



UNC
HEALTH CARE

LEADING

TEACHING

CARING

There's a reason UNC Health Care's motto is worded as it is: Leading, Teaching, Caring. In the end, it all comes down to caring. UNC Health Care employees have embraced the initiative that formalizes our approach to patient care and employee satisfaction. Called Commitment to Caring, the initiative empowers employees with the skills and desire to improve the experience of every patient they meet.



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GREETINGS

It's a scene that plays out every day across the state: An out-of-town couple makes a reservation, stops at the front desk for their key and settles in for their stay. Only when Mt. Gilead, N.C. resident John Carroll and his wife arrived at their Chapel Hill destination on March 31, 2008, they weren't checking into a hotel or motel. The Carrolls were the first residents of the State Employees' Credit Union Family House, a new hospitality house for adult patients of UNC Hospitals and their families. Thanks to the Family House, Mr. Carroll—who required 100 days of observation following a stem cell transplant for leukemia—was spared countless four-hour round trips between Mt. Gilead and Chapel Hill and the high cost of a motel room.

The Family House was the brainchild of Dr. Mark Johnson, a former UNC Health Care liver transplant surgeon who was dismayed by the logistical challenges experienced by the families of adult patients who lived outside the Triangle area. (Parents of pediatric transplant patients had the Ronald McDonald House to turn to.) Worrying about their loved ones was unnecessarily stressful for such patients, who needed all their strength just to survive treatment. Dr. Johnson's concern transcended medicine and manifested itself in the drive to create the Family House.

Dr. Johnson may be noteworthy, but he's not unique. There's a reason UNC Health Care's motto is worded as it is: Leading, Teaching, Caring. In the end, it all comes down to caring. Our employees care for patients every day in many ways – from the admissions counselor who spends extra time with a patient worried about his insurance coverage, to the nurse comforting a mother whose baby was born prematurely, to the first-year resident who summons his college Spanish to reassure a nervous ER patient.

Although they need no prompting to show they care, UNC Health Care employees have embraced the initiative that formalizes our approach to patient care and employee satisfaction. Called Commitment to Caring, the initiative empowers employees with the skills and desire to improve the experience of every patient they meet. And, in 2008, it set employee performance goals that are related directly to patient care.

Looking back over the year, it's easy to see how our other accomplishments, plans and challenges directly affect patient care. For example:

- UNC Health Care is scoring above national averages on www.hospitalcompare.hhs.gov, a Web site created through the efforts of the Centers for Medicare & Medicaid Services (CMS), the Department of Health and Human Services and other members of the Hospital Quality Alliance to better inform patients by sharing patient evaluations. Patient care measures in which UNC scored the highest include the percent of patients who would definitely recommend the hospital to friends and family (90 percent), hospital overall patient satisfaction (90 percent) and patient communication (84 percent).
- UNC Health Care was one of only 14 institutions in the country to receive a Translational and Clinical Sciences grant from the National Institutes of Health. The \$61 million award will support the UNC Translational and Clinical Sciences Institute, which circulates medical knowledge among patients, researchers and physicians. The ultimate goal: to shorten the time between discovery and treatment.
- Dozens of researchers are making significant progress on groundbreaking work that has been funded by the University Research Cancer Fund, established by the N.C. General Assembly in 2007. From a novel DNA analysis that might match breast tumors, to the most effective chemotherapy drugs, to a massive study seeking the genetic markers of nicotine addiction, to the application of nanotechnology, to imaging devices, UNC scientists are putting the people's money to its best and highest use. Some day, all citizens will benefit from the innovations in cancer detection and treatment that result from the efforts of these scientists.

- We continue our mandate to serve all who come through our doors. In 2008, we provided \$227 million in uncompensated care, an increase of 9 percent over 2007. As the effects of a worldwide recession begin to be felt even in North Carolina's relatively immune economy, the amount of uncompensated care we provide will surely continue to rise.
- Ensuring access to our services remains one of the ways we demonstrate concern for North Carolinians. The number of patients we serve at our hospitals in Chapel Hill is growing in tandem with the state's booming population. We are moving ahead with an already approved plan to reconfigure existing offices and other spaces into patient rooms, which will yield additional beds by the year 2010, and considering other ways to accommodate the need to increase capacity.
- We're also expanding our efforts to bring UNC Health Care to people who live in cities and towns beyond the Triangle. With this summer's purchase of the 25-bed Chatham Hospital in Siler City, we made significant progress toward that goal. The hospital, which moved into a new, state-of-the-art building earlier this year, serves a community that has one of the largest concentrations of Hispanics in the state. As part of the agreement, UNC Health Care has committed \$9.3 million to develop health care services in Chatham County over the next seven years, giving us the opportunity to bring hope and healing to a largely underserved population.

Despite the momentum that each new accomplishment adds, we remain realistic about the obstacles we face. Our population is growing, getting older and experiencing more chronic diseases, all of which will affect our ability to deliver quality care. And if the economy gets worse before it gets better, our budget will be severely strained by more patients who can't pay their bills and fewer state dollars available to us to help support our overhead.

But in these uncertain times, we can be sure that the people of UNC Health Care are up to the challenge, as the facts and stories that follow will show. We hope you will enjoy reading about them, and know that with such talented, dedicated people on our team, we will always find a way to provide the best care possible to those who need it most.

As in years past, the second half of this report contains financial statements for the UNC Health Care System (UNC HCS). They are pro forma due to the complexities of blending the system's various entities. The law that created the system says that the operations of the University of North Carolina Hospitals (UNCH) and the clinical patient outpatient care programs of the School of Medicine of the University of North Carolina at Chapel Hill (the University) shall be governed by the board of directors of the UNC Health Care System. Rex Healthcare, Inc. (Rex) and various community-based clinics have been added since the legislation that created the system was passed.

While Rex and UNC Hospitals are individually audited, the operations of the clinical patient care programs of the University's School of Medicine—known as UNC Physicians & Associates—are included in the overall audit of the University. Producing consolidated financial statements for the UNC Health Care System and a separate audit would be hard, if not impossible, to accomplish. We feel that these pro forma statements are the best way to characterize the overall operations of the UNC Health Care System. Further discussion of the financial statement pro forma presentation and its implications can be found in the Management's Discussion and Analysis section as well as in the Notes to the Report.

On behalf of the employees and patients of UNC Health Care, thank you for your continued support.


Sincerely,



William L. Roper, MD, MPH

Chief Executive Officer

University of North Carolina Health Care System



Charles Sanders, MD

Chair, Board of Directors (November 2007–Present)

University of North Carolina Health Care System

INSPIRING PEOPLE *and* PROGRAMS: PARTNERS, EMPLOYEES *and* VOLUNTEERS SHOW THEY CARE

A HOME AWAY *from* HOME

People helping people—whether they're patients, partners, employees or volunteers—is a hallmark of UNC Health Care's commitment to caring. Nowhere is this more evident than in a new facility that opened this past March near UNC Hospitals. The State Employees' Credit Union (SECU) Family House is a hospitality home for adult patients receiving treatment at UNC Hospitals and their families. Family House represents a two-year labor of love started by former UNC Health Care employee Mark Johnson, a liver transplant surgeon, along with volunteers who shared his concern for the families of patients needing long-term care at UNC Hospitals. Many of these family members wanted to support their loved ones but lived too far away to commute and could not afford a lengthy motel stay.

Inspired by the success of Ronald McDonald House, which serves families of children receiving hospital care, the volunteers sparked an effort to raise funds to build and equip the house. The SECU Foundation stepped up with a lead gift of \$2 million, its largest gift ever, according to David King, chairman of the board of the SECU Foundation. "They are North Carolina's hospital, we are North Carolina's credit union," said King of SECU's decision to help fund the project. "Statistically, 15 percent of UNC Hospitals' patients are our members. It struck us as a natural fit and an opportunity to make a difference in people's lives."



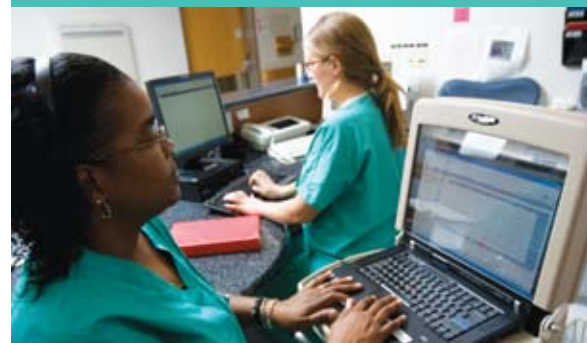


One person whose life was touched by Dr. Johnson's vision and the generosity of SECU members was leukemia patient John Carroll, a retired Marine colonel from Mt. Gilead, N.C. As part of a stem cell transplant that was his best chance of fighting the disease, Mr. Carroll was required to return to the N.C. Memorial Hospital weekly for a period of 100 days. He and his wife despaired over making the four-hour roundtrip several days a week and worried about the havoc that a long motel stay would wreak on their savings, but went ahead with the transplant anyway and moved into a local motel following the procedure.

Then, seven weeks into the Carrolls' stay, the SECU Family House opened on a quiet street just five minutes from UNC Hospitals. The Carrolls were the first guests to check into the comfortably appointed, 40-bedroom facility, which suggests a \$35 per night donation. It was the answer to John Carroll's prayers.

"Without Family House, I probably would have spent a great deal more money. I probably would have worried a lot more, not so much about myself but about my wife, and I probably did not need that stress at that particular time. It's a beautiful place."

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REACHING OUT *in* RALEIGH

Through its outreach programs, partner facilities, telemedicine initiatives and open-door policy on its main campus, UNC Health Care cares for patients from all 100 North Carolina counties. In Wake County, its mission of care reaches residents via Rex Healthcare, which has been a part of the UNC family for several years. The parade of tiny pink and blue bundles carried out of Rex every day attests to the faith Wake County families place in the hospital.

More women choose Rex Healthcare to deliver their babies than any other hospital in the Triangle for a number of reasons. First, there are the accolades: Rex is the first hospital in the Triangle, and one of only 10 in North Carolina, to earn “magnet recognition” from the American Nurses Credentialing Center, placing its nurses among the top 2 percent in the country. It’s also included among the Thomson Healthcare Top 100 Hospitals for 2008, which recognizes hospitals for excellence in clinical outcomes, patient safety, financial performance and efficiency. Rex also received distinction as one of the Top 100 Performance Improvement Leaders by Thomson Reuters for its continued commitment to quality and patient safety.

