University of California,
Davis Medical Center

Report on Audits of Financial Statements
For the Years Ended June 30, 2004 and 2003

University of California, Davis Medical Center
Report on Audits of Financial Statements

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying financial statements, as shown on pages 9 through 31, present fairly, in all material respects, the financial position of the University of California, Davis Medical Center (the "Medical Center"), a division of the University of California ("University"), at June 30, 2004 and 2003, and changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Medical Center are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the University that is attributable to the transactions of the Medical Center. They do not purport to, and do not, present fairly the financial position of the University as of June 30, 2004 and 2003, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

September 17, 2004

Introduction

This Management Discussion and Analysis of the University of California, Davis Medical Center's (the "Medical Center") financial performance should be read in conjunction with the financial statements, starting on page 9, and the notes to the financial statements, starting on page 13. This section provides explanatory detail and perspective on the Medical Center finances for the fiscal year ended June 30, 2004. The term "Health System" is used to define the total of the "Medical Center" and the UC Davis School of Medicine.

Overview of the Medical Center

The Medical Center has served as the principal clinical teaching site for the UC Davis School of Medicine since the school was founded in 1966. Initially an agreement was reached with Sacramento County to use the county hospital for clinical training, but in 1973 The Regents acquired the hospital outright and began operating it as the UC Davis Medical Center. The Medical Center is now licensed for 576 acute care beds, 23 operating rooms and a full complement of ancillary, support and ambulatory services in over 2.9 million gross square feet of facilities mostly sited on the 140-acre Sacramento campus.

The Medical Center serves as a tertiary care referral hospital for a 33-county 65,000-square-mile service area with a population of approximately six million. It provides a comprehensive range of inpatient and outpatient services for adults and children, including the only Level 1 Adult & Pediatric Trauma Center between San Francisco and Portland, and the only National Institutes of Health designated Cancer Center in the same area.

Services are provided at the hospital facilities of the Medical Center, at outpatient hospital-based clinics (both primary care and specialty) located on or near the Medical Center campus and at the UC Davis Primary Care Network (the "PCN"). The latter consists of 17 satellite clinics located in several communities in Northern California, including Auburn, Carmichael, Colusa, Davis, Elk Grove, Folsom, Rancho Cordova, Rocklin, Roseville, and Sacramento.

The Medical Center participates in a variety of cooperative outreach activities with health care providers in the service area. For example, joint ventures have been established with two community-based providers in Marysville and Merced to offer cancer services such as radiation oncology and medical oncology. In addition, the Medical Center operates a nationally recognized clinical telemedicine, distance education and rural affiliation program. Through a variety of agreements and by using advanced telecommunications technology, the Medical Center is connected to 15 rural healthcare systems and approximately 80 sites across the state.

Inpatient and outpatient medical services are provided by the UC Davis Medical Group, which has a clinical practice of approximately 650 faculty and contract physicians, 550 residents and fellows, and 100 PCN physicians.

(Dollars in thousands)

For the fiscal year ended June 30, 2004, 32,235 patients were admitted to the Medical Center, of which approximately 47% were admitted through the emergency room, and overall occupancy was approximately 79%. During the same period, there were over 886,000 outpatient visits, of which approximately 790,000 were visits to the Clinics and the PCN Sites and approximately 49,000 were emergency room visits.

Operating Statistics

The following table presents utilization statistics for the Medical Center for fiscal 2004, 2003 and 2002:

Statistics	2004	2003	2002
Admissions	32,235	31,340	30,765
Average daily census	415	416	407
Average length of stay	4.7	4.9	4.9
Case Mix Index	1.53	1.52	1.52
Patient days:			
Medicare (non-risk)	34,050	33,607	33,091
Medi-Cal (non-risk)	39,689	37,291	34,364
Commercial	168	120	748
County	14,106	14,469	15,216
Contracts (discount/per-diem)	41,343	42,356	39,638
Contracts (capitated) *	20,955	22,339	22,956
Non-sponsored/Self-pay	1,490	1,553	2,597
Total patient days	151,801	151,735	148,610
Outpatient visits:			
Hospital clinics	337,857	360,416	332,037
Primary care network	422,346	427,442	448,237
Home Health/Hosp	46,781	42,251	39,963
Emergency visits	49,341	53,710	55,132
PCN outreach	29,880	-	-
Total visits	886,205	883,819	875,369

* Includes Medicare (risk)
Medi-Cal (risk)

In 2004, Admissions increased by 895 or 2.9% over 2003. However, the average length of stay decreased from 4.9 to 4.7 due to increased efficiencies. Hospital clinic visits decreased by 6.3% but this decrease was shifted to PCN Outreach, a program developed in fiscal 2004. PCN visits decreased by 1.2% due to less physician staffing. Home Health visits increased by 10.7% based on program expansion. Emergency visits decreased by 8.1% in 2004 which was the trend from 2002. These changes in activity for visits in fiscal 2004 are consistent with the changes for 2003.

University of California, Davis Medical Center
Management's Discussion and Analysis
(Dollars in thousands)

Statements of Revenues, Expenses and Changes in Net Assets

Table of operating results for fiscal years 2004, 2003 and 2002:

	2004	2003	2002
Net patient service revenue	$783,260	$767,839	$679,449
Other operating revenue	14,678	14,226	15,858
Total operating revenue	797,938	782,065	695,307
Total operating expenses	752,648	726,855	648,748
Income from operations	45,290	55,210	46,559
Total nonoperating expenses	(12,282)	(11,946)	(11,238)
Income before other changes in net assets	$ 33,008	$ 43,264	$ 35,321
Margin	4.1%	5.5%	5.1%

Revenues:

Table of Net Patient Revenue by Funding Source for fiscal years 2004, 2003 and 2002:

Payor	2004	2003	2002
Medicare (non-risk)	$129,994	$147,934	$126,017
Medi-Cal (non-risk)	121,386	110,905	90,540
Commercial	1,877	2,510	5,015
County	32,746	29,081	23,870
Contracts (discount/per-diem)	381,644	365,374	329,822
Contracts (capitated) *	111,722	108,280	99,178
Non-sponsored/Self-pay	3,891	3,755	5,007
Total	$783,260	$767,839	$679,449

* Includes Medicare (risk)
Medi-Cal (risk)

Total Net Patient Revenue increased by $15.4 million or 2.0% from June 30, 2003 to June 30, 2004. This increase resulted from improved payor mix and new supplemental funding of $7.3 million from AB 915, the Public Hospital Outpatient Services Supplemental Reimbursement Program. In addition, at June 30, 2003, certain reserves were maintained based on management's estimates for reductions in reimbursement from the Medicare program. However, due to favorable developments in fiscal 2004, reserves in the amount of $4.6 million were released to income and are reflected in Net Patient Revenue. In 2003, total Net Patient Revenue increased by $88.4 million or 13.0% from 2002 which resulted from increased volume and improved contracts.

