# University of California, Davis Medical Center

## Report on Audits of Financial Statements
## For the Years Ended June 30, 2008 and 2007

# University of California, Davis Medical Center
## Index
## June 30, 2008 and 2007

PRICEWATERHOUSECOOPERS

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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 12 through 33, 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, 2008 and 2007, 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, 2008 and 2007, 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 11 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

October 10, 2008

## Introduction

The objective of the Management's Discussion and Analysis is to help readers better understand the University of California, Davis Medical Center's financial position and operating activities for the year ended June 30, 2008, with selected comparative information for the years ended June 30, 2007 and 2006. 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 (2006, 2007, 2008, 2009, etc.) in this discussion refer to the fiscal years ended June 30.

## Overview

The University of California, Davis 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 the school used the Sacramento County hospital for clinical training, but in 1973 the University acquired the hospital outright and began operating it as the UC Davis Medical Center.

Licensed as a 577-bed general acute care hospital with 29 operating rooms, the Medical Center provides a full range of inpatient general acute and intensive care, and a full complement of ancillary, support and ambulatory services. These services are housed in about 3 million gross square feet of facilities, most of which are sited on the 140-acre campus in the City of Sacramento. Ambulatory care is provided at the hospital-based clinics and at the 17 Primary Care Network ("PCN") satellite clinics in the surrounding communities of Auburn, Carmichael, Colusa, Davis, Elk Grove, Folsom, Rancho Cordova, Rocklin, Roseville, and Sacramento.

The Medical Center serves as a tertiary care referral hospital for a 33-county 65,000-square-mile service area with a population of six million. Its range of services includes heart and vascular surgery, transplant, and neurological surgery, and it is a designated Children's Hospital within a Hospital. It is the only provider of several tertiary/quaternary services between San Francisco and Portland, including Level 1 Adult & Pediatric Trauma care, National Institutes of Health designated Cancer Center, and adult burn care.

The Medical Center participates in a variety of cooperative outreach activities with regional health care providers. These include UC Davis Cancer Care Network, with community-based cancer centers in Marysville and Merced, and which is currently expanding to Pleasanton and Truckee. In addition, the Medical Center operates a nationally recognized clinical telemedicine, distance education and rural affiliation program and has affiliations with the VA and Lawrence Livermore National Laboratory and the adjacent Shriners' Hospital for Children.

Inpatient and outpatient medical services are provided by the UC Davis Medical Group, with approximately 760 faculty and contract physicians, 660 residents and fellows, and 110 PCN physicians.

For the year ended June 30, 2008, 33,678 patients were admitted to the Medical Center, of which approximately 53 percent were admitted through the emergency room, and overall occupancy was approximately 84 percent. During the same period, there were over 1,022,000 outpatient visits, of which approximately 923,000 were visits to the Clinics and the PCN Sites and approximately 56,000 were emergency room visits.

### Operating Statistics

The following table presents utilization statistics for the Medical Center for 2008, 2007 and 2006:

| Statistics | 2008 | 2007 | 2006 |
|---|---|---|---|
| Admissions | 33,678 | 33,825 | 33,341 |
| Average daily census | 476 | 471 | 442 |
| Average length of stay | 5.2 | 5.1 | 4.8 |
| Case mix index | 1.63 | 1.56 | 1.55 |
| Patient days: | | | |
| Medicare (non-risk) | 41,217 | 39,949 | 37,499 |
| Medi-Cal (non-risk) | 46,020 | 45,462 | 39,457 |
| Commercial | 278 | 104 | 206 |
| County | 14,340 | 15,758 | 14,641 |
| Contracts (discounted/per diem) | 49,071 | 48,678 | 46,197 |
| Contracts (capitated)* | 21,594 | 20,051 | 20,678 |
| Non-sponsored/self-pay | 1,621 | 1,852 | 2,787 |
| Total patient days | 174,141 | 171,854 | 161,465 |
| Outpatient visits: | | | |
| Hospital clinics | 405,975 | 368,253 | 373,661 |
| Primary care network | 477,296 | 423,372 | 419,319 |
| Home health/hospice | 43,972 | 44,020 | 52,595 |
| Emergency visits | 55,758 | 52,937 | 47,906 |
| PCN outreach | 39,444 | 35,617 | 39,536 |
| Total visits | 1,022,445 | 924,199 | 933,017 |

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

In 2008, admissions decreased by 147 or 0.4 percent over 2007. The average length of stay increased from 5.1 to 5.2 days due to a higher case mix index and several discharges with length of stays of greater than 200 days. Hospital clinic visits increased by 10.2 percent. PCN visits increased by 12.7 percent in 2008 and PCN outreach visits increased by 10.7. Emergency visits increased by 5.3 percent in 2008 primarily due to the continuing Fast Track program. Home Health visits decreased by 0.1 percent due to high staff turnover.

## Statements of Revenues, Expenses and Changes in Net Assets

This statement shows the revenue, expenses and changes in net assets for the Medical Center for 2008 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2008, 2007 and 2006 (dollars in thousands):

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Net patient service revenue | $ 1,014,318 | $ 928,896 | $ 850,041 |
| Other operating revenue | 14,857 | 14,736 | 13,674 |
| Total operating revenue | 1,029,175 | 943,632 | 863,715 |
| Total operating expenses | 976,766 | 881,503 | 799,047 |
| Income from operations | 52,409 | 62,129 | 64,668 |
| Total non-operating expenses | (7,441) | (4,915) | (6,791) |
| Income before other changes in net assets | $ 44,968 | $ 57,214 | $ 57,877 |
| Margin | 4.4 percent | 6.1 percent | 6.7 percent |
| Other changes in net assets | 23,051 | 11,531 | (13,766) |
| Net assets – beginning of year | 680,300 | 611,555 | 567,444 |
| Net assets – end of year | $ 748,319 | $ 680,300 | $ 611,555 |

**Revenues**

Total operating revenues for the year ended June 30, 2008 were $1,029 million, an increase of $85.5 million, or 9.1 percent, over 2007. Total operating revenues for 2007 of $943.6 million increased by $79.9 million, or 9.3 percent, over 2006.

