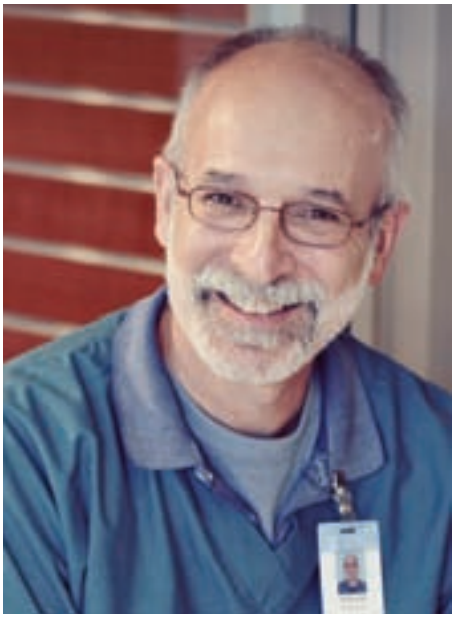

The best of our past.

The brightest of our future.

The University of North Carolina Health Care System
2009 Annual Report

FEATURED ON COVER (CLOCKWISE FROM TOP LEFT):

Linda Van Le, MD, professor and interim co-division director, *Gynecologic Oncology*
Jiselle Arrington (and parents), cancer survivor, Raleigh, N.C.
Jerome Schiro, RN, staff nurse, *Outpatient Hematology and Oncology*
Jan S. Halle, MD, associate professor, *Radiation Oncology*
Paul Godley, MD, PhD, professor, *Hematology and Oncology*
Michele Busshart, RN, assistant nurse manager, *Inpatient Oncology*
James Hardin, cancer survivor, Fayetteville, N.C.

PHOTO CREDITS:

Neil Boyd Photography
Tamara Lackey Photography
Brian Strickland Photography

Table of Contents

Introduction

Financials and Statistics

Dear Friends:

In August 2009, the first patients began receiving care at the N.C. Cancer Hospital, the clinical home of the UNC Lineberger Comprehensive Cancer Center. For the first time in our history, we have a hospital that provides a central place for cancer care, research and teaching.

In the following pages, you will find stories of the many people — researchers, providers and patients — who define the continued commitment to the treatment of cancer represented by the hospital.

We also have celebrated many other successes across our organization. While we have all felt the pressures of decreased resources this year, these tough times have also pushed us to be better, stronger and wiser. UNC Health Care has focused on value through our successes in patient care, research and growth.

One example is our Commitment to Caring, the formal dedication to enhancing patient care through improved efficiency and quality. In 2008, we achieved our organizational goals in finance, quality and employee and patient satisfaction. Nationally and here at home, we have been recognized for our outstanding patient care. HealthGrades placed UNC Hospitals in the top 5 percent of hospitals nationwide based on patient scores from the Hospital Consumer Assessment of Healthcare Providers and Systems (HCAHPS) survey. We also were recognized by *U.S. News & World Report* as one of the Best Hospitals and one of the Best Children's Hospitals, and ranked third for best nursing care. More than 200 of our physicians were named to the Best Doctors in America® list in 2009 — the highest number of UNC physicians ever to be included.

Another way we strive for continued excellence in patient care is by offering top training to the next generation of providers. *U.S. News & World Report* recognized the UNC School of Medicine as second among primary care medical schools, 20th among all research medical schools and sixth among public research medical schools. Our specialty programs topped the lists as well.

To continue our educational leadership, the UNC School of Medicine will begin a new cardiothoracic residency program in 2010. We are one of just six institutions in the country to offer this type of program.

Equally important are our efforts to maintain leadership in our research endeavors. The generous appropriation from the N.C. General Assembly to create the University Cancer Research Fund (UCRF) provides $50 million a year to help foster discovery, innovation and delivery of new cancer treatments. In 2009, we received almost $350 million in medical research funds and were honored with 149 American Recovery and Reinvestment Act awards. These funds are put to use each day by our researchers, teachers and providers to benefit patients around the globe.

To meet our responsibility to provide quality health care to all North Carolinians, we have also advanced efforts to grow beyond our walls and throughout the state.

In addition to the N.C. Cancer Hospital, we are expanding our campus with several more new facilities. The Genetic Medicine Building, completed in fall 2008, is the largest and most sophisticated research building ever built at UNC-Chapel Hill. It is occupied by the departments of genetics, biochemistry and biophysics, and pharmacology and will support laboratories, classrooms and offices.

We have also cleared the construction site for the new Imaging Research Building, anticipated to open in June 2013. The building will house the Biomedical Research Imaging Center and serve as a state resource for handling the acquisition, processing, analysis, storage and retrieval of scientific images.

As you may know, we have submitted plans to build a 68-bed campus in Hillsborough to meet growing patient needs. If approved, we would be able to begin providing care to patients by 2014.

Not only are we experiencing physical growth, we are also building relationships throughout the state. Rex Healthcare in Raleigh has joined two local physician groups to create Rex Surgical Specialists, expanding the surgical services available to patients throughout the Triangle.

While it has been a truly successful year, it has not been without its challenges. We could not, in good faith, write this letter without addressing the health care reform debate that has underscored our country's political discussion this year. As a health care provider, academic institution and research organization, this debate has and will continue to impact the very core of our system.

We know reform of our health care system is necessary. As the state's safety net hospital, the economic and health care challenges of the state and nation are mirrored at UNC Health Care. We provide care for those who need it across all 100 counties of North Carolina, regardless of their ability to pay.

In 2008, one in 10 of our patients had no insurance, and that number increased to one in eight in 2009. At some of our clinics, 40 percent of the patients we see are uninsured. Our uncompensated care costs in 2008 were $228 million and rose to almost $270 million for 2009. As unemployment continues to take its toll on our state, we can expect to see more people losing their insurance and turning to us for care.

This model is not sustainable long-term, and we believe that our efforts, combined with national emphasis on reform, will push health care providers to continue to strive for new and better ways to deliver cost-effective care to everyone. Reform of our system would also encourage additional access to information to help improve care and further research.

Academic medical centers are a unique resource, and our costs are higher than most others — precisely because we teach and do research. It is too soon to know the long-term ramifications of reform on our system, but we do know that our institution would be better able to function, at least in the immediate future, if those now uninsured were covered.

***

UNC Health Care is making substantial progress in supporting research, deploying new technologies, increasing our capacity and broadening health education in spite of the many challenges confronting our state: population growth, budget cuts, a shortage of health care providers and impending health reform.

N.C. Cancer Hospital

We know reform of the system is both possible and necessary, but it will require compromise across all parties. While health reform will take time, we do know that in order to achieve sustainable reform, there must be a continued effort from all of us to look for ways to overhaul the way we finance and deliver health care. We need to talk about these issues, be smart with our resources and lay the groundwork to meet our health care needs in the future.

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On behalf of the employees and patients of UNC Health Care, thank you for your continued support. We hope you enjoy the stories of the people and progress that define our organization on the following pages.

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

Working Toward the Future of Medical Research

UNC Health Care opened the doors to a new era of cancer research and patient care in North Carolina with the dedication of the N.C. Cancer Hospital in September 2009. With members of the N.C. General Assembly, Gov. Beverly Perdue and other distinguished guests on hand, the new hospital was dedicated to serve all cancer patients and their families across the state.

Known as a leader in cancer research and care, UNC Health Care now has a facility that matches the caliber of excellence demonstrated by our providers, researchers and staff. This gleaming, light-filled building holds the promise of the next generation of innovative new treatments and possibly even a cure for the pervasive disease that takes almost 17,500 lives in North Carolina every year.

