

# 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, 2017

AN AFFILIATED ENTERPRISE OF THE UNIVERSITY OF NORTH CAROLINA  
SYSTEM AND A COMPONENT UNIT OF THE STATE OF NORTH CAROLINA



**NCOSA**  
The Taxpayers' Watchdog

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



**Beth A. Wood, CPA**  
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## AUDITOR'S TRANSMITTAL

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The Honorable Roy Cooper, 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 for the year ended June 30, 2017, and our audit results are included in this report. You will note from the independent auditor's report that we determined that the financial statements are presented fairly in all material respects.

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

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

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

Beth A. Wood, CPA  
State Auditor



Beth A. Wood, CPA  
State Auditor

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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 and any organization that receives public funding. The Auditor also has the power to summon people to produce records and to answer questions under oath.



# **INDEPENDENT AUDITOR'S REPORT**

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



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

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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), which is a part of the University of North Carolina Health Care System that is an affiliated enterprise 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, 2017, 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, 2017, 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 of the University of North Carolina Health Care System Funds are intended to present the financial position, changes in financial position, and cash flows that are only attributable to the transactions of the University of North Carolina Health Care System Funds. They do not purport to, and do not, present fairly the financial position of the University of North Carolina Health Care System nor the University of North Carolina System as of June 30, 2017, the changes in its financial position, or its cash flows, for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### Other Matters – Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis, as listed in the table of contents, 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 11, 2018 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, reading "Beth A. Wood". The signature is written in a cursive, flowing style.

Beth A. Wood, CPA  
State Auditor

Raleigh, North Carolina

June 11, 2018



# **MANAGEMENT'S DISCUSSION AND ANALYSIS**



## Introduction

Management's discussion and analysis provides an overview of the financial position activities of the University of North Carolina Health Care System (UNC Health Care) Funds (System Fund) for the fiscal year ended June 30, 2017.

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 the 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), and UNC Physicians Network Group Practice (UNCPNGP) have been added to the organization since its inception. Entities listed above, along with UNC Hospitals at Chapel Hill, 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, 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. Operating revenues include activities that have characteristics of exchange transactions, such as the user fees charged to UNC Health Care entities for using assets held by the System Fund. Nonoperating activities include investment

transactions. Other activities include transfers in and transfers out from/to UNC Health Care entities and the UNC School of Medicine. 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 operating activities, 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 and investments, fair value measurements, investment in affiliates, the System Fund's escrow account for certified public expenditures, information on long-term liabilities, capital assets, receivables, payables, transfers in and out, related parties, and subsequent events. 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 2017 to 2016**

Data for 2017 and 2016 are presented in Table 1 of this report and discussed in the following sections. Discussion in the following sections is pertinent to fiscal year 2017 results and changes relative to ending balances in fiscal year 2016.

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

#### **Statement of Net Position**

The sub-accounts of the System Fund collectively hold assets of \$510.8 million. Total assets increased by \$76.2 million, or 17.5%, over the prior year. Cash on hand increased by \$78.5 million of which a significant portion was related to UNC Hospitals' prepayment of \$38.4 million for fiscal year 2018 commitments and the capital user fees paid in advance by the System Fund's owned and managed entities. Noncurrent assets increased by \$30.1 million primarily due to the System Fund's investment of \$20.1 million with UNC Management Company. See Note 2 and Note 3 for further details on investments.

The other significant increases in total assets resulted from the capital assets associated with the implementation of a system-wide electronic medical record (EMR) system during the year. Continued costs for the EMR system and other IT costs were approximately \$56.3 million for fiscal year 2017. Implementation costs have been completed for all the system affiliates, but optimization of the system and implementation for managed entities will continue in fiscal year 2018. See Note 5 to the financial statements for further details on capital assets.

Total liabilities increased by \$49.3 million, or 15.5%. Long-term liabilities increased by \$15.4 million due entirely to the increase in notes payable. An additional \$32.3 million was borrowed from UNC Health Care entities to complete phase two of system-related capital purchases detailed below. Other noncurrent liabilities increased by \$33.9 million due to the

System Fund's owned and managed entities prepaying user fees of \$33.8 million for shared IT assets.

The purchase of system-related capital for UNC Health Care's benefit was divided into two phases. In fiscal year 2014, phase one established notes between the System Fund and its affiliates to fund the purchase of \$77.1 million in new capital. In fiscal year 2016, phase two established additional notes to fund the purchase of \$76 million in new capital. As of June 30, 2016, only \$44.1 million of the approved phase two funding was requested. There was a final draw in fiscal year 2017 to fund the full amount. The notes for both phases end on June 30, 2024. See Note 8 to the financial statements for further details on notes payable.

Net position increased \$26.9 million compared to fiscal year 2016. The net investment in capital assets is \$47.6 million as of June 30, 2017, which is an increase of \$67.3 million. The increase in net investment in capital assets is due to capital asset additions as well as the System Fund receiving assessments to pay off capital debt associated with the acquisition and construction of capital assets. Unrestricted net position decreased \$40.4 million during fiscal year 2017 due to the transfer activity discussed below.

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

User fees revenue increased \$15.9 million during fiscal year 2017 to pay off the additional notes payable borrowed for phase two of the system-related capital purchases discussed above.