Net patient service revenue for 2008 increased by $85.4 million, or 9.2 percent, over 2007. Net patient service revenue in 2007 increased by $78.9 million, or 9.3 percent, over 2006. The increase in 2008 was primarily due to increased inpatient days and favorable payor mix. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medi-Cal and other third-party payors and have been estimated based on the terms of reimbursement and contracts currently in effect.

Other operating revenue consisted primarily of State Clinical Teaching Support Funds ("CTS") and other non-patient services such as cafeteria and campus revenues.

The following table summarizes net patient service revenue for 2008, 2007 and 2006 (dollars in thousands):

| Payor | 2008 | 2007 | 2006 |
|---|---|---|---|
| Medicare (non-risk) | $ 186,471 | $ 178,598 | $ 158,273 |
| Medi-Cal (non-risk) | 115,914 | 108,683 | 119,728 |
| Commercial | 1,871 | 1,378 | 2,261 |
| County | 45,174 | 32,718 | 30,968 |
| Contracts (discounted/per-diem) | 505,491 | 461,842 | 406,917 |
| Contracts (capitated)* | 153,729 | 140,839 | 124,350 |
| Non-sponsored/self-pay | 5,668 | 4,838 | 7,544 |
| Total | $ 1,014,318 | $ 928,896 | $ 850,041 |

* Includes Medicare and Medi-Cal risk

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. Medicare reimburses the Medical Center for allowable costs 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. Settlements with the Medicare program for prior years cost reports are recognized in the year the settlement is resolved. Excluding settlement adjustments, net patient revenue for Medicare increased by $12.0 million over the prior fiscal year.

Payments for Medi-Cal patients include a combination of Medi-Cal inpatient fee for service (FFS) payments, Medi-Cal Disproportionate Share ("DSH") payments, and Safety Net Care Pool ("SNCP"). The net patient revenue for Medi-Cal increased by $7.2 million from 2007. This increase is primarily due to a change in the allocation of the new Safety Net Care Pool and increased patient days.

County net patient revenue increased by $12.5 million, or 38.1 percent, primarily due to a $7.4 million increase in the Sacramento County Lump Sum contract and a 4.4 percent in volume.

Contracts net patient revenue (discounted/per-diem) increased by $43.6 million or 9.5 percent primarily due to volume and contract rate increases.

The net patient service revenue for contracts that are full-risk capitation increased by $12.9 million, or 9.2 percent, due primarily to increased enrollment and prior year revenue adjustments.

The non-sponsored/self-pay net revenue increased from the prior year by $0.8 million, or 17.2 percent. This category fluctuates from year to year depending on the volume and type of patients.

**Operating Expenses**

During 2008, total operating expenses of $976.8 million increased by $95.3 million, or 10.8 percent, over 2007 and were primarily due to inflation and the increased cost of goods and services. Increases were primarily in salaries and benefits, professional services and medical supplies. In 2007, total operating expenses of $881.5 million increased by $82.5 million, or 10.0 percent, over 2006 primarily due to volume.

Salary and employee benefit expenses include wages paid to hospital employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance and other employee benefits. Amounts paid for other contracted labor are included in purchased services.

Salary and employee benefit expenses increased by $60.3 million, or 11.7 percent, over 2007. Salary expenses increased in 2008 by $50.8 million, or 12 percent. In addition to annual salary adjustments for all employees, full time equivalent employees grew by 2.3 percent and accrued one-time retroactive increases to nursing and patient care technical bargaining units totaled $5.3 million. Increases in employee benefit costs for 2008 were $9.5 million, or 10.1 percent. Health insurance benefits were higher by $7.3 million, partially offset by workers' compensation insurance expense that decreased by $3.3 million due to lower rates and a worker's compensation premium rebate that was $1.1 million more than received in 2007. Other post employment benefits for retirees increased by $1.3 million.

In 2007, salary and benefit expenses increased by $51.4 million, or 11.1 percent. Salary expenses grew by $43.0 million, or 11.4 percent, attributable to increases in both FTE's and annual salary adjustments, including contractual increases for represented employees. Employee benefit expenses increased by $8.4 million, generally due to health insurance benefit cost for both active employees and retirees.

Payments for professional services increased by $12.4 million, or 19.4 percent, over 2007 due to increases in services and support provided by the UC Davis School of Medicine. In 2007, professional services increased by $1.6 million, or 2.6 percent, over 2006 due to increases in these same services and support.

Medical supplies expense for 2008 increased by $16.3 million, or 11.7 percent, over 2007 due to the impact of patient volumes and inflation. The cost of pharmaceuticals increased by $5.6 million, or 10 percent, as a result of increased utilization. The cost of surgical supplies increased by $2.6 million, or 36 percent, due to inflation, and the cost of blood and blood products increased by $2.0 million, or 21 percent, due to inflation. Medical supplies expense for 2007 increased by $11.5 million, or 9.0 percent, over 2006 due to inflationary increases in implantable devices, which showed a $3 million increase in cost, and volume increases in pharmaceuticals and general medical supplies, which showed $2 million and $4.5 million increases, respectively.

Other supplies and purchased services increased by $3.8 million, or 4.2 percent, over the prior year. Other supplies and purchased services increased $18.2 million in 2007 over 2006.

Depreciation and amortization expense increased by $2.2 million over the prior year due to investment in capital assets.

Insurance expense of $8.0 million was primarily the Medical Center's contribution to the University of California's self-insured malpractice fund. This expense increased by $1.5 million, or 23.4 percent, over the prior year.

**Non-operating Revenues (Expenses)**
Total non-operating expenses were $7.4 million for 2008 compared to $4.9 million in the prior year. The increase was primarily due to an increase in interest expense of $3.5 million, a decrease in interest income of $1.1 million offset by an increase in other non-operating revenue of $1.7 million.

**Income before Other Changes in Net Assets**
The Medical Center's income before other changes in net assets was $45.0 million for 2008 compared to $57.2 million for 2007 and $57.9 million in 2006. The Medical Center had increased revenues from volume and improved payor mix; however, operating expenses had greater increases in salaries, benefits, medical supplies and professional services.

