Embracing Excellence

The University of North Carolina Health Care System

2010 Annual Report

FEATURED ON COVER:

Emily Moody, BSN, RN, staff nurse in an acute care surgery unit for vascular and urology patients

Jerry Sherwood, patient

Cover photo courtesy of Kaitlin Rogers for Tamara Lackey Photography

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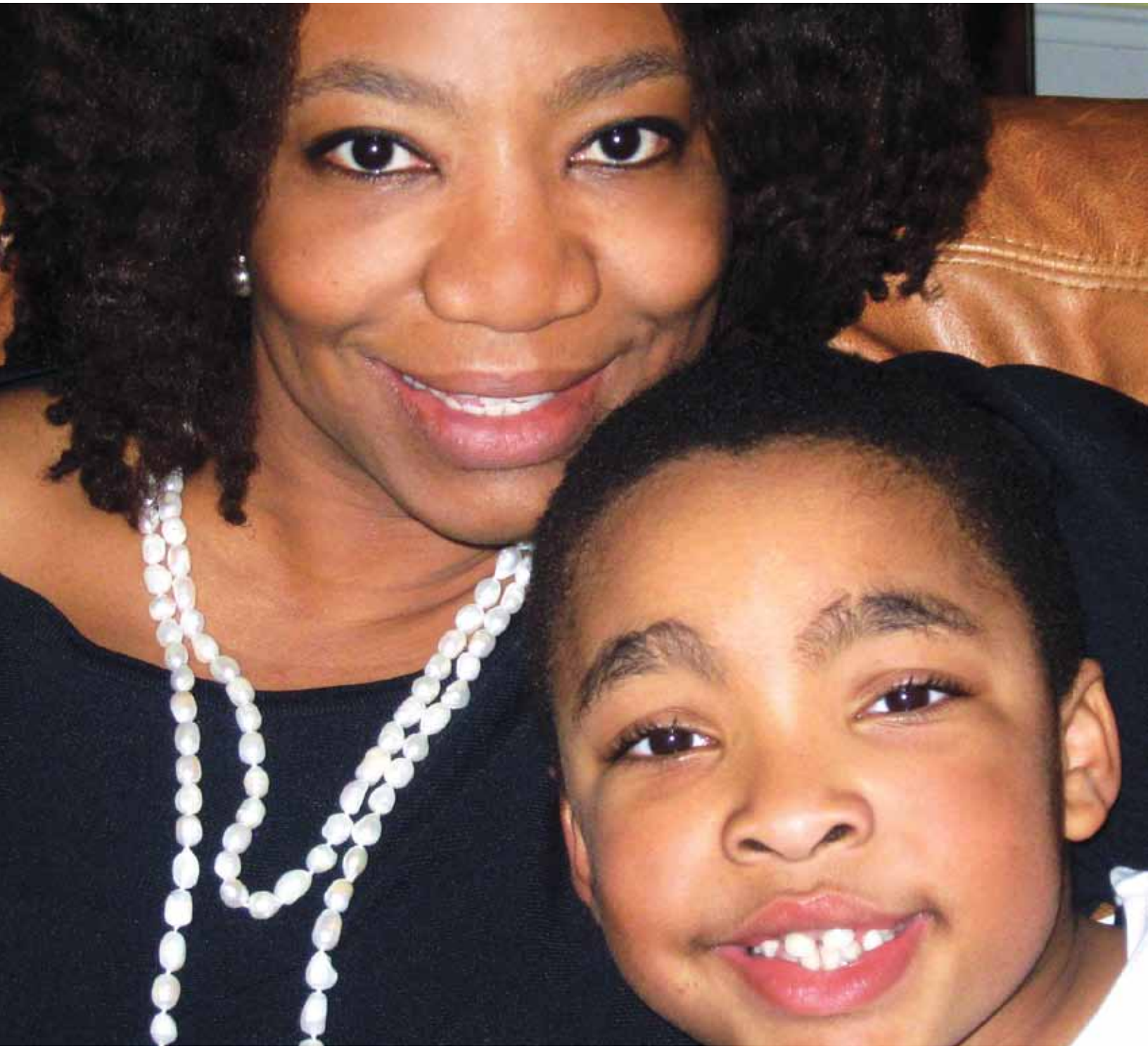

Patient Karen Howard with son Matthew (see Karen's story on page 12)

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UNC Health Care celebrates receiving Magnet designation from the American Nurses Credentialing Center.

YEAR IN PERSPECTIVE

Dear Friends: *As we look back on our achievements in 2010, we never forget the people who count on UNC Health Care to provide cutting-edge medical treatment and a better quality of life. Knowing that, we have pushed ourselves harder to embrace a culture of excellence in all aspects of our work. From receiving prestigious Nurse Magnet recognition, to expanding access to medical education and care, to earning national accolades for our physicians and specialties, excellence flourishes here at UNC Health Care.*

This would not be possible without the dedication of committed individuals throughout the organization like our nursing staff. UNC Health Care was recognized in November 2010 when UNC Hospitals received Nurse Magnet designation from the American Nurses Credentialing Center (ANCC). This is a prestigious acknowledgement of excellent patient care and an honor only 6 percent of hospitals in the United States have achieved. Magnet designation, the highest accolade awarded by the ANCC, requires demonstrated excellence in nursing services, an environment that supports professional nursing practice, and established programs to foster growth and development of nursing staff.

The 2011-2012 Best Doctors in America® list also named 240 of our physicians to the list, the highest number of UNC Health Care physicians ever to be included. Only 3 to 5 percent of physicians in the United States receive this honor. Another prominent physician ranking organization, America's Top Doctors®, recognized 66 of our physicians on its latest list.

This level of excellence can be seen throughout our organization, in the work we do and through the progress we have made over the past year:

EXPANDING MEDICAL EDUCATION

To address the shortage of primary care physicians in North Carolina, particularly in rural areas, the UNC School of Medicine has established two satellite campuses: one in Charlotte at Carolinas Medical Center and one in Asheville at Mission Hospitals. Third- and fourth-year students will have the option to study at these campuses and gain greater exposure to practicing in other areas of our state.

Additionally, to help students afford the costs of pursuing medical and other health-related degrees, we provided more than $3.3 million in scholarships and financial support for our students during the 2009-2010 school year.

MORE SERVICES CLOSER TO HOME

The UNC School of Medicine established the Department of Neurosurgery last July, reflecting UNC's belief in the importance of research and treatment of neurological conditions. With the combination of this department, Neurology and Neuroscience, we expect to become a leader in the development and advancement of world-class care for brain conditions. Elevating neurosurgery to departmental status coincided with the opening of the UNC Neuroscience Intensive Care Unit and the completion of the UNC Imaging & Spine Center, which will enhance our ability to treat North Carolinians who suffer from head, neck, spine and back problems. The Center will be located on N.C. Highway 54 within an ever-growing health resource area that includes UNC Ambulatory Care Center; Cardiac Rehabilitation; Endoscopy Center; Ear, Nose and Throat; Hearing and Voice Center; Pediatrics & Family Medicine; Rheumatology, Allergy, and Immunology; Oncology; and a UNC School of Medicine research facility. This area also will be the future home to UNC Urgent Care and Orthopaedics and Sports Medicine, as well as expanded heart and vascular facilities.

We also are expanding our ability to deliver excellent cancer care through the establishment of the N.C. Cancer Hospital at Rex Hospital in Raleigh. This dedicated cancer care center, scheduled to open in 2014, will provide residents of fast-growing Wake County and the surrounding area with comprehensive care closer to home. In collaboration with Rex Healthcare, we recently launched the Triangle Physician Network to increase the System's ability to support the region's rapidly changing and growing health care needs. The regional network will facilitate coordination between primary care and specialty physician practices and the health care System's electronic medical records. It also will provide patients with greater access to specialty and sub-specialty care providers. Integrating clinical and operational services allows both physicians and UNC Health Care to focus on our top priority: caring for patients.

Our 68-bed hospital in Hillsborough, scheduled to open in 2015, also will meet the increasing demand for patient care. The Hillsborough hospital will include an emergency department, six operating rooms and a wide range of patient support services.

To better meet patient care needs in Wake County and eastern North Carolina, UNC Health Care affiliated with Wake Heart & Vascular Associates to expand the heart and vascular services we are able to offer to patients. A physician office building to provide a clinical home for these physicians will open in 2012.

PROOF OF OUR COMMITMENT

Our Commitment to Caring initiative formalizes our dedication to enhancing patient care through improved efficiency and quality. In 2010 surveys, we exceeded our organizational goals in finance, quality, and employee and patient satisfaction. HealthGrades placed UNC Hospitals in the top 5 percent of hospitals nationwide based on patient scores from the Hospital Consumer Assessment of Health Plans. *U.S. News & World Report* also ranked four UNC Health Care specialty areas — oncology; gastroenterology; gynecology; and ear, nose and throat — in its 2010-2011 Best Hospitals list. The publication's 2010-2011 Best Children's Hospital rankings also designated N.C. Children's Hospital as one of the Best Children's Hospitals for respiratory disorders and diabetes and endocrinology care.