The hospital is the clinical home of the UNC Lineberger Comprehensive Cancer Center, one of only 40 facilities in the nation designated as a comprehensive cancer center by the National Cancer Institute. By bringing our research and patient care under one roof, we are fostering collaboration between researchers and providers, as well as speeding new discoveries and treatments from the bench to the bedside.

The state-of-the-art hospital has triple the space of our former cancer facility, helping provide top-notch care to more patients than ever before. More space also allows for expansion of our multidisciplinary clinics, giving patients more opportunities to see a range of providers and giving our School of Medicine students more hands-on training. From the technological capabilities to the layout, every aspect of the building has been designed to cultivate an atmosphere of healing, with features like ample natural lighting, a beautiful outdoor atrium and natural finishes in the patient rooms.

N.C. Cancer Hospital

UCRF: FUNDING THE NEXT GENERATION OF CANCER RESEARCH

The building is aligned with the leading-edge research conducted by our world-class researchers. And funding our efforts is the UCRF, with $50 million for cancer research promised annually.

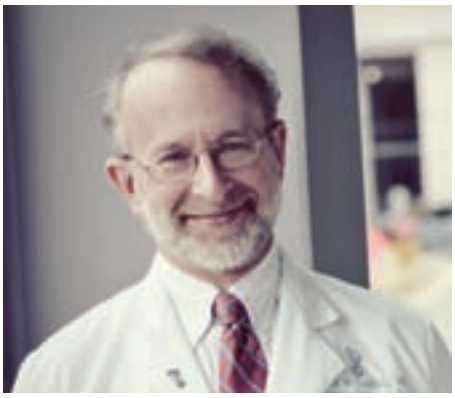
Created to foster discovery, innovation and delivery of new cancer treatments, the UCRF has funded several initiatives this year, including multiple projects through the UCRF Innovation Awards. With this generous funding, our teams are pioneering new discoveries in every field of cancer research from nanotechnology to radiation therapy to personalized medicine and drug development.

In addition, the UCRF has supported the growth of our faculty — 42 new members have joined our team across the spectrum of cancer research. With these valuable new individuals come important new ideas that enhance our knowledge and resources in different disciplines.

The UNC Cancer Network: Leading-edge technology reaches across the state

Supported by the UCRF, the UNC Cancer Network is providing initiatives in research, patient care, survivorship and education across the state, from the mountains to the sea. Built on a partnership between UNC Health Care and other North Carolina health systems, this network connects oncologists in other counties to the providers and specialists at the N.C. Cancer Hospital. Facilitated through video conferencing capabilities, physicians hold virtual tumor boards with multidisciplinary teams to discuss treatments, share specialized knowledge and ask questions in an effort to provide personalized, comprehensive care for their patients. We already have 13 sites around the state participating through our telemedicine technology.

Richard M. Goldberg, MD, distinguished professor and chief, division of Hematology and Oncology, physician-in-chief, N.C. Cancer Hospital



RAM lab: Bringing breakthroughs in personalized medicine

In recent years, medical science has revealed that genetics plays a significant role in the diagnosis and prognosis of cancer. In an emerging field — clinical cancer genomics — researchers and doctors study the link between genetics and cancer, looking for ways to personalize treatments for greater impact. With the new Rapid Adoption Molecular (RAM) lab, UNC Health Care now has an advantage in this rapidly advancing field. Thanks to the support of the UCRF, the RAM lab is equipped with high-tech microarray equipment, allowing simultaneous analysis of multiple genes and the development of new tests to personalize medicine.

RAM Lab

NATIONAL RECOGNITION AND FUNDING

We continue to earn awards and support for our outstanding contributions to the field of health care. As of October 2009, the School of Medicine faculty members received $50 million in new funding through the American Recovery and Reinvestment Act to help research diseases and potential treatments. Added to our financial support from the National Institutes of Health, as well as a Clinical and Translational Science Award, these funds make it possible for us to partner with communities throughout the state and continue to transform and advance our capabilities in cancer research.

NEW INNOVATIONS IN ROBOTIC SURGERY

When UNC Health Care acquired the da Vinci robotic surgical system in 2004, Eric Wallen, MD, and his fellow urologists took a patient-focused, results-oriented approach to the new technology. "We didn't just look at mastering the technique of robotic surgery, but also how we could effectively teach it to our residents — and most importantly — how to evaluate outcomes for our patients in a meaningful way," says Dr. Wallen. After performing hundreds of surgeries, UNC Hospitals has earned a reputation for excellence in the field of robotic surgery.

"We've become an international leader in robotic cystectomy surgery for bladder cancer," says Dr. Wallen. "Our team is one of the most experienced in the world, which allows us to refine the technique and report it in the literature for other robotic surgeons to follow." In fact, he and his colleague, Raj Pruthi, MD, one of the most well-respected surgeons in the country and pioneer of this procedure, wrote its guidelines.

But the expertise and skill of Drs. Pruthi and Wallen matters most to patients like Kenneth Harris, a salesman from Hertford, N.C. Last year, Harris was diagnosed with prostate cancer. "When my doctor called and told me to come in and bring my wife, I knew it wasn't good," says Harris. After hearing the news, he immediately went home and began researching his options for surgery online. "One of my main concerns was avoiding a blood transfusion," says Harris, which is why he was very excited to learn about the minimally invasive nature of the da Vinci surgery. "A true and recognized advantage of the robotic technique is that there is significantly less blood loss," says Dr. Wallen.

Harris inquired about the surgery at other facilities but ran into financial barriers. At UNC Health Care, he found an incredibly caring and consistent team ready to help him through every step of the process. "Without a doubt, this has to be one of the best hospitals in the state," he says. "The staff showed my family and me sincere personal attention, going beyond the call of duty in every way."

Most amazing to Harris was how quickly he began to recover. Despite the fact that this was major surgery, he was in and out of the hospital in less than 24 hours. Within a day and a half, he was back on his feet and answering the door when visitors came to call. "A friend of ours told my wife that it wasn't fair — her husband had been in bed for six weeks after having the same procedure," says Harris.

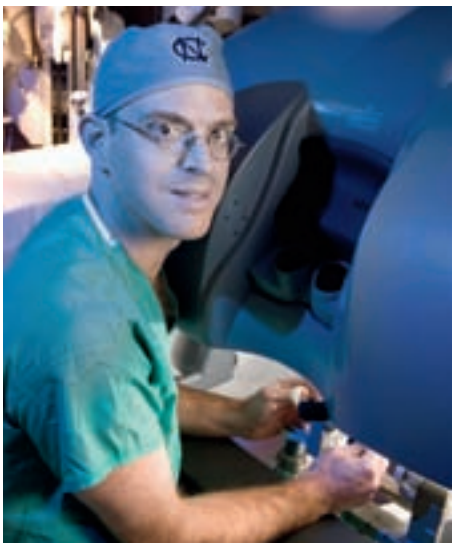
"All of the robotic surgeries in the field of urology are showing their benefits to the patient," says Dr. Wallen. "We're not claiming that this is a better option in terms of curing people, but we're saying it's equivalent in effectiveness to traditional surgery with a quicker and less painful recovery." A quality of life study published by the urology team at UNC Health Care showed that patients who receive robotic surgery feel better and return to regular activities sooner than patients who have traditional open surgery.

Now cancer free, Harris certainly agrees. His surgery was in March of 2009 and since then he says he's been "better than good and better than most."

Dr. Wallen and his team continue to pioneer new discoveries in the field of robotic surgery. "We just completed a trial comparing open surgery to robotic surgery for cystectomy, and our results were accepted for publication," he says. "We're making a scientific case to show that this is a very viable alternative to open surgery."

For people like Kenneth Harris, that means better care and a brighter hope for facing cancer.

Kenneth Harris, cancer survivor, and his wife, Michelle



Eric M. Wallen, MD, associate professor and director, Urologic Laparoscopy

"Without a doubt, this has to be one of the best hospitals in the state. The staff showed my family and me sincere personal attention, going beyond the call of duty in every way."