Depreciation and amortization expense increased \$11.3 million during fiscal year 2017 due to the additions to capital assets.

Both transfers in and out of the System Fund increased during fiscal year 2017, compared to fiscal year 2016. This was largely due to the inclusion of additional shared services across UNC Health Care, the continued implementation of the electronic medical record system, and mission support assessments. Transfers in to the System Fund exceeded transfers out by \$37.1 million. However, overall net position only increased by \$26.9 million due to a net loss realized from operating and nonoperating activities.

### **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. Strong operating performance has enabled UNC Health Care to make investments in support of the clinical, education, and research programs of UNC Faculty Physicians, the UNC School of Medicine, and other network entities. These continued investments have yielded positive results as measured by growth in needed services, expansion of the medical school class, and increased research funding.

UNC Health Care strives to remain a leader by evolving to meet the demands of an ever changing environment. Pressure on healthcare providers comes in a variety of forms including 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. We are addressing these demands in a number of ways including expansion of access points as well as looking at streamlining operations to maximize efficiencies.

UNC Health Care is committed to connecting with patients where they are and is investing in several new access points and services including the construction of the North Carolina Heart and Vascular Hospital on the Rex campus which opened March 2017. Other major investments in the communities we serve include developing a replacement perioperative tower on the Chapel Hill campus, increasing UNC Health Care's presence in Holly Springs, and developing a state of the art cancer center on the Rex campus. There are also several smaller initiatives to increase services such as expansion of behavioral health, imaging, pharmacy, among other services.

UNC Health Care completed a review of all operations through a program known as Carolina Value. This program was developed and executed to enable UNC Health Care to be more integrated operationally and clinically. The ongoing goal is to improve the health of North Carolina, provide exceptional patient care and service, become more efficient and work together as one team across UNC Health Care.

UNC Health Care has implemented an integrated medical record system across the system at all of the owned network entities and is extending the EMR to managed entities as well.

Third party payors, including government sponsored programs, continue to migrate from fee-for-service to fee-for-value. Traditional fee-for-service 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. For the most part, providers have been insulated from the total cost of care they provide. In order to be successful in a fee-for-value environment, UNC Health Care is developing and implementing changes in our care delivery model that reduce reliance on continued growth in interventions and encourage providers to focus on the overall health of the populations we serve.

Payment in a fee-for-value environment rewards improvement in the quality of care we provide and the reduction of total cost of care for a population. The risk, accountability, and reward for providing the right care, at the right time, in the right setting shifts 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. Through this leadership, UNC Health Care endeavors to attract larger populations to our enterprise.

We are engaging with new partners as the provider community consolidates. Of the more than 100 hospitals in North Carolina, today fewer than 20 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, such as Caldwell Memorial Hospital and Johnston Health Services Corporation, have joined UNC Health Care. Subsequent to the fiscal year ended June 30, 2017, UNC Health Care acquired Morehead Memorial Hospital, now UNC Rockingham Health Care. See Note 13 for additional information regarding the subsequent event. 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 that are otherwise unaffordable, and they will become more efficient by leveraging UNC Health Care's scale.

Successfully managing in the future requires tighter integration of administrative functions across the entities of UNC Health Care, caring for patients in lower cost delivery settings, and comprising sufficient scale to spread the cost of major investments across a broad base.

UNC Health Care continues to plan for these changes through a health system-wide planning and implementation process.

Further information about UNC Health Care can be found in our annual report available at <https://www.unchealthcare.org/about-us/annual-reports/>.

University of North Carolina Health Care System Funds  
Summary of Condensed Financial Statements Totals  
For the Fiscal Years Ended June 30, 2017 and 2016