Operating Expenses and Non-Operating Losses:

During fiscal year 2004 total operating expenses of $752.6 million increased by $25.8 million or 3.5% over the prior year due primarily to rising labor costs and inflationary increases in pharmaceuticals and medical supplies. In 2003, total operating expenses of $726.9 million increased by $78.1 million or 12.0% due to the same factors.

Salary and employee benefit expense includes wages paid to hospital employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health and other employee benefits. Amounts paid for other contracted labor are included in purchased services. The total paid for salaries and employee benefits in fiscal year 2004 increased by $25.9 million or 6.8% over 2003, and fiscal year 2003 increased by $38 million or 11.1% over 2002, both due to wage increases and associated increases in employee benefit expense. Workers' compensation expense increased $2.5 million or 16.8% over 2003 due to increased premiums and increased employee staffing. However, this increase is a significant improvement over the $7.3 million or 98.1% increase from 2002 to 2003.

Payments for professional services decreased by $3.0 million or 4.8% over fiscal year 2003 due to changes in contractual obligations. The increasing trend from 2003 which was $17.5 million or 39.5% higher than 2002 was based on increases in services provided to UC Davis Health System capitated patients.

Medical supply expense for fiscal year 2004 increased by $9.9 million or 10.3% over the prior year. The cost of prosthetics and other implants increased by $3.3 million over the prior year while the cost of pharmaceuticals increased $4.0 million due to the impact of inflation and increased usage of high cost drugs. This same trend existed between 2003 and 2002.

Non-operating revenues and expenses, which include interest earned on invested cash, interest expense on debt, and losses from disposal or retirement of capital assets, increased by $0.3 million or 2.8% over fiscal year 2003. Interest expense decreased by $2.8 million or 14.2% from 2003 due to the 2003 bond refinancing. However, this savings was offset by a decrease in interest income of $2.0 million due to lower cash balances and yields. Losses from disposal of assets increased by $0.5 million.

University of California, Davis Medical Center
Management's Discussion and Analysis
(Dollars in thousands)

Statement of Net Assets

Table showing abbreviated statement of net assets at 6/30/04, 6/30/03 and 6/30/02:

	2004	2003	2002
Current assets:			
Cash	$162,815	$208,069	$197,791
Restricted assets, held by trustee	7,569	7,326	15,523
Patient accounts receivable (net)	113,834	113,667	96,416
Other current assets	37,224	23,695	20,003
Total current assets	321,442	352,757	329,733
Capital assets (net)	660,544	632,633	610,753
Other assets	10,729	10,673	10,001
Total assets	992,715	996,063	950,487
Current liabilities	113,979	140,023	132,670
Long-term debt	348,793	343,796	343,501
Total liabilities	462,772	483,819	476,171
Net assets:			
Invested in capital assets (net)	307,145	278,964	259,006
Restricted - expendable for debt service	7,569	7,326	15,523
Unrestricted	215,229	225,954	199,787
Total net assets	$529,943	$512,244	$474,316

Total current assets decreased by $31.3 million from June 30, 2003 to June 30, 2004. Cash decreased by $45.3 million while other current assets increased by $14 million. Cash decreased primarily due to the increase in capital expenditures and the pay down of third party settlements. Total current assets for 2003 increased by $23.0 million over 2002 mainly due to a $17.3 million increase in patient accounts receivable.

Net capital assets increased by $27.9 million from June 30, 2003 to June 30, 2004 due to planned expenditures for projects and equipment. The increase was $21.9 million from 2002 to 2003 and was in line with long range capital planning.

Current liabilities decreased by $26.0 million from June 30, 2003 to June 30, 2004 primarily due to third party settlements. An increase of $7.4 million occurred between 2002 and 2003 due to the timing of accrued payroll.

Long-term debt increased by $5.0 million from June 30, 2003 to June 30, 2004 due to favorable escrow restructuring of deferred financing costs on the 2003 Revenue Refunding Bonds.

(Dollars in thousands)

Net assets increased by $17.7 million from June 30, 2003 to June 30, 2004. This increase reflects $33.0 million from income before other changes in net assets, $2.0 million from transfers for capital by the University, less $17.3 million of Health System capital and operational support for the research and the teaching mission of the Health System.

Liquidity and Capital Resources

The following table shows key liquidity and capital ratios for fiscal years 2004, 2003 and 2002:

	2004	2003	2002
Days of revenue in accounts receivable	54	58	52
Debt service coverage	3.9	4.3	3.8
Days cash on hand	90	114	118

Days of revenue in accounts receivable decreased from 58 at June 30, 2003 to 54 on June 30, 2004. The decrease is the result of increased cash collections. Days were slightly lower at 52 as of June 30, 2002.

Debt service coverage decreased from 4.3 at June 30, 2003 to 3.9 at June 30, 2004 due to the $10.3 million decrease in income before other changes in net assets. At June 30, 2002, debt service coverage was 3.8.

Days cash on hand decreased from 114 at June 30, 2003 to 90 at June 30, 2004. This decrease in days is detailed in the accompanying Statement of Cash Flows on page 11.

Regulatory Activity

The Health Insurance Portability and Accountability Act of 1996 (HIPAA)

This Act mandates that new privacy regulations became effective April 2003, new electronic transactions/code sets requirements effective October 2003, and security regulations effective April 2005. Costs of compliance with these new regulations including improvements to information technology, procedures to maintain tighter security over patient records, risk assessment and surveillance, and education for physicians, residents and hospital staff, approximated $0.2 million for the fiscal year ended June 30, 2004. Projected ongoing annual costs to comply with HIPAA approximate $0.3 million.

The Hospital Facilities Seismic Safety Act (SB 1953)

During 2004, the UC Davis Medical Center's capital program continued to address the requirements in the Hospital Facilities Seismic Safety Act. The projected cost for the UC Davis Medical Center, which will be compliant with the requirements by January 1, 2008, is $117 million. The capital cost of compliance will be financed through the use of State lease revenue bond funds, Medical Center reserves and gift funds. In 2004 $8.5 million was spent.

