

# STATE OF NORTH CAROLINA

OFFICE OF THE STATE AUDITOR  
BETH A. WOOD, CPA



## UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM FUNDS

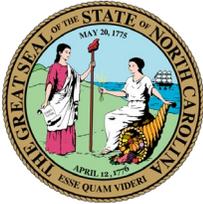
CHAPEL HILL, NORTH CAROLINA  
FINANCIAL STATEMENT AUDIT REPORT  
FOR THE YEAR ENDED JUNE 30, 2020

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**  
State Auditor

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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, 2020, 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.

Beth A. Wood, CPA  
State Auditor

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

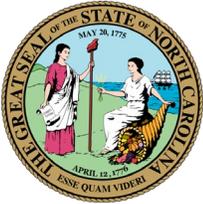
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Chapter 147, Article 5A of the *North Carolina General Statutes*, gives the Auditor broad powers to examine all books, records, files, papers, documents, and financial affairs of every state agency and any organization that receives public funding. 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**

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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, 2020, 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, 2020, 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, 2020, 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 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 29, 2021 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.



Beth A. Wood, CPA  
State Auditor

Raleigh, North Carolina

July 29, 2021



# **MANAGEMENT'S DISCUSSION AND ANALYSIS**

## Introduction

Management's discussion and analysis provides an overview of the financial position of the University of North Carolina Health Care System (UNC Health) Funds (System Fund) for the fiscal year ended June 30, 2020 and includes comparative information for the fiscal year ended June 30, 2019. This discussion and analysis should be read in conjunction with the financial statements and related notes which follow this discussion and analysis.

UNC Health was established November 1, 1998, by *North Carolina General Statute 116-37*. UNC Health is governed by a Board of Directors as an affiliated enterprise of the University of North Carolina System. UNC Health 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. 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 and the UNC School of Medicine. UNC Health has signed management service agreements with various other health care entities across North Carolina which are considered managed entities within UNC Health. 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. Initially formed as the Enterprise Fund to facilitate investments in support of the clinical, academic, and research missions of UNC Health 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. As such, the Enterprise Fund, Patient Safety Fund, and Recruitment Fund each function as sub-accounts within 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*, 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, changes in financial accounting and reporting, 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 2020 to 2019**

Financial results for fiscal year 2020 and 2019 are presented in Table 1 of this report and discussed in the following sections. Discussion in the following sections is related to fiscal year 2020 results and changes relative to ending balances in fiscal year 2019.

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

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

The sub-accounts of the System Fund collectively hold assets of \$399.9 million, which is a decrease of \$29.4 million, or 6.8%, below the prior year. Current assets decreased by \$32.8 million. The current amount due from UNC Health Care Entities decreased by \$30.3 million related to the prior year UNC Hospitals mission support accrual that was received in the current year. Noncurrent assets increased by \$3.9 million, or 1.2%. The noncurrent portion of notes receivable decreased \$22.5 million, primarily in relation to the annual payment for the Sale of High Point Regional Health (HPRH), while the Assets Whose Use is Limited or Restricted increased by \$15.4 million in relation to the increase in Funds Held in Escrow amount explained in the liabilities section below. The noncurrent due to UNC Health Care Entities increased by \$5.3 million, as a portion of UNC Hospitals mission support is not expected to be received next year. See Note 5 to the financial statements for further details on notes receivable.

Total liabilities decreased by \$33.0 million, or 14.0% overall. Current liabilities decreased \$114.4 million and are driven primarily by \$140.0 million reduction in current funds due to UNC Health Care Shared Administrative Services Fund, of which, \$74.0 million was paid back during FY20. The remaining \$66.0 million due to UNC Health Care Shared Administrative Services Fund was reassessed during the year and it was determined that it would be paid back during

FY22, resulting in a reclassification to noncurrent. The amount due to UNC School of Medicine increased \$24.2 million during the year in relation to the mission support accrual. The noncurrent liabilities increased by \$81.4 million, primarily related to the remaining portion of the due to UNC Health Care Shared Administrative Services Fund amount being recognized as noncurrent. Also contributing to this change was an increase of \$15.4 million of the Escrow for Certified Public Expenditures, which was a result of removing closed years in the escrow for FY15 & and FY16 and adding two open years for FY18 and FY19 to the calculations. The later years required a higher escrow amount due to an increase in the certified public expenditures that were reported compared to the earlier years. See Note 7 to the financial statements for further details on the Escrow for Certified Public Expenditures.

