University of California, Irvine Medical Center

Report on Audits of Financial Statements
For the Years Ended June 30, 2006 and 2005

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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 14 through 33 present fairly, in all material respects, the financial position of the University of California, Irvine Medical Center (the “Medical Center”), a division of the University of California (“University”), at June 30, 2006 and 2005, 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, 2006 and 2005, 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 13 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 22, 2006

Introduction

The objective of the Management's Discussion and Analysis is to help readers better understand the University of California, Irvine Medical Center's financial position and operating activities for the years ended June 30, 2006, with selected comparative information for the years ended June 30, 2005 and 2004. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes to the financial statements. Unless otherwise indicated, years (2004, 2005, 2006, 2007, etc.) in this discussion refer to the fiscal years ended June 30.

Overview

The University of California, Irvine Medical Center (the "Medical Center") serves as the principal clinical teaching site for the University of California, Irvine School of Medicine. In 1976, Orange County agreed to give the formerly known as Orange County Hospital to the University of California, now called, University of California, Irvine Medical Center. It is the county's only academic medical center encompassing hospital-based and ambulatory patient care services, teaching, and clinical research.

The Medical Center is licensed to provide acute care hospital services in Orange, California, and is licensed to operate 453 beds. The Medical Center serves as a major tertiary referral center for Orange County and is also the county's only Level I Trauma Center and Regional Burn Center. Currently, construction of a new, state-of-the-art hospital building is under way starting in February 2005 and is expected to be completed in early 2009. The complete new hospital will have 191 private rooms and 13 surgical suites in the new main hospital building, in addition to the existing 102 beds in the medical center's tower and the 84-bed Neuropsychiatric center.

Outpatient services are provided by the Medical Center, which has a clinical practice group of over 550 faculty physicians, primarily at the main campus Pavilion buildings, Chao Cancer Center, Gottschalk Medical Plaza on the Irvine Campus, and Family Health Centers at Anaheim, Santa Ana, and Westminster clinics. The two Family Health Centers in Santa Ana and Anaheim are the only designated Federally Qualified Health Centers in Orange County.

These sites enable the Medical Center to provide a full scope of high quality patient care services and attract the volume and diversity of patients required to support the education and research programs of the School of Medicine. Together, these sites provide increased patient volumes, expanded market share, better serve the community, attract favorable payor mix, and generate a stable financial environment.

The Medical Center continues to be selected as one of the best hospitals in the United States by U.S. News & World Report for the sixth consecutive year. The Medical Center ranks among the best in the following specialties: gynecology, urology, cancer, and digestive disorders.

During 2006, the Medical Center remained financially sound with an increased cash position and profitable operations.

For the year ended June 30, 2006, the Medical Center reported net income of $64.4 million and generated a margin of 13.5 percent. During 2006, the Medical Center improved patient census, managed labor costs during a period of labor shortages, and increased its cash position to $117.4 million from $100.7 million in 2005.

These significant events and the impact of each on the Medical Center's operating results are summarized below.

- *Termination of full-risk managed care contracts*
  As of December 31, 2005, two full-risk capitated contracts: CalOptima and Healthy Family plans were terminated. The CalOptima plan was converted to an at-risk sub contract for the Aged, Blind and Disabled (ABD) membership with Garden Grove Hospital. Capitation membership declined from 22,052 members in June 2005 to 3,293 members in June 2006.

- *Increase in labor costs*
  The nation-wide nursing shortage had a significant impact on both the salary costs of hospital-employed nurses as well as the rates charged for nurses employed from nurse registry agencies. Overall, labor costs for hospital-paid employees increased by 7.5 percent over 2005.

  The passing of the State Assembly 394, effective January 1, 2004 established a higher registered nurse to patient ratios for all of the Medical Center nursing units. The Medical Center has increased approximately 53 registered nurses to be in compliance with this legislation.

- *New Executive Management Team*
  The Chief Executive Officer position of the Medical Center was filled on an interim basis by Maureen Zehntner starting November 2005.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2006, 2005 and 2004:

Statistics	2006	2005	2004
Discharges	17,179	17,529	17,821
Average length of stay	6.0	6.1	5.9
Patient Days:			
Medicare (non-risk)	27,524	26,611	23,948
Medi-Cal (non-risk)	32,081	32,902	32,220
CalOptima	4,769	7,444	9,061
Commercial insurance	865	1,262	1,677
Contracts (discount/per diem)	25,904	25,505	24,419
Contract (capitated)	–	–	818
County/Uninsured	12,761	13,025	12,710
Total Patient Days	103,904	106,749	104,853
Ambulatory/emergency room visits	557,847	595,662	594,751

Discharges and patient days (excluding newborns) decreased by 2.0 percent and 2.7 percent respectively in 2006 due to the termination of the full-risk capitated contract with CalOptima on December 31, 2005.

Total ambulatory and emergency visits decreased by 37,815, or 6.3 percent, over the prior year, primarily in clinic visits.

