

STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR

BETH A. WOOD, CPA



UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM FUNDS

CHAPEL HILL, NORTH CAROLINA
FINANCIAL STATEMENT AUDIT REPORT
FOR THE YEAR ENDED JUNE 30, 2014

A CONSTITUENT INSTITUTION OF THE UNIVERSITY OF NORTH CAROLINA SYSTEM
AND A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA



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STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
<http://www.ncauditor.net>

AUDITOR'S TRANSMITTAL

The Honorable Pat McCrory, Governor
The General Assembly of North Carolina
Board of Directors, University of North Carolina Health Care System

We have completed a financial statement audit of the University of North Carolina Health Care System Funds (System Fund) for the year ended June 30, 2014, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

Our consideration of internal control over financial reporting and compliance and other matters based on an audit of the financial statements disclosed a deficiency that is detailed in the Findings, Recommendations, and Responses section of this report. The System Fund's response is included following the finding.

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

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

Beth A. Wood, CPA
State Auditor



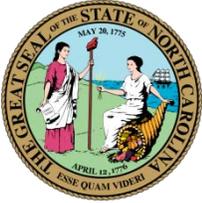
Beth A. Wood, CPA
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Article V, Chapter 147 of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency. The Auditor also has the power to summon people to produce records and to answer questions under oath.

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying financial statements of the University of North Carolina Health Care System Funds (System Fund), a part of the University of North Carolina Health Care System, which is a part of the multi-campus University of North Carolina System, a component unit of the State of North Carolina, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the System Fund's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the System Fund's preparation and fair presentation of

the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the System Fund's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the University of North Carolina Health Care System Funds, as of June 30, 2014, and the changes in financial position and cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

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

Other Matters – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated June 12, 2015 on our consideration of the System Fund's 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 internal control over financial

reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System Fund's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Beth A. Wood". The signature is written in a cursive, flowing style.

Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

June 12, 2015



MANAGEMENT'S DISCUSSION AND ANALYSIS

Introduction

Management's discussion and analysis provides an overview of the financial activities of the University of North Carolina Health Care System (UNC Health Care) Funds (System Fund) for the fiscal year ending June 30, 2014.

UNC Health Care was established November 1, 1998, by *North Carolina General Statute 116-37*. UNC Health Care is governed by a Board of Directors as an affiliated enterprise of the University of North Carolina System. UNC Health Care and UNC Chapel Hill School of Medicine (UNC School of Medicine) are affiliated entities within the University System. The University of North Carolina Faculty Physicians (UNCFP) is the clinical service component of the UNC School of Medicine and provides a full range of care to the patients of UNC Health Care. Rex Healthcare, Inc. (Rex), Chatham Hospital, Inc. (Chatham), High Point Regional Health, Inc. (HPRH), Caldwell Memorial Hospital (Caldwell), UNC Physicians Network, LLC (UNCPN), Johnston Health Services Corporation, and UNC Physicians Network Group Practice (UNCPNGP) have been added to the organization since its inception. Entities listed above collectively perform the operating functions of UNC Health Care and the UNC School of Medicine. The System Fund, conversely, does not perform revenue generating activities. The System Fund functions as a centralized financial clearinghouse for the integrated health care system.

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

Using this Financial Report

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

The *Statement of Net Position* provides the financial position and includes all assets (resources), deferred outflows of resources, liabilities (claims to resources), deferred inflows of resources, and net position (equity). Assets and liabilities on this Statement are categorized as either current or noncurrent. Current assets are those that are available to pay for expenses in the next fiscal year, and it is anticipated that they will be used to pay for current liabilities. Current liabilities are those payable in the next fiscal year. Net position on this statement is categorized as net investment in capital assets and unrestricted. Management estimates are necessary in some instances to determine current or noncurrent categorization. The *Statement of Net Position* provides information relative to the financial strength of the System Fund and its ability to meet current and long-term obligations.

The *Statement of Revenues, Expenses, and Changes in Net Position* provides information relative to the results of the System Fund's operations, nonoperating activities, and other activities affecting net position. Nonoperating activities include interest income. Other activities include transfers in and transfers out from/to UNC Health Care entities. The

Statement of Revenues, Expenses, and Changes in Net Position provides information relative to the management of the organization's operations and its ability to maintain its financial stability.

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

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, information on long-term liabilities, capital assets, receivables, payables, and transfers in and out. These disclosures provide information to better understand details, risk and uncertainty associated with the amounts reported and are considered an integral part of the financial statements.

Comparison of Two-Year Data for 2014 to 2013

Audited data for 2014 and 2013 are presented in Table 1 of this report and discussed in the following sections. Discussion in the following sections is pertinent to fiscal year 2014 results and changes relative to ending balances in fiscal year 2013.

Analysis of Overall Financial Position and Results of Operations

Statement of Net Position

The sub-accounts of the System Fund collectively hold assets of \$262.9 million. Total assets increased by 103.6% over the prior year. Total liabilities increased by 185.4%. Pre-payments of UNC Hospitals' fiscal year 2015 commitments decreased by \$13.5 million over last year and account for 10.0% of the System Fund assets and 11.3% of the System Fund liabilities as of June 30, 2014. Assets associated with the Enterprise Fund, the Patient Safety Fund, and the Shared Administrative Services Fund increased due to higher assessments in fiscal year 2014 to support UNC Health Care initiatives.

