University of California, Irvine Medical Center

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

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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 13 through 34 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, 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 12 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, Irvine 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, Irvine Medical Center (the "Medical Center") serves as the principal clinical teaching site for the University of California, Irvine School of Medicine. In 1976, the University of California, Irvine Medical Center, formerly known as Orange County Hospital, was purchased by The Regents. 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 444 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. Construction of a new, state-of-the-art hospital building began in February 2005 and will be completed in two phases. Phase I will be complete in September 2008 and open for patient care in early 2009. Phase II will be complete at the end of 2011. The new 480,000-square-foot hospital will contain 424 licensed beds, including 236 beds in the new main hospital building, 107 beds in the existing medical center's tower, 67 neuropsychiatric beds, and 14 rehabilitation beds. The new replacement hospital will meet the State of California's SB 1953, The Hospital Facilities Seismic Safety Act.

Outpatient services are provided by the Medical Center, which has a clinical practice group of over 450 faculty physicians and surgeons, primarily at the main campus pavilion buildings, Chao Cancer Center, Gottschalk Medical Plaza on the Irvine Campus, and Family Health Centers at Anaheim and Santa Ana clinics. The two Family Health Centers in Santa Ana and Anaheim are the designated Federally Qualified Health Centers owned and operated by the Medical Center to serve the underserved population 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 was selected as one of the best hospitals in the United States by *U.S. News & World Report* for the eighth consecutive year. The Medical Center ranks among the best in three specialty areas: urology, geriatrics, and gynecology.

During 2008, the Medical Center remained financially sound with a stable cash position and increased profitable operations.

For the year ended June 30, 2008, the Medical Center reported net income of $47.1 million and generated a margin of 8.9 percent. Total operating revenue increased by 7.7 percent. Total operating expenses increased by 7.7 percent due to increased staffing costs, inflationary increases in pharmaceuticals and medical supplies, and increased depreciation in facilities and equipment. The year ended with a cash position of $96.0 million.

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

- *Increase in labor costs*
  Labor costs continue to be adversely affected by the nationwide nursing shortage, compliance with legislation covering nurse staffing ratios, and increased premiums for employee healthcare. These combined factors 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 9.8 percent over 2007.

- *New University Hospital Financing*
  The construction of the New University Hospital included two phases. Phase I was budgeted to be $392.9 million and Phase II to be $162.9 million for construction and equipment. This project will be funded through a combination of hospital reserves, philanthropy, and bonds issuance. The Regents had issued $62.9 million of the Medical Center Pooled Revenue Bonds 2007 Series A in January 2007. During 2008, the Medical Center spent $102.9 million on the new hospital construction.

- *Medical Center Renovation Projects*
  In January 2008, the Regents approved five projects, including three separate projects on the Medical Center campus and two Phase II projects in the New University Hospital. The Phase II projects will complete development of the New University Hospital. The other three projects will upgrade two existing clinical facilities which include renovation in Obstetrics for clinical and education programs, construction of the Clinical Laboratory Replacement building, and renovation in the Chao Comprehensive Cancer Center. The renovation costs of the three projects totaling $33.7 million will be funded from hospital reserves, external financing, and capital leases.

Operating Statistics

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

Statistics	2008	2007	2006
Discharges	16,719	16,793	17,179
Average length of stay	6.1	6.1	6.0
Patient days:			
Medicare (non-risk)	26,624	26,137	27,524
Medi-Cal (non-risk)	37,483	35,141	32,081
CalOptima	–	1,888	4,769
Commercial	1,078	892	865
Contracts (discounted/per diem)	25,631	27,312	25,904
County/uninsured	10,865	11,543	12,761
Total patient days	101,681	102,913	103,904
Ambulatory/emergency room visits	524,422	527,358	557,847

Discharges and patient days (excluding newborns) decreased slightly by 0.4 percent and 1.2 percent, respectively, in 2008 due to the termination of all full-risk capitated contracts.