Statements of Revenues, Expenses and Changes in Net Assets

The following table summarizes the operating results for the Medical Center for fiscal years 2006, 2005 and 2004 (dollars in thousands):

	2006	2005	2004
Net patient service revenue	$ 455,140	$ 433,446	$ 374,473
Other operating revenue	22,114	21,353	20,914
Total operating revenue	477,254	454,799	395,387
Total operating expenses	415,932	391,068	353,151
Income from operations	61,322	63,731	42,236
Total non-operating revenue (expenses)	3,092	126	(100)
Income before other changes in net assets	$ 64,414	$ 63,857	$ 42,136
Margin	13.5 percent	14.0 percent	10.7 percent
Other changes in net assets	18,524	20,058	(16,485)
Net assets – beginning of year	272,025	188,110	162,459
Net assets – end of year	$ 354,963	$ 272,025	$ 188,110

Revenues

Total operating revenues for the year ended June 30, 2006 were $477.3 million, an increase of $22.5 million or 4.9 percent, over 2005. Operating revenues for 2005 were $454.8 million, an increase of $59.4 million, or 15.0 percent, over 2004.

Net patient service revenue for 2006 increased by $21.7 million, or 5.0 percent, over the prior year. Net patient service revenue in 2005 increased by $59 million, or 15.8 percent, over 2004. The increase in 2006 was due to changes in a more favorable patient mix, improvements in charge capture, and increased Medi-Cal supplemental funding. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medi-Cal, the County of Orange, and other third-party payors which have been estimated based on the principles of reimbursements and terms of the contracts currently in effect.

Other operating revenue consists primarily of State Clinical Teaching Support funds and other non-patient services such as referral lab, cafeteria and parking operations. The increase in other operating revenue was due primarily to the increase in various non-patient revenues.

The following table summarizes net patient service revenue for 2006, 2005 and 2004 (dollars in thousands):

Payor	2006	2005	2004
Medicare (non-risk)	$ 106,619	$ 97,920	$ 66,678
Medi-Cal (non-risk)	132,757	136,836	108,895
CalOptima	13,905	22,220	33,215
Commercial Insurance	21,770	25,687	33,518
Contracts (discount/per diem)	151,245	130,397	118,009
Contracts (capitated)	–	–	2,662
County/Uninsured	34,621	26,823	19,230
Total	$ 460,917	$ 439,883	$ 382,207

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Managed Medicare payments are paid on a per-diem or per discharge basis. The Medical Center also receives additional payments from Medicare for direct or indirect medical education.

Net revenue for Medicare patients including managed care patients, increased by $8.7 million from 2005 due primarily to increase in Medicare reimbursement rate and a slight increase in patient volumes in 2006.

Payments for Medi-Cal patients are made on a per-diem basis for inpatient services and paid based on a fixed-fee schedule for outpatient services. Managed Medi-Cal patients are paid on a per-diem basis. Net revenue for Medi-Cal also includes supplemental funding in recognition of the Medical Center's indigent care and teaching activities.

Net Medi-Cal revenue decreased by $4.1 million over 2005 due to the decrease in overall patient days. For the years ended June 30, 2006, the Medical Center recorded additional revenue of $82.4 million from the Medi-Cal hospital waiver DSH payments and under Senate Bill 1100. In addition, the Medical Center recognized $1.8 million of retrospective payments under Senate Bill 855 for prior years.

CalOptima net patient revenue decreased by $8.3 million in 2006 due to the termination of the full risk capitated CalOptima contract.

Net revenue for contracts increased by $20.8 million from 2005 due to the Medical Center's continued efforts in contract negotiations and improved pricing strategies.

County/Uninsured patient service revenues includes payments from the County of Orange under the Medical Center's contract to provide emergency medical services to the county's indigent population and emergency and non-emergency medical services to County public health patients. Net revenue for County/Uninsured patient services increased from the prior year by $7.8 million, or 29.0 percent. This category fluctuates from year to year depending on the volume and type of patients.

Operating Expenses
During 2006, total operating expenses of $415.9 million increased by $24.9 million or 6.4 percent over the prior year due to several factors – but primarily to an increase in labor costs, inflationary increases in medical supplies, and increase in facility costs. Total operating expenses for 2005 increased by $37.9 million or 10.7 percent over 2004 also due to increases in similar areas.

Salary and employee benefit expenses includes wages paid to hospital employees, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health and other employee benefits. Amounts paid for nurse registry and other contract labor are included in other expenses. The total paid for salaries and employee benefits in 2006 increased by $16 million or 7.5 percent over the prior year due to union negotiated and inflationary increases in wages and in related employee benefits. Salary and employee benefit costs for 2005 increased by $20.4 million or 10.5 percent over 2004.

Payments for professional services, decreased slightly by $11.9 thousand, or 0.8 percent, over 2005 due to decrease in contracted medical director expenses. In 2005, professional services increased by $184 thousand, or 13.2 percent, over 2004.

