission Support was first established in fiscal year 2009, and has been paid in each subsequent year. To date, only UNC Hospitals has met the criteria to enable the payment to the system. While only UNC Hospitals and UNC P&A currently participate, the goal is to include all of UNC Health Care's entities in the program.

**Program Support** - The primary function of the System Fund is to support those programs that have been identified as being beneficial to achieving UNC Health Care's patient-care, research, and education mission but that cannot support themselves or otherwise need additional funding to achieve the desired outcome. Program Support payments fill the funding gap for these programs. For the current fiscal year, 79% of the program support payments went to UNC P&A and UNC School of Medicine.

**Shared Administrative Services Assessments and Transfers Out** - Shared administrative services refers to those administrative functions across UNC Health Care's affiliated entities that benefit multiple locations and the resulting cost should be shared or allocated across the System. UNC Health Care assesses each applicable entity for services received and then reimburses the entities providing the service and incurring the shared cost. The assessment is established annually based on budgeted shared costs.

### NOTE 2 - DEPOSITS

The System Fund is the name of UNC Health Care's bank account for central administrative functions. It contains several distinct funds and is subject to the provisions of the Executive Budget Act, except for trust funds identified in *North Carolina General Statutes 116-36.1* (Regulation of Institutional Trust Funds) and *116-37.2* (Regulation of UNC Hospitals Funds). These statutes primarily apply to the receipts generated by patient billings and other revenues from the operations of UNC Hospitals and UNC P&A. As defined in the statutes, these funds may consist of moneys received from or for the operation by an institution of any of its self-supporting auxiliary enterprises or moneys received by an institution in respect to fees and other payments for services rendered by medical, dental or other health care professionals under an organized practice plan approved by the institution or under a contractual agreement between the institution and a hospital or other health care provider.

At June 30, 2011, the amount shown on the Statement of Net Assets as current cash and cash equivalents of \$63,903,572 and noncurrent cash and cash equivalents of \$4,000,000, represent the System Fund's equity position in the

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

State Treasurer's Short-Term Investment Fund. The Short-Term Investment Fund (a portfolio within the State Treasurer's investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.9 years as of June 30, 2011. Assets and shares of the Short-Term Investment Fund are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's Short-Term Investment Fund) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports," or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

A reconciliation of deposits and corresponding designations as of June 30, 2011 is as follows:

	Enterprise Fund	Outreach Fund	Recruitment Fund	Patient Safety Fund	Shared Administrative Services Fund	Total
Deposits						
Current:						
Undesignated Funds	\$ 1,776,197	\$ 0	\$ 0	\$ 362,284	\$ 0	\$ 2,138,481
Designated for UNC Physicians & Associates Program Support	26,200,000					26,200,000
Designated for UNC Physicians & Associates Mission Support	13,563,071					13,563,071
Designated for Shared Administrative Services					13,002,020	13,002,020
Designated for UNC Faculty Recruitment			7,000,000			7,000,000
Designated for Graduate Medical Education Support		2,000,000				2,000,000
Noncurrent:						
Designated for Graduate Medical Education Support		4,000,000				4,000,000
Total Deposits	<u>\$ 41,539,268</u>	<u>\$ 6,000,000</u>	<u>\$ 7,000,000</u>	<u>\$ 362,284</u>	<u>\$ 13,002,020</u>	<u>\$ 67,903,572</u>

### NOTE 3 - DUE FROM UNC HEALTH CARE ENTITIES

Amounts due from UNC Health Care entities at June 30, 2011 by type and entity were as follows:

	Amount
<b>Assessments</b>	
UNC Hospitals	\$ 513,940
Rex Healthcare	175,000
<b>Shared Administrative Services</b>	
UNC Hospitals	3,460,374
UNC Physicians & Associates	1,156,395
Rex Healthcare	216,485
<b>Total Due from UNC Health Care Entities</b>	<u>\$ 5,522,194</u>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 4 - DUE TO UNC HEALTH CARE ENTITIES