**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 for 2008 are the following:

- Contributions from the University for the building program of $42.2 million are related to the Surgery and Emergency Pavilion project and represent funding from the State Public Works Board Bonds.

- Health system support represents transfers primarily to the School of Medicine for academic and research support. The Medical Center transferred $10.6 million in 2008.

- Transfers to the University totaled $17.0 million and were primarily the book value of three buildings now designated as research and academic yet formerly were clinical.

In total, the net assets increased for the year ended June 30, 2008 by $68.0 million to $748.3 million. The majority of this increase is due to income before other changes in net assets.

## Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2008, 2007 and 2006 (dollars in thousands):

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Current assets: | | | |
| Cash | $ 176,473 | $ 153,305 | $ 142,852 |
| Restricted assets, held by trustee | 848 | 1,819 | 8,622 |
| Patient accounts receivable (net) | 180,752 | 153,362 | 135,599 |
| Other current assets | 45,551 | 34,869 | 47,863 |
| Total current assets | 403,624 | 343,355 | 334,936 |
| Restricted assets – Cash for capital projects | – | 64,967 | – |
| Capital assets (net) | 916,211 | 818,576 | 737,738 |
| Other assets | 19,192 | 20,479 | 17,528 |
| Total assets | 1,339,027 | 1,247,377 | 1,090,202 |
| Current liabilities | 188,207 | 161,445 | 134,219 |
| Long-term debt | 402,501 | 405,632 | 344,428 |
| Total liabilities | 590,708 | 567,077 | 478,647 |
| Net assets: | | | |
| Invested in capital assets (net) | 464,101 | 441,727 | 375,358 |
| Restricted – expendable for debt service | 848 | 1,819 | 8,622 |
| Unrestricted | 283,370 | 236,754 | 227,575 |
| Total net assets | $ 748,319 | $ 680,300 | $ 611,555 |

Total current assets increased by $60.3 million, or 17.6 percent, from 2007 to 2008 primarily due to an increase in patient accounts receivable of $27.4 million and cash of $23.2 million. Total current assets for 2007 increased by $8.4 million over 2006.

Cash increased by $23.2 million in 2008. The increase was primarily due to the timing of payments.

Net patient accounts receivable increased by $27.4 million from the prior year due to increased volume.

Other current assets, including non-patient receivables, inventory and prepaid expenses, increased by $10.7 million over the prior fiscal year. The increase was primarily related to $8.4 million for the Safety Net Care Pool in non-patient receivables.

Restricted assets – Cash for capital projects decreased by $65.0 million from 2007 because this cash was drawn for expenditures on the Surgery and Emergency Services Pavilion project.

Net capital assets increased by $97.6 million from 2007 to 2008 primarily due to construction of the Surgery and Emergency Services Pavilion and Davis Tower, and purchased equipment. The increase of $80.8 million from 2006 to 2007 was primarily due to the Surgery and Emergency Services Pavilion and the Electronic Medical Records (EMR).

Current liabilities increased by $26.8 million from 2007 to 2008 primarily due to an increase of $15.9 million in accrued payroll, $3.2 million in accrued compensation (vacation) and $6.4 million in current portion of long term debt.

Long term debt decreased by $3.1 million from 2007 to 2008 primarily due to debt service payments. Long-term debt increased by $61.2 million from 2006 to 2007 primarily due to new pooled revenue bonds to help fund the Pavilion project.

Total net assets increased by $68.0 million from 2007 to 2008. This increase reflects $45.0 million from income before other changes in net assets and $50.6 million of contributions from the University for building program. Decreases include $10.6 million of Health System capital and operational support for the research and teaching missions of the Health System and $17.0 million for three buildings now designated as primarily used for research and academic.

## Liquidity and Capital Resources

During 2008, the Medical Center generated $90.8 million from operating activities.

Cash flows from non-capital financing activities show the Medical Center's cash was reduced by $8.3 million primarily for transfers to the University for Health System support.

Included in cash flows from capital and related financing activities were contributions from the University for funding from the State Public Works Board Bonds of $42.2 million, proceeds from financing loans of $25.0 million, purchases of capital assets of $174.0 million, principal payments on long-term debt and capital leases of $20.9 million and interest paid of $14.9 million. Additionally, proceeds from new debt issuance totaled $333.6 while the refinancing of outstanding debt decreased cash flows by $324.3.

Cash flows from investing activities show that $5.7 million was provided by interest income and $66.0 million was provided by decreased cash held for capital projects. Overall cash increased to $176.5 million in 2008 from $153.3 million in 2007.

The following table shows key liquidity and capital ratios for 2008, 2007 and 2006:

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Days cash on hand | 68 | 65 | 71 |
| Days of revenue in accounts receivable | 58 | 47 | 55 |
| Debt service coverage ratio | 2.5 | 3.5 | 4.2 |

Days cash on hand increased to 68 days in 2008 from 65 days in 2007. 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. In 2008, days in accounts receivable increased by 11 days to 58. The main reason for this increase was the result of increased patient volume.

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 2008 is 2.5 versus 3.5 in 2007. The decrease was due to increased scheduled debt service and less funds available for debt service. This ratio is higher than the 1.2 required by the Bond Indenture for 2007.

## Looking Forward

*The Hospital Facilities Seismic Safety Act (SB 1953)*
During 2008, the UC Davis 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 statutory requirements by January 1, 2013, is $227.3 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 2008, $42.2 million was spent on these requirements.

*Payments from Federal and State Health Care Programs*
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 as well as auditors, contractors, and intermediaries retained by the federal, state, or local governments (collectively "Government Agents"). Resolution of such audits or reviews often extends (and in some cases does not even commence until) several years beyond the year in which services were rendered and/or fees received.