Net position increased \$3.6 million compared to fiscal year 2019 due to transfer activity and investment income discussed below.

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

Net investment income decreased \$5.3 million during fiscal year 2020 which reflects the general market conditions during the fourth quarter of 2020. Investment income from affiliates increased \$3.2 million from 2019. This change was driven primarily by the 2019 write off of the System Fund's investment in Provider-Led and Patient-Centered Care, LLC (PLPCC). Other nonoperating expenses decreased \$8.7 million as no additional reserves were recorded in connection to the sale of High Point Regional Health (HPRH).

Transfers into and transfers out of the System Fund decreased \$225.6 million and \$194.5 million, respectively, during fiscal year 2020. The transfers relating to the sale of HPRH in fiscal year 2019 were the major components of these activities during that year, therefore, the fiscal year 2020 transfers are less in comparison.

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

UNC Health derives the vast majority of its operating revenues from patient care services. Strong operating performance in the past and earning a positive operating margin during fiscal year 2020 has enabled UNC Health 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 has adapted to the challenges presented by the COVID-19 pandemic and continues to evolve in order to remain a leader in providing the continuum of services required in health care. Providing these services relies on a variety of options for program and service development as well as significant capital investment. UNC Health utilizes acquisitions, partnerships, network development, contracts, and other means to expand its provision of care as opportunities are developed. Guided by a philosophy of collaboration and partnership with other providers, UNC Health continues to evaluate options of strategic importance to its development. Acquisitions and affiliations include hospitals, home health, hospice, physician practices and infusion services. We are making significant infrastructure investments to modernize and expand our patient care. The funding for these acquisitions and investments is coordinated through the System Fund.

Third-party payors, including governmental sponsored programs, continue to migrate from fee-for-service to fee-for-value. Significant investments have been made in population health care to prepare for a value-based reimbursement regulatory environment. UNC Health Alliance, LLC, a subsidiary of UNCPN, is a clinically integrated network designed to enable private practice community physicians to enter into value contracts jointly with UNC Health and third-party payors, with the goal of increasing quality and better managing the cost of care. UNC Senior Alliance, LLC is also a subsidiary of UNCPN and has entered into an agreement with the Centers for Medicare and Medicaid Services (CMS) to participate in the Next Generation Accountable Care Organization (ACO) for Medicare recipients effective January 1, 2017. The Next Generation ACO Model is a value-based payment model that encourages providers to assume greater accountability in coordinating the health care of Medicare fee-for-service beneficiaries. Learning from these programs will allow UNC Health to more rapidly scale and ramp-up our initiatives when appropriate.

Continued reductions to payment levels for Medicaid patients, added legislative burdens, market consolidation, and cuts to the UNC School of Medicine place added pressures on the organization and its ability to fund initiatives.

Management is committed to proper expense management while maintaining high quality patient care, innovation, and very satisfied patients. Successfully managing in the future requires tighter integration of administrative functions across the entities of UNC Health, caring for patients in lower cost delivery settings, and developing sufficient scale to spread the cost of major investments across a broad base. UNC Health continues to implement these changes through a health system-wide planning and implementation process.

On March 11, 2020, the World Health Organization declared the novel coronavirus (COVID-19) a global pandemic. The pandemic substantially impacted the global economy as well as created significant volatility in the financial markets. Additionally, patient volumes and associated patient net revenues at our hospital facilities were significantly reduced in the months of March, April and May 2020. On March 27, 2020, President Trump signed into law the Coronavirus Aid, Relief, and Economic Security (CARES) Act authorizing \$100 billion in funding to hospitals and other healthcare providers. UNC Health hospitals were recipients of funding from the CARES Act which assisted with mitigating the deleterious effects resulting from lowered patient volumes. We continue to carefully monitor this situation at all levels and pursue actions to mitigate the financial effects of the pandemic.