Regulatory Risk
Entities doing business with governmental payors, including Medicare and Medicaid (Medi-Cal in California), are subject to risks unique to the government-contracting environment that are hard to anticipate and quantify. Revenues are subject to adjustment as a result of examination by government agencies or contractors. The audit process and the resolution of significant related matters (including disputes based on differing interpretations of the regulations) often are not finalized until several years after the services were rendered.

Medicaid Reform
There are efforts at both the federal and state levels of government to reform the Medicaid (Medi-Cal in California) program. Areas that are being proposed are to narrow the scope of allowable hospital costs, policies requiring the exclusion of costs relating to furnishing hospital services to undocumented patients, move patients classified as Aged, Blind and Disabled (ABD) into Medi-Cal managed care, and to replace intergovernmental transfer programs with a Certified Public Expenditure program. Such reform efforts could be disruptive to services provided to low-income families and have an unfavorable financial impact on hospitals, which treat a large number of Medi-Cal and low-income patients.

Cautionary Note Regarding Forward-Looking Statements

Certain information provided by the Medical Center, including written as outlined above or oral statements made by its representatives, may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, which address activities, events or developments that the Medical Center expects or anticipates will or may occur in the future contain forward-looking information.

In reviewing such information it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information. This forward-looking information is based upon various factors and was derived using various assumptions. The Medical Center does not undertake to update forward-looking information contained in this report or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.

University of California, Davis Medical Center
Statements of Net Assets
June 30, 2004 and 2003
(Dollars in thousands)

	2004	2003
Assets		
Current assets:		
Cash	$162,815	$208,069
Restricted assets, held by trustee	7,569	7,326
Patient accounts receivable, net of estimated uncollectibles of $27,209 and $29,653, respectively	113,834	113,667
Other receivables, net of estimated uncollectibles of $2,773 and $2,764, respectively	22,384	15,141
Inventory	6,871	4,572
Prepaid expenses and other assets	7,969	3,982
Total current assets	321,442	352,757
Capital assets, net	660,544	632,633
Investments in joint ventures	10,729	10,673
Total assets	992,715	996,063
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	21,494	19,303
Accrued salaries and benefits	42,383	49,509
Third-party payor settlements	19,859	36,548
Current portion of long-term debt and capital leases	9,503	5,886
Other liabilities	20,740	28,777
Total current liabilities	113,979	140,023
Long-term debt and capital leases, net of current portion	348,793	343,796
Total liabilities	462,772	483,819
Net Assets		
Invested in capital assets, net of related debt	307,145	278,964
Restricted:		
Expendable:		
Debt service	7,569	7,326
Unrestricted	215,229	225,954
Total net assets	$529,943	$512,244

The accompanying notes are an integral part of these financial statements.

University of California, Davis Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2004 and 2003
(Dollars in thousands)

	2004	2003
Net patient service revenue	$783,260	$767,839
Other operating revenue:		
Clinical teaching support	8,430	7,262
Other	6,248	6,964
Total other operating revenue	14,678	14,226
Total operating revenue	797,938	782,065
Operating expenses:		
Salaries and employee benefits	408,694	382,837
Professional services	58,854	61,828
Medical supplies	106,298	96,374
Other supplies and purchased services	64,739	72,940
Depreciation and amortization	47,331	47,947
Provision for doubtful accounts	58,062	58,118
Insurance	5,794	5,555
Other	2,876	1,256
Total operating expenses	752,648	726,855
Income from operations	45,290	55,210
Nonoperating revenue (expenses):		
Interest income	5,676	7,724
Interest expense	(16,987)	(19,809)
Loss on disposal of capital assets	(1,428)	(902)
Other	457	1,041
Total nonoperating expenses	(12,282)	(11,946)
Income before other changes in net assets	33,008	43,264
Other changes in net assets:		
State capital appropriations	-	8,462
Contributions from University for building program	-	9,145
Health system support	(17,320)	(23,834)
Transfers from University	2,011	891
Total other changes in net assets	(15,309)	(5,336)
Increase in net assets	17,699	37,928
Net assets - beginning of year	512,244	474,316
Net assets – end of year	$529,943	$512,244

The accompanying notes are an integral part of these financial statements.

University of California, Davis Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2004 and 2003
(Dollars in thousands)

	2004	2003
Cash flows from operating activities:		
Receipts from patients and third-party payors	$701,099	$ 678,499
Payments to employees	(337,528)	(300,268)
Payments to suppliers	(244,899)	(224,960)
Payments for benefits	(81,898)	(75,730)
Other receipts	12,490	12,230
Net cash provided by operating activities	49,264	89,771
Cash flows from noncapital financing activities:		
Health system support	(17,320)	(23,834)
Transfers from University	2,011	891
Net cash used in noncapital financing activities	(15,309)	(22,943)
Cash flows from capital and related financing activities:		
State capital appropriations	-	8,462
Proceeds from contributions from University for building program	-	9,145
Proceeds from sale of capital assets	10	21
Purchases of capital assets	(77,626)	(70,750)
Principal paid on long-term debt and capital leases	(8,068)	(6,090)
Proceeds from financing loan	8,082	-
Proceeds from 2003 Refunding Hospital Revenue Bonds	-	347,775
Defeasance of 1996 Hospital Revenue Bonds	-	(300,720)
Proceeds from 2003 General Revenue Bonds	(15,252)	-
Refinance of 1989 Multiple Purpose Project Bonds	15,820	-
Amortization of (deferral of) financing costs and cost of issuance - 2003 bonds	9,168	(41,717)
Interest paid on long-term debt and capital leases	(16,987)	(19,809)
Net cash used in capital and related financing activities	(84,853)	(73,683)
Cash flows from investing activities:		
Interest income received	5,676	7,724
Distributions from investments in joint ventures, net	206	224
Change in restricted cash, held by trustee	(243)	8,197
Other non-operating income	5	988
Net cash provided by investing activities	5,644	17,133
Net increase (decrease) in cash	(45,254)	10,278
Cash - beginning of year	208,069	197,791
Cash - end of year	$162,815	$208,069

The accompanying notes are an integral part of these financial statements.

University of California, Davis Medical Center
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2004 and 2003
(Dollars in thousands)

	2004	2003
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 45,290	$ 55,210
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	47,331	47,947
Provision for doubtful accounts	58,062	58,118
Changes in operating assets and liabilities:		
Patient accounts receivable	(58,229)	(75,369)
Other receivables	(7,243)	(3,863)
Inventory	(2,299)	(600)
Prepaid expenses and other assets	(3,987)	771
Accounts payable and accrued expenses	2,191	3,610
Accrued salaries and benefits	(7,126)	10,398
Third-party payor settlements	(16,689)	(10,108)
Other liabilities	(8,037)	3,657
Net cash provided by operating activities	$ 49,264	$ 89,771
Supplemental noncash activities information:		
Investment income from joint ventures	$ 457	$ 896
Loss on disposal of capital assets	$ (1,428)	$ (902)

The accompanying notes are an integral part of these financial statements.