But its success as a birthing center—approximately 7,000 babies were born at Rex in 2008—is also due to the support it offers new moms. Contrary to popular belief, not all women adjust easily to their new roles. So Rex created a program called Moms Supporting Moms, a support group for women who experience difficulties related to childbirth and motherhood, from mild twinges of anxiety to postpartum depression. All meetings are led by counselors with expertise in treating postpartum depression. Mothers share their feelings and experiences in an atmosphere of encouragement and hope, taking comfort that they are not alone.

QUANTIFYING CARE SYSTEM WIDE

Caring comes naturally to people who create programs like Moms Supporting Moms, spearhead a campaign like the one that launched Family House, or volunteer with countless organizations across the state such as the March of Dimes, the N.C. Stroke Advisory Council, the Race for the Cure and the Juvenile Diabetes Foundation. But caring can also be formalized, as with UNC Health Care's Commitment to Caring initiative, which aims to improve the patient experience and boost employee morale.

Commitment to Caring includes patient satisfaction measures and quality indicators designed to improve everything that affects clinical practice, from the quality and safety of patient care to operational efficiency to financial stability to peer support to the deployment of new technology and knowledge. While these aren't new goals, institutionalizing them aligns everyone involved in patient care behind a common purpose.

Commitment to Caring—which also includes tying employee performance incentives to caring measures—is receiving high marks from employees and patients alike. From patients, UNC Health Care is receiving scores well above national averages on www.hospitalcompare.hhs.gov, a Web site created through the efforts of the Centers for Medicare & Medicaid Services (CMS), the Department of Health and Human Services and other members of the Hospital Quality Alliance to better inform patients through the sharing of patient evaluations. These efforts make for a better, higher-quality care system and will continue to help streamline the system improvement process.



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LAYING *the* FOUNDATION *for* TOMORROW'S CARE

NEW FUND INVESTS *in* MEDICAL POTENTIAL

Anyone who has tried to quit smoking knows it can be incredibly hard. No matter how motivated they are to improve their health, many smokers find that even the latest treatments can't help them overcome their nicotine addiction. And that's a problem for all of us: tobacco use is linked to several of the most expensive chronic diseases and is the leading cause of preventable death in the state and nation.

Scientists have long suspected a genetic component to nicotine addiction, the understanding of which could lead to a radical improvement in smoking cessation drugs or treatments. But until recently, very little research had been done on the DNA of smoking.

That changed when Helena Furberg, Ph.D., and her colleagues in the genetics department at the UNC School of Medicine established the Tobacco and Genetics (TAG) Consortium with a \$200,000 grant from the University Cancer Research Fund (UCRF). Dr. Furberg and her team were among the first researchers to receive funding from the UCRF, which was established at UNC in 2007 thanks to the generosity and vision of the North Carolina General Assembly. The purpose of the fund, which will grow to the equivalent of a \$1 billion endowment, is to support UNC researchers in finding better ways to prevent, detect and treat cancer.

TAG Consortium researchers are using the grant to analyze genetic information from nearly 75,000 participants from several completed studies worldwide. The studies had different purposes but all asked participants the same routine questions about whether they smoked and if so, how much. By pooling this genome data of smokers, Furberg and her team will be able to scan approximately 2.2 million genetic markers and see if some are more common among heavy smokers. If enough samples share identical markers, researchers will be able to identify genes to target for smoking cessation treatments.

“Given how complex tobacco addiction is, our findings won’t be a magic bullet,” said Dr. Furberg. “But it’s the first step on a long pathway that can inform a lot of cancer prevention and control disciplines.”

The TAG Consortium has a chance to improve—and possibly save—the lives of the approximately 21 percent of North Carolinians who smoke. And it’s not the only UCRF-funded research effort with that kind of potential. Dozens of UNC researchers with UCRF grants are working night and day to unravel cancer’s deadly secrets, map out safer treatments and develop less invasive diagnostic tools. One UCRF team in particular wanted to find a better way to deliver powerful drugs only to cancer cells. Led by Dr. Joseph DeSimone, Ph.D., they have begun to create cellular Trojan horses, particles so small and so correctly shaped that only cancer cells admit them, leaving healthy cells unscathed. Their research may one day lead to the development of cancer drugs that have fewer side effects than today’s treatments—or possibly none at all. While the science itself is gratifying, what motivates UNC researchers is the way caring doctors will one day apply their findings, whether it’s to say to a worried patient, “It’s benign” or to tell a cancer patient, “You’re going to make it.”



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*Helena Furberg, Ph.D.
Assistant Professor, UNC
Department of Genetics*





FINDING NEW WAYS *to* IMPROVE *and* SERVE

The UCRF is just one example of how UNC Health Care is investing in tomorrow's care today. In UNC hospitals, research facilities, clinics and outreach sites throughout the state, system leaders are taking a proactive approach by focusing on growth, innovation and infrastructure. Such forward-looking projects and initiatives include:

The recent opening of the Genetic Medicine Building, the largest and most sophisticated research building ever built at UNC Chapel Hill and one of UNC's best researcher recruitment assets. It houses labs such as those used by researchers with UCRF grants, plus classrooms and offices for both the School of Medicine and the School of Pharmacy. Having students and faculty from both schools in such close proximity will foster interdisciplinary collaboration that could lead to breakthrough drugs and treatments.

The construction of the N.C. Cancer Hospital, the state's first public comprehensive cancer hospital, scheduled to open on the Chapel Hill campus in the fall of 2009. The 50-bed, seven-story hospital will enable UNC cancer physicians to treat more than twice as many patients as they currently see. It will also house the UNC Lineberger Comprehensive Cancer Center, one of the country's leading comprehensive cancer centers and the only public cancer center in the state.

Greater access to the resources of UNC Hospitals via Rex Healthcare in Raleigh. Although Rex has been part of the UNC family for several years, several recent changes promise to make the relationship even more collaborative. These include the opening of the N.C. Children's Specialty Clinic, a new outpatient





clinic on the Rex campus operated by the physicians of N.C. Children's Hospital; enabling patients at the Rex Cancer Center to participate in UNC clinical trials; allowing Rex radiation oncologists to become members of the UNC Physician Associates practice; and making the UNC CyberKnife® radiation treatment facility available to Rex cancer patients.

The creation of the N.C. Clinical and Translational Sciences Institute, thanks to a \$61 million grant from the National Institutes of Health. UNC was one of only 14 programs nationwide to receive the grant, which will be used to apply medical discoveries to patient care across the state. The initiative will narrow the divide between research and clinical care and hasten the progress of lab discoveries to doctors' offices and operating rooms.

Inroads and outreach in Chatham County, Eastern North Carolina and the Coast. With the recent purchase of Chatham Hospital in Siler City, UNC Health Care now has a major presence in this rural, largely Hispanic community, and has pledged \$9.3 million to develop health care services in the area. In the east, UNC Health Care is teaming up with the Leo Jenkins Cancer Center at East Carolina University (ECU) to share best practices, and with Manteo's oncologists to provide telemedicine consultations so that cancer patients can receive state-of-the-art care without leaving the coast.

CyberKnife is a registered trademark of Acuray Incorporated in the United States and other countries.

EDUCATING FUTURE PHYSICIANS

The state will experience a 25 percent shortfall in the number of primary care physicians over the next 25 years, according to the North Carolina Institute of Medicine. The physician supply cannot keep pace with a population expected to reach 13 million by 2030, compared with 9 million today. The average age of North Carolina's residents is also increasing, which places a greater demand on the state's providers.

To help address this need, UNC School of Medicine is taking steps to produce more physicians by putting forth a proposal that would phase in about 70 additional slots to the School of Medicine over several years. Subject to state appropriations, UNC leaders plan to expand the school in the most cost-effective way: by allowing students to spend their last two years of school at either Carolinas Healthcare System in Charlotte or Mission Health and Hospitals in Asheville. Partnering with already established clinical programs—in this case, in Charlotte or Asheville—limits additional cost burdens for both UNC and its partner organizations. A similar plan to increase enrollment at the Brody School of Medicine at ECU by using off-site facilities was also approved by the UNC Board of Governors; both UNC and ECU are still awaiting final state approval and funding, most of which will be used to create or renovate facilities.

While there's no guarantee that expanding its medical school will boost the number of physicians practicing in the state, UNC Health Care deserves credit for taking action said Dr. Warren Newton, a family physician and executive associate dean for education at the School of Medicine. That's because new doctors tend to seek practices in areas they were exposed to as third- and fourth-year medical students or, more commonly, where they did their residencies; nearly 40 percent of North Carolina's doctors completed their residencies in the state. So hospitals throughout North Carolina are being encouraged to expand their residency programs.

Another important component is physician retention, including programs offering loan-repayment incentives for young physicians to practice in a given county or town. "Any plan to increase the total number of doctors has to focus both on residency programs and retention programs," Dr. Newton said. "You can't do one without the other."



Tony Rodriguez exemplifies the young doctor who decides to stay in town after completing his residency. Dr. Rodriguez, who is co-chief resident in the family medicine program at UNC Hospitals, will look for a job in the Triangle when his residency ends in June 2009. He and his wife, Dr. Anitha Jain-Rodriguez, a pediatric resident at UNC Hospitals, are both Florida natives who went to medical school at the University of Florida, but like the Raleigh-Durham-Chapel Hill area so much they want to put down roots here. Thanks to the strength of UNC's residency programs and the livability quotient of the Triangle, North Carolina has gained two dedicated primary care providers at a time when it needs them most.

And Dr. Rodriguez is optimistic about UNC's plan to send third- and fourth-year medical students to clinical settings in other parts of the state. He thinks exposing students to the critical role primary care physicians play in rural areas may inspire them to forgo more lucrative specialties in favor of family practice, internal medicine or pediatrics.

"When I first started medical school, I thought I was going into gastroenterology," said Dr. Rodriguez. "Driving through the Florida Panhandle during my clinical training, though, I was exposed to the need for more primary care in rural areas. For students who are on the fence about what to specialize in, maybe being in these communities as third- and fourth-years might encourage them to choose primary care, too."



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Tony Rodriguez, M.D.
Co-Chief Resident, UNC Hospitals Family Medicine



A new fund to help researchers win the war on cancer. A transformational grant from the NIH. A cancer hospital nearing completion. The opening of a state-of-the-art research building. Ambitious plans to expand the School of Medicine. And a systematic approach to care-related benchmarks.

