

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, 2019

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



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AUDITOR'S TRANSMITTAL

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, 2019, 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 black ink, reading "Beth A. Wood".

Beth A. Wood, CPA
State Auditor



Beth A. Wood, CPA
State Auditor

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INDEPENDENT AUDITOR'S REPORT

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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, 2019, 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, 2019, 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, 2019, 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.

As discussed in Note 12, during the year ended June 30, 2019, the System Fund transferred the Shared Administrative Services Fund to its own financial reporting entity. Our opinion is not modified with respect to this matter.

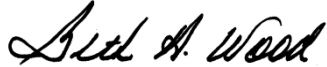
Other Matters – Required Supplementary Information

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 July 24, 2020 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

July 24, 2020



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, 2019 and includes comparative information for the fiscal year ended June 30, 2018.

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), Caldwell Memorial Hospital (Caldwell), UNC Rockingham Health Care, Inc. (Rockingham), 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 (UNCH), collectively perform the operating functions of UNC Health Care and the UNC School of Medicine. UNC Health Care signed management service agreements with various other health care entities across North Carolina which are considered managed entities within UNC Health Care. See Note 1 for further details regarding these entities. 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, and Recruitment Fund each function as sub-accounts within the System Fund.

The Shared Administrative Services Fund within UNC Health Care represents those activities that benefit all of the owned entities such as legal, marketing, and information technology services. The annual flow of funds involves budgeting the Shared Administrative Services required to support UNC Health Care's operations over the course of the next year and then billing the applicable entities for their allocated share. Managed entities are provided services on a contractual basis. These transactions have historically been managed as a sub-account within the System Fund but have grown to the point that they are managed more effectively in a separate company. It is important to note as you review this report that a separate company and financial reporting entity was created for this purpose and the transition of the Shared Administrative Services Fund to this new company was made effective July 1, 2018. See Note 12 for further details related to the change in reporting entity. The following financial statements and notes have been restated to reflect this change.

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*, along with accompanying *Notes to the Financial Statements*.

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 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 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 noncapital 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, capital assets, receivables, payables, transfers in and out, related parties, and restatements due to change in reporting entity. 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 2019 to 2018

Data for 2019 and 2018 is presented in Table 1 of this report and discussed in the following sections. Discussion in the following sections is pertinent to fiscal year 2019 results and changes relative to ending balances in fiscal year 2018. Fiscal year 2018 has been restated to reflect the removal of the Shared Administrative Services Fund from the System Fund.

Analysis of Overall Financial Position and Results of Operations

Statement of Net Position

The sub-accounts of the System Fund collectively hold assets of \$429.3 million, which is an increase of \$130.3 million, or 43.6%, over the prior year. Cash and cash equivalents and amounts due from UNC Health Care entities decreased by \$3.1 million and \$3.9 million, respectively, while current notes receivable increased \$21.3 million for future payments due as a result of the sale of High Point Regional Health, Inc. (HPRH) to Wake Forest Baptist Medical Center. Noncurrent assets increased by \$116.3 million, or 59.9%, primarily due to investment purchases of \$64.0 million, reinvested investment income of \$11.6 million, and the

\$42.6 million noncurrent portion of aforementioned notes receivable. See Note 5 to the financial statements for further details on notes receivable.

Total liabilities increased by \$102.2 million, or 76.4% overall. Current liabilities increased \$102.5 million and are driven by \$140.0 million of funds due to the UNC Health Care Shared Administrative Services Fund and to a lesser extent, \$9.4 million contingency reserve recorded in relation to the sale of HPRH. These increases are offset by a \$47.1 million decrease in assessments paid in advance as no entities prepaid their assessments as compared to prior year.

Net position increased \$28.2 million compared to fiscal year 2018 due to transfer activity and investment income discussed below.

Statement of Revenues, Expenses, and Changes in Net Position

Net investment income increased \$9.5 million during fiscal year 2019 due to improved returns on investments. The improved investment returns were primarily from a shift to higher yielding investments and a larger investment principal base over much of the year as a result of invested proceeds from the sale of HPRH. Loss on investments in affiliates of \$1.5 million during fiscal year 2019, compared to a gain of \$0.7 million in the previous year, was primarily driven by writing off the System Fund's investment in Provider-Led and Patient-Centered Care, LLC (PLPCC) which is described in more detail in Note 11. Other nonoperating expenses increased \$8.6 million as a result of reserves recorded in connection to the sale of HPRH.