Total ambulatory and emergency visits decreased slightly by 2,936, or 0.6 percent, over the prior year, primarily in clinic visits.

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	$ 502,829	$ 467,882	$ 455,140
Other operating revenue	23,614	20,922	22,114
Total operating revenue	526,443	488,804	477,254
Total operating expenses	481,906	447,693	415,932
Income from operations	44,537	41,111	61,322
Total non-operating revenue	2,537	4,085	3,092
Income before other changes in net assets	$ 47,074	$ 45,196	$ 64,414
Margin	9.0 percent	9.2 percent	13.5 percent
Other changes in net assets	50,665	41,763	18,524
Net assets – beginning of year	441,922	354,963	272,025
Net assets – end of year	$ 539,661	$ 441,922	$ 354,963

Revenues
Total operating revenues for the year ended June 30, 2008 were $526.4 million, an increase of $37.6 million, or 7.7 percent, over 2007. Operating revenues for 2006 were $488.8 million, an increase of $11.6 million, or 2.4 percent, over 2006.

Net patient service revenue for 2008 increased by $34.9 million, or 7.5 percent, over the prior year. Net patient service revenue in 2007 increased by $12.7 million, or 2.8 percent, over 2006. The increase in 2008 was due to changes in a more favorable patient mix and improvements in charge capture. 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 ("CTS") funds and other non-patient services such as referral lab, cafeteria and parking operations. Other operating revenue increased by $2.7 million, or 12.9 percent, over 2007 due primarily to the increase in various county funding and non-patient revenues.

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

Payor	2008	2007	2006
Medicare (non-risk)	$ 129,580	$ 108,006	$ 106,619
Medi-Cal (non-risk)	118,695	123,765	132,757
CalOptima	–	3,780	13,905
Commercial	24,378	16,308	15,993
Contracts (discounted/per diem)	199,688	178,722	151,245
County/Uninsured	30,488	37,301	34,621
Total	$ 502,829	$ 467,882	$ 455,140

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 from Medicare 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. Net revenue for Medicare patients including managed care patients, increased by $21.6 million from 2007 due primarily to increased managed Medicare utilization, favorable Medicare decisions, and increased reimbursement under the new MS-DRG system.

Payments for Medi-Cal patients are made on a cost-based 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 continued to decrease by $5.1 million over 2007 due to the decrease in supplemental funding primarily, Medi-Cal hospital waiver DSH payments. For the year ended June 30, 2008, the Medical Center recorded additional revenue of $74.6 million from the Medi-Cal hospital waiver DSH payments under Senate Bill 1100, a decrease of $4.3 million from 2007.

Net revenue for contracts maintained a stable growth by increasing $21.0 million from 2007 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 decreased from the prior year by $6.8 million, or 18.3 percent. This category fluctuates from year to year depending on the patient volume and type of patients.

Operating Expenses

During 2008, total operating expenses of $481.9 million increased by $34.2 million, or 7.7 percent, over the prior year due to several factors – but primarily to an increase in labor costs, increased depreciation in facilities and equipment, and inflationary increases in purchased services and facility costs. Total operating expenses for 2007 increased by $31.8 million, or 7.6 percent, over 2006 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 employee salaries and benefits in 2008 increased by $24.8 million, or 9.8 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 2007 increased by $21.4 million, or 9.3 percent, over 2006.

Payments for professional services increased by $569 thousand, or 63.7 percent, over 2007 due to increase in contracted medical director expenses. In 2007, professional services decreased by $674 thousand, or 43.0 percent, over 2006.

Medical supply expense for 2008 increased by $1.4 million, or 1.8 percent, over the prior year due to a combination of inflationary increases and higher drug costs. Furthermore, medical supply expense increased by $5.2 million, or 7.7 percent, in 2007 over 2006 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 $4.3 million, or 4.2 percent, over 2007 due primarily to a $3.6 million increase in facility costs.