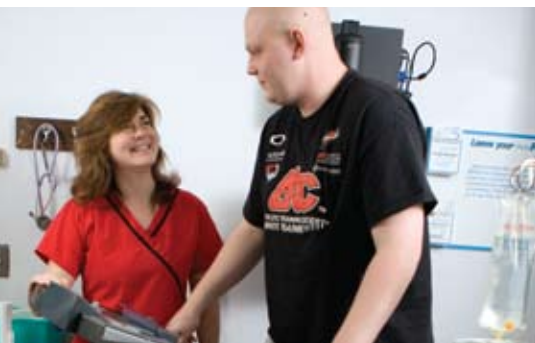
Every partnership, every building, every new program at UNC Health Care has been created for one purpose alone: to care for all the state's citizens. And for every effort UNC Health Care launches, whether dependent on bricks and mortar, technology or creative partnerships, there are dedicated people making it happen.

Their contributions have never been more important. North Carolina's health providers face unprecedented challenges, from a tough economy to an exploding population to a looming doctor shortage to a continuing rise in chronic diseases. UNC Health Care will work collaboratively to address these issues, and its people are committed to caring for North Carolina's residents for years to come.

L E T T E R *o f* T R A N S M I T T A L

N O V E M B E R 3 0 , 2 0 0 8

To the Governor, the State Auditor, members of the General Assembly, members of the UNC Board of Governors, UNC Chapel Hill Board of Trustees, members of the UNC HCS Board of Directors, supporters of the University of North Carolina Health Care System, and William L. Roper, CEO.



I N T R O D U C T I O N

This Annual Report includes a compilation of the operating results and financial position of the University of North Carolina Health Care System (UNC HCS) as established by General Statute 116-37. The financial reports as presented represent a summary of data generated by the various entities under the control of the Board of Directors of the UNC HCS. The University of North Carolina Hospitals (UNCH) and Rex Healthcare, Inc. (REX) prepare and publish their own separate audit reports on an annual basis. The University of North Carolina Physicians & Associates (UNC P&A) is included in the audited report for The University of North Carolina at Chapel Hill (UNC-CH). Additional information regarding the organization structure can be found in the notes to the annual report.

This annual report is compiled to provide useful information about the entity's operations and programs and to ensure its accountability to the citizens of North Carolina. While the management of the UNC HCS believes this information to be accurate, it should be noted that these documents are **unaudited** and not intended to be used for any financial decisions.

The **Financial Section** presents management's discussion and analysis and pro forma financial statements for UNC HCS and financial statements for UNC P&A. This section includes selected statistical and financial ratio information. Management's discussion and analysis provides a review of the financial operations and the notes to the annual report provide additional explanations for the reader.



FINANCIAL INFORMATION

INTERNAL CONTROL STRUCTURE

The management of the UNC HCS establishes and maintains an internal control structure to achieve the objectives of effective and efficient operations, reliable financial reporting, and compliance with applicable laws and regulations. Management applies the internal control standards to meet each of the internal control objectives and to assess internal control effectiveness. When evaluating the effectiveness of internal control over financial reporting and compliance with financial-related laws and regulations, management follows the assessment process to ensure the State of North Carolina and the public that the UNC HCS is committed to safeguarding its assets and providing reliable financial information. One objective of an internal control structure is to provide management with reasonable, although not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition. Another objective is to ensure that transactions are executed in accordance with appropriate authorization and recorded properly in the financial records so that financial statements may be prepared in accordance with generally accepted accounting principles. Annually, management provides assurances on internal control in its Performance and Accountability Report, including a separate assurance on internal control over financial reporting along with a report on identified material weaknesses and corrective actions.

As a recipient of federal and State funds, the UNC HCS is responsible for ensuring compliance with all applicable laws and regulations. A combination of State and UNC HCS policies and procedures, integrated with a system of internal controls, provides for this compliance. The accounts and operations of UNC Hospitals and UNC P&A (as a part of UNC-CH) are subject to an annual examination by the Office of the State Auditor. REX has an annual audit performed by an outside independent CPA firm. All three entities are an integral part of the State's reporting entity represented in the *State's Comprehensive Annual Financial Report* and the *State's Single Audit Report*. The audit procedures are conducted in accordance with auditing standards generally accepted in the United States of America and *Government Auditing Standards* issued by the Comptroller General of the United States.

BUDGETARY CONTROLS

On an annual basis, the Board of Directors of the UNC HCS reviews the budget for UNC P&A and approves a budget for UNCH and REX. Each member of the UNC HCS produces monthly reports that compare budget and actual operating results. Department Heads are expected to review the reports and identify significant variances from their budget. If necessary, action plans are implemented that will improve negative variances. In addition to the monthly reports, an encumbrance system is maintained by UNCH and UNC P&A to track open purchase orders and commitments made to vendors.

N. C. General Statute 116-37 granted to the UNC HCS flexibility for management of UNCH in regard to its policies for personnel and salary management, purchasing of goods, services and property, and property construction. On an annual basis, the UNC HCS submits a report on its activity under this flexibility. The report is sent to the Health Affairs Committee of the Board of Governors and the Joint Legislative Commission on Governmental Operations on or before September 30 each year.

The UNC HCS is subject to the provisions of the Executive Budget Act, except for trust funds identified in N. C. General Statutes 116-36.1 and 116-37.2. These two statutes primarily apply to the receipts generated by patient billings and other revenues from the operations of UNCH and UNC P&A. UNCH submits monthly reports to the Office of State Budget and Management that reflect both the state appropriation received and their overall operations. Under the budgetary procedure followed by the State, all State revenues are appropriated by the General Assembly

pursuant to appropriation acts adopted every two years, with modifications in the second year. The UNC HCS through UNCH received State Appropriation of approximately \$47 million for the past fiscal year. The General Assembly appropriates these funds from the General Fund to cover a portion of operating expenses, including a portion of the expenses attributable to the cost of providing (i) care to indigent patients and (ii) graduate medical education.

DEBT ADMINISTRATION

During the past year, UNCH and REX had no additional borrowings. The Board of UNC HCS authorized UNCH to enter into a future swap agreement for a portion of the 1999 Revenue Bonds which are outstanding in February 2009. This arrangement is expected to result in estimated savings of \$2.5 million. There were no instances of default or covenant noncompliance in regard to debt service payments. The UNC HCS's goal is to continue to maintain its bond ratings at the highest level possible in order to provide access to the tax-exempt bond market for future issues. In recognition of its strong performance for the past few years, UNCH received an upgrade on its bond rating from Moody's. UNCH's new ratings are Aa3 from Moody's and AA- from Standard and Poor's.

CASH AND INVESTMENT MANAGEMENT

The UNC HCS continues to work with the Office of the State Treasurer to maximize the investment earnings for UNCH based on changes in the General Statutes that were made during the 2005 session of the General Assembly. In addition, UNC-CH has allowed UNC P&A to invest a portion of their funds in an intermediate fund beginning in FY08. Any additional investment earnings will subsidize operating income and enable UNC HCS to provide more services to the citizens of the State of North Carolina. The cash management policy includes all areas of receipts and disbursements so that investment earnings are maximized and vendor relations are maintained.

RISK MANAGEMENT

Exposures to loss are handled by a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. The key to managing risk is to ensure that programs are in place that educate and guide employees to the best practices for our industry. We have a responsibility to safeguard our patients so that no additional harm comes to them while under our care. In addition, we have to ensure a safe workplace for our employees.

In addition to the typical litigation risks with which we are faced, we have to recognize the risk and rewards associated with the health care industry. Continual evaluation of existing programs and new service development is the only way to maintain or increase our competitive advantage.

ACKNOWLEDGEMENTS

Preparation for this Annual Report in a timely manner would not have been possible without the coordinated efforts of the various financial staffs within the UNC HCS, with special assistance from the CEO's office and Public Affairs Office.



John P. Lewis
Chief Financial Officer

THE BOARD of DIRECTORS

NOVEMBER 2008 - OCTOBER 2009

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Chapel Hill, NC*

Dr. Etta Pisano

*Vice Dean for Academic Affairs
Professor, UNC Department of
Radiology
Chapel Hill, NC*

Dr. William L. Roper

*Dean, School of Medicine
Vice Chancellor for Medical Affairs
CEO, UNC Health Care System
Chapel Hill, NC*

Dr. Marschall Runge

*President, UNC Physicians
Chair, UNC Department of Medicine
Chapel Hill, NC*

Rev. Robert Seymour

*Retired Pastor
Chapel Hill, NC*

James H. Speed, Jr.