Moreover, different Government Agents frequently interpret government regulations and other requirements differently. For example, Government Agents might disagree on a patient's principal medical diagnosis, the appropriate code for a clinical procedure, or many other matters. Such disagreements might have a significant effect on the ultimate payout due from the government to fully recoup sums already paid. Governmental agencies may make changes in program interpretations, requirements, or "conditions of participation," some of which may have implications for amounts previously estimated. In addition to varying interpretation and evolving codification of the regulations, standards of supporting documentation and required data are subject to wide variation.

In accordance with generally accepted accounting principles, to account for the uncertainty around Medicare and Medicaid revenues, the Medical Center estimates the amount of revenue that will ultimately be received under the Medicare and Medi-Cal programs. Amounts ultimately received or paid may vary significantly from these estimates.

*Medicaid Reform*
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 ("waiver") that will govern Medicaid FFS inpatient hospital payments through fiscal year 2010. The California state legislature enacted 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 from 2006 through 2010 – at a minimum medical centers will receive the Medicaid inpatient hospital payments they received in 2005 adjusted for yearly changes in costs. 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. Although the new federal inpatient hospital financing waiver and SB 1100 are designed to ensure a predictable Medicaid supplemental payment funding level and provide growth funding, the full financial impact of these changes in the future cannot be determined.

*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, there have not been any Medical Center contributions to the UCRP. In addition, since 1990, the required employee member contributions to the UCRP have been suspended. However, employee member contributions are required to be made to the separate defined contribution plan maintained by the University.

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, shared between the Medical Center and employees, based upon UCRP's current normal cost. The Regents have not yet authorized the initial resumption of shared employer and employee contributions.

## 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, 2008 and 2007
## (Dollars in thousands)

| | 2008 | 2007 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 176,473 | $ 153,305 |
| Restricted assets, held by trustee | 848 | 1,819 |
| Patient accounts receivable, net of estimated uncollectibles of $32,688 and $27,033, respectively | 180,752 | 153,362 |
| Other receivables, net of estimated uncollectibles of $300 and $0, respectively | 22,212 | 13,398 |
| Inventory | 13,824 | 12,213 |
| Prepaid expenses and other assets | 9,515 | 9,258 |
| Total current assets | 403,624 | 343,355 |
| Restricted assets: | | |
| Cash restricted for capital projects | – | 64,967 |
| Capital assets, net | 916,211 | 818,576 |
| Investments in joint ventures | 16,313 | 14,311 |
| Deferred costs of issuance | 2,879 | 6,168 |
| Total assets | 1,339,027 | 1,247,377 |
| **Liabilities** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | 47,003 | 44,620 |
| Accrued salaries and benefits | 70,217 | 51,103 |
| Third-party payor settlements | 33,835 | 34,863 |
| Current portion of long-term debt and capital leases | 25,939 | 19,509 |
| Other liabilities | 11,213 | 11,350 |
| Total current liabilities | 188,207 | 161,445 |
| Long-term debt and capital leases, net of current portion | 402,501 | 405,632 |
| Total liabilities | 590,708 | 567,077 |
| **Net Assets** | | |
| Invested in capital assets, net of related debt | 464,101 | 441,727 |
| Restricted: | | |
| Expendable: | | |
| Debt service | 848 | 1,819 |
| Unrestricted | 283,370 | 236,754 |
| Total net assets | $ 748,319 | $ 680,300 |

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, 2008 and 2007
### (Dollars in thousands)

| | 2008 | 2007 |
|---|---|---|
| Net patient service revenue, net of provision for doubtful accounts of $41,877 and $37,994, respectively | $ 1,014,318 | $ 928,896 |
| Other operating revenue: | | |
| Clinical teaching support | 7,789 | 7,789 |
| Other | 7,068 | 6,947 |
| Total other operating revenue | 14,857 | 14,736 |
| Total operating revenue | 1,029,175 | 943,632 |
| Operating expenses: | | |
| Salaries and employee benefits | 576,616 | 516,291 |
| Professional services | 76,283 | 63,871 |
| Medical supplies | 155,856 | 139,585 |
| Other supplies and purchased services | 93,686 | 89,893 |
| Depreciation and amortization | 57,562 | 55,377 |
| Insurance | 7,975 | 6,461 |
| Other | 8,788 | 10,025 |
| Total operating expenses | 976,766 | 881,503 |
| Income from operations | 52,409 | 62,129 |
| Non-operating revenues (expenses): | | |
| Interest income | 5,726 | 6,829 |
| Interest expense | (16,936) | (13,447) |
| Loss on disposal of capital assets | (246) | (577) |
| Other | 4,015 | 2,280 |
| Total non-operating expenses | (7,441) | (4,915) |
| Income before other changes in net assets | 44,968 | 57,214 |
| Other changes in net assets: | | |
| Contributions from University for building program | 50,576 | 16,073 |
| Donated assets | – | 8,200 |
| Health system support | (10,557) | (14,137) |
| Transfers to University, net | (16,968) | 1,395 |
| Total other changes in net assets | 23,051 | 11,531 |
| Increase in net assets | 68,019 | 68,745 |
| Net assets – beginning of year | 680,300 | 611,555 |
| Net assets – end of year | $ 748,319 | $ 680,300 |

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, 2008 and 2007
## (Dollars in thousands)