Medical supply expense for 2006 increased by $5.2 million, or 8.2 percent, over the prior year due to a combination of inflationary increases, higher drug costs, and increase in patient activity. Furthermore, medical supply expense increased by $8.8 million or 16.2 percent in 2005 over 2004 due to similar increases in patient utilization and inflation.

Other supplies and purchased services expenses include nursing registry, residents, and the cost of medical and non-medical purchased services. The overall other expenses increased by $2.8 million or 3.0 percent over 2005 due primarily to a $2.6 million increase in facility costs.

Depreciation and amortization expense increased by $522 thousand over the prior year due to increased capital expenditures. In 2005, depreciation and amortization decreased by $188 thousand, or 1.2 percent, from the prior year due to increased disposal of capital assets.

Insurance expense of $1.9 million was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $254 thousand, or 15.8 percent, over the prior year.

Non-Operating Revenue (Expenses)
Non-operating gains, which include interest earned on invested cash balances, interest expense on debt, and losses from disposal or retirement of capital assets, increased by almost $3.0 million over 2005 due to a $2.1 million increase in STIP interest income and the overall decrease in interest expenses. Non-operating gains increased by $0.2 million in 2005 over 2004, due to a similar increase in STIP income.

Income (Loss) Before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $64.4 million in 2006 as compared to $63.9 million in 2005 and $42.1 million in 2004. The Medical Center's net income increased $557 thousand in 2006 over the prior year due to increased patient revenue and interest income.

Other Changes in Net Assets
The lower section of the Statement of Revenues, Expenses and Changes in Net Assets shows the other changes to net assets in addition to the income or loss. Net assets are the difference between the total assets and total liabilities. The other changes in net assets represent additional funds the Medical Center receives and cash outflow for support and transfers to other university entities.

Included in the other changes in net assets are the following:

- Health system support represents transfers primarily to the School of Medicine for academic and clinical support including the Primary Care Network. The Medical Center transferred $33 million this year.

- Transfers from the University included $46.4 million from the state and federal appropriations and $5.0 million from donated assets.

In total, the net assets increased for the year by $82.9 million to $355 million. The majority of this increase is the result of the excess of revenues over expenses of $64.4 million, the receipt of state capital appropriations for infrastructure projects of $46.4 million, the receipt from gift funds of $5.0 million, and the health system support of $33.0 million transferred out to the University.

Statement of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2006, 2005 and 2004 (dollars in thousands):

	2006	2005	2004
Current assets:			
Cash	$ 117,378	$ 100,700	$ 48,184
Patient accounts receivable, net	61,541	59,661	46,672
Other current assets	28,407	17,269	23,023
Total current asset	207,326	177,630	117,879
Capital assets	237,446	180,814	142,450
Total assets	444,772	358,444	260,329
Current liabilities	75,205	66,709	53,334
Long-term debt	14,604	19,710	18,885
Total liabilities	89,809	86,419	72,219
Net assets:			
Invested in capital assets, net	215,626	153,456	116,204
Unrestricted	139,337	118,569	71,906
Total net assets	$ 354,963	$ 272,025	$ 188,110

Total current assets increased by $29.7 million, or 16.7 percent, compared to the prior year due to the increase in cash and cash equivalents. Total assets at June 30, 2006 were $86.3 million higher than the previous year.

Cash increased by $16.7 million or 16.6 percent in 2006 due primarily to an increase in patient accounts receivable collections and increased net income of the Medical Center.

Net patient accounts receivable, net of estimated uncollectibles, increased by 3.2 percent from the prior year due to the increase in net patient service revenue. The methodology deployed in calculating the allowance for doubtful accounts is based on historical collection experience and current economic factors.

Other current assets, which include non-patient receivables, inventory, prepaid expenses and advances, increased by $11.1 million in 2006. The increase was primarily due to the $8.7 million payments due under the Medi-Cal hospital waiver and outpatient payments under Assembly Bill 915.

Capital assets increased by $56.6 million from the prior year primarily due to the construction of the new replacement hospital.

Current liabilities increased by $8.5 million from the prior year mainly in the following areas: a $2.0 million increase in accounts payable and accrued expenses due to increases in capital and operating expenditures and a $6.2 million increase in third party payor settlements due to pending open cost report settlements.

Long-term debt includes the 2003 Multiple Purpose Project Bonds and long-term capital leases. The long-term debt liability decreased by $5.1 million from the prior year as principal repayments exceeded new debts.

Net assets increased by $82.9 million in 2006. The change in net assets includes income before other changes in net assets of $64.4 million and contributed capital assets of $51.6 million reduced by the transfer of $33.0 million of funds to the School of Medicine as health system support.

Liquidity and Capital Resources

During 2006, the Medical Center generated $73.0 million from operating activities.

Cash flows from non-capital financing activities show the Medical Center's cash was reduced by $33.0 million for transfers to the University for health system support.

Included in cash flows from capital and related financing activities are transfers from the University of $51.0 million, proceeds from long-term borrowings of $2.0 million and purchases of capital assets of $72.0 million. Principal payments on long-term debt and capital leases were $8.0 million and interest paid was about $1.0 million.