— Kenneth Harris, Hertford, N.C.

Charlie Morlock, cancer survivor

FAMILY-CENTERED CARE

"We're always greeted with smiling faces, and the nurses know us all. It's obvious that they care about us as a family."

— Meredith Morlock, Cary, N.C.

Meredith Morlock knows what it means to be in the right place at the right time. "We are so fortunate to live in this area, with the resources and comprehensive care provided by UNC Health Care," she says. In 2006, Morlock found some light blue bruises on her then 5-year-old son Charlie and decided to keep an eye on them. When they hadn't gone away three weeks later, she took Charlie to SAS, where her husband worked, to be checked out by the on-site doctor.

Within 45 minutes, they knew Charlie had a form of leukemia, and the doctor referred them immediately to Stuart Gold, MD, professor and chief of the Pediatric Oncology and Hematology Division at the UNC School of Medicine. While the anxious family waited in the Emergency Department, the nursing staff took good care of them. "They brought snacks and movies to keep us occupied. We felt welcome from the very beginning," says Morlock.

Her 10-year-old daughter Sara has since shown a special admiration for the nurses after watching them take care of her brother. "She's told me that she would like to be a nurse one day."

Less than 12 hours later, they had Charlie's diagnosis: acute lymphoblastic leukemia. "We of course were horrified, but Dr. Gold was very soothing and helped to calm us down," says Morlock. "We felt very well taken care of."

And that's still true today. Now almost 8 years old, Charlie is nearing the end of his three-year treatment and is being seen at the N.C. Cancer Hospital once a month. "For those of us who know the old building, this place feels like a palace," says Morlock. "We're always greeted with smiling faces, and the nurses know us all. It's obvious that they care about us as a family." And that makes all the difference.

Enhancing Our Method of Patient Care

Through every research initiative, innovative program and facility enhancement, UNC Health Care is striving towards one goal: unparalleled patient care. Every year, more than 15,000 cancer patients make more than 110,000 visits to UNC, coming from all 100 counties across our state.

Regardless of background, family situation and financial means, each of our patients deserves our best care. That is what the new N.C. Cancer Hospital offers to every person who walks through the door — the most advanced treatments available, top researchers in every field of cancer study, a caring staff and a comprehensive approach to cancer treatment — supporting not just the patient, but the entire family as well.

Here, patients will find an atmosphere of healing and a group of health care professionals passionate about caring. Our holistic approach to treatment extends to the patient's mental and emotional well-being with our Psycho-oncology Clinical Service, a new addition under the umbrella of our Comprehensive Cancer Support Program. Other patient support services include symptom management clinics, nutrition counseling, a significantly expanded resource center and integrative medicine services such as yoga, massage therapy, acupuncture and biofeedback. We have a boutique in the hospital that provides wigs, hats and scarves to patients at no cost. While we're proud of the new facilities we can offer our patients, our commitment to care extends beyond the walls of our new building to touch our communities and patients throughout North Carolina.

INVESTING IN THE FUTURE OF EVERY PATIENT

The UCRF not only funds our cutting-edge research, it also provides much-needed programs, like Nurse Navigators and N.C. SPEED, to ensure our quality care reaches every corner of the state.

Nurse Navigators: Guiding care on a local level

As a collaboration of the Dare County Department of Public Health, UNC Lineberger and the N.C. Cancer Hospital, the Nurse Navigator program supplements the local medical community to help at-home patients continue receiving quality cancer care. Over the past year, the program has guided more than 6,000 patients through the medical system, providing one-on-one assistance with scheduling, coordination of care and transportation, and offering information about clinical trials, cancer screenings, financial assistance and community health care resources.

N.C. SPEED: Educating communities about cancer prevention

In the age of increased access to technology and information, anyone can claim to be an expert in fitness and nutrition, even medical treatments, which is why educating communities about proven cancer prevention techniques is more important than ever. N.C. SPEED (Statewide Push for Excellence, Engagement and Delivery) is taking the latest research findings to local health care organizations to ensure community wellness programs are built on fact-based approaches. The UNC faculty and staff are working with the community personnel to give them the tools they need to accurately educate the community on cancer prevention.

Billie Ann Peterson, cancer survivor

"My doctors had been studying my MRI prior to the surgery. They knew I was worried about the cancer being in my liver, so one of my doctors took the time to call me on a holiday to put my fears to rest and let me know that he didn't believe that it was."

— Billie Ann Peterson, Pinehurst, N.C.

MULTIDISCIPLINARY APPROACH TO PATIENT CARE

When Billie Ann Peterson noticed she was getting a little rounder in the midsection, she thought it was time to add some crunches to her daily exercise. She soon discovered the real cause of her stomach bulge — a 10-pound, football-shaped tumor in her abdomen. "That was the first of a long series of tumors," says Peterson, and the first of many surgeries to remove them.

As a relatively new attending physician and recent addition to the surgical oncology team at UNC Health Care, H.J. Kim, MD, remembers meeting Peterson. "The first time I saw Billie, she presented with recurrent tumors," says Dr. Kim. "Like many of the cases we see here, hers was a complicated one." Peterson already had one abdominal surgery and six underarm surgeries. "But the nice thing about the way we take care of cancer patients here is that we treat all of our patients with a multidisciplinary approach," says Dr. Kim.

The tumors that brought Peterson to see Dr. Kim were detected on her kidney and gall bladder when she went to the Emergency Department for a severe urinary tract infection. Unable to get an appointment that week in her hometown of Pinehurst, N.C., someone recommended she contact UNC Health Care. Dr. Pruthi was able to see her within two days. "As I was walking into the hospital, I looked at how big it was and thought how incredibly impersonal the care must be," says Peterson. "I couldn't have been more wrong."

Peterson met with Dr. Pruthi first. Then Dr. Pruthi met with Dr. Kim and Joel Tepper, MD, a radiation oncologist who specializes in intraoperative radiation. "We're actually one of a very limited number of centers in the entire country, if not the world, that can deliver intraoperative radiation therapy, due in large part to Dr. Tepper," says Dr. Kim. The three of them discussed her case and determined a precise treatment plan.

"I had security in the fact that all of my doctors got together and discussed me — in like a war room," Peterson says. "It was nice to know nothing was being overlooked. Everyone who needed to know what was going on with me did."

H.J. Kim, MD, associate professor, Surgical Oncology

Her doctors chose to do surgery and administer intraoperative radiation during the procedure. "The individuals we have in place for each of the different disciplines are established leaders in their field. Our surgical oncology team is very talented, so when we render an opinion, it's well thought out," says Dr. Kim.

This time was no exception. Dr. Kim successfully performed the abdominal surgery to remove Peterson's kidney and gall bladder with the tumors. Luckily, the cancer wasn't in her liver, which she found out on New Year's Eve. "My doctors had been studying my MRI prior to the surgery," says Peterson. "They knew I was worried about the cancer being in my liver, so one of my doctors took the time to call me on a holiday to put my fears to rest and let me know that he didn't believe that it was."

Dr. Kim has also performed two additional surgeries for Peterson to remove recurrent tumors from under both her left and right arms. Since then, she has been completely cancer free. "Dr. Kim paid close attention to the margins," she says. "He cut away enough of the surrounding tissue to prevent the cancer from coming back."