| | 2008 | 2007 |
|---|---|---|
| Cash flows from operating activities: | | |
| Receipts from patients and third-party payors | $ 977,086 | $ 935,977 |
| Payments to employees | (457,145) | (418,821) |
| Payments to suppliers | (335,687) | (313,165) |
| Payments for benefits | (103,973) | (94,469) |
| Other receipts, net | 10,497 | 11,582 |
| Net cash provided by operating activities | 90,778 | 121,104 |
| Cash flows from noncapital financing activities: | | |
| Health system support | (10,557) | (14,137) |
| Transfers from University | 2,213 | 1,395 |
| Net cash used by noncapital financing activities | (8,344) | (12,742) |
| Cash flows from capital and related financing activities: | | |
| Proceeds from contributions by University for building program | 50,576 | 16,073 |
| Proceeds from debt issuance | 333,626 | 65,543 |
| Proceeds from financing loan | 24,959 | 15,170 |
| Proceeds from sale of capital assets | 875 | 193 |
| Bond issuance cost | (2,020) | (911) |
| Swap termination payment | (6,795) | – |
| Refinancing of outstanding debt | (324,275) | – |
| Purchases of capital assets | (174,046) | (113,906) |
| Principal paid on long-term debt and capital leases | (20,946) | (17,356) |
| Interest paid on long-term debt and capital leases | (14,897) | (11,380) |
| Net cash used by capital and related financing activities | (132,943) | (46,574) |
| Cash flows from investing activities: | | |
| Interest income received | 5,726 | 6,829 |
| Distributions from investments in joint ventures, net | 2,013 | – |
| Change in restricted assets | 65,938 | (58,164) |
| Net cash provided (used) by investing activities | 73,677 | (51,335) |
| Net increase in cash | 23,168 | 10,453 |
| Cash – beginning of year | 153,305 | 142,852 |
| Cash – end of year | $ 176,473 | $ 153,305 |

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, 2008 and 2007
## (Dollars in thousands)

| | 2008 | 2007 |
|---|---|---|
| Reconciliation of income from operations to net cash provided by operating activities: | | |
| Income from operations | $ 52,409 | $ 62,129 |
| Adjustments to reconcile income from operations to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 57,562 | 55,377 |
| Provision for doubtful accounts | 41,877 | 37,994 |
| Changes in operating assets and liabilities: | | |
| Patient accounts receivable | (69,267) | (55,757) |
| Other receivables | (8,814) | 18,707 |
| Inventory | (1,611) | (5,928) |
| Prepaid expenses and other assets | (257) | 215 |
| Accounts payable and accrued expenses | (930) | (4,843) |
| Accrued salaries and benefits | 19,114 | 6,308 |
| Third-party payor settlements | (1,028) | 6,136 |
| Other liabilities | (137) | (8,920) |
| Net cash provided by operating activities | $ 90,778 | $ 121,104 |
| Supplemental noncash activities information: | | |
| Amortization of deferred financing costs and bond premium | $ 1,768 | $ 1,783 |
| Amortization of deferred costs of issuance | $ 271 | $ 284 |
| Donated land | $ – | $ 8,200 |
| Property and equipment transfers to University | $ 19,181 | $ – |
| Payables for property and equipment | $ 1,453 | $ 14,923 |

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 577 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. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions,* was adopted by the Medical Center during the fiscal year ended June 30, 2008. The Medical Center's participation in the University's postemployment benefit program is effectively as a cost-sharing employer participating in a plan administered as a trust. As a result, the Medical Center recognizes as an expense in the statement of revenues, expenses and changes in net assets the amount associated with the University's common assessment rate on an accrual basis. Accordingly, implementation of Statement No. 45 did not have any significant effect on its financial statements other than to the extent the University changed the common assessment rate from the prior year.

***Cash***

All University operating entities maximize the 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. 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, 2008 and 2007 was $176,473 and $153,305, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation.

## 2. Summary of Significant Accounting Policies (Continued)

***Cash (Continued)***
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 2008 annual report of the University.

***Restricted Assets***
Proceeds from the Medical Center Pooled Revenue Bonds are held by the Treasurer of The Regents. Bond proceeds remain on deposit with the Treasurer until the project is constructed.

***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 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.

***Deferred Costs of Issuance***
Costs incurred in the issuance of long-term debt, including legal fees, bank fees, and accounting and consulting costs have been capitalized and are being amortized as interest expense on the straight-line basis over the term of the related long-term debt, which approximates the effective interest method.

***Bond Premium***
The premium received in the issuance of long-term debt is amortized as a reduction to interest expense over the term of the related long-term debt.

**2. Summary of Significant Accounting Policies (Continued)**

***Deferred Financing Costs***
Refinancing or defeasance of previously outstanding debt has resulted in deferred financing costs comprised of the difference between the reacquisition price and the net carrying amount of the old debt. This is reflected as unamortized deferred financing costs which are included as an offset to the current and noncurrent portion of long-term debt, as appropriate, in the Medical Center's statement of net assets. These costs are being amortized as interest expense over the remaining life of the defeased or refinanced bonds, whichever is shorter.

***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. The Medical Center had no restricted nonexpendable net assets at June 30, 2008 and 2007.

    - 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. *S*ubstantially 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.

## 2. Summary of Significant Accounting Policies (Continued)

***Revenues and Expenses (Continued)***
Substantially all of the Medical Center's operating expenses are directly or indirectly related to patient care activities.

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, donated assets and other transactions with the University are classified as other changes in net assets.

***Retiree Health Benefits Expense***
The University established the University of California Retiree Health Benefit Trust (UCRHBT) to allow certain University locations and affiliates, including the Medical Center, to share the risks, rewards and costs of providing for retiree health benefits and to accumulate funds on a tax-exempt basis under an arrangement segregated from University assets. The Regents serve as Trustee of UCRHBT and has the authority to amend or terminate the Trust.

The UCRHBT provides retiree health benefits to retired employees of the Medical Center. Contributions from the Medical Center to the UCRHBT are effectively made to a cost-sharing single-employer health plan administered by the University. The Medical Center is required to contribute at a rate assessed each year by the UCRHBT. As a result, the Medical Center's required contributions are recognized as an expense in the statements of revenues, expenses and changes in net assets.

***UCRP Benefits Expense***
The University of California Retirement plan (UCRP) provides retirement benefits to retired employees of the Medical Center. Contributions from the Medical Center to the UCRP are effectively made to a cost-sharing single-employer defined benefit pension plan administered by the University. The Medical Center is required to contribute at a rate assessed each year by the UCRP. As a result, the Medical Center's required contributions, if any, are recognized as an expense in the statements of revenues, expenses and 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.

## 2. Summary of Significant Accounting Policies (Continued)

***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 from federal and state income taxes on related income.

***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.

***Reclassification***

Within the statement of cash flows, certain amounts related to the accrual of fixed asset purchases have been reclassified from operating activities to capital and related financing activities. The prior year amounts have been reclassified to conform with the current year presentation.