Cash flows from investment activities show that $4.0 million was provided by interest income. Overall, cash flow increased to $117.4 million from $100.7 million in 2005.

The following table shows key capital and liquidity ratios for 2006, 2005 and 2004:

	2006	2005	2004
Days cash on hand	106.5	97.5	52
Days in accounts receivable	63.2	57	53
Debt service coverage (times)	9.3	8.8	6.8

Days cash on hand increased to 106.5 days in 2006 from 97.5 days in 2005. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash. The goal set by the University of California Office of the President is 60 days.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The Medical Center's ratio for 2006 is 9.3 versus 8.8 in 2005. The increase in debt service coverage ratio was due to the decrease in long-term debt and the related principal and interest repayments in 2006. This ratio is higher than the 1.2 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act (SB 1953)
During 2006, the UC Irvine Medical Center's capital program continued to address the requirements in the State of California Senate Bill 1953 (SB 1953). The projected cost for the Medical Center, which will be compliant with the requirements by January 1, 2008, is $357.5 million. The capital cost of compliance will be financed through the use of state lease revenue bond funds, Hospital Reserves, gift funds and debt. In 2006, $9.8 million was spent from hospital reserve and gift funds.

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 difficult 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
In 2006, California implemented a new Medicaid fee-for-service (FFS) inpatient hospital payment system. The new payment system is the result of a new federal Medicaid hospital financing waiver that will govern Medicaid FFS inpatient hospital payments for the next five years. In September 2005, the state legislature enacted State of California Senate Bill 1100 (SB 1100) to implement the new waiver. SB 1100 is designed to protect baseline Medicaid funding for the University's medical centers over the next five years – at a minimum hospitals will receive the Medicaid inpatient hospital payments they received in 2005 adjusted for future utilization changes. SB 1100 also allows the University's medical centers to receive additional waiver growth funding subject to the availability of funds. Payments to the University's medical centers under SB 1100 include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share (DSH) payments and Safety Net Care Pool (SNCP) payments. The SNCP is a new federal allotment available under the waiver. The combination of these payments effectively replace the prior year Medi-Cal inpatient per diem payments, Medi-Cal DSH payments, Medi-Cal SB 1255 supplemental payments, and the Medi-Cal Medical Education supplemental payments. Although the new federal inpatient hospital financing waiver and SB 1100 are designed to ensure a predictable funding Medicaid supplemental payment funding level and provide growth funding, the full financial impact of these changes cannot be fully assessed at this time.

Children's Hospital Bond Act of 2004

California voters passed Proposition 61 that enables the state of California to issue $750 million in General Obligation bonds to fund capital improvement projects for children's hospitals. Each of the University medical centers is eligible for $30 million of grant funding from this pool of funds. Grant funds must be used for capital projects associated with the care of children and must be used prior to June 30, 2014.

University of California Retirement Plan

The University of California Retirement Plan ("UCRP") costs are funded by a combination of investment earnings, employee member and employer contributions. Since 1990, the Medical Center's contribution rate to the UCRP has been zero. In addition, since 1990, most of the required employee member contributions to the UCRP are being redirected to the separate defined contribution plan maintained by the University.

In 2006, the Regents updated the funding policy for UCRP to provide for a targeted funding level of 100 percent over the long term, and for University and UCRP member contributions at rates necessary to maintain that level within a range of 95 percent to 110 percent. The University will implement a multi-year contribution strategy under which shared employer and employee contribution rates will increase gradually over time to 16 percent of covered compensation, based upon UCRP's current normal cost. The Regents have authorized the initial resumption of shared employer and employee contributions beginning July 1, 2007, gradually increasing over future years towards the normal costs, subject to funding and completion of the budget process.

Pooled Financing for the University's Academic Medical Centers

The Regents of the University of California have authorized University management to establish an Academic Medical Center Pooled Revenue Bond Indenture (AMC Indenture) that will allow the operating revenues of the five University medical centers, including the UC Irvine Medical Center, to be pooled and pledged for debt repayment, regardless of which medical center uses the proceeds of the financing. Currently, the operating revenues of each medical center are pledged for the financing of their specific capital projects.

Under generally accepted accounting principles, each medical center will include on its statement of net assets only the debt specifically used by each medical center. The contingent liability for each medical center associated with the pooling of its operating revenues under the AMC Indenture will be disclosed in the financial statements.

The University anticipates beginning the implementation of the AMC Indenture during fiscal 2006-07.