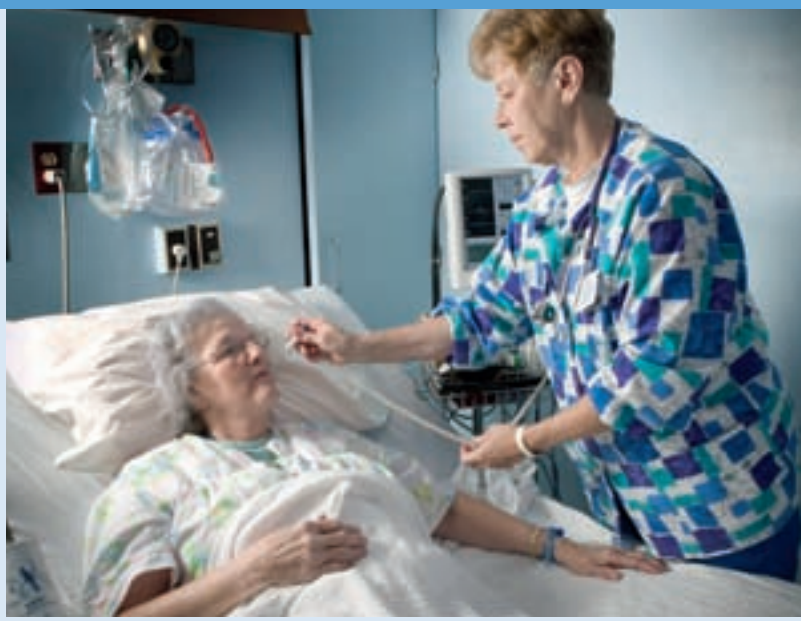
"We gave Billie the multidisciplinary approach every time she had one of these tumors," says Dr. Kim. "She's been happy with it, and none of her tumors have recurred."

Peterson was overwhelmed with the warm, receptive care she received at UNC Health Care. "Everyone there was so kind and friendly," she says. "They all helped build my courage and made me feel secure."

"My team and I are dedicated only to cancer care. We're a very collaborative group, and there's a palpable collegiality here," says Dr. Kim. And patients like Peterson benefit from the strength of that team care approach.

COMMITMENT TO CARING

UNC Health Care ties for third highest score for nursing care in 2009 by U.S. News & World Report



Academic health centers like UNC Health Care are known for having cutting-edge knowledge and technology. Patients may even have access to treatment options that aren't available other places through clinical trials. Because of the strong focus on developing new cures and training health professionals, these centers are sometimes perceived as less warm and friendly in their patient care. We believe it's possible to do both extremely well. The key is understanding what patients and their families need and expect from their health care provider.

When a patient comes to UNC Hospitals, they probably aren't aware of the work that goes on behind the scenes to provide the best care possible. There is much more to patient care than diagnosing and treating illnesses.

"We provide excellent clinical care as indicated by our ranking in *U.S. News & World Report* and the Centers for Medicare and Medicaid Services' (CMS) core measures, such as infection rates services and process and outcome indicators," says Mary Tonges, RN, PhD, senior vice president and chief nursing officer at UNC Hospitals. "We also score very highly on the patient satisfaction tool used by CMS, the HCAHPS survey." In this survey, discharged patients are asked questions like, "how often did your nurse explain your medications?" and "would you recommend this hospital to others?"

However, there is always room for improvement, and through surveys conducted by Press Ganey, an industry consulting organization, we've identified some areas of strengths and areas to work on. Using the survey feedback, Dr. Tonges worked with a committee to develop a set of guidelines for nursing as part of interdisciplinary teams called Carolina Care.

"One of the key characteristics of Carolina Care is hourly rounding," says Dr. Tonges. Nurses visit each patient on a regular basis to anticipate patient needs rather than wait for the patient to push the call button. "By frequently checking in with patients, we reassure them that we're always available. This approach has tremendously reduced the number of call button requests, and patients are more satisfied."

Some of the other steps outlined in Carolina Care include:

- Identifying key points to remember when communicating with patients and families so they know what is happening and why.
- Having the nurse manager visit patients daily, as well as rounding with managers of interdisciplinary teams so they can get feedback first-hand about the service they provide.
- Spending time sitting with the patient and taking time to really focus on the non-medical issues the patient and his or her family may be dealing with (called Moments of Caring).
- Addressing situations promptly. Whoever becomes aware of a problem first is responsible for seeing that it's addressed immediately.

The improvement in patient satisfaction scores was so promising that Carolina Care is being implemented across UNC Hospitals. As one example, satisfaction with the speed patient call lights were answered reached the 95th percentile, meaning we rank in the top 5 percent for satisfaction with answering call lights compared to other academic health centers in the nation.

Ultimately, the goal of Carolina Care and the other patient initiatives at UNC Health Care is to meet and exceed the needs of our patients — and we are always working toward that goal. "We're here to care for patients in a way that meets their needs and keeps them safe," says Dr. Tonges. "Patients and families can count on us to consistently provide excellent care."

UNC HEALTH CARE

Financials and Statistics

CHAPEL HILL, NORTH CAROLINA

For the year ending June 30, 2009

Thomas C. Shea, MD, professor, director, Bone Marrow Transplant Program, associate director for clinical outreach programs, UNC Lineberger Comprehensive Cancer Center

Raj S. Pruthi, MD, associate professor, director, Urologic Oncology

Letter of Transmittal

NOVEMBER 30, 2009

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

N.C. Cancer Hospital

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 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 and Statistics 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 the UNC HCS policies and procedures, integrated with a system of internal controls, provides for this compliance. The accounts and operations of UNCH and UNC P&A (as a part of the 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 is also subject to approval by the 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 $42 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. The Board of the UNC HCS previously authorized UNCH to enter into a future swap agreement for a portion of the 1999 Revenue Bonds which were outstanding

in February 2009. This arrangement was executed as authorized by the Board. 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, the 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. In addition, we have to ensure a safe workplace for our employees.

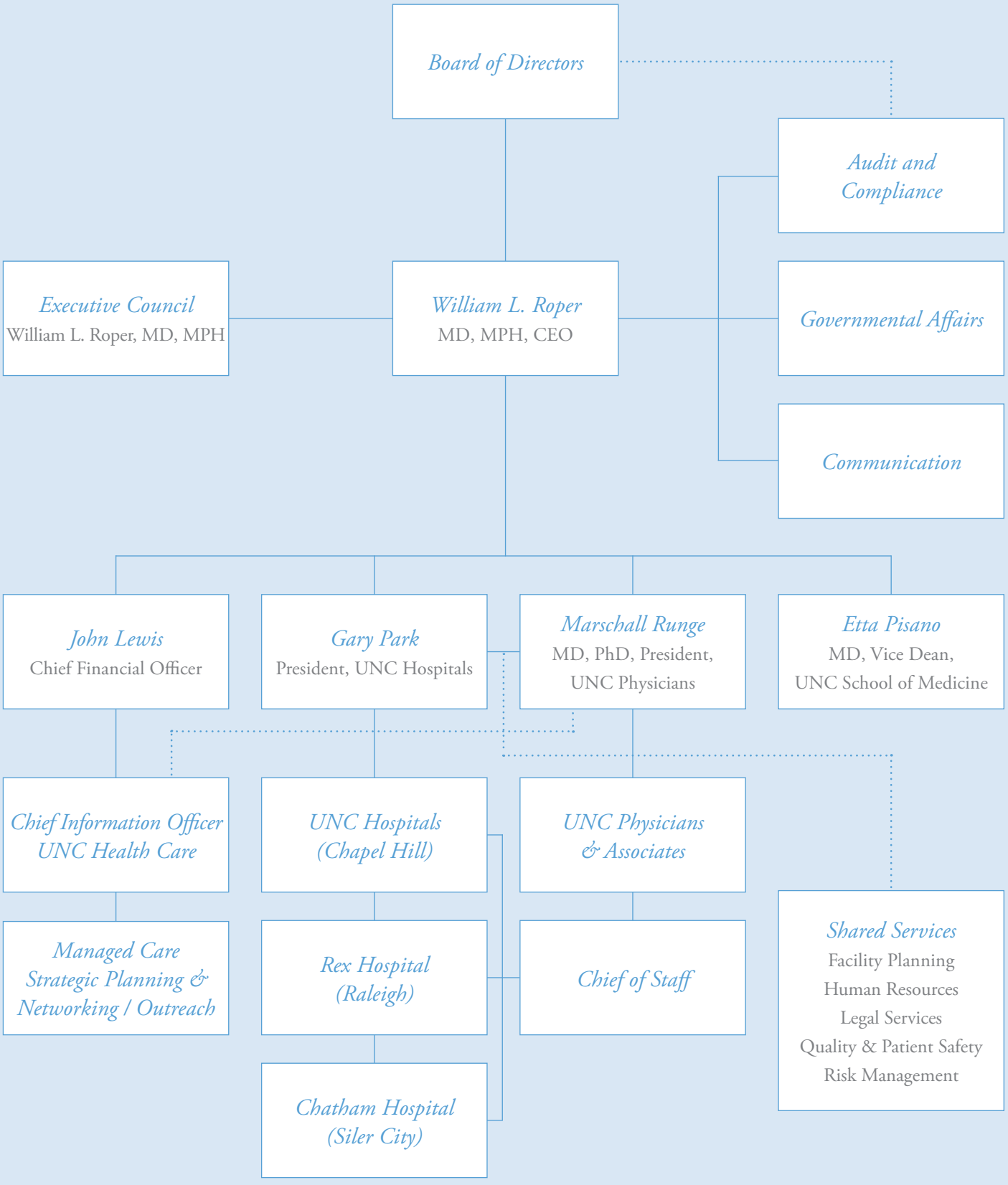
In addition to the typical litigation risks with which we are faced, we have to recognize the risk and rewards associated with the health care industry. Continual evaluation of existing programs and new service development is the only way to maintain or increase our competitive advantage.