Depreciation and amortization expense increased by $3.0 million over the prior year due to increased depreciation of the capital assets. In 2007, depreciation and amortization increased by $2.2 million over 2006 due to similar increases in capital expenditures.

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 $90 thousand, or 5.0 percent, over the prior year.

Non-operating Revenues (Expenses)

Non-operating revenues, which include interest earned on invested cash balances and losses from disposal or retirement of capital assets, decreased by $1.5 million over 2007 due primarily to a decrease in STIP income. Non-operating revenues increased by $1.0 million in 2007 over 2006, due to an increase in STIP income.

Income before Other Changes in Net Assets

The Medical Center reported income before other changes in net assets of $47.1 million in 2008 as compared to $45.2 million in 2007 and $64.4 million in 2006. The Medical Center's net income increased by $1.9 million in 2008 over the prior year primarily due to increased patient revenue as a result of improved payor mix and the continued revenue/program enhancements.

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 $35.3 million this year.

- Transfers from the University included $77.7 million from the state and federal appropriations and $8.2 million from donated assets.

In total, the net assets increased for the year by $97.7 million to $539.7 million. The majority of this increase is the result of the excess of revenues over expenses of $47.1 million, the receipt of state capital appropriations for infrastructure projects of $77.7 million, the receipt from gift funds of $8.2 million, and the health system support of $35.3 million transferred out to the University.

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	$ 95,954	$ 100,823	$ 117,378
Patient accounts receivable (net)	63,924	61,818	61,541
Other current assets	31,131	29,218	28,407
Total current assets	191,009	191,859	207,326
Capital assets	513,933	381,163	237,446
Other assets	14,495	29,703	–
Total assets	719,437	602,725	444,772
Current liabilities	91,554	76,680	75,205
Long-term debt	88,222	84,123	14,604
Total liabilities	179,776	160,803	89,809
Net assets:			
Invested in capital assets (net)	409,689	286,892	215,626
Restricted:			
Expendable:			
Capital projects	13,643	28,677	–
Unrestricted	116,329	126,353	139,337
Total net assets	$ 539,661	$ 441,922	$ 354,963

Total current assets decreased by $0.9 million, or 0.5 percent, compared to the prior year due to the decrease in cash and cash equivalents. Total assets at June 30, 2008 were $116.7 million higher than the previous year.

Cash decreased by $4.9 million, or 4.8 percent, in 2008 due primarily to increased investments in capital assets.

Net patient accounts receivable, net of estimated uncollectibles, increased by 3.4 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 slightly by $1.9 million, or 6.6 percent, in 2008. The increase was primarily due to a combination of $1.2 million increase in pharmaceutical and supply inventories and a $2.0 million increase in other receivables, offset by a $1.5 million decrease in advances.

Capital assets increased by $132.8 million, or 34.8 percent, from the prior year primarily due to the increase in equipment and building costs of the new replacement hospital.

Other assets, including restricted funds for the replacement hospital and the bond issuance costs, decreased by $15.2 million, or 51.2 percent, from the prior year. The decrease in the restricted funds is due to the on-going expenditures in the construction of the replacement hospital.

Current liabilities increased by $14.8 million from the prior year mainly in the following areas: a $4.0 million increase in accounts payable, a $9.4 million increase in accrued salaries and benefits due to the timing of bi-weekly payroll payments, a $1.0 million increase in third party payor settlements due to pending open cost report settlements accounts payable, and a $0.6 million increase in the current portion of long-term debt due to the increase in capital leases, offset by $0.1 million decrease in other liabilities.

Long-term debt includes the 2007 Series A Pooled Revenue Bonds and long-term capital leases. The long-term debt increased by $4.1 million from the prior year, mainly due to the increase in long-term new debts. The long-term capital leases increased by $4.4 million from the prior year as capital expenditures increased to invest and replace existing equipment.

Net assets increased by $97.7 million in 2008. The change in net assets includes the excess of revenues over expenses of $47.1 million, contributed capital assets of $85.9 million, and the transfer of $35.3 million of funds to the School of Medicine as health system support.