N.C. Memorial Hospital

TOP RESEARCH RANKINGS

Our research efforts have again enabled us to be counted among the best in the country. The *U.S. News & World Report* 2010-2011 Best Graduate Schools rankings placed the UNC School of Medicine second among all the schools on the magazine's list of primary care medical schools and 20th among all research medical schools. Moreover, FY2010 brought a record amount of research funding for the School of Medicine: a total of $424.3 million. That figure represents $294.5 million from the National Institutes of Health, including $85.1 million of American Recovery and Reinvestment Act project awards. The Clinical and Translational Science Award program funding continues to transform the way we perform research here at the school, and the generous $1 billion University Cancer Research Fund endowment helps foster discovery, innovation and delivery of new cancer treatments.

ELEVATING HEALTH CARE

As the state's health care provider, we continue to push for superior care beyond our walls to all corners of North Carolina. We had 313,167 visits to our off-campus clinics and our home health program provided care to patients in Alamance, Chatham, Durham and Orange counties in FY2010.

One innovative initiative promises to change the model of primary care: the Patient-Centered Primary Care Collaborative, a national approach to coordinating health care through the primary care provider for greater continuity of care. Warren Newton, MD, MPH, vice dean of education and chair of the Department of Family Medicine, leads the Virginia and Carolinas' pilot collaborative of 25 academic primary care physician teaching programs to advance a patient-centered medical home model that represents a new approach to quality care.

We offer care to all people across our state, regardless of their ability to pay. Due to current economic conditions, we are providing more uncompensated care than ever. In FY2010, we provided almost $300 million in uncompensated care.

To learn more about our work throughout the state, please refer to the Community Benefit Report that supplements this report, or visit our online data map at **www.unchealthcare.org**

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In the following pages, we share more firsthand examples of how we are pursuing excellence. On behalf of the staff and patients of UNC Health Care, thank you for your continued support that makes this work possible.

Sincerely,

William L. Roper

William L. Roper, MD, MPH
Chief Executive Officer
The University of North Carolina Health Care System

Richard M. Krasno

Richard M. Krasno, PhD
Chairman, Board of Directors (November 2009-Present)
The University of North Carolina Health Care System

For the employees of UNC Health Care, excellence is more than just an inspiring goal. It is a spirit of unwavering determination that changes the focus of daily work into an ongoing mission: to deliver the highest quality health care possible to North Carolinians. Over the past year, that determination has been demonstrated through national recognition for its patient care and for its medical expertise. UNC Health Care employees have the gratifying privilege of caring for patients from across the state. The best measure of its mission lies within the individual stories of patients served by UNC Health Care. From all walks of life and with varying medical needs, the common focus on excellence in caring for all North Carolinians is a common theme.

Patient Gabrielle "Gabby" Gutierrez

EMBRACING EXCELLENCE IN OTOLARYNGOLOGY

When Gabrielle "Gabby" Gutierrez came home from a soccer game with a sore throat, her mother, Kathy Gutierrez, did not know she was dealing with something much worse than strep throat. She also could never have guessed that her daughter's treatment would require the use of robotic surgery.

Adam Zanation, MD, and Carlton Zdanski, MD

Initially, the Jacksonville teen was prescribed antibiotics, but they were ineffective and her condition worsened. When it became so severe that she was unable to swallow water, she was admitted to the hospital at Camp Lejeune for an MRI and a biopsy. Physicians discovered a lymphangioma, a tumor mass growing at the base of Gabby's tongue. Typically found in young children, these tumors are usually benign and easily removed. In Gabby's case, the location of the tumor obstructed her airway and posed a serious threat to her ability to breathe, drink and eat.

Gabby was referred to UNC Health Care and a team of care providers led by Adam Zanation, MD, director of the Head and Neck robotics program, and Carlton Zdanski, MD, FCAS, surgical director at the North Carolina Children's Airway Center. This referral meant Gabby was being treated at one of the top health care facilities equipped to handle her case. *U.S. News & World Report* listed the institution 21st in Ear, Nose & Throat care in the magazine's 2010-2011 Best Hospitals rating.

Combining their therapeutic and technical expertise, Drs. Zanation and Zdanski reviewed various surgical options with Gabby and her family. The conventional approach would require cutting through her jawbone and throat, leaving a large scar. This could potentially be very dangerous — and devastating to a 15-year-old girl. Another alternative was laser surgery, but the limited flexibility of lasers may not have been able to remove the entire tumor, leaving a chance that it could grow back and block her airway again. Instead, Gabby and her family chose robotic surgery to ensure the tumor would be removed completely.

Gabby's procedure marked the first time this technology had been used on a tumor in a child at UNC Health Care. "The robotic surgery program has really evolved for the Department of Otolaryngology," said Dr. Zanation. "We're expanding into pediatric tumors because there's really no better way to get deep enough to remove them."

Now in its sixth year, UNC Health Care's robotic-assisted surgery is one of the world's leading robotics programs. The state-of-the-art daVinci® surgical system offers three-dimensional imaging and four robotic arms that mimic the motion of the surgeon's hands and wrists. While not new technology, this minimally invasive approach benefits both surgeons and patients, and its use is being expanded as new procedures are developed. UNC Health Care surgeons are using this innovative technology extensively to perform cardiac, gynecologic, urologic and oncologic surgeries. Only recently has it been used for head and neck surgeries.

"I was really encouraged by how much more we could do surgically," said Dr. Zdanski. "You actually see in three dimensions — that is superior. We're doing things better now, but the future will give us even better results."

One of the benefits of robotic surgery is faster recovery. Gabby's mother said she bounced back very quickly. "Gabby could talk right after the surgery, and the very next day she was off of the pain medicine."

Within a month of her surgery, Gabby was back where she belonged: on the soccer field.

For more information about Gabby's surgery, visit **http://uncmedne.ws/gabby.**

EMBRACING EXCELLENCE IN NURSING

UNC Health Care welcomes the ANCC appraisers.

The nursing staff at UNC Health Care delivers the innovation and quality of care for which the institution is known. These nurses play a central role in fulfilling the mission of the system, and its entire staff, to deliver optimal care to patients. Therefore, it comes as no surprise that UNC Hospitals earned the prestigious Magnet designation from American Nurses Credentialing Center (ANCC), the world's largest and most prestigious nurse credentialing organization. The recognition honors organizations that meet stringent standards of excellence — representing only about 6 percent of hospitals in the United States.

"It is amazing to see what nurses can accomplish with some time and resources," said Chief Nursing Officer Mary Tonges, PhD, RN, of her staff. "They fully embrace and fulfill our mission of caring for the people of North Carolina."

According to Dr. Tonges, becoming a Magnet-designated organization reaffirms what patients and care providers have known all along: UNC Health Care offers excellence in care.

Magnet institutions have demonstrated fewer patient complications, lower mortality rates and higher patient satisfaction. The goal at UNC Health Care is to not only meet these Magnet requirements, but to exceed the five key characteristics established by the ANCC:

Transformational leadership — guiding teams with vision, influence, knowledge and expertise.
Structural empowerment — creating an environment in which professional practice flourishes.
Exemplary professional practice — understanding and fulfilling the nurse's role.
New knowledge, innovations and improvements — contributing to patient care and the profession.
Empirical quality results — demonstrating positive clinical, workforce, patient and organizational outcomes.

One example of UNC Health Care's approach to achieving quality goals is its relationship-based approach to care. By building therapeutic and consistent relationships with patients and their families, nurses can better manage the patient's medical needs and provide exceptional, compassionate care. This model of care extends to building relationships with colleagues to foster a healthy work environment.

To prepare the Magnet application, Cathy Madigan, RN, MSN, associate chief nursing officer and Magnet initiative co-chair, led a committee that documented these characteristics as they exist at UNC Health Care, ultimately submitting a 1,400-page report to ANCC reviewers. They also hosted a panel of ANCC appraisers, who visited nearly every nursing unit and interviewed a wide range of internal and external audiences — from doctors and social workers to nutritionists, hospital security staff and community members.

"It was not enough to say we had a great program," said Madigan. "We had to demonstrate it."

According to Dr. Tonges, Magnet designation places an organization on a higher level of visibility, trustworthiness and prestige. It lets patients know they will receive a certain level of care and helps retain quality nurses by indicating a preferred work environment. "Magnet designation is external validation of the excellence of the nursing care and practice environment at UNC Health Care," she said.

The nursing team is honored both by the Magnet recognition and by the trust patients put in them every day. While the recognition is an extraordinary source of pride for nurses, they say it belongs to everyone at UNC Health Care. According to Madigan, the spirit of collaboration can be found in all areas of the hospital, inspiring nurses to share best practices and valuable learning experiences.

