

**University of California,  
Davis Medical Center**  
**Report on Audits of Financial Statements**  
**For the Years Ended June 30, 2009 and 2008**

**University of California, Davis Medical Center**  
**Index**  
**June 30, 2009 and 2008**

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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 15 through 38, 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, 2009 and 2008, 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, 2009 and 2008, 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 14 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.



October 12, 2009

# University of California, Davis Medical Center

## Management's Discussion and Analysis

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### Introduction

The objective of 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, 2009, with selected comparative information for the years ended June 30, 2008 and 2007. 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 (2007, 2008, 2009, 2010, etc.) in this discussion refer to 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 University of California Davis ("UCD") 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 613-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 16 Primary Care Network ("PCN") satellite clinics in the surrounding communities of Auburn, Carmichael, 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, Merced, 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 770 faculty and contract physicians, 660 residents and fellows, and 110 PCN physicians.

For the year ended June 30, 2009, 33,295 patients were admitted to the Medical Center, of which approximately 52 percent were admitted through the emergency room, and overall occupancy was approximately 85 percent. During the same period, there were over 973,000 outpatient visits, of which approximately 880,000 were visits to the Clinics and the PCN Sites and approximately 55,000 were emergency room visits.

# University of California, Davis Medical Center

## Management's Discussion and Analysis

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The Medical Center is constructing a new surgical and emergency services pavilion. Besides housing the surgery and emergency departments, the new hospital pavilion will house intensive care units, the burn unit and several ancillary departments such as the laboratory, radiology, and pharmacy and therapy services. The additional space in the pavilion is designed to expand facilities to meet programmatic requirements. Additionally, the project is vital to compliance with the seismic safety mandated by Senate Bill 1953 ("SB 1953"). The new hospital pavilion will provide replacement space for the north and south wings of the hospital which are not seismically compliant.

### Operating Statistics

The following table presents utilization statistics for the Medical Center for 2009, 2008 and 2007:

<u>Statistics</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Admissions	33,295	33,678	33,825
Average daily census	480	476	471
Discharges	33,230	33,584	33,706
Average length of stay	5.3	5.2	5.1
Case mix index	1.65	1.63	1.56
Patient days:			
Medicare (non-risk)	42,231	41,217	39,949
Medi-Cal	48,006	46,020	45,462
Commercial	121	278	104
County	13,324	14,340	15,758
Contracts (discounted/per-diem)	49,143	49,071	48,678
Contracts (capitated)	20,526	21,594	20,051
Emergency visits	<u>1,898</u>	<u>1,621</u>	<u>1,852</u>
Total patient days	<u>175,249</u>	<u>174,141</u>	<u>171,854</u>
Outpatient visits:			
Hospital clinics	419,165	405,114	368,253
Primary care network	461,264	469,207	458,989
Home Health/Hospice	37,607	43,972	44,020
Emergency Visits	<u>55,238</u>	<u>55,758</u>	<u>52,937</u>
Total visits	<u>973,274</u>	<u>974,051</u>	<u>924,199</u>

Patient service revenue depends on inpatient occupancy levels, the complexity of care provided, the volume of outpatient visits, and the charges or negotiated payment rates for services provided. In 2009, admissions decreased by 383 or 1.1 percent as compared to 2008. The average length of stay increased from 5.2 to 5.3 days due to a slightly higher case mix index, a measure of the acuity of care, in 2009. The Medical Center's case mix index has continued to rise as a result of growing surgical volumes. Total outpatient visits were flat in 2009 as compared to 2008. Hospital based clinic visits increased 3.5 percent due to initiatives undertaken by management to improve patient access. The decrease of 1.7 percent in primary care network visits is due to turnover of physicians and our ability to fill physician vacancies. Home health and hospice visits decreased due to the additional time required during each visit to capture patient data during the transition period to the new electronic medical record system.