Total assets increased overall due to the acquisition and construction of capital assets. The Enterprise Fund made \$3.9 million contributions toward the upfit costs of the facility at Carolina Crossing in Chapel Hill. The System Fund also implemented a system-wide electronic medical record (EMR) system during the year across all entities in the Triangle area. Implementation costs for the EMR system totaled \$86.0 million for fiscal year 2014. Implementation costs will continue into fiscal year 2016 as the EMR system is implemented at the remaining entities.

Current liabilities associated with the Shared Administrative Services Fund increased \$81.8 million due to increased shared costs associated with the EMR system. Noncurrent liabilities increased \$70.2 million as the System Fund entered into promissory note agreements with UNC Hospitals, Rex, and UNCFP to fund the implementation of the system-wide EMR system.

Statement of Revenues, Expenses, and Changes in Net Position

Transfers in and out of the System Fund increased during fiscal year 2014, compared to fiscal year 2013. This was largely due to the implementation of the electronic medical record system. Transfers out of the System Fund ultimately exceeded transfers into the System Fund by \$16.7 million. Thus, net position decreased by \$18.3 million including interest income and depreciation and amortization expense.

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

UNC Health Care derives the vast majority of its operating revenues from patient care services. In recent years, the largest entities of UNC Health Care experienced strong operating performance. That performance has enabled investments made in support of the clinical, education, and research programs of UNCFP and the UNC School of Medicine. These investments have yielded positive results as measured by growth in needed services, expansion of the medical school class and increased research funding.

The healthcare sector continues to face tumultuous change. Pressure on healthcare providers has come in the form of expectations to provide greater value at a lower cost, to have fully interoperable electronic health records, to care for the uninsured, to integrate care for individual patients, and to improve wellness across populations.

UNC Health Care has sought to remain a leader in evolving to meet the demands of the changing environment. We are making infrastructure investments to modernize our patient care. The inpatient census at the academic medical center in Chapel Hill is regularly near maximum capacity. Further, many of our facilities, especially in procedural areas, were designed for the way care was delivered five decades ago. To address these needs, we are developing our Hillsborough Campus as an extension of the academic campus and a perioperative tower on the Chapel Hill campus. These facilities are being designed to optimize efficiency and the patient experience.

During fiscal year 2014, we implemented an integrated medical record across all of our Triangle service area. UNC Health Care long operated with electronic medical records. However, the system used at the academic medical center was unique from the system at Chatham Hospital, the system at Rex Hospital, or the several systems used in our community physician practices and new affiliates. These systems did not "talk" well with one another and any form of data transfer between them was limited and cumbersome. Therefore, we established a vision for one patient to have one record everywhere within UNC Health Care. We implemented the EMR system at UNC Medical Center (UNC Hospitals and UNCFP), Rex, Chatham and the UNCPN physician practices in fiscal year 2014. The phased rollout will continue across our remaining entities in fiscal years 2015 and 2016. This is a pervasive endeavor requiring organizational focus and resources.

The fiscal state of healthcare across the nation is in the midst of rapid change. Increasingly, third-party payors, including governmental sponsored programs, are migrating from fee-for-service to fee-for-value. Traditional payment mechanisms have paid providers for each intervention. As a result, providers have been paid more for providing more care, not necessarily for providing better care. UNC Health Care is seeking ways to shift to a new model that shifts risk and accountability to UNC Health Care. UNC Health Care is positioning itself to be a leader in the new healthcare environment that will ultimately reimburse less for services currently provided to our patients. We are testing a number of different programs

aimed at learning how to continue to prosper in this new healthcare environment. We have implemented programs aimed at different aspects of population health management at each of our medical institutions. These programs include an operational and strategic partnership with Alignment Healthcare for population management. This partnership will kick off with the offering of a new Medicare Advantage HMO plan for seniors in Wake County, North Carolina in the fall of 2014. This is but one example among several that we are pursuing as we embrace the long-term view that to increase the value of our clinical services, we must accept and be rewarded for accepting increased accountability and risk.

We are engaging with new partners as the provider community consolidates. Of the more than 100 hospitals in North Carolina, today fewer than 25 remain unaffiliated with larger systems. Nationally and in North Carolina, the increasing demands on providers, both physician groups and hospitals, has caused many to seek partners in larger systems. Several of these - High Point Regional Health System, Caldwell Memorial Hospital, and Johnston Health Services Corporation have joined UNC Health Care. With our help, these hospitals will be able to provide more of the care needed in local communities, they will be able to access our state-of-the-art information systems (e.g. Epic) that are otherwise unaffordable, and they will become more efficient by leveraging UNC Health Care's scale.

We are responding to the State's needs and the needs of underserved populations. UNC Health Care has proudly cared for underserved patients as a safety net provider. In recent years, the cost we incur for those unable to pay for their care has exceeded \$300 million. We also serve North Carolina in other ways such as providing much of the specialty and hospital care for the Department of Public Safety. We have found multiple cost-saving measures that will preserve taxpayer resources. In early 2013, we also extended our psychiatric services in Wake County. We have opened new inpatient acute psychiatric beds, but also operate two levels of step down care that can be a model for better care.