1. Organization

The University of California, Davis Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"), an independent board composed of 26 members. The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority being delegated to the Medical Center Director by the Chancellor of the Davis campus. The Medical Center has 576 licensed beds.

2. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of the Medical Center have been prepared in accordance with accounting principles generally accepted in the United States of America, including all applicable statements of the Governmental Accounting Standards Board ("GASB"), and all statements of the Financial Accounting Standards Board through November 30, 1989. The proprietary fund method of accounting is followed and uses the economic resources measurement focus and the accrual basis of accounting. In addition, these statements follow generally accepted accounting principles applicable to the health care industry, which are included in the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Organizations* to the extent that these principles do not contradict GASB.

Cash

All University operating entities invest surplus cash balances in a short-term investment pool ("STIP") managed by the Treasurer of The Regents. The Regents is responsible for managing the University's investments and establishing investment policy, which is carried out by the Treasurer of The Regents.

All Medical Center deposits into the STIP are considered demand deposits. Unrealized gains and losses associated with the fluctuation in the fair value of the investments included in the STIP (and predominately held to maturity) are not recorded by each operating entity but are absorbed by the University, as the manager of the pool.

The Medical Center's cash at June 30, 2004 and 2003 was $162,815 and $208,069, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation.

Interest income is reported as non-operating revenue in the statements of revenues, expenses and changes in net assets.

2. Summary of Significant Accounting Policies (Continued)

Cash (continued)

Additional information on cash and investments can be obtained from the 2003-2004 annual report of the University.

Restricted Assets, Held by Trustee

Indenture requirements of bond financing (see Note 8, "Long-term Debt") provide for the establishment and maintenance of various accounts with a trustee. The indenture terms require that the trustee control the expenditure of bond proceeds as well as the payment of principal and interest to the bondholders. Assets held by trustee consist of short-term investments, recorded at cost, which approximates fair value.

Inventory

The Medical Center's inventory consists primarily of pharmaceuticals and medical supplies which is stated on a first-in, first-out basis at the lower of cost or market.

Prepaid Expenses and Other Assets

The Medical Center's prepaid expenses and other assets are primarily prepayments for pharmaceuticals and medical supplies, rent, equipment and maintenance contracts.

Capital Assets

The Medical Center's capital assets are reported at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. Equipment under capital lease is amortized over the shorter period of the lease term or the estimated useful life of the equipment. Lease amortization is included in depreciation and amortization expense. The range of the estimated useful lives for buildings and land improvements is 5 to 40 years and for equipment is 3 to 20 years. Interest on borrowings to finance facilities is capitalized during construction. University guidelines mandate that land purchased with Medical Center funds be recorded as an asset of the Medical Center. Land utilized by the Medical Center but purchased with other sources of funds is recorded as an asset of the University. Incremental cost, including salaries and employee benefits, directly related to the acquisition, development and installation of major software projects are included in the cost of the capital assets.

2. Summary of Significant Accounting Policies (Continued)

Net Assets

Net assets are required to be classified for accounting and reporting purposes in the following categories:

- Invested in capital assets, net of related debt – Capital assets, net of accumulated depreciation, reduced by outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- Restricted – The Medical Center classifies net assets resulting from transactions with purpose restrictions as restricted net assets until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.
    - Nonexpendable – Net assets subject to externally imposed restrictions that must be retained in perpetuity by the Medical Center.
    - Expendable – Net assets whose use by the Medical Center is subject to externally imposed restrictions that can be fulfilled by actions of the Medical Center pursuant to those restrictions or that expire by the passage of time.
- Unrestricted – Net assets that are neither restricted nor invested in capital assets, net of related debt. Unrestricted net assets may be designated for specific purposes by management or The Regents. Substantially all unrestricted net assets are allocated for operating initiatives or programs, or for capital programs.

Revenues

Revenues received in conducting the programs and services of the Medical Center are presented in the financial statements as operating revenue.

Operating revenue includes net patient service revenue reported at the estimated net realizable amounts from patients, third-party payors including Medicare and Medi-Cal, and others for services rendered, including estimated retroactive audit adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period the related services are rendered and adjusted in future periods as final settlements are determined. Laws and regulations governing the Medicare and Medi-Cal programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates will change by a material amount in the near term.

2. Summary of Significant Accounting Policies (Continued)

Revenues (continued)

Non-operating revenue and expense includes interest income and expense, and the gain or loss on the disposal of capital assets.

State capital appropriations, health system support and other transactions with the University are classified as other changes in net assets.

Operating Expenses

Substantially all of the Medical Center's operating expenses are directly or indirectly related to patient care activities.

Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as net patient service revenue. The Medical Center also provides services to other indigent patients under Medi-Cal and other publicly sponsored programs, which reimburse at amounts less than the cost of the services provided to the recipients. The difference between the cost of services provided to these indigent persons and the expected reimbursement is included in the estimated cost of charity care.

Transactions with the University and University Affiliates

The Medical Center has various transactions with the University and University affiliates. The University, as the primary reporting entity, has at its discretion the ability to transfer funds from the Medical Center at will (subject to certain restrictive covenants or bond indentures) and use those funds at its discretion. The Medical Center records expense transactions where direct and incremental economic benefits are received by the Medical Center. Those payments which constitute subsidies or payments for which the Medical Center does not receive direct and incremental economic benefit, are recorded as health system support in the statements of revenues, expenses and changes in net assets.

Certain expenses are allocated from the University to the Medical Center. Allocated expenses reported as operating expenses in the statements of revenues, expenses, and changes in net assets are management's best estimates of the Medical Center's arms-length payment of such amounts for its market specific circumstances. To the extent that payments to the University exceed an arms-length estimated amount relative to the benefit received by the Medical Center, they are recorded as health system support.

2. Summary of Significant Accounting Policies (Continued)

Compensated Absences

The Medical Center accrues annual leave for employees at rates based upon length of service and job classification and compensatory time based upon job classification and hours worked.

Tax Exemption

The Regents of the University of California is a California public corporation and is a tax-exempt organization under the provisions of the Internal Revenue Code.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual amounts could differ from those estimates.

