STATE OF
NORTH CAROLINA

FINANCIAL STATEMENT AUDIT REPORT OF

UNIVERSITY OF NORTH CAROLINA HOSPITALS

CHAPEL HILL, NORTH CAROLINA

FOR THE YEARS ENDED JUNE 30, 2004 AND 2003

OFFICE OF THE STATE AUDITOR

LESLIE W. MERRITT, JR., CPA, CFP

STATE AUDITOR

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STATE OF NORTH CAROLINA
Office of the State Auditor

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AUDITOR'S TRANSMITTAL

The Honorable Michael F. Easley, Governor
The General Assembly of North Carolina
Board of Directors, The University of North Carolina Health Care System

This report presents the results of our financial statement audits of the University of North Carolina Hospitals, which is a part of The University of North Carolina Health Care System, which is a part of The University of North Carolina System, a component unit of the State of North Carolina, for the years ended June 30, 2004 and 2003. Our audits were made by authority of Article 5A of Chapter 147 of the *North Carolina General Statutes*.

The accounts and operations of the Hospitals are an integral part of the State's reporting entity represented in the State's *Comprehensive Annual Financial Report* (CAFR) and the State's *Single Audit Report*. In those reports, the State Auditor expresses an opinion on the State's financial statements. In the *Single Audit Report*, the State Auditor also presents the audit results on the State's internal controls and on the State's compliance with laws, regulations, contracts, and grants applicable to the State's financial statements and to its federal financial assistance programs.

As part of the audit work necessary for the CAFR and the *Single Audit Report*, the accounts and operations of the Hospitals were subjected to audit procedures as we considered necessary. In addition, we performed auditing procedures that we considered necessary for us to report on the accompanying financial statements that relate solely to the University of North Carolina Hospitals. The audit procedures were conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

The purpose of this report is to present the results of our audits on the accompanying financial statements that relate solely to the University of North Carolina Hospitals. A summary of our reporting objectives and audit results is:

1. **Objective –** To express an opinion on the accompanying financial statements that relate solely to the University of North Carolina Hospitals.

   Results - The accompanying financial statements present fairly, in all material respects, the amounts and disclosures made in accordance with accounting principles generally accepted in the United States of America. These matters are more fully described in the Independent Auditor's Report on the Financial Statements.

2. **Objective –** To present significant deficiencies, if any, in internal control over financial reporting which could adversely affect the Hospitals' ability to record, process, summarize, and report financial data in the financial statements and present instances of noncompliance, if any, with laws, regulations, contracts, or grants.

   Results - Our tests disclosed no material weaknesses in internal control over financial reporting and no instances of noncompliance which require disclosure herein under *Government Auditing Standards*. These matters are more fully described in the Independent Auditor's Report on Internal Control over Financial Reporting and on Compliance and Other Matters.

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.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

TABLE OF CONTENTS

PAGE

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INDEPENDENT AUDITOR'S REPORT

Board of Directors
The 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 Hospitals, which is a part of The University of North Carolina Health Care System, which is a part of The University of North Carolina System, a component unit of the State of North Carolina, as of and for the years ended June 30, 2004 and 2003, as listed in the table of contents. These financial statements are the responsibility of the Hospitals' management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States 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 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.

As discussed in Note 1, the financial statements present only the University of North Carolina Hospitals and are not intended to present fairly the financial position of The University of North Carolina Health Care System and the results of its operations and cash flows in conformity with auditing standards 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 Hospitals as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15 to the financial statements, the Hospitals implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units,* during the year ended June 30, 2004.

INDEPENDENT AUDITOR'S REPORT (CONCLUDED)

In accordance with *Government Auditing Standards*, we have also issued our report dated November 18, 2004 on our consideration of the Hospitals' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and 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 audits.

The Management's Discussion and Analysis (MD&A), 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.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

November 18, 2004

Introduction

The following discussion and analysis is provided by the University of North Carolina Hospitals' financial management as an overview to assist the reader in interpreting and understanding the accompanying basic financial statements. It includes comparative financial analysis with discussion of significant changes between fiscal years 2004 and 2003, 2003 and 2002, as well as, pertinent facts, decisions, and conditions.

Using the Financial Statements

The financial statements of the Hospitals provide information regarding its financial position and results of operations as of the report date. The Statements of Net Assets; the Statements of Revenues, Expenses, and Changes in Net Assets; and the Statements of Cash Flows comprise the basic financial statements required by the Governmental Accounting Standards Board (GASB). In accordance with the GASB, the financial statements are presented and follow reporting concepts consistent with those required of a private business enterprise. The financial statement balances reported are presented in a classified format to aid the reader in understanding the nature of the financial statement balance. The Notes to the Financial Statements are an integral part of and should be read in conjunction with the financial statements.

The Statements of Net Assets provide information relative to the Hospitals' 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 are anticipated to 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 invested in capital assets (net of related debt), restricted or unrestricted. Restricted net assets are categorized as expendable for the purposes noted. Overall, the Statements of Net Assets provide information relative to the financial strength of the Hospitals and its ability to meet current and long-term obligations.

The Statements of Revenues, Expenses, and Changes in Net Assets provide information relative to the results of the Hospitals' operations, nonoperating activities, and other activities affecting net assets, which occurred during the fiscal year. Nonoperating activities include subsidies from the State in the form of appropriations, noncapital gifts and grants, as well as interest expense on financing activities, investment income (net of investment expenses) and loss realized on the disposition of capital assets. Other activities include change in fair value of investments and gain or loss on affiliate activity. Overall, the Statements of Revenues, Expenses, and Changes in Net Assets provide information relative to the Hospitals' management of its operations and its ability to maintain its financial strength.

The Statements of Cash Flows provide information relative to the Hospitals' sources and uses of cash for operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The statements provide a reconciliation of beginning cash balances to ending cash balances and are representative of the activity reported on the Statements of Revenues, Expenses, and Changes in Net Assets as adjusted for changes in the beginning and ending balances of noncash accounts on the Statements of Net Assets.

The Notes to the Financial Statements provide information relative to the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on long-term liabilities, detailed information on accounts receivable, accounts payable, revenues and expenses, required information on pension plans and other postemployment benefits, insurance against losses, commitments and contingencies, accounting changes, and a discussion of adjustments to prior periods and events subsequent to the Hospitals' financial statement period when appropriate. Overall, these disclosures provide information to better understand details, risk, and uncertainty associated with amounts reported in the financial statements.

Comparison of Two-Year Data for 2004 to 2003 and 2003 to 2002

Comparative financial data of 2004 to 2003 is summarized in Table 1. Comparative financial data of 2003 to 2002 is summarized in Table 2. Additional comparative data can be found in the financial statements. Discussion of comparative data is included in the following section.

Analysis of Overall Financial Position and Results of Operations

Fiscal Year 2004 Statements of Net Assets

Overall assets decreased slightly by $7 million or 0.7% from the prior year. Within the current assets category, cash and cash equivalents decreased by $22.8 million due to ongoing relocation and renovation of space vacated with the opening of the Women's and Children's Hospitals, the renovation of the administrative office building at Meadowmont as well as normal capital replacement. Current patient accounts receivable – net increased by $10 million as a result of a rate increase implemented during the fiscal year and additional patient activity.

Liabilities decreased overall by $12.1 million as debts to vendors and bondholders were paid down. $4.8 million of this decrease is attributable to the reduction in liabilities related to accrued salaries and benefits as compared to the prior year.

Fiscal Year 2003 Statements of Net Assets

Current assets decreased by $5.0 million or 2.2% from the prior year. In contrast, noncurrent assets increased by $34.5 million or 4.6%. Current cash and investments decreased by $25.9 million due to construction or acquisition of noncurrent capital assets such as the new administrative office building in Meadowmont, the Wellness Center, ongoing relocation and renovation of space vacated with the opening of the Women's and Children's Hospitals as well as normal capital replacement. Current patient accounts receivable – net increased by $14.3 million as a result of a rate increase implemented during the fiscal year, blending

Carolina Dialysis' accounts receivable with the Hospitals and additional patient activity. Estimated third party settlements also increased by $3.3 million for a receivable related to the Champus program for Federal employees.

Both current and noncurrent liabilities decreased from the prior year as debts to vendors and bondholders were paid down. There was an increase in liabilities related to employee salaries and accumulated leave balances. This increase was the result of salary increases, an increase in the overall number of paid full time employee equivalents and an increase in the number of leave hours accumulated.

FY2004 Statements of Revenues, Expenses, and Changes in Net Assets

The Statements of Revenues, Expenses, and Changes in Net Assets reflect an operating loss of $36.2 million before net nonoperating revenues. However, this translates into $1.6 million of income after taking the State appropriation of $37.8 million into account and an additional $3.5 million in nonoperating revenue, primarily from investment income, for a total increase in net assets of $5.1 million.

Net patient service revenue continues to be strong as evidenced by a 9.9% increase over the prior year in spite of an ongoing deterioration in reimbursement. The increase in revenue is a function of increases in both price and volume. During the past year, the Hospitals implemented an average rate increase of 8.6% to gross charges. Inpatient days of care, discharges and outpatient visits all increased by approximately 5%.

Total operating expenses increased by 7%. Salaries and benefits comprised 57% of the total operating expenses for FY2004 and increased by 5.8% over the prior year. The second largest component of operating expenses, medical and surgical supplies, represented 18% of the total operating expenses and experienced an increase of 13% over the prior year. The largest categorical increase in expense was in depreciation. Depreciation expense was under budget for the year but increased by 18.9% over the amount recognized in FY2003. This increase is attributed to the additional capital placed into service during the year as well as adjustments to depreciation recognized to correct life to date expense.

FY2003 Statements of Revenues, Expenses, and Changes in Net Assets

The Statements of Revenues, Expenses, and Changes in Net Assets reflect an operating loss before net nonoperating revenues. While there was a $1.3 million reduction from the prior year level of State appropriation, investment activity net of all debt-related interest and fees continues to offset the loss from operations. Interest expenses rose for the current year, because $4.6 million of interest payments were capitalized as a part of the construction project in the prior year.

Net patient service revenue continues to be strong as evidenced by its 7.1% increase over the prior year. During 2003, the Hospitals implemented an average rate increase of 5.3% to gross charges and inpatient days increased by approximately 5% with an overall occupancy percentage of 83.2%. Outpatient volume remained constant with over a million visits.

Total operating expenses increased by 10.2%. Salaries and benefits comprised 57.8% of the total operating expenses for FY03 and increased by 9.7% over the prior year. The factors driving this increase were a performance-based increase of 4% and the Hospitals' dependence on contract staffing to supplement medical professionals where there was a shortage in the labor market. The second largest component of operating expenses, medical and surgical supplies, represented 17% of the total operating expenses and experienced an increase of 5.1% over the prior year due to growth in patient service volume, inflation and also from recognizing 100% of this category of expense from Carolina Dialysis. Medical malpractice costs showed the largest percentage increase over the prior year and depreciation increased due to a full year's depreciation for the Women's and Children's Hospitals.

FY2004 Analysis of Net Asset Balances

At June 30, 2004, net assets invested in capital assets, net of related debt, totaled $176,261,291 representing the gross value of plant assets ($580,160,548) plus bond issuance costs ($1,607,851) less accumulated depreciation ($219,606,766) and related debt ($185,900,342). Restricted expendable net assets totaled $67,861,682 representing amounts subject to externally imposed restrictions. Unrestricted net assets totaled $383,144,305 representing amounts not subject to externally imposed stipulations but internally designated for various activities and initiatives, as well as future construction projects.