## University of California, Davis Medical Center Management's Discussion and Analysis

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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. Primary care network visits increased by 2.2 percent in 2008. Emergency visits increased by 5.3 percent in 2008 primarily due to the growth in population in the Sacramento area.

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

This statement shows the revenues, expenses and changes in net assets for the Medical Center for 2009 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2009, 2008 and 2007 (dollars in thousands):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net patient service revenue	\$ 1,061,848	\$ 1,014,318	\$ 928,896
Other operating revenue	<u>15,519</u>	<u>14,857</u>	<u>14,736</u>
Total operating revenue	1,077,367	1,029,175	943,632
Total operating expenses	<u>1,019,452</u>	<u>976,766</u>	<u>881,503</u>
Income from operations	57,915	52,409	62,129
Total non-operating expenses	<u>(2,767)</u>	<u>(7,441)</u>	<u>(4,915)</u>
Income before other changes in net assets	<u>\$ 55,148</u>	<u>\$ 44,968</u>	<u>\$ 57,214</u>
Margin	5.1 percent	4.4 percent	6.1 percent
Other changes in net assets	(9,522)	23,051	11,531
Net assets – beginning of year	<u>748,319</u>	<u>680,300</u>	<u>611,555</u>
Net assets – end of year	<u>\$ 793,945</u>	<u>\$ 748,319</u>	<u>\$ 680,300</u>

### **Revenues**

Total operating revenues for the year ended June 30, 2009 were \$1.077 million, an increase of \$48.2 million, or 4.7 percent, over 2008. Total operating revenues for 2008 of \$1.029 million, an increase of \$85.5 million, or 9.1 percent, over 2007.

Net patient service revenue for 2009 increased by \$47.5 million, or 4.7 percent, over 2008. 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. Revenues increased in 2009 due to a slight increase in patient days, the higher case mix index, improved reimbursement from third-party payors and one-time favorable cost report settlements and appeals of \$7.9 million in the current year. Net patient service revenue in 2008 increased by \$85.4 million, or 9.2 percent, over 2007. The increase in 2008 was primarily due to increased inpatient days and favorable payor mix.

## University of California, Davis Medical Center Management's Discussion and Analysis

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

The following table summarizes net patient service revenue for 2009, 2008 and 2007 (dollars in thousands):

<u>Payor</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Medicare (non-risk)	\$ 205,835	\$ 186,471	\$ 178,598
Medi-Cal (non-risk)	135,173	115,914	108,683
Commercial	897	1,871	1,378
County	37,452	45,174	32,718
Contracts (discounted/per diem)	522,340	505,491	461,842
Contracts (capitated)*	157,609	153,729	140,839
Non-sponsored/self-pay	<u>2,542</u>	<u>5,668</u>	<u>4,838</u>
Total	<u>\$ 1,061,848</u>	<u>\$ 1,014,318</u>	<u>\$ 928,896</u>

\*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 \$11.4 million over the prior fiscal year. This increase is primarily due to increased patient days and a higher case mix index for Medicare patients in 2009. In 2008, net patient revenue for Medicare increased by \$7.9 million over 2007. This increase was primarily due to increased admissions and patient days.

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”). Net patient revenue for Medi-Cal increased in 2009 by \$19.3 million from 2008. This increase is primarily due to the receipt of more waiver growth funding related to the increased volumes of Medi-Cal patients treated by the Medical Center. In 2008, 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.

## University of California, Davis Medical Center Management's Discussion and Analysis

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In 2009, county net patient revenue decreased by \$7.7 million, or 17.1 percent, primarily due to cancellation of the contract with the County. The Medical Center is continuing to treat patients covered by the County, however, due to the current economic environment; the County has delayed authorization and payment for eligible patients. In 2008, 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 increase in volume.