## 2. Summary of Significant Accounting Policies (Continued)

***New Accounting Pronouncements***
In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations,* effective for the Medical Center's fiscal year beginning July 1, 2008. This Statement establishes criteria to ascertain whether certain events result in a requirement for the Medical Center to estimate the components of any expected pollution remediation costs and determine whether these costs should be accrued as a liability or, if appropriate, capitalized.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for the Medical Center fiscal year beginning July 1, 2009. This statement requires capitalization of identifiable intangible assets in the statements of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life.

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, also effective for the Medical Center's fiscal year beginning July 1, 2009. This statement requires the Medical Center to report its derivative instruments at fair value. Changes in fair value for effective hedges that are achieved with derivative instruments are to be reported as deferrals in the statements of net assets. Derivative instruments that either do not meet the criteria for an effective hedge or are associated with investments that are already reported at fair value are to be classified as investment derivative instruments. Changes in fair value of those derivative instruments are to be reported as investment revenue.

The Medical Center is currently evaluating the effect, if any, that Statements No. 49, 51 and 53 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.

### 3. Net Patient Service Revenue (Continued)

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. 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 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, 2008 and 2007, the Medical Center recorded total Medi-Cal revenue of $115,914 and $108,683, 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, 2008 and 2007, the Medical Center applied for and received additional revenue of $4,485 and $8,151, 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.

- ***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, 2008 and 2007, the Medical Center recorded revenue of $6,911 and $5,037, 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.

**3. Net Patient Service Revenue (Continued)**

- 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.

- Capitated contracts with health plans that reimburse the Medical Center on a per-member-per-month basis, regardless of whether services are actually rendered. The Medical Center assumes a certain financial risk as the contract requires patient treatment for all covered services. Expected losses on capitated agreements are accrued when probable and can be reasonably estimated.

- Certain health plans that have established a shared-risk pool where the Medical Center shares in any surplus associated with health care utilization as defined in the related contracts. Additionally, the Medical Center may assume the risk of certain health care utilization costs, 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 that reimburse the Medical Center for certain indigent patients covered under county contracts.

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 24 percent and 37 percent of net patient accounts receivable at June 30, 2008 and 2007, respectively.

For the years ended June 30, 2008 and 2007, net patient service revenue included $2.1 million and $3.5 million, respectively, due to favorable cost report settlements with Medicare, Medi-Cal and the County Medical Services Program.

(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:

| | 2008 | 2007 |
|---|---|---|
| Medicare (non-risk) | $ 186,471 | $ 178,598 |
| Medicare (risk) | 28,981 | 27,593 |
| Medi-Cal (non-risk) | 115,914 | 108,683 |
| Medi-Cal (risk) | 13,540 | 11,850 |
| Commercial | 1,871 | 1,378 |
| Contract (discounted or per diem) | 505,491 | 461,842 |
| Contract (capitated) | 111,208 | 101,396 |
| County | 45,174 | 32,718 |
| Non-sponsored/self-pay | 5,668 | 4,838 |
| Total | $ 1,014,318 | $ 928,896 |

## 4. Charity Care

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

| | 2008 | 2007 |
|---|---|---|
| Charity care at established rates | $ 102,433 | $ 94,902 |
| Estimated cost of charity care | $ 21,101 | $ 20,598 |

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $123,856 and $97,995 for the years ended June 30, 2008 and 2007, respectively.

## 5. Restricted Assets, Held by Trustee

Restricted assets held by trustee are for future payment of principal and interest in accordance with various indenture and other long-term debt requirements. Securities are held by the trustee in the name of the University. The trust agreement permits the trustee to invest in U.S. and state government or agency obligations, commercial paper, or other corporate obligations meeting certain credit rating requirements.

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

| | 2008 | 2007 |
|---|---|---|
| Short-term, highly liquid investments | $ 848 | $ 1,819 |

### (Dollars in thousands)

## 6. Capital Assets

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

| | 2006 | Additions | Disposals | 2007 | Additions | Disposals | 2008 |
|---|---|---|---|---|---|---|---|
| **Original Cost** | | | | | | | |
| Land | $ 29,606 | $ 8,200 | $ – | $ 37,806 | $ – | $ (1,131) | $ 36,675 |
| Buildings and improvements | 726,407 | 10,089 | – | 736,496 | 19,384 | (28,010) | 727,870 |
| Equipment | 268,804 | 43,330 | (22,405) | 289,729 | 30,143 | (15,476) | 304,396 |
| Construction in progress | 115,593 | 75,410 | – | 191,003 | 125,972 | – | 316,975 |
| Capital assets, at cost | $ 1,140,410 | $ 137,029 | $ (22,405) | $ 1,255,034 | $ 175,499 | $ (44,617) | $1,385,916 |

| | 2006 | Depreciation | Disposals | 2007 | Depreciation | Disposals | 2008 |
|---|---|---|---|---|---|---|---|
| **Accumulated Depreciation and Amortization** | | | | | | | |
| Buildings and improvements | $ 239,504 | $ 25,167 | $ – | $ 264,671 | $ 26,227 | $ (9,679) | $ 281,219 |
| Equipment | 163,168 | 30,210 | (21,591) | 171,787 | 31,335 | (14,636) | 188,486 |
| Accumulated depreciation and amortization | $ 402,672 | $ 55,377 | $ (21,591) | $ 436,458 | $ 57,562 | $ (24,315) | $ 469,705 |
| Capital assets, net | $ 737,738 | | | $ 818,576 | | | $ 916,211 |

Equipment under capital lease obligations and related accumulated amortization is $811 and $811 in 2008, respectively, and $811 and $540 in 2007, 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.