*President and CEO
North Carolina Mutual Life Insurance
Company
Durham, NC*

Holden Thorp

*Chancellor, UNC Chapel Hill
Chapel Hill, NC*

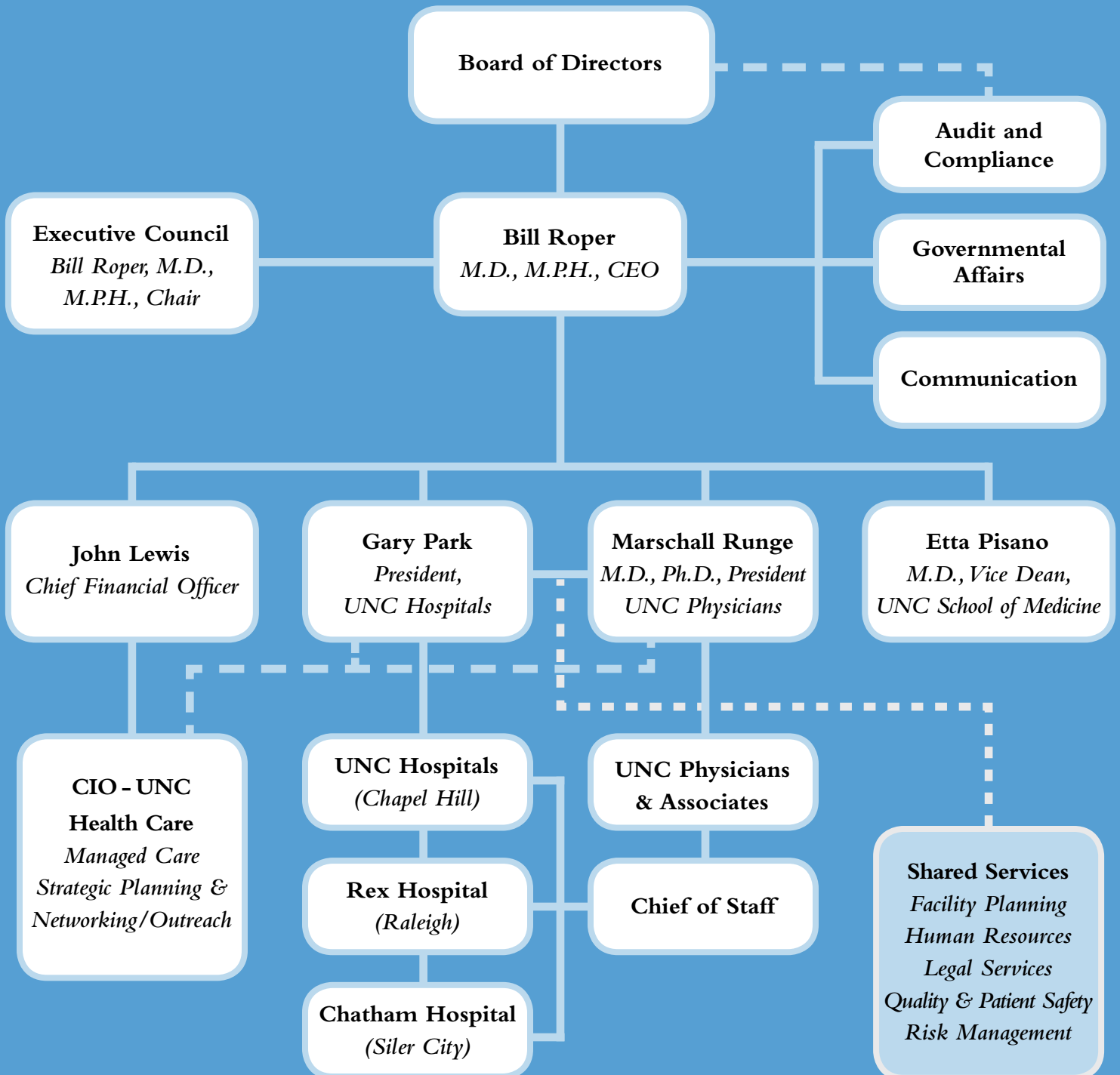
D. Jordan Whichard

*Publisher, The Daily Reflector
Greenville, NC*

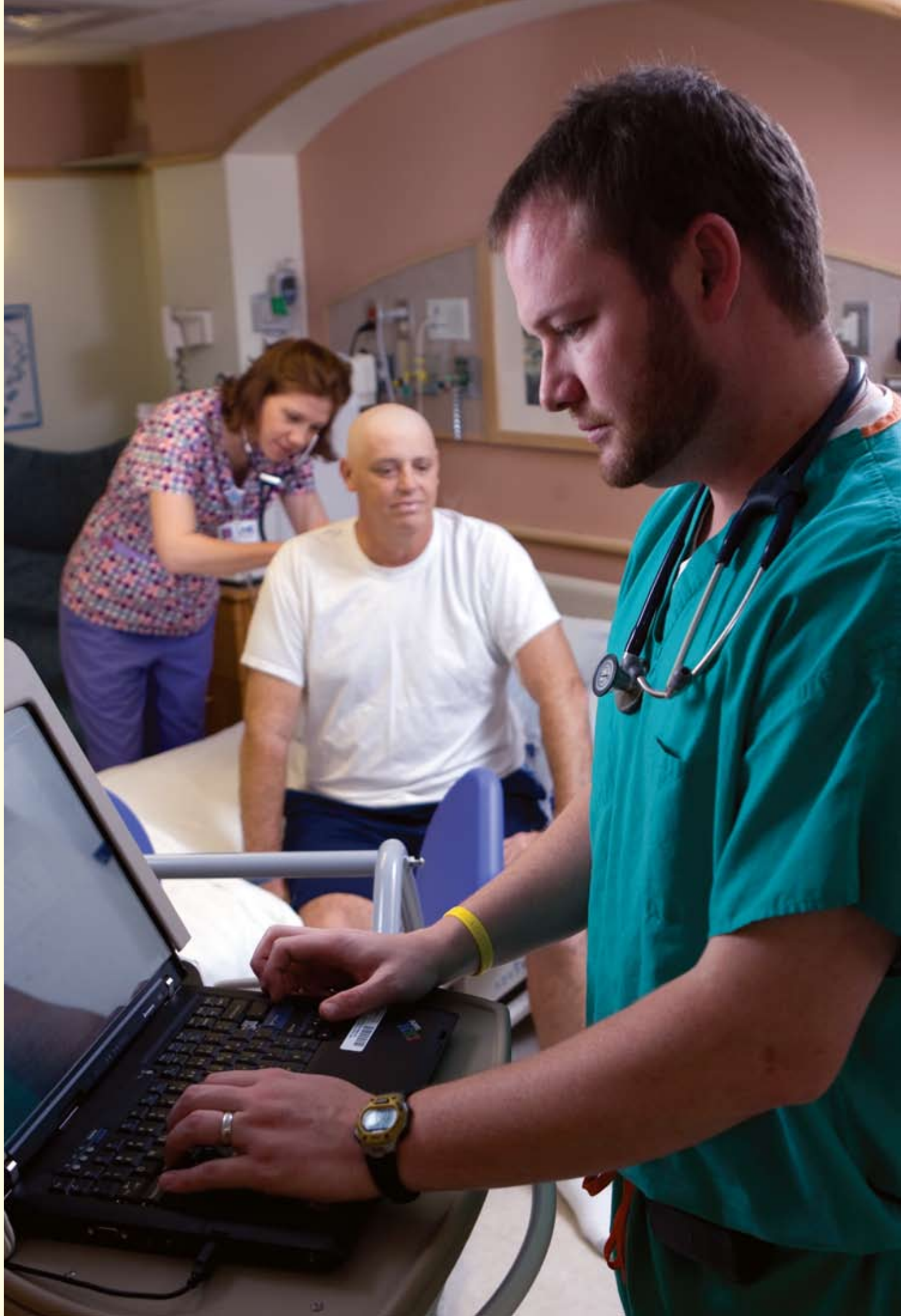
Richard T. Williams

*Vice President
Duke Energy
Charlotte, NC*

UNC HEALTH CARE SYSTEM REPORTING STRUCTURE



The shared services components work collaboratively across the UNC HCS, and Mr. Park and Dr. Runge will work in partnership in these areas.



FINANCIALS *and* STATISTICS

CHAPEL HILL, NORTH CAROLINA
FOR THE YEAR ENDING JUNE 30, 2008



UNC
HEALTH CARE

MANAGEMENT'S DISCUSSION
and ANALYSIS

Management's discussion and analysis provides an introduction and overview of the financial position and activities of the University of North Carolina Health Care System (UNC HCS) for the fiscal years ending June 30, 2008 and 2007.

INTRODUCTION

Management's discussion and analysis provides an introduction and overview of the financial position and activities of the University of North Carolina Health Care System (UNC HCS) for the fiscal years ending June 30, 2008 and 2007. The financial statements included for the UNC HCS—Statement of Net Assets, and Statement of Revenues and Expenses—are labeled “pro forma” to demonstrate that they are an aggregation of assets and liabilities and results of financial activities which can not easily be the subject of an unqualified opinion by an independent auditor. The reasons for the pro forma descriptive are as follows:

The UNC HCS was established November 1, 1998 by North Carolina General Statute 116-37. The original legislation included only the University of North Carolina Hospitals (UNCH) and the clinical patient care programs of the University of North Carolina at Chapel Hill (UNC-CH). The UNC HCS is governed by a Board of Directors and as an affiliated enterprise of the University of North Carolina. The UNC HCS and UNC-CH are sister entities. Rex Healthcare, Inc. (REX) and various community-based clinics have been added to the organization since its inception. Chatham Hospital became a member of the UNC Health Care family on July 1, 2008. The financial statements and related notes and discussion do not include any data for the operations of Chatham Hospital for the past fiscal year.

As illustrated on the organization chart on page 23 in the Introductory Section, the UNC HCS owns and controls the net assets and financial operations of UNCH and REX. UNC-CH owns and controls the net assets and financial operations of UNC Physicians & Associates (UNC P&A). The UNC HCS Board of Directors governs and oversees physician credentialing, quality and patient safety, and resident training and acts to advise and review the financial activities of UNC P&A. Final direct control of the monetary operations of UNC P&A remains within UNC-CH. The physicians who provide patient care at UNCH and in UNC-CH clinics are employees of UNC-CH. Non-physician employees who assist in providing patient care and the associated administrative, billing and collection services are employees of UNC HCS.

For purposes of these financial statements, UNC P&A serves as a financial proxy for the “clinical patient care programs of the School of Medicine.” The financial statements for the two entities directly controlled by the UNC HCS (UNCH and REX) are separately audited on an annual basis and have received unqualified opinions for their prior year reports. The financial activities of UNC P&A are included in the financial report and audit report of UNC-CH. Since an unqualified audit opinion on the aggregation of financial information for these three entities cannot be obtained, we have used the term “pro forma” to describe fairly the full financial scope and worth of the UNC HCS.

In the interest of being concise, we have included pro forma consolidated financial statements for the UNC HCS, which include UNCH, REX, and UNC P&A. Since UNC P&A's financial activities are not separately disclosed elsewhere, we also are presenting UNC P&A's Statement of Net Assets and Statement of Revenues and Expenses for the fiscal years ending June 30, 2008 and 2007.

USING *the* FINANCIAL STATEMENTS

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

The pro forma financial statements are presented and follow reporting concepts consistent with those required of a private business enterprise. The balances reported are presented in a classified format to aid the reader in understanding the nature of the operations. The accompanying notes are an integral part of this report and should be read in conjunction with the financial statements to enhance understanding.

The pro forma Statement of Net Assets provides information relative to the assets, liabilities, and net assets as of the last day of the fiscal year. Assets and liabilities on this Statement are categorized as either current or noncurrent. Current assets are those that are available to pay for expenses in the next fiscal year, and it is anticipated that they will be used to pay for current liabilities. Current liabilities are those payable in the next fiscal year. Under GASB, the net assets should be categorized as invested in capital assets (net of related debt), restricted or unrestricted; but due to the complexities of the various entities, no such distinction has been made. Overall, the Statement of Net Assets provides information relative to the financial strength of the organization and its ability to meet current and long-term obligations.

The pro forma Statement of Revenues and Expenses provides information relative to the results of the enterprise's operations, nonoperating activities, and other activities affecting net assets, which occurred during the fiscal year. Nonoperating activities include noncapital gifts and grants, investment income (net of investment expenses), and loss realized on the disposition of capital assets. Other activities include change in fair value of investments and gain or loss on affiliate activity. Under GASB, the subsidies from the State of North Carolina in the form of appropriations and bond interest expense are considered nonoperating activities; but for these pro forma statements, they are presented as operating. In general, the Statement of Revenues and Expenses provides information relative to the management of the organization's operations and its ability to maintain its financial strength.

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

The Notes provide information relative to the significant accounting principles applied in the financial statements and further detail concerning the organization and its operations. In general, 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

Comparative data for 2008 and 2007 is presented this year and a discussion of the data is in the following sections.