Acknowledgements

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

John P. Lewis
Chief Financial Officer
The University of North Carolina Health Care System

UNC Health Care System Reporting Structure



The Board of Directors

November 2009 – October 2010

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Chapel Hill, NC

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Jiselle Arrington, cancer survivor, Raleigh, N.C.

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, 2009, and June 30, 2008. 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 Nov. 1, 1998, by North Carolina General Statute 116-37. The original legislation included only the University of North Carolina Hospitals (UNCH) and the clinical patient care programs of the University of North Carolina at Chapel Hill (UNC-CH). The UNC HCS is governed by a Board of Directors and as an affiliated enterprise of the University of North Carolina. The UNC HCS and the UNC-CH are sister entities. Rex Healthcare, Inc. (Rex) and various community-based clinics have been added to the organization since its inception. Chatham Hospital, Inc. (Chatham) became a member of the UNC HCS family on July 1, 2008. The financial statements and related notes and discussion include only data for the operations of Chatham Hospital for the 12 months ending June 30, 2009.

As illustrated in the reporting structure on page 20, 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. For reporting purposes, this annual report includes 12 months of operating activity for Chatham, even though the audit was done on a shorter period (nine months ending June 30 to synchronize Chatham's year-end and other HCS entities). 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 three 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 and UNC P&A. Since UNC P&A's financial activities are not separately disclosed elsewhere, we also are presenting UNC P&A's Statement of Net Assets and Statement of Revenues and Expenses for the fiscal years ending June 30, 2009 and 2008.

USING THE FINANCIAL STATEMENTS

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

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

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

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

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

The Notes provide information relative to the significant accounting principles applied in the financial statements and further detail concerning the organization and its operations. In general, these disclosures provide information to better understand details, risk and uncertainty associated with the amounts reported and are considered an integral part of the financial statements.

COMPARISON OF TWO-YEAR DATA

Comparative data for 2009 and 2008 is presented this year, and a discussion of the data is in the following sections.

Analysis of Overall Financial Position and Results of Operations

The UNC HCS Statement of Net Assets reflects a large, successful system, with more than $2 billion in total assets. Total assets declined by 1.4 percent over the prior year, while net assets declined by 4.2 percent during the year ending June 30, 2009. For the year, the UNC HCS generated an operating margin of 3.6 percent, or $62.5 million on net operating revenue of $1.7 billion. Net loss was $58.1 million, or -3.6 percent negative margin. The net income margin was negative as the UNC HCS experienced an unrealized loss for the year due to the stock market decline. FY2009 operations benefited from cost report settlements in the amount of $43.9 million. Without these settlements, the operating margin would be 1.1 percent. In order to remain financially strong, to reinvest in new facilities, and to retain the most highly trained work force, the UNC HCS's goal is to average at least 3 percent for its annual operating margin.

UNC P&A experienced a net loss for the year of $12.6 million or -4.8 percent on operating revenue of $243.9 million. This loss was driven by the changing payor mix of our patients and the implementation of a new billing and scheduling system. The new system should improve operations in future years. Operating revenues showed a 0.9 percent decline over the prior year, and expenses declined by 0.3 percent mainly as the result of improved performance in its self-insurance program.

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. Most notably, the Physicians Office Building was completed and turned over to the UNC-CH, and the N.C. Cancer Hospital was completed and dedicated in September 2009. Other projects at UNCH included continued renovation of patient space for bed expansion and relocation and upgrades to infrastructure for the chiller plant.

Rex experienced significant growth in FY2009, with the opening of two new campuses — Rex Healthcare of Wakefield and Rex Healthcare of Knightdale. Capital projects placed in service at Rex in 2009 and 2008 included a second da Vinci Robotic Surgical System, a replaced linear accelerator, new hyperbaric oxygen chambers and upgraded HD surgical video systems.

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. UNCH executed a swap agreement in February 2009 that allowed the refunding of the 1999 Revenue Bonds. Additional information about debt activity can be found in the notes to the pro forma statements.

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

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

The self-pay discount policy implemented by 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 25 percent discount in FY2007). During FY2008, a total of $25.9 million in charges were discounted whereas in FY2009, the total was $31.4 million. These discounts along with adjustments for charity care, bad debt and governmental programs resulted in costs for uncompensated care of $227.5 million for FY2008 compared to $266.1 million for FY2009. This trend reflects a 17 percent increase, while the overall costs represent 16.2 percent of the net patient revenue of the UNC HCS.

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. The national health reform debate adds additional uncertainty to the operating environment. The immediate near-term effect should be favorable as more patients will have some sort of insurance coverage, pushing down the cost of uncompensated care. The medium and longer-term effect is uncertain, and our outlook is 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 $12.7 million reported in FY2009. Per the State Plan for Medical Assistance for North Carolina, the medical faculty practice plan of the UNC-CH is reimbursed at cost and is cost-settled at year-end for services provided to Medicaid patients. A change to terminate this North Carolina Medicaid reimbursement methodology would materially alter the financial outlook for UNC P&A.

The outlook for Medicare reimbursement rates for UNC P&A is uncertain. While we anticipate that the previously scheduled reduction in payments of 21.5 percent will be rescinded, this is part of the ongoing health care reform debate and will require congressional action to finalize. Any reduction would also impact Medicaid and Tricare rates as well, since each is indexed to Medicare rates. These three payors represent 53 percent of UNC P&A gross revenues, and thus any reduction would negatively impact net patient service revenue.

UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Statement of Net Assets

For the Years Ended June 30, 2009, and June 30, 2008

	2009	2008
CURRENT ASSETS		
Cash and investments	$337,165,442	$269,095,242
Patient Accounts Receivable - Net	206,852,866	199,685,366
Inventories	25,649,950	25,147,916
Estimated Third-Party Settlements	50,777,655	16,219,186
Other Assets and Receivables	32,863,057	38,143,002
Assets Whose Use Is Limited or Restricted	26,682,219	42,953,769
Prepaid Expenses	9,479,256	10,673,770
Total Current Assets	**689,470,445**	**601,918,251**
NONCURRENT ASSETS		
Property, Plant & Equipment - Net	804,084,500	758,213,143
Assets Whose Use Is Limited or Restricted	504,614,611	667,502,966
Other Assets	21,331,788	19,654,405
Total Noncurrent Assets	**1,330,030,899**	**1,445,370,514**
Total Assets	**2,019,501,344**	**2,047,288,765**
CURRENT LIABILITIES		
Accounts & Other Payables	88,817,513	75,900,027
Accrued Salaries & Benefits	56,623,558	51,289,793
Estimated Third-Party Settlements	73,568,005	51,665,840
Notes & Bonds Payable	34,085,483	31,110,293
Interest Payable	1,455,234	1,964,823
Other	8,217,950	37,883,713
Total Current Liabilities	**262,767,743**	**249,814,489**
NONCURRENT LIABILITIES		
Notes & Bonds Payable	368,389,136	357,878,955
Compensated Absences	61,191,761	54,336,740
Total Noncurrent Liabilities	**429,580,897**	**412,215,695**
Total Liabilities	**692,348,640**	**662,030,184**
NET ASSETS	**1,327,152,704**	**1,385,258,581**
TOTAL LIABILITIES AND NET ASSETS	**$2,019,501,344**	**$2,047,288,765**

UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Statement of Revenues and Expenses

For the Years Ended June 30, 2009, and June 30, 2008

	2009	2008
OPERATING REVENUE		
Net Patient Service Revenue	$1,581,458,037	$1,429,218,512
Cost Report Settlements	43,876,434	27,915,876
State Appropriations	42,002,451	47,409,965
Other Operating Revenue	62,215,338	73,084,359
Net Operating Revenue	**1,729,552,260**	**1,577,628,712**
OPERATING EXPENSES		
Salaries and Fringe Benefits	959,301,335	882,242,986
Medical and Surgical Supplies	305,882,791	258,721,968
Contracted Services	174,043,473	152,931,421
Other Supplies and Services	94,844,917	111,810,962
Communications and Utilities	28,556,226	25,530,745
Medical Malpractice Costs	5,354,599	15,380,000
Depreciation	71,636,472	63,726,193
Bond and Other Interest Expense	18,216,877	19,205,563
Medical School Trust Fund (MSTF)	9,184,472	9,176,951
Total Operating Expenses	**1,667,021,163**	**1,538,726,789**
OPERATING INCOME (LOSS)	**62,531,097**	**38,901,923**
NONOPERATING GAINS (LOSSES)		
Interest and Investment Activity	(120,164,012)	(33,138,212)
Nonoperating Income (Expense)	(8,246,541)	(1,485,993)
Capital Grants	7,773,578	60,358,473
Total Nonoperating Gains (Losses)	**(120,636,974)**	**25,734,268**
NET INCOME (LOSS)	**($58,105,877)**	**$64,636,191**

UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Statement of Cash Flows

For the Years Ended June 30, 2009, and June 30, 2008

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Patients and Third Parties	$1,605,510,667	$1,483,373,679
Payments to Employees and Fringe Benefits	(947,112,549)	(871,434,158)
Payments to Vendors and Suppliers	(537,403,876)	(556,267,703)
Payments for Medical Malpractice	(13,524,004)	(8,323,395)
Other Receipts	37,829,520	70,503,046
Net Cash Provided (Used)	**145,299,758**	**117,851,469**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State Appropriations	42,002,451	47,409,965
Net Cash Provided (Used)	**42,002,451**	**47,409,965**
CASH FLOWS FROM CAPITAL FINANCING AND RELATED FINANCING ACTIVITIES		
Principal & Arbitrage Paid on Outstanding Debt	(31,402,292)	(30,343,751)
Interest & Fees Paid on Debt	(15,825,761)	(17,882,823)
Capital Grants	7,773,578	60,358,473
Acquisition and Construction of Capital Assets	(119,665,031)	(154,835,666)
Net Cash Provided (Used)	**(159,119,506)**	**(142,703,767)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income & Other Activity	11,456,948	25,045,815
Purchase and Sale of Investments, Net of Fees	47,538,945	(93,019,231)
Investments in and Loans to Affiliated Enterprises - Net	(19,108,396)	(17,840,938)
Net Cash Provided (Used)	**39,887,497**	**(85,814,354)**
NET INCREASE (DECREASE)	**68,070,200**	**(63,256,687)**
BEGINNING CASH AND CASH EQUIVALENTS	**269,095,242**	**332,351,929**
ENDING CASH AND CASH EQUIVALENTS	**$337,165,442**	**$269,095,242**

Statement of Net Assets (Unaudited)

For the Years Ended June 30, 2009, and June 30, 2008

	2009	2008
CURRENT ASSETS		
Cash and Investments	$81,474,119	$25,553,921
Patient Accounts Receivable - Net	29,229,498	24,828,306
Estimated Third-Party Settlements	16,946,470	13,119,186
Other Assets and Receivables	65,246	7,454,720
Assets Whose Use Is Limited or Restricted	10,669,854	75,977,281
Prepaid Expenses	20,406	-
Total Current Assets	**138,405,593**	**146,933,414**
NONCURRENT ASSETS		
Property, Plant & Equipment - Net	5,999,200	7,249,000
Total Noncurrent Assets	5,999,200	7,249,000
Total Assets	**144,404,793**	**154,182,414**
CURRENT LIABILITIES		
Accounts and Other Payables	4,401,632	7,002,680
Accrued Salaries and Benefits	6,014,294	3,242,455
Estimated Third-Party Settlements	4,550,000	2,500,000
Notes & Bonds Payable	1,349,800	1,249,800
Total Current Liabilities	**16,315,726**	**13,994,935**
NONCURRENT LIABILITIES		
Notes & Bonds Payable	4,649,400	5,999,200
Compensated Absences	20,964,694	19,154,288
Total Noncurrent Liabilities	**25,614,094**	**25,153,488**
Total Liabilities	**41,929,820**	**39,148,423**
NET ASSETS	**102,474,973**	**115,033,991**
TOTAL LIABILITIES AND NET ASSETS	**$144,404,793**	**$154,182,414**

Statement of Revenues and Expenses (Unaudited)

For the Years Ended June 30, 2009, and June 30, 2008

	2009	2008
OPERATING REVENUE		
Net Patient Service Revenue	$219,352,448	$207,378,544
Other Operating Revenue	24,499,993	38,596,143
Net Operating Revenue	**243,852,441**	**245,974,687**
OPERATING EXPENSES		
Salaries and Fringe Benefits	205,268,614	189,481,826
Medical and Surgical Supplies	19,899,849	-
Contracted Services	15,644,400	17,923,933
Other Supplies and Services	16,739,542	40,826,778
Communications and Utilities	2,942,222	2,739,175
Medical Malpractice Costs	(2,313,527)	8,121,068
Bond and Other Interest Expense	1,577,424	1,538,499
Medical School Trust Fund (MSTF)	9,184,472	9,176,951
Total Operating Expenses	**268,942,996**	**269,808,230**
OPERATING INCOME (LOSS)	**(25,090,555)**	**(23,833,543)**
NONOPERATING GAINS (LOSSES)		
Interest and Investment Income	(8,595,073)	3,568,295
Nonoperating Income (Expense)	-	(297,401)
Transfers to HCS Enterprise Fund	(3,500,004)	(3,400,000)
Transfers from HCS Enterprise Fund	24,626,614	22,747,500
Total Nonoperating Gains (Losses)	**12,531,537**	**22,618,394**
NET INCOME (LOSS)	**($12,559,018)**	**($1,215,149)**

Statement of Cash Flows (Unaudited)