FY2003 Analysis of Net Asset Balances

Net assets invested in capital assets, net of related debt, totaled $183,525,184 representing the gross value of plant assets ($560,487,950) plus bond issuance costs ($1,693,958) less accumulated depreciation ($197,869,505) and related debt ($180,787,219). Restricted expendable net assets totaled $59,734,267 representing amounts subject to externally imposed restrictions. Unrestricted net assets totaled $378,898,573 representing amounts not subject to externally imposed stipulations but internally designated for various activities and initiatives, as well as future construction projects.

Discussion of Capital Asset and Long-Term Debt Activity

FY2004 Capital Assets

The Hospitals continued to improve and modernize its facilities during FY2004. Current projects underway include the renovation of the central Administrative Office Building, the renovation of Seventh Floor Rehabilitation space, the replacement of the Patient Kitchen and additional renovation of inpatient care space vacated with the opening of the Women's and Children's Hospitals. As of June 30, 2004, the Hospitals had $18,440,989 remaining in the 2001 Construction Fund for these and other projects.

The Hospitals expended $32,582,050 during the year for the construction of buildings/infrastructure, the renovation or repair of its facilities, and the purchase of new or replacement equipment.

At June 30, 2004, outstanding commitments on construction contracts were $5,413,349 while outstanding commitments related to capital purchase orders for fixed and movable equipment totaled $15,043,988.

Looking to the future, considerable progress has been made on projects in planning. On August 5th, 2004, House Bill 1264 of the 2004 North Carolina Legislative Session was ratified and authorizes the State to issue special indebtedness of up to $180,000,000 in principal for acquiring, constructing, and equipping a new cancer rehabilitation and treatment center, a nearby physicians' office building, and a walkway between the two. These facilities will be located at the University of North Carolina Hospitals at Chapel Hill.

FY2003 Capital Assets

The Hospitals expended $51,983,311 during FY2003 for the construction of new buildings/infrastructure, the renovation or repair of its facilities, and the purchase of new or replacement equipment.

Bond funds were used for the following renovation projects, which were still in progress as of June 30, 2003: the renovation of the central Administrative Office Building, the renovation of the Seventh Floor Rehabilitation space, the replacement of the Patient Kitchen and additional renovation of inpatient care space vacated with the opening of the Women's and Children's Hospitals.

Additionally, the Hospitals opened its Wellness Center at Meadowmont in November 2002, with funding provided from its accumulated reserves.

Outstanding commitments on construction contracts were $9,593,198 on June 30, 2003.

FY2004 Long-Term Debt Activities

At June 30, 2004, the Hospitals had outstanding bond indebtedness in the amount of $293,145,000 of which $5,615,000 is due within the next year. During the past year, Standard and Poor's Ratings Services reduced the Hospitals' rating to AA- from AA.

FY2003 Long-Term Debt Activities

The Hospitals' 2003 Revenue Bonds received a rating of A1/VMIGI from Moody's Investors Service, Inc. and a rating of AA/A-1+ (Series 2003A) and AA/A-1 (Series 2003B) from Standard and Poor's Ratings Services. No additional bonds have been issued since the 2003 Bonds.

At June 30, 2003, the Hospitals had outstanding bond indebtedness in the amount of $298,690,000 of which $5,545,000 was due within the next twelve months.

Discussion of Conditions that may have a Significant Effect on Net Assets or Revenues, Expenses, and Changes in Net Assets

The major source of funding for the Hospitals is the revenue it generates from patient care services. While rates are adjusted annually, overall reimbursement has continued to deteriorate due to payer reimbursement rates and payer mix which has required management to focus on further reductions in expense to improve the Hospitals' financial results.

An analysis of the overall results for FY2004 would be incomplete without noting that the percentage of expenses funded by appropriations from the State of North Carolina has been virtually the same for the 2003 and 2004 fiscal years while expenses continue to rise due to increases in volume and inflation. More aggressive cost reduction efforts were begun in FY2004 as a direct result of changes in management and will continue in FY2005 in response to these economic conditions.

Summary of Condensed Financial Statements Totals **Table 1**

	FY04	FY03	Change
STATEMENTS OF NET ASSETS			
Current Assets	$ 206,793,633	$ 212,820,533	$ (6,026,900)
Capital Assets, Net	360,553,782	362,618,445	(2,064,663)
Other Noncurrent Assets	422,322,026	421,222,575	1,099,451
TOTAL ASSETS	**989,669,441**	**996,661,553**	**(6,992,112)**
Current Liabilities	70,706,288	68,087,826	2,618,462
Noncurrent Liabilities	291,695,875	306,415,703	(14,719,828)
TOTAL LIABILITIES	**362,402,163**	**374,503,529**	**(12,101,366)**
Invested in Capital Assets, Net of Related Debt	176,261,291	183,525,184	(7,263,893)
Restricted for Expendable Uses	67,861,682	59,734,267	8,127,415
Unrestricted	383,144,305	378,898,573	4,245,732
TOTAL NET ASSETS	**$ 627,267,278**	**$ 622,158,024**	**$ 5,109,254**
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS			
Net Patient Service Revenue	$ 536,334,520	$ 488,060,051	$ 48,274,469
Other Operating Revenues	13,936,265	16,259,958	(2,323,693)
TOTAL OPERATING REVENUES	**550,270,785**	**504,320,009**	**45,950,776**
Salaries and Benefits	335,100,889	316,587,610	18,513,279
Medical and Surgical Supplies	105,255,835	93,135,775	12,120,060
Other Operating Expenses	146,096,543	138,323,791	7,772,752
TOTAL OPERATING EXPENSES	**586,453,267**	**548,047,176**	**38,406,091**
OPERATING LOSS	**(36,182,482)**	**(43,727,167)**	**7,544,685**
State Appropriations	37,787,880	37,770,647	17,233
Investment Activity	15,448,627	51,902,899	(36,454,272)
Other Nonoperating Revenues	142,082	2,158,521	(2,016,439)
Nonoperating Expenses	(12,086,853)	(12,536,368)	449,515
NET NONOPERATING REVENUES	**41,291,736**	**79,295,699**	**(38,003,963)**
INCREASE IN NET ASSETS	**5,109,254**	**35,568,532**	**(30,459,278)**
NET ASSETS - BEGINNING OF YEAR, AS RESTATED	**622,158,024**	**586,589,492**	**35,568,532**
NET ASSETS - END OF YEAR	**$ 627,267,278**	**$ 622,158,024**	**$ 5,109,254**

Summary of Condensed Financial Statements Totals **Table 2**

	FY03	FY02	Change
STATEMENTS OF NET ASSETS			
Current Assets	$ 212,820,533	$ 217,785,107	$ (4,964,574)
Capital Assets, Net	362,618,445	341,009,244	21,609,201
Other Noncurrent Assets	421,222,575	408,335,402	12,887,173
TOTAL ASSETS	**996,661,553**	**967,129,753**	**29,531,800**
Current Liabilities	68,087,826	71,741,003	(3,653,177)
Noncurrent Liabilities	306,415,703	308,799,258	(2,383,555)
TOTAL LIABILITIES	**374,503,529**	**380,540,261**	**(6,036,732)**
Invested in Capital Assets, Net of Related Debt	183,525,184	179,481,715	4,043,469
Restricted for Expendable Uses	59,734,267	54,629,969	5,104,298
Unrestricted	378,898,573	352,477,808	26,420,765
TOTAL NET ASSETS	**$ 622,158,024**	**$ 586,589,492**	**$ 35,568,532**
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS			
Net Patient Service Revenue	$ 488,060,051	$ 455,857,171	$ 32,202,880
Other Operating Revenues	16,259,958	10,165,933	6,094,025
TOTAL OPERATING REVENUES	**504,320,009**	**466,023,104**	**38,296,905**
Salaries and Benefits	316,587,610	288,629,005	27,958,605
Medical and Surgical Supplies	93,135,775	88,582,472	4,553,303
Other Operating Expenses	138,323,791	120,169,848	18,153,943
TOTAL OPERATING EXPENSES	**548,047,176**	**497,381,325**	**50,665,851**
OPERATING LOSS	**(43,727,167)**	**(31,358,221)**	**(12,368,946)**
State Appropriations	37,770,647	39,092,359	(1,321,712)
Investment Activity	51,902,899	39,803,697	12,099,202
Other Nonoperating Revenues	2,158,521	1,654,989	503,532
Nonoperating Expenses	(12,536,368)	(10,151,810)	(2,384,558)
NET NONOPERATING REVENUES	**79,295,699**	**70,399,235**	**8,896,464**
INCREASE IN NET ASSETS	**35,568,532**	**39,041,014**	**(3,472,482)**
NET ASSETS - BEGINNING OF YEAR, AS RESTATED	**586,589,492**	**550,665,845**	**35,923,647**
Prior year adjustment		(3,117,367)	3,117,367
NET ASSETS - END OF YEAR	**$ 622,158,024**	**$ 586,589,492**	**$ 35,568,532**

UNIVERSITY OF NORTH CAROLINA HOSPITALS
STATEMENTS OF NET ASSETS
JUNE 30, 2004 AND 2003

Exhibit A-1

		2004		2003
ASSETS				
Current Assets:				
Cash and Cash Equivalents (Note 2)	$	42,233,581	$	65,047,580
Restricted Cash and Cash Equivalents (Note 2)		4,228,348		3,104,394
Patient Accounts Receivable, Net (Note 3)		115,376,511		105,398,598
Accrued Interest Receivable - Bonds		1,011,717		1,356,552
Restricted Accrued Interest Receivable -Trust Funds		63,543		123,337
Estimated Third Party Settlements (Note 4)		7,000,100		4,269,966
Inventories		14,221,729		13,769,842
Notes Receivable				127,000
Other Accounts Receivable		20,474,845		17,429,769
Prepaid Expenses		2,183,259		2,193,495
Total Current Assets		206,793,633		212,820,533
Noncurrent Assets:				
Cash and Cash Equivalents (Note 2)		325,869,999		319,736,429
Restricted Cash and Cash Equivalents (Note 2)		89,766,214		97,149,755
Advance Deposits with Liability Insurance Trust Fund		1,543,962		100,000
Patient Accounts Receivable, Net (Note 3)		1,019,319		316,935
Bond Issuance Costs, Net		1,938,565		2,037,106
Start-Up Costs, Net		595,765		613,627
Investments in Affiliates (Note 14)		1,588,202		1,268,723
Capital Assets - Nondepreciable (Note 5)		41,390,095		40,422,792
Capital Assets - Depreciable, Net (Note 5)		319,163,687		322,195,653
Total Noncurrent Assets		782,875,808		783,841,020
Total Assets		989,669,441		996,661,553