Analysis of Overall Financial Position and Results of Operations

The UNC HCS Statement of Net Assets reflects a large, successful system, with almost two billion dollars in total assets. Total assets increased by 5.5% over the prior year, while net assets increased by 4.9% during the year ending June 30, 2008. For the year, the System generated an operating margin of 2.5%, or \$38.9 million on net operating revenue of \$1.6 billion. Net income was \$64.6 million, or 4.0% margin. The net income margin was less than the prior year as the System realized a loss for the year due to the stock market decline. FY08 operations benefited from cost report settlements in the amount of \$27.9 million. Without these settlements, the operating margin would be 0.7%. In order to remain financially strong, to reinvest in new facilities, and to retain the most highly trained work force, the UNC HCS's goal is to average at least 3% for its annual operating margin.

UNC P&A experienced a net loss for the year of \$1.2 million, or -0.5%, on operating revenue of \$246 million. Operating revenues showed an increase of 10.6% over the prior year, but expenses increased by 14.1% as new faculty and staff were hired to improve access to patient care.

Discussion of Capital Asset and Long-Term Debt Activity

Capital Assets

The System continued to improve and modernize its facilities during the past year. Projects at UNCH included continued construction of the cancer hospital and physician office building, renovation of patient space for bed expansion and relocation, and upgrades to infrastructure for the chiller plant and purchases such as a CyberKnife® and MRI.

Capital projects placed in service at REX in 2008 and 2007 included a state-of-the-art surgical center and an electronic medical record system. REX also purchased several parcels of land for future development.

Long-Term Debt Activity

The UNC HCS has no borrowing authority. Both UNCH and REX have issued revenue bonds in the past and may issue additional debt in the future if the need arises to finance construction projects and the market rates are favorable. UNC P&A issues its bonds through UNC-CH. As such, its revenues and assets are a part of the bond covenants of UNC-CH.

During the past fiscal year, UNCH and REX entered into no additional debt-financing arrangements. UNCH has a future swap agreement that will occur in February 2009, which will allow for the refunding of the 1999 Revenue Bonds. Additional information about debt activity can be found in the notes to the pro forma statements.

Discussion of Conditions That May Have a Significant Effect on Net Assets or Revenues and Expenses

The major source of funding for the UNC HCS is the revenue it generates from patient care services. Despite adjustments to billing rates on an annual basis, overall reimbursement has continued to deteriorate in recent years due to pressure from third-party payors and changes in the mix of the patient population. Meanwhile, salaries, supplies and other operating expenses have continued to increase.

The self-pay discount policy implemented by UNC Hospitals and UNC Physicians and Associates continues to expand in terms of total dollars and number of qualifying patients. This policy was increased mid-year to provide a 35% discount on medically necessary procedures to all patients who do not have insurance coverage (up from a 25% discount in FY07). During FY07, a total of \$23.4 million in charges were discounted whereas in FY08, the total was \$25.9 million. These discounts, along with adjustments for charity care, bad debt and governmental programs, resulted in costs for uncompensated care of \$207.9 million for FY07 compared to \$226.9 million for FY08. This trend reflects a 9.1% increase, while the overall costs represent 15.7% of the net patient revenue of the UNC HCS.

The System continues to pursue ways to increase patient access and revenue enhancement while reducing costs without any decrease to the level of patient care. However, the UNC HCS faces more challenges as the health care environment changes, along with the additional competition for governmental dollars that may be diverted away from the Medicare and Medicaid programs to fund other programs.

These environmental changes are a result of efforts by the federal and state governments, private insurance companies and business coalitions to reduce and contain health care costs, including, but not limited to, the costs of inpatient and outpatient care,

physician fees, capital expenditures and the costs of graduate medical education. Continuously under consideration are a wide variety of federal and state regulatory actions and legislative and policy changes by both governmental and private agencies that administer Medicare, Medicaid and other third-party payor programs that could impact our reimbursement. In addition, we are subject to actions by, among others, the Joint Commission on Accreditation of Healthcare Organizations (JCAHO), the Centers for Medicare and Medicaid Services (CMS) of the U.S. Department of Health and Human Services (DHHS), and other federal, state and local government agencies. The biggest concern for the UNC HCS would be the elimination of cost-based reimbursement that is currently received by UNCH and UNC P&A from the Medicaid program and any changes to the appropriation support received from the State of North Carolina.

Medicaid Cost Report income represents an important source of funding for UNC P&A as represented by the \$22.2 million in net proceeds in FY08. This number includes about \$13.1 million in adjustments for prior year reports that have not yet been settled. Per the State Plan for Medical Assistance for North Carolina, the medical faculty practice plan of the UNC-CH is reimbursed at cost and is cost-settled at year-end for services provided to Medicaid patients. A change to terminate this North Carolina Medicaid reimbursement methodology would materially alter the financial outlook for UNC P&A.

The outlook for Medicare reimbursement rates for UNC P&A is uncertain. While the previously scheduled reduction in payments has been replaced with a 1.1% increase in Medicare payments, these amounts continue to be subject to congressional change. Any reduction would impact Medicaid and Tricare rates as well, since each is indexed to Medicare rates. These three payors represent fifty-one percent (51%) of UNC P&A gross revenues, and thus the scheduled reduction would negatively impact net patient service revenue.

University of North Carolina Health Care System
 Pro Forma Statement of Net Assets
 For the Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Current Assets		
Cash and Investments	\$269,095,242	\$332,351,929
Patient Accounts Receivable - Net	199,685,366	203,397,323
Inventories	25,147,916	21,805,414
Estimated Third-Party Settlements	16,219,186	15,452,171
Other Assets and Receivables	38,143,002	26,872,356
Assets Whose Use Is Limited or Restricted	42,953,769	38,169,162
Prepaid Expenses	10,673,770	9,733,750
Total Current Assets	601,918,251	647,782,105
Noncurrent Assets		
Property, Plant and Equipment - Net	758,213,143	657,849,291
Assets Whose Use Is Limited or Restricted	667,502,966	621,678,924
Other Assets	19,654,405	12,476,411
Total Noncurrent Assets	1,445,370,514	1,292,004,626
Total Assets	2,047,288,765	1,939,786,731
Current Liabilities		
Accounts and Other Payables	75,900,027	63,634,654
Accrued Salaries and Benefits	56,330,050	48,834,944
Estimated Third-Party Settlements	51,665,840	28,371,491
Notes and Bonds Payable	31,110,293	30,265,533
Interest Payable	1,964,823	2,452,923
Other	37,883,713	13,420,935
Total Current Liabilities	254,854,746	186,980,480
Noncurrent Liabilities		
Notes and Bonds Payable	357,878,955	386,201,100
Compensated Absences	49,296,483	45,982,761
Total Noncurrent Liabilities	407,175,438	432,183,861
Total Liabilities	662,030,184	619,164,341
NET ASSETS	1,385,258,581	1,320,622,390
TOTAL LIABILITIES AND NET ASSETS	\$2,047,288,765	\$1,939,786,731

University of North Carolina Health Care System
 Pro Forma Statement of Revenues and Expenses
 For the Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Operating Revenue		
Net Patient Service Revenue	\$1,429,218,512	\$1,342,707,893
Cost Report Settlements	27,915,876	45,634,816
State Appropriations	47,409,965	45,673,970
Other Operating Revenue	73,084,359	60,145,523
Net Operating Revenue	1,577,628,712	1,494,162,202
Operating Expenses		
Salaries and Fringe Benefits	882,242,986	790,577,350
Medical and Surgical Supplies	258,721,968	240,342,479
Contracted Services	152,931,421	139,233,611
Other Supplies and Services	111,810,962	96,956,360
Communications and Utilities	25,530,745	24,341,024
Medical Malpractice Costs	15,380,000	20,111,780
Depreciation	63,726,193	60,390,623
Bond and Other Interest Expense	19,205,563	21,126,655
Medical School Trust Fund (MSTF)	9,176,951	9,250,447
Total Operating Expenses	1,538,726,789	1,402,330,329
OPERATING INCOME (LOSS)	38,901,923	91,831,873
Nonoperating Gains (Losses)		
Interest and Investment Activity	(33,138,212)	98,268,267
Nonoperating Income (Expense)	(1,485,993)	(2,707,235)
Capital Grants	60,358,473	39,477,567
Total Nonoperating Gains (Losses)	25,734,268	135,038,599
NET INCOME (LOSS)	\$64,636,191	\$226,870,472

University of North Carolina Health Care System
Pro Forma Statement of Cash Flows
For the Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Cash Flows From Operating Activities		
Received from Patients and Third Parties	\$1,483,373,679	\$1,361,170,336
Payments to Employees and Fringe Benefits	(871,434,158)	(783,017,677)
Payments to Vendors and Suppliers	(556,267,703)	(490,322,024)
Payments for Medical Malpractice	(8,323,395)	(21,127,824)
Other Receipts	70,503,046	60,549,264
Net Cash Provided (Used)	117,851,469	127,252,075
Cash Flows From Noncapital Financing Activities		
State Appropriations	47,409,965	45,673,970
Net Cash Provided (Used)	47,409,965	45,673,970
Cash Flows From Capital Financing and Related Financing Activities		
Principal & Arbitrage Paid on Outstanding Debt	(30,343,751)	(28,805,008)
Interest and Fees Paid on Debt	(17,882,823)	(19,435,924)
Capital Grants	60,358,473	39,477,567
Acquisition and Construction of Capital Assets	(154,835,666)	(111,431,803)
Net Cash Provided (Used)	(142,703,767)	(120,195,168)
Cash Flows From Investing Activities		
Investment Income & Other Activity	25,045,815	98,268,267
Purchase and Sale of Investments, Net of Fees	(93,019,231)	(34,819,238)
Investments In and Loans to Affiliated Enterprises - Net	(17,840,938)	(13,193,198)
Net Cash Provided (Used)	(85,814,354)	50,255,831
NET INCREASE (DECREASE)	(63,256,687)	102,986,708
BEGINNING CASH AND CASH EQUIVALENTS	332,351,929	229,365,221
ENDING CASH AND CASH EQUIVALENTS	269,095,242	332,351,929