New Accounting Pronouncements

The GASB has issued Statement No. 39, *Determining Whether Certain Organizations are Component Units*, effective for years beginning July 1, 2003. Statement No. 39 had no effect on the Medical Center's financial statements.

The GASB has also issued Statement No. 40, *Deposit and Investment Risk Disclosures,* effective for the fiscal year beginning July 1, 2004. Statement No. 40 establishes additional disclosure requirements addressing common risks of investments. The Statement will have no effect on the Medical Center's net assets or changes in net assets.

In November 2003, the GASB issued Statement No. 42, *Accounting and Reporting for Impairment of Capital Assets and for Insurance Recoveries*, effective for the fiscal year beginning July 1, 2005. Statement No. 42 requires an evaluation of prominent events or changes in circumstances to determine whether an impairment loss should be recorded and that any insurance recoveries be netted with the impairment loss. The Medical Center is currently evaluating the effect that Statement No. 42 will have on its financial statements.

2. Summary of Significant Accounting Policies (Continued)

New Accounting Pronouncements (continued)

In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the fiscal year beginning July 1, 2007. Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefit (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. The Medical Center is currently evaluating the effect, if any, that Statement No. 45 will have on its financial statements.

3. Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments at amounts different from the Medical Center's established rates. A summary of the payment arrangements with major third-party payors follows:

- ***Medicare*** – Medicare patient revenues include traditional reimbursement under Title XVIII of the Social Security Act (non-risk) or Medicare capitated contract revenue (risk).

  Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. The Medical Center does not believe that there are significant credit risks associated with this government agency.

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 1999.

3. Net Patient Service Revenue (Continued)

- ***Medi-Cal*** – Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed under a contract at a prospectively determined negotiated per-diem rate. Outpatient services are reimbursed based upon prospectively determined fee schedules. Medi-Cal patient revenues include traditional reimbursement under the California State Department of Health Services for patients covered under Title XIX of the Social Security Act (non-risk) or Medi-Cal capitated contract revenue (risk).

- ***Senate Bill 855 and 1255 Funds*** – State of California Senate Bills 855 (SB-855) and 1255 (SB-1255) provide supplemental payments to hospitals that provide a disproportionate share of their services to Medi-Cal and low income patients. For the years ended June 30, 2004 and 2003, the Medical Center received additional revenue of $14,999 and $16,021 under SB-855, and $21,000 and $15,953 under SB-1255, respectively.

- ***Senate Bill 1732*** – State of California Senate Bill 1732 (SB-1732) provides for supplemental Medi-Cal reimbursement to disproportionate share hospitals for costs (i.e., principal and interest) of qualified patient care capital construction. For the years ended June 30, 2004 and 2003, the Medical Center applied for and received $7,210 and $4,023 respectively. The amounts received are related to the reimbursement of costs for certain debt financed construction projects based on the Medical Center's Medi-Cal utilization rate. The funds received are recorded as an increase in net patient service revenue.

- ***Medical Education Fund*** – The Medical Education Fund provides for a supplemental payment in recognition of both direct and indirect medical education costs associated with inpatient health care services rendered to Medi-Cal beneficiaries. For the years ended June 30, 2004 and 2003, the Medical Center received additional revenue of $5,827 and $10,293, respectively.

- ***Assembly Bill 915*** – State of California Assembly Bill 915 (AB 915), *Public Hospital Outpatient Services Supplemental Reimbursement Program*, provides for supplemental reimbursement equal to the federal share of unreimbursed facility costs incurred by public hospital outpatient departments. This supplemental payment, which was approved for implementation on September 12, 2003, covers only Medi-Cal fee-for-service outpatient services, beginning July 1, 2002. The supplemental payment is based on each eligible hospital's certified public expenditures (CPE), which are matched with federal Medicaid funds. The $7,280 recorded by the Medical Center in the year ended June 30, 2004 was for two years of patient services rendered, i.e., from July 1, 2002 through June 30, 2004.

3. Net Patient Service Revenue (Continued)

- ***Other*** – The Medical Center has entered into agreements with numerous non-government third-party payors to provide patient care to beneficiaries under a variety of payment arrangements. These include arrangements with:

    - Commercial insurance companies reimburse the Medical Center for reasonable and customary charges. Workers' compensation plans pay negotiated rates and are reported as contract (discounted or per-diem).

    - Managed care contracts such as those with HMO's and PPO's, which reimburse the Medical Center at contracted or per-diem rates, which are usually less than full charges.

    - Capitated contracts with health plans, which reimburse the Medical Center on a per-member-per-month basis, whether or not services are actually rendered. The Medical Center takes on a certain amount of financial risk as the contract requires them to treat a patient for all covered services. Expected losses on capitated agreements are accrued when probable and can be reasonably estimated.

    - Certain health plans established a shared-risk pool through which the Medical Center shares in any surplus of budget over actual health care utilization costs as defined in the related contracts. Additionally, the Medical Center bears risk of health care utilization cost above budgeted cost, as determined in the related agreements. Differences between the final contract settlement and the amount estimated as receivable or payable relating to the shared-risk arrangements are recorded in the year of final settlement.

    - Counties in the State of California, which reimburse the Medical Center for certain indigent patients covered under county contracts.

The most common payment for inpatient services is a prospectively determined per-diem rate. The most common payment arrangement for outpatient care is a prospective payment system that uses ambulatory payment classifications.

Amounts due from Medicare and Medi-Cal represent 33% and 34% of net patient accounts receivable at June 30, 2004 and 2003, respectively.

For the years ended June 30, 2004 and 2003, net patient service revenue included $2,013 and $3,499, respectively, due to favorable cost report settlements with Medicare, Medi-Cal and the County Medical Services Program. In addition, in fiscal 2004, reserves in the amount of $4.6 million were released to income and are reflected in Net Patient Revenue.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

Net patient service revenue by major payor for the years ended June 30 is as follows:

	2004	2003
Medicare (Non-Risk)	$129,994	$147,934
Medicare (Risk)	18,298	21,121
Medi-Cal (Non-Risk)	121,386	110,905
Medi-Cal (Risk)	17,281	17,261
Commercial Insurance	1,877	2,510
Contract (Discounted or Per-Diem)	381,644	365,374
Contract (Capitated)	76,143	69,898
County	32,746	29,081
Non-sponsored/self-pay	3,891	3,755
Total	$783,260	$767,839

4. Charity Care

Information related to the Medical Center's charity care for the years ended June 30 is as follows (unaudited):

	2004	2003
Charity care at established rates	$29,959	$29,462
Estimated cost of charity care	7,597	7,741

Estimated cost in excess of reimbursement for Medi-Cal and county services was $129,167 and $139,155 for the years ended June 30, 2004 and 2003, respectively (unaudited).