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

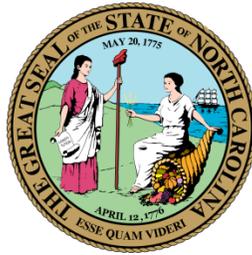
University of North Carolina Health Care System Funds  
Summary of Condensed Financial Statements Totals

Table 1

	FY20	FY19	Change	% Change
<b>CONDENSED STATEMENTS OF NET POSITION</b>				
Current Assets	\$ 82,180,888	\$ 115,023,881	\$ (32,842,993)	(28.6%)
Capital Assets, Net	3,287,051	3,652,279	(365,228)	(10.0%)
Noncurrent Assets	<u>314,443,182</u>	<u>310,592,420</u>	<u>3,850,762</u>	1.2%
<b>TOTAL ASSETS</b>	<b><u>399,911,121</u></b>	<b><u>429,268,580</u></b>	<b><u>(29,357,459)</u></b>	<b>(6.8%)</b>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>				
	<u>0</u>	<u>0</u>	<u>0</u>	
Current Liabilities	60,603,395	175,005,812	(114,402,417)	(65.4%)
Noncurrent Liabilities	<u>142,301,727</u>	<u>60,896,149</u>	<u>81,405,578</u>	133.7%
<b>TOTAL LIABILITIES</b>	<b><u>202,905,122</u></b>	<b><u>235,901,961</u></b>	<b><u>(32,996,839)</u></b>	<b>(14.0%)</b>
<b>DEFERRED INFLOWS OF RESOURCES</b>				
	<u>0</u>	<u>0</u>	<u>0</u>	
Investment in Capital Assets	3,287,051	3,652,279	(365,228)	(10.0%)
Unrestricted	<u>193,718,948</u>	<u>189,714,340</u>	<u>4,004,608</u>	2.1%
<b>TOTAL NET POSITION</b>	<b><u>\$ 197,005,999</u></b>	<b><u>\$ 193,366,619</u></b>	<b><u>\$ 3,639,380</u></b>	<b>1.9%</b>
<b>CONDENSED STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION</b>				
<b>Operating Revenues:</b>	<u>\$ 0</u>	<u>\$ 0</u>	<u>\$ 0</u>	0.0%
<b>Operating Expenses:</b>				
Depreciation	<u>365,228</u>	<u>365,228</u>		0.0%
Operating Loss	<u>(365,228)</u>	<u>(365,228)</u>		0.0%
<b>Nonoperating Revenues (Expenses):</b>				
Investment Income (Net of Investment Expense)	6,317,929	11,631,343	(5,313,414)	(45.7%)
Gain (Loss) on Investments in Affiliates	1,764,666	(1,459,020)	3,223,686	220.9%
Other Nonoperating Expenses	<u>(82,159)</u>	<u>(8,756,022)</u>	<u>(8,673,863)</u>	(99.1%)
Net Nonoperating Revenues	<u>8,000,436</u>	<u>1,416,301</u>	<u>6,584,135</u>	464.9%
Transfers In	108,513,539	334,130,441	(225,616,902)	(67.5%)
Transfers Out	<u>112,509,367</u>	<u>307,028,401</u>	<u>(194,519,034)</u>	(63.4%)
<b>Increase in Net Position</b>	<b><u>3,639,380</u></b>	<b><u>28,153,113</u></b>	<b><u>(24,513,733)</u></b>	<b>(87.1%)</b>
<b>Net Position - Beginning of Year</b>	<b><u>193,366,619</u></b>	<b><u>165,213,506</u></b>	<b><u>28,153,113</u></b>	<b>17.0%</b>
<b>Net Position - End of Year</b>	<b><u>\$ 197,005,999</u></b>	<b><u>\$ 193,366,619</u></b>	<b><u>\$ 3,639,380</u></b>	<b>1.9%</b>

Fiscal year 2020 revenues (excluding transfers in) totaled \$8,082,595 and expenses (excluding transfers out) totaled \$447,387.

Fiscal year 2019 revenues (excluding transfers in) totaled \$11,631,343 and expenses (excluding transfers out) totaled \$10,580,270.