Transfers into the System Fund increased \$155.1 million during fiscal year 2019 due primarily to the sale of HPRH and an increase in mission support assessments. Transfers out increased by \$164.3 million during fiscal year 2019 and were driven by funds paid to support academic and UNC Health Care programs.

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, facilitated by the System Fund, have yielded positive results as measured by growth in needed services, expansion of the medical school class, and increased research funding.

UNC Health Care continues implementation of a health care delivery system that provides the continuum of services now required in health care. UNC Health Care's strategy relies on a variety of options for program and service development and utilizes acquisitions, partnerships, network development, contracts, and other means as opportunities are developed. Guided by a philosophy of collaboration and partnership with other providers of care, UNC Health Care continues to evaluate options of strategic importance to its development. Acquisitions and affiliations include those in areas such as home health, hospice, physician practices, and infusion services. The funding for these acquisitions is coordinated through the System Fund.

Our teams continue to focus on our Commitment to Caring patient experience which has proven to be a differentiator in care delivered by UNC Health Care for many years. We also

continue to respond to the State's needs and proudly address the needs of its underserved populations as a safety net provider.

UNC Health Care management is committed to proper expense management while maintaining high quality patient care, innovation, and very satisfied patients. Managing Shared Administrative Services as its own stand-alone process and company is one of the many steps taken to effectively manage costs. 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 implement these changes through a health system-wide planning and implementation process.

All of these steps collectively move us towards our ongoing goals of improving the health of North Carolina, providing exceptional patient care and service, becoming more efficient, and working together as one team across UNC Health Care.

Management recognizes that there will be a financial impact on FY 2020 and future operations as a result of COVID-19 (Novel Coronavirus). This impact will be felt at all our hospital and physician operations and may ultimately impact the operation of the System Fund. We are monitoring this situation at all levels and are pursuing actions to mitigate the financial impact caused by the virus, but our primary focus is the safety and health of our patients and employees as we continue to develop strategies to respond to the virus.

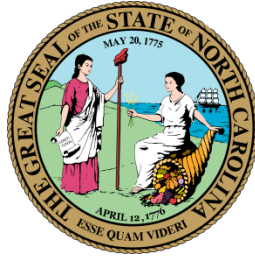
Further information about UNC Health Care can be found in our annual report available at <https://www.unchealthcare.org/about-us/annual-reports/>.

University of North Carolina Health Care System Funds
Summary of Condensed Financial Statements Totals

Table 1

	FY19	FY18 As Restated	Change	% Change
CONDENSED STATEMENTS OF NET POSITION				
Current Assets	\$ 115,023,881	\$ 100,679,101	\$ 14,344,780	14.2%
Capital Assets, Net	3,652,279	4,017,507	(365,228)	(9.1%)
Noncurrent Assets	310,592,420	194,256,219	116,336,201	59.9%
TOTAL ASSETS	429,268,580	298,952,827	130,315,753	43.6%
DEFERRED OUTFLOWS OF RESOURCES				
	0	0	0	
Current Liabilities	175,005,812	72,533,025	102,472,787	141.3%
Noncurrent Liabilities	60,896,149	61,206,296	(310,147)	(0.5%)
TOTAL LIABILITIES	235,901,961	133,739,321	102,162,640	76.4%
DEFERRED INFLOWS OF RESOURCES				
	0	0	0	
Investment in Capital Assets	3,652,279	4,017,507	(365,228)	(9.1%)
Unrestricted	189,714,340	161,195,999	28,518,341	17.7%
TOTAL NET POSITION	\$ 193,366,619	\$ 165,213,506	\$ 28,153,113	17.0%
CONDENSED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION				
Operating Revenues:	\$ 0	\$ 0	\$ 0	0.0%
Operating Expenses:				
Depreciation	365,228	365,228		0.0%
Operating Loss	(365,228)	(365,228)		0.0%
Nonoperating Revenues (Expenses):				
Investment Income (Net of Investment Expense)	11,631,343	2,088,765	9,542,578	456.9%
Gain (Loss) on Investments in Affiliates	(1,459,020)	693,314	(2,152,334)	(310.4%)
Other Nonoperating Expenses	(8,756,022)	(175,911)	8,580,111	4877.5%
Net Nonoperating Revenues	1,416,301	2,606,168	(1,189,867)	(45.7%)
Transfers In	334,130,441	178,981,303	155,149,138	86.7%
Transfers Out	307,028,401	142,679,942	164,348,459	115.2%
Increase in Net Position	28,153,113	38,542,301	(10,389,188)	(27.0%)
Net Position - Beginning of Year, Restated	165,213,506	126,671,205	38,542,301	30.4%
Net Position - End of Year	\$ 193,366,619	\$ 165,213,506	\$ 28,153,113	17.0%