"Nurses do not work in a vacuum," added Madigan. "Every day, we collaborate with colleagues in every department to provide our patients with outstanding care. So this recognition focuses on nursing, but it honors our entire organization."

EMBRACING EXCELLENCE IN TREATING GASTROINTESTINAL DISORDERS

Virtually everyone faces gastrointestinal (GI) problems at some point, but it is the patients who come to UNC Health Care with chronic, treatment-resistant GI issues that benefit most from its research-based approach to GI care.

UNC Health Care's expansive GI research — including work on pancreaticobiliary diseases, functional GI and motility disorders, inflammatory bowel diseases, liver diseases and epidemiology — leads to rare insight into the complexity of GI ailments. Close physician collaboration and a particularly thorough gathering of clinical information facilitate deeper physician-patient relationships. This helps caregivers better understand the total impact of the illness on the patient's life.

Douglas A. Drossman, MD, professor of Medicine and Psychiatry and co-director of the UNC Center for Functional GI and Motility Disorders in the Division of Gastroenterology and Hepatology, is a leader in research to understand the biopsychosocial interactions that make the diagnosis and treatment of GI conditions so challenging. As co-director of the Center, he coordinates the functional GI clinic and oversees a variety of research initiatives regarding:

- use of centrally targeted agents for treating severe abdominal pain;
- narcotic bowel syndrome;
- abuse and its correlation to GI illness;
- point of care assessment and outcome assessment in functional GI clinic; and
- improvement of patient-doctor communications.

Douglas Drossman, MD, and Kunwardeep Sohal, MD

Dr. Drossman's research efforts at UNC Health Care began 35 years ago with the clinical and epidemiological study of irritable bowel syndrome and other functional GI disorders; this later evolved into work on psychosocial outcomes including abuse history and its correlation to illness. He and his fellow researchers have gained a deeper understanding that, for patients, simply suffering from a chronic illness brings on psychological symptoms. Dr. Drossman, who has received international recognition for his research on the mind-body connection, has gathered substantial evidence that effective GI care must combine the technical aspects of medicine with a strong focus on the patient's personal experience. "The physician-patient relationship remains the cornerstone of our treatment approach," said Dr. Drossman. "It is very different than focusing on a specific disease — we're focusing on the person who has that disease."

This approach relies on rigorous outcomes research and strong communications skills that are a priority for a teaching facility. "We're continually working to refine how we relate to patients and track outcomes to see how more effective connections can lead to better results," said Dr. Drossman.

UNC Health Care is in a strong position to foster this multidisciplinary, patient-centered approach, according to Dr. Drossman. As an academic medical center, UNC Health Care researchers are able to work across psychology, psychiatry, public health and medical disciplines to understand the patient in a more comprehensive way.

UNC Health Care has worked to optimize outcomes across all GI disciplines. *U.S. News & World Report* ranked UNC Health Care 27th in gastroenterology in its 2010-2011 Best Hospitals list. Also in 2010, its bariatric surgery program was recognized as a Center of Excellence by the American Society for Metabolic and Bariatric Surgery. This designation affirms that UNC Health Care has achieved the level of expertise and volume of procedures that research shows result in better outcomes and a much lower risk of complications. It also shows that UNC Health Care continues to strive for high levels of patient safety and to restrain health care costs by minimizing complications and optimizing outcomes. Given the rising incidence of morbid obesity in the state, access to safe and effective bariatric procedures is becoming increasingly important to North Carolinians.

It is a potent mix: rigorous research, a multidisciplinary approach to treatment, and a deeper and more insightful relationship with patients. Together, these aspects set UNC Health Care GI care apart and benefit each patient who comes for help.

EMBRACING EXCELLENCE IN PEDIATRIC CARE

Ali Calikoglu, MD, chief of the UNC Division of Pediatric Endrocrinology and associate professor

The smallest patients often come to UNC Health Care with big diagnoses. N.C. Children's Hospital offers exceptional expertise in a variety of disciplines to help address the comprehensive medical issues children face, from non-life-threatening illnesses to the most severe chronic diseases.

U.S. News & World Report recently recognized N.C. Children's Hospital as one of the Best Children's Hospitals, ranking it 9th for respiratory disorders and 23rd for diabetes and endocrinology care on its 2010-2011 list. The pulmonology program's ninth-place ranking makes N.C. Children's Hospital the only children's hospital in North Carolina to place in the Top 10.

Seven-year-old Jenna Boyer from Gibsonville was born prematurely with Down syndrome; she also had underdeveloped lungs and a small esophagus. Her severe lung issues kept her in the neonatal intensive care unit for the first six months of her life. From birth, she breathed through a tracheostomy and received nourishment through a feeding tube. Already, Jenna has undergone several major surgeries to help manage her condition and to improve her quality of life. By 2009, her doctors decided she no longer needed to depend on a ventilator to breathe.

Her mother, Andrea Boyer, continued to search for ways to help her daughter, and while attending a class on feeding and swallowing disorders, she met a UNC Health Care speech pathologist who recommended the North Carolina Children's Airway Center. The Center brings together the largest concentration of pediatric airway specialists in the Southeast, and their team approach leads to the best outcomes for patients. Jenna's combination of medical conditions requires a team of specialists who work in pulmonology, gastroenterology, otolaryngology and social services. Her doctors hold regular group meetings to review her case and any new issues as they arise.

"It's awesome because you have to look at the whole patient," said Boyer. "This way, you get their collective intelligence."

Jenna's mother and her team of doctors continue to work toward the improvement and lifelong management of her condition. Floyd Gaeth understands firsthand the importance of finding the right doctors

Ali Calikoglu, MD, with patient Timothy Gaeth

> *"This case is teaching us more about how the central nervous system and eyes develop, and how the pancreas works to produce insulin. This family is helping us develop treatment strategies for the future."*
> — Ali Calikoglu, MD

to treat very complex medical conditions. His son, 7-year-old Timothy, was born with multiple abnormalities of the central nervous system, eyes and lungs. Prior to Timothy's birth, doctors told Gaeth there was a 1 percent chance that he would survive, but Gaeth felt that 1 percent was enough to give them hope.

Timothy's parents knew he would have Down syndrome, but the diagnosis was much more complex. Shortly after birth, Timothy exhibited extreme blood sugar fluctuations, and doctors added another diagnosis: neonatal diabetes mellitus.

At five months, Timothy had to be airlifted from his home in Wilmington to UNC Health Care, where he was eventually seen by Ali Calikoglu, MD, chief of the UNC Division of Pediatric Endocrinology and associate professor. Dr. Calikoglu, who has extensive experience with pediatric diabetes and using insulin pumps for young children, was able to recommend the appropriate pump for Timothy to keep his blood sugar stabilized.

Dr. Calikoglu has worked with Timothy and his family for the past six years and has been instrumental in improving Timothy's condition. The complexity of his case requires that he is cared for by a number of doctors to address his many medical needs. Constellation of his congenital abnormalities and challenging diabetes management are unlike anything the division's 30-person team has seen before. Timothy is the only known living person in the world with these particular conditions: holopresencephaly, microophthalmia, hypopituitarism, neonatal diabetes mellitus due to mutations in PAX6 gene, and trisomy 21.

While UNC Health Care is making a difference in Timothy's health, Timothy also is making a difference in medical research.

"I've learned more from working with Timothy than in my whole career," said Dr. Calikoglu. "This case is teaching us more about how the central nervous system and eyes develop, and how the pancreas works to produce insulin. This family is helping us develop treatment strategies for the future."

As leading physicians bring deep expertise to the medical challenges of children, they continue to expand their body of knowledge. And children such as Jenna and Timothy who are living with complex health conditions benefit from this comprehensive, advanced approach to care.

EMBRACING EXCELLENCE IN CANCER CARE

N.C. Cancer Hospital

The N.C. Cancer Hospital, which opened in August 2009, is the clinical home of the UNC Lineberger Comprehensive Cancer Center. UNC Lineberger is one of only 40 facilities in the nation designated as a Comprehensive Cancer Center by the National Cancer Institute. During the past year, this new facility has become an integral part of the UNC Health Care System and its work has led to a Top 50 ranking for cancer care in U.S. News & World Report's *2010-2011 Best Hospitals list.*

The generous appropriation from the N.C. General Assembly to create the University Cancer Research Fund (UCRF) provides $50 million a year to foster discovery, innovation and delivery of new cancer treatments at UNC Lineberger and the N.C. Cancer Hospital, and in their partnerships with communities and organizations across the state. Throughout the past year, this funding has led to progress in hundreds of research initiatives ranging from innovative prevention strategies to high-impact laboratory findings to leading-edge clinical trials that bring the latest cancer treatments to North Carolinians.