Table 1

	FY17	FY16	Change	% Change
<b>STATEMENTS OF NET POSITION</b>				
Current Assets	\$ 227,262,237	\$ 203,091,634	\$ 24,170,603	11.9%
Capital Assets, Net	178,440,785	156,525,469	21,915,316	14.0%
Noncurrent Assets	105,058,537	74,965,674	30,092,863	40.1%
<b>TOTAL ASSETS</b>	<b>510,761,559</b>	<b>434,582,777</b>	<b>76,178,782</b>	<b>17.5%</b>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	<b>0</b>	<b>0</b>	<b>0</b>	
Current Liabilities	212,397,072	212,379,855	17,217	0.0%
Long-Term Liabilities	110,542,189	95,124,558	15,417,631	16.2%
Other Noncurrent Liabilities	44,621,571	10,767,081	33,854,490	314.4%
<b>TOTAL LIABILITIES</b>	<b>367,560,832</b>	<b>318,271,494</b>	<b>49,289,338</b>	<b>15.5%</b>
<b>DEFERRED INFLOWS OF RESOURCES</b>	<b>0</b>	<b>0</b>	<b>0</b>	
Net Investment in Capital Assets	47,582,207	(19,752,980)	67,335,187	340.9%
Unrestricted	95,618,520	136,064,263	(40,445,743)	(29.7%)
<b>TOTAL NET POSITION</b>	<b>\$ 143,200,727</b>	<b>\$ 116,311,283</b>	<b>\$ 26,889,444</b>	<b>23.1%</b>
<b>STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION</b>				
<b>Operating Revenues:</b>				
User Fees	\$ 24,569,465	\$ 8,719,208	\$ 15,850,257	181.8%
<b>Operating Expenses:</b>				
Depreciation and Amortization	34,431,617	23,098,932	11,332,685	49.1%
<b>Operating Loss</b>	<b>(9,862,152)</b>	<b>(14,379,724)</b>	<b>(4,517,572)</b>	<b>(31.4%)</b>
<b>Nonoperating Revenues (Expenses):</b>				
Investment Income (Net of Investment Expense)	635,096	576,895	58,201	10.1%
Interest and Fees on Debt	(2,523,500)	(1,833,882)	689,618	37.6%
Gain on Investment in Affiliates	1,578,704	1,013,328	565,376	55.8%
<b>Net Nonoperating Expenses</b>	<b>(309,700)</b>	<b>(243,659)</b>	<b>66,041</b>	<b>27.1%</b>
Transfers In	691,626,634	619,160,966	72,465,668	11.7%
Transfers Out	654,565,338	578,374,785	76,190,553	13.2%
<b>Increase in Net Position</b>	<b>26,889,444</b>	<b>26,162,798</b>	<b>726,646</b>	<b>2.8%</b>
<b>Net Position - Beginning of Year</b>	<b>116,311,283</b>	<b>90,148,485</b>	<b>26,162,798</b>	<b>29.0%</b>
<b>Net Position - End of Year</b>	<b>\$ 143,200,727</b>	<b>\$ 116,311,283</b>	<b>\$ 26,889,444</b>	<b>23.1%</b>
Total Revenues	\$ 718,409,899	\$ 629,470,397	\$ 88,939,502	14.1%
Total Expenses	691,520,455	603,307,599	88,212,856	14.6%



# **FINANCIAL STATEMENTS**

**University of North Carolina Health Care System Funds**  
**Statement of Net Position**  
**June 30, 2017**

**Exhibit A-1**

**ASSETS**

Current Assets:

Cash and Cash Equivalents:

Undesignated Funds (Note 2)	\$ 6,230,203
Designated for UNC School of Medicine Program Support (Note 2)	29,139,561
Designated for UNC School of Medicine Mission Support (Note 2)	26,867,556
Designated for Shared Administrative Services (Note 2)	58,616,890
Designated for UNC Faculty Recruitment (Note 2)	5,750,000

Cash and Cash Equivalents Total	126,604,210
Due from UNC Health Care Entities (Note 4)	94,181,026
Due from UNC School of Medicine	5,179,606
Notes Receivable (Note 11)	847,395
Line of Credit (Note 11)	450,000

Total Current Assets	227,262,237
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Noncurrent Assets:

Investments (Note 2)	20,176,064
Assets Whose Use is Limited or Restricted (Note 6)	10,822,424
Notes Receivable (Note 11)	3,945,480
Investment in Affiliates (Note 12)	70,114,569
Capital Assets - Nondepreciable (Note 5)	1,194,771
Capital Assets - Depreciable, Net (Note 5)	177,246,014

Total Noncurrent Assets	283,499,322
-------------------------	-------------

Total Assets	510,761,559
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**DEFERRED OUTFLOWS OF RESOURCES**

0

**LIABILITIES**

Current Liabilities:

Due to UNC Health Care Entities (Note 7)	109,961,367
Due to UNC School of Medicine	29,607,400
Notes Payable (Note 8)	16,866,331
Assessments Paid in Advance	38,376,000
User Fees Paid in Advance	9,519,960
Funds Held for Others	8,066,014

Total Current Liabilities	212,397,072
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Noncurrent Liabilities:

Notes Payable (Note 8)	110,542,189
User Fees Paid in Advance	33,799,147
Funds Held in Escrow (Note 6)	10,822,424

Total Noncurrent Liabilities	155,163,760
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Total Liabilities	367,560,832
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**DEFERRED INFLOWS OF RESOURCES**

0

**NET POSITION**

Net Investment in Capital Assets	47,582,207
Unrestricted	95,618,520

Total Net Position	\$ 143,200,727
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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, 2017**

**Exhibit A-2**

**REVENUES**

Operating Revenues:

User Fees	\$ 24,569,465
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**EXPENSES**

Operating Expenses:

Depreciation and Amortization	34,431,617
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Operating Loss	(9,862,152)
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**NONOPERATING REVENUES (EXPENSES)**

Investment Income (Net of Investment Expense of \$9,519)	635,096
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Interest and Fees on Debt	(2,523,500)
---------------------------	-------------

Gain on Investment in Affiliates	1,578,704
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Net Nonoperating Expenses	(309,700)
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**TRANSFERS IN**

Regular Assessments (Note 9)	82,651,150
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Special Assessments (Note 9)	114,126,244
------------------------------	-------------

Mission Support Assessments (Note 9)	36,108,137
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Shared Administrative Services Assessments (Note 9)	458,741,103
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Total Transfers In	691,626,634
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**TRANSFERS OUT**

Program Support (Note 10)	199,616,712
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Shared Administrative Services (Note 10)	439,448,626
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Mission Support (Note 10)	15,500,000
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Total Transfers Out	654,565,338
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Increase in Net Position	26,889,444
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**NET POSITION**