University of North Carolina Health Care System
 University of North Carolina Physicians & Associates
 Statement of Net Assets (Unaudited)
 For the Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Current Assets		
Cash and Investments	\$25,553,921	\$94,922,261
Patient Accounts Receivable - Net	24,828,306	27,730,545
Estimated Third-Party Settlements	13,119,186	1,700,000
Other Assets and Receivables	7,454,720	4,693,080
Assets Whose Use Is Limited or Restricted	75,977,281	12,841,592
Total Current Assets	146,933,414	141,887,478
Noncurrent Assets		
Property, Plant and Equipment - Net	7,249,000	8,398,700
Total Noncurrent Assets	7,249,000	8,398,700
Total Assets	154,182,414	150,286,178
Current Liabilities		
Accounts and Other Payables	7,002,680	2,500,872
Accrued Salaries and Benefits	8,282,712	5,906,918
Estimated Third-Party Settlements	2,500,000	2,500,000
Notes and Bonds Payable	1,249,800	1,149,700
Total Current Liabilities	19,035,192	12,057,490
Noncurrent Liabilities		
Notes and Bonds Payable	5,999,200	7,249,000
Compensated Absences	14,114,031	14,730,548
Total Noncurrent Liabilities	20,113,231	21,979,548
Total Liabilities	39,148,423	34,037,038
NET ASSETS	115,033,991	116,249,140
TOTAL LIABILITIES AND NET ASSETS	\$154,182,414	\$150,286,178

University of North Carolina Health Care System
 University of North Carolina Physicians & Associates
 Statement of Revenues and Expenses (Unaudited)
 For the Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Operating Revenue		
Net Patient Service Revenue	\$185,174,634	\$184,199,976
Cost Report Settlements	22,203,910	12,050,082
State Appropriations	-	-
Other Operating Revenue	38,596,143	26,246,515
Net Operating Revenue	245,974,687	222,496,573
Operating Expenses		
Salaries and Fringe Benefits	189,481,826	175,612,765 ¹
Medical and Surgical Supplies		664,104
Contracted Services	17,923,933	8,414,897
Other Supplies and Services	40,826,778	27,525,170
Communications and Utilities	2,739,175	2,751,474
Medical Malpractice Costs	8,121,068	10,411,069
Depreciation		200,734
Bond and Other Interest Expense	1,538,499	1,601,070
Medical School Trust Fund (MSTF)	9,176,951	9,250,447
Total Operating Expenses	269,808,230	236,431,730
OPERATING INCOME (LOSS)	(23,833,543)	(13,935,157)
Nonoperating Gains (Losses)		
Interest and Investment Income	3,568,295	6,592,539
Nonoperating Income (Expense)	(297,401)	(995,499)
Transfers to HCS Enterprise Fund	(3,400,000)	(2,350,000)
Transfers from HCS Enterprise Fund	22,747,500	13,912,500
Total Nonoperating Gains (Losses)	22,618,394	17,159,540
NET INCOME (LOSS)	\$(1,215,149)	\$3,224,383

Notes: ¹ Included in the salaries and fringe benefits amount for FY07 is a one-time bonus of \$5,000 per clinician for a total of approximately \$5 million.

University of North Carolina Health Care System
 University of North Carolina Physicians & Associates
 Statement of Cash Flows (Unaudited)
 For the Years Ended June 30, 2008 and June 30, 2007

	2008	2007
Cash Flows From Operating Activities		
Received from Patients and Third Parties	\$210,280,783	\$196,375,882
Payments to Employees and Fringe Benefits	(187,722,549)	(174,053,624)
Payments to Vendors and Suppliers	(55,695,160)	(43,596,334)
Payments for Medical Malpractice	(1,213,620)	(6,634,168)
Operating Capital Grants	22,747,500	13,912,500
Other Receipts	16,637,349	16,878,590
Net Cash Provided (Used)	5,034,303	2,882,846
Cash Flows From Noncapital Financing Activities		
State Appropriations	-	-
Net Cash Provided (Used)	-	-
Cash Flows From Capital Financing and Related Financing Activities		
Principal & Arbitrage Paid on Outstanding Debt	(1,149,700)	(1,149,700)
Interest and Fees Paid on Debt	(388,799)	(451,370)
Net Cash Provided (Used)	(1,538,499)	(1,601,070)
Cash Flows From Investing Activities		
Investment Income & Other Activity	2,169,312	6,592,539
Purchase of Investments and Related Fees	(71,336,055)	
Investments In and Loans to Affiliated Enterprises - Net	(3,697,401)	(3,345,499)
Net Cash Provided (Used)	(72,864,144)	3,247,040
NET INCREASE (DECREASE)	(69,368,340)	4,528,816
BEGINNING CASH AND CASH EQUIVALENTS	94,922,261	90,393,445
ENDING CASH AND CASH EQUIVALENTS	25,553,921	94,922,261

University of North Carolina Health Care System
 Pro Forma Selected Statistics and Ratios
 For the Years Ended June 30, 2008 and June 30, 2007

	REX Sites	UNC Sites	UNC HCS 2008 Total	UNC HCS 2007 Total
Patient Service Statistics				
Patient Days	118,851	240,572	359,423	347,351
Inpatient Discharges	34,875	40,195	75,070	72,043
Average Length of Stay	3.4	6.0	4.8	4.8
Inpatient Operating Room Cases	9,143	10,903	20,046	18,825
Outpatient Operating Room Cases	38,067	13,614	51,681	47,877
Emergency Department Visits	57,811	62,446	120,257	118,873
Clinic Visits	63,350	781,914	845,264	805,179
Births/Deliveries	6,757	3,796	10,553	9,731
Financial Ratios				
Operating Margin Percentage			2.47%	6.15%
Operating Margin Percentage (excluding cost report settlements)			0.71%	3.19%
Days in Net Accounts Receivable			51.00	55.29
Days of Cash on Hand			215.17	215.63
Average Payment Period (days)			50.46	46.94
Long-Term Debt to Equity			20.53%	22.64%
Current Debt Service Coverage			3.06	6.39
Maximum Future Debt Service Coverage			3.20	6.41



NOTES

UNIVERSITY *of* NORTH CAROLINA HEALTH CARE SYSTEM

NOTES *to* THE ANNUAL REPORT *for* THE YEAR ENDING JUNE 30, 2008

Note 1 - Significant Accounting Policies:

Organization – The University of North Carolina Health Care System (UNC HCS) was established November 1, 1998, by North Carolina General Statute 116-37. It is governed and administered as an affiliated enterprise of The University of North Carolina system with its stated purpose to provide patient care, facilitate the education of physicians and other health care providers, conduct research in collaboration 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.

The original legislation included the University of North Carolina Hospitals at Chapel Hill (UNCH) and the clinical patient care programs established or maintained by the School of Medicine of the University of North Carolina at Chapel Hill. The

UNC HCS is under the governance of the board of directors of the UNC HCS. Rex Healthcare, Inc. and various community-based clinics have been added to the organization since its inception.

The University of North Carolina

Hospitals is the only State-owned teaching hospital in North Carolina. With a licensed base of 727 beds, this facility serves as an acute care teaching hospital for The University of North Carolina at Chapel Hill. UNCH consists of North Carolina Memorial Hospital, North Carolina Children's Hospital, North Carolina Neurosciences Hospital, and North Carolina Women's Hospital. As a State agency, UNCH is required to conform to financial requirements established by various statutory and constitutional provisions. While UNCH is exempt from both federal and State income taxes, a small portion of its revenue is subject to the unrelated business income tax.

Other activities blended into the financial statements for UNCH include:

Health System Properties, LLC – Health System Properties (HSP) was established to purchase, develop and/or lease real property. HSP is reported as part of UNCH because UNC HCS is the sole member manager and HSP is governed by the same Board that directs UNCH's operations. To date, the only properties owned by HSP either have been or are being developed for the sole use and benefit of UNCH.

Carolina Dialysis, LLC – Carolina Dialysis, LLC (CDLLC) was formed for the purpose of owning and operating chronic dialysis programs, thus improving the quality of care to end-stage renal disease patients by providing dialysis services and conducting research in the field of nephrology in the State of North Carolina. UNCH has a two-thirds ownership interest in the CDLLC. Renal Research Institute owns the remaining one-third interest. A Board of Managers comprised of six members manages the CDLLC, with four appointed by UNCH through the Chief Executive Officer and two appointed by Renal Research Institute. The financial results for CDLLC are blended with those of UNCH, since it provides services almost entirely to patients of UNCH.

The University of North Carolina Physicians & Associates (UNC P&A) is the clinical service component of the UNC School of Medicine. At the heart of UNC P&A are approximately 1,000 physicians, who provide a full range of specialty and primary care services for patients of UNC Health Care. While the great majority of services are rendered at the inpatient units of UNC Hospitals and the outpatient clinics on the UNC campus, there is a growing range of services provided at clinics in the community.

There are 17 clinical departments, two affiliated departments and two administrative units that collectively form UNC P&A:

Clinical Departments:

- Anesthesiology
- Emergency Medicine
- Medicine
- Obstetrics & Gynecology
- Orthopaedics
- Pathology
- Physical Medicine & Rehabilitation
- Radiology
- Dermatology
- Family Medicine
- Neurology
- Ophthalmology
- Otolaryngology/HNS
- Pediatrics
- Psychiatry
- Radiation Oncology
- Surgery

Affiliated Departments:

- Allied Health Sciences
- Center for Development and Learning

Administrative Units:

- Administrative Office (Billing & Collections, Managed Care)
- Ambulatory Administration

While UNC P&A is affiliated with the UNC HCS, the net assets of UNC P&A are held in a UNC-CH trust fund. The operating income and expenses for UNC P&A are managed via the UNC-CH's accounting infrastructure; and, as such, its operational results are included in the annual audit for UNC-CH.

Rex Healthcare, Inc. (REX) is a North Carolina not-for-profit corporation organized to provide a broad range of health care services to residents of the Triangle area of North Carolina. Acting through its network of operating affiliates, REX provides health care to patients from several locations through continued development of acute care and non-hospital programs.

REX's sole member is the UNC HCS and UNC HCS appoints eight of the 13 seats on REX's Board of Trustees. Additionally, the UNC HCS reviews and approves REX's annual operating and capital budgets.

The activities of the principal corporate entities under the common control of REX are summarized as follows:

Rex Hospital, Inc. – Rex Hospital, Inc. (the “Hospital”), located in Raleigh, North Carolina, is a 433-bed hospital. The Hospital provides inpatient, outpatient and emergency services primarily to the residents of Wake County, North Carolina. The Hospital operates on its main campus Rex Cancer Center, Rex Women’s Center, Rex Rehab, and Nursing Care Center of Raleigh, a 120-bed nursing facility. Other service locations for the Hospital are its Cary, North Carolina campus, where it provides outpatient surgery, urgent care and diagnostic service; its Wakefield campus in Raleigh, North Carolina, where it provides urgent care, family medicine and diagnostic service; and Rex Nursing Care Center of Apex, a 107-bed nursing facility located in Apex, North Carolina. The Hospital also owns Rex Home Services, Inc., a North Carolina not-for-profit corporation, organized to provide home care services primarily to the residents of the Wake County, North Carolina.