5. Restricted Assets, Held by Trustee

The composition of restricted assets at June 30 is as follows:

	2004	2003
Short-term investments	$7,569	$7,326

(Dollars in thousands)

6. Capital Assets

The Medical Center's capital asset activity for the years ended June 30 is as follows:

	2002	Additions	Disposals	2003	Additions	Disposals	2004
Original Cost							
Land	$ 29,356	$ -	$ -	$ 29,356	$ 250	$ -	$ 29,606
Buildings and improvements	624,667	29,170	-	653,837	10,807	(6,277)	658,367
Equipment	217,361	29,772	(11,182)	235,951	40,195	(17,235)	258,911
Construction in progress	28,401	11,808	-	40,209	26,374	-	66,583
Capital assets, at cost	899,785	70,750	(11,182)	959,353	77,626	(23,512)	1,013,467
	2002	**Depreciation**	**Disposals**	**2003**	**Depreciation**	**Disposals**	**2004**
Accumulated Depreciation and Amortization							
Buildings and improvements	151,762	22,567	-	174,329	23,390	(5,586)	192,133
Equipment	137,270	25,380	(10,259)	152,391	23,941	(15,542)	160,790
Accumulated depreciation and amortization	289,032	$47,947	($10,259)	326,720	$47,331	($21,128)	352,923
Capital assets, net	$610,753			$632,633			$ 660,544

There was no equipment under capital lease obligations at June 30, 2004.

The University has acquired certain facilities and equipment under capital leases with the State of California Public Works Board. These facilities and equipment were contributed at cost by the University to the Medical Center to support the operations of the Medical Center. Principal and interest payments required under the leases are the obligations of the University and are not reflected in the financial statements of the Medical Center.

During 2004 and 2003, the University has been making seismic improvements in order to be in compliance with Senate Bill 1953, the Hospital Seismic Safety Act. A portion of the improvements are financed under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $0 during 2004 and $9,145 during 2003 are shown as Contributions from University for building program on the Statement of Revenues, Expenses and Changes in Net Assets.

7. Investments in Joint Ventures

The Medical Center has entered into joint venture arrangements with various third party entities which include home health services, cancer center operations and a health maintenance organization. Investments in these joint ventures are recorded using the equity method.

(Dollars in thousands)

8. Long-term Debt and Capital Leases

The Medical Center’s outstanding debt at June 30 is as follows:

	Outstanding Debt	
	2004	**2003**
The Regents of the University of California Hospital Revenue Bonds (University of California, Davis Medical Center, Series 1996), interest rates of 10% payable semi-annually, with annual principal payments through 2006	$ 21,050	$ 26,830
The Regents of the University of California Refunding Hospital Revenue Bonds (University of California, Davis Medical Center, Series 2003) Series A-E, variable rate bonds payable semi-annually, with annual principal payments through 2026 (outstanding debt - $346,025 and $347,775 less unamortized cost of financing of $31,706 and $40,874 in 2004 and 2003, respectively), net	314,319	306,901
The Regents of the University of California Revenue Bonds (1989 Multiple Purpose Project Bonds), interest rates from 6.6% to 6.8%, payable semi-annually, with annual principal payments through 2023	-	15,820
The Regents of the University of California General Revenue Bonds 2003, interest rates from 2.0% to 5.25%, payable semi-annually, with annual principal payments through 2023	14,886	-
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 5.7% to 6.1%, payable through 2003, collateralized by underlying equipment	-	131
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.7% to 3.2%, payable through 2009, collateralized by underlying equipment	8,041	-
Total debt and capital leases	358,296	349,682
Less: Current portion of debt and capital leases	(9,503)	(5,886)
Noncurrent portion of debt and capital leases	$348,793	$343,796

(Dollars in thousands)

8. Long-term Debt and Capital Leases (Continued)

The activity with respect to current and noncurrent debt for the years ended June 30 is as follows:

	Revenue Bonds	Other Debt Obligations	Total
Year Ended June 30, 2004			
Current portion at June 30, 2003	$ 5,755	$ 131	$ 5,886
Reclassification from noncurrent	7,973	1,571	9,544
Principal payments	(7,896)	(172)	(8,068)
Change in cost of financing	2,141	-	2,141
Current portion at June 30, 2004	$ 7,973	$1,530	$ 9,503
Noncurrent portion at June 30, 2003	$343,796	$ -	$343,796
New obligations	15,252	8,082	23,334
Refinanced 1989 Multiple Purpose Project bonds	(15,820)	-	(15,820)
Reclassification to current	(7,973)	(1,571)	(9,544)
Change in cost of financing	7,027	-	7,027
Noncurrent portion at June 30, 2004	$342,282	$6,511	$348,793
Year Ended June 30, 2003			
Current portion at June 30, 2002	$ 5,700	$ 390	$ 6,090
Reclassification from noncurrent	5,755	131	5,886
Principal payments	(5,700)	(390)	(6,090)
Current portion at June 30, 2003	$ 5,755	$ 131	$ 5,886
Noncurrent portion at June 30, 2002	$343,370	$ 131	$343,501
New obligations (total - $347,775 less $40,874, unamortized cost of financing)	306,901	-	306,901
Defeased 1996 revenue bonds	(300,720)	-	(300,720)
Reclassification to current	(5,755)	(131)	(5,886)
Noncurrent portion at June 30, 2003	$343,796	$ -	$343,796

In September 2003, the University issued General Revenue Bonds, collateralized solely by general revenues of the University, to refinance a substantial portion of the outstanding 1989 Multiple Purpose Project bonds. Certain Medical Center projects were financed with the 1989 Multiple Purpose Project bonds. As a result, Medical Center projects with outstanding debt totaling $15,820 were also refinanced. The Medical Center is charged for its proportionate share of total principal and interest payments made on the General Revenue Bonds pertaining to Medical Center projects.