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, Irvine Medical Center
Statements of Net Assets
June 30, 2006 and 2005
(Dollars in thousands)

	2006	2005
Assets		
Current assets:		
Cash	$ 117,378	$ 100,700
Patient accounts receivable, net of estimated uncollectibles of $2,929 and $5,004, respectively	61,541	59,661
Other receivables	11,523	3,117
Inventory	10,851	10,081
Prepaid expenses and other assets	6,033	4,071
Total current assets	207,326	177,630
Capital assets, net	237,446	180,814
Total assets	444,772	358,444
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	20,685	18,671
Accrued salaries and benefits	23,751	22,931
Third-party payor settlements	23,514	17,331
Current portion of long-term debt and capital leases	7,216	7,648
Other liabilities	39	128
Total current liabilities	75,205	66,709
Long-term debt and capital leases, net of current portion	14,604	19,710
Total liabilities	89,809	86,419
Net Assets		
Invested in capital assets, net of related debt	215,626	153,456
Unrestricted	139,337	118,569
Total net assets	$ 354,963	$ 272,025

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

University of California, Irvine Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2006 and 2005
(Dollars in thousands)

	2006	2005
Net patient service revenue, net of provision for doubtful accounts of $5,777 and $6,437, respectively	$ 455,140	$ 433,446
Other operating revenue:		
Clinical teaching support	8,195	8,023
Other	13,919	13,330
Total other operating revenue	22,114	21,353
Total operating revenue	477,254	454,799
Operating expenses:		
Salaries and employee benefits	231,402	215,324
Professional services	1,567	1,579
Medical supplies	68,099	62,916
Other supplies and purchased services	97,275	94,438
Depreciation and amortization	15,724	15,201
Insurance	1,865	1,610
Total operating expenses	415,932	391,068
Income from operations	61,322	63,731
Nonoperating revenue (expenses):		
Interest income	4,201	2,054
Interest expense	(971)	(1,700)
Loss on disposal of capital assets	(138)	(228)
Total nonoperating revenues (expenses)	3,092	126
Income before other changes in net assets	64,414	63,857
Other changes in net assets:		
Health system support	(32,994)	(24,633)
Transfers from University, net	51,518	44,691
Total other changes in net assets	18,524	20,058
Increase in net assets	82,938	83,915
Net assets – beginning of year	272,025	188,110
Net assets – end of year	$ 354,963	$ 272,025

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

University of California, Irvine Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2006 and 2005
(Dollars in thousands)

	2006	2005
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 459,443	$ 425,519
Payments to employees	(183,501)	(165,365)
Payments to suppliers	(167,660)	(157,350)
Payments for benefits	(47,080)	(44,204)
Other receipts	11,754	26,185
Net cash provided by operating activities	72,956	84,785
Cash flows from noncapital financing activities:		
Health system support	(32,994)	(24,633)
Transfers (to) from University	157	(272)
Net cash used by noncapital financing activities	(32,837)	(24,905)
Cash flows from capital and related financing activities:		
Transfers from University	51,361	44,963
Proceeds from long-term borrowings	2,286	9,038
Proceeds from sale of capital assets	4	4
Purchases of capital assets	(72,497)	(53,797)
Principal paid on long-term debt and capital leases	(7,825)	(7,926)
Interest paid on long-term debt and capital leases	(971)	(1,700)
Net cash used by capital and related financing activities	(27,642)	(9,418)
Cash flows from investing activities:		
Interest income received	4,201	2,054
Net cash provided by investing activities	4,201	2,054
Net increase in cash	16,678	52,516
Cash – beginning of year	100,700	48,184
Cash – end of year	$ 117,378	$ 100,700

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

University of California, Irvine Medical Center
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2006 and 2005
(Dollars in thousands)

	2006	2005
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 61,322	$ 63,731
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	15,724	15,201
Provision for doubtful accounts	5,777	6,437
Changes in operating assets and liabilities:		
Patient accounts receivable	(7,657)	(19,426)
Other receivables	(8,406)	6,363
Inventory	(770)	(663)
Prepaid expenses and other assets	(1,962)	54
Accounts payable and accrued expenses	2,014	2,192
Accrued salaries and benefits	820	5,755
Third-party payor settlements	6,183	5,062
Other liabilities	(89)	79
Net cash provided by operating activities	$ 72,956	$ 84,785
Supplemental noncash activities information:		
Gifts of capital assets	$ 7,668	$ 3,399
Transfer of capital assets to the University	$ (33)	$ 141

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

1. Organization

The University of California, Irvine 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 Irvine campus. The Medical Center has 453 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.

GASB Statement No. 47, *Accounting for Termination Benefits*, was adopted during the year ended June 30, 2006. Statement No. 47 requires benefits such as early retirement incentives or severance to employees who are involuntarily terminated to be recognized in the period the Medical Center becomes obligated to provide the benefits. Benefits provided to employees who voluntarily terminate must be recognized when the termination offer is accepted. The effect of the implementation of GASB Statement No. 47 was not significant to the Medical Center's net assets or changes in net assets for the year ended June 30, 2006.

Cash

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

2. Summary of Significant Accounting Policies (Continued)

Cash (Continued)

Substantially all of the Medical Center's cash is deposited into the STIP. 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, 2006 and 2005 was $117,378 and $100,700, 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.

Additional information on cash and investments can be obtained from the 2006 annual report of the University.