Fiscal year 2019, revenues (excluding transfers in) totaled \$11,631,343 and expenses (excluding transfers out) totaled \$10,580,270.
Fiscal year 2018, revenues (excluding transfers in) totaled \$2,782,079 and expenses (excluding transfers out) totaled \$541,139.



FINANCIAL STATEMENTS

University of North Carolina Health Care System Funds
Statement of Net Position
June 30, 2019

Exhibit A-1

ASSETS

Current Assets:

Cash and Cash Equivalents (Note 2):	
Undesignated Funds	\$ 8,633
Designated for UNC School of Medicine Program Support	37,306,076
Designated for UNC School of Medicine Mission Support	6,877,739
Designated for UNC Faculty Recruitment	5,750,000
Cash and Cash Equivalents Total	49,942,448
Due from UNC Health Care Entities (Note 4)	41,844,619
Due from UNC School of Medicine	63,793
Notes Receivable (Note 5)	22,473,021
Line of Credit (Note 10)	700,000
Total Current Assets	115,023,881

Noncurrent Assets:

Investments (Note 2)	122,061,666
Assets Whose Use is Limited or Restricted (Note 2)	60,896,149
Notes Receivable (Note 5)	56,285,742
Investment in Affiliates (Note 11)	71,348,863
Capital Assets - Depreciable, Net (Note 6)	3,652,279
Total Noncurrent Assets	314,244,699
Total Assets	429,268,580

DEFERRED OUTFLOWS OF RESOURCES

0

LIABILITIES

Current Liabilities:

Due to UNC Health Care Shared Administrative Services Fund	140,000,000
Due to UNC School of Medicine	22,230,121
Other Liabilities	9,402,102
Funds Held for Others	3,373,589
Total Current Liabilities	175,005,812

Noncurrent Liabilities:

Funds Held in Escrow (Note 7)	60,896,149
Total Liabilities	235,901,961

DEFERRED INFLOWS OF RESOURCES

0

NET POSITION

Investment in Capital Assets	3,652,279
Unrestricted	189,714,340
Total Net Position	\$ 193,366,619

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, 2019

Exhibit A-2

OPERATING REVENUES	\$ 0
OPERATING EXPENSES	
Depreciation	365,228
Operating Loss	(365,228)
NONOPERATING REVENUES (EXPENSES)	
Investment Income (Net of Investment Expense of \$150,476)	11,631,343
Loss on Investment in Affiliates	(1,459,020)
Other Nonoperating Expenses	(8,756,022)
Net Nonoperating Revenues	1,416,301
TRANSFERS IN	
Regular Assessments (Note 8)	70,622,553
Special Assessments (Note 8)	16,624,178
Mission Support Assessments (Note 8)	32,661,369
Other Transfers In (Note 8)	214,222,341
Total Transfers In	334,130,441
TRANSFERS OUT	
Program Support (Note 9)	264,929,662
Mission Support (Note 9)	28,877,739
Other Transfers Out (Note 9)	13,221,000
Total Transfers Out	307,028,401
Increase in Net Position	28,153,113
NET POSITION	
Net Position - July 1, 2018, as Restated (Note 12)	165,213,506
Net Position - June 30, 2019	\$ 193,366,619