8. Long-term Debt and Capital Leases (Continued)

In March 2003, Refunding Hospital Revenue Bonds totaling $347.8 million with a variable interest rate were issued to advance refund and defease $300.7 million of outstanding UC Davis Medical Center Revenue Bonds. The Medical Center also entered into interest rate swap agreements in connection with the UC Davis Medical Center Refunding Hospital Revenue Bonds with the intention that the variable interest rate it pays on the bonds will approximate the variable payments it receives from the interest rate swaps, resulting in a fixed interest of 3.1%. Proceeds were used to pay for issuance costs and to purchase $341.0 million of U.S. government securities sufficient to fund retirement of the specified obligations. The defeasance resulted in deferred financing costs of $35.3 million, included as an offset to the current and noncurrent portion of long-term debt, as appropriate, in the University's statement of net assets, and is being amortized as interest expense over the remaining life of the defeased bonds. Aggregate debt service payments were reduced by $55.3 million over the next 23 years and the University was able to obtain an economic gain of $41.9 million, based on the assumption that the variable rate bond payments will be offset by the variable receipts under the interest rate swaps.

Interest Rate Swap Agreements

As a means to lower the University's borrowing costs, when compared against fixed-rate bonds at the time of issuance in March 2003, the University entered into interest rate swaps with three financial institutions in connection with its variable-rate Refunding Hospital Revenue Bonds (Series A–E). The intention of the swap transaction was to effectively change the variable interest rate on the bonds to a fixed rate of 3.1385%.

The bonds and the related swap agreement mature on September 1, 2026, and the aggregate notional amount of swaps matches the outstanding amounts on the bonds throughout the entire term of the bonds. Under the swaps, the Medical Center pays the swap counterparties a fixed payment of 3.1385% and receives a variable payment computed as 67% of 30 day London Interbank Offered Rate (LIBOR). The Medical Center believes that over time the variable interest rates it pays on the bonds will approximate the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment on the swaps as the net payment obligation for the transaction.

Because interest rates have increased since execution of the swaps, the swaps have an estimated positive fair value of $12.4 million as of June 30, 2004. The fair value is an indication of the difference in value of the swap fixed interest payments due on the swap and swap fixed rate payments due on a swap with identical terms executed on June 30, 2004. The fair value of the interest rate swap is the estimated amount the University would have received if the swap agreement was terminated on June 30, 2004. The fair value was estimated by the financial institutions using quoted market prices when available or a forecast of expected discounted future net cash flows.

(Dollars in thousands)

8. Long-term Debt and Capital Leases (Continued)

Interest Rate Swap Agreements (continued)

The swap exposes the Medical Center to basis risk whenever the interest rates on the bonds are reset. The interest rate on the bonds is a tax-exempt interest rate, while the basis of the variable receipt on the interest rate swaps is taxable (67% of 30 day LIBOR). Tax exempt interest rates can change without a corresponding change in the 30 day LIBOR rate due to factors affecting the tax exempt market which do not have a similar effect on the taxable market. For example, the swap exposes the Medical Center to risk if reductions in the federal personal income tax cause the relationship between the variable interest rate on the bonds to be greater than 67% of 30 day LIBOR.

Although the Medical Center has the interest rate swaps with creditworthy financial institutions, there is exposure to losses in the event of non-performance by counterparties or unfavorable interest rate movements. The swap may be terminated if the insurer's credit quality rating falls below "A –" as issued by Fitch Ratings or Standard & Poor's, thereby canceling the synthetic interest rate and returning the interest rate payments to the variable interest rates on the bonds. At termination, the University may also owe a termination payment if the fair value of the swaps is negative for the Medical Center.

Interest payments on the bonds are reset each 28 days for Series A, weekly for Series B–D, and daily for Series E. As rates vary, variable-rate bond interest payments and net swap payments will vary. Although not a prediction by the Medical Center of the future interest rate bonds or the impact of the interest rate swaps, using rates as of June 30, 2004, debt service requirements of the variable-rate debt and net swap payments are as follows:

	Variable-Rate Bond			
	Principal	**Interest**	**Interest Rate Swap, Net**	**Total**
Fiscal Year Ending June 30				
2005	$ 3,150	$ 3,464	$ 7,625	$ 14,239
2006	3,275	3,431	7,553	14,259
2007	3,375	3,397	7,479	14,251
2008	11,950	3,291	7,245	22,486
2009	12,375	3,167	6,972	22,514
2010-2014	68,525	13,818	30,421	112,764
2015-2019	81,175	10,009	22,036	113,220
2020-2024	96,175	5,497	12,102	113,774
2025-2027	66,025	792	1,743	68,560
Total	$346,025	$46,866	$103,176	$496,067

Additional information on the General Revenue Bonds can be obtained from the 2003-2004 annual report of the University.

(Dollars in thousands)

8. Long-term Debt and Capital Leases (Continued)

Future debt service payments for each of the five fiscal years subsequent to June 30, 2004 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Other Debt	Total Payments	Principal	Interest
2005	$ 23,605	$1,737	$ 25,342	$ 11,567	$ 13,775
2006	23,593	1,737	25,330	12,385	12,945
2007	23,550	1,737	25,287	13,249	12,038
2008	23,706	1,737	25,443	14,195	11,248
2009	23,733	1,688	25,421	14,642	10,779
2010 – 2014	118,858	-	118,858	71,971	46,887
2015 – 2019	119,304	-	119,304	85,504	33,800
2020 – 2024	118,625	-	118,625	100,465	18,160
2025 – 2027	68,558	-	68,558	66,024	2,534
Total future debt service	543,532	8,636	552,168	$390,002	$162,166
Less: Interest component of future payments	(161,571)	(595)	(162,166)		
Principal portion of future payments	381,961	8,041	390,002		
Adjusted by: Unamortized cost of financing	(31,706)	-	(31,706)		
Total Debt	$350,255	$8,041	$358,296		

In July 1996, Hospital Revenue Bonds Series 1996 totaling $345,880 were issued to finance the acquisition and construction of certain health care and related facilities at the Medical Center, including a new hospital tower, an ambulatory care clinic, a central plant, inpatient radiology, and a parking structure. The Bonds have sinking fund requirements and optional redemption provisions. In addition, under the bond indentures, the Medical Center is required to maintain a debt service coverage ratio of 1.2 to 1 and has limitations as to additional borrowings and the purchase or sale of business assets. The Hospital Revenue Bonds are collateralized by the gross revenues of the Medical Center.

(Dollars in thousands)

8. Long-term Debt and Capital Leases (Continued)

In March 2003, Refunding Hospital Revenue Bonds associated with the Medical Center totaling $347.8 million with a variable interest rate were issued to advance refund and defease $300.7 million of outstanding Hospital Revenue Bonds Series 1996. The Bonds have sinking fund requirements and optional redemption provisions. In addition, under the bond indentures, the Medical Center is required to maintain a debt service coverage ratio of 1.1 to 1.0 and has limitations as to additional borrowings and the purchase or sale of business assets. The Refunding Hospital Revenue Bonds are collateralized by the gross revenues of the Medical Center.