# FINANCIAL STATEMENTS

**University of North Carolina Health Care System Funds**  
**Statement of Net Position**  
**June 30, 2020**

**Exhibit A-1**

**ASSETS**

Current Assets:

Cash and Cash Equivalents (Note 2):	
Undesignated Funds	\$ 8,633
Designated for UNC School of Medicine Program Support	15,961,434
Designated for UNC School of Medicine Mission Support	25,685,165
Designated for UNC Faculty Recruitment	<u>5,750,000</u>
Cash and Cash Equivalents Total	47,405,232
Due from UNC Health Care Entities (Note 4)	11,569,968
Notes Receivable (Note 5)	22,505,688
Line of Credit (Note 10)	<u>700,000</u>
Total Current Assets	<u>82,180,888</u>

Noncurrent Assets:

Investments (Note 2)	125,941,662
Assets Whose Use is Limited or Restricted (Note 2)	76,300,047
Due from UNC Health Care Entities (Note 4)	5,307,891
Notes Receivable (Note 5)	33,780,053
Investment in Affiliates (Note 11)	73,113,529
Capital Assets - Depreciable, Net (Note 6)	<u>3,287,051</u>
Total Noncurrent Assets	<u>317,730,233</u>

Total Assets	<u>399,911,121</u>
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**DEFERRED OUTFLOWS OF RESOURCES**

0

**LIABILITIES**

Current Liabilities:

Due to UNC School of Medicine	46,423,084
Other Liabilities	10,871,722
Funds Held for Others	<u>3,308,589</u>
Total Current Liabilities	<u>60,603,395</u>

Noncurrent Liabilities:

Due to UNC Health Care Shared Administrative Services Fund	66,001,680
Funds Held in Escrow (Note 7)	<u>76,300,047</u>
Total Noncurrent Liabilities	<u>142,301,727</u>

Total Liabilities	<u>202,905,122</u>
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**DEFERRED INFLOWS OF RESOURCES**

0

**NET POSITION**

Investment in Capital Assets	3,287,051
Unrestricted	<u>193,718,948</u>
Total Net Position	<u>\$ 197,005,999</u>

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, 2020**

**Exhibit A-2**

<b>OPERATING REVENUES</b>	\$ 0
<b>OPERATING EXPENSES</b>	
Depreciation	365,228
Operating Loss	(365,228)
<b>NONOPERATING REVENUES (EXPENSES)</b>	
Investment Income (Net of Investment Expense of \$241,689)	6,317,929
Gain on Investment in Affiliates	1,764,666
Other Nonoperating Expenses	(82,159)
Net Nonoperating Revenues	8,000,436
<b>TRANSFERS IN</b>	
Regular Assessments (Note 8)	74,771,812
Mission Support Assessments (Note 8)	7,773,818
Other Transfers In (Note 8)	25,967,909
Total Transfers In	108,513,539
<b>TRANSFERS OUT</b>	
Program Support (Note 9)	78,262,479
Mission Support (Note 9)	34,246,888
Total Transfers Out	112,509,367
Increase in Net Position	3,639,380
<b>NET POSITION</b>	
Net Position - July 1, 2019	193,366,619
Net Position - June 30, 2020	\$ 197,005,999

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, 2020**

**Exhibit A-3**

**CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES**

Transfers In from Entities	\$ 133,544,092
Transfers Out to Entities	(155,655,177)
Third Party Payor Pass-through Payments Received	99,604,494
Third Party Payor Pass-through Payments	(104,941,580)
Certified Public Expenditures Funds Received	15,403,898
Certified Public Expenditures Funds to Escrow	(15,403,898)
Notes Receivable Repaid by Entities	<u>22,473,022</u>
Net Cash Used by Noncapital Financing Activities	<u>(4,975,149)</u>

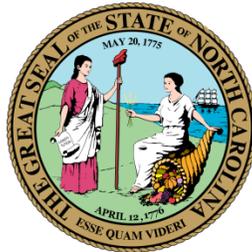
**CASH FLOWS FROM INVESTING ACTIVITIES**

Investment Income	3,269,739
Purchase of Investments and Related Fees	<u>(831,806)</u>
Net Cash Provided by Investing Activities	<u>2,437,933</u>
Net Decrease in Cash and Cash Equivalents	(2,537,216)
Cash and Cash Equivalents - July 1, 2019	<u>49,942,448</u>
Cash and Cash Equivalents - June 30, 2020	<u><u>\$ 47,405,232</u></u>

**NONCASH INVESTING AND FINANCING ACTIVITIES**

Change in Fair Value of Investments	\$ 3,048,190
Gain on Investment in Affiliates	1,764,666

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) was established November 1, 1998 by *North Carolina General Statute* 116-37. UNC Health 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 is governed by a Board of Directors (Board) as an affiliated enterprise of the University of North Carolina (UNC) System. UNC Health 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. 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, an integrated health care provider. UNC Health 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.