UNC Health Care agreed to provide, enhance and expand all services offered in the past at Wake County's Wake Brook facility. Pursuant to agreements with Wake County and Alliance Behavioral Health, UNC Health Care began with the operation of WakeBrook Crisis and Assessment services on February 1, 2013. WakeBrook is now fully operational, providing the behavioral health and medical services in the areas of crisis and assessment, residential facility, detoxification bed, onsite medical care, primary care clinic and an Assertive Community Treatment Team. WakeBrook was included in UNC Hospital's accreditation survey by The Joint Commission in December 2013. UNC Health Care committed to invest \$40 million in behavioral health services in Wake County, including the operation of 28 inpatient beds, over the next five to ten years. The System Fund is key to the funding of this program.

Successfully managing in the future requires tighter integration of administrative functions across the entities of UNC Health Care, caring for patients in lower cost delivery settings, and at sufficient scale to spread the cost of major investments across a broad base. UNC Health Care continues to plan for these changes through a health system wide planning and implementation process.

University of North Carolina Health Care System Funds
 Summary of Condensed Financial Statements Totals
 For the Fiscal Years Ended June 30, 2014 and 2013

Table 1

	FY14	FY13	Change	% Change
STATEMENTS OF NET POSITION				
Current Assets	\$ 158,476,227	\$ 112,853,240	\$ 45,622,987	40.4%
Capital Assets, Net	89,578,026	1,438,864	88,139,162	6125.6%
Noncurrent Assets	14,852,619	14,844,132	8,487	0.1%
TOTAL ASSETS	262,906,872	129,136,236	133,770,636	103.6%
Current Liabilities	149,009,065	67,159,388	81,849,677	121.9%
Noncurrent Liabilities	85,058,550	14,844,132	70,214,418	473.0%
TOTAL LIABILITIES	234,067,615	82,003,520	152,064,095	185.4%
Net Investment in Capital Assets	3,001,337	1,438,864	1,562,473	108.6%
Unrestricted	25,837,920	45,693,852	(19,855,932)	(43.5%)
TOTAL NET POSITION	\$ 28,839,257	\$ 47,132,716	\$ (18,293,459)	(38.8%)
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION				
Operating Revenues	\$ 0	\$ 0	\$ 0	0.0%
Operating Expenses:				
Depreciation and Amortization	1,797,674		1,797,674	100.0%
Operating Loss	(1,797,674)		(1,797,674)	(100.0%)
Nonoperating Revenues	223,700	246,674	(22,974)	(9.3%)
Transfers In	424,159,748	275,784,961	148,374,787	53.8%
Transfers Out	440,879,233	269,155,080	171,724,153	63.8%
INCREASE/(DECREASE) IN NET POSITION	(18,293,459)	6,876,555	(25,170,014)	(366.0%)
NET POSITION - Beginning of Year	47,132,716	40,256,161	6,876,555	17.1%
NET POSITION - End of Year	\$ 28,839,257	\$ 47,132,716	\$ (18,293,459)	(38.8%)



FINANCIAL STATEMENTS

University of North Carolina Health Care System Funds
Statement of Net Position
June 30, 2014

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents:

Undesignated Funds (Note 2)	\$ 611,139
Designated for UNC Faculty Physicians Program Support (Note 2)	26,795,949
Designated for UNC Faculty Physicians Mission Support (Note 2)	11,173,882
Designated for Shared Administrative Services (Note 2)	2,277,953
Designated for UNC Faculty Recruitment (Note 2)	<u>5,750,000</u>

Cash and Cash Equivalents Total	46,608,923
Due from UNC Health Care Entities (Note 3)	<u>111,867,304</u>

Total Current Assets	<u>158,476,227</u>
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Noncurrent Assets:

Assets Whose Use is Limited or Restricted (Note 5)	14,852,619
Capital Assets - Nondepreciable (Note 4)	5,355,079
Capital Assets - Depreciable, Net (Note 4)	<u>84,222,947</u>

Total Noncurrent Assets	<u>104,430,645</u>
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Total Assets	<u>262,906,872</u>
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DEFERRED OUTFLOWS OF RESOURCES

Total Deferred Outflows of Resources	<u>0</u>
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LIABILITIES

Current Liabilities:

Due to UNC Health Care Entities (Note 6)	108,779,058
Due to UNC School of Medicine	6,959,348
Notes Payable (Note 7)	6,870,659
Assessments Paid in Advance	<u>26,400,000</u>

Total Current Liabilities	<u>149,009,065</u>
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Noncurrent Liabilities:

Notes Payable (Note 7)	70,205,931
Funds Held in Escrow (Note 5)	<u>14,852,619</u>

Total Noncurrent Liabilities	<u>85,058,550</u>
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Total Liabilities	<u>234,067,615</u>
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DEFERRED INFLOWS OF RESOURCES

Total Deferred Inflows of Resources	<u>0</u>
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NET POSITION

Net Investment in Capital Assets	3,001,337
Unrestricted	<u>25,837,920</u>

Total Net Position	<u>\$ 28,839,257</u>
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The accompanying notes to the financial statements are an integral part of this statement.