Inventory

The Medical Center's inventory consists primarily of pharmaceuticals and medical supplies which are 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 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 leases 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 10 to 40 years and for equipment is 5 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 costs 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 asset.

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 and Expenses

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.

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

2. Summary of Significant Accounting Policies (Continued)

Revenues and Expenses (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.

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 publicly sponsored programs, which may 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 cash from the Medical Center at will (subject to certain restrictive covenants or bond indentures) and use that cash at its discretion. The Medical Center records expense transactions where direct and incremental economic benefits are received by the Medical Center. 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.

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 qualified as a tax-exempt organization under the provisions of Section 501(c)(3)of the Internal Revenue Code and is exempt form federal and state income taxes on related income.

2. Summary of Significant Accounting Policies (Continued)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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. Although management believes these estimates and assumptions are reasonable, they are based upon information available at the time of the estimate or judgment is made and actual amounts could differ from those estimates.

Comparative Information

Certain revisions in classification have been made in the June 30, 2005 financial statements. The provision for doubtful accounts is now recorded as an offset to net patient service revenue rather than an operating expense. The effect on the 2005 presentation was to reduce both operating revenue and operating expense by $6,437.

While the effect on prior period financial statements was not material, management elected to make the revisions to the 2005 presentation to conform with the 2006 presentation. The revisions in classifications to the Medical Center's 2005 financial statements had no effect on previously reported total assets, liabilities and net assets, or increase or decrease in net assets, or net increase or decrease in cash.

New Accounting Pronouncements

In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the Medical Center's 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).

  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 is 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, 2002.

- ***Medi-Cal*** – The federal Medicaid program is referred to as Medi-Cal in California. Effective July 1, 2005 Medi-Cal fee-for-service (FFS) inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 (SB 1100). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 is designed to protect baseline Medi-Cal funding for the Medical Center over the next five years – at a minimum the Medical Center will receive the Medi-Cal inpatient hospital payments they received in 2004-05 adjusted for future utilization changes. SB 1100 also allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share (DSH) payments, and Safety Net Care Pool (SNCP). The SNCP is a new federal allotment available under the waiver. For the year ended June 30, 2006, the Medical Center recorded total Medi-Cal revenue of $84,273, including $1,843 associated with prior years.

3. Net Patient Service Revenue (Continued)

The combination of the payments described above replaced the prior year Medi-Cal inpatient per diem payments, Medi-Cal DSH payments, Medi-Cal SB 1255 supplemental payments and the Medi-Cal Medical Education supplemental payments. For the year ended June 30, 2005, the Medical Center recorded total Medi-Cal revenue of $70,640, including $7,874 associated with prior years.

- ***CalOPTIMA*** – Orange County's HMO-model County Organized Health System for Medi-Cal Patients ("CalOPTIMA") became operational on October 1, 1995. Under the CalOPTIMA program reimbursement for a majority of the Medi-Cal patients in Orange County converted from fee-for-service (per-diem payments from the state) to a capitated system (set monthly payments per enrollee from CalOPTIMA). Historically, the Medical Center has been a major provider of care to Medi-Cal patients in Orange County. Under CalOPTIMA, there are a number of provider plans from which Medi-Cal beneficiaries may select. Each beneficiary has selected, or will select a primary care physician and related health plan, thus expanding the choice for Medi-Cal patients. The CalOptima capitated contract was terminated effective December 31, 2005.

  The Medical Center entered into a CalOptima sub-contract with Garden Grove Hospital for the Aged, Blind and Disabled (ABD) membership beginning January 1, 2006.

- ***Assembly Bill 915*** – State of California Assembly Bill ("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 covers only Medi-Cal fee-for-service outpatient services. The supplemental payment is based on each eligible hospital's certified public expenditures ("CPE"), which are matched with federal Medicaid funds. For the years ended June 30, 2006 and 2005, the Medical Center recorded revenue of $2,133 and $2,079, respectively.

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

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

  - Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

The most common payment arrangement 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 36.4 percent and 26.6 percent of net patient accounts receivable for fiscal years at June 30, 2006 and 2005, respectively.

For the years ended June 30, 2006 and 2005, net patient service revenue included favorable cost report settlements of $3,104 and $6,059, respectively, from Medicare, Medi-Cal and CalOPTIMA Programs.

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

	2006	2005
Medicare (non-risk)	$ 106,619	$ 97,920
Medi-Cal (non-risk)	132,757	136,836
CalOptima	13,905	22,220
Commercial Insurance	21,770	25,687
Contracts (discount/per diem)	151,245	130,397
County	10,543	8,841
Non-sponsored (uninsured)	24,078	17,982
Total	$ 460,917	$ 439,883

4. Charity Care

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

	2006	2005
Charity care at established rates	$ 115,985	$ 103,692
Estimated cost of charity care	$ 26,757	$ 25,186

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $16,803 and $19,892 for the years ended June 30, 2006 and 2005, respectively.