Amounts due to UNC Health Care entities at June 30, 2011 by type and entity were as follows:

	Amount
<b>Current:</b>	
<b>Assessments</b>	
UNC Physicians & Associates	\$ 2,000,000
<b>Mission Support</b>	
UNC Hospitals	2,178,186
UNC Physicians & Associates	11,384,885
<b>Shared Administrative Services</b>	
UNC Hospitals	8,794,025
UNC Physicians & Associates	737,172
<b>Total Current Due to UNC Health Care Entities</b>	<b>\$ 25,094,268</b>
<b>Noncurrent:</b>	
<b>Assessments</b>	
UNC Physicians & Associates	<b>\$ 4,000,000</b>

### NOTE 5 - TRANSFERS IN

Transfers in by source and entity are presented as follows:

	Amount
<b>Regular Assessments</b>	
UNC Hospitals	\$ 26,513,940
UNC Physicians & Associates	5,500,000
UNC School of Medicine	300,000
Rex Healthcare	1,400,000
Total Regular Assessments	<b>\$ 33,713,940</b>
<b>Special Assessments</b>	
UNC Hospitals	\$ 38,517,876
UNC Physicians & Associates	1,254,470
Rex Healthcare	4,208,580
Total Special Assessments	<b>\$ 43,980,926</b>
<b>Mission Support Assessments</b>	
UNC Hospitals	<b>\$ 15,605,799</b>
<b>Shared Administrative Services Assessments</b>	
UNC Hospitals	\$ 34,643,981
UNC Physicians & Associates	9,337,933
Rex Healthcare	830,026
Total Shared Administrative Services Assessments	<b>\$ 44,811,940</b>

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

### NOTE 6 - TRANSFERS OUT

Transfers out by purpose and entity at June 30, 2011 are as follows:

	Amount
<b>Program Support</b>	
UNC Physicians & Associates	
Anesthesiology	\$ 12,035,000
Dermatology	645,000
Emergency Medicine	1,075,000
Gastroenterology	300,000
Heart & Vascular	1,300,000
Nephrology	250,000
Neurology	1,755,000
Obstetrics Gynecology	386,786
Oncology	5,002,000
Orthopaedics	2,157,600
Other	138,000
Otolaryngology	155,625
Pediatrics	1,348,225
Physical Medicine & Rehabilitation	118,429
Primary Care	780,000
Radiology	2,400,000
Surgery	4,072,400
Total UNC Physicians & Associates Program Support	33,919,065
UNC School of Medicine	30,511,185
Triangle Physician Network	11,370,311
Chatham Hospital	5,500,000
Piedmont Health Services	750,000
Total Program Support	\$ 82,050,561
<b>Shared Administrative Services</b>	
UNC Hospitals	\$ 43,911,130
UNC Physicians & Associates	152,062
Rex Healthcare	3,608
Total Shared Administrative Services	\$ 44,066,800
<b>Mission Support</b>	
UNC Physicians & Associates	\$ 13,843,389

### NOTE 7 - RELATED PARTIES

**University of North Carolina Hospitals at Chapel Hill** - The UNC Hospitals at Chapel Hill (UNC Hospitals) is the only state-owned teaching hospital in North Carolina. With a licensed base of 799 beds, this facility serves as an acute care teaching hospital for the University of North Carolina at Chapel Hill. As a state agency, UNC Hospitals conforms to financial requirements established by statutory and constitutional provisions. While UNC Hospitals is exempt from both federal and state income taxes, a small portion of its revenue is subject to the unrelated business income tax.

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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UNC Hospitals paid \$115,281,596 for assessments, mission support, and shared administrative services to the System Fund over the course of the year. Likewise, the System Fund also made \$43,911,130 in payments to UNC Hospitals for shared administrative services expenses during the year ended June 30, 2011.

**University of North Carolina School of Medicine** - The UNC School of Medicine was assessed and paid the System Fund \$300,000 during the year and received \$30,511,185 in program support during the year ended June 30, 2011.