University of North Carolina Health Care System Funds
Statement of Revenues, Expenses, and
Changes in Net Position
For the Fiscal Year Ended June 30, 2014

Exhibit A-2

REVENUES	
Operating Revenues	\$ 0
EXPENSES	
Operating Expenses:	
Depreciation/ Amortization	1,797,674
Operating Loss	(1,797,674)
NONOPERATING REVENUES	
Interest Income	223,700
TRANSFERS IN	
Regular Assessments (Note 8)	47,978,741
Special Assessments (Note 8)	95,108,117
Mission Support Assessments (Note 8)	1,668,773
Shared Administrative Services Assessments (Note 8)	279,404,117
Total Transfers In	424,159,748
TRANSFERS OUT	
Program Support (Note 9)	153,387,395
Shared Administrative Services (Note 9)	282,991,838
Mission Support (Note 9)	4,500,000
Total Transfers Out	440,879,233
Decrease in Net Position	(18,293,459)
NET POSITION	
Net Position, July 1, 2013	47,132,716
Net Position, June 30, 2014	\$ 28,839,257

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

University of North Carolina Health Care System Funds
Statement of Cash Flows
For the Fiscal Year Ended June 30, 2014

Exhibit A-3

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Transfers In from Entities	\$ 370,253,071
Transfers Out to Entities	(387,428,179)
Upper Payment Limit Pass-through Payments Received	38,124,975
Upper Payment Limit Pass-through Payments	(42,486,440)
Certified Public Expenditures Payments Received	<u>3,977,437</u>
Net Cash Used by Noncapital Financing Activities	<u>(17,559,136)</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Proceeds from Capital Debt	51,326,000
Acquisition and Construction of Capital Assets	<u>(55,233,310)</u>
Net Cash Used by Capital and Related Financing Activities	<u>(3,907,310)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Interest Income	<u>223,700</u>
Net Decrease in Cash and Cash Equivalents	(21,242,746)
Cash and Cash Equivalents, July 1, 2013	<u>67,851,669</u>
Cash and Cash Equivalents, June 30, 2014	<u>\$ 46,608,923</u>

RECONCILIATION OF CASH AND CASH EQUIVALENTS

Current Assets:	
Cash and Cash Equivalents	<u>\$ 46,608,923</u>
Total Cash and Cash Equivalents - June 30, 2014	<u>\$ 46,608,923</u>

NONCASH INVESTING, CAPITAL, AND FINANCING ACTIVITIES

Assets Acquired through Assumption of a Liability	\$ 35,250,689
Increase in Receivables Related to Capital Debt Proceeds	25,750,590

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



NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - SIGNIFICANT ACCOUNTING POLICIES

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

UNC Health Care is governed by a Board of Directors (Board) as an affiliated enterprise of the University of North Carolina (UNC) System. UNC Health Care and UNC-CH are affiliated entities within the University of North Carolina System. The University of North Carolina Faculty Physicians (UNCFP) is the clinical service component of the UNC School of Medicine and provides a full range of care to patients of UNC Health Care. Rex Healthcare, Inc. (Rex), Chatham Hospital, Inc. (Chatham), High Point Regional Health Inc., Caldwell Memorial Hospital, UNC Physicians Network, LLC (UNCPN), and UNC Physicians Network Group Practices, LLC are owned and controlled entities within UNC Health Care, an integrated health care provider.

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

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

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

The Enterprise Fund – The Enterprise Fund provides support for the teaching, research and clinical missions of UNC Health Care and the UNC School of Medicine. It is funded by assessments against revenues of UNC Health Care entities and UNC School of Medicine, made at least annually. Assessments to the constituent entities are determined on an annual basis or more often as necessary. UNC Hospitals, UNCFP, and Rex make additional mission support contributions to the Enterprise Fund if they have met required organizational goals.

The Outreach Fund – The Outreach Fund was initially invested in innovative projects designed to improve the health of the community with

particular focus on geriatrics and other underserved constituencies. The initial funds were formed by a one-time contribution from UNC Hospitals. These funds were fully expended by the end of fiscal year 2009. The Outreach Fund was subsequently re-chartered in fiscal year 2010 by a transfer from the Enterprise Fund in the amount of \$10,000,000. These funds were expended at a rate of \$2,000,000 per year to offset expenses incurred by clinical departments for graduate medical education (GME). These funds have been fully expended as of June 30, 2014.

The Recruitment Fund – The Recruitment Fund was established through a special assessment at the end of fiscal year 2010 in the amount of \$7,000,000, to enable critical faculty recruitments to the UNC School of Medicine. The Recruitment Fund is designed to provide salary support for recruitments deemed critical to the missions of the UNC School of Medicine. It was formed by contributions from UNC Hospitals, UNCFP, and several UNC School of Medicine clinical departments in response to a crisis in UNC Health Care’s cardiac surgery program. These funds are set aside to enable UNC Hospitals, UNCFP, and the UNC School of Medicine to collaboratively recruit faculty physicians to better serve the people of North Carolina. During fiscal year 2014, allocations were made to the departments of Heart and Vascular and Surgery to the tune of \$750,000 and \$500,000, respectively.

The Patient Safety Fund – The Patient Safety Fund (Performance Improvement and Patient Safety Innovations Fund or PIPSIF) enables UNC Health Care to designate resources specifically intended to improve patient care and further reduce potential harm to patients.

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

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

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

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

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

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

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

- E. Cash and Cash Equivalents** - This classification includes deposits held by the State Treasurer in the Short-Term Investment Fund (STIF). The STIF 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. 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 System Fund capitalizes assets that have a value or cost of \$5,000 or greater at the date of acquisition and an estimated useful life of more than one year except for internally generated software which is capitalized when the value or cost is \$1,000,000 or greater.

Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the assets, generally 10 years for computer software and 5 years for computer hardware.