Liquidity and Capital Resources

During 2008, the Medical Center generated $69.0 million from operating activities.

Cash flows from non-capital financing activities show the Medical Center's cash was reduced by $35.3 million for transfers to the University as health system support.

Included in cash flows from capital and related financing activities are state capital appropriations of $77.6 million and purchases of capital assets of $123.3 million. Principal payments on long-term debt and capital leases were $9.7 million and interest paid was $2.8 million.

Cash flows from investment activities show that $4.0 million was provided by interest income. Overall, cash flow decreased to $96.0 million from $100.8 million in 2007 due mainly to the increased capital expenditures in the new hospital.

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

	2008	2007	2006
Days cash on hand	76.0	85.4	106.5
Days of revenue in accounts receivable	53.3	56.3	63.2
Debt service coverage ratio	6.3	7.0	9.3

Days cash on hand decreased to 76 days in 2008 from 85.4 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, net days in receivables decreased by 3 days to 53.3. The decrease was the result of the success in improving billing and cash collection efforts.

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 6.3 versus 7.0 in 2007. The decrease in debt service coverage ratio was due to the increase in long-term debt, including the issuance of capital leases and the related principal and interest repayments in 2008.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2008, the UC Irvine Medical Center's capital program continued to address the requirements in the State of California Senate Bill 1953 ("SB 1953"). The cost for the Medical Center, which is now compliant with the requirements, is $357.5 million. The capital cost of compliance was financed through the use of state lease revenue bond funds, hospital reserves, gift funds and debt. In 2008, $14.9 million was spent from hospital reserve and gift funds.

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, Irvine Medical Center
Statements of Net Assets
June 30, 2008 and 2007
(Dollars in thousands)

	2008	2007
Assets		
Current assets:		
Cash	$ 95,954	$ 100,823
Patient accounts receivable, net of estimated uncollectibles of $4,456 and $4,810, respectively	63,924	61,818
Other receivables	13,596	11,599
Inventory	13,147	11,978
Prepaid expenses and other assets	4,388	5,641
Total current assets	191,009	191,859
Restricted assets:		
Cash restricted for replacement hospital	13,643	28,677
Capital assets, net	513,933	381,163
Deferred costs of issuance	852	1,026
Total assets	719,437	602,725
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	19,936	16,006
Accrued salaries and benefits	36,099	26,719
Third-party payor settlements	25,860	24,823
Current portion of long-term debt and capital leases	9,375	8,732
Other liabilities	284	400
Total current liabilities	91,554	76,680
Long-term debt and capital leases, net of current portion	88,222	84,123
Total liabilities	179,776	160,803
Net Assets		
Invested in capital assets, net of related debt	409,689	286,892
Restricted:		
Expendable:		
Capital projects	13,643	28,677
Unrestricted	116,329	126,353
Total net assets	$ 539,661	$ 441,922

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, 2008 and 2007
(Dollars in thousands)

	2008	2007
Net patient service revenue, net of provision for doubtful accounts of $7,666 and $6,242, respectively	$ 502,829	$ 467,882
Other operating revenue:		
Clinical teaching support	8,308	8,168
Other	15,306	12,754
Total other operating revenue	23,614	20,922
Total operating revenue	526,443	488,804
Operating expenses:		
Salaries and employee benefits	277,636	252,831
Professional services	1,462	893
Medical supplies	74,698	73,348
Other supplies and purchased services	105,347	100,941
Depreciation and amortization	20,877	17,884
Insurance	1,886	1,796
Total operating expenses	481,906	447,693
Income from operations	44,537	41,111
Non-operating revenues (expenses):		
Interest income	4,030	5,062
Interest expense	(1,086)	(862)
Loss on disposal of capital assets	(407)	(115)
Total non-operating revenues	2,537	4,085
Income before other changes in net assets	47,074	45,196
Other changes in net assets:		
Health system support	(35,292)	(37,731)
Transfers from University, net	85,957	79,494
Total other changes in net assets	50,665	41,763
Increase in net assets	97,739	86,959
Net assets – beginning of year	441,922	354,963
Net assets – end of year	$ 539,661	$ 441,922