Net Position - July 1, 2016	116,311,283
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Net Position - June 30, 2017	\$ 143,200,727
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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 Cash Flows**  
**For the Fiscal Year Ended June 30, 2017**

**Exhibit A-3**

**Page 1 of 2**

**CASH FLOWS FROM OPERATING ACTIVITIES**

User Fees Received	\$ 63,788,345
Cash Provided by Operating Activities	<u>63,788,345</u>

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Transfers In from Entities	756,515,474
Transfers Out to Entities	(631,845,692)
Upper Payment Limit Pass-through Payments Received	95,008,390
Upper Payment Limit Pass-through Payments	(89,401,385)
Line of Credit Issued to Entities	(1,150,000)
Line of Credit Repaid by Entities	<u>1,750,000</u>
Net Cash Provided by Noncapital Financing Activities	<u>130,876,787</u>

**CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES**

Proceeds from Capital Debt	32,275,301
Principal Paid on Notes Payable	(19,206,497)
Interest Paid on Notes Payable	(3,380,423)
Assessment for Capital Acquisition	28,709,743
Acquisition and Construction of Capital Assets	<u>(135,087,918)</u>
Net Cash Used by Capital Financing and Related Financing Activities	<u>(96,689,794)</u>

**CASH FLOWS FROM INVESTING ACTIVITIES**

Interest Income	634,403
Purchase of Investments and Related Fees	(20,139,404)
Assessments for Investment in Affiliates	4,375,020
Investment in Affiliates	<u>(4,375,020)</u>
Net Cash Used by Investing Activities	<u>(19,505,001)</u>
Net Increase in Cash and Cash Equivalents	78,470,337
Cash and Cash Equivalents - July 1, 2016	<u>48,133,873</u>
Cash and Cash Equivalents - June 30, 2017	<u><u>\$ 126,604,210</u></u>

**University of North Carolina Health Care System Funds**  
**Statement of Cash Flows**  
**For the Fiscal Year Ended June 30, 2017**

**Exhibit A-3**  
**Page 2 of 2**

**RECONCILIATION OF NET OPERATING LOSS  
TO CASH PROVIDED BY OPERATING ACTIVITIES**

Operating Loss	\$	(9,862,152)
Adjustments to Reconcile Operating Loss to Cash Provided by Operating Activities:		
Depreciation/ Amortization Expense		34,431,617
Changes in Assets and Deferred Outflows of Resources:		
Due from UNC Health Care Entities		692,648
Notes Receivable		(4,792,875)
Changes in Liabilities and Deferred Inflows of Resources:		
User Fees Paid in Advance		43,319,107
Cash Provided by Operating Activities	\$	<u>63,788,345</u>

**RECONCILIATION OF CASH AND CASH EQUIVALENTS**

Current Assets:		
Cash and Cash Equivalents	\$	<u>126,604,210</u>
Total Cash and Cash Equivalents - June 30, 2017	\$	<u>126,604,210</u>

**NONCASH INVESTING AND CAPITAL ACTIVITIES**

Assets Acquired through the Assumption of a Liability	\$	38,584,817
Change in Fair Value of Investments		36,660

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. UNC Hospitals at Chapel Hill, 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. UNC Health Care signed management service agreements with Henderson County Hospital Corporation d/b/a Margaret R. Pardee Memorial Hospital, Nash Health Care Systems, Johnston Health Services Corporation, Wayne Memorial Hospital, and Lenoir Memorial Hospital which are considered managed entities within UNC Health Care.

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 four 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 the 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 Recruitment Fund** - The Recruitment Fund was established through a special assessment at the end of fiscal year 2010 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.

**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 General Statute* 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 part 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. Investments** - To the extent available, investments are recorded at fair value based on quoted market prices in active markets on a trade-date basis. Additional information regarding the fair value measurement of investments is disclosed in Note 3. Because of the inherent uncertainty in the use of estimates, values that are based on estimates may differ from the values that would have been used had a ready market existed for the investments. The net change in the value of investments is recognized as a component of investment income.
- G. Capital Assets** - Capital assets are stated at cost at date of acquisition or acquisition value at date of donation in the case of gifts. Donated capital assets acquired prior to July 1, 2015 are stated at fair value as of the date of donation. 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 in the following manner:

<u>Asset Class</u>	<u>Estimated Useful Life</u>
Buildings	10-40 years
Machinery and Equipment	3-20 years
Computer Software	3-10 years

**H. 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 liabilities 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 investment income.

**I. Revenue and Expense Recognition** - The System Fund classifies its revenues and expenses as operating or nonoperating in the accompanying Statement of Revenues, Expenses, and Changes in Net Position. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the System Fund's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as the user fees charged to UNC Health Care entities for using assets held by the System Fund. 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, such as investment income, include activities that have the characteristics of nonexchange transactions. Transfers in and out are presented separately after nonoperating revenues and expenses.

**J. Transfers In and Transfers Out** - The System Fund supports UNC Health Care and the 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 the 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 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 is achieved. Mission Support was first established in fiscal year 2009 and has been paid in each subsequent year. UNC Hospitals and Rex made mission support payments to the System Fund during fiscal year 2017.

**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 AND INVESTMENTS

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.