Rex Enterprises, Inc. – Rex Enterprises, Inc. is a North Carolina for-profit corporation organized to promote the health and welfare of the residents of Wake County.

Rex Healthcare Foundation, Inc – Rex Healthcare Foundation, Inc. is a North Carolina not-for-profit corporation organized to promote the health and welfare of the people of the Triangle area by promoting philanthropic contributions and public support of REX.

Smithfield Radiation Oncology, LLC – Smithfield Radiation Oncology, LLC (SRO) is a limited liability company organized to own and operate a linear accelerator. Rex obtained 100% ownership of SRO in 2008.

Community-Based Practices (CBP) –

The network of CBP is an outreach activity of

the UNC HCS, which brings quality primary and specialty outpatient care to communities in the Triangle region, including several rural communities. This network has 13 outreach clinics providing over 150,000 visits a year. Ten of the 13 practices are UNC HCS sponsored. The physicians practicing in the network clinics spend all or almost all of their time providing ambulatory patient care. The other practices are sponsored by and are the financial responsibility of either UNC School of Medicine departments or UNC Hospitals, with consultative support provided by CBP Administration as needed. These CBP are the source of a significant amount of ancillary testing, inpatient care and specialty care referred to the main Chapel Hill campus.

Basis of Presentation – The accompanying financial statements present all activities under the direction of the UNC HCS Board of Directors. The financial statements for UNC HCS are presented as a compilation of the various statements generated by its separate entities. UNCH and REX issue their own audited financial statements while UNC P&A is included as a part of the audited statements for UNC-CH.

In compiling the financial statements for the UNC HCS, significant intercompany transactions and balances between the related parties have been eliminated. In addition, while the general statutes refer only to the clinical operations of the School of Medicine – which are reported through UNC P&A – this annual report includes the assets, liabilities and net assets of UNC P&A, which are included in the audited financial statements for UNC-CH.

Basis of Accounting – The statements of the various entities have been prepared using the accrual basis of accounting for UNCH and REX and the modified basis of accounting for UNC P&A. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an

obligation has been incurred. When preparing the financial statements, management makes estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from the estimates. For UNC P&A, monthly financials are maintained on a cash basis; at year-end, adjustments are made to accrue all known material amounts for revenue and expense.

Financial Statement Classifications and Categories

Current and Noncurrent Designation –

Assets are classified as current when they are expected to be collected within the next twelve months or consumed for a current expense in the case of cash or prepaid items. Liabilities are classified as current if they are due and payable within the next 12 months.

Revenue and Expense Recognition –

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

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions that represent subsidies

or gifts, as well as investment income, are considered nonoperating since these are either investing, capital, or noncapital financing activities.

Cash and Cash Equivalents – This classification includes petty cash, security deposits, cash on deposit in private bank accounts, and deposits held by the State Treasurer in its short-term investment fund (STIF). The STIF account 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. All highly liquid investments with an original maturity of three months or less, and which are not designated as investments, are considered to be cash equivalents and are recorded at cost, which approximates market.

UNC-CH manages the funds of UNC P&A as authorized by The University of North Carolina Board of Governors pursuant to General Statute 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina. Special funds and funds received for services rendered by health care professionals pursuant to General Statute 116-36.1(h) are invested in the same manner as the State Treasurer is required to invest. Investments of various funds may be pooled unless prohibited by statute or by terms of the gift or contract. UNC-CH utilizes investment pools to manage investments and distribute investment income. Shares in the Temporary pool trade at a fixed value of \$1 per share.

Investments – This classification includes marketable debt and equity securities with readily determinable fair values, including assets whose use is limited, and are measured at fair value. Investment income or loss (including realized and unrealized gains and losses on investments, interest and dividends) is included in nonoperating income (loss). The calculation of realized gains and losses is

independent of a calculation of the net change in the fair value of investments.

Patient Accounts Receivable, Net – Net patient accounts receivable consist of unbilled (in-house patients, inpatients discharged but not final billed, and outpatients not final billed) and billed amounts. Payment of these charges comes primarily from managed care payors, Medicare, Medicaid and, to a lesser extent, the patient. The amounts recorded in the financial statements are net of indigent care, contractual allowances, and allowances for bad debt to determine the net realizable value of the accounts receivable balance.

Reserves for these deductions are recorded based on the historical collection percentage realized for each payor and projections for future collection rates. Flexible payment arrangements with selected payors have been established to optimize collection of past-due accounts, and any amounts payable beyond one year are classified as noncurrent assets.

Estimated Third-Party Settlements – Estimated third-party amounts represent settlements with Medicare, Tricare and Medicaid programs that may result in a receivable or a payable. Reimbursement for cost-based items are paid at a tentative interim rate with final settlement determined after submission of annual cost reports and audits thereof by fiscal intermediaries. Final settlements under the Medicare and Medicaid programs are based on regulations established by the respective programs and as interpreted by fiscal intermediaries. The classification of patients under the Medicare and Medicaid programs, as well as the appropriateness of their admission, is subject to review. Several years of cost reports are currently under review.

Inventories – Inventories consist of medical and surgical supplies, pharmaceuticals, prosthetics and

other supplies that are used to provide patient care or by service departments. Inventories are stated at the lower of cost or market on the FIFO (first-in, first-out) basis.

Other Assets and Receivables – Other assets and receivables relate to items such as sales tax refunds due from the North Carolina Department of Revenue, amounts due from affiliates and other State agencies, and billings to outside companies for ancillary testing.

Assets Whose Use is Limited or Restricted – Current assets whose use is limited or restricted include the debt service funds established with the trustee in accordance with the bond indenture agreements and donor restrictions. The debt service funds will be used to pay bond interest and principal as it becomes due.

Noncurrent assets whose use is limited or restricted include the bond proceeds for construction projects, the funds required by the bond indenture agreements, funds in the maintenance reserve fund that will be used to acquire or construct future property, plant or equipment, and the money on deposit with the Liability Insurance Trust Fund.

Prepaid Expenses – Prepaid expenses represent current year expenditures for services that extend beyond the current reporting cycle. Payments include insurance premiums, maintenance contracts and lease arrangements.

Property, Plant and Equipment – Property, plant and equipment are stated at cost at date of acquisition, or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred during the period of construction are capitalized. Only assets having a cost or fair value of at least \$5,000 and an estimated

useful life of three years or more are capitalized. Assets under capital lease are stated at the present value of the minimum lease payments at the inception of the lease.

Depreciation is computed using the straight-line method over the estimated useful lives of the assets, generally three to 20 years for equipment, 10 to 50 years for buildings and fixed equipment, and five to 25 years for general infrastructure and building improvements. Assets under capital leases and leasehold improvements are depreciated over the related lease term, generally periods ranging from five to seven years.

Other Noncurrent Assets – Other noncurrent assets include amounts for long-term payment arrangements for patient accounts receivable, bond issuance costs-net of amortization, and investments in affiliates.

Accounts and Other Payables – Accounts and other payables represent the accrual of expenses for goods and services that have been received as of the end of the year but have not been paid.

Accrued Salaries and Benefits – Accrued salaries and benefits represent the accrual of salaries and associated benefits earned as of the end of the year but which have not been paid.

Notes and Bonds Payable – Note and bonds payable represent debt issued for the construction of buildings and the acquisition of equipment. The current amount is the portion of bonds due within one year, and the balance is reflected as noncurrent. The bonds carry interest rates ranging from 2.50% to 5.25%. The various bond series have fixed, variable, or synthetic rates with final maturity in February 2031.

Bonds payable are reported net of unamortized discount, premium and deferred loss on refundings.

Amortization of these amounts is done using either the effective interest method or the straight-line method.

The notes payable carry various interest rates ranging from 2.92% to 3.76% with a final maturity in September 2010.

Interest Payable – Interest payable represents accrued interest at the end of the year that has not yet been paid.

Other Current Liabilities – Other current liabilities represent funds held for others and amounts due to patients or third parties for credit balances.

Compensated Absences – Compensated absences represent the liability for employees with accumulated leave balances earned through various leave programs. These amounts would be payable if an employee terminated employment. Employees earn leave at varying rates depending upon their years of service and the leave plan in which they participate.

Net Assets – Net assets represent the difference between assets and liabilities. Due to the complexities of consolidating these entities, only a combined number is shown for net assets. Normally, under general accepted accounting principles, the net asset category would be further categorized as the amounts (1) Invested in Capital Assets, Net of Related Debt, (2) Restricted Net Assets – Expendable, and (3) Unrestricted Net Assets.

Net Patient Service Revenue – Patient service revenue is recorded at established rates when services are provided with contractual adjustments, estimated bad debt expenses, and services qualifying as charity care deducted to arrive at net patient service revenue. Contractual adjustments arise under reimbursement agreements

with Medicare, Medicaid, certain insurance carriers, health maintenance organizations, and preferred provider organizations, which provide for payments that are generally less than established billing rates. The difference between established rates and the estimated amount collectable is recognized as revenue deductions on an accrual basis.

Charity care provided represents health care services that were provided free of charge or at rates that are less than the established rates to individuals who meet the criteria of the UNC HCS's charity care and uninsured policy. For UNCH and UNC P&A, uninsured patients receive a 35% discount for medically necessary treatment. Charity care provided is not considered to be revenue, since no effort is made to collect accounts that fall under this policy.

Medicare reimburses for inpatient acute care services under the provisions of the Prospective Payment System (PPS). Under PPS, payment is made at predetermined rates for treating various diagnoses and performing procedures that have been grouped into defined diagnostic-related groups (DRGs) applicable to each patient discharge rather than on the basis of the Hospitals' allowable charges. Psychiatric and Rehabilitation inpatient services are reimbursed under separate programs.

A prospective payment system for outpatient services was implemented August 1, 2000, and is based on ambulatory payment classifications. It applies to most hospital outpatient services other than ambulance, rehabilitation services, clinical diagnostic laboratory services, dialysis for end-stage renal disease, non-implantable durable medical equipment, prosthetic devices, and orthotics.

Medicaid reimburses inpatient services on an interim basis under a Prospective Payment System. Medicaid uses the Medicare DRG system with some modifications.

Medicaid reimburses outpatient services on

an interim basis at an agreed-upon percent of charges, but is settled based on documented cost for all services except hearing aids, durable medical equipment (DME), outpatient pharmacy and home health.

Hospital payments for Medicare and Medicaid services are made based on a tentative reimbursement rate with final settlement determined after submission of the appropriate cost reports by the entities within the UNC HCS. Medicaid reimburses physician services at a rate of 95% of Medicare rates. UNC P&A is also reimbursed on a cost-basis, receiving the federally reimbursed portion of costs of providing care to Medicaid patients not covered by fee-for-service reimbursement.