**University of North Carolina Physicians & Associates** - The UNC Physicians & Associates (UNC P&A) is the clinical service component of the UNC School of Medicine. At the heart of UNC P&A are the approximately 1,200 faculty physicians who provide a full range of specialty and primary care services for patients of UNC Health Care. While the great majority of services are rendered at the inpatient units of UNC Hospitals and the outpatient clinics on the UNC campus, there is a growing range of services provided at clinics in the community. There are 18 clinical departments, one clinical center, two affiliated departments, and two administrative units that collectively form UNC P&A.

### **Clinical Departments:**

Anesthesiology	Orthopaedics
Dermatology	Otolaryngology
Emergency Medicine	Pathology & Laboratory Medicine
Family Medicine	Pediatrics
Medicine	Psychiatry
Neurology	Physical Medicine & Rehabilitation
Neurosurgery	Radiation Oncology
Obstetrics & Gynecology	Radiology
Ophthalmology	Surgery

### **Clinical Center:**

Heart & Vascular

### **Affiliated Departments:**

Allied Health Sciences  
Carolina Institute for Developmental Disabilities

### **Administrative Units:**

Administrative Office  
Ambulatory Administration

## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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While UNC P&A is affiliated with the UNC Health Care, the net assets of UNC P&A are held in a UNC Chapel Hill (UNC-CH) trust fund. The operating income and expenses for UNC P&A are incorporated into UNC-CH's accounting infrastructure. As such, its operational results are included in the UNC-CH annual audit.

UNC P&A paid \$16,092,403 for assessments and shared administrative services to the System Fund over the course of the year. The System Fund also made payments to UNC P&A in the amount of \$47,914,516 for program support, mission support, and shared administrative services reimbursements during the year ended June 30, 2011.

**Rex Healthcare, Inc.** - Rex Healthcare, Inc. (Rex) is a not-for-profit corporation and is exempt from federal and North Carolina income taxation as a 501(c)(3) charitable organization. Rex does not conduct active operations but serves as the parent corporation for a multi-entity health care delivery system that was organized to provide health care services to the residents of Wake County, North Carolina and surrounding counties. UNC Health Care acquired Rex in 2000 and is the sole member of the corporation. UNC Health Care appoints eight of the 13 seats on Rex's Board of Trustees and also reviews and approves Rex's annual operating and capital budgets. The principal corporate entities under the common control of Rex are:

**Rex Hospital, Inc.** - Rex Hospital, Inc. is a 433-bed hospital located in Raleigh, North Carolina that provides inpatient, outpatient, and emergency services primarily to the residents of Wake County. Rex Hospital operates Rex Cancer Center, Rex Women's Center, and Rex Rehab and Nursing Care Center of Raleigh on its main campus. Rex Hospital has additional campuses in Cary, Wakefield (in Raleigh), Knightdale, and Apex. Rex Hospital, Inc. also owns Rex Home Services, Inc. and Smithfield Radiation Oncology, LLC.

**Rex Enterprises Company, Inc.** - Rex Enterprises Company, Inc. is a North Carolina for-profit corporation organized to hold investments in various affiliates and to promote the development of real property in support of the mission of Rex. Rex Enterprises Company, Inc. is the sole member of Rex CDP Ventures, LLC, which is a limited liability company organized to own and develop real estate in the Wakefield community of northern Wake County.

**Rex Healthcare Foundation, Inc.** - Rex Healthcare Foundation, Inc. is a North Carolina not-for-profit corporation organized to promote the health and welfare of residents in Rex's service area by promoting philanthropic contributions and public support of Rex.



## NOTES TO THE FINANCIAL STATEMENTS (CONTINUED)

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**Rex Holdings, LLC** - Rex Holdings, LLC was formed in 2007 to provide medical services through various affiliations, joint ventures and independent physician practices. Rex Holdings is the sole member of Rex Physicians, LLC, which was established in 2009 to employ physicians of specialty practices.

Rex paid \$6,438,606 for assessments and shared administrative services to the System Fund and received \$3,608 for shared administrative service expenses during the year ended June 30, 2011.