Specifically, with UCRF funding, researchers have identified the protein related to effective therapeutic options to treat pancreatic cancer and have confirmed that the most common form of malignant brain cancer in adults is actually a set of four diseases, each with a distinct underlying molecular process. Findings like these help researchers develop more targeted, effective forms of treatment.

Funding also supports UNC Lineberger's efforts to reduce cancer disparities through clinical outreach and health education throughout the state.

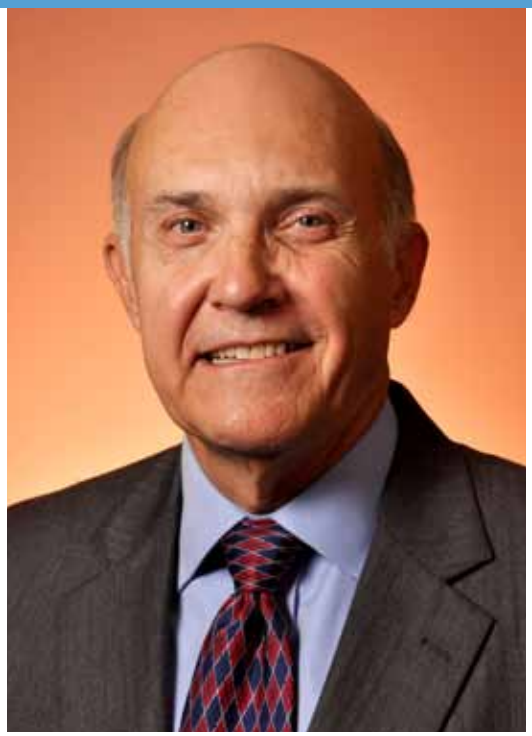
FROM PATIENT TO LEADER

Ray Hutchins, a native of High Point, came to UNC Health Care in 2002 with Stage 3 lung cancer — a diagnosis which took him by surprise.

The news got tougher: the cancer was inoperable because it was in both of his lungs. His physicians, Jan Halle, MD, associate professor in the UNC Department of Radiation Oncology, and Mark Socinski, MD, professor in the UNC Department of Medicine's Division of Hematology and Oncology, developed a treatment plan for Hutchins that included intensive chemotherapy followed by nine weeks of high-dose radiation therapy.

Despite a difficult diagnosis and intense treatment, Hutchins said his experience at UNC Health Care was positive from the beginning. "The doctors take time to get to know you here. You're not a number," he said. Now in remission for eight years, Hutchins credits the treatment he received with saving his life.

Hutchins has turned his success story into a long-term commitment to helping UNC Health Care serve others. As an inaugural member of the N.C. Cancer Hospital's new Patient and Family Advisory Board and a member



Raymond Hutchins, cancer survivor

"The one thing that has not changed is the people. They have an attitude of help and care, not only for the patient, but just as importantly, for the family and caregiver. From top to bottom, this spirit creates an atmosphere for healing both physically and mentally."
— Raymond Hutchins, High Point, N.C.

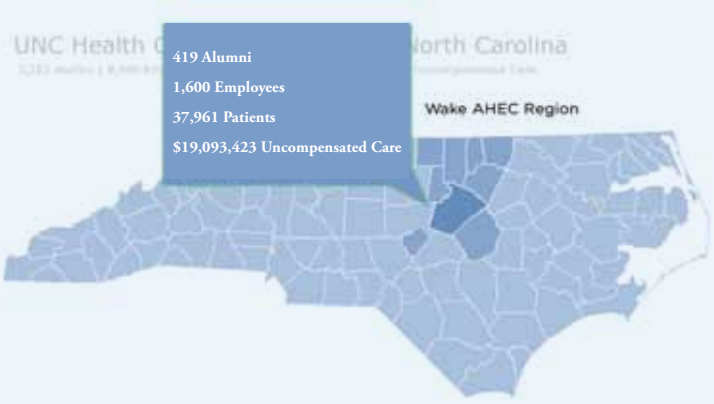
of the hospital's education committee, Hutchins seeks feedback from patients about their experiences at the facility. This provides an external perspective that helps the hospital continually improve the care it provides.

"The one thing that has not changed is the people," said Hutchins. "They have an attitude of help and care, not only for the patient, but just as importantly, for the family and caregiver. From top to bottom, this spirit creates an atmosphere for healing both physically and mentally."

"UNC Health Care is the greatest thing the state has to offer," he said. Hutchins and his fellow Board members work diligently to make sure this remains true.

Join the N.C. Cancer Hospital in celebrating cancer survivorship. Read and share patient stories at **www.newfaceofcancercare.org.**

EMBRACING EXCELLENCE: SERVING THE STATE



UNC Health Care created this interactive map to help North Carolinians track the impact of the health care system on communities across the state. UNC Health Care data has been incorporated into an easy-to-read, pop-up format that lets viewers quickly find information about a specific county. By scrolling over a county on the map, the viewer will see how UNC Health Care is serving that community. Information available for each county includes:

- the number of employees who live in the county
- the number of residents who have been treated at UNC Health Care facilities
- the value of uncompensated care provided to patients from the county
- the number of UNC School of Medicine alumni currently residing in the county

EMBRACING EXCELLENCE IN GYNECOLOGIC CARE

Catherine Matthews, MD

"Within the last several years, technology has made the treatment [for prolapsed uterus] more appropriate for this problem. Before, the surgery was almost worse than the disease."
— Catherine Matthews, MD

The gifts of motherhood are precious and endless. From bedtime hugs to refrigerator art, Karen Howard, of Chapel Hill, enjoys the daily joys of caring for her children six-fold. However, one of the possible complications of childbirth, and more so with multiple births, is a prolapsed uterus, which means the muscles holding the uterus in place are weakened, allowing the uterus to move out of its normal position. Several years after giving birth, Howard was diagnosed with this condition.

The daily discomfort interfered with Howard's normal routine, and by 2009, the problem had escalated and she decided it was time to see what treatment options were available to her.

Howard's gynecologist explained the usual treatment options for her condition: using a pessary, a special medical device designed to support the pelvic organs, or having a traditional hysterectomy. With six children at home, Howard felt a traditional hysterectomy was not an option because it would require a six-week recovery period and would greatly restrict her activity level. Her gynecologist referred her to UNC Health Care, which ranked 27th in *U.S. News & World Report's* 2010-2011 Best Hospitals list.

At UNC Health Care, Howard saw Catherine Matthews, MD, who has specialty training and extensive experience in robotic surgery for pelvic floor reconstruction. Dr. Matthews is director of the Department of Obstetrics and Gynecology's Division of Urogynecology and Reconstructive Pelvic Surgery and an associate professor at the UNC School of Medicine. She felt Howard was an optimal candidate for a robotic surgical hysterectomy rather than the traditional procedure.

"It's really the gold standard for surgery for prolapse," said Dr. Matthews. "Within the last several years, technology has made the treatment more appropriate for this problem. Before, the surgery was almost worse than the disease."

Having a dedicated women's health hospital and recovery floor helps improve the patient experience, according to Dr. Matthews, who also said that having a team focused exclusively on robotic surgery makes the specialized procedure more efficient, which reduces the cost to the patient.

Howard said she is happy she chose to have the procedure done and is pleased with the results. Her recovery was much shorter and less painful than a traditional procedure would have been. She only needed one dose of pain reliever for mild discomfort after her surgery but otherwise immediately felt more like her former healthy self.

"I had not felt normal in so long I'd forgotten what it felt like," Howard said. "I just have four tiny little scars."

Thanks to the expertise of her care team, within two weeks of her surgery Howard was back to doing what she loves: caring for her six active children.

UNC HEALTH CARE

Financials and Statistics

CHAPEL HILL, NORTH CAROLINA

For the year ending June 30, 2010

Letter of Transmittal

NOVEMBER 30, 2010

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.

INTRODUCTION

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 N.C. 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), Rex Healthcare, Inc. (Rex), and Chatham Hospital, Inc. (Chatham) 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 the 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 to permit the preparation of financial statements 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 and Chatham have annual audits performed by outside independent CPA firms. All four 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 approves a budget for UNCH, UNC P&A, Rex, and Chatham. The budget for UNC P&A also is subject to approval by UNC-CH. 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 $41 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, Rex, and Chatham had no additional borrowings. 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 maintained an Aa3 bond rating from Moody's and an AA- bond rating from Standard and Poor's. Rex's rating was reaffirmed as A+ by Fitch Ratings.

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 FY2008. Any additional investment earnings will subsidize operating income and enable the 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. We also have to ensure a safe workplace for our employees.