UNIVERSITY OF NORTH CAROLINA HOSPITALS
STATEMENTS OF NET ASSETS *Exhibit A-1*
JUNE 30, 2004 AND 2003 *Page 2*

	2004	2003
LIABILITIES		
Current Liabilities:		
Accounts Payable - Operating	11,509,418	14,389,211
Accounts Payable - Capital	2,549,614	3,657,352
Accrued Salaries and Benefits	12,845,089	17,692,171
Estimated Third Party Settlements (Note 4)	19,184,925	8,694,659
Due to Patients or Third Parties	7,308,164	9,388,160
Bond Interest Payable	1,842,110	1,902,973
Notes Payable	2,328,601	2,489,473
Capital Leases Payable	170,057	235,614
Bonds Payable (Note 6)	5,615,000	5,545,000
Compensated Absences	3,631,830	3,461,029
Funds Held for Others	3,721,480	632,184
Total Current Liabilities	70,706,288	68,087,826
Noncurrent Liabilities:		
Notes Payable		2,319,895
Capital Leases Payable		166,760
Bonds Payable, Net (Note 6)	270,043,972	274,929,048
Arbitrage Rebate Payable	3,703,029	3,215,797
Compensated Absences	13,236,864	12,169,329
Estimated Third Party Settlements (Note 4)	4,712,010	13,614,874
Total Noncurrent Liabilities	291,695,875	306,415,703
Total Liabilities	362,402,163	374,503,529
NET ASSETS		
Invested in Capital Assets, Net of Related Debt	176,261,291	183,525,184
Restricted for Expendable Uses for:		
Bond Covenants	65,886,599	59,247,775
Liability Insurance Trust Fund	1,543,962	100,000
Trust Fund Donations	431,121	386,492
Unrestricted	383,144,305	378,898,573
Total Net Assets	$ $627,267,278	$ $622,158,024

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

UNIVERSITY OF NORTH CAROLINA HOSPITALS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND 2003

Exhibit A-2

	2004	2003
REVENUES		
Operating Revenues:		
Net Patient Service Revenue (Note 8)	$ 536,334,520	$ 488,060,051
Other Operating Revenue	14,714,959	10,146,999
Prior Year Third Party Settlements	(778,694)	6,112,959
Total Operating Revenues	550,270,785	504,320,009
EXPENSES		
Operating Expenses:		
Salaries and Benefits	335,100,889	316,587,610
Medical and Surgical Supplies	105,255,835	93,135,775
Contracted Services	59,294,870	57,747,796
Other Supplies and Services	32,659,152	32,130,123
Communications, Utilities and Travel	12,511,562	13,393,562
Medical Malpractice Costs	6,542,794	5,543,292
Depreciation and Amortization	35,088,165	29,509,018
Total Operating Expenses	586,453,267	548,047,176
Operating Loss	(36,182,482)	(43,727,167)
NONOPERATING REVENUES (EXPENSES)		
State Appropriations	37,787,880	37,770,647
Noncapital Unrestricted Gifts and Grants	139,816	2,056,685
Noncapital Restricted Gifts and Grants	2,266	86,635
Investment Activity		
Investment Income	14,770,639	23,835,063
Net Increase in Fair Value of Investments	2,791,438	24,801,044
Gain (Loss) on Investments in Affiliates	(867,074)	3,417,724
Minority Interest - LLC	(1,246,376)	(150,932)
Interest and Fees on Debt	(11,104,211)	(11,439,567)
Restricted Interest Income	(169)	15,201
Loss on Disposal of Capital Assets	(982,473)	(1,096,801)
Net Nonoperating Revenues	41,291,736	79,295,699
Increase in Net Assets	5,109,254	35,568,532
NET ASSETS		
Net Assets - Beginning of Year, as Restated (Note 16)	622,158,024	586,589,492
Net Assets - End of Year	$ 627,267,278	$ 622,158,024

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

UNIVERSITY OF NORTH CAROLINA HOSPITALS
STATEMENTS OF CASH FLOWS
FOR THE FISCAL YEARS ENDED JUNE 30, 2004 AND 2003 *Exhibit A-3*

		2004		2003
CASH FLOWS FROM OPERATING ACTIVITIES				
Received from Patients and Third Parties	$	525,723,644	$	481,188,231
Payments to Employees and Fringe Benefits		(342,370,051)		(311,444,192)
Payments to Vendors and Suppliers		(217,088,283)		(200,870,528)
Payments for Medical Malpractice		(7,986,756)		(1,336,289)
Other Receipts		17,353,042		5,239,100
Net Cash Used by Operating Activities		(24,368,404)		(27,223,678)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES				
State Appropriations		37,787,880		37,770,647
Interest and Fees Paid on Revenue Bonds		(918,678)		(1,216,572)
Principal Paid on Revenue Bonds		(680,000)		(680,000)
Noncapital Gifts and Grants		142,082		2,143,320
Net Cash Provided by Noncapital Financing Activities		36,331,284		38,017,395
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES				
Proceeds from Sale of Capital Assets		18,004		422,471
Issuance Costs Paid				(234,009)
Principal Paid on Capital Revenue Bonds		(4,865,000)		(4,160,000)
Interest and Fees Paid on Capital Debt		(11,353,828)		(11,230,313)
Proceeds from Refunding Bonds for Issuance Costs				282,247
Principal Paid on Capital Leases and Notes Payable		(2,713,084)		(1,965,103)
Acquisition and Construction of Capital Assets		(32,582,050)		(51,983,311)
Net Cash Used by Capital Financing and Related Financing Activities		(51,495,958)		(68,868,018)
CASH FLOWS FROM INVESTING ACTIVITIES				
Proceeds from Sales and Maturities of Investments		2,791,438		436,447,359
Investment Income		15,662,331		15,358,924
Investments In and Loans to Affiliated Enterprises:				
Cash Received		737,761		3,786,770
Cash Payments		(2,598,468)		(455,744)
Net Cash Provided by Investing Activities		16,593,062		455,137,309
Net Increase (Decrease) in Cash and Cash Equivalents		(22,940,016)		397,063,008
Cash and Cash Equivalents, Beginning		485,038,158		87,975,150
Cash and Cash Equivalents, Ending	$	462,098,142	$	485,038,158

UNIVERSITY OF NORTH CAROLINA HOSPITALS
STATEMENTS OF CASH FLOWS — ***Exhibit A-3***
FOR THE YEARS ENDED JUNE 30, 2004 AND 2003 — ***Page 2***

		2004		2003
RECONCILIATION OF NET OPERATING REVENUES (EXPENSES) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:				
Operating Loss	$	(36,182,482)	$	(43,727,167)
Adjustments to Reconcile Operating (Loss) to Net Cash Provided (Used) by Operating Activities:				
Depreciation and Amortization Expense		35,088,165		29,509,018
Changes in Assets and Liabilities:				
Patient Accounts Receivable		(11,370,934)		(13,594,096)
Other Accounts Receivable		2,599,343		(4,907,899)
Estimated Third Party Settlements		(2,730,134)		(3,346,335)
Inventories		(451,887)		(595,779)
Prepaid Expenses		10,236		(329,385)
Advance Deposits with Liability Insurance Trust Fund		(1,443,962)		4,207,003
Accrued Salaries and Benefits		(4,847,082)		3,472,468
Accounts and Other Payables		(8,813,842)		(3,538,108)
Due to Patients or Third Parties		(553,457)		4,025,191
Funds Held for Others		3,089,296		(69,539)
Compensated Absences		1,238,336		1,670,950
Net Cash Used by Operating Activities	$	(24,368,404)	$	(27,223,678)
RECONCILIATION OF CASH AND CASH EQUIVALENTS				
Current Assets:				
Cash and Cash Equivalents	$	42,233,581	$	65,047,580
Restricted Cash and Cash Equivalents		4,228,348		3,104,394
Noncurrent Assets:				
Cash and Cash Equivalents		325,869,999		319,736,429
Restricted Cash and Cash Equivalents		89,766,214		97,149,755
Total Cash and Cash equivalents - End of Year	$	462,098,142	$	485,038,158
NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES:				
Investments in Affiliated Enterprises:				
Current Gain (Loss) from Discontinued Affiliated Operations	$	(1,215,215)	$	3,003,123
Current Gain (Loss) from Equity Method Adjustments		(898,235)		263,669
Assets Acquired through the Assumption of a Liability				2,944,527
Bonds Issued to Partially Refund Series 1996 Bonds				98,015,000
Payment to Refunded Bond Escrow Agent				97,496,593

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

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NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES:

A. Organization - The University of North Carolina Hospitals (the Hospitals) is the only State-owned teaching hospital in North Carolina. With a licensed base of 688 beds, this facility serves as an acute care teaching hospital for The University of North Carolina at Chapel Hill. The Hospitals consists of North Carolina Memorial Hospital, North Carolina Children's Hospital, North Carolina Neurosciences Hospital, and North Carolina Women's Hospital. As a State agency, the Hospitals is required to conform to financial requirements established by various statutory and constitutional provisions. While the Hospitals is exempt from both federal and State income taxes, a small portion of its revenue is subject to the unrelated business income tax.

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, 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 Hospitals is a part of the University of North Carolina (UNC) Health Care System which is a part of the 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 of North Carolina's *Comprehensive Annual Financial Report*.

The accompanying financial statements present all funds belonging to the Hospitals for which the UNC Health Care System Board of Directors is responsible. The Hospitals' component units are blended in the Hospitals' financial statements. The blended component units, although legally separate, are, in substance, part of the Hospitals' operations and therefore, are reported as if they were part of the Hospitals.

Blended Component Units – Although legally separate, Health System Properties, LLC (the LLC) and Carolina Dialysis, LLC, (the CDLLC), component units of the Hospitals, are reported as if they were part of the Hospitals.

The LLC was established to purchase, develop and/or lease real property. The LLC is reported as part of the Hospitals because the UNC Health Care System is the sole member manager and the LLC is governed by the same Board that directs the Hospitals' operations. Additionally, the only property owned to date by the LLC in the Meadowmont Complex is for the sole use and benefit of the Hospitals.

The Hospitals has a two-third ownership interest in the CDLLC. Renal Research Institute owns the remaining one-third interest. A Board of Managers comprised of six members manages the CDLLC, with four appointed by the Hospitals through the Chief Executive Officer and two appointed by Renal Research Institute. The CDLLC was formed for the purposes of owning and operating chronic dialysis programs, thus improving the quality of care to end-stage renal disease patients by providing dialysis services and conducting research in the field of nephrology in the State of North Carolina. The CDLLC is included as part of the Hospitals because of the nature and significance of the relationship of the CDLLC with the Hospitals. Because the CDLLC provides services almost entirely to the Hospitals' patients, its financial statements have been blended with those of the Hospitals.

Separate financial statements for the LLC and CDLLC may be obtained from the Chief Financial Officer, University of North Carolina Hospitals, 6011 East Wing, 101 Manning Drive, Chapel Hill, North Carolina 27514, or by calling (919) 966-1727. Other related foundations and similar nonprofit corporations for which the Hospitals is not financially accountable are not part of the accompanying financial statements.

C. Basis of Presentation - The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America 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* and as amended by GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, the full scope of the Hospitals' activities is considered to be a single business-type activity (BTA) and accordingly, is reported within a single column in the basic financial statements.

In accordance with GASB Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities That Use Proprietary Fund Accounting*, the Hospitals has elected to apply the provisions of all applicable GASB pronouncements as well as the following pronouncements issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements: Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board (APB) Opinions, and Accounting Research Bulletins (ARBs).

D. Basis of Accounting - The financial statements of the Hospitals 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.

Nonexchange transactions, in which the Hospitals receives (or gives) value without directly giving (or receiving) equal value in exchange includes State appropriations, certain grants, and donations. Revenues are recognized, net of estimated uncollectible amounts, as soon as all eligibility requirements imposed by the provider have been met, if probable of collection.

E. Cash and Cash Equivalents - This classification includes petty cash, security deposits, cash on deposit in private bank accounts, and deposits held by the State Treasurer in the short-term investment portfolio. The short-term investment portfolio 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. Patient Accounts Receivable - The Hospitals' patient accounts receivable consists of unbilled (in house patients, inpatients discharged but not final billed and outpatients not final billed) and billed amounts. Payment of these charges comes primarily from Managed Care payers, Medicare, Medicaid and, to a lesser extent, the patient. These amounts are recorded in the financial statements net of indigent care, contractual allowances and allowances for bad debt to determine the net realizable value of the accounts receivable balance. See the section Net Patient Service Revenue later in the Significant Accounting Policies for a further discussion of these reductions.