Pursuant to *North Carolina General Statute* 116-37(e), all receipts, except for General Fund appropriations, may be invested by the State Treasurer on behalf of UNC Health Care as allowed in G.S. 147-69.2(b3).

NCGS § 116-37.2, as revised by S.L. 2011-145, Section 9.6E(c), allows UNC Health Care's Board to be responsible for the custody and management of funds, including developing policies for deposit, investment, and administration of funds. With this legislative flexibility and under the guidance of the Finance Committee of the Board, the System Fund has made the following investments:

**Short-Term Investment Fund** - At June 30, 2017, the amount shown on the Statement of Net Position as cash and cash equivalents of \$126,604,210 represents the System Fund's equity position in the State Treasurer's Short-Term Investment Fund (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 or subject to any other regulatory oversight and does not have a credit rating) had a weighted average maturity of 1.6 years as of June 30, 2017. Assets and shares of the STIF are valued at 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 North Carolina Department of State Treasurer Investment Programs' separately issued audit report. This separately issued report can be obtained from the Department of State Treasurer, 3200 Atlantic Avenue, Raleigh, NC 27604 or can be accessed from the Department of State Treasurer's website at <https://www.nctreasurer.com/> in the Audited Financial Statements section.

A reconciliation of deposits and corresponding designations as of June 30, 2017 is as follows:

Designation	Enterprise Fund	Recruitment Fund	Patient Safety Fund	Shared Administrative Services Fund	Total
Undesignated Funds	\$ 5,386,766	\$ 0	\$ 843,437	\$ 0	\$ 6,230,203
Designated for UNC-SOM Program Support	22,463,007			6,676,554	29,139,561
Designated for UNC-SOM Mission Support	26,867,556				26,867,556
Designated for Shared Administrative Services				58,616,890	58,616,890
Designated for UNC Faculty Recruitment		5,750,000			5,750,000
<b>Total Deposits</b>	<b>\$ 54,717,329</b>	<b>\$ 5,750,000</b>	<b>\$ 843,437</b>	<b>\$ 65,293,444</b>	<b>\$ 126,604,210</b>

**UNC Investment Fund, LLC** - At June 30, 2017, the System Fund's investments include \$20,176,064 which represents the System Fund's equity position in the UNC Investment Fund, LLC (UNC Investment Fund). The UNC

Investment Fund is an external investment pool that is not registered with the Securities and Exchange Commission, does not have a credit rating, and is not subject to any regulatory oversight. Investment risks associated with the UNC Investment Fund are included in audited financial statements of the UNC Investment Fund, LLC which may be obtained from UNC Management Company, Inc., 1400 Environ Way, Chapel Hill, NC 27517.

### NOTE 3 - FAIR VALUE MEASUREMENTS

To the extent available, the System Fund's investments are recorded at fair value as of June 30, 2017. GASB Statement No. 72, *Fair Value Measurement and Application*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This statement establishes a hierarchy of valuation inputs based on the extent to which the inputs are observable in the marketplace. Inputs are used in applying the various valuation techniques and take into account the assumptions that market participants use to make valuation decisions. Inputs may include price information, credit data, interest and yield curve data, and other factors specific to the financial instrument. Observable inputs reflect market data obtained from independent sources. In contrast, unobservable inputs reflect the entity's assumptions about how market participants would value the financial instrument. Valuation techniques should maximize the use of observable inputs to the extent available.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following describes the hierarchy of inputs used to measure fair value and the primary valuation methodologies used for financial instruments measured at fair value on a recurring basis:

Level 1	Investments whose values are based on quoted prices (unadjusted) for identical assets in active markets that a government can access at the measurement date.
Level 2	Investments with inputs – other than quoted prices included within Level 1 – that are observable for an asset, either directly or indirectly.
Level 3	Investments classified as Level 3 have unobservable inputs for an asset and may require a degree of professional judgment.

The following table summarizes the System Fund's investments, including the Short-Term Investment Fund, within the fair value hierarchy at June 30, 2017:

	Fair Value	Fair Value Measurements Using		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investments by Fair Value Level				
Other Securities				
Short-Term Investment Fund	\$ 126,604,210	\$ 0	\$ 126,604,210	\$ 0
UNC Investment Fund	20,176,064			20,176,064
Total Investments by Fair Value Level	<u>\$ 146,780,274</u>	<u>\$ 0</u>	<u>\$ 126,604,210</u>	<u>\$ 20,176,064</u>

**Short-Term Investment Fund** - Ownership interest of the STIF is determined on a fair market valuation basis as of fiscal year end in accordance with the STIF operating procedures. Valuation of the underlying assets is performed by the custodian.

**UNC Investment Fund** - Ownership interests of the UNC Investment Fund are determined on a market unit valuation basis each month and in accordance with the UNC Investment Fund's operating procedures.

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

Amounts due from UNC Health Care Entities at June 30, 2017 by type and entity were as follows:

	Amount
Assessments	
Owned Entities	<u>\$ 26,520,025</u>
Shared Administrative Services	
Owned Entities	<u>67,661,001</u>
Total Due from UNC Health Care Entities	<u>\$ 94,181,026</u>

Additional information regarding transactions with the entities is included in Note 11.