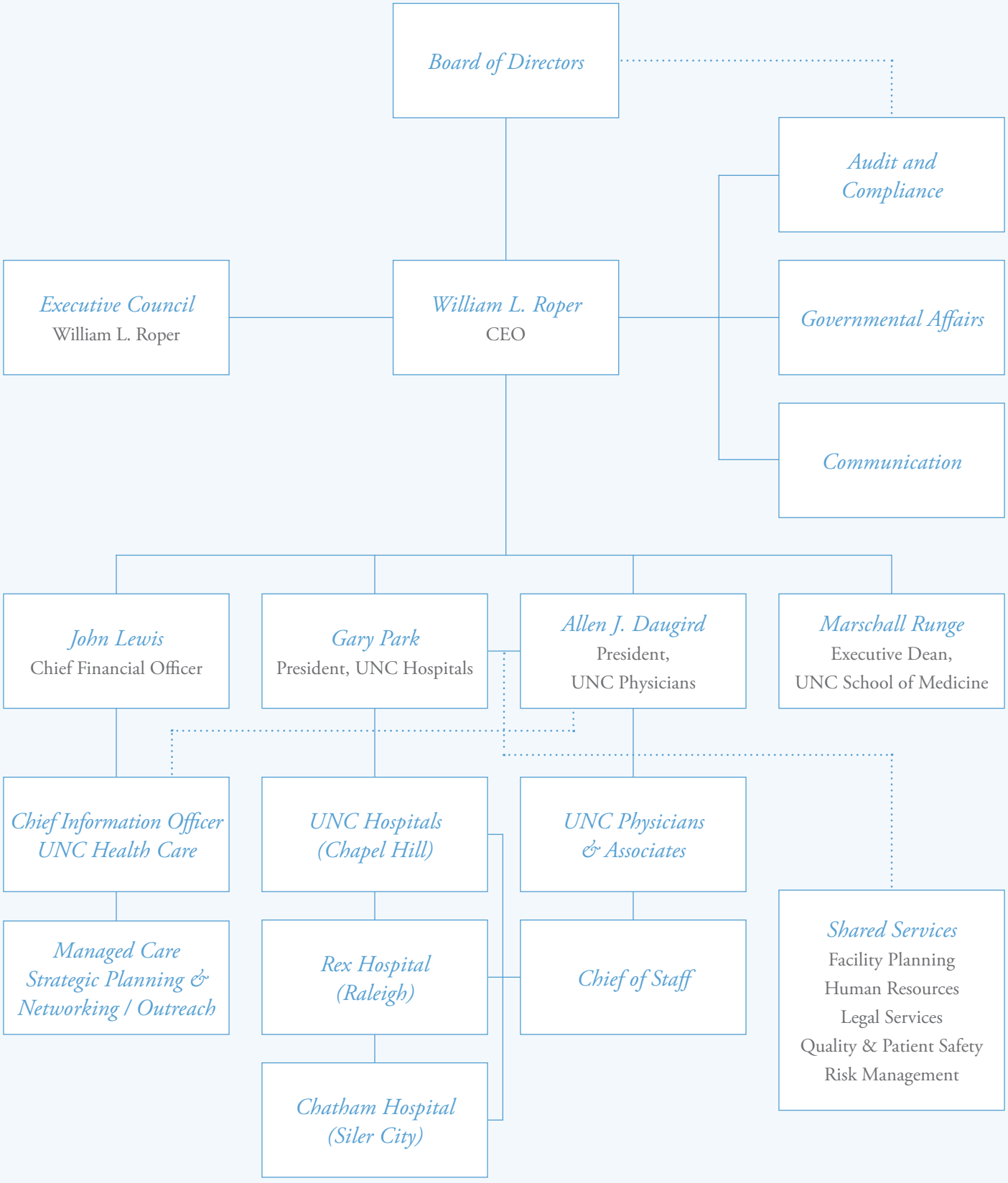
In addition to the typical litigation risks with which we are faced, we have to recognize the risk and rewards associated with the health care industry. Continual evaluation of existing programs and new service development is the only way to maintain or increase our competitive advantage.

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 University of North Carolina Health Care System

UNC Health Care System Reporting Structure



The Board of Directors

November 2010–October 2011

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Chapel Hill, NC

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President, Bessemer Improvement Company
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Management's Discussion and Analysis

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, 2010, and June 30, 2009. 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 that cannot 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 N.C. 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 the UNC-CH are sister entities. Rex Healthcare, Inc. (Rex), Chatham Hospital, Inc. (Chatham), and Triangle Physician Network (TPN) have been added to the organization since its inception.

As illustrated in the reporting structure on page 18, the UNC HCS owns and controls the net assets and financial operations of UNCH, Rex and Chatham. The 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 the UNC-CH. The physicians who provide patient care at UNCH and in the UNC-CH clinics are employees of the UNC-CH. Most non-physician employees who assist in providing patient care and the associated administrative, billing and collection services are employees of the 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 entities directly controlled by the UNC HCS (UNCH, Rex, and Chatham) 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 the UNC-CH. Since an unqualified audit opinion on the aggregation of financial information for these entities cannot be efficiently 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 includes UNCH, Rex, Chatham, TPN and UNC P&A. Since UNC P&A's financial activities are not disclosed separately 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, 2010, and 2009.

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.

Pro forma financial statements are presented and follow reporting concepts consistent with those required of a private business enterprise. The financial statement balances reported are presented in a classified format to aid the reader in understanding the nature of the operations. The *Notes to Financials* 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.

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 non-current. 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, non-operating activities and other activities affecting net assets, which occurred during the fiscal year. Non-operating 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 non-operating 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 System's sources and uses of cash for operating activities, noncapital financing activities, capital and related financing activities, and investing activities. The Statement provides a reconciliation of 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 to the Financial Statements* provide information relative to the significant accounting principles applied in the financial statements, authority for and associated risk of deposits and investments, detailed information on long-term liabilities, detailed information on accounts receivable, accounts payable, revenues and expenses, required information on pension plans and other post employment benefits, insurance against losses, commitments and contingencies, accounting changes, and a discussion of adjustments to prior periods and events subsequent to the enterprise's financial statement period when appropriate. Overall, 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 2010 and 2009 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 statements reflect a large, successful system, with more than $2 billion in total assets. Total assets increased by 10.7 percent over the prior year, while net assets increased by 11.8 percent during the year ending June 30, 2010. For the year, the UNC HCS generated an operating margin of 5.5 percent, or $101.7 million on net operating revenue of $1.9 billion. Net income was $157.3 million, an 8.4 percent total margin. The positive net margin was the result of strong operations enhanced by the improved investment activity of a recovering stock market. FY2010 operations benefited from aggressive cost containment efforts. In order to remain financially strong, to reinvest in new facilities, and to retain its highly trained work force, the UNC HCS must maintain at least a 4 percent annual operating margin.

Discussion of Capital Asset and Long-Term Debt Activity

CAPITAL ASSETS

The UNC HCS continued to improve and modernize its facilities during the past year.

UNCH expended $37.7 million during the year for capital equipment throughout the facilities, $35.8 million for the construction of buildings, infrastructure and renovations and $18 million for land in Hillsborough, N.C. that will eventually be used for a satellite campus. The N.C. Cancer Hospital was completed and dedicated in September 2009. Construction of the UNCH Imaging and Outpatient Center is underway, with planned completion in FY2011. Other projects at UNCH included continued renovation of patient space for bed expansion and relocation.

Rex continued growth seen in FY2009. During FY2010, Rex's major routine capital investments included two replacement linear accelerators, new inpatient beds and a replacement cardiac catheterization lab. Rex continued to invest in information technology with enhancements to its electronic medical record system. Chatham continued significant capital investment in infrastructure projects, primarily the Meditech Hospital Information System and construction of the Medical Office Building.

LONG-TERM DEBT ACTIVITY

The UNC HCS has no borrowing authority. UNCH, Rex and Chatham 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 the UNC-CH. As such, its revenues and assets are a part of the bond covenants of the UNC-CH.

During the past fiscal year, UNCH and Rex entered into no additional debt-financing arrangements. Long-term debt amounts increased on the pro forma *Statement of Net Assets*, but did so as a result of arbitrage agreements on synthetically-fixed debt. Standard and Poor's and Moody's Ratings Services classify UNCH's bonds as AA- and Aa3 respectively. Standard and Poor's classify Rex's bonds as A+ with a stable outlook. Both entities anticipate issuing new debt in FY2011. 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 UNCH and UNC P&A continues to expand in terms of total dollars and number of patients qualifying. This policy was increased during FY2008 to provide a 35 percent discount on medically necessary procedures to all patients who do not have insurance coverage (up from a 25 percent discount in FY2007). During FY2009, a total of $31.4 million in charges were discounted. In FY2010, $33.6 million in charges were discounted. These discounts along with adjustments for charity care, bad debt and governmental programs resulted in costs for uncompensated care of $273.3 million for FY2009 compared to $282.6 million for FY2010. At 3.4 percent, the trend slowed in FY2010 but continues to increase. The overall costs of uncompensated care represent 16.8 percent of the net patient revenue of the UNC HCS. Uncompensated care is expected to surpass $300 million in FY2011.