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, 2019

Exhibit A-3

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Transfers In from Entities	\$ 226,928,941
Transfers Out to Entities	(163,486,701)
Third Party Payor Pass-through Payments Received	101,966,807
Third Party Payor Pass-through Payments	(105,322,822)
Notes Receivable Repaid by Entities	1,141,237
	<hr/>
Net Cash Provided by Noncapital Financing Activities	61,227,462

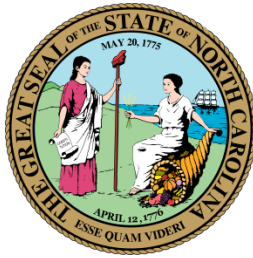
CASH FLOWS FROM INVESTING ACTIVITIES

Investment Income	5,214,552
Purchase of Investments and Related Fees	(69,261,597)
Assessment for Investment in Affiliates	670,000
Investment in Affiliates	(1,000,000)
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Net Cash Used by Investing Activities	(64,377,045)
	<hr/>
Net Decrease in Cash and Cash Equivalents	(3,149,583)
	<hr/>
Cash and Cash Equivalents - July 1, 2018, As Restated	53,092,031
	<hr/>
Cash and Cash Equivalents - June 30, 2019	\$ 49,942,448

NONCASH INVESTING AND FINANCING ACTIVITIES

Notes Receivable Issued	\$ 63,900,000
Change in Fair Value of Investments	6,416,791
Loss on Investment in Affiliates	(1,459,020)

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 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), UNC Rockingham Health Care, Inc. (Rockingham), 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 Health Corporation, Lenoir Memorial Hospital, and Onslow County Hospital Authority, 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 three 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, UNC School of

Medicine, 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 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 and 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.

- 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. These financial statements do not include the Shared Administrative Services Fund. See Note 12 for further details regarding change in reporting entity.

- C. Basis of Presentation** - The accompanying financial statements are presented in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

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

in the basic financial statements. 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 investment income.

- 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. Assets Whose Use is Limited or Restricted** - This classification represents investments held in escrow for Certified Public Expenditures as discussed further in Note 7.

- H. 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.

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.

Depreciation is 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

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

Investment in Capital Assets - This represents the System Fund's total investment in capital assets.

Unrestricted Net Position - Unrestricted net position includes resources derived from assessments, mission support, and investment income.

- J. 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 in connection with the System Fund's principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions. 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 expenses.

- K. 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 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 UNC School of Medicine 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, UNC School of Medicine, 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 made mission support payments to the System Fund during fiscal year 2019.

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.

Other Transfers In and Out - This represents transfer activity not classified elsewhere. For fiscal year 2019, the activity comprised of transactions associated with the sale of High Point Regional Health, Inc. to Wake Forest Baptist Medical Center.

NOTE 2 - DEPOSITS AND INVESTMENTS

- A. Deposits** - The System Fund is the name of UNC Health Care's bank account for central administrative functions. It contains several distinct funds and is subject to the provisions of the Executive Budget Act, except for trust funds identified in *North Carolina General Statutes* 116-36.1 (Regulation of Institutional Trust Funds) and 116-37.2 (Regulation of UNC Hospitals Funds). These statutes primarily apply to the receipts generated by patient billings and other revenues from the operations of UNC Hospitals and UNC School of Medicine. 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, 2019, the amount shown on the Statement of Net Position as cash and cash equivalents of \$49,942,448 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 1.3 years as of June 30, 2019. 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 summary of deposits and corresponding designations as of June 30, 2019 is as follows:

Designation	Enterprise Fund	Recruitment Fund	Patient Safety Fund	Total
Undesignated Funds	\$ 0	\$ 0	\$ 8,633	\$ 8,633
Designated for UNC-SOM Program Support	37,306,076			37,306,076
Designated for UNC-SOM Mission Support	6,877,739			6,877,739
Designated for UNC Faculty Recruitment		5,750,000		5,750,000
Total Deposits	\$ 44,183,815	\$ 5,750,000	\$ 8,633	\$ 49,942,448

B. Investments - 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).

North Carolina General Statute 116-37.2, as revised by Session Law 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 investments as described below.