G. Net Position - The System Fund's net position is classified as follows:

Net Investment in Capital Assets – This represents the System Fund's total investment in capital assets, net of outstanding debt obligations and payables 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 Net Investment in Capital Assets.

Unrestricted Net Position - Unrestricted net position includes resources derived from assessments, mission support, shared administrative services, and interest income.

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

Regular Assessments – Ongoing funding needs which are estimated annually based on requests submitted, reviewed and approved, and paid for by monies transferred from UNC Health Care entities and UNC School of Medicine. Funding amounts required and the corresponding assessments are determined annually but may be revised throughout the year as necessary.

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

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

UNC Hospitals, UNCFP, and Rex make additional payments to the System Fund if a specific set of predetermined organizational goals are achieved. Mission Support was first established in fiscal year 2009 and has been paid in each subsequent year. Rex made additional mission support payments to the System Fund during the fiscal year, and the goal is for all of the other UNC Health Care entities to contribute in the future.

Program Support – The primary function of the System Fund is to support those programs that have been identified as being beneficial to achieving UNC Health Care's patient care, research, and education mission but that cannot support themselves or otherwise need additional

funding to achieve the desired outcome. Program Support payments fill the funding gap for these programs.

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

NOTE 2 - DEPOSITS

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

At June 30, 2014, the amount shown on the Statement of Net Position as current cash and cash equivalents of \$46,608,923 represents the System Fund's equity position in the State Treasurer's STIF. The STIF (a portfolio within the State Treasurer's Investment Pool, an external investment pool that is not registered with the Securities and Exchange Commission and does not have a credit rating) had a weighted average maturity of 1.3 years as of June 30, 2014. Assets and shares of the STIF are valued at amortized cost, which approximates fair value. Deposit and investment risks associated with the State Treasurer's Investment Pool (which includes the State Treasurer's STIF) are included in the State of North Carolina's *Comprehensive Annual Financial Report*. An electronic version of this report is available by accessing the North Carolina Office of the State Controller's Internet home page <http://www.osc.nc.gov/> and clicking on "Reports," or by calling the State Controller's Financial Reporting Section at (919) 707-0500.

NOTES TO THE FINANCIAL STATEMENTS

A reconciliation of deposits and corresponding designations as of June 30, 2014 is as follows:

	Enterprise Fund	Recruitment Fund	Patient Safety Fund	Shared Administrative Services Fund	Total
Deposits					
Current:					
Undesignated Funds	\$ 0	\$ 0	\$ 611,139	\$ 0	\$ 611,139
Designated for UNCFP Program Support	26,795,949				26,795,949
Designated for UNCFP Mission Support	11,173,882				11,173,882
Designated for Shared Administrative Services				2,277,953	2,277,953
Designated for UNC Faculty Recruitment		5,750,000			5,750,000
Total Deposits	\$ 37,969,831	\$ 5,750,000	\$ 611,139	\$ 2,277,953	\$ 46,608,923

NOTE 3 - DUE FROM UNC HEALTH CARE ENTITIES

Amounts due from UNC Health Care entities at June 30, 2014 by type and entity were as follows:

	Amount
Assessments	
UNC Hospitals	\$ 5,320,641
UNC Faculty Physicians	13,366,960
Rex Healthcare	7,895,284
Chatham Hospital	242,766
High Point Regional	50,000
UNC Physicians Network	297,454
Subtotal	27,173,105
Shared Administrative Services	
UNC Hospitals	30,125,900
UNC Faculty Physicians	6,838,262
Rex Healthcare	45,684,383
High Point Regional	250,000
UNC Physicians Network	1,795,654
Subtotal	84,694,199
Total Due from UNC Health Care Entities	\$ 111,867,304

NOTE 4 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2014, is presented as follows:

	Balance July 1, 2013	Increases	Decreases	Balance June 30, 2014
Capital Assets, Nondepreciable:				
Construction in Progress	\$ 1,438,864	\$ 3,916,215	\$ 0	\$ 5,355,079
Total Capital Assets, Nondepreciable	1,438,864	3,916,215		5,355,079
Capital Assets, Depreciable:				
Computer Software		79,492,051		79,492,051
Computer Hardware		6,528,570		6,528,570
Total Capital Assets, Depreciable		86,020,621		86,020,621
Less Accumulated Depreciation/ Amortization for:				
Computer Software		1,492,900		1,492,900
Computer Hardware		304,774		304,774
Total Accumulated Depreciation/ Amortization		1,797,674		1,797,674
Total Capital Assets, Depreciable, Net		84,222,947		84,222,947
Capital Assets, Net	\$ 1,438,864	\$ 88,139,162	\$ 0	\$ 89,578,026

NOTE 5 - ESCROW FOR CERTIFIED PUBLIC EXPENDITURES

With the help of the North Carolina Hospital Association, UNC Health Care entered into an agreement to receive the benefit of additional Certified Public Expenditures (CPEs) (as defined by Federal Regulation 45 CFR 95.13 and 42 CFR 433.51) from public hospitals (as defined in the North Carolina State Plan for Medicaid payments) that chose to assist UNC Health Care System meet its obligations to fund the remaining Disproportionate Share Hospital (DSH) allotment. DSH payments are special payments for hospitals which serve a disproportionate share of low income patients. By making additional CPEs available, the public hospitals risk possible DSH overpayments that would require repayment to state or federal agencies. In order to mitigate the public hospitals' risk, UNC Health Care established a reserve fund to be held in escrow. This fund will reimburse participating public hospitals for any repayments that should result from this program. At June 30, 2014, \$14,852,619 was held by the Escrow Agent, First-Citizens Bank & Trust Company.