(Dollars in thousands)

5. Capital Assets

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

	2004	Additions	Disposals	2005	Additions	Disposals	2006
Original Cost							
Land	$ 3,398	$ 3,996	–	$ 7,394	–	–	$ 7,394
Buildings and improvements	184,194	5,893	$ (4,325)	185,762	$ 6,660	–	192,422
Equipment	94,715	10,309	(2,642)	102,382	7,727	$ (7,614)	102,495
Construction in progress	34,372	33,736	–	68,108	58,166	–	126,274
Capital assets, at cost	$ 316,679	$ 53,934	$ (6,967)	$ 363,646	$ 72,553	$ (7,614)	$ 428,585

	2004	Depreciation	Disposals	2005	Depreciation	Disposals	2006
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 117,794	$ 6,136	$ (4,289)	$ 119,641	$ 6,493	–	$ 126,134
Equipment	56,435	9,206	(2,450)	63,191	9,285	(7,471)	65,005
Accumulated depreciation and amortization	$ 174,229	$ 15,342	$ (6,739)	$ 182,832	$ 15,778	$ (7,471)	$ 191,139
Capital assets, net	$ 142,450			$ 180,814			$ 237,446

Equipment under capital lease obligations and related accumulated amortization was $34,634 and $17,391 in 2006, respectively, and $38,583 and $16,296 in 2005, respectively.

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.

(Dollars in thousands)

5. Capital Assets (Continued)

The Medical Center is currently 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 $177 thousand and $2.3 million for the years ended June 30, 2006 and 2005, respectively, are shown as Contributions from the University for building program on the Statement of Revenues, Expenses and Changes in Net Assets.

6. Long-term Debt and Capital Leases

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

	2006	2005
The Regents of the University of California General Revenue Bonds (2003 series A) interest rates from 1.0 to 5.125 percent, payable semi-annually, with annual principal payments through 2017	$ 4,112	$ 4,396
Capital lease obligation, primarily for computer and medical equipment, with fixed interest rates of 3.1percent to 6.3 percent payable through 2010, collateralized by underlying equipment	17,708	22,962
Total debt and capital leases	21,820	27,358
Less: Current portion of debt and capital leases	(7,216)	(7,648)
Noncurrent portion of debt and capital leases	$ 14,604	$ 19,710

(Dollars in thousands)

6. 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	Capital Lease Obligations	Total
Year Ended June 30, 2006			
Current portion at June 30, 2005	$ 284	$ 7,364	$ 7,648
New obligations	–	177	177
Reclassification from noncurrent	296	6,920	7,216
Principal payments	(284)	(7,541)	(7,825)
Current portion at June 30, 2006	$ 296	$ 6,920	$ 7,216
Noncurrent portion at June 30, 2005	$ 4,112	$ 15,598	$ 19,710
New obligations	–	2,110	2,110
Reclassification to current	(296)	(6,920)	(7,216)
Noncurrent portion at June 30, 2006	$ 3,816	$ 10,788	$ 14,604
Year Ended June 30, 2005			
Current portion at June 30, 2004	$ 272	$ 7,088	$ 7,360
New obligations	–	566	566
Reclassification from noncurrent	284	7,364	7,648
Principal payments	(272)	(7,654)	(7,926)
Current portion at June 30, 2005	$ 284	$ 7,364	$ 7,648
Noncurrent portion at June 30, 2004	$ 4,396	$ 14,490	$ 18,886
New obligations	–	8,472	8,472
Reclassification to current	(284)	(7,364)	(7,648)
Noncurrent portion at June 30, 2005	$ 4,112	$ 15,598	$ 19,710

Additional information on the General Revenue Bonds can be obtained from the 2006 annual report of the University.

(Dollars in thousands)

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

Future debt service payments for each of the five fiscal years subsequent to June 30, 2006 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Capital Leases	Total Payments	Principal	Interest
2007	$ 499	$ 7,422	$ 7,921	$ 7,216	$ 705
2008	498	5,752	6,250	5,790	460
2009	497	3,381	3,878	3,583	295
2010	496	1,797	2,293	2,099	194
2011	496	290	786	640	146
2012-2016	2,461	–	2,461	2,027	434
2017-2021	489	–	489	465	24
Total future debt service	5,436	18,642	24,078	$ 21,820	$ 2,258
Less: Interest component of future payments	(1,324)	(934)	(2,258)		
Principal portion of future payments	$ 4,112	$ 17,708	$ 21,820		

The University has an internal working capital program which allows the Medical Center to receive internal advances from the University up to 60 percent of the Medical Center's accounts receivable for any working capital needs. Interest on any such advance is based upon the earnings rate on the Short Term Investment Pool. Repayment of any advances made to the Medical Center under the working capital program is not secured by a pledge of revenues. Currently, there are no advances to the Medical Center. The University may cancel or change the terms of the working capital program at its sole discretion. However, the University has historically provided working capital advances under informal or formal programs for the Medical Center.

(Dollars in thousands)

7. Operating Leases

The Medical Center leases certain buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2006 and 2005 was $3,091 and $2,751, respectively. The terms of the operating leases extend through the year of 2011.