The reserves recorded for these deductions are used to determine net patient accounts receivable and are calculated based on the historical collection percentage realized for each payer. The collection rates are updated monthly in order to reflect the most up to date information available.

The Hospitals has established flexible payment arrangements with selected payers to optimize collection of past-due accounts. Amounts due beyond one year under these arrangements are classified as noncurrent assets.

G. **Other Receivables -** In addition to patient accounts receivable, the Hospitals recognizes other receivables related to its operations. These items include the sales tax refund due from the North Carolina Department of Revenue, amounts due from affiliates and other State agencies, and billings to outside companies for ancillary testing.

H. **Inventories -** Inventories consist of medical and surgical supplies, pharmaceuticals, prosthetics, and other supplies that are used to provide patient care or by service departments within the Hospitals. Inventories are stated at FIFO (first-in, first-out) cost.

I. **Capital Assets -** Capital assets are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred are capitalized during the period of construction.

The Hospitals capitalizes assets having a cost or fair value of at least $5,000 at the date of acquisition and an estimated useful life of three years or more. Useful life estimates are assigned based upon the American Hospital Association publication *Estimated Useful Lives of Depreciable Hospital Assets*.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally 3 to 20 years for equipment, 10 to 50 years for buildings and fixed equipment, and 5 to 25 years for general infrastructure.

J. **Restricted Assets -** Unexpended proceeds of revenue bonds and unexpended capital contributions are classified as restricted assets because their use is limited by applicable bond covenants or donor/grantor agreements. Certain other assets are classified as restricted because their use is limited by external parties or statute.

K. **Bonds Payable –** Bonds payable are reported net of unamortized discount and deferred losses on refundings. The Hospitals amortizes bond discounts over the life of the bonds using the effective interest method. The deferred losses on refundings are amortized over the life of the old debt (new debt and old debt payoff at the same time) using the straight-line method. Bond issuance costs are amortized using the straight-line method over the life of the bonds.

L. **Compensated Absences -** The Hospitals' policy is to record the cost of annual leave when earned. Employees earn annual leave at varying rates depending upon years of service and the leave plan in which they participate.

Traditional Plan - The policy provides for a maximum accumulation of unused annual leave of 30 days that can be carried forward beyond the pay period that includes December 31. During the pay period that includes December 31, any excess accumulation over 30 days of annual leave is converted to sick leave. Upon termination of employment, employees are paid for the current balance of annual leave accumulated up to the maximum of 30 days. Employees earn holiday leave at the rate of 11 or 12 days per year with an unlimited accumulation. The Hospitals' policy requires that employees use holiday hours in excess of 40 hours prior to using earned annual leave. At termination, employees are paid for any accumulated holiday leave. Employees earn sick leave at the rate of one day per month with an unlimited accumulation.

Paid Time Off (PTO) Plan - The PTO program combines the various leave types that employees may earn into one earning rate that varies depending upon years of service. This program is mandatory for all new employees, and existing employees may convert to the PTO program at the end of calendar year 2002, 2003, and 2004. This is a voluntary choice, but once they change, employees cannot return to the traditional program. The policy provides for a maximum accumulation of 280 hours of unused PTO time at the last day of the last pay period of the calendar year that includes December 31. At that time, the excess accumulation over 280 hours is converted to catastrophic leave, which is treated similar to sick leave in the Traditional Plan. Upon termination of employment, employees are paid for their current balance in PTO based upon their years of service. Once an employee has more than five years of service, the entire accumulated balance is paid up to 280 hours. The PTO program also has an annual sell back feature that allows employees to sell back 50% of their accumulated hours over a minimum floor. The payout occurs in January each year.

Liability Calculation - The liability for accumulated annual leave, holiday leave, and PTO leave is calculated for each employee at year-end by taking the leave carried forward at the previous December 31 plus the leave earned, less the leave taken between January 1 and June 30. The liability is equal to the accumulated hours multiplied by the employee's current hourly rate plus benefits for social security and State retirement.

The Hospitals has the policy of recording the cost of sick leave when taken and paid rather than when the leave is earned. Employees are not paid for accumulated sick leave upon termination; however, additional service credit for pension benefits is given for accumulated sick leave upon retirement.

When classifying compensated absences into current and noncurrent, leave is considered taken using a last-in, first-out (LIFO) method.

M. Net Assets - The Hospitals' net assets are classified as follows:

Invested in Capital Assets, Net of Related Debt - This represents the Hospitals' total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Restricted Net Assets – Expendable - Expendable restricted net assets include resources for which the Hospitals is legally or contractually obligated to spend the resources in accordance with restrictions imposed by external parties.

Unrestricted Net Assets - Unrestricted net assets include resources derived from patient care and ancillary services, unrestricted gifts and investment income.

Restricted and unrestricted resources are tracked using a fund accounting system and are spent in accordance with established fund authorities. Fund authorities provide rules for the fund activity and are separately established for restricted and unrestricted activities. When both restricted and unrestricted funds are available for expenditure, the decision for funding is transactional based and determined by Hospitals' departmental managers. For projects funded by tax-exempt debt proceeds and other sources, the debt proceeds are always used first.

N. Revenue and Expense Recognition - The Hospitals classifies its revenues and expenses as operating or nonoperating in the accompanying Statements of Revenues, Expenses, and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the Hospitals' principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as charges for inpatient and outpatient services as well as external customers who purchase medical services or supplies. Operating expenses are all expense transactions incurred other than those related to capital and noncapital financing or investing activities as defined by GASB

Statement No. 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities That Use Proprietary Fund Accounting*.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions and State appropriations that represent subsidies or gifts to the Hospitals, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities.

O. Net Patient Service Revenue – Patient service revenue is recorded at the Hospitals' established rates and includes all charges for inpatient accounts discharged after June 30, 2003 (less amounts previously recorded at June 30, 2003 for in-house patients) and all charges on in-house accounts and all charges for outpatient accounts registered after June 30, 2003. The difference between established rates and the estimated amount collectable is recognized as revenue deductions on an accrual basis and deducted from gross patient service revenue to report service revenue at net realizable value. Revenue deductions consist of charges for indigent care, contractual allowances and bad debt.

Indigent care provided represents health care services that were provided free of charge to individuals who meet the criteria of the Hospitals' charity care policy. Indigent care provided is not considered to be revenue to the Hospitals.

Differences between the amounts paid for services under third party reimbursement programs and established rates are accounted for as contractual adjustments. Final determinations of contractual adjustments arising under reimbursement agreements with third party payers are subject to review by appropriate authorities. Retroactively calculated adjustments are recorded as prior year third party settlements in the year in which the adjustments can be reasonably estimated.

P. Medical Malpractice Costs - Medical malpractice costs represent the actuarially determined contribution to the Liability Insurance Trust Fund. See Note 11 for further discussion of the Liability Insurance Trust Fund.

Q. Donated Services - No amounts have been included for donated services since no objective basis is available to measure the value of such services. However, a substantial number of volunteers donated significant amounts of their time to the Hospitals' operations.

NOTE 2 - DEPOSITS

Unless specifically exempt, the Hospitals is required by General Statute 147-77 to deposit moneys received with the State Treasurer or with a depository institution in the name of the State Treasurer. In addition, the University of North Carolina Board of Governors, pursuant to General Statute 116-36.1, requires the Hospitals to deposit its institutional trust funds, except for funds received for services rendered by health care professionals, with the State Treasurer. Although specifically exempted, the Hospitals may voluntarily deposit endowment funds, special funds, revenue bond proceeds, debt service funds, and funds received for services rendered by health care professionals with the State Treasurer. Special funds consist of moneys for agency funds held directly by the Hospitals. Bond proceeds and debt service funds are invested in accordance with the bond resolutions which will by their terms mature on or before the date funds are expected to be required for expenditure or withdrawal.

At June 30, 2004, deposits include cash and cash equivalents totaling $462,080,110. Cash on hand was $18,032. The Hospitals' portion of the State Treasurer's Investment Pool was $460,459,195. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name. The carrying amount of the Hospitals' deposits not with the State Treasurer was $1,620,915 and the bank balance was $2,601,131. Of the bank balance, $257,183 was covered by federal depository insurance and $2,343,948 was uninsured and uncollateralized.

At June 30, 2003, deposits include cash and cash equivalents of $485,020,468. Cash on hand was $17,690. The Hospitals' portion of the State Treasurer's Investment Pool was $484,084,121. It is the State Treasurer's policy and practice for deposits not covered by federal depository insurance to be covered by collateral held by the State of North Carolina's agent in the name of the State and for investments to be held by the State's agent in the State's name. The carrying amount of the Hospitals' deposits not with the State Treasurer was $936,347 and the bank balance was $1,441,680. Of the bank balance, $355,851 was covered by federal depository insurance and $1,085,829 was uninsured and uncollateralized.

North Carolina General Statutes 147-69.1(c), applicable to the State's General Fund and 147-69.2, applicable to institutional trust funds, authorize the State Treasurer to invest in the following: obligations of or fully guaranteed by the United States, obligations of certain federal agencies, repurchase agreements, obligations of the State of North Carolina, time deposits of specified institutions, prime quality commercial paper, and asset-backed securities with specified ratings. Also, General Statute 147-69.1(c) authorizes the following: specified bills of exchange or time drafts and corporate bonds and notes with specified ratings. General Statute 147-69.2 authorizes the following: general obligations of other states, general obligations of North Carolina local governments, and obligations of certain entities with specified ratings.

The financial statements and disclosures for the State Treasurer's Cash and Investment Pool 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.state.nc.us/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

NOTE 3 - PATIENT ACCOUNTS RECEIVABLE - NET

A. Current - Net patient accounts receivable consist of amounts due from patients and third parties at estimated realizable value. Included in gross receivables are amounts receivable at established billing rates less payments received through June 30. Allowances for uncollectible accounts and contractual adjustments are estimated using historical collection statistics and projections of reimbursement. The components of current net Patient Accounts Receivable reflected in the accompanying Statements of Net Assets are as follows at June 30, 2004 and 2003:

	2004	2003
In House Patients	$ 27,334,323	$ 25,176,313
Discharged (not final billed) Patients	24,172,954	19,604,933
Total Unbilled	51,507,277	44,781,246
Discharged Patients	153,514,549	134,300,506
Payment Arrangements	846,549	414,473
Indigent Care Provided	(8,327,186)	(16,778,749)
Current Gross	197,541,189	162,717,476
Allowance for Bad Debts	(9,266,699)	(17,435,665)
Contractual Allowances	(72,897,979)	(39,883,213)
Total Allowances	(82,164,678)	(57,318,878)
Current - Net	$ 115,376,511	$ 105,398,598

B. Noncurrent - Net Patient Accounts Receivable consisted of $1,019,319 and $316,935 as of June 30, 2004 and 2003. Noncurrent amounts represent payment arrangements that extend beyond one year and are based on signed contractual agreements for a specific monthly payment amount.

NOTE 4 - ESTIMATED THIRD PARTY SETTLEMENTS

Assets:

Medicare Pass-through Payments - Medicare makes interim payments to the Hospitals for certain portions of inpatient acute care costs that continue to be reimbursed at cost or adjusted cost under the Prospective Payment System. The Hospitals earned $12,526,658 and $12,492,877 in pass-through payments for 2004 and 2003, including $547,633 earned but not received as of June 30, 2004 and $958,322 as of June 30, 2003.