The UNC HCS continues to pursue ways to increase patient access and revenue enhancement, while reducing costs without any decrease to the level of patient care or safety. 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. Uncertainty exists despite the passage of new health reform legislation. Hospitals and providers across the country are struggling to operationalize the new law, while leadership changes in the Congress threaten to repeal portions of the legislation. The near-term effect of the current law should be favorable to the UNC HCS. More patients will have some sort of insurance coverage, pushing down the cost of uncompensated care. The medium and longer-term effects are uncertain, and our outlook remains cautious.

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, 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 concerns for the UNC HCS would be the elimination of cost-based reimbursement that is currently received from the Medicare and Medicaid programs 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 $10.1 million reported in FY2010. 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 stable for FY2011 but remains uncertain over the long-term. Anticipated payment reductions were temporarily rescinded. Looking beyond FY2011, we anticipate that the 21.5 percent reduction in payments will be debated vigorously as temporary relief expires. At this point, we cannot accurately predict the outcome. Any reduction also would impact Medicaid and Tricare rates, since each is indexed to Medicare rates. These three payors represent more than half of UNC P&A gross revenues. Any reduction would negatively impact net patient service revenue.

THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Statement of Net Assets

For the Years Ended June 30, 2010, and June 30, 2009

	2010	2009*
CURRENT ASSETS		
Cash and investments	$264,231,512	$337,165,442
Patient Accounts Receivable - Net	210,530,989	206,852,866
Inventories	14,387,323	25,649,950
Estimated Third-Party Settlements	-	50,777,655
Other Assets and Receivables	76,536,726	32,863,057
Assets Whose Use Is Limited or Restricted	62,107,657	26,682,219
Prepaid Expenses	10,579,763	9,479,256
Total Current Assets	638,373,970	689,470,445
NONCURRENT ASSETS		
Property, Plant & Equipment - Net	854,490,653	804,084,500
Assets Whose Use Is Limited or Restricted	651,026,044	504,614,611
Other Assets	41,317,736	21,331,788
Total Noncurrent Assets	1,546,834,433	1,330,030,899
Total Assets	**2,185,208,403**	**2,019,501,344**
CURRENT LIABILITIES		
Accounts & Other Payables	112,215,734	88,817,513
Accrued Salaries & Benefits	71,501,809	56,623,558
Estimated Third-Party Settlements	24,508,851	73,568,005
Notes & Bonds Payable	24,387,004	34,085,483
Interest Payable	1,344,199	1,455,234
Other	9,569,653	8,217,950
Total Current Liabilities	243,527,250	262,767,743
NONCURRENT LIABILITIES		
Notes & Bonds Payable	387,714,056	368,389,136
Compensated Absences	64,819,158	61,191,761
Total Noncurrent Liabilities	452,533,214	429,580,897
Total Liabilities	**696,060,464**	**692,348,640**
NET ASSETS	**1,489,147,939**	**1,327,152,704**
TOTAL LIABILITIES AND NET ASSETS	**$2,185,208,403**	**$2,019,501,344**

*2009 restated

THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Statement of Revenues and Expenses

For the Years Ended June 30, 2010, and June 30, 2009

	2010	2009*
OPERATING REVENUE		
Net Patient Service Revenue	$1,740,552,200	$1,581,458,037
Cost Report Settlements	8,849,190	43,876,434
State Appropriations	41,811,381	42,002,451
Other Operating Revenue	70,840,743	62,215,338
Net Operating Revenue	**1,862,053,514**	**1,729,552,260**
OPERATING EXPENSES		
Salaries and Fringe Benefits	1,042,487,665	959,301,335
Medical and Surgical Supplies	300,865,242	305,882,791
Contracted Services	165,868,801	174,043,473
Other Supplies and Services	102,020,936	94,844,917
Communications and Utilities	32,009,080	28,556,226
Medical Malpractice Costs	12,426,328	5,354,599
Depreciation	81,454,480	71,636,472
Bond and Other Interest Expense	15,593,756	18,216,877
Medical School Trust Fund (MSTF)	7,593,882	9,184,472
Total Operating Expenses	**1,760,320,170**	**1,667,021,163**
OPERATING INCOME (LOSS)	**101,733,344**	**62,531,097**
NONOPERATING GAINS (LOSSES)		
Interest and Investment Activity	50,192,290	(120,164,012)
Nonoperating Income (Expense)	(186,547)	(8,246,541)
Capital Grants	5,561,534	7,773,578
Total Nonoperating Gains (Losses)	**55,567,277**	**(120,636,974)**
NET INCOME (LOSS)	**$157,300,621**	**($58,105,877)**

*2009 restated

THE UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Statement of Cash Flows

For the Years Ended June 30, 2010, and June 30, 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Patients and Third Parties	$1,752,136,383	$1,605,510,667
Payments to Employees and Fringe Benefits	(1,023,982,017)	(947,112,549)
Payments to Vendors and Suppliers	(557,806,442)	(537,403,876)
Payments for Medical Malpractice	(10,559,107)	(13,524,004)
Other Receipts	19,365,368	37,829,520
Net Cash Provided (Used)	**179,154,185**	**145,299,758**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Appropriations	40,484,580	42,002,451
Net Cash Provided (Used)	**40,484,580**	**42,002,451**
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Principal & Arbitrage Paid on Outstanding Debt	(32,218,416)	(31,402,292)
Interest & Fees Paid on Debt	(12,211,368)	(15,825,761)
Capital Grants	16,041,744	7,773,578
Acquisition and Construction of Capital Assets	(104,773,697)	(119,665,031)
Net Cash Provided (Used)	**(133,161,737)**	**(159,119,506)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income & Other Activity	20,578,395	11,456,948
Purchase and Sale of Investments, Net of Fees	(161,970,562)	47,538,945
Investments in and Loans to Affiliated Enterprises - Net	(18,018,791)	(19,108,396)
Net Cash Provided (Used)	**(159,410,958)**	**39,887,497**
NET INCREASE (DECREASE)	**(72,933,930)**	**68,070,200**
BEGINNING CASH AND CASH EQUIVALENTS	**337,165,442**	**269,095,242**
ENDING CASH AND CASH EQUIVALENTS	**264,231,512**	**$337,165,442**

Statement of Net Assets (Unaudited)

For the Years Ended June 30, 2010, and June 30, 2009

	2010	2009
CURRENT ASSETS		
Cash and Investments	$83,067,938	$81,474,119
Patient Accounts Receivable - Net	23,831,412	29,229,498
Estimated Third-Party Settlements	29,283,470	16,946,470
Other Assets and Receivables	11,687,329	65,246
Assets Whose Use Is Limited or Restricted	10,065,335	10,669,854
Prepaid Expenses	-	20,406
Total Current Assets	**157,935,484**	**138,405,593**
NONCURRENT ASSETS		
Property, Plant & Equipment - Net	$4,649,400	5,999,200
Total Noncurrent Assets	4,649,400	5,999,200
Total Assets	**162,584,884**	**144,404,793**
CURRENT LIABILITIES		
Accounts and Other Payables	8,404,061	4,401,632
Accrued Salaries and Benefits	8,215,430	6,014,294
Estimated Third-Party Settlements	5,628,430	4,550,000
Notes & Bonds Payable	1,449,800	1,349,800
Total Current Liabilities	**26,448,419**	**16,315,726**
NONCURRENT LIABILITIES		
Notes & Bonds Payable	3,199,600	4,649,400
Compensated Absences	24,740,862	20,964,694
Total Noncurrent Liabilities	**27,940,462**	**25,614,094**
Total Liabilities	**54,388,881**	**41,929,820**
NET ASSETS	**108,196,003**	**102,474,973**
TOTAL LIABILITIES AND NET ASSETS	**$162,584,884**	**$144,404,793**

Statement of Revenues and Expenses (Unaudited)

For the Years Ended June 30, 2010, and June 30, 2009

	2010	2009
OPERATING REVENUE		
Net Patient Service Revenue	$223,787,226	$219,352,448
Other Operating Revenue	52,775,000	24,499,993
Net Operating Revenue	**276,562,226**	**243,852,441**
OPERATING EXPENSES		
Salaries and Fringe Benefits	251,015,295	205,268,614
Medical and Surgical Supplies	6,865,349	19,899,849
Contracted Services	19,027,654	15,644,400
Other Supplies and Services	18,778,129	16,739,542
Communications and Utilities	2,754,305	2,942,222
Medical Malpractice Costs	1,710,699	(2,313,527)
Bond and Other Interest Expense	1,553,819	1,577,424
Medical School Trust Fund (MSTF)	7,593,882	9,184,472
Total Operating Expenses	**309,299,132**	**268,942,996**
OPERATING INCOME (LOSS)	**(32,736,906)**	**(25,090,555)**
NONOPERATING GAINS (LOSSES)		
Interest and Investment Income	1,210,775	(8,595,073)
Nonoperating Income (Expense)	875,000	-
Transfers to HCS Enterprise Fund	(7,500,429)	(3,500,004)
Transfers from HCS Enterprise Fund	43,872,590	24,626,614
Total Nonoperating Gains (Losses)	**38,457,936**	**12,531,537**
NET INCOME (LOSS)	**$5,721,030**	**($12,559,018)**