The Medical Center is currently making seismic improvements in order to be in compliance with Senate Bill 1953, the *Hospital Facilities Seismic Safety Act*. A portion of the improvements is financed under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $42,230 and $16,073 for the years ended June 30, 2008 and 2007, respectively, are shown as contributions from University for building program on the statements 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 that 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:

| | 2008 | 2007 |
|---|---|---|
| University of California Medical Center Pooled Revenue Bonds – Series D, interest rates ranging from 2.5 percent to 5.5 percent, payable semi-annually, with annual principle payments beginning in 2009 through 2027 | $ 322,980 | $ – |
| University of California Medical Center Pooled Revenue Bonds – Series A, interest rates ranging from 4.5 percent to 5.0 percent, payable semi-annually, with annual principle payments beginning in 2012 through 2047 | 65,000 | 65,000 |
| University of California Refunding Hospital Revenue Bonds (University of California, Davis Medical Center, Series 2003) Series A-E, variable rate bonds, with annual principal payments through 2026 | – | 336,225 |
| University of California General Revenue Bonds 2003, interest rates from 2.0 percent to 5.25 percent, payable semi-annually, with annual principal payments through 2023 | 12,672 | 13,254 |
| Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.7 percent to 4.0 percent, payable through 2012 | 46,518 | 29,784 |
| Capital lease obligations, for computer software, with a fixed interest rate of 3.0 percent, payable through 2010, collateralized by underlying computer software | 399 | 589 |
| Unamortized bond premium | 10,986 | 537 |
| Unamortized deferred financing costs | (30,115) | (20,248) |
| Total debt and capital leases | 428,440 | 425,141 |
| Less: Current portion of debt and capital leases | (25,939) | (19,509) |
| Noncurrent portion of debt and capital leases | $ 402,501 | $ 405,632 |

(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, 2008** | | | |
| Current portion at June 30, 2007 | $ 10,801 | $ 8,708 | $ 19,509 |
| Reclassification from noncurrent | 317,413 | 13,671 | 331,084 |
| Refinancing of 2003 Refunding Revenue Bonds | (305,476) | – | (305,476) |
| Principal payments | (12,531) | (8,415) | (20,946) |
| Amortization of bond premium | (198) | – | (198) |
| Amortization of deferred financing costs | 1,966 | – | 1,966 |
| Current portion at June 30, 2008 | $ 11,975 | $ 13,964 | $ 25,939 |
| Noncurrent portion at June 30, 2007 | $ 383,967 | $ 21,665 | $ 405,632 |
| New obligations | 322,980 | 24,959 | 347,939 |
| Bond premium | 10,646 | – | 10,646 |
| Deferred financing costs | (30,632) | – | (30,632) |
| Reclassification to current | (317,413) | (13,671) | (331,084) |
| Noncurrent portion at June 30, 2008 | $ 369,548 | $ 32,953 | $ 402,501 |
| **Year Ended June 30, 2007** | | | |
| Current portion at June 30, 2006 | $ 9,844 | $ 5,729 | $ 15,573 |
| Reclassification from noncurrent | 10,806 | 8,703 | 19,509 |
| Principal payments | (11,632) | (5,724) | (17,356) |
| Amortization of bond premium | (6) | – | (6) |
| Amortization of deferred financing costs | 1,789 | – | 1,789 |
| Current portion at June 30, 2007 | $ 10,801 | $ 8,708 | $ 19,509 |
| Noncurrent portion at June 30, 2006 | $ 329,230 | $ 15,198 | $ 344,428 |
| New obligations | 65,000 | 15,170 | 80,170 |
| Bond premium | 543 | – | 543 |
| Reclassification to current | (10,806) | (8,703) | (19,509) |
| Noncurrent portion at June 30, 2007 | $ 383,967 | $ 21,665 | $ 405,632 |

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

Medical Center Pooled Revenue Bonds are issued to provide financing to the University's medical centers and are collateralized by a joint and several pledge of the operating revenues, as defined in the Indenture, of all five of the University's medical centers. The Medical Center Pooled Revenue Bond indenture requires the medical centers to set rates, charges and fees each year sufficient for the medical center operating revenues to pay for the annual principal and interest on the bonds and certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2008 are $1.1 billion of which $388.0 million are specifically for capital projects at the Medical Center. Combined operating revenues of the University's five medical centers for the years ended June 30, 2008 and 2007 were $5.0 and $4.6 billion, respectively.

In April 2008, Medical Center Pooled Revenue Bonds totaling $322,980, plus a bond premium of $10,646, were issued specifically for the Medical Center to refinance certain improvements to the Medical Center. Proceeds were used to refund $324,275 of Medical Center Refunding Revenue Bonds and for a swap termination payment of $6,800. The bonds mature at various dates through 2027 and have a weighted average interest rate of 4.7 percent. The deferred premium will be amortized over the term of the bonds. Additional deferred costs of financing totaling $11,800 will be amortized as interest expense over the term of the bonds.

In January 2007, Medical Center Pooled Revenue Bonds totaling $65,000 were issued specifically for the Medical Center to finance certain improvements to the Medical Center. Proceeds, including a bond premium of $543, were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through November 2011, mature at various dates through 2047 and have a weighted average interest rate of 4.55 percent.

The University issued General Revenue Bonds Series 2003, collateralized solely by general revenues of the University, to refinance certain Medical Center projects. 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.

Medical Center revenues are not pledged for any other purpose than under the indentures for the Medical Center Pooled Revenue Bonds. The pledge of medical center revenues under Medical Center Pooled Revenue Bonds is on a parity with interest rate swap agreements. The Medical Center's obligations under the terms of the General Revenue Bonds are subordinate to the Medical Center Pooled Revenue Bonds.

**(Dollars in thousands)**

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

The University has an internal working capital program which allows the Medical Center to receive internal advances 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 STIP. Repayment of any advances made to the Medical Center under the working capital program is not collateralized 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.