**Chatham Hospital, Inc.** - Chatham Hospital, Inc. is a private, nonprofit 501(c)(3) corporation that owns and operates a 25-bed critical access facility located in Siler City, North Carolina. The facility operates 21 acute/swing beds and four intensive care beds, along with a complement of surgical suites, emergency room, and ancillary services.

UNC Health Care acquired Chatham Hospital in 2008 and is the sole member of the corporation. UNC Health Care appoints nine of the 15 members on the Chatham Hospital, Inc. Board and reviews and approves its annual operating and capital budgets.

Due to Chatham's financial circumstances, it was not assessed by the System Fund but received \$5,500,000 in program support during the year ended June 30, 2011.

**Triangle Physician Network, LLC** - Triangle Physician Network, LLC (TPN) is a wholly-owned subsidiary of UNC Health Care, but a private employer, that owns and operates 17 community-based practices throughout the Triangle (Raleigh, Durham, and Chapel Hill), North Carolina area.

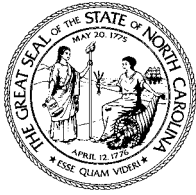
TPN is a physician-led network structured to meet the needs of the community and community practice physicians by creating a partnership for physicians and UNC Health Care to face the challenging health care environment. TPN incorporates ten legacy UNC Health Care community-based practices as well as newly acquired practices and is actively seeking affiliation with private practices throughout the region.

UNC Health Care formed TPN in November 2009. As a relatively new entity, TPN did not have the financial capacity to pay for assessments or Shared Administrative Services to the System Fund during the fiscal year but received \$11,370,311 in program support during the year ended June 30, 2011 to fund start-up expenses including substantial information technology costs, administrative functions and a central billing office.

## NOTES TO THE FINANCIAL STATEMENTS (CONCLUDED)

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**Piedmont Health Services, Inc.** - Piedmont Health Services, Inc. (PHS) is a North Carolina non-profit corporation with six locations serving fourteen counties in the Piedmont region. To further its mission of promoting the health of North Carolinians, UNC Health Care contractually agreed to fund the development of a coordinated system of clinical care intended to increase access to care for the uninsured. The System Fund contributed \$750,000 to PHS for this program during the year ended June 30, 2011.



**Beth A. Wood, CPA**  
State Auditor

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**INDEPENDENT AUDITOR'S REPORT  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS**

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Board of Directors  
University of North Carolina Health Care System  
Chapel Hill, North Carolina

We have audited the basic financial statements of the University of North Carolina Health Care System Enterprise and Related Funds (System Fund), a part of the University of North Carolina Health Care System, which is a part of the multi-campus University of North Carolina System, a component unit of the State of North Carolina, as of and for the year ended June 30, 2011, and have issued our report thereon dated February 15, 2012.

As discussed in Note 1, the financial statements present only the University of North Carolina Health Care System Enterprise and Related Funds (System Fund) and are not intended to present fairly the financial position of the University of North Carolina Health Care System nor the University of North Carolina System, and the results of its operations and cash flows in conformity with accounting principles generally accepted in the United States of America.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System Fund's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System Fund's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System Fund's internal control over financial reporting.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the System Fund's financial statements will not be prevented, or detected and corrected on a timely basis.

**INDEPENDENT AUDITOR'S REPORT  
ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN  
AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH  
GOVERNMENT AUDITING STANDARDS (CONCLUDED)**


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Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System Fund's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of management of the System Fund, the Board of Governors, the Board of Directors of the University of North Carolina Health Care System, the Audit and Compliance Committee, others within the entity, the Governor, the General Assembly, and the State Controller, and is not intended to be and should not be used by anyone other than these specified parties.



Beth A. Wood, CPA  
State Auditor

February 15, 2012

## **ORDERING INFORMATION**

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Audit reports issued by the Office of the State Auditor can be obtained from the web site at [www.ncauditor.net](http://www.ncauditor.net). Also, parties may register on the web site to receive automatic email notification whenever reports of interest are issued. Otherwise, copies of audit reports may be obtained by contacting the:

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