Statement of Cash Flows (Unaudited)

For the Years Ended June 30, 2010, and June 30, 2009

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Patients and Third Parties	$217,926,742	$217,001,256
Payments to Employees and Fringe Benefits	(245,037,991)	(200,686,369)
Payments to Vendors and Suppliers	(40,166,177)	(33,965,454)
Payments for Medical Malpractice	(1,591,907)	(3,800,004)
Operating Capital Grants	32,250,507	24,626,614
Other Receipts	45,181,118	18,877,711
Net Cash Provided (Used)	**8,562,292**	**22,053,754**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Net Cash Provided (Used)	-	-
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Principal & Arbitrage Paid on Outstanding Debt	(1,349,800)	(1,249,800)
Interest and Fees Paid on Debt	(204,019)	(327,624)
Net Cash Provided (Used)	**(1,553,819)**	**(1,577,424)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income & Other Activity	1,210,775	(8,595,073)
Purchase and Sale of Investments, Net of Fees	-	47,538,945
Investments in and Loans to Affiliated Enterprises - Net	(6,625,429)	(3,500,004)
Net Cash Provided (Used)	**(5,414,654)**	**35,443,868**
NET INCREASE (DECREASE)	**1,593,819**	**55,920,198**
BEGINNING CASH AND CASH EQUIVALENTS	**81,474,119**	**25,553,921**
ENDING CASH AND CASH EQUIVALENTS	**83,067,938**	**$81,474,119**

Pro Forma Selected Statistics and Ratios

For the Years Ended June 30, 2010, and June 30, 2009

	REX SITES	CHATHAM SITES	UNC SITES	2010 UNC HCS TOTAL	2009 UNC HCS TOTAL
PATIENT SERVICE STATISTICS					
Patient Days	124,531	3,908	239,552	365,563	364,083
Inpatient Discharges	34,187	965	40,115	75,322	74,302
Average Length of Stay	3.6	4.0	6.0	4.9	4.9
Inpatient Operating Room Cases	8,954	99	11,084	20,598	20,038
Outpatient Operating Room Cases	26,789	850	14,853	36,333	41,642
Emergency Department Visits	55,608	12,840	64,480	135,587	120,088
Clinic Visits	64,784	13,076	835,666	956,781	900,450
Births/Deliveries	6,791	1	3,797	9,935	10,588
FINANCIAL RATIOS					
Operating Margin Percentage				5.46%	3.62%
Operating Margin Percentage (excluding cost report settlements)				5.01%	1.11%
Days in Net Accounts Receivable				44.15	47.74
Days of Cash on Hand (includes investments)				171.95	163.80
Average Payment Period (days)				68.18	53.73
Long-Term Debt to Equity				20.66%	21.73%
Current Debt Service Coverage				5.12	2.73
Maximum Future Debt Service Coverage				6.27	2.69

Notes to Financials

NOTE 1 // SIGNIFICANT ACCOUNTING POLICIES

A. ORGANIZATION – The University of North Carolina Health Care System (UNC HCS) was established November 1, 1998, by N.C. 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 collaboratively with the health sciences schools of the University of North Carolina at Chapel Hill (UNC-CH) and render other services designed to promote the health and well-being of the citizens of North Carolina.

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 including University of North Carolina Physicians and Associates (UNC P&A). The UNC HCS is under the governance of the Board of Directors of the UNC HCS. Rex Healthcare, Inc. (Rex), Chatham Hospital, Inc. (Chatham) and Triangle Physician Network, LLC (TPN) have been added to the organization since its inception.

The University of North Carolina Hospitals – The University of North Carolina Hospitals at Chapel Hill (UNCH) is the only state-owned teaching hospital in North Carolina. With a licensed base of 799 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, North Carolina Women's Hospital and North Carolina Cancer 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 the UNCH 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-third 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 the 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 – 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 the 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 UNCH and the outpatient clinics on the UNC campus, there is a growing range of services provided at clinics in the community. There are 18 clinical departments, two affiliated departments and two administrative units that collectively form UNC P&A.

CLINICAL DEPARTMENTS:

- Anesthesiology
- Dermatology
- Emergency Medicine
- Family Medicine
- Medicine
- Neurology
- Neurosurgery
- Obstetrics & Gynecology
- Ophthalmology
- Orthopaedics

- Otolaryngology
- Pediatrics
- Psychiatry
- Radiation Oncology
- Radiation Oncology
- Radiology
- Pathology & Laboratory Medicine
- Physical Medicine & Rehabilitation
- 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 the UNC-CH.

Rex Healthcare Inc. 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 the 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 principal corporate entities under common control of Rex Healthcare, Inc. are:

REX HOSPITAL, INC. – Rex Hospital, Inc. (the "Hospital") located in Raleigh, N.C., is a 433-bed hospital. The Hospital provides inpatient, outpatient and emergency services primarily to the residents of Wake County, N.C. The Hospital operates Rex Cancer Center, Rex Women's Center, and Rex Rehab and Nursing Care Center of Raleigh on its main campus. The Hospital has additional campuses in Cary, Wakefield (in Raleigh), Knightdale and Apex. Rex also owns Rex Home Services, Inc., that primarily serves residents of Wake County, and Smithfield Radiation Oncology, LLC.

REX HOLDINGS, LLC – Rex formed and became the sole member of Rex Holdings, LLC ("Holdings"), a single member limited liability company. Holdings was formed to hold membership interest in various limited liability companies.

REX PHYSICIANS, LLC – Holdings formed and became the sole member of Rex Physicians ("Physicians"), a single member limited liability company which has elected to be treated as a taxable corporation. Physicians was formed to operate specialty physician practices serving the residents of Wake County and surrounding areas. Physicians currently operates physician practices in the areas of general surgery, heart and vascular services, and thoracic surgery.

REX ENTERPRISES COMPANY, INC. – Rex Enterprises Company, Inc., ("Enterprises") is a North Carolina for-profit corporation organized to hold investments in various affiliates to promote the development of real property in support of the mission of Rex.

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 Healthcare.

REX HOME SERVICES, INC. – The Hospital owns Rex Home Services, Inc., ("Home Services") a North Carolina not-for-profit corporation, organized to provide home health services primarily to the residents of Wake County, N.C.

SMITHFIELD RADIATION ONCOLOGY, LLC – Smithfield Radiation Oncology, LLC, (SRO) is a limited liability company organized to own and operate a linear accelerator. Rex Healthcare is the sole member.

Chatham Hospital, Inc. Chatham is a private, not-for-profit health care organization located in Siler City, N.C. Chatham's sole corporate member is the UNC HCS. Additionally, the UNC HCS reviews and approves Chatham's annual operating and capital budgets.

The facility is a 25-bed critical access hospital with a 70-year history of providing quality health services. Chatham provides comprehensive care, including emergency, general surgery, lab, CT, MRI, nuclear medicine, pharmacy, cardio-pulmonary and intensive care on its campus. Chatham reaches beyond the

hospital setting to provide diabetes education, physical therapy and cardiac rehabilitation.

Triangle Physician Network, LLC TPN is a wholly owned subsidiary of the System that owns and operates 12 community-based practices throughout the North Carolina Triangle (Raleigh, Durham and Chapel Hill) area. The purpose of the TPN is to provide care close to home for the convenience of the patients and allow clinicians and staff of the System to be part of their local communities.

B. BASIS OF PRESENTATION – The accompanying financial statements present all activities under the direction of the UNC HCS Board of Directors. The financial statements for the UNC HCS are presented as a compilation of the various statements generated by its separate entities. UNCH, Rex and Chatham issue their own audited financial statements while UNC P&A is included as a part of the audited statements for the 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 to only 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 the UNC-CH.

C. BASIS OF ACCOUNTING – The statements of the various entities have been prepared using the accrual basis of accounting for UNCH, Rex and Chatham and the modified accrual basis of accounting for UNC P&A and TPN. 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 and TPN, monthly financials are maintained on a cash basis; and then at year-end, adjustments are made to accrue all known material amounts for revenue and expense.

D. CURRENT AND NON-CURRENT DESIGNATION – Assets are classified as current when they are expected to be collected within the next 12 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.

E. REVENUE AND EXPENSE RECOGNITION – Revenues and expenses are classified as operating or non-operating 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 for 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.

Non-operating 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 non-operating since these are investing, capital or noncapital financing activities.

F. 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 the 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.

The UNC-CH manages the funds of UNC P&A as authorized by the University of North Carolina Board of Governors pursuant to N.C. 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 N.C. 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. The 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.

G. 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 non-operating income (loss). The calculation of realized gains and losses is independent of a calculation of the net change in the fair value of investments.