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 at contracted rates or per-diem rates, which are less than billed charges. In 2009, contracts net patient revenue discounted and per-diem contracts increased by \$16.8 million, or 3.3 percent, over 2008 primarily due to increased contract rates and slightly higher volumes. In 2008, contracts net patient revenue increased by \$43.6 million, or 9.5 percent, also due to contract rate increases and higher volumes.

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. In 2009, the net patient service revenue for contracts that are full-risk capitation increased by \$3.9 million, or 2.5 percent, primarily due to increased enrollment and higher contract rates. In 2008, the increase was \$12.9 million, or 9.2 percent, due primarily to increased enrollment and prior year revenue adjustments.

The non-sponsored/self-pay net revenue decreased by \$3.1 million, or 55.2 percent in 2009, and increased by \$0.8 million, or 17.2 percent, in 2008. This category fluctuates from year to year due to changes in the volume of uninsured patients and current overall economic conditions.

### Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2009, 2008 and 2007 (dollars in thousands):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Salaries and wages	\$ 490,873	\$ 472,640	\$ 421,822
Employee benefits	113,408	103,976	94,469
Professional services	80,347	76,283	63,871
Medical supplies	166,422	155,856	139,585
Other supplies and purchased services	84,967	93,686	89,893
Depreciation and amortization	57,372	57,562	55,377
Insurance	9,940	7,975	6,461
Other	<u>16,123</u>	<u>8,788</u>	<u>10,025</u>
Total operating expenses	<u>\$ 1,019,452</u>	<u>\$ 976,766</u>	<u>\$ 881,503</u>

During 2009, total operating expenses for 2009 were \$1,019 million, an increase of \$42.7 million, or 4.4 percent, over 2008. Increases in operating expense were primarily due to higher patient volumes, and inflationary pressures in employee benefit costs, pharmaceuticals and supply costs. In 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 impact of labor costs of the continued nursing shortage.



## University of California, Davis Medical Center Management's Discussion and Analysis

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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. About one-half of the Medical Center's workforce, including nurses and employees providing ancillary services, expands or contracts with patient volumes. In 2009, salaries and wages grew by \$18.2 million, or 3.9 percent, over the prior year due to higher patient volumes. Due to current economic conditions, Medical Center management implemented cost control measures by limiting the growth in full time equivalent employees and foregoing annual salary adjustments. In 2008, salary and wages grew by \$50.8 million, or 12.0 percent, attributable to increases in both FTE's and annual salary adjustments, including contractual increases for represented employees.

In 2009, increases in employee benefit costs were \$9.4 million, or 9.1 percent. The increase is primarily due to higher health insurance premiums as a result of inflation. 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.

Professional services include payments to the UC Davis School of Medicine for physician services in the hospital and clinics, payments to other health care providers for capitated patients, outside lab fees, organ acquisition fees, transcription and legal fees. Payments for professional services increased by \$4.1 million, or 5.3 percent, over 2008 due to higher health care costs paid to other providers for capitated patients. In 2008, professional services increased by \$12.4 million, or 19.4 percent, over 2007 due to higher payments to the UC Davis School of Medicine for physician services.

Medical supplies expense, including pharmaceuticals, for 2009 increased by \$10.6 million, or 6.8 percent, over 2008. Medical supplies expense for 2008 increased by \$16.3 million, or 11.7 percent. Medical supplies increased partly due to higher inpatient and clinic volumes. Medical supplies are subject to significant inflationary pressures, due to escalating pharmaceutical costs and continued innovation in implants, prosthetics and other medical supplies. Supply costs have remained steady at 15.7, 15.4 and 15.0 percent in 2009, 2008 and 2007 as a percentage of net patient service revenue due to ongoing supply chain improvement initiatives undertaken by management.

Other supplies and purchased services include non-medical supplies and other purchased services. Other supplies and purchased services decreased by \$8.7 million, or 9.3 percent, over the prior year due to reduced discretionary spending. Other supplies and purchased services increased \$3.8 million, or 4.2 percent, in 2008 over 2007.