Reopenings and Adjusted Settlements - Settlements are reviewed regularly for accuracy and completeness based on supporting documentation submitted to the financial intermediary. Several years are currently under review for amounts that have been determined to be due to the Hospitals. It is estimated that Medicare and Medicaid owe the Hospitals $611,603 and $1,306,816, respectively, as of June 30, 2004.

Tricare/Champus DRG-Based Payments - Tricare/Champus is a federal insurance program for eligible active duty and retired military personnel and their dependents. Tricare/Champus makes adjustments to its interim payments to the Hospitals for certain portions of direct medical education and capital costs. These amounts are computed upon completion of the Medicare Cost Report. The Hospitals estimated $4,534,048 in payments earned but not received as of June 30, 2004 and $3,311,644 as of June 30, 2003.

Liabilities:

Annual Audits and Tentative Cost Settlements - The Hospitals' cost reports for Medicare and Medicaid are subject to annual audits which may result in various adjustments and interim settlements relating to the cost-based portion of reimbursement.

At June 30, 2004, the Hospitals estimated a current liability of $7,687,140 and $11,497,785 for amounts due to Medicare and Medicaid, respectively. Cost settlements estimated as noncurrent are $3,454,510 and $1,257,500 for Medicare and Medicaid, respectively.

At June 30, 2003, the Hospitals estimated a current liability of $2,134,659 and $6,560,000 for amounts due to Medicare and Medicaid, respectively. Cost settlements estimated as noncurrent are $11,114,874 and $2,500,000 for Medicare and Medicaid, respectively.

NOTE 5 - CAPITAL ASSETS:

A summary of changes in capital assets for the year ended June 30, 2004 is presented as follows:

	Balance July 1, 2003	Adjustments	Increases	Decreases	Balance June 30, 2004
Capital Assets, Nondepreciable:					
Land	$ 22,378,736	$ 0	$ 0	$ 0	$ 22,378,736
Construction in Progress	18,044,056	(12,387,043)	13,354,346		19,011,359
Total Capital Assets, Nondepreciable	40,422,792	(12,387,043)	13,354,346		41,390,095
Capital Assets, Depreciable:					
Buildings	247,843,258	15,907,906			263,751,164
Machinery and Equipment	266,528,310	(2,006,804)	19,611,647	(14,927,664)	269,205,489
General Infrastructure	5,693,590	120,210			5,813,800
Total Capital Assets, Depreciable	520,065,158	14,021,312	19,611,647	(14,927,664)	538,770,453
Less Accumulated Depreciation for:					
Buildings	58,535,373		6,937,517		65,472,890
Machinery and Equipment	136,708,960		27,840,754	(13,333,042)	151,216,672
General Infrastructure	2,625,172		292,032		2,917,204
Total Accumulated Depreciation	197,869,505		35,070,303	(13,333,042)	219,606,766
Total Capital Assets, Depreciable, Net	322,195,653	14,021,312	(15,458,656)	(1,594,622)	319,163,687
Capital Assets, Net	$ 362,618,445	$ 1,634,269	$ (2,104,310)	$ (1,594,622)	$ 360,553,782

NOTE 6 - LONG-TERM LIABILITIES

A. **Changes in Long-Term Liabilities -** A summary of the changes in the long-term liabilities for the year ended June 30, 2004 is presented as follows:

	Balance July 1, 2003	Additions	Reductions	Balance June 30, 2004	Current Portion
Notes Payable	$ 4,809,368	$ 0	$ (2,480,767)	$ 2,328,601	$ 2,328,601
Capital Leases Payable	$ 402,374	$ 0	$ (232,317)	$ 170,057	$ 170,057
Bonds Payable	$ 298,690,000	$ 0	$ (5,545,000)	$ 293,145,000	$ 5,615,000
Less: Discount	(714,800)		16,796	(698,004)	
Less: Deferred Charge on Refunding	(17,501,152)		713,128	(16,788,024)	
Total Bonds Payable	$ 280,474,048	$ 0	$ (4,815,076)	$ 275,658,972	$ 5,615,000
Arbitrage Rebate Payable	$ 3,215,797	$ 487,232	$ 0	$ 3,703,029	$ 0
Compensated Absences	$ 15,630,358	$ 24,529,562	$ (23,291,226)	$ 16,868,694	$ 3,631,830

Additional information regarding capital lease obligations is included in Note 7A.

B. **Notes Payable** - The Hospitals was indebted for notes payable for the purposes shown in the following table:

Purpose	Financial Institution	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2004	Principal Outstanding 06/30/2004
Purchase Computer Hardware and Software	IBM Global	4.82% to 6.12%	04/01/2005	$ 4,394,447	$ 3,567,814	$ 826,633
Patient Care Beds	Hill Rom	4.12%	12/15/2004	2,944,527	1,442,559	1,501,968
Total Notes Payable				$ 7,338,974	$ 5,010,373	$ 2,328,601

C. Bonds Payable - The Hospitals was indebted for bonds payable for the purposes shown in the following table:

Purpose	Series	Interest Rate/ Ranges	Final Maturity Date	Original Amount of Issue	Principal Paid Through 06/30/2004	Principal Outstanding 06/30/2004
Construction of Women's and Children's Hospitals	1996	4.20% to 5.375%	02/15/2015	$ 45,545,000	$ 9,205,000	$ 36,340,000
Refund 1992 Revenue Bonds	1999	4.00% to 5.25%	02/15/2024	58,925,000	6,600,000	52,325,000
Rex Acquisition and Hospital Renovations	2001A 2001B	Variable	02/15/2031	110,000,000	3,000,000	107,000,000
Refund Portion of 1996 Revenue Bonds	2003A 2003B	Variable	02/01/2029	98,015,000	535,000	97,480,000
Total Bonds Payable (principal only)				$ 312,485,000	$ 19,340,000	293,145,000
Less: Unamortized Loss on Refunding						(16,788,024)
Less: Unamortized Discount						(698,004)
Total Bonds Payable						$ 275,658,972

D. Demand Bonds - Included in bonds payable are several variable rate demand bond issues. Demand bonds are securities that contain a "put" feature that allows bondholders to demand payment before the maturity of the debt upon proper notice to the Hospitals' remarketing agents.

With regards to the following demand bonds, the Hospitals has entered into legal agreements, which would convert the demand bonds not successfully remarketed into another form of long-term debt.

University of North Carolina Hospitals at Chapel Hill Revenue Bonds-Series 2001A and Series 2001B: On January 31, 2001, the Hospitals issued two series of tax-exempt variable rate demand bonds in the amount of $55,000,000 (2001A) and $55,000,000 (2001B) that have a final maturity date of February 15, 2031. The bonds are subject to mandatory sinking fund redemption that began on February 15, 2002. A portion of the proceeds was used to reimburse the Hospitals for $75,000,000 spent allowing the UNC Health Care System to acquire controlling interest in Rex Healthcare Inc. The remaining proceeds are to be used for the renovation of space vacated after the opening of the North Carolina Women's Hospital, North Carolina Children's Hospital, and associated support services. While initially bearing interest in a daily mode, the mode on these bonds may change to a weekly rate, a unit pricing rate, a term rate or a fixed rate.

While in daily mode, the bonds are subject to purchase on any business day upon demand by telephonic notice of tender to the Remarketing Agent on the purchase date and delivery to the bond Tender Agent, Wachovia Bank, National Association. The Hospitals' remarketing agents, Merrill Lynch, Pierce, Fenner & Smith Incorporated (Series 2001A) and Banc of America Securities LLC (Series 2001B) have agreed to exercise their best efforts to remarket bonds for which a notice of purchase has been received. The quarterly remarketing fee is payable in arrears and is equal to 0.08% of the outstanding principal amount of the bonds assigned to each agent.

Under separate Standby Bond Purchase Agreements for the Series 2001A and Series 2001B (Agreements) between the Hospitals and *Landesbank Hessen-Thuringen Girozentrale*, a Liquidity Facility has been established for the Tender Agent to draw amounts sufficient to pay the purchase price and accrued interest on bonds delivered for purchase when remarketing proceeds or other funds are not available. These Agreements require a facility fee equal to .22% of the available commitment, payable quarterly in arrears, beginning on April 2, 2001, and on the first business day of each July, October, January and April thereafter until the expiration date or the termination date of the Agreements.

Under the Agreements, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Formula Rate (Base Rate equal to the higher of the Prime Rate for such day or the sum of .50% plus the Federal Funds Rate) subject to a maximum rate as permitted by law. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is due quarterly (the first business day of January, April, July and October) for each period in which Bank Bonds are outstanding. At June 30, 2004 and 2003, there were no Bank Bonds held by the Liquidity Facility.

Included in the Agreements is a take out provision, in case the remarketing agent is unable to resell any bonds that are "put" within 90 days of the "put" date. In this situation, the Hospitals is required to redeem the Bank Bonds held by the Liquidity Facility. The agreements allow the Hospitals to redeem bank bonds in equal quarterly installments, on the first business day of January, April, July and October. The payments will commence with the first business day of any such month that is at least 90 days following the applicable Purchase Date of the Bank Bond and end no later than the fifth anniversary of such Purchase Date. If the take out agreement were to be exercised because the entire outstanding $107,000,000 of demand bonds was "put" and not resold, the

Hospitals would be required to pay $23,717,756 a year for five years under the installment loan agreement assuming a 4 percent prime interest rate.

The current expiration date of the Agreements is July 26, 2005. The Hospitals may request additional extensions of up to 364 days. Extensions are at the discretion of Liquidity Provider.

University of North Carolina Hospitals at Chapel Hill Revenue Refunding Bonds-Series 2003A and Series 2003B: On February 13, 2003, the Hospitals issued two series of tax-exempt variable rate demand bonds in the amount of $63,770,000 (2003A) and $34,245,000 (2003B) that have a final maturity date of February 1, 2029. The bonds are subject to mandatory sinking fund redemption that began on February 1, 2004. The proceeds were used to advance refund $88,325,000 of the Series 1996 Bonds. While initially bearing interest in a weekly mode, the mode on these bonds may change to a daily rate, a unit pricing rate, a term rate or a fixed rate.

While in the weekly mode, the bonds are subject to purchase on demand with seven days' notice to the Remarketing Agent and delivery to the bond Tender Agent, Wachovia Bank, National Association. The Hospitals' remarketing agents, Banc of America Securities LLC (Series 2003A) and Wachovia Bank, National Association (Series 2003B) have agreed to exercise their best efforts to remarket bonds for which a notice of purchase has been received. The quarterly remarketing fee is payable in arrears and is equal to 0.08% of the outstanding principal amount of the bonds assigned to the remarketing agent for Series 2003A and is equal to 0.07% of the outstanding principal amount of the bonds assigned to the remarketing agent for Series 2003B.

Under separate Standby Bond Purchase Agreements for the Series 2003A and Series 2003B (Agreements) between the Hospitals and Bank of America, N.A. (Series 2003A) or Wachovia Bank, National Association (Series 2003B) a Liquidity Facility has been established for the Tender Agent to draw amounts sufficient to pay the purchase price on bonds delivered for purchase when remarketing proceeds or other funds are not available. These Agreements require a facility fee equal to .20% for Series 2003A and .22% for Series 2003B of the available commitment, payable quarterly in advance, beginning on February 13, 2003, and on each February 1, May 1, August 1, and November 1 thereafter until the expiration date or the termination date of the Agreements.