H. 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 non-current assets.

I. 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 is 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.

J. 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.

K. 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.

L. 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.

Non-current 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.

M. 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.

N. 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.

O. OTHER NON-CURRENT ASSETS – Other non-current assets include amounts for long-term payment arrangements for patient accounts receivable, bond issuance costs-net of amortization and investments in affiliates.

P. 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.

Q. 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.

R. NOTES AND BONDS PAYABLE – Notes 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 non-current. The bonds carry interest rates ranging from 0.17 percent to 10.1 percent. The various bond series have fixed, variable or synthetic rates with final maturity in February 2033.

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 1.76 percent to 3.76 percent with a final maturity in September 2010.

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

T. OTHER CURRENT LIABILITIES – Other current liabilities represent funds held for others and amounts due to patients or third parties for credit balances.

U. 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.

V. 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.

W. 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 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 percent 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 Aug. 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 ninety-five percent (95 percent) of Medicare rates. UNC P&A also is 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.

X. MEDICAL AND SURGICAL SUPPLIES – Medical and surgical supplies represent the items used to provide patient care. This includes instruments, special medical devices and pharmaceuticals.

Y. 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.

Z. MEDICAL SCHOOL TRUST FUND – Medical School Trust Fund (MSTF) expenses represent an assessment of 4.6 percent of net patient service revenue. The MSTF funds are at the Dean's discretion for the support of projects such as program development and recruitment incentives for new department chairs.

AA. 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.

BB. 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 collectability. 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 – 21 percent, Managed care – 26 percent, Commercial – 18 percent, Medicaid – 16 percent, Self pay – 18 percent and Other – 1 percent.

NOTE 2 // ESTIMATED THIRD-PARTY SETTLEMENTS

The amount shown as current assets represents estimated receivables due from Medicaid in the amount of $61.2 million, Tricare/Champus in the amount of $4.0 million and Medicare in the amount of $1.1 million.

The amount shown as current liabilities represents estimated payables due to Medicaid in the amounts of $34.1 million and due to Medicare in the amount of $55.6 million.

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:

	FY2010	FY2009
Land and Improvements	91,501,833	66,613,285
Buildings and Improvements	810,808,973	638,975,948
Equipment	655,075,368	626,479,968
Construction in Progress	40,814,360	154,888,632
Gross PP&E	**1,598,200,534**	**1,486,957,833**
Accumulated Depreciation	(743,709,881)	(682,873,333)
Net PP&E	**$854,490,653**	**$804,084,500**

NOTE 4 // LONG-TERM DEBT

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

	FY2010	FY2009
Chatham Series 2007 Bonds	$29,550,000	$30,505,000
UNC P&A Series Bonds	4,649,400	5,999,200
Rex Series 1998 Bonds	74,415,000	80,420,000
UNCH Series 1999 Bonds	-	-
UNCH Series 2001 Bonds	99,600,000	101,000,000
UNCH Series 2003 Bonds	94,600,000	95,125,000
UNCH Series 2005 Bonds	18,540,000	21,735,000
UNCH Series 2009 Bonds	42,020,000	44,290,000
FACE VALUE OF BONDS OUTSTANDING	**363,374,400**	**379,074,200**
Deferred Costs - Discount on Issuance	(509,000)	(548,000)
Deferred Costs - Loss on Refunding	(13,242,203)	(15,561,371)
Deferred Costs - Premium on Issuance	579,121	2,344,657
Arbitrage Rebate Payable	268,892	268,892
NET VALUE OUTSTANDING	**350,471,210**	**365,578,378**
Current Portion of Bonds	16,139,800	15,364,800
Current Portion of Notes	8,247,204	18,720,683
TOTAL CURRENT BONDS AND NOTES	**24,387,004**	**34,085,483**
Noncurrent Portion of Bonds	353,141,056	350,213,578
Noncurrent Portion of Notes	33,702,000	17,629,558
Other Noncurrent Debt	871,000	546,000
TOTAL NONCURRENT BONDS AND NOTES	**$387,714,056**	**$368,389,136**

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, 2010, are:

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2011	$16,139,800	$11,195,558	$27,335,358
2012	16,724,800	10,597,205	27,322,005
2013	17,664,800	9,847,617	27,512,417
2014	16,715,000	9,110,575	25,825,575
2015	17,410,000	8,377,478	25,787,478
2016-2020	83,935,000	31,381,695	115,316,695
2021-2025	81,765,000	16,597,743	98,362,743
2026-2030	86,565,000	6,017,048	92,582,048
2031-2035	26,455,000	1,003,734	27,458,734
TOTAL	**$363,374,400**	**$134,738,080**	**$467,503,053**

Annual requirements to pay principal and interest on the notes outstanding at June 30, 2010, are:

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2011	$8,247,204	$727,250	$8,974,454
2012	31,612,467	1,156,000	32,768,467
2013	785,155	0	785,155
2014	417,673	0	417,673
TOTAL	**$41,949,204**	**$1,883,250**	**$43,832,454**

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 (TSERS) as a condition of employment. TSERS 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 10 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 percent 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, 2010, UNCH and UNC P&A had advance deposits with the Fund totaling $16.3 million.

Additional disclosures relative to the funding status and obligations of the Fund are set forth in the audited financial statements of the Liability Insurance Trust Fund for the years ended June 30, 2010, and June 30, 2009. Copies of this report may be obtained from The University of North Carolina Liability Insurance Trust Fund, 211 Friday Center Drive, Hedrick Building - Room 2029, Chapel Hill, N.C., 27517.

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 UNCH, 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 the 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 the UNC-CH School of Medicine agreed to finance the Enterprise Fund. For the year ending June 30, 2010, total assessments of $27.6 million were made, of which $28.3 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.

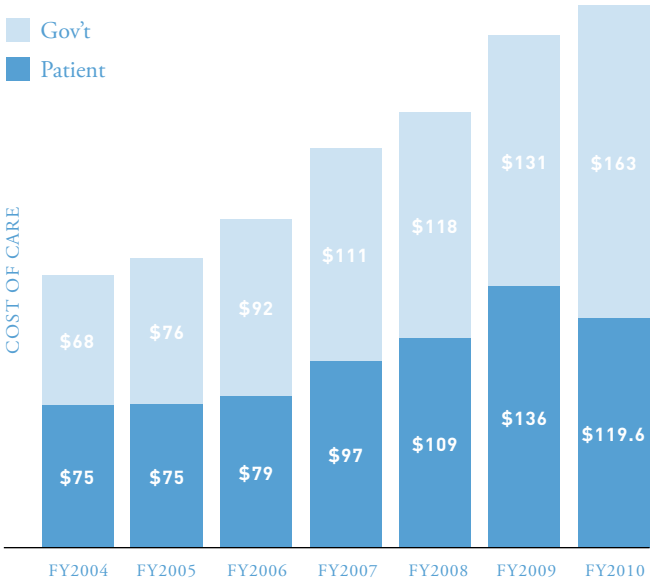
John Rex Endowment – The John Rex Endowment (Endowment) operates as a 501(c)(3) corporation and is independent of the Board of Directors of the UNC HCS. Its purpose is to advance the health and well-being of the residents of the greater Triangle area, with specific funds set aside for indigent care and 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 the UNC HCS in April 2000. The Endowment has committed $25 million for capital projects at Rex.

NOTE 9 // COMMUNITY BENEFITS

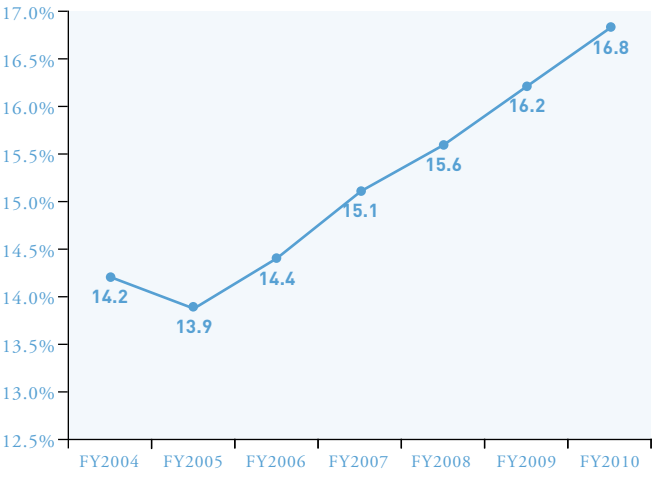
In addition to providing care without charge, or at amounts less than established rates to certain patients identified as qualifying for charity care, the UNC HCS also recognizes its responsibility to provide health care services and programs for the benefit of the community, at no cost or at reduced rates. The 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. The 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 show the cost of uncompensated care provided by the 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.

UNC HCS Uncompensated Care FY2004 – FY2010 ($ Millions)



Uncompensated Care as Percentage of Net Patient Revenue



UNC
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