Investments are subject to the following risks as defined by GASB Statement No. 40, *Deposit and Investment Risk Disclosures – An Amendment of GASB Statement No. 3*.

Interest Rate Risk: Interest rate risk is the risk the System Fund may face should interest rate variances affect the value of investments. System Fund does not have a formal policy that addresses interest rate risk.

Credit Risk: Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. System Fund does not have a formal policy that addresses credit risk.

UNC Investment Fund, LLC - At June 30, 2019, the System Fund's investments include \$114,353,104 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.

Non-Pooled Investments - The following table presents investments by type and investments subject to interest rate risk at June 30, 2019, for the System Fund's non-pooled investments. A portion of these investments

are held in escrow for purposes of the Certified Public Expenditures. See Note 7 for further details.

Investment Type	Amount	Investment Maturities (in Years)	
		Less Than 1	1 to 5
Debt Securities			
Debt Mutual Funds	\$ 21,178,682	\$ 606,992	\$ 20,571,690
Other Securities			
International Mutual Funds	15,296,435		
Equity Mutual Funds	32,129,594		
Total Non-Pooled Investments	\$ 68,604,711		

At June 30, 2019, the System Fund's non-pooled investments had the following credit quality distribution for securities with credit exposure:

	Amount	AAA Aaa	AA Aa	A	BBB Baa	BB/Ba and below
Debt Mutual Funds	\$ 21,178,682	\$ 15,470,066	\$ 532,804	\$ 2,240,246	\$ 2,914,994	\$ 20,572

Rating Agency: Moody's

Total Investments - The following table presents the total investments at June 30, 2019:

Investment Type	Amount
Debt Securities	
Debt Mutual Funds	\$ 21,178,682
Other Securities	
UNC Investment Fund	114,353,104
International Mutual Funds	15,296,435
Equity Mutual Funds	32,129,594
Total Investments	\$ 182,957,815

NOTE 3 - FAIR VALUE MEASUREMENTS

To the extent available, the System Fund's investments are recorded at fair value as of June 30, 2019. 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 deposits in the Short-Term Investment Fund, within the fair value hierarchy at June 30, 2019:

	Fair Value	Fair Value Measurements Using		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
Investments by Fair Value Level				
Debt Securities				
Debt Mutual Funds	\$ 21,178,682	\$ 21,178,682	\$ 0	\$ 0
Other Securities				
International Mutual Funds	15,296,435	15,296,435		
Equity Mutual Funds	32,129,594	32,129,594		
Total Investments by Fair Value Level	68,604,711	\$ 68,604,711	\$ 0	\$ 0
Investments as a Position in an External Investment Pool				
Short-Term Investment Fund	49,942,448			
UNC Investment Fund	114,353,104			
Total Investments as a Position in an External Investment Pool	164,295,552			
Total Investments Measured at Fair Value	\$ 232,900,263			

Short-Term Investment Fund - Ownership interests of the STIF are 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. Pool investments are measured at fair value in accordance with GASB 72. The System Fund's position in the pool is measured and reported at fair value and the STIF is not required to be categorized within the fair value hierarchy.

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. Valuation of the underlying assets is performed by the custodian. Pool investments are measured at fair value in accordance with GASB 72. The System Fund's position in the pool is measured and reported at fair value and the UNC Investment Fund is not required to be categorized within the fair value hierarchy.

Debt and Equity Securities - Debt and equity securities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

NOTE 4 - DUE FROM UNC HEALTH CARE ENTITIES

Amounts due from UNC Health Care Entities at June 30, 2019 by type and entity were as follows:

	Amount
Assessments	
Owned Entities	\$ 41,844,619

Additional information regarding transactions with the entities is included in Note 10.

NOTE 5 - NOTES RECEIVABLE

Effective June 1, 2018, the System Fund extended a \$16,000,000 note receivable to Chatham. The loan was used to retire Chatham's existing debt of the North Carolina Medical Care Commission for its FHA Mortgage Revenue Bonds for the Chatham Hospital Project Series 2007. The unpaid principal amount bears interest at a rate of 2.75%.