The Board's vision for UNC Health 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. Initially formed as the Enterprise Fund to facilitate investments in support of the clinical, academic, and education missions of UNC Health 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 and the UNC School of Medicine. It is funded by assessments against revenues of UNC Health 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'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 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, 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.

- 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 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, 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 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 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.

**Mission Support Assessments and Transfers Out** - UNC Hospitals and UNC School of Medicine are entities of UNC Health 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 2020.

**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'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** - This represents transfer activity not classified elsewhere. For fiscal year 2020, the activity comprised of transactions associated with a refund of prior year invoices for the UNC Health Care Shared Administrative Services Fund that were paid by the System Fund.

**NOTE 2 - DEPOSITS AND INVESTMENTS**

- A. Deposits** - The System Fund is the name of UNC Health'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, 2020, the amount shown on the Statement of Net Position as cash and cash equivalents of \$47,405,232 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, 2020. 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, 2020 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	15,961,434			15,961,434
Designated for UNC-SOM Mission Support	25,685,165			25,685,165
Designated for UNC Faculty Recruitment		5,750,000		5,750,000
<b>Total Deposits</b>	<b>\$ 41,646,599</b>	<b>\$ 5,750,000</b>	<b>\$ 8,633</b>	<b>\$ 47,405,232</b>

**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 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’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, 2020, the System Fund’s investments include \$115,536,515 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, 2020, 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	\$ 24,389,612	\$ 1,180,703	\$ 23,208,909
Other Securities			
International Mutual Funds	16,256,171		
Equity Mutual Funds	46,059,411		
<b>Total Non-Pooled Investments</b>	<b>\$ 86,705,194</b>		

At June 30, 2020, 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	\$ 24,389,612	\$ 17,846,442	\$ 610,696	\$ 2,567,752	\$ 3,341,143	\$ 23,579

Rating Agency: Moody's

**Total Investments** - The following table presents the total investments at June 30, 2020:

Investment Type	Amount
Debt Securities	
Debt Mutual Funds	\$ 24,389,612
Other Securities	
International Mutual Funds	16,256,171
Equity Mutual Funds	46,059,411
UNC Investment Fund	115,536,515
<b>Total Investments</b>	<b>\$ 202,241,709</b>

**NOTE 3 - FAIR VALUE MEASUREMENTS**

To the extent available, the System Fund’s investments are recorded at fair value as of June 30, 2020. 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, 2020:

	Fair Value	Fair Value Measurements Using		
		Level 1 Inputs	Level 2 Inputs	Level 3 Inputs
<b>Investments by Fair Value Level</b>				
Debt Securities				
Debt Mutual Funds	\$ 24,389,612	\$ 24,389,612	\$ 0	\$ 0
Other Securities				
International Mutual Funds	16,256,171	16,256,171		
Equity Mutual Funds	46,059,411	46,059,411		
<b>Total Investments by Fair Value Level</b>	<b>86,705,194</b>	<b>\$ 86,705,194</b>	<b>\$ 0</b>	<b>\$ 0</b>
<b>Investments as a Position in an External Investment Pool</b>				
Short-Term Investment Fund	47,405,232			
UNC Investment Fund	115,536,515			
<b>Total Investments as a Position in an External Investment Pool</b>	<b>162,941,747</b>			
<b>Total Investments Measured at Fair Value</b>	<b>\$ 249,646,941</b>			

**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, 2020 by type and entity were as follows:

	<u>Amount</u>
<b>Current Assessments:</b>	
Owned Entities	<u>\$ 11,569,968</u>
<b>Noncurrent Assessments:</b>	
Owned Entities	<u>\$ 5,307,891</u>

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 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 on the anniversary date of September 1, 2018. While there is a provision for WFBMC to accelerate these payments, no such accelerated payments have been made to date. There is no interest associated with this note receivable.