Under the Agreements, any bonds purchased through the Liquidity Facility become Bank Bonds and shall, from the date of such purchase and while they are Bank Bonds, bear interest at the Bank Bond Interest Rate (for Series 2003A, the rate equals LIBOR plus 2.50% for the first 90 days and then equals LIBOR plus 4.00%; for Series 2003B, the rate equals Prime Rate for the first 90 days and then equals Prime plus 1.00%) subject to a maximum rate as permitted by law. Upon remarketing of Bank Bonds and the receipt of the sales price by the Liquidity Provider, such bonds are no longer considered Bank Bonds. Payment of the interest on the Bank Bonds is on the first business day of each month for each period in which Bank Bonds are outstanding. At June 30, 2004 and 2003, there were no Bank Bonds held by the Liquidity Facility.

Included in the Agreements is a take out provision, in case the remarketing agent is unable to resell any bonds that are "put" within 90 days of the "put" date. In this situation, the Hospitals is required to redeem the Bank Bonds held by the Liquidity Facility. The Series 2003A agreement allows the Hospitals to redeem bank bonds in twelve equal quarterly installments beginning on the first February 1, May 1, August 1, or November 1, that occurs at least 90 days following the applicable Purchase Date of the Bank Bond. If the take out agreement were to be exercised because the entire outstanding $63,420,000 of demand bonds was "put" and not resold, the Hospitals would be required to pay $23,029,812 a year for three years under the installment loan agreement assuming a 5.37 percent interest rate (LIBOR plus 4%). The Series 2003B agreement allows the Hospitals to redeem bank bonds in 36 equal monthly installments, on the first business day of each calendar month after the loan date. Payments commence with the first business day of any such month that is at least 120 days following the applicable Purchase Date of the Bank Bond. If the take out agreement were to be exercised because the entire outstanding $34,060,000 of demand bonds was "put" and not resold, the Hospitals would be required to pay $12,249,708 a year for three years under the installment loan agreement assuming a 5.00 percent interest rate (Prime plus 1%).

The current expiration date of the Series 2003A Agreement is July 1, 2005 and July 31, 2006 for the Series 2003B Agreement. The Hospitals may request additional extensions, which are approved at the discretion of the Liquidity Provider.

Interest Rate Swap Agreement

Objective: In order to protect against the risk of interest rate changes, the Hospitals entered into an interest rate swap contract agreement with Bank of America, N.A. (BOA) on February 13, 2003. The agreement covers the variable rate Revenue Refunding Bonds, Series 2003A ($63,770,000) and Series 2003B ($34,245,000). The 2003 series of bonds partially refunded fixed rate Revenue Bonds, Series 1996.

Terms, fair values, and credit risk: Under this agreement, BOA pays the Hospitals interest on the notional amount based on 67% of the arithmetic mean of the USD-LIBOR-BBA (with a designated maturity of one month) on a monthly basis. Also on a monthly basis, the Hospitals pays BOA interest at the fixed rate of 3.48%. No cash was paid or received by the Hospitals upon initiation of the agreement. The notional amount of the swap reduces annually; the reductions began in February 2004 and end in February 2029. The swap agreement terminates February 1, 2029. As of June 30, 2004, rates were as follows:

	Terms	2003A Rates	2003B Rates
Fixed payment to BOA	Fixed	3.48	3.48
Variable payment from BOA	LIBOR[1]-BBA[2]	0.81	0.81
Net interest rate swap payments		2.67	2.67
Variable rate bond coupon payments		1.08	1.04
Synthetic interest rate on bonds		3.75	3.71

(1) London Inter-Bank Offered Rate

(2) British Bankers Association

Because rates have started to increase, the swap agreement has a mark-to-market value of $1,393,549 as of June 30, 2004 compared to a negative mark-to-market value of $5,972,285 as of June 30, 2003. BOA develops the fair value. Their method calculates the present value of the future net settlement payments required by the swap assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for LIBOR due on the date of each future net settlement on the swap.

As of June 30, 2004, the Hospitals is exposed to credit risk equal to the value of the swap. BOA is currently rated AA- by Fitch Ratings, Aa1 by Moody's Investor's Service, and AA- by Standard and Poor's Corporation. At such time that their ratings fall below A3 for Moody's or below A- for S&P, BOA will be required to collateralize a portion of their exposure (up to 100%). The following instruments can serve as eligible collateral: Cash, U.S. Treasury Obligations, U.S. Government Agency Fixed Rate Fixed Maturity Securities, U.S. Government Agency Single Class Mortgage-Backed Securities, U.S. Treasury STRIPS and other U.S. Government Agency Mortgage-Backed Securities. Posted collateral received will be entered in one or more accounts with a domestic office of a commercial bank, trust company or financial institution organized under the laws of the United States (or any state or a political subdivision thereof).

Basis risk: The Hospitals receives 67% of 1-month LIBOR-BBA Index from BOA and pays a floating rate to its bondholders set by the remarketing agent. The Hospitals incurs basis risk when its bonds trade at a yield above 67% of 1-month LIBOR-BBA Index. If the relationship of the Hospitals' bonds trade to a percentage of LIBOR greater than 67%, the Hospitals will experience an increase in debt service above the fixed rate on the swap.

Termination risk: The derivative contract uses the International Swap Dealers Association Master Agreement, which includes standard termination events, such as failure to pay and bankruptcy. The Hospitals or the counterparty may terminate the swap if the other party fails to perform under the terms of the contract. If the swap is terminated, the associated variable-rate bonds would no longer carry synthetic interest rates. Also, if at the time of termination the swap has a negative fair value, the Hospitals would be liable to the counterparty for that amount. Termination could result in the Hospitals being required to make an unanticipated termination payment.

Swap payments and associated debt: Using the rates as of June 30, 2004 for the 2003A and 2003B revenue bonds, debt service requirements of the variable rate debt and net swap payments, assuming current interest rates remain the same for their term, are as follows. As rates vary, variable rate bond interest payments and net swap payments will vary.

Fiscal Year	Principal	Interest	Interest Rate Swaps, Net	Total Payments
2005	$ 435,000	$ 1,035,586	$ 2,593,767	$ 4,064,353
2006	455,000	1,032,541	2,586,143	4,073,684
2007	470,000	1,027,624	2,573,830	4,071,454
2008	490,000	1,024,174	2,565,191	4,079,365
2009	505,000	1,015,588	2,543,688	4,064,276
2010-2014	2,830,000	4,999,827	12,522,827	20,352,654
2015-2019	22,170,000	4,462,171	11,176,214	37,808,385
2020-2024	31,825,000	2,946,408	7,379,756	42,151,164
2025-2029	38,300,000	1,087,579	2,724,022	42,111,601
Total	$ 97,480,000	$ 18,631,498	$ 46,665,438	$ 162,776,936

E. Annual Requirements - The annual requirements to pay principal and interest on long-term obligations at June 30, 2004 are as follows:

Fiscal Year	Bonds Payable Principal	Bonds Payable Interest
2005	$ 5,615,000	$ 9,218,844
2006	6,030,000	9,010,746
2007	6,245,000	8,781,313
2008	6,470,000	8,546,089
2009	6,910,000	8,272,080
2010-2014	39,375,000	36,764,721
2015-2019	49,785,000	27,441,553
2020-2024	61,415,000	17,385,563
2025-2029	75,700,000	6,803,764
2030-2031	35,600,000	434,772
Total Requirements	$ 293,145,000	$ 132,659,445

Interest on the variable rate 2001A and 2001B revenue bonds is calculated based upon the daily rates at which the bonds were remarketed on
June 30, 2004, of 1.04% and 1.10%, respectively. Interest on the variable rate 2003A and 2003B revenue bonds is calculated based upon the synthetic rates of 3.75% and 3.71% as noted above. See Note 6D for more information on the demand bonds and the interest rate swap agreement.

Fiscal Year	Notes Payable Principal	Notes Payable Interest
2005	$ 2,328,601	$ 81,302

F. Bond Defeasance - The Hospitals has extinguished long-term debt obligations by the issuance of new long-term debt instruments as follows:

On February 13, 2003 the Hospitals defeased $88,325,000 of outstanding University of North Carolina Hospitals at Chapel Hill Revenue Bonds Series 1996. An irrevocable trust was established with an escrow agent to provide for all future debt service payments on the defeased bonds. The trust assets and the liability for the defeased bonds are not included in the Hospitals' Statements of Net Assets. At June 30, 2004 the outstanding balance of the defeased University of North Carolina Hospitals at Chapel Hill Revenue Bonds Series 1996 was $88,325,000.

NOTE 7 - LEASE OBLIGATIONS

A. Capital Lease Obligations - Capital lease obligations relating to medical equipment are recorded at the present value of the minimum lease payments. Future minimum lease payments under capital lease obligations consist of the following at June 30, 2004:

Fiscal Year	Amount
2005	$ 166,760
Total Minimum Lease Payments	166,760
Amount Representing Interest (6% Rate of Interest)	(3,297)
Present Value of Future Lease Payments	$ 170,057

Medical equipment acquired under capital lease amounted to $325,083 at June 30, 2004.

B. Operating Lease Obligations - The Hospitals entered into operating leases for space rental. Future minimum lease payments under noncancelable operating leases consist of the following at June 30, 2004:

Fiscal Year	Amount
2005	$ 510,029
2006	380,746
2007	369,665
2008	351,098
2009	234,645
2010-2012	312,713
Total Minimum Lease Payments	$ 2,158,896

Rental expense for all operating leases during the year was $2,177,890.

NOTE 8 - NET PATIENT SERVICE REVENUE

Medicare: The Hospitals is reimbursed for inpatient acute care services under the provisions of the Prospective Payment System (PPS). Under PPS, payment is made at predetermined rates for treating various diagnoses and performing procedures that have been grouped into defined diagnostic-related groups (DRGs) applicable to each patient discharge, rather than on the basis of the Hospitals' allowable charges. The difference in the standard hospital charge and the prospective payment for such services is reflected as an adjustment from patient service revenue. The DRG payments include adjustments for indirect medical education and disproportionate share. Capital-related costs are reimbursed based upon a predetermined amount per discharge.

Medicare makes payments for Direct Graduate Medical Education (DGME) in support of the direct costs of residency training. These pass-through payments are discussed further in Note 4, Estimated Third Party Settlements.

Medicare reimburses the Hospitals for inpatient hospital services furnished in the inpatient rehabilitation unit, referred to as an inpatient rehabilitation facility (IRF), under the provisions of the Inpatient Rehabilitation Facility Prospective Payment System (IRF PPS). Payments made under this system cover the inpatient operating and capital costs of covered rehabilitation services and are made on a per discharge basis.

Inpatient services provided in the Hospitals' inpatient psychiatric unit are reimbursed by Medicare under the provisions of the Tax Equity and Fiscal Responsibility Act (TEFRA) of 1982. Under TEFRA, inpatient psychiatric units are paid on the basis of Medicare reasonable costs per case, limited by a hospital specific target amount per discharge. The Hospitals is also eligible for bonus payments if its costs are under or over its target limit.

The Balanced Budget Act of 1997 required the implementation of a prospective payment system for outpatient services. The system became effective August 1, 2000 and is based on ambulatory payment classifications. It applies to most hospital outpatient services other than ambulance, rehabilitation services, clinical diagnostic laboratory services, dialysis for end-stage renal disease, non-implantable durable medical equipment, prosthetic devices and orthotics. Previously, payment for outpatient services varied by type of service: fee schedule, the lower of cost or charges, or a blend of the fee schedules and cost.