Pursuant to the Member Substitution Agreement between UNC Health Care and Wake Forest Baptist Medical Center (WFBMC) entered into as of March 8, 2018, the purchase price of High Point Regional would be made in installments with a payment on the closing date and then WFBMC will make three subsequent annual payments of \$21,300,000 to UNC Health Care on the anniversary date of September 1, 2018. While there is a provision for WFBMC to accelerate these payments, to date they have only made the payment required on September 1, 2019. There is no interest associated with this note receivable.

Notes receivable activity for the year ended June 30, 2019 is presented as follows:

Entity	Balance July 1, 2018 (as Restated)	Additions	Reductions	Balance June 30, 2019	Current Portion
Chatham Hospital	\$ 16,000,000	\$ 0	\$ 1,141,237	\$ 14,858,763	\$ 1,173,021
Wake Forest Baptist Medical Center		63,900,000		63,900,000	21,300,000
Total Notes Receivable	\$ 16,000,000	\$ 63,900,000	\$ 1,141,237	\$ 78,758,763	\$ 22,473,021

NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2019, is presented as follows:

	Balance July 1, 2018 (as Restated)	Increases	Decreases	Balance June 30, 2019
Capital Assets, Depreciable:				
Buildings	\$ 5,478,419	\$ 0	\$ 0	\$ 5,478,419
Less Accumulated Depreciation	1,460,912	365,228		1,826,140
Total Capital Assets, Depreciable, Net	\$ 4,017,507	\$ (365,228)	\$ 0	\$ 3,652,279

NOTE 7 - ESCROW FOR CERTIFIED PUBLIC EXPENDITURES

With the help of the North Carolina Hospital Association, UNC Health Care entered into an agreement with other Public Hospitals in North Carolina 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) 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, 2019, \$60,896,149 was held by the Escrow Agent, First Citizens Bank & Trust Company.

NOTE 8 - TRANSFERS IN

Transfers in by source and entity for the year ended June 30, 2019 were as follows:

	Amount
Regular Assessments:	
Owned Entities	\$ 58,289,843
UNC School of Medicine	12,332,710
Total Regular Assessments	70,622,553
Special Assessments:	
Owned Entities	16,624,178
Mission Support Assessments:	
Owned Entities	32,661,369
Other Transfers In:	
Sale of High Point Regional	214,222,341
Total Transfers In	\$ 334,130,441

Additional information regarding transactions with the entities is included in Note 10.

NOTE 9 - TRANSFERS OUT

Transfers out by purpose and entity for the year ended June 30, 2019 were as follows:

	Amount
Program Support:	
Owned Entities	\$ 54,700,000
UNC School of Medicine	70,229,662
Shared Administrative Services Fund	140,000,000
Total Program Support	264,929,662
Mission Support:	
UNC School of Medicine	28,877,739
Other Transfers Out:	
Owned Entities	13,221,000
Total Transfers Out	\$ 307,028,401

Additional information regarding transactions with the entities is included in Note 10.

NOTE 10 - RELATED PARTIES

University of North Carolina Hospitals at Chapel Hill - UNC Hospitals at Chapel Hill (UNC Hospitals) is the only state-owned teaching hospital in North Carolina. With a licensed base of 951 beds, this facility serves as an acute care teaching hospital for The University of North Carolina at Chapel Hill.

UNC Hospitals was assessed \$94,983,119 in fiscal year 2019 for assessments and mission support to the System Fund. As of June 30, 2019, the System Fund had receivables of \$41,286,527.

University of North Carolina School of Medicine - UNC School of Medicine, which includes UNC Faculty Physicians, provides 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.

UNC School of Medicine was assessed \$12,332,710 in fiscal year 2019 for assessments to the System Fund. In turn, the System Fund made payments of \$99,107,041 for program support and mission support. As of June 30, 2019, the System Fund had receivables of \$63,793 and payables of \$22,230,121.

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 was assessed \$10,793,808 in fiscal year 2019 for assessments to the System Fund. The System Fund also made payments to Rex in the amount of \$39,700,000 for support. As of June 30, 2019, the System Fund had receivables of \$395,808.