NOTE 6 - DUE TO UNC HEALTH CARE ENTITIES

Amounts due to UNC Health Care entities at June 30, 2014 by type and entity were as follows:

	<u>Amount</u>
Allocations	
UNC Hospitals	\$ 2,436,926
UNC Faculty Physicians	<u>7,355,835</u>
Subtotal	<u>9,792,761</u>
Shared Administrative Services	
UNC Hospitals	80,034,723
UNC Faculty Physicians	2,881,762
Rex Healthcare	15,585,682
Chatham Hospital	216,199
UNC Physicians Network	<u>267,931</u>
Subtotal	<u>98,986,297</u>
Total Due to UNC Health Care Entities	<u><u>\$ 108,779,058</u></u>

NOTE 7 - NOTES PAYABLE

The System Fund borrowed \$77,076,590 from UNC Hospitals, Rex, and UNCFP to fund the purchase and implementation of UNC Health Care's electronic medical record system (EMR). The principal amount is to be repaid in 120 monthly installments at a simple interest rate equal to 2.5%. The holders acknowledge that the System Fund's ability to repay the note is dependent upon EMR user fees charged to the UNC Health Care constituent entities. In the event such user fees fail to support the note's repayment, the parties agree to negotiate, in good faith, a restructuring of the note.

Notes payable activity for the year ended June 30, 2014 is presented as follows:

<u>Entity</u>	<u>Balance July 1, 2013</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2014</u>	<u>Current Portion</u>
UNC Hospitals	\$ 0	\$ 40,881,862	\$ 0	\$ 40,881,862	\$ 3,644,237
Rex Healthcare		23,668,447		23,668,447	2,109,821
UNC Faculty Physicians		<u>12,526,281</u>		<u>12,526,281</u>	<u>1,116,601</u>
Total Notes Payable	<u>\$ 0</u>	<u>\$ 77,076,590</u>	<u>\$ 0</u>	<u>\$ 77,076,590</u>	<u>6,870,659</u>

NOTE 8 - TRANSFERS IN

Transfers in by source and entity at June 30, 2014 are as follows:

	<u>Amount</u>
Regular Assessments:	
UNC Hospitals	\$ 28,740,683
UNC Faculty Physicians	14,902,059
Rex Healthcare	2,950,026
Chatham Hospital	155,403
High Point Regional	600,000
Caldwell Memorial	240,000
UNC Physicians Network	90,570
UNC School of Medicine	300,000
	<u>47,978,741</u>
Total Regular Assessments	<u>\$ 47,978,741</u>
Special Assessments:	
UNC Hospitals	\$ 60,685,084
UNC Faculty Physicians	3,367,796
Rex Healthcare	30,011,814
First Health	1,043,423
	<u>95,108,117</u>
Total Special Assessments	<u>\$ 95,108,117</u>
Mission Support:	
Rex Healthcare	\$ 1,668,773
	<u>1,668,773</u>
Shared Administrative Services:	
UNC Hospitals	\$ 154,966,309
UNC Faculty Physicians	45,231,683
Rex Healthcare	64,656,339
Chatham Hospital	3,375,860
UNC Physicians Network	10,773,924
High Point Regional	250,000
Caldwell Memorial	150,002
	<u>279,404,117</u>
Total Shared Administrative Services	<u>\$ 279,404,117</u>

NOTE 9 - TRANSFERS OUT

Transfers out by purpose and entity at June 30, 2014 are as follows:

	<u>Amount</u>
Program Support:	
UNC Faculty Physicians	
Anesthesiology	\$ 11,785,000
Emergency Medicine	1,150,000
Gastroenterology	850,000
Heart & Vascular	4,550,001
Hepatology	980,000
Medical Office Building - Hillsborough	4,349,148
Neonatology	4,500,000
Neurology	3,986,713
Obstetrics Gynecology	574,520
Oncology	7,291,285
Orthopaedics	3,333,990
Other	6,320,628
Pathology	1,400,000
Pediatrics	2,115,638
Psychiatry	1,303,322
Primary Care	850,000
Radiology	1,140,000
Surgery	4,705,000
Urology	1,444,443
	<hr/>
Total UNC Faculty Physicians Program Support	62,629,688
UNC Hospitals	2,436,926
UNC School of Medicine	8,678,652
UNC Physicians Network	22,692,129
High Point Regional Medical Center	25,000,000
Caldwell Memorial Hospital	5,000,000
Johnston Health	26,200,000
Piedmont Health	750,000
	<hr/>
Total Program Support	<u>\$ 153,387,395</u>
Shared Administrative Services:	
UNC Hospitals	\$ 224,246,705
UNC Faculty Physicians	28,210,706
Rex Healthcare	29,297,875
Chatham Hospital	1,131,128
UNC Physicians Network	105,424
	<hr/>
Total Shared Administrative Services	<u>\$ 282,991,838</u>
Mission Support:	
UNC Faculty Physicians	<u>\$ 4,500,000</u>

NOTE 10 - RELATED PARTIES

University of North Carolina Hospitals at Chapel Hill - The UNC Hospitals at Chapel Hill (UNC Hospitals) is the only state-owned teaching hospital in North Carolina. With a licensed base of 830 beds, this facility serves as an

acute care teaching hospital for the University of North Carolina at Chapel Hill. As a state agency, UNC Hospitals conforms to financial requirements established by statutory and constitutional provisions. While UNC Hospitals is exempt from both federal and state income taxes, a small portion of its revenue is subject to the unrelated business income tax.