Medicaid: Medicaid reimburses inpatient services on an interim basis under a Prospective Payment System. Medicaid uses the Medicare DRG system with the addition of six neonatal DRGs. A settlement is made at year-end to adjust from the interim DRG reimbursement to a cost-based reimbursement basis.

Medicaid reimburses outpatient services on the basis of documented cost for all services except ambulance, hearing aids, durable medical equipment (DME), outpatient pharmacy, home health, dialysis and diagnostic laboratory services. Payment is made based on a tentative reimbursement rate with final settlement determined after submission of annual cost reports by the Hospitals.

Contracting Hospital Agreement (CHA): The Hospitals enters into a CHA each year with Blue Cross and Blue Shield of North Carolina (BCBS) whereby both parties accept a schedule of charges for all inpatient and outpatient services delivered. BCBS reimburses the Hospitals on behalf of its subscribers based upon 100% of the charges approved in the contract, less any deductibles or co-payments applicable to specific terms of insurance policies. All patient charges (regardless of payor) conform to the approved rates in the CHA and are subject to change at the Hospitals' discretion.

Other Agreements: The Hospitals has also entered into reimbursement agreements with certain commercial insurance carriers and managed care organizations to accept patients on a discounted fee for service basis. The basis for reimbursement under these agreements includes case rates per discharge, discounts from established charges, fee schedules and per diem rates.

In general, all payments for inpatient and outpatient services are subject to deductibles and co-payments that are the patient's responsibility. Additionally, insurance plans may reimburse their subscribers or make direct payment to the Hospitals on an assignment of benefits basis.

A summary of net patient service revenue for the years ended June 30, 2004 and 2003 follows:

	2004	2003
Inpatient Routine	$ 227,897,779	$ 201,325,157
Inpatient Ancillary	447,226,412	389,546,521
Outpatient	346,536,889	293,376,472
Indigent Care Provided	(48,029,688)	(40,677,245)
Gross Patient Service Revenue	973,631,392	843,570,905
Medicare Contractual	(125,069,933)	(90,516,691)
Medicaid Contractual	(112,661,405)	(75,156,135)
Managed Care Contractual	(147,193,776)	(139,535,262)
Other Contractuals	(14,017,195)	(16,034,129)
Bad Debt	(38,354,563)	(34,268,637)
Contractual Adjustments	(437,296,872)	(355,510,854)
Net Patient Service Revenue	$ 536,334,520	$ 488,060,051

NOTE 9 - PENSION PLANS

A. **Retirement Plans -** Each permanent full-time employee, as a condition of employment, is a member of the Teachers' and State Employees' Retirement System (the System). The System is a cost sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units and local boards of education. The plan is administered by the North Carolina State Treasurer. Graduate medical residents, temporary employees and permanent part-time employees with appointments of less than 30 hours per week are not covered by the plan.

Benefit and contribution provisions for the System are established by *North Carolina General Statutes* 135-5 and 135-8 and may be amended only by the North Carolina General Assembly. Employer and member contribution rates are set each year by the North Carolina General Assembly based on annual actuarial valuations. For the year ended June 30, 2004, these rates were set at .22% of covered payroll for employers and 6% of covered payroll for members.

For the year ended June 30, 2004, the Hospitals had a total payroll of $265,020,941 of which $220,726,119 was covered under the System.

Total employee and employer contributions for pension benefits for the year were $13,243,583 and $485,598, respectively. The Hospitals made one hundred percent of its employer required contributions to the System for the years ended June 30, 2004, 2003, and 2002, which were $485,598, $0, and $3,429,358, respectively.

The System's financial information is 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.state.nc.us/ and clicking on "Financial Reports", or by calling the State Controller's Financial Reporting Section at (919) 981-5454.

B. Deferred Compensation and Supplemental Retirement Income Plans - IRC Section 457 Plan - The State of North Carolina offers its permanent employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457 through the North Carolina Public Employee Deferred Compensation Plan (the Plan). The Plan permits each participating employee to defer a portion of his or her salary until future years. The deferred compensation is available to employees upon separation from service, death, disability, retirement or financial hardships if approved by the Board of Trustees of the Plan. The Board, a part of the North Carolina Department of Administration, maintains a separate fund for the exclusive benefit of the participating employees and their beneficiaries, the *North Carolina Public Employee Deferred Compensation Trust Fund*. The Board also contracts with an external third party to perform certain administrative requirements and to manage the trust fund's assets. All costs of administering and funding the Plan are the responsibility of the Plan participants. No costs are incurred by the Hospitals. The voluntary contributions by employees amounted to $296,674 in 2004 and $227,066 in 2003.

IRC Section 401(k) Plan - All members of the Teachers' and State Employees' Retirement System are eligible to enroll in the Supplemental Retirement Income Plan, a defined contribution plan, created under Internal Revenue Code Section 401(k). All costs of administering the Plan are the responsibility of the Plan participants. No costs are incurred by the Hospitals except for a 5% employer contribution for the Hospitals' law enforcement officers, which is mandated under General Statute 143-166.30(e). Total employer contributions on behalf of Hospitals' law enforcement officers were $48,638 in 2004 and $44,871 in 2003. Voluntary contributions by employees amounted to $1,134,878 in 2004 and $1,102,699 in 2003.

IRC Section 403(b) and 403(b)(7) Plans - Eligible employees can participate in tax sheltered annuity plans created under Internal Revenue Code Sections 403(b) and 403(b)(7). The employee's eligible contributions, made through salary reduction agreements, are exempt from federal and State income taxes until the annuity is received or the contributions are withdrawn. These plans are exclusively for employees of universities and certain charitable and other nonprofit institutions. All costs of administering and funding these plans are the responsibility of the Plan participants. No costs are incurred by the Hospitals. Voluntary contributions by employees amounted to $4,603,244 in 2004 and $4,059,245 in 2003.

NOTE 10 - OTHER POSTEMPLOYMENT BENEFITS

A. **Health Care for Long-Term Disability Beneficiaries and Retirees –** The Hospitals participates in State-administered programs that provide postemployment health insurance to eligible former employees. Eligible former employees include long-term disability beneficiaries of the Disability Income Plan of North Carolina and retirees of the Teachers' and State Employees' Retirement System. These benefits were established by Chapter 135, Article 3, Part 3 of the General Statutes and may be amended only by the North Carolina General Assembly. Funding for the health care benefit for long-term disability beneficiaries and retirees is financed on a pay-as-you-go basis. The Hospitals contributed 3.20% of the covered payroll under the Teachers' and State Employees' Retirement System for these health care benefits. For the fiscal years ending
June 30, 2004 and 2003, the Hospitals' total contribution to the plan was $7,063,238 and $4,552,311, respectively. The Hospitals assumes no liability for retiree health care benefits provided by the programs other than its required contributions. Additional detailed information about these programs can be located in the State of North Carolina's *Comprehensive Annual Financial Report.*

B. **Long-Term Disability -** The Hospitals participates in the Disability Income Plan of North Carolina (DIPNC). Established by Chapter 135, Article 6, of the General Statutes, DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. Long-term disability income benefits are advance funded on an actuarially determined basis using the one-year term cost method. Employer contributions are established in the Appropriations Bill by the General Assembly. The Hospitals was not required to contribute to the DIPNC for the fiscal year ended June 30, 2004. For the fiscal years ending June 30, 2004 and 2003, the

Hospitals' total contribution to the Plan was $0 and $1,007,320, respectively. The Hospitals assumes no liability for long-term disability benefits under the Plan other than its contribution. Additional detailed information about DIPNC is disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*.

NOTE 11 - RISK MANAGEMENT

The Hospitals is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; injuries to employees; and natural disasters. These exposures to loss are handled by a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year and settled claims have not exceeded coverage in any of the past three fiscal years.

Tort claims of up to $500,000 are self-insured under the authority of the State Tort Claims Act.

The Hospitals is required to maintain fire and lightning coverage on all State-owned buildings and contents through the State Property Fire Insurance Fund (Fund), an internal service fund of the State. Such coverage is provided at no cost to operations supported by the State's General Fund. Other operations not supported by the State's General Fund are charged for the coverage. Losses covered by the Fund are subject to a $500 per occurrence deductible. The Hospitals also purchased through the Fund "all risks" replacement cost basis insurance for buildings and contents subject to a $25,000 per occurrence deductible. No significant losses occurred during the year.

All State-owned vehicles are covered by liability insurance through a private insurance company and handled by the North Carolina Department of Insurance. The liability limits for losses occurring in-State are $500,000 per claim and $5,000,000 per occurrence and out-of-State are $1,000,000 per claim and $5,000,000 per occurrence. The Hospitals pays premiums to the North Carolina Department of Insurance for the coverage.

The Hospitals is protected for losses from employee dishonesty and computer fraud. This coverage is with a private insurance company and is handled by the North Carolina Department of Insurance. The Hospitals is charged a premium by the private insurance company. Coverage limit is $5,000,000 per occurrence with a $50,000 deductible and a 10% participation in each loss above the deductible.

The Hospitals purchased other authorized coverages from private insurance companies through the North Carolina Department of Insurance. These coverages include:

- Boiler and Machinery insurance up to $25,000,000 with a deductible of $5,000 per occurrence
- Directors and Officers Liability insurance up to $10,000,000 with a deductible of $200,000 per occurrence
- Master Crime insurance up to $500,000 with a deductible of $1,000
- Comprehensive General Liability insurance up to $1,000,000 with a deductible of $10,000 per occurrence
- Automobile Physical Damage (for vehicles costing greater than $75,000) insurance up to $5,000,000 per accident with a deductible of $500 per occurrence
- General Liability for Helipad on Premises insurance up to $20,000,000 with a deductible of $7,500 per occurrence
- General Liability for Non-owned Aircraft insurance up to $20,000,000 with no deductible
- Business Travel insurance for aircraft flight team up to $600,000 per accident with no deductible
- Computerized Business Equipment replacement cost insurance up to $1,246,204 with a deductible of $10,000 per occurrence
- Fine Arts Floater insurance up to $50,000 ($5,000 per item) with a deductible of $1,000 per occurrence

Employees and retirees are provided comprehensive major medical care benefits. Coverage is funded by contributions to the State Health Plan (Plan), a pension and other employee benefit trust fund of the State of North Carolina. The Plan has contracted with third parties to process claims.

The North Carolina Workers' Compensation Program provides benefits to workers injured on the job. All employees of the State and its component units are included in the program. When an employee is injured, the Hospitals' primary responsibility is to arrange for and provide the necessary treatment for work related injury. The Hospitals is responsible for paying medical benefits and compensation in accordance with the North Carolina Workers' Compensation Act. The Hospitals is self-insured for workers' compensation.

Term life insurance (death benefits) of $25,000 to $50,000 is provided to eligible workers. This Death Benefit Plan is administered by the State Treasurer and funded via employer contributions. The employer contribution rate was 0.00% and 0.16% for the fiscal years ending June 30, 2004 and 2003.

Additional details on the State-administered risk management programs are disclosed in the State of North Carolina's *Comprehensive Annual Financial Report*, issued by the Office of the State Controller.

Liability Insurance Trust Fund - The Hospitals participates in the Liability Insurance Trust Fund (the Fund), a claims-servicing public entity risk pool for professional liability protection. The Fund acts as a servicer of professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Fund.

Chapter 116, Article 26, of the *North Carolina General Statutes* and The University of North Carolina Board of Governors' Resolution of June 9, 1978 created the Fund to provide professional liability protection for program participants and individual health care practitioners working as employees, agents, or officers of the University of North Carolina Hospitals at Chapel Hill (the Hospitals) and The University of North Carolina at Chapel Hill Physicians and Associates (UNC P&A). The Fund is exempt from federal and State income taxes, and is not subject to regulation by the North Carolina Department of Insurance.