Chatham Hospital, Inc. - Chatham Hospital, Inc. (Chatham) is a private, not-for-profit 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 was assessed \$231,672 in fiscal year 2019 for assessments to the System Fund. As of June 30, 2019, the System Fund had receivables of \$3,133. The System Fund extended a \$16,000,000 note receivable to Chatham in fiscal year 2018, of which \$14,858,763 was still outstanding as of June 30, 2019. Of this amount, \$1,173,021 is due in the next year.

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) and beyond.

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 was assessed \$721,963 in fiscal year 2019 for assessments to the System Fund. As of June 30, 2019, the System Fund had receivables of \$129,391.

Effective July 1, 2018 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 July 1, 2018 plus 0.75% (5.75%). As of June 30, 2019, the balance outstanding was \$425,000. This agreement was renewed on July 1, 2019 and all unpaid amounts including accrued interest are due on June 30, 2021.

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%). This agreement was renewed on July 1, 2019 and all unpaid amounts including accrued interest are due on June 30, 2021. As of June 30, 2019, there was no balance outstanding.

Effective July 1, 2018, 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, 2018 plus 0.75% (5.75%). As of June 30, 2019, the balance outstanding was \$275,000. This agreement was renewed on July 1, 2019 and all unpaid amounts including accrued interest are due on June 30, 2020.

The following table summarizes the activity in the lines of credit for the year ended June 30, 2019:

Entity	Balance July 1, 2018	Borrowings	Payments	Balance June 30, 2019
Boylan Clinic	\$ 425,000	\$ 0	\$ 0	\$ 425,000
Garner Family Practice Clinic	275,000			275,000
	<u>\$ 700,000</u>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 700,000</u>

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 was assessed \$589,760 in fiscal year 2019 for assessments to the System Fund. The System Fund also made payments to Caldwell in the amount of \$15,000,000 for program support. As of June 30, 2019, the System Fund had receivables of \$29,760.

UNC Rockingham Health Care, Inc. - UNC Rockingham Health Care, Inc. (Rockingham) is a not-for-profit acute care hospital located in Eden, North Carolina providing inpatient, outpatient, emergency care, and nursing services to communities in north central North Carolina and south central Virginia.

Rockingham was assessed \$255,068 in fiscal year 2019 for assessments to the System Fund. As part of the High Point Regional Health, Inc. sale, the System Fund transferred \$13,221,000 to Rockingham.

UNC Health Care Managed Entities - UNC Health Care has 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 Health Corporation, Lenoir Memorial Hospital, and Onslow County Hospital Authority, which are considered managed entities within UNC Health Care.

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.

UNC Health Care Shared Administrative Services Fund - The UNC Health Care Shared Administrative Services Fund (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.) represent activities that benefit all of the owned entities and functions to support UNC Health Care's operations throughout the year. Previously, this activity was managed through the System Fund but growth of this function has necessitated separation of the Shared Administrative Services Fund from the System Fund. During fiscal year 2019, the System Fund transferred \$140,000,000 to the Shared Administrative Services Fund for support which remains a payable as of June 30, 2019.

NOTE 11 - INVESTMENT IN AFFILIATES

The System Fund has investments in affiliates and joint ventures accounted for using the equity and cost methods. A summary of changes in the investments in affiliates for the year ended June 30, 2019 is presented as follows:

Affiliate	Balance July 1, 2018	Additions	Reductions	Balance June 30, 2019
Johnston Health Services Corporation	\$ 62,907,060	\$ 2,330,529	\$ 0	\$ 65,237,589
Alignment Healthcare Partners, LP	6,111,274			6,111,274
Provider-Led and Patient-Centered Care, LLC	2,789,549		2,789,549	
Total Investment in Affiliates	<u>\$ 71,807,883</u>	<u>\$ 2,330,529</u>	<u>\$ 2,789,549</u>	<u>\$ 71,348,863</u>

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.

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.