For the Years Ended June 30, 2009, and June 30, 2008

	2009	2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Received from Patients and Third Parties	$217,001,256	$210,280,783
Payments to Employees and Fringe Benefits	(200,686,369)	(187,722,549)
Payments to Vendors and Suppliers	(33,965,454)	(55,695,160)
Payments for Medical Malpractice	(3,800,004)	(1,213,620)
Operating Capital Grants	24,626,614	22,747,500
Other Receipts	18,877,711	16,637,349
Net Cash Provided (Used)	**22,053,754**	**5,034,303**
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	(1,249,800)	(1,149,700)
Interest and Fees Paid on Debt	(327,624)	(388,799)
Net Cash Provided (Used)	**(1,577,424)**	**(1,538,499)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment Income & Other Activity	(8,595,073)	2,169,312
Purchase and Sale of Investments, Net of Fees	47,538,945	(71,336,055)
Investments In and Loans to Affiliated Enterprises - Net	(3,500,004)	(3,697,401)
Net Cash Provided (Used)	**35,443,868**	**(72,864,144)**
NET INCREASE (DECREASE)	**55,920,198**	**(69,368,340)**
BEGINNING CASH AND CASH EQUIVALENTS	**25,553,921**	**94,922,261**
ENDING CASH AND CASH EQUIVALENTS	**$81,474,119**	**$25,553,921**

UNIVERSITY OF NORTH CAROLINA HEALTH CARE SYSTEM

Pro Forma Selected Statistics and Ratios

For the Years Ended June 30, 2009, and June 30, 2008

	REX SITES	CHATHAM SITES	UNC SITES	2009 UNC HCS TOTAL	2008 UNC HCS TOTAL
PATIENT SERVICE STATISTICS					
Patient Days	124,531	3,908	239,552	364,083	359,423
Inpatient Discharges	34,187	965	40,115	74,302	75,070
Average Length of Stay	3.6	4.0	6.0	4.9	4.8
Inpatient Operating Room Cases	8,954	99	11,084	20,038	20,046
Outpatient Operating Room Cases	26,789	850	14,853	41,642	51,681
Emergency Department Visits	55,608	12,840	64,480	120,088	120,257
Clinic Visits	64,784	13,076	835,666	900,450	845,264
Births/Deliveries	6,791	1	3,797	10,588	10,553
FINANCIAL RATIOS					
Operating Margin Percentage				3.62 percent	2.47 percent
Operating Margin Percentage (excluding cost report settlements)				1.11 percent	0.71 percent
Days in Net Accounts Receivable				47.74	51.00
Days of Cash on Hand (includes investments)				163.80	215.17
Average Payment Period (days)				53.73	50.46
Long-Term Debt to Equity				21.73 percent	20.53 percent
Current Debt Service Coverage				2.73	3.06
Maximum Future Debt Service Coverage				2.69	3.20

N.C. Cancer Hospital

Notes

NOTE 1 // SIGNIFICANT ACCOUNTING POLICIES

Organization – The University of North Carolina Health Care System (UNC HCS) was established Nov. 1, 1998, by North Carolina General Statute 116-37. It is governed and administered as an affiliated enterprise of The University of North Carolina system with its stated purpose to provide patient care, facilitate the education of physicians and other health care providers, conduct research 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. The UNC HCS is under the governance of the Board of Directors of the UNC HCS. Rex Healthcare, Inc., Chatham Hospital, Inc. (Chatham) and various community-based clinics have been added to the organization since its inception.

The University of North Carolina Hospitals is the only State-owned teaching hospital in North Carolina. With a licensed base of 739 beds, this facility serves as an acute care teaching hospital for The University of North Carolina at Chapel Hill. UNCH consists of N.C. Memorial Hospital, N.C. Children's Hospital, N.C. Neurosciences Hospital, N.C. Women's Hospital and N.C. 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 UNC HCS is the sole member manager and HSP is governed by the same Board that directs UNCH's operations. To date, the only properties owned by HSP either have been or are being developed for the sole use and benefit of UNCH.

CAROLINA DIALYSIS, LLC – Carolina Dialysis, LLC (CDLLC) was formed for the purpose of owning and operating chronic dialysis programs, thus improving the quality of care to end-stage renal disease patients by providing dialysis services and conducting research in the field of nephrology in the State of North Carolina. UNCH has a two-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 (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 17 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
- Obstetrics & Gynecology
- Ophthalmology
- Orthopaedics
- Otolaryngology
- Pathology & Laboratory Medicine
- Pediatrics
- Physical Medicine & Rehabilitation
- Psychiatry
- Radiology
- Radiation Oncology
- Surgery

AFFILIATED DEPARTMENTS:

- Allied Health Sciences
- Center for Development and Learning

ADMINISTRATIVE UNITS:

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

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

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

Rex's sole member is the UNC HCS, and 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 activities of the principal corporate entities under the common control of Rex are summarized as follows:

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

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

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

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

REX WAKEFIELD WELLNESS, LLC – Enterprises formed and became the sole member of Rex Wakefield Wellness, LLC ("Wellness"), a single member limited liability company. Wellness was created to develop a wellness center building on the Wakefield campus. Rex Hospital leases the building from Wellness.

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, which is located in the Siler City Business Park approximately 3.5 miles from the main campus.

Community-Based Practices (CBP's) – The network of CBP's is an outreach activity of the UNC HCS which brings quality primary and specialty outpatient care to communities in the Triangle region, including several rural communities. This network has 11 outreach clinics providing more than 150,000 visits a year. Ten of the 11 practices are UNC HCS sponsored.

The physicians practicing in the network clinics spend all or almost all of their time providing ambulatory patient care. The other practice is a joint venture LLC rural oncology practice with First Health of the Carolinas. These CBP's are the source of a significant amount of ancillary testing, inpatient care and specialty care referred to the main Chapel Hill campus.

Basis of Presentation – The accompanying financial statements present all activities under the direction of the UNC HCS Board of Directors. The financial statements for 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.

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. 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, its 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.

FINANCIAL STATEMENT CLASSIFICATIONS AND CATEGORIES

Current and Noncurrent 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.

Revenue and Expense Recognition – Revenues and expenses are classified as operating or nonoperating in the accompanying Statements of Revenues, Expenses and Changes in Net Assets. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with the principal ongoing operations. Operating revenues include activities that have characteristics of exchange transactions, such as charges for inpatient and outpatient services as well as 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.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions. Revenues from nonexchange transactions that represent subsidies or gifts, as well as investment income, are considered nonoperating since these are either investing, capital or noncapital financing activities.

Cash and Cash Equivalents – This classification includes petty cash, security deposits, cash on deposit in private bank accounts and deposits held by the State Treasurer in 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 General Statute 116-36.2 and Section 600.2.4 of the Policy Manual of the University of North Carolina. Special funds and funds received for services rendered by health care professionals pursuant to General Statute 116-36.1(h) are invested in the same manner as the State Treasurer is required to invest. Investments of various funds may be pooled unless prohibited

by statute or by terms of the gift or contract. 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.

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

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

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

Estimated Third-Party Settlements – Estimated third-party amounts represent settlements with Medicare, Tricare and Medicaid programs that may result in a receivable or a payable. Reimbursement for cost-based items 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.

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

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

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

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

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

Property, Plant and Equipment – Property, plant and equipment are stated at cost at date of acquisition or fair value at date of donation in the case of gifts. The value of assets constructed includes all material direct and indirect construction costs. Interest costs incurred during the period of construction are capitalized. Only assets having a cost or fair value of at least $5,000 and an estimated useful life of three years or more are capitalized. Assets under capital lease are stated at the present value of the minimum lease payments at the inception of the lease.

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

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

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

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

Notes and Bonds Payable – 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 noncurrent. 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.