## NOTES TO THE FINANCIAL STATEMENTS

Notes receivable activity for the year ended June 30, 2020 is presented as follows:

Entity	Balance July 1, 2019	Additions	Reductions	Balance June 30, 2020	Current Portion
Chatham Hospital	\$ 14,858,763	\$ 0	\$ 1,173,022	\$ 13,685,741	\$ 1,205,688
Wake Forest Baptist Medical Center	63,900,000		21,300,000	42,600,000	21,300,000
<b>Total Notes Receivable</b>	<b>\$ 78,758,763</b>	<b>\$ 0</b>	<b>\$ 22,473,022</b>	<b>\$ 56,285,741</b>	<b>\$ 22,505,688</b>

### NOTE 6 - CAPITAL ASSETS

A summary of changes in the capital assets for the year ended June 30, 2020, is presented as follows:

	Balance July 1, 2019	Increases	Decreases	Balance June 30, 2020
Capital Assets, Depreciable:				
Buildings	\$ 5,478,419	\$ 0	\$ 0	\$ 5,478,419
Less Accumulated Depreciation	1,826,140	365,228		2,191,368
<b>Total Capital Assets, Depreciable, Net</b>	<b>\$ 3,652,279</b>	<b>\$ (365,228)</b>	<b>\$ 0</b>	<b>\$ 3,287,051</b>

### NOTE 7 - ESCROW FOR CERTIFIED PUBLIC EXPENDITURES

With the help of the North Carolina Hospital Association, UNC Health 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 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 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, 2020, \$76,300,047 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, 2020 were as follows:

	<u>Amount</u>
<b>Regular Assessments:</b>	
Owned Entities	\$ 61,733,812
UNC School of Medicine	<u>13,038,000</u>
Total Regular Assessments	<u>74,771,812</u>
<b>Mission Support Assessments:</b>	
Owned Entities	<u>7,773,818</u>
<b>Other Transfers In:</b>	
UNC Health Care Shared Administrative Services Fund	<u>25,967,909</u>
<b>Total Transfers In</b>	<u>\$ 108,513,539</u>

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, 2020 were as follows:

	<u>Amount</u>
<b>Program Support:</b>	
Owned Entities	\$ 584,004
UNC School of Medicine	<u>77,678,475</u>
Total Program Support	<u>78,262,479</u>
<b>Mission Support:</b>	
UNC School of Medicine	<u>34,246,888</u>
<b>Total Transfers Out</b>	<u>\$ 112,509,367</u>

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 \$62,026,626 in fiscal year 2020 for assessments and mission support to the System Fund. In turn, the System Fund made payments of \$584,004 for program support. As of June 30, 2020, the System Fund had receivables of \$15,909,757.

**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. 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 \$13,038,000 in fiscal year 2020 for assessments to the System Fund. In turn, the System Fund made payments of \$111,925,363 for program support and mission support. As of June 30, 2020, the System Fund had payables of \$46,423,084.

**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 is the sole member of Rex.

Rex was assessed \$5,604,000 in fiscal year 2020 for assessments to the System Fund. As of June 30, 2020, the System Fund had receivables of \$580,562.

**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 is the sole member of Chatham.

Chatham was assessed \$188,004 in fiscal year 2020 for assessments to the System Fund. As of June 30, 2020, the System Fund had receivables of \$58,605. The System Fund extended a \$16,000,000 note receivable to Chatham in fiscal year 2018, of which \$13,685,741 was still outstanding as of June 30, 2020. Of this amount, \$1,205,688 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, 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 to face the challenging health care environment.

UNCPN was assessed \$824,004 in fiscal year 2020 for assessments to the System Fund. As of June 30, 2020, the System Fund had receivables of \$90,935.

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, 2020, the balance outstanding was \$425,000. This agreement was renewed on July 1, 2020 and all unpaid amounts including accrued interest are due on June 30, 2021.

Effective November 30, 2015, the Boylan Clinic entered into a 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, 2020 and all unpaid amounts including accrued interest are due on June 30, 2021. As of June 30, 2020, 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, 2020, the balance outstanding was \$275,000. This agreement was renewed on July 1, 2020 and all unpaid amounts including accrued interest are due on June 30, 2021.

The following table summarizes the activity in the lines of credit for the year ended June 30, 2020:

Entity	Balance July 1, 2019	Borrowings	Payments	Balance June 30, 2020
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 became the sole corporate member of Caldwell on May 1, 2013.