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 11 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. Per the North Carolina Department of Health and Human Services (NCDHHS), the North Carolina General Assembly adjourned in November of 2019 without providing the required new spending in order to

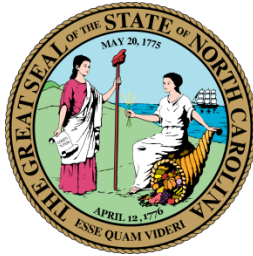
implement the managed care program. The NCDHHS has stated that the program will not go live on February 1, 2020 as previously planned. UNC Health Care has written off its investment in PLPCC given that the underlying conditions existed as of June 30, 2019.

NOTE 12 - NET POSITION RESTATEMENT: CHANGE IN REPORTING ENTITY

On July 1, 2018, the System Fund transferred the activity of the Shared Administrative Services Fund, a sub-account within the System Fund, to a separate reporting entity within UNC Health Care. The purpose of the transfer was to categorically segregate the activities related to these shared administrative services from those of the System Fund. The System Fund assesses, holds, and allocates funds across the entities of UNC Health Care while the Shared Administrative Services Fund reflects the activities that are beneficial to all entities within UNC Health Care. The growth of these two activities necessitated their separation into distinct operations and financial reporting entities so that they could be more effectively and clearly managed. Because of this transfer, net position as previously reported was restated as of July 1, 2018. The System Fund recorded no gain or loss, disposed of no assets (capital or other), and exchanged no consideration related to this transfer. The impact of the financial reporting entity change is reflected in the table below.

NOTES TO THE FINANCIAL STATEMENTS

	July 1, 2018 as Previously Reported	Restatement	July 1, 2018 as Restated
ASSETS			
Current Assets:			
Cash and Cash Equivalents	\$ 83,900,366	\$ (30,808,335)	\$ 53,092,031
Due from UNC Health Care Entities	104,234,411	(58,488,579)	45,745,832
Due from UNC School of Medicine	5,441,931	(5,441,931)	
Notes Receivable	2,040,899	(899,661)	1,141,238
Line of Credit	700,000		700,000
Total Current Assets	196,317,607	(95,638,506)	100,679,101
Noncurrent Assets:			
Investments	46,383,278		46,383,278
Assets Whose Use is Limited or Restricted	61,206,296		61,206,296
Notes Receivable	17,904,585	(3,045,823)	14,858,762
Investment in Affiliates	71,807,883		71,807,883
Capital Assets, Net	187,375,295	(183,357,788)	4,017,507
Total Noncurrent Assets	384,677,337	(186,403,611)	198,273,726
Total Assets	580,994,944	(282,042,117)	298,952,827
DEFERRED OUTFLOWS OF RESOURCES	0	0	0
LIABILITIES			
Current Liabilities:			
Due to UNC Health Care Entities	51,766,619	(51,766,619)	
Due to UNC School of Medicine	12,369,398	9,675,038	22,044,436
Notes Payable	15,189,077	(15,189,077)	
Assessments Paid in Advance	47,115,000		47,115,000
User Fees Paid in Advance	24,695,595	(24,695,595)	
Funds Held for Others	3,394,476	(20,887)	3,373,589
Total Current Liabilities	154,530,165	(81,997,140)	72,533,025
Noncurrent Liabilities:			
Notes Payable	81,905,001	(81,905,001)	
User Fees Paid in Advance	100,325,540	(100,325,540)	
Funds Held in Escrow	61,206,296		61,206,296
Total Noncurrent Liabilities	243,436,837	(182,230,541)	61,206,296
Total Liabilities	397,967,002	(264,227,681)	133,739,321
DEFERRED INFLOWS OF RESOURCES	0	0	0
NET POSITION			
Net Investment in Capital Assets	90,526,215	(86,508,708)	4,017,507
Unrestricted	92,501,727	68,694,272	161,195,999
Total Net Position	\$ 183,027,942	\$ (17,814,436)	\$ 165,213,506



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**

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 part of the University of North Carolina 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, 2019, 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 July 24, 2020.

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, 2019, 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

July 24, 2020

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For additional information, contact the
North Carolina Office of the State Auditor at 919-807-7666



This audit required 634 hours at an approximate cost of \$65,936.