In 2009, depreciation and amortization expense decreased by \$.2 million as compared to the prior year since most of the capital expenditures during 2009 were related to the construction of the new hospital pavilion, which has not been placed in service. In 2008, depreciation and amortization expense increased by \$2.2 million over the prior year due to additional purchases of capital equipment made during the year.

## University of California, Davis Medical Center Management's Discussion and Analysis

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The Medical Center is insured through the University's malpractice, general liability, workers' compensation and health and welfare self-insurance programs. All claims and related expenses are paid from the University's self-insurance funds. Net insurance expense of \$9.9 million was paid for 2009, representing the Medical Center's premiums for the self-insured programs. Net insurance expense of \$8.0 million was paid for 2008 and \$6.5 million was paid for 2007. Due to favorable claims experience, the Medical Center received refunds of premiums from the University, of \$6.3 million for 2009, \$7.3 million for 2008 and \$6.2 million for 2007 for workers' compensation.

Other expenses increased \$7.3 million for 2009 and decreased \$1.2 million for 2008.

### Income from Operations

The Medical Center reported income from operations of \$57,915 and operating revenue of \$1,077,367, resulting in an operating margin of 5.4 percent in 2009 as compared to an operating margin of 5.1 percent in 2008 and 6.6 percent in 2007. One-time favorable cost report settlements and appeals and cost control measures implemented by management resulted in an increase in the operating margin in 2009. For 2008, expense inflation, primarily for labor and supply costs, outpaced increases in patient volumes and reimbursement rates.

### Non-operating Revenue (Expenses)

Non-operating revenue and expense includes interest income and expense and the gain or loss on disposal of capital assets. Total non-operating expenses were \$2.8 million for 2009 compared to \$7.4 million in the prior year. The decrease in non-operating expenses was primarily related to capitalizing additional interest on the hospital pavilion which is in the process of being constructed.

In 2008, total non-operating expenses were \$7.4 million compared to \$4.9 million in 2007. 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 \$55.1 million for 2009 compared to \$45.0 million for 2008 and \$57.2 million in 2007. The Medical Center's net income increased in 2009 mainly due to improvements in the operating margin and decreased interest expense related to capitalizing additional interest on the construction in progress. In 2008, the decrease was a result of a lower operating margin and higher interest expense.

### Other Changes in Net Assets

The other changes in net assets for 2009, 2008 and 2007 include:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
State capital appropriations	\$ 37,630	\$ 50,576	\$ 16,073
Donated assets	—	—	8,200
Health system support	(48,783)	(10,557)	(14,137)
Transfers from university, net	<u>1,631</u>	<u>(16,968)</u>	<u>1,395</u>
Total other changes in net assets	<u>\$ (9,522)</u>	<u>\$ 23,051</u>	<u>\$ 11,531</u>

## University of California, Davis Medical Center Management's Discussion and Analysis

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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 2009 and 2008 are the following:

- Contributions from the University for the building program of \$37.6 million are related to the Surgery and Emergency Pavilion project and represent funding from the State Public Works Board Bonds. In 2008, the contributions for the building program were \$50.6 million.
- Health system support represents transfers primarily to the School of Medicine for academic and research support. The Medical Center transferred \$48.8 million in 2009 and \$10.6 million in 2008.
- Transfers from the University totaled \$1.6 million and were primarily related to parking and gift revenues that were transferred to the hospital. Transfers in 2008 totaled \$17.0 million and were primarily the book value of three buildings used for research and academic activities by the School of Medicine that were formerly used for clinical activities.

In total, the net assets increased for the year ended June 30, 2009 by \$45.6 million to \$793.9 million. 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.