Caldwell was assessed \$584,004 in fiscal year 2020 for assessments to the System Fund. As of June 30, 2020, the System Fund had receivables of \$165,937 and payables of \$20,000.

**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 \$280,992 in fiscal year 2020 for assessments to the System Fund. As of June 30, 2020, the System Fund had receivables of \$72,063.

**UNC Health Care Managed Entities** - UNC Health 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.

**WakeBrook Mental Health Campus** - UNC Health 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 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'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's operations throughout the year.

The Shared Administrative Services Fund refunded the System Fund \$25,967,909 in fiscal year 2020 for shared services invoices previously paid by the System Fund. As of June 30, 2020, the System Fund had payables of \$66,001,680.

**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, 2020 is presented as follows:

Affiliate	Balance July 1, 2019	Additions	Reductions	Balance June 30, 2020
Johnston Health Services Corporation	\$ 65,237,589	\$ 1,764,666	\$ 0	\$ 67,002,255
Alignment Healthcare Partners, LP	6,111,274			6,111,274
<b>Total Investment in Affiliates</b>	<b>\$ 71,348,863</b>	<b>\$ 1,764,666</b>	<b>\$ 0</b>	<b>\$ 73,113,529</b>

Effective February 1, 2014, Johnston Memorial Hospital Authority (JMHA) and UNC Health 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 has a 35.25 percent membership in JHSC and has provided \$57,600,000 in contributions over the years.

UNC Health 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 has no future financial obligation or commitment to Alignment Healthcare Partners, LP.

**NOTE 12 - CHANGES IN FINANCIAL ACCOUNTING AND REPORTING**

For the fiscal year ended June 30, 2020, the System Fund implemented the following pronouncements issued by the Governmental Accounting Standards Board (GASB):

*GASB Statement No. 89, Accounting for Interest Costs Incurred before the End of a Construction Period*

*GASB Statement No. 95, Postponement of the Effective Dates of Certain Authoritative Guidance*

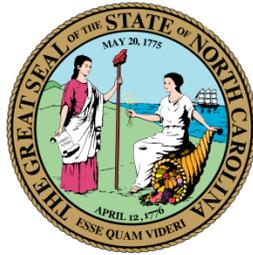
GASB Statement No. 89 establishes accounting requirements for interest costs incurred before the end of a construction period. Interest costs incurred before the end of a construction period are to be recognized as an expense in the period in which the costs are incurred for financial statements prepared using the economic resources measurement focus. Interest costs incurred before the end of a construction period will not be included in the historical cost of a capital asset reported in a business-type activity. The requirements of this Statement have been applied prospectively.

GASB Statement No. 95 provides temporary relief to governments and other stakeholders in light of the COVID-19 pandemic by postponing the effective dates of certain provisions in Statements and Implementation Guides that first became effective or are scheduled to become effective for periods beginning after June 15, 2018.

**NOTE 13 - SUBSEQUENT EVENTS**

For the year ended June 30, 2020, UNC Health owned a small interest in Alignment Healthcare Partners, LP which was reported under the financial statement category Investment in Affiliates. This investment was valued at cost of \$6,111,274 (see Note 11 for further information). On March 26, 2021, there was an Initial Public Offering (IPO) of Alignment Healthcare, Inc. (ALHC) which is now being traded on the Nasdaq Stock Exchange under the symbol ALHC. ALHC is the surviving entity of a merger with Alignment Healthcare Partners, LP. After the IPO, UNC Health owns 3,289,230 shares of the new company which represents less than 2% of the outstanding stock.

On November 4, 2020, Rex Healthcare, Inc. formalized a joint operating agreement with Johnston Memorial Hospital Authority (JMHA) and as a party to the agreement, UNC Health acquired an additional membership interest of 14.65% in Johnston Health Services Corporation (JHSC), which is reported under the financial statement category Investment in Affiliates (see Note 11 for further information). UNC Health agreed to provide \$40 million toward the completion of a hospital tower on Johnston's Clayton Campus over the course of construction. The agreement increases UNC Health membership interest to 49.90% in fiscal year 2021.



# **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, 2020, 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 29, 2021.

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, 2020, 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) as a basis for designing 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 financial statements. 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 29, 2021

# ORDERING INFORMATION

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**919-807-7666**



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This audit required 670 hours at an approximate cost of \$69,680.