UNC Hospitals paid \$244,392,076 for assessments and shared administrative services to the System Fund and extended a \$40,881,862 note receivable to the System Fund over the course of the year. Likewise, the System Fund also made \$226,683,631 in payments to UNC Hospitals for program support and shared administrative services expenses during the year ended June 30, 2014.

University of North Carolina School of Medicine – The UNC School of Medicine was assessed and paid the System Fund \$300,000 during the year and received \$8,678,652 in program support during the year ended June 30, 2014.

University of North Carolina Faculty Physicians – The UNC Faculty Physicians (UNCFP) is the clinical service component of the UNC School of Medicine. At the heart of UNCFP are the approximately 1,100 faculty physicians who provide a full range of specialty and primary care services for patients of UNC Health Care. While the great majority of services are rendered at the inpatient units of UNC Hospitals and the outpatient clinics on the UNC campus, there is a growing range of services provided at clinics in the community. There are 19 clinical departments, two affiliated departments, and two administrative units that collectively form UNCFP.

Clinical Departments:

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

Affiliated Departments:

- Allied Health Sciences
- Center for Development and Learning

Administrative Units:

- Administrative Office
- Ambulatory Administration

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

UNCFP paid \$63,501,538 for assessments and shared administrative services to the System Fund and extended a \$12,526,281 note receivable to the System Fund over the course of the year. The System Fund also made payments to UNCFP in the amount of \$95,340,394 for program support, mission support, and shared administrative services reimbursements during the year ended June 30, 2014.

Rex Healthcare, Inc. – Rex Healthcare, Inc. (Rex) is a North Carolina not-for-profit corporation organized to provide a wide range of health care services to the residents of the Triangle area of North Carolina.

UNC Health Care is the sole member of the corporation and appoints eight of the 13 seats on Rex's Board of Trustees and also reviews and approves Rex's annual operating and capital budgets.

Rex paid \$99,286,952 for assessments, mission support, and shared administrative services to the System Fund and extended a \$23,668,447 note receivable to the System Fund over the course of the year. The System Fund also made payments to Rex in the amount of \$29,297,875 for shared administrative service expenses during the year ended June 30, 2014.

Chatham Hospital, Inc. – Chatham Hospital, Inc. (Chatham) is a private, nonprofit corporation that owns and operates a critical access facility located in Siler City, North Carolina. UNC Health Care is the sole member of Chatham, appoints nine of the 15 members on the Chatham Board, and reviews and approves its annual operating and capital budgets.

Chatham paid \$3,531,263 for assessments and shared administrative services to the System Fund and received \$1,131,128 for shared administrative service expenses during the year ended June 30, 2014.

UNC Physicians Network, LLC and UNC Physicians Network Group Practices, LLC – UNC Physicians Network, LLC (UNCPN) and UNC Physicians Network Group Practices, LLC are wholly-owned subsidiaries of UNC Health Care, but private employers that own and operate more than thirty community-based practices throughout the Triangle region of North Carolina (Raleigh, Durham, and Chapel Hill).

These are physician-led networks structured to meet the needs of the community and community practice physicians by creating a partnership for physicians and UNC Health Care to face the challenging health care environment.

UNCPN paid \$10,864,494 for assessments and shared administrative services to the System Fund and received \$22,797,553 for program support and shared administrative service expenses during the year ended June 30, 2014.

High Point Regional Health, Inc. – High Point Regional Health, Inc. (HPRH) is a not-for-profit corporation in High Point, North Carolina, organized to promote and advance charitable, educational and scientific purposes, and to provide and support health care services.

UNC Health Care became the sole corporate member of HPRH on March 31, 2013. HPRH is the parent holding company of High Point Regional Health Foundation, High Point Health Care Ventures, Inc., and High Point Regional Health Services, Inc.

HPRH paid \$850,000 for assessments and shared administrative services to the System Fund and received \$25,000,000 for program support during the year ended June 30, 2014.

Caldwell Memorial Hospital - Caldwell Memorial Hospital (Caldwell) is a private, not-for-profit community hospital in Lenoir, North Carolina and is an acute care hospital with a provider network of more than fifty primary and specialty care physicians and advanced practice professionals. UNC Health Care became the sole corporate member of Caldwell on May 1, 2013.

Caldwell paid \$390,002 for assessments and shared administrative services to the System Fund and received \$5,000,000 for program support during the year ended June 30, 2014.

Johnston Health Services Corporation – Effective February 1, 2014, Johnston Memorial Hospital Authority (JMHA) and the System entered into a Master Agreement to form Johnston Health Services Corporation (JHSC), a joint venture created to achieve the long term vision of providing high quality health care to the residents of Johnston County, North Carolina. Oversight and governance of the joint venture is controlled by a Board of Directors consisting of appointees from JMHA and UNC Health Care. UNC Health Care manages the day-to-day operations of JHSC under the terms of a Management Services Agreement entered into effective November 1, 2013. UNC Health Care has a 35.25 percent membership in JHSC.