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, 2008 and 2007
(Dollars in thousands)

	2008	2007
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 501,760	$ 468,915
Payments to employees	(216,196)	(200,081)
Payments to suppliers	(184,140)	(181,916)
Payments for benefits	(52,060)	(49,782)
Other receipts, net	19,615	19,548
Net cash provided by operating activities	68,979	56,684
Cash flows from noncapital financing activities:		
Health system support	(35,292)	(37,731)
Net cash used by noncapital financing activities	(35,292)	(37,731)
Cash flows from capital and related financing activities:		
Transfers from (to) University	505	(122)
Proceeds from debt issuance	–	63,441
Proceeds from sale of capital assets	32	–
Bond issuance costs	–	(1,048)
State capital appropriations	77,604	75,939
Purchases of capital assets	(123,317)	(141,184)
Principal paid on long-term debt and capital leases	(9,655)	(8,064)
Interest paid on long-term debt and capital leases	(2,789)	(855)
Net cash used by capital and related financing activities	(57,620)	(11,893)
Cash flows from investing activities:		
Interest income received	4,030	5,062
Change in restricted assets	15,034	(28,677)
Net cash provided (used) by investing activities	19,064	(23,615)
Net decrease in cash	(4,869)	(16,555)
Cash – beginning of year	100,823	117,378
Cash – end of year	$ 95,954	$ 100,823

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, 2008 and 2007
(Dollars in thousands)

	2008	2007
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 44,537	$ 41,111
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	20,877	17,884
Provision for doubtful accounts	7,666	6,242
Changes in operating assets and liabilities:		
Patient accounts receivable	(9,772)	(6,519)
Other receivables	(1,997)	(76)
Inventory	(1,169)	(1,127)
Prepaid expenses and other assets	1,253	392
Accounts payable and accrued expenses	(2,717)	(5,861)
Accrued salaries and benefits	9,380	2,968
Third-party payor settlements	1,037	1,309
Other liabilities	(116)	361
Net cash provided by operating activities	$ 68,979	$ 56,684
Supplemental noncash activities information:		
Capital assets acquired through capital lease obligations	$ 14,410	$ 15,673
Amortization of deferred bond premium	$ 13	$ 15
Amortization of deferred costs of issuance	$ 17	$ 22
Payables for property and equipment	$ 6,647	$ 1,182
Gifts of capital assets	$ 8,207	$ 3,677
Transfer of capital assets from (to) the University	$ 359	$ (115)
Capitalized interest	$ 2,894	$ 845

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 444 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 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.

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.

2. Summary of Significant Accounting Policies (Continued)

Cash (Continued)
The Medical Center's cash at June 30, 2008 and 2007 was $95,954 and $100,823, 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 2008 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 prepayments for pharmaceuticals and medical supplies, rent, equipment and maintenance contracts.

Restricted Assets, Replacement Hospitals
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.

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.

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)

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.

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.

2. Summary of Significant Accounting Policies (Continued)

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 statement 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 statement 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.

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.

2. Summary of Significant Accounting Policies (Continued)

Transactions with the University and University Affiliates (Continued)
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.

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.

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's fiscal year beginning July 1, 2009. This statement requires capitalization of identifiable intangible assets in the statement of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life.

2. Summary of Significant Accounting Policies (Continued)

New Accounting Pronouncements (Continued)
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 statement 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).

  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.

3. Net Patient Service Revenue (Continued)

- ***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 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, 2008 and 2007, the Medical Center recorded total Medi-Cal waiver revenue of $74,599 and $78,958, respectively.

- ***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 $1,883 and $1,201, 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.

Amounts due from Medicare and Medi-Cal represent 15.9 percent and 21.6 percent of net patient accounts receivable for fiscal year at June 30, 2008. In 2007, the amount due from Medicare and Medi-Cal were 12.1 percent and 20.2 percent respectively.