9. Operating Leases

The Medical Center leases certain facilities under operating leases with terms of 1 to 15 years. Total rental expense on operating leases for the years ended June 30, 2004 and 2003 was $8,628 and $8,338, respectively. As of June 30, 2004, amounts payable under noncancelable operating leases are as follows:

Year Ending June 30,	
2005	$ 8,464
2006	7,716
2007	6,934
2008	5,854
2009	4,561
2010 – 2013	6,529
Total	$40,058

10. Retirement Plans

The University maintains retirement plans, which are administered by the University of California Retirement System. The plans consist of The University of California Retirement Plan (“UCRP”), a single employer defined benefit plan, and two defined contribution plans with several investment portfolios funded with employee non-elective and elective contributions (collectively the “Plans”). Substantially all full-time employees of the Medical Center participate in the Plans.

10. Retirement Plans (Continued)

The UCRP is a defined benefit plan funded with University and employee contributions, and provides lifetime retirement income, disability protection, and survivor benefits to eligible employees. Benefits are based on average highest three years compensation, age, and years of service and are subject to limited cost-of-living increases. The University's policy is to fund actuarially determined contributions.

The actuarial value of UCRP assets and the actuarial accrued liability as of June 30, 2004 were $41.3 billion and $35.0 billion, respectively. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $39.2 billion at June 30, 2004. For the years ended June 30, 2004 and 2003, there was no employer contribution, annual pension cost or net pension obligation for the University. The annual pension cost was equal to the actuarially determined contributions.

The two defined contribution plans (DC Plan and 403(b) Plan) provide savings incentives and additional retirement security for all eligible employees. The DC Plan accepts both pre-tax and after-tax contributions. There are no employer contributions to either of these two plans. Benefits from the DC and 403(b) Plans are based on participants' mandatory and voluntary contributions, plus earnings, and are immediately vested.

Information as to contributions made, Plan assets and liabilities, as they relate to Medical Center employees, is not readily available. Additional information on the Plans can be obtained from the 2003-2004 annual report of the University.

11. University Self-Insurance

The Medical Center is insured through the University's malpractice, general liability, workers' compensation, and health and welfare self-insurance programs. All operating departments of the University are charged premiums to finance the workers' compensation and health and welfare programs. The University's medical centers are charged premiums to finance the malpractice insurance. All claims and related expenses are paid from the University's self-insurance funds. Such risks are subject to various per claim and aggregate limits, with excess liability coverage provided by an independent insurer. The Medical Center is contingently liable for the obligations under these self-insurance programs.

The Medical Center paid $23,057 and $20,274 for the years ended June 30, 2004 and 2003. These amounts are included in salaries and employee benefits, and insurance on the statement of revenues, expenses and changes in net assets.

(Dollars in thousands)

12. Transactions with Other University Entities

Services purchased from the University include repairs and maintenance, administrative and treasury services, and insurance. Services provided to the University include physician office rentals, building maintenance, billing services, and cafeteria services. Such amounts are netted and included in the statements of revenues, expenses and changes in net assets for the years ended June 30 as follows:

	2004	2003
Salaries and employee benefits	$17,291	$14,809
Professional services	30,711	28,508
Other supplies and purchased services	3,924	4,135
Interest income	(5,676)	(7,724)
Insurance	5,794	5,555
Total	$52,044	$45,283

Additionally, the Medical Center makes payments to the University of California, Davis School of Medicine ("School of Medicine"). Services purchased from the School of Medicine include physician services that benefit the Medical Center, such as emergency room coverage, physicians providing medical direction to the Medical Center, and the Medical Center's allocation of malpractice insurance. Such expenses are reported as operating expenses in the statements of revenue, expenses and changes in net assets. Health system support includes amounts paid by the Medical Center to fund School of Medicine operating activities, payments to support clinical research, transfers to faculty practice plans, as well as other payments made to support various School of Medicine programs.

The total net amount of payments made by the Medical Center to the School of Medicine were $52,048 and $62,678 in 2004 and 2003, respectively. Of these amounts, $34,728 and $38,844 are reported as operating expenses for the years ended June 30, 2004 and 2003, respectively, and $17,320 and $23,834 are reported as health system support for the years ended June 30, 2004 and 2003, respectively.

13. State Funds for Capital Acquisitions

The 2000 State Budget Act provided $50 million in state capital appropriations for non-seismic capital improvement (i.e., infrastructure) projects at the University's medical centers. The Medical Center was allocated $5 million of the $50 million state capital appropriation. During fiscal years 2004 and 2003, the Medical Center expended $0 and $5,000 of these funds and accounted for them as a state capital appropriation in the statements of revenues, expenses and changes in net assets.

13. State Funds for Capital Acquisitions (Continued)

During fiscal year 2001, $25 million was appropriated to the University's medical centers by the State of California under the 2000-2001 Operating Budget, for the purchase of equipment. Under the provisions of the appropriation, the funds are not to supplant other funds that would otherwise have been used for the purchase of equipment during the current year. Each of the medical centers was allocated $5 million by the University to fund these expenditures. During fiscal years 2004 and 2003, the Medical Center expended $0 and $3,462, respectively, of its total allocation and placed liens against the remainder. The Medical Center accounted for the expended funds as a state capital appropriation in the statements of revenues, expenses and changes in net assets.

14. Commitments and Contingencies

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. Compliance with these laws and regulations is subject to periodic government review, interpretation and audits, as well as regulatory actions unknown and unasserted at this time.

The University is contingently liable in connection with certain claims and contracts, including those currently in litigation, arising out of the normal course of its activities.

Management and General Counsel are of the opinion that the outcome of such matters will not have a material effect on the financial statements.

California Senate Bill 1953, Hospital Facilities Seismic Safety Act, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. By January 1, 2008, all general acute care inpatient buildings must be life safe. By January 1, 2030, all general acute care inpatient buildings must be operational after an earthquake. The State of California's 2000-01 budget authorizes the University to use $600 million in lease-revenue bond funds for earthquake safety renovations. In November 2000, The Regents approved the allocation of the $600 million among the University's medical centers, of which $120 million was allocated to the Medical Center. During fiscal year 2004, the Medical Center expended $0 of its allocation and in fiscal year 2003, $9,145 was expended. As of June 30, 2004, any repayment the Medical Center maybe obligated for under these financing arrangements are still being determined.