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

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

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

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

Net Patient Service Revenue – Patient service revenue is recorded at established rates when services are provided with contractual adjustments, estimated bad debt expenses and services qualifying as charity care deducted to arrive at net patient service revenue. Contractual adjustments arise under reimbursement agreements with Medicare, Medicaid, certain insurance carriers, health maintenance organizations and preferred provider organizations, which provide for payments that are generally less than established billing rates. The difference between established rates and the estimated amount collectable is recognized as revenue deductions on an accrual basis.

CHARITY CARE 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 is also reimbursed on a cost-basis, receiving the federally reimbursed portion of costs of providing care to Medicaid patients not covered by fee-for-service reimbursement.

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

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

Medical School Trust Fund – Medical School Trust Fund (MSTF) expenses represent an assessment of 4.6 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.

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

Concentrations of Credit Risk – The UNC HCS provides services to a relatively compact area surrounding the Research Triangle Park, without collateral or other proof of ability to pay. Concentration of credit risk with respect to patient accounts receivable are limited due to large numbers of patients served and formalized agreements with third-party payors. Significant accounts receivable are dependent upon the performance of certain governmental programs, primarily Medicare and North Carolina Medicaid for their 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 – 20 percent, Managed care – 32 percent, Commercial – 13 percent, Medicaid – 15 percent, Self pay – 19 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 $47 million, Tricare/Champus in the amount of $3.1 million and Medicare in the amount of $0.7 million.

The amount shown as current liabilities represents estimated payables due to Medicaid in the amounts of $33.3 million and due to Medicare in the amount of $40.3 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:

	FY2009	FY2008
Land and Improvements	66,613,285	66,118,685
Buildings and Improvements	638,975,948	586,429,399
Equipment	626,479,968	583,187,773
Construction in Progress	154,888,632	136,987,372
Gross PP&E	1,486,957,833	1,372,723,229
Accumulated Depreciation	(682,873,333)	(614,510,086)
Net PP&E	$804,084,500	$758,213,143

NOTE 4 // LONG-TERM DEBT

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

	FY2009	FY2008
Chatham Series 2007 Bonds	$30,505,000	-
UNC P&A Series Bonds	5,999,200	7,249,000
Rex Series 1998 Bonds	80,420,000	86,160,000
UNCH Series 1999 Bonds	-	45,420,000
UNCH Series 2001 Bonds	101,000,000	102,400,000
UNCH Series 2003 Bonds	95,125,000	95,630,000
UNCH Series 2005 Bonds	21,735,000	24,775,000
UNCH Series 2009 Bonds	44,290,000	-
FACE VALUE OF BONDS OUTSTANDING	**379,074,200**	**361,634,000**
Deferred Costs - Discount on Issuance	(548,000)	(1,135,217)
Deferred Costs - Loss on Refunding	(15,561,371)	(14,906,237)
Deferred Costs - Premium on Issuance	2,344,657	1,093,497
Arbitrage Rebate Payable	268,892	268,892
NET VALUE OUTSTANDING	**365,578,378**	**346,954,935**
Current Portion of Bonds	15,364,800	13,849,800
Current Portion of Notes	18,720,683	17,260,492
TOTAL CURRENT BONDS AND NOTES	**34,085,483**	**31,110,292**
Noncurrent Portion of Bonds	350,213,578	333,105,135
Noncurrent Portion of Notes	17,629,558	23,964,820
Other Noncurrent Debt	546,000	809,000
TOTAL NONCURRENT BONDS AND NOTES	**$368,389,136**	**$357,878,955**

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

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

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2010	$15,364,800	$12,970,808	$28,335,608
2011	16,014,800	12,295,417	28,310,217
2012	16,714,800	11,608,992	28,323,792
2013	17,654,800	10,850,809	28,505,609
2014	16,700,000	10,123,440	26,823,440
2015-2019	85,340,000	38,893,572	124,233,572
2020-2024	80,705,000	23,819,170	104,524,170
2025-2029	80,640,000	11,176,389	91,816,389
2030-2034	49,940,000	2,999,483	52,939,483
TOTAL	**$379,074,200**	**$134,738,080**	**$513,812,280**

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

FISCAL YEAR	PRINCIPAL	INTEREST	TOTAL
2010	$18,720,683	$874,640	$19,595,323
2011	7,120,558	134,474	7,255,032
2012	8,133,000	122,000	8,255,000
2013	386,000	2,000	388,000
TOTAL	**$36,350,241**	**$1,133,114**	**$37,483,355**

NOTE 5 // PENSION PLANS

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

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

Rex sponsors a single-employer defined benefit retirement plan available to eligible employees. The benefit formula is based on the highest five consecutive years of an employee's compensation during the 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, UNCH and UNC P&A had advance deposits with the Fund totaling $18.3 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, 2009, and June 30, 2008. 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 UNC Hospitals, then the amount would be recorded at the time of receipt on UNCH's financial statements.

UNC Health Care System Enterprise Fund – The Board of Directors of 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, 2009, total assessments of $30.2 million were made, of which $24.6 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. Other allocations included $5 million to help offset future year assessments.

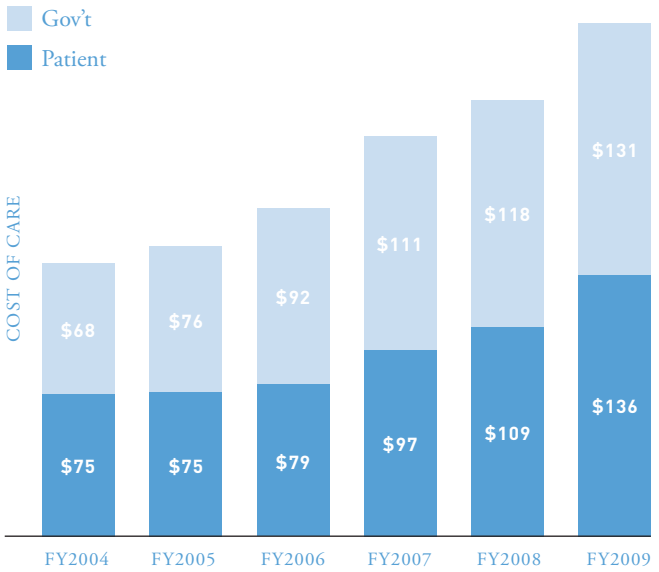
John Rex Endowment – The John Rex Endowment (Endowment) operates as a 501(c)(3) corporation and is independent of the Board of Directors of the UNC HCS. Its purpose is to advance the health and well-being of the residents of the greater Triangle area, with specific funds set aside for indigent care and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

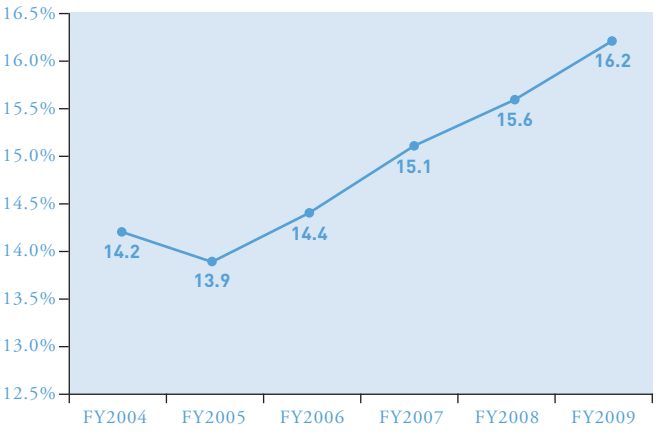
In addition to providing care without charge, or at amounts less than established rates to certain patients identified as qualifying for charity care, the UNC HCS also recognizes its responsibility to provide health care services and programs for the benefit of the community, at no cost or at reduced 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 – FY2009 ($ Millions)



Uncompensated Care as Percentage of Net Patient Revenue



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