Future minimum payments on operating leases with an initial or non-cancelable term in excess of one year are as follows:

Year Ending June 30	Minimum Annual Lease Payments
2007	$ 3,571
2008	3,590
2009	3,268
2010	1,230
2011	733
Total	$ 12,392

8. Retirement Plans

Substantially all full-time employees of the Medical Center participate in the University of California Retirement System ("UCRS") that is administered by the University. The UCRS consists of The University of California Retirement Plan ("UCRP"), a single employer defined benefit plan, and the University of California Retirement Savings Program ("UCRSP") that includes three defined contribution plans with several investment portfolios generally funded with employee non-elective and elective contributions.

The UCRP 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. Contributions to the UCRP may be made by the University and its employees. The University's policy is to provide for a targeted funding level of 100 percent over the long-term, and for the University and UCRP member contributions to be set at rates necessary to maintain that level within a range of 95 percent to 110 percent.

The actuarial value of UCRP assets and the actuarial accrued liability using the entry age normal cost method as of June 30, 2006 were $42.0 billion and $40.3 billion, respectively. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net Assets were $43.4 billion at June 30, 2006. For the years ended June 30, 2006 and 2005, 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.

8. Retirement Plans (Continued)

The UCRSP plans (DC Plan, 403(b) Plan and 457(b) Plan) provide savings incentives and additional retirement security for all eligible employees. The DC Plan accepts both pre-tax and after-tax employee contributions. The 403(b) and 457(b) plans accept pre-tax employee contributions. The Medical Center may also make contributions on behalf of certain members of management. Benefits from the plans are based on participants' mandatory and voluntary contributions, plus earnings, and are immediately vested.

Information related 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 2006 annual report of the University.

9. 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's self-insurance premiums were $7,805 and $7,974 for the years ended June 30, 2006 and 2005, respectively.

Workers' compensation premiums, included as salaries and employee benefits expense in the statement of revenues, expenses and changes in net assets, were $5,940 and $6,364 for the years ended June 30, 2006 and 2005, respectively. During 2006, as a result of the most recent actuarial analysis, the Medical Center reviewed a refund of premiums of $496 from the University that reduced the overall workers' compensation cost for the year.

Combined malpractice and general liability premiums, recorded as insurance expense in the statement revenues, expenses and changes in net assets, were $1,865 and $1,610 for the years ended June 30, 2006 and 2005, respectively.

(Dollars in thousands)

10. Transactions with Other University Entities

Services purchased from the University include office and medical supplies, building maintenance, repairs and maintenance, administrative, treasury, medical services, and insurance. Services provided to the University include health care services to the Medical Group's capitated members, physician office rentals, pharmaceuticals, billing services, medical supplies, 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:

	2006	2005
Professional services	$ 1,567	$ 1,573
Other supplies and purchased services	20,531	23,975
Interest income (net)	(2,925)	(1,728)
Insurance	1,865	1,610
Administrative costs	(4,570)	(4,734)
Total	$ 16,468	$ 20,696

Additionally, the Medical Center makes payments to the University of California, Irvine 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 amounts of payments made by the Medical Center to the School of Medicine were $49,462 and $45,329 in 2006 and 2005, respectively. Of these amounts, $16,468 and $20,696 are reported as operating expenses for the years ended June 30, 2006 and 2005, respectively, and $32,994 and $24,633 are reported as health system support for the years ended June 30, 2006 and 2005, respectively.

11. 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.

(Dollars in thousands)

11. Commitments and Contingencies (Continued)

State of 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. Previously, the state of California's budget authorized the University to use $600 million in lease-revenue bond funds for earthquake safety renovations. The Regents have approved the allocation of the $600 million among the University's medical centers, of which $235 million was allocated to the Medical Center. The Medical Center spent $32.0 and $39.5 million of its allocation during the years ended June 30, 2006 and 2005, respectively. As of June 30, 2006, any repayment the Medical Center may be obligated for under these financing arrangements is still being determined.

The Medical Center is in construction to build a new replacement hospital. The total cost of this Medical Center project is currently estimated to be $ 357.5 million, excluding interest. The replacement hospital financing sources are estimated as follows:

Gift Funds	$ 47.5
State Lease Revenue Bonds	235.0
External Financing	65.0
Hospital Reserves	10.0
Total	$ 357.5

At June 30, 2006, the Medical Center had outstanding commitments for capital expenditures in connection with the construction of approximately $231.2 million. The Medical Center expects to fund these costs principally through the proceeds of financing sources noted above. Accordingly, no liability has been recorded in the accompanying financial statements.

Gift funds used for construction in progress totaling $4.1 million in 2006 and $3.1 million in 2005 are reflected in the statements of revenues, expenses and changes in net assets. Additional gift funds and pledges received but not used as of June 30, 2006 are not reflected on the financial statements of the Medical Center. These funds are reflected on the financial statements of the University and transferred to the Medical Center when used.