**NOTE 5 - CAPITAL ASSETS**

A summary of changes in the capital assets for the year ended June 30, 2017, is presented as follows:

	Balance July 1, 2016	Increases	Decreases	Balance June 30, 2017
Capital Assets, Nondepreciable:				
Computer Software in Development	\$ 4,142,311	\$ 3,727,425	\$ 6,674,965	\$ 1,194,771
<b>Total Capital Assets, Nondepreciable</b>	<u>4,142,311</u>	<u>3,727,425</u>	<u>6,674,965</u>	<u>1,194,771</u>
Capital Assets, Depreciable:				
Buildings	6,135,238			6,135,238
Machinery and Equipment	46,867,322	21,274,237		68,141,559
Computer Software	135,973,493	38,020,236		173,993,729
<b>Total Capital Assets, Depreciable</b>	<u>188,976,053</u>	<u>59,294,473</u>		<u>248,270,526</u>
Less Accumulated Depreciation/Amortization for:				
Buildings	805,970	409,323		1,215,293
Machinery and Equipment	9,276,564	12,437,403		21,713,967
Computer Software	26,510,361	21,584,891		48,095,252
<b>Total Accumulated Depreciation/ Amortization</b>	<u>36,592,895</u>	<u>34,431,617</u>		<u>71,024,512</u>
<b>Total Capital Assets, Depreciable, Net</b>	<u>152,383,158</u>	<u>24,862,856</u>		<u>177,246,014</u>
<b>Capital Assets, Net</b>	<u>\$ 156,525,469</u>	<u>\$ 28,590,281</u>	<u>\$ 6,674,965</u>	<u>\$ 178,440,785</u>

**NOTE 6 - 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 43351) from public hospitals (as defined in the North Carolina State Plan for Medicaid payments) which decided to assist UNC Health Care in meeting 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 CPE's 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. The fund will reimburse participating public hospitals for any repayments that should result from this program. At June 30, 2017, \$10,822,424 was held by the Escrow Agent, First Citizens Bank & Trust Company.

**NOTE 7 - DUE TO UNC HEALTH CARE ENTITIES**

Amounts due to UNC Health Care entities at June 30, 2017 by type and entity were as follows:

	<u>Amount</u>
<b>Mission Support</b>	
Owned Entities	<u>\$ 6,118,362</u>
<b>Shared Administrative Services</b>	
Owned Entities	103,735,921
Managed Entities	<u>107,084</u>
Subtotal	<u>103,843,005</u>
<b>Total Due to UNC Health Care Entities</b>	<u><u>\$ 109,961,367</u></u>

Additional information regarding transactions with the entities is included in Note 11.

**NOTE 8 - NOTES PAYABLE**

The System Fund originally borrowed \$77,076,590 from UNC Hospitals, Rex, and UNC School of Medicine to fund the purchase and implementation of UNC Health Care's electronic medical record system (EMR) in Phase I. The principal amount is to be repaid in 120 monthly installments at a simple interest rate equal to 2.5%. In 2016, as a part of Phase II, an additional \$44,133,785 was borrowed from UNC Hospitals, Rex, UNC School of Medicine, UNC Physicians Network, Chatham, Caldwell, Johnston, and Pardee. In 2017, an additional \$32,275,301 was borrowed to complete Phase II as shown in the table below. The principal amount for Phase II is to be repaid in 96 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, 2017 is presented as follows:

<u>Entity</u>	<u>Balance July 1, 2016</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance June 30, 2017</u>	<u>Current Portion</u>
Owned Entities	\$ 88,082,490	\$ 23,349,485	\$ 15,297,226	\$ 96,134,749	\$ 12,726,312
Managed Entities	11,447,314	8,126,049	1,309,006	18,264,357	2,417,834
UNC School of Medicine	14,809,912	799,767	2,600,265	13,009,414	1,722,185
<b>Total Notes Payable</b>	<u><u>\$ 114,339,716</u></u>	<u><u>\$ 32,275,301</u></u>	<u><u>\$ 19,206,497</u></u>	<u><u>\$ 127,408,520</u></u>	<u><u>\$ 16,866,331</u></u>

**NOTE 9 - TRANSFERS IN**

Transfers in by source and entity at June 30, 2017 were as follows:

	<u>Amount</u>
<b>Regular Assessments:</b>	
Owned Entities	\$ 62,227,094
UNC School of Medicine	<u>20,424,056</u>
Total Regular Assessments	<u>82,651,150</u>
<b>Special Assessments:</b>	
Owned Entities	105,422,436
Managed Entities	6,335,845
UNC School of Medicine	<u>2,367,963</u>
Total Special Assessments	<u>114,126,244</u>
<b>Mission Support:</b>	
Owned Entities	<u>36,108,137</u>
<b>Shared Administrative Services:</b>	
Owned Entities	383,277,482
Managed Entities	23,772,312
UNC School of Medicine	<u>51,691,309</u>
Total Shared Administrative Services	<u>458,741,103</u>
<b>Total Transfers In</b>	<u><u>\$ 691,626,634</u></u>

Additional information regarding transactions with the entities is included in Note 11.