Medical and Surgical Supplies – Medical and surgical supplies represent the items used to provide patient care. This includes instruments, special medical devices and pharmaceuticals.

Medical Malpractice Costs – Medical malpractice costs represent the actuarially determined contributions required for self-insured funding or commercial premiums for third-party coverage. The coverage is intended to include both reported claims and claims that have been incurred but not yet reported.

Medical School Trust Fund – Medical school trust fund (MSTF) expenses represent an assessment of 4.6% of net patient service revenue. The MSTF funds are available at the Dean's discretion for the support of projects such as program development and recruitment incentives for new department chairs.

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

Concentrations of Credit Risk – The UNC HCS provides services to a relatively compact area surrounding the Research Triangle Park, without collateral or other proof of ability to pay. Concentration of credit risk with respect to patient accounts receivable are limited due to large numbers of patients served and formalized agreements with third-party payors. Significant accounts receivable are dependent upon the performance of certain governmental programs—primarily Medicare and North Carolina Medicaid for their collectibility. Management does not believe there are significant credit risks associated with these governmental programs.

The aggregate mix of gross receivables from patients and third-party payors on June 30 was Medicare – 20%, Managed care – 29%, Commercial – 14%, Medicaid – 18%, Self pay – 16%, and Other – 3%.

Note 2 – Estimated Third-Party Settlements

The amount shown as current assets represents estimated receivables due to UNCH from Tricare/Champus in the amount of \$3.1 million and amounts due to UNC P&A for Medicaid in the amount of \$13.1 million.

The amount shown as current liabilities represents estimated payables due to Medicaid in the amounts of \$2.7 million from Rex, \$2.5 million from UNC P&A and \$4.8 million from UNCH. In addition, estimated payables to Medicare are \$0.2 million from Rex and \$41.5 million from UNCH.

For Medicare and Medicaid, reported amounts reflect the net difference between the filed cost report settlements and amounts reserved for possible future audit findings. Tricare/Champus is a federal insurance program for eligible active duty and retired military personnel and their dependents. Tricare/Champus makes payments on an interim

basis. Upon completion of the Medicare Cost Report, Tricare will reimburse certain portions of direct medical and paramedical education and capital costs from the Medicare Cost Report.

Note 3 – Capital Assets:

A summary of capital assets as of June 30 was:

Land and Improvements	66,118,685
Buildings and Improvements	586,429,399
Equipment	583,187,773
Construction in Progress	136,987,372
Gross PP&E	1,372,723,229
Accumulated Depreciation	(614,510,086)
Net PP&E	758,213,143

Note 4 – Long-Term Debt:

A summary of outstanding bond debt and related issuance costs as of June 30 was:

Rex Series 1998 Bonds	86,160,000
UNC P&A Series Bonds	7,249,000
UNCH Series 1999 Bonds	45,420,000
UNCH Series 2001 Bonds	102,400,000
UNCH Series 2003 Bonds	95,630,000
UNCH Series 2005 Bonds	24,775,000
Face Value of Bonds Outstanding	361,634,000

Deferred Costs - Discount on Issuance	(1,135,217)
Deferred Costs - Loss on Refunding	(14,906,237)
Deferred Costs - Premium on Issuance	1,093,497
Arbitrage Rebate Payable	268,892
Net Value Outstanding	346,954,935

Current Portion of Bonds	13,849,800
Current Portion of Notes	17,260,492
Total Current Bonds & Notes	31,110,292

Noncurrent Portion of Bonds	333,105,135
Noncurrent Portion of Notes	23,964,820
Other Noncurrent Debt	809,000
Total Noncurrent Bonds & Notes	357,878,955

As currently constituted, the UNC HCS has no authority to issue debt. Only the individual entities within the UNC HCS have assets and revenue that can be pledged as collateral for the debt.

Annual requirements to pay principal and interest on the bonds outstanding at June 30 are:

Fiscal Year	Principal	Interest	Total
2009	13,849,800	13,746,679	27,596,479
2010	14,489,800	13,115,552	27,605,352
2011	15,164,800	12,441,736	27,606,536
2012	15,844,800	11,820,371	27,665,171
2013	16,774,800	11,046,995	27,821,795
2014-2018	82,110,000	43,908,622	126,018,622
2019-2023	78,655,000	27,231,020	105,886,020
2024-2028	72,710,000	12,888,016	85,598,016
2029-2031	52,035,000	2,260,754	54,295,754
Total	361,634,000	148,459,745	510,093,745

Annual requirements to pay principal and interest on the notes outstanding at June 30 are:

Fiscal Year	Principal	Interest	Total
2009	17,260,492	1,250,376	18,510,868
2010	17,938,262	662,784	18,601,046
2011	6,026,558	132,359	6,158,917
Total	41,225,312	2,045,519	43,270,831

Note 5 – Pension Plans

The UNC HCS has a variety of retirement plans available to its permanent full-time employees. The majority of employees of UNCH and UNC P&A are members of the Teachers’ and State Employees’ Retirement System (the System) as a condition of employment. The System is a cost-sharing multiple-employer defined benefit pension plan established by the State to provide pension benefits for employees of the State, its component units, and local boards of education. The plan is administered by the North Carolina State Treasurer. Graduate medical residents, temporary employees, and permanent part-time employees with appointments of less than 30 hours per week are not covered by the plan.

The Optional Retirement Program (the Program) is a defined contribution retirement plan that provides retirement benefits with options for payments to beneficiaries in the event of the participant’s death. Administrators and eligible faculty of the University may join the Program instead of the Teachers’ and State Employees’ Retirement System. The Board of Governors of The University of North Carolina is responsible for the administration of the Program. Participants in the Program are immediately vested in the value of employee contributions. The value of employer contributions is vested after five years of participation in the Program. Participants become eligible to receive distributions when they terminate employment or retire.

REX sponsors a single-employer defined benefit retirement plan available to eligible employees. The benefit formula is based on the highest five consecutive years of an employee's compensation during the ten plan years preceding retirement. There are no employee contributions to the plan.

Funding amounts for all of the plans are based upon actuarial calculations.

In addition to the employer plans, the UNC HCS employees may elect to participate in any number of deferred compensation and Supplemental Retirement Income Plans. These include 401(k) plans, 403(b) plans and 457 plans. All costs of administering and funding the plans are the responsibility of the participants. REX employees may contribute to a tax-deferred annuity plan through which REX matches one-half of each participant's voluntary contributions on a graduated scale based on length of service, not to exceed 5% of the participant's annual salary.

Note 6 - Other Employment Benefits

UNCH and UNC P&A participate in State-administered programs that provide health insurance and life insurance to current and eligible former employees. Funding for the health care benefit is financed on a pay-as-you-go basis based upon actuarial reports. UNCH and UNC P&A assume no liability for retiree health care benefits provided by the programs other than their required contributions.

UNCH and UNC P&A participate in the Disability Income Plan of North Carolina (DIPNC). DIPNC provides short-term and long-term disability benefits to eligible members of the Teachers' and State Employees' Retirement System. UNCH and UNC P&A assume no liability for long-term disability benefits under the plan other than their contribution.

REX offers a full menu of employment benefits to its employees through various third-party carriers. These include medical insurance, dental coverage, short-term and long-term disability benefits, and life insurance coverage.

More information about these plans can be found in the individual audit reports for the various entities.

Note 7 - Risk Management

The UNC HCS is exposed to various risks of loss related to torts; theft of, damage to, and the destruction of assets; errors and omissions; employee injuries and illnesses; natural disasters; medical malpractice; and various employee plans for health, dental, and accident. These exposures to loss are handled by a combination of methods, including participation in State-administered insurance programs, purchase of commercial insurance, and self-retention of certain risks. There have been no significant reductions in insurance coverage from the previous year.

Liability Insurance Trust Fund – UNCH and UNC P&A participate in the Liability Insurance Trust Fund (the Fund), a claims-servicing public entity risk pool for professional liability protection. The Fund acts as a servicer of professional liability claims, managing separate accounts for each participant from which the losses of that participant are paid. Although participant assessments are determined on an actuarial basis, ultimate liability for claims remains with the participants and, accordingly, the insurance risks are not transferred to the Fund. On June 30, UNCH and UNC P&A had advance deposits with the Fund totaling \$10.1 million.

Additional disclosures relative to the funding status and obligations of the Fund are set forth in the audited financial statements of the Liability Insur-

ance Trust Fund for the years ended June 30, 2008 and 2007. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, University of North Carolina Hospitals, 101 Manning Drive, Chapel Hill, North Carolina 27514.

Note 8 – Related Party Transactions

The Medical Foundation of North Carolina, Inc. – UNCH and UNC P&A

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

UNC Health Care System Enterprise

Fund – The Board of Directors of UNC HCS authorized and approved the creation of an Enterprise Fund to support the UNC HCS's mission and vision to be the nation's leading public academic health care system. Pursuant to a memorandum of understanding effective July 1, 2005, UNCH, UNC P&A, REX and UNC-CH School of Medicine agreed to finance the Enterprise Fund. For the year ending June 30, 2008, total assessments of \$23.7 million were made, of which \$22.5 million was allocated to various departments within UNC P&A in support of the areas of clinical care, research and teaching within the academic medical center.

John Rex Endowment – The John Rex Endowment (Endowment) operates as a 501(c)(3) corporation and is independent of the Board of Directors of the UNC HCS. Its purpose is to advance the health and well-being of the residents of the greater Triangle area, with specific funds set aside for indigent care and to make grants to support health services, education, prevention, and research. In discharging its purposes, priority consideration will be given to any funding requests from REX, the UNC HCS, and their affiliates. The funding source for the Endowment is the \$100 million transfer that came from UNC HCS in April 2000. The Endowment has committed \$25 million for capital projects at REX.

Note 9 – Community Benefits

In addition to providing care without charge, or at amounts less than established rates to certain patients identified as qualifying for charity care, UNC HCS also recognizes its responsibility to provide health care services and programs for the benefit of the community, at no cost or at reduced rates. UNC HCS sponsors many community health initiatives, including breast and prostate cancer screenings, cardiovascular and pulmonary awareness and diabetes education programs that ultimately result in the overall improved health of our community. UNC HCS also provides contributions, cash and in-kind, to various charitable and community organizations. The costs of these programs are included in operating expenses in the accompanying pro forma statements of revenues and expenses.

The following charts on the next page show the cost of uncompensated care provided by UNC HCS and the relative percentage of net patient service revenue.

As shown, the amount of uncompensated care is increasing for both the government payors (Medicaid, Medicare and Tricare), as well as the patients with little or no health insurance coverage.