In consideration of the agreement and 35.25 percent membership in JHSC, UNC Health Care agreed to provide \$57,600,000 in contributions over five years. UNC Health Care transferred \$26,200,000 of the contribution for the year ended June 30, 2014. A second cash contribution of \$26,400,000 is due in February 2015. Furthermore, a cash contribution of \$1,000,000 is due annually starting February 2015 and ending February 2019.

WakeBrook Mental Health Campus – UNC Health Care agreed to provide, enhance and expand all services offered in the past at Wake County's WakeBrook facility. Pursuant to agreements with Wake County and Alliance

Behavioral Health, UNC Health Care began with the operation of WakeBrook Crisis and Assessment services on February 1, 2013. WakeBrook is now fully operational, providing behavioral health and medical services in the areas of crisis and assessment, residential facility, detoxification beds, onsite medical care via the primary care clinic and Assertive Community Treatment Team.

The Enterprise Fund has committed to backstop the losses from WakeBrook operations.

First Health - UNC HCS, LLC – First Health - UNC HCS, LLC was a joint venture between UNC Health Care and First Health of the Carolinas, Inc., which was created to purchase and operate Sanford Hematology & Oncology (SHO), a clinic located in Sanford, North Carolina. Each entity had a 50% ownership interest in SHO.

UNC Health Care and First Health agreed that the future of the practice would be better served by First Health assuming sole ownership of the practice. Effective July 1, 2013, UNC Health Care sold its 50% share of the practice and the LLC was dissolved. UNC Health Care received \$1,043,423 in consideration of the dissolution.

STATE OF NORTH CAROLINA
Office of the State Auditor



Beth A. Wood, CPA
State Auditor

2 S. Salisbury Street
20601 Mail Service Center
Raleigh, NC 27699-0601
Telephone: (919) 807-7500
Fax: (919) 807-7647
<http://www.ncauditor.net>

**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
University of North Carolina Health Care System
Chapel Hill, North Carolina

We have audited, in accordance with the 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, the financial statements of the University of North Carolina Health Care System Funds (System Fund), a part of the University of North Carolina Health Care System, which is a part of the multi-campus University of North Carolina System, a component unit of the State of North Carolina, as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the System Fund's basic financial statements, and have issued our report thereon dated June 12, 2015.

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

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the System Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the System Fund's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable

possibility that a material misstatement of the System Fund's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying Findings, Recommendations, and Responses section, we identified a deficiency in internal control that we consider to be a significant deficiency.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System Fund's financial statements are free from 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*.

System Fund's Response to Findings

The System Fund's response to the finding identified in our audit is described in the accompanying Findings, Recommendations, and Responses section. The System Fund's response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the System Fund's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the System Fund's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Beth A. Wood, CPA
State Auditor

Raleigh, North Carolina

June 12, 2015



FINDINGS, RECOMMENDATIONS, AND RESPONSES

Matters Related to Financial Reporting

The following audit finding was identified during the current audit and describes a condition that represents a deficiency in internal control.

LACK OF FINANCIAL STATEMENT REVIEW LEFT ERRORS UNDETECTED

The financial statements and related notes to the financial statements prepared for the University of North Carolina Health Care System Funds contained errors and misclassifications that were corrected as a result of our audit.

A review of the System Fund's financial statements identified significant variances for the financial statement account balances between the year under audit and the previous year. Upon further review of the underlying financial information, auditors identified the following misstatements:

- The System Fund omitted \$22,692,129 in transfers received through special assessments from the UNC Health Care System entities. The System Fund also omitted the related transfers out to the UNC Physicians Network in the same amount. As a result, the transfers in (Special Assessments) and transfers out (Program Support) were understated.
- Funds Held in Escrow of \$14,852,619 were originally recorded as liabilities to UNC Health Care System entities. These funds are held in escrow in the event that it is necessary to reimburse public hospitals under a special agreement.¹

Additionally, the notes to the financial statements required multiple adjustments to correctly and fairly present the activities of the System Fund. The capital assets disclosure in the notes to the financial statements was omitted when submitted for audit.

Without these corrections, users of the financial statements could be misinformed about the System Fund's financial condition and results of operations.

These errors occurred because management did not perform a complete and thorough review of the financial statements. Had management performed a year-over-year analysis of the financial statement account balances, these misstatements would have been detected and corrected prior to submission for audit.

The System Fund's management is responsible for the fair presentation of the financial statements and related notes to the financial statements in conformity with accounting principles generally accepted in the United States. Additionally, best practices require management to periodically review and analyze financial information. The Government Accountability Office (GAO) recommends that senior management should regularly review actual performance against prior period results.² The GAO also recommends that "financial and program managers review and compare financial, budgetary, and operational performance to planned or expected results."

¹ See Note 5 in the Notes to the Financial Statements for further information on the arrangement between the UNC Health Care System and the public hospitals.

² GAO, Internal Control Management and Evaluation Tool, 2001

Recommendation

The System Fund's management should perform a thorough review of the financial statements submitted for audit to evaluate and assess the accuracy of the financial information reported.

Response

Management agrees with the Auditor's recommendation. A thorough review of the financial statements will be completed including an analysis of the financial statements in comparison to the prior year.

ORDERING INFORMATION

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Office of the State Auditor
State of North Carolina
2 South Salisbury Street
20601 Mail Service Center
Raleigh, North Carolina 27699-0601

Telephone: 919-807-7500
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For additional information contact:
Bill Holmes
Director of External Affairs
919-807-7513