For the years ended June 30, 2008 and 2007, net patient service revenue included favorable cost report settlements of $6,328 and $3,258, respectively, primarily from Medicare and Medi-Cal Programs.

(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)	$ 129,580	$ 108,006
Medi-Cal (non-risk)	118,695	123,765
CalOptima	–	3,780
Commercial	24,378	16,308
Contracts (discount/per diem)	199,688	178,722
County	18,994	14,552
Non-sponsored (uninsured)	11,494	22,749
Total	$ 502,829	$ 467,882

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	$ 96,831	$ 110,122
Estimated cost of charity care	$ 21,363	$ 27,519

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $10,694 and $15,918 for the years ended June 30, 2008 and 2007, respectively.

(Dollars in thousands)

5. 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	$ 7,394	$ –	$ –	$ 7,394	$ –	$ –	$ 7,394
Buildings and improvements	192,422	7,228	–	199,650	11,015	(997)	209,668
Equipment	102,495	21,337	(3,811)	120,021	27,907	(4,842)	143,086
Construction in progress	126,274	133,151	–	259,425	115,523	–	374,948
Capital assets, at cost	$ 428,585	$ 161,716	$ (3,811)	$ 586,490	$ 154,445	$ (5,839)	$ 735,096

	2006	Depreciation	Disposals	2007	Depreciation	Disposals	2008
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 126,134	$ 7,010	$ –	$ 133,144	$ 7,805	$ (706)	$ 140,243
Equipment	65,005	10,874	(3,696)	72,183	13,431	(4,694)	80,920
Accumulated depreciation and amortization	$ 191,139	$ 17,884	$ (3,696)	$ 205,327	$ 21,236	$ (5,400)	$ 221,163
Capital assets, net	$ 237,446			$ 381,163			$ 513,933

Equipment under capital lease obligations and related accumulated amortization was $48,819 and $18,137 in 2008, respectively, and $45,060 and $19,684 in 2007, respectively.

The University has acquired certain facilities and equipment under capital leases with the State of California Public Works Board (SPWB). 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. Capital assets acquired with SPWB funds were $72,272 and $74,954 for the years ended June 30, 2008 and 2007, respectively.

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. There was no expenditure from this source in the year ended June 30, 2008. A total of $183 was shown as contributions from the University for building program on the statement of revenues, expenses and changes in net assets for the year ended June 30, 2007.

(Dollars in thousands)

6. 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, interest rates ranging from 4.5 percent to 5.0 percent, payable semi-annually, with annual principle payments beginning in 2012 through 2047	$ 62,920	$ 62,920
University of California General Revenue Bonds, interest rates from 1.0 to 5.125 percent, payable semi-annually, with annual principal payments through 2017	3,507	3,816
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 2.5 percent to 4.1 percent payable through 2013	30,677	25,613
Unamortized bond premium	493	506
Total debt and capital leases	97,597	92,855
Less: Current portion of debt and capital leases	(9,375)	(8,732)
Noncurrent portion of debt and capital leases	$ 88,222	$ 84,123

(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, 2008			
Current portion at June 30, 2007	$ 307	$ 8,425	$ 8,732
Reclassification from noncurrent	336	9,975	10,311
Principal payments	(309)	(9,346)	(9,655)
Amortization of bond premium	(13)	–	(13)
Current portion at June 30, 2008	$ 321	$ 9,054	$ 9,375
Noncurrent portion at June 30, 2007	$ 66,935	$ 17,188	$ 84,123
New obligations	–	14,410	14,410
Reclassification to current	(336)	(9,975)	(10,311)
Noncurrent portion at June 30, 2008	$ 66,599	$ 21,623	$ 88,222
Year Ended June 30, 2007			
Current portion at June 30, 2006	$ 296	$ 6,920	$ 7,216
Reclassification from noncurrent	322	9,286	9,608
Principal payments	(296)	(7,768)	(8,064)
Amortization of bond premium	(15)	–	(15)
Current portion at June 30, 2007	$ 307	$ 8,425	$ 8,732
Noncurrent portion at June 30, 2006	$ 3,816	$ 10,788	$ 14,604
New obligations	62,920	15,673	78,593
Bond premium	521	–	521
Reclassification to current	(322)	(9,286)	(9,608)
Noncurrent portion at June 30, 2007	$ 66,935	$ 17,188	$ 84,123

Medical Center Pooled Revenue Bonds are issued to finance 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 $1,054,910 of which $62,920 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.