***Future Debt Service***

Future debt service payments for each of the five fiscal years subsequent to June 30, 2008 and thereafter are as follows:

| Year Ending June 30, | Revenue Bonds | Other Debt | Total Payments | Principal | Interest |
|---|---|---|---|---|---|
| 2009 | $ 33,304 | $ 15,291 | $ 48,595 | $ 27,687 | $ 20,908 |
| 2010 | 33,019 | 11,738 | 44,757 | 25,780 | 18,977 |
| 2011 | 32,711 | 9,016 | 41,727 | 23,448 | 18,279 |
| 2012 | 33,144 | 8,717 | 41,861 | 24,481 | 17,380 |
| 2013 | 32,806 | 5,358 | 38,164 | 21,517 | 16,647 |
| 2014 – 2018 | 158,989 | – | 158,989 | 88,251 | 70,738 |
| 2019 – 2023 | 149,342 | – | 149,342 | 101,410 | 47,932 |
| 2024 – 2028 | 110,198 | – | 110,198 | 88,330 | 21,868 |
| 2029 – 2033 | 18,537 | – | 18,537 | 8,765 | 9,772 |
| 2034 – 2038 | 18,536 | – | 18,536 | 10,950 | 7,586 |
| 2039 – 2043 | 18,535 | – | 18,535 | 13,645 | 4,890 |
| 2044 – 2048 | 14,833 | – | 14,833 | 13,305 | 1,528 |
| Total future debt service | 653,954 | 50,120 | 704,074 | $ 447,569 | $ 256,505 |
| Less: Interest component of future payments | (253,302) | (3,203) | (256,505) | | |
| Principal portion of future payments | 400,652 | 46,917 | 447,569 | | |
| Adjusted by: | | | | | |
| Unamortized deferred financing costs | (30,115) | – | (30,115) | | |
| Unamortized bond premium | 10,986 | – | 10,986 | | |
| Total debt | $ 381,523 | $ 46,917 | $ 428,440 | | |

Additional information on the revenue bonds can be obtained from the 2008 annual report of the University.

(Dollars in thousands)

## 9. 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, 2008 and 2007 was $12,080 and $11,749, respectively. The terms of the operating leases extend through the year 2016.

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 |
|---|---|
| 2009 | $ 10,078 |
| 2010 | 8,017 |
| 2011 | 7,567 |
| 2012 | 5,876 |
| 2013 | 4,198 |
| 2014 – 2016 | 7,159 |
| Total | $ 42,895 |

## 10. Retiree Health Plans

The University administers single-employer health plans to provide health and welfare benefits, primarily medical, dental and vision benefits, to eligible retirees of the University of California and its affiliates. The Regents have the authority to establish or amend the benefit plans.

The contribution requirements of the eligible retirees and the participating University locations, such as the Medical Center, are established and may be amended by the University. Membership in the UCRP is required to become eligible for retiree health benefits. Contributions toward benefits are shared with the retiree. The University determines the employer's contribution. Retirees are required to pay the difference between the employer's contribution and the full cost of the health insurance. Retirees employed by the Medical Center prior to 1990 are eligible for the maximum employer contribution if they retire before age 55 and have at least 10 years of service, or if they retire at age 55 or later and have at least 5 years of service. Retirees employed by the Medical Center after 1989 and not rehired after that date are subject to graduated eligibility provisions that generally require 10 years of service before becoming eligible for 50 percent of the maximum employer contribution, increasing to 100 percent after 20 years of service.

Participating University locations, such as the Medical Center, are required to contribute at a rate assessed each year by the UCRHBT. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $2.86, $2.75 and $2.55 per $100 of UCRP covered payroll resulting in Medical Center contributions of $11.6 million, $10.3 million and $8.3 million for the years ended June 30, 2008, 2007 and 2006, respectively.

## 10. Retiree Health Plans (Continued)

The University has estimated the unfunded liability for retiree health benefits as approximately $12 billion as of July 1, 2007. Additional information on the retiree health plans can be obtained from the 2007–2008 annual report of the University of California Health and Welfare Plans.

## 11. 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 Medical Center and the employees. The rates for employer and employee contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy based upon recommendations of the consulting actuary. Employee contributions are subject to collective bargaining. As a result of the funded status of the UCRP, during the years ended June 30, 2008 and 2007, there were no required Medical Center or employee contributions.

The actuarial value of UCRP assets and the actuarial accrued liability using the entry age normal cost method as of July 1, 2007, the date of the latest actuarial valuation, were $43.3 billion and $41.3 billion, respectively. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $42.02 billion at June 30, 2008. For the years ended June 30, 2008 and 2007, University contributions were $2,657 and $23,934, respectively. The annual UCRP expense was equal to the actuarially determined contributions. As a result, there was no obligation to UCRP at the end of either year.

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 retirement plans can be obtained from the 2007–2008 annual reports of the University of California Retirement plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

(Dollars in thousands)

## 12. 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.

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $975 and $4,336 for the years ended June 30, 2008 and 2007, respectively. During 2008 and 2007, as a result of an actuarial analysis, the Medical Center received a refund of premiums from the University of $7,319 and $6,187, respectively, that reduced the overall workers' compensation cost for the year.

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $7,975 and $6,461 for the years ended June 30, 2008 and 2007, respectively.

## 13. 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:

| | 2008 | 2007 |
|---|---|---|
| Salaries and employee benefits | $ 975 | $ 4,336 |
| Professional services | 40,718 | 31,719 |
| Other supplies and purchased services | 3,676 | 3,249 |
| Interest income (net) | (5,726) | (6,829) |
| Insurance | 7,975 | 6,461 |
| Total | $ 47,618 | $ 38,936 |

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.

## 13. Transactions with Other University Entities (Continued)

The total net amount of payments made by the Medical Center to the School of Medicine were $58,175 and $53,073 in 2008 and 2007, respectively. Of these amounts, $47,618 and $38,936 are reported as operating expenses for the years ended June 30, 2008 and 2007, respectively, and $10,557 and $14,137 are reported as health system support for the years ended June 30, 2008 and 2007, respectively.

## 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.

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. The Medical Center received an extension to complete the required renovation that by January 1, 2013 all general acute care inpatient buildings must be life safe. In addition, 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 $120 million was allocated to the Medical Center. The Medical Center spent $42,230 and $16,073 of its allocation during the years ended June 30, 2008 and 2007, respectively. As of June 30, 2008, any repayment the Medical Center may be obligated for under these financing arrangements is still being determined.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately $6.5 million, excluding interest, as of June 30, 2008.