**NOTE 10 - TRANSFERS OUT**

Transfers out by purpose and entity at June 30, 2017 were as follows:

	<u>Amount</u>
<b>Program Support:</b>	
Owned Entities	\$ 99,754,918
UNC School of Medicine	<u>99,861,794</u>
Total Program Support	<u>199,616,712</u>
<b>Shared Administrative Services:</b>	
Owned Entities	399,360,189
Managed Entities	909,147
UNC School of Medicine	<u>39,179,290</u>
Total Shared Administrative Services	<u>439,448,626</u>
<b>Mission Support:</b>	
UNC School of Medicine	<u>15,500,000</u>
<b>Total Transfers Out</b>	<u><u>\$ 654,565,338</u></u>

Additional information regarding transactions with the entities is included in Note 11.

**NOTE 11 - 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 929 beds, this facility serves as an acute care teaching hospital for the University of North Carolina at Chapel Hill.

During the fiscal year, UNC Hospitals paid \$373,515,002 for assessments, mission support, and shared administrative services to the System Fund and extended a \$3,207,286 note receivable to the System Fund. In turn, the System Fund made payments of \$323,445,764 to UNC Hospitals for program support and shared administrative service expenses as well as principal repayments in the amount of \$9,144,479. As of June 30, 2017, the System Fund had receivables of \$13,518,719 and payables of \$100,040,206.

**University of North Carolina School of Medicine** - The UNC School of Medicine was assessed and paid the System Fund \$706,032 during the year and received \$24,653,666 in program support. As of June 30, 2017, the System Fund had payables of \$16,502,718.

**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 1,150 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 an administrative unit that collectively forms UNCFP.

While UNCFP is affiliated with 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, and as such, its operational results are included in the annual audit for UNC-CH.

UNCFP paid \$73,777,296 for assessments and shared administrative services to the System Fund and extended a \$799,767 note receivable to the System Fund during fiscal year 2017. The System Fund also made payments to UNCFP in the amount of \$129,887,418 for program support, mission support, and shared administrative services as well as principal repayments in the amount of \$2,600,265. As of June 30, 2017, the System Fund had receivables of \$5,179,606 and payables of \$13,104,682.

**Rex Healthcare, Inc.** - Rex Healthcare, Inc. (Rex) is a North Carolina not-for-profit corporation that provides 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 Rex.

Rex paid \$144,714,603 for assessments, mission support, and shared administrative services to the System Fund and extended a \$2,877,706 note receivable to the System Fund during fiscal year 2017. The System Fund also made payments to Rex in the amount of \$64,975,164 for shared administrative service expenses as well as principal repayments in the amount of \$5,170,990. As of June 30, 2017, the System Fund had receivables of \$9,617,329 and payables of \$4,686,128.

**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.

Chatham paid \$8,415,546 for assessments and shared administrative services to the System Fund and extended a \$70,310 note receivable to the System Fund during fiscal year 2017. The System Fund also made payments to Chatham in the amount of \$7,835,015 for program support and shared administrative service expenses as well as principal repayments in the amount of \$31,983. As of June 30, 2017, the System Fund had receivables of \$74,948 and payables of \$170,881.

**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 are private employers that own and operate more than 60 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 \$15,540,155 for assessments and shared administrative services to the System Fund and extended a \$271,318 note receivable to the System Fund during fiscal year 2017. The System Fund also made payments to UNCPN in the amount of \$47,648,620 for program support and shared administrative service expenses as well as principal repayments in the amount of \$94,760. As of June 30, 2017, the System Fund had receivables of \$127,576 and payables of \$3,853,024.

Effective August 1, 2015, the Boylan Clinic entered into a line of credit agreement for up to \$475,000 with the System Fund for use in operations as necessary. Outstanding draws on this line of credit bear simple interest at a fixed rate of the prime rate as of August 1, 2015 plus 0.75% (4.25%). As of June 30, 2017, the balance outstanding was \$300,000. This agreement was renewed on August 1, 2017 and all unpaid amounts including accrued interest are due on June 30, 2018.



Effective November 30, 2015, the Boylan Clinic entered into a second line of credit agreement for up to \$200,000 with the System Fund for use in funding income tax payments related to tax liabilities on its earned income. Outstanding draws on this line of credit bear simple interest at a fixed rate of the prime rate as of November 30, 2015 plus 0.75% (4.00%). All unpaid amounts including accrued interest are due on November 30, 2018. As of June 30, 2017, there was no balance outstanding.

Effective July 1, 2016, the Garner Family Practice Clinic entered into a line of credit agreement for up to \$475,000 with the System Fund for use in operations as necessary. Outstanding draws on this line of credit bear simple interest at a fixed rate of the prime rate as of July 1, 2015 plus 0.75% (4.25%). All unpaid amounts including accrued interest are due on June 30, 2018. As of June 30, 2017, the balance outstanding was \$150,000.

Effective July 1, 2015, the Clinton Medical Clinic entered into a line of credit agreement for up to \$2,000,000 with the System Fund for use in operations as necessary. Outstanding draws on this line of credit bear simple interest at a fixed rate of the prime rate as of July 1, 2015 plus 0.75% (4.25%). As of June 30, 2017, Clinton Medical Center is no longer associated with UNC Physicians Network Group Practices. All unpaid amounts including accrued interest were paid back to the System Fund by June 30, 2017.