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

General Revenue Bonds, collateralized solely by general revenues of the University, finance certain Medical Center projects. The Medical Center is charged for its proportional 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 indenture 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.

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 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.

(Dollars in thousands)

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

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	Capital Leases	Total Payments	Principal	Interest
2009	$ 3,394	$ 9,904	$ 13,298	$ 9,375	$ 3,923
2010	3,393	8,320	11,713	8,083	3,630
2011	3,393	6,813	10,206	6,824	3,382
2012	4,082	5,446	9,528	6,363	3,165
2013	4,081	2,131	6,212	3,218	2,994
2014 – 2018	19,909	–	19,909	5,951	13,958
2019 – 2023	17,946	–	17,946	5,370	12,576
2024 – 2028	17,944	–	17,944	6,745	11,199
2029 – 2033	17,950	–	17,950	8,490	9,460
2034 – 2038	17,942	–	17,942	10,600	7,342
2039 – 2043	17,942	–	17,942	13,210	4,732
2044 – 2047	14,355	–	14,355	12,875	1,480
Total future debt service	142,331	32,614	174,945	$ 97,104	$ 77,841
Less: Interest component of future payments	(75,904)	(1,937)	(77,841)		
Principal portion of future payments	66,427	30,677	97,104		
Adjusted by:					
Unamortized bond premium	493	–	493		
Total debt	$ 66,920	$ 30,677	$ 97,597		

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

(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, 2008 and 2007 was $4,454 and $3,774, respectively. The terms of the operating leases extend through the year of 2013.

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	$ 4,635
2010	2,542
2011	1,914
2012	1,021
2013	516
Total	$ 10,628

8. 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 $5.7 million, $5.0 million and $4.3 million for the years ended June 30, 2008, 2007 and 2006, respectively.

8. 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.

9. 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)

10. 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 statement of revenues, expenses and changes in net assets, were $4,847 and $5,915 for the years ended June 30, 2008 and 2007, respectively. During 2008 and 2007, as a result of actuarial analysis, the Medical Center received a refund of premiums of $2,318 and $1,721, respectively, 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 $1,886 and $1,796 for the years ended June 30, 2008 and 2007, respectively.

11. 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:

	2008	2007
Professional services	$ 1,462	$ 893
Other supplies and purchased services	23,170	20,212
Interest income (net)	(3,843)	(4,861)
Insurance	1,886	1,796
Administrative costs	(4,406)	(4,406)
Total	$ 18,269	$ 13,634

11. Transactions with Other University Entities (Continued)

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 $53,561 and $51,365 in 2008 and 2007, respectively. Of these amounts, $18,269 and $13,634 are reported as operating expenses for the years ended June 30, 2008 and 2007, respectively, and $35,292 and $37,731 are reported as health system support for the years ended June 30, 2008 and 2007, respectively.

12. 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. 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 $90 million and $32 million 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.

(Dollars in thousands)

12. Commitments and Contingencies (Continued)

The Medical Center is near completion of the phase I construction of the new replacement hospital. The total cost of this phase I 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, 2008, the Medical Center had outstanding commitments for capital expenditures in connection with the construction of approximately $22.1 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.

The total project cost for the phase II construction of the new replacement hospital is estimated to be $162.9 million funded from external financing.

Gift funds used for construction in progress totaling $7.3 million in 2008 and $3.6 million in 2007 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, 2008 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.