Participation in the Fund is open to the University of North Carolina, any constituent institution of the University of North Carolina, the Hospitals, and any health care institution, agency or entity that has an affiliation agreement with the University of North Carolina, with a constituent institution of the University of North Carolina, or with the Hospitals. Only UNC P&A and the Hospitals have participated in the Fund to date. Participants provide management and administrative services to the Fund at no cost.

The Liability Insurance Trust Fund Council (the Council) governs the Fund. The Council consists of thirteen members as follows: one member each appointed by the State Attorney General, the State Auditor, the State Insurance Commissioner, the Director of the Office of State Budget and Management, the State Treasurer, (each serving at the pleasure of the appointer); and eight members appointed to three year terms (with no limit on the number of terms) by the Board of Governors of the University of North Carolina.

The Fund establishes claim liabilities based on estimates of the ultimate cost of claims (including future expenses and claim adjustment expenses) that have been reported but not settled and of claims incurred but not reported. Claim liabilities are recomputed annually based on an independent actuary's study to produce current estimates that reflect recent settlements, claims frequency, inflation, and other factors. Participant assessments are determined at a level to fund claim liabilities, discounted for future investment earnings. Each participant is required by statute to maintain a fund balance of $100,000 at all times. Participants are subject to additional premium assessments in the event of deficiencies.

The Fund provides coverage for entity participants as well as the individual employees and professional staff participants within the course and scope of their employment. As of July 1, 2002 through April 30, 2003, the Fund provided coverage on an occurrence basis of $57,000,000 per claim/annual aggregate, provided through a combination of self-insurance through the Fund and commercial excess coverage. The Fund is responsible for the first $7,000,000 for each and every claim, and the next $10,000,000 per claim/annual aggregate for the July 1, 2002 – April 30, 2003 policy year. As of May 1, 2003 through June 30, 2004, the Fund provided coverage on an occurrence basis of $7,000,000 per individual for each and every claim, self-insured through the Fund. For the period July 1, 2002 through April 30, 2003, the Fund purchased an excess policy on a claims made basis for $40,000,000 of coverage above the self-insured retention. During the period May 1, 2003 – June 30, 2004, the Fund had no excess of loss reinsurance coverage. For fiscal years ending June 30, 2003 and June 30, 2004, the Fund purchased a direct insurance policy to cover the first $1,000,000 per occurrence and $3,000,000 in the aggregate for dental residents. The Fund provides coverage of $500,000 per occurrence, in accordance with the limited waiver of sovereign immunity afforded by the State Tort Claims Act, for any recovery against the entity participants for the negligence of its employees. To assure that both existing and future claims will be paid, the Board of Governors of the University of North Carolina is authorized by law to borrow up to $30 million to replenish the Trust Fund. No borrowings have been made under this line of credit to date. The Council believes adequate funds are on deposit in the Fund to meet estimated losses based upon the results of the independent actuary's report.

The Fund has purchased annuity contracts to settle claims for which the claimant has signed an agreement releasing the Fund from further obligation. The related claim liabilities have been removed from estimated malpractice costs. The likelihood that the Fund will be required to make future payments on these claims is considered remote.

The Council may choose to terminate the Fund, or the respective participants may choose to terminate their participation. In the event of such termination by either the Council or a participant, an updated actuarial study will be performed to determine amounts due to or from the participants based on loss experience up to the date of termination.

At June 30, 2004 and 2003, the Hospitals had advance deposits with the Fund totaling $1,543,962 and $100,000, respectively.

Additional disclosures relative to the funding status and obligations of the Fund are set forth in the audited financial statements of the Liability Insurance Trust Fund for the years ended June 30, 2004 and 2003. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 6001 East Wing, University of North Carolina Hospitals, 101 Manning Drive, Chapel Hill, North Carolina 27514, or by calling (919) 966-3041.

NOTE 12 - COMMITMENTS AND CONTINGENCIES

A. Commitments – The Hospitals has established an encumbrance system to track its outstanding commitments on construction projects and other purchases. Outstanding commitments on construction contracts were $5,413,349 and on other purchases were $22,633,715 at June 30, 2004. Outstanding commitments on construction contracts were $9,593,198 at June 30, 2003.

B. Pending Litigation and Other Contingencies - The Hospitals is party to other litigation and claims in the ordinary course of its operations. Since it is not possible to predict the ultimate outcome of those matters, no provision for any liability has been made in the accompanying financial statements. Hospitals' management is of the opinion that the liability, if any, for any of these matters will not have a material adverse effect on the financial position of the Hospitals.

NOTE 13 - RELATED PARTY TRANSACTIONS

The Medical Foundation of North Carolina, Inc. - The Hospitals is a participant in The Medical Foundation of North Carolina, Inc., a nonprofit Foundation for the University of North Carolina at Chapel Hill and the Hospitals, which solicits gifts and grants for both entities. The Board of Directors of the Medical Foundation administers the funds of the Foundation. Transactions are recorded only by the Foundation. If the Foundation were to purchase any equipment for the Hospitals, then the amount would be recorded at the time of receipt in the accompanying financial statements.

UNC Health Care System - On April 13, 2000, the UNC Health Care System (System) entered into a contractual agreement with Rex Healthcare, Inc. (Rex) and the John Rex Endowment (a private, nonprofit corporation separate from the System) to gain a controlling interest in the governance of Rex Healthcare Inc. and related entities. At the signing of the agreement, the Hospitals transferred $100 million on behalf of the System to the John Rex Endowment as a result of the contractual agreement. The transaction was recorded as an equity transfer. In addition, the agreement calls for future funding of Rex capital needs for the next ten years up to $58 million. To date, there have been no calls under the agreement, because the capital needs have been funded by Rex's operating surplus.

John Rex Endowment - The John Rex Endowment (Endowment) operates as a 501(c)(3) corporation and is independent of the Board of Directors of the UNC Health Care System. Its purpose is to advance the health and well-being of the residents of the greater Triangle area, with specific funds set aside for indigent care and to make grants to support health services, education, prevention and research. In discharging its purposes, priority consideration will be given to any funding requests from Rex, UNC Health Care System and their affiliates. The funding source for the Endowment is the $100 million transfer that came from UNC Hospitals. The Endowment has committed $25 million for capital projects at Rex Healthcare, Inc.

NOTE 14 - INVESTMENTS IN AFFILIATES

The Hospitals has investments in affiliates and joint ventures accounted for on the equity method. Investments in affiliates were $1,588,202 and $1,268,723 at June 30, 2004 and 2003. The Hospitals' share of these affiliates and joint ventures is not significant individually. The summarized unaudited financial information below represents an aggregation of the ongoing affiliates and joint ventures:

	(unaudited) 2004	(unaudited) 2003
TOTAL AFFILIATE ACTIVITY		
Current Assets	$ 3,155,735	$ 3,508,244
Noncurrent Assets	1,443,545	1,705,925
Current Liabilities	415,059	540,864
Noncurrent Liabilities		631
Shareholders Equity	4,184,221	4,672,674
Revenue	6,519,135	6,263,288
Net Gain	639,966	913,765
HOSPITALS' SHARE OF ACTIVITY		
Affiliate Gain - Ongoing Operations	348,141	453,038
Affiliate Gain (Loss) - Discontinued Operations	(1,215,215)	2,964,686
Total Gain (Loss) Realized from Affiliate Activities	$ (867,074)	$ 3,417,724

NOTE 15 - CHANGE IN FINANCIAL ACCOUNTING AND REPORTING

For the fiscal year ended June 30, 2004, the Hospitals implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations are Component Units.* This statement amends GASB Statement No. 14, *The Financial Reporting Entity,* to provide additional guidance to determine whether certain organizations for which the Hospitals is not financially accountable should be reported as component units based on the nature and significance of their relationship to the Hospitals.

The Hospitals changed the reporting of Carolina Dialysis, LLC to include it as a 100% blended component unit of the Hospitals after reevaluating the requirements and the intent of GASB Statement No. 14. The one-third ownership interest held by Renal Research Institute is presented as minority interest on the Hospitals' financial statements. Previously the Hospitals reported its share of the Carolina Dialysis, LLC operation as an investment in affiliates. Prior year financial information was restated to reflect this change.

Also, the Hospitals changed its method of reporting community based clinics (the CBC). The CBC operations are being treated as cost sharing arrangements between the Hospitals and the University of North Carolina Physicians and Associates. Payments to the CBC are reported as contracted services expense on the Hospitals' financial statements in the year of payment. In prior years, the CBC was reported as investments in affiliates. The Hospitals financial statements were restated for the prior years to reflect these changes.

NOTE 16 - NET ASSET RESTATEMENTS

As of July 1, 2002 and 2003, net assets as previously reported were restated as follows:

	Amount
July 1, 2002 Net Assets as Previously Reported	$ 589,706,859
Restatements:	
Increase Contractual Allowances Related to Patient Accounts Receivable	(2,438,361)
Correct Reporting for Community Based Clinics	(438,097)
Reclass Agency Trust Funds	(240,909)
July 1, 2002 Net Assets as Restated	$ 586,589,492
July 1, 2003 Net Assets as Previously Reported	626,097,105
Restatements:	
Restatement to July 1, 2002 Net Assets (See Above)	(3,117,367)
Correct Reporting for Community Based Clinics	(1,408,616)
Correct Reporting of Carolina Dialysis, LLC	586,902
July 1, 2003 Net Assets as Restated	$ 622,158,024

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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*

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

We have audited the financial statements of the University of North Carolina Hospitals, which is a part of The University of North Carolina Health Care System, which is a part of The University of North Carolina System, a component unit of the State of North Carolina, as of and for the years ended June 30, 2004 and 2003, and have issued our report thereon dated November 18, 2004.

As discussed in Note 1, the financial statements present only the University of North Carolina Hospitals and are not intended to present fairly the financial position of The University of North Carolina Health Care System and the results of its operations and cash flows in conformity with auditing standards generally accepted in the United States of America. As discussed in Note 15 to the financial statements, the Hospitals implemented Governmental Accounting Standards Board Statement No. 39, *Determining Whether Certain Organizations Are Component Units,* during the year ended June 30, 2004.

We conducted our audits 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 Hospitals' internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Hospitals' 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 the Audit Committee, the Board of Directors of The University of North Carolina Health Care System, management and staff of the Hospitals, the Governor, the State Controller, the General Assembly, and federal awarding agencies and pass-through entities and is not intended to be, and should not be, used by anyone other than these specified parties.

Leslie W. Merritt, Jr.

Leslie W. Merritt, Jr., CPA, CFP
State Auditor

November 18, 2004

DISTRIBUTION OF AUDIT REPORT

In accordance with General Statutes 147-64.5 and 147-64.6(c)(14), copies of this report have been distributed to the public officials listed below. Additional copies are provided to other legislators, state officials, the press, and the general public upon request.

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The Honorable Roy A. Cooper, III	Attorney General
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Mr. Robert L. Powell	State Controller
Ms. Molly Corbett Broad	President, The University of North Carolina
Mr. Gary L. Park	President, University of North Carolina Hospitals
Mr. Charles F. Ayscue	Senior Vice President and Chief Financial Officer University of North Carolina Hospitals
Mr. James B. Hyler, Jr.	Chairman, Board of Directors The University of North Carolina Health Care System

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Mr. James D. Johnson	Director, Fiscal Research Division

January 31, 2005

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