The following table summarizes the activity in the lines of credit for the year ended June 30, 2017:

	Balance July 1, 2016	Borrowings	Payments	Balance June 30, 2017
Boylan Clinic	\$ 300,000	\$ 500,000	\$ 500,000	\$ 300,000
Garner Family Practice Clinic	150,000	325,000	325,000	150,000
Clinton Medical Clinic	600,000	325,000	925,000	
	<u>\$ 1,050,000</u>	<u>\$ 1,150,000</u>	<u>\$ 1,750,000</u>	<u>\$ 450,000</u>

**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 \$30,672,717 for assessments and shared administrative services to the System Fund and extended a \$15,500,000 note receivable to the System Fund during fiscal year 2017. The System Fund also made payments to HPRH in the amount of \$42,598,170 for program support and shared

administrative service expenses. As of June 30, 2017, the System Fund had receivables of \$58,978,475 and payables of \$631,675.

**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 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 \$14,177,126 for assessments and shared administrative services to the System Fund and extended a \$1,422,865 note receivable to the System Fund during fiscal year 2017. The System Fund also made payments to Caldwell in the amount of \$12,612,374 for program support and shared administrative service expenses as well as principal repayments in the amount of \$855,014. As of June 30, 2017, the System Fund had receivables of \$11,863,979 and payables of \$472,369.

**UNC Health Care Managed Entities** - UNC Health Care signed management service agreements with Henderson County Hospital Corporation d/b/a Margaret R. Pardee Memorial Hospital, Nash Health Care Systems, Johnston Health Services Corporation, Wayne Memorial Hospital, and Lenoir Memorial Hospital, which are considered managed entities within UNC Health Care.

The managed entities paid \$30,108,157 for assessments and shared administrative services to the System Fund and extended an \$8,126,049 note receivable to the System Fund during fiscal year 2017. The System Fund extended a \$4,792,875 note receivable to the managed entities during fiscal year 2017, of which \$847,395 is due within the next year. The System Fund also made payments to the managed entities in the amount of \$1,309,006 for principal repayment. The System Fund also made payments to managed entities in the amount of \$909,147 for shared administrative service expenses. As of June 30, 2017, the System Fund had payables of \$107,084.

**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 started operating 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.

## **NOTE 12 - INVESTMENT IN AFFILIATES**

The System Fund has investments in affiliates and joint ventures accounted for using the equity method. Investments in affiliates were \$70,114,569 at

June 30, 2017. See below for more information regarding the ongoing affiliates and joint ventures:

Effective February 1, 2014, Johnston Memorial Hospital Authority (JMHA) and UNC Health Care 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. UNC Health Care has a 35.25 percent membership in JHSC and has agreed to provide \$57,600,000 in contributions over the years. UNC Health Care transferred \$26,200,000 of the contribution for the year ended June 30, 2014. A second cash contribution of \$27,400,000 was made for the year ended June 30, 2015. Furthermore, a cash contribution of \$1,000,000 is due annually starting February 2016 and ending February 2019. As of June 30, 2017, UNC Health Care's investments were \$61,213,746.

UNC Health Care owns a small minority ownership interest (less than 5%) in Alignment Healthcare Partners, LP, a company that provides population health services to health systems and health plans with current operations in California, Florida, and North Carolina. UNC Health Care has no future financial obligation or commitment to Alignment Healthcare Partners, LP. Separate financial statements for Alignment Healthcare Partners, LP are not publicly available. As of June 30, 2017, UNC Health Care's investments were \$6,111,274.

UNC Health Care owns a small minority ownership interest (less than 10%) in Provider-Led and Patient-Centered Care, LLC (PLPCC), a company that is a collaboration of eleven North Carolina health systems formed to develop a provider-led and owned Medicaid Prepaid Health Plan (PHP). PLPCC is acting in support of the General Assembly and Governor's goal to transform the State's current Medicaid system to a program that provides budget predictability for the taxpayers of the State while ensuring adequate access and high quality of care to those in need. As of June 30, 2017, UNC Health Care's investments were \$2,789,549.

**NOTE 13 - SUBSEQUENT EVENTS**

On December 19, 2017, UNC Health Care acquired Morehead Memorial Hospital for \$13,500,000. Morehead Memorial Hospital is now known as UNC Rockingham Health Care.

On March 8, 2018, UNC Health Care announced that it signed a binding agreement to transition ownership of High Point Regional Health, Inc. to Wake Forest Baptist Medical Center. This transaction will be finalized in early fiscal year 2019.



# **INDEPENDENT AUDITOR'S REPORT**

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



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

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

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

We have audited, 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) which is a part of the University of North Carolina Health Care System that is an affiliated enterprise 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, 2017, 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 11, 2018.

As discussed in Note 1, the financial statements of the University of North Carolina Health Care System Funds are intended to present the financial position, changes in financial position, and cash flows that are only attributable to the transactions of the University of North Carolina Health Care System Funds. They do not purport to, and do not, present fairly the financial position of the University of North Carolina Health Care System nor the University of North Carolina System as of June 30, 2017, the changes in its financial position, or its cash flows, for the year then ended in accordance 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 opinion 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. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

### 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*.

### 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 11, 2018

# ORDERING INFORMATION

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For additional information contact:  
Brad Young  
Director of External Affairs  
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This audit required 590 hours at an approximate cost of \$60,770.