## University of California, Davis Medical Center Management's Discussion and Analysis

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### Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2009, 2008 and 2007 (dollars in thousands):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Current assets:			
Cash	\$ 122,721	\$ 176,473	\$ 153,305
Restricted assets	954	848	1,819
Patient accounts receivable (net)	161,351	180,752	153,362
Other current assets	<u>60,339</u>	<u>45,551</u>	<u>34,869</u>
Total current assets	345,365	403,624	343,355
Capital assets (net)	1,014,077	916,211	818,576
Other assets	<u>23,195</u>	<u>19,192</u>	<u>85,446</u>
Total assets	<u>1,382,637</u>	<u>1,339,027</u>	<u>1,247,377</u>
Current liabilities	197,567	188,207	161,445
Long-term debt	<u>391,125</u>	<u>402,501</u>	<u>405,632</u>
Total liabilities	<u>588,692</u>	<u>590,708</u>	<u>567,077</u>
Net assets:			
Invested in capital assets (net)	579,838	464,101	441,727
Restricted	954	848	1,819
Unrestricted	<u>213,153</u>	<u>283,370</u>	<u>236,754</u>
Total net assets	<u>\$ 793,945</u>	<u>\$ 748,319</u>	<u>\$ 680,300</u>

Total current assets decreased by \$58.0 million, or 14.4 percent, from 2008 to 2009 primarily due to the use of cash for capital investments. Total current assets for 2008 increased by \$60.3 million over 2007 primarily due to an increase in patient accounts receivable of \$27.4 million and cash of \$23.2 million.

Cash decreased by \$53.8 million in 2009. The decrease was primarily due to the use of cash for construction of the hospital pavilion, offset by the cash generated from operations. Cash increased by \$23.2 million in 2008 mainly due to the timing of payments.

Net patient accounts receivable decreased by \$19.4 million in 2009 due to an increased focus on collection efforts for patient accounts from third-party payors and increased by \$27.4 million in 2008 due to increases in volumes and rates.

In 2009, other current assets, including non-patient receivables, inventory and prepaid expenses, increased by \$14.8 million over the prior fiscal year. In 2008, other current assets increased by \$10.7 million over 2007.

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Other non-current assets increased by \$4.0 million in 2009 from 2008 due to income earned on joint venture investments. In 2008, other non-current assets decreased by \$66.3 million from 2007 because \$65.0 million was drawn for expenditures on the hospital pavilion project.

Net capital assets increased by \$97.9 million from 2008 to 2009 and \$97.6 million from 2007 to 2008 primarily due to continued construction of the hospital pavilion, offset by depreciation expense.

Current liabilities increased by \$9.4 million from 2008 to 2009 primarily due to an increase of \$13.7 million in the third-party settlement payable, an increase of \$4.6 million in accrued salaries and benefits and a decrease in accounts payable and accrued expenses of \$10.7 million. 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 \$11.4 million from 2008 to 2009 and \$3.1 million from 2007 to 2008. The decreases are primarily due to debt service payments.

Total net assets increased by \$45.6 million from 2008 to 2009. This increase reflects income of \$55.1 million, contributions from the University building program of \$37.6 million, offset by payments to the School of Medicine of \$48.8 million to support the research and academic missions. In 2008, total net assets increased by \$68.0 million from 2007 to 2008 due to \$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 activities.

# University of California, Davis Medical Center

## Management's Discussion and Analysis

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### Liquidity and Capital Resources

During 2009, the Medical Center generated \$135.5 million and \$90.8 million from operating activities in 2009 and 2008, respectively.

In 2009, cash flows from non-capital financing activities show the Medical Center's cash was reduced by \$47.2. In 2008, cash flows from non-capital financing activities show the Medical Center's cash was reduced by \$8.3 million. These reductions were primarily for transfers to the University for health system support.

In 2009, cash flows from capital and related financing activities included the contributions from the University for funding from the State Public Works Board Bonds of \$37.6 million, proceeds from financing loans of \$15.6 million, purchases of capital assets of \$163.1 million, principal payments on long-term debt and capital leases of \$27.7 million, interest paid of \$9.1 million. In 2008, cash flows from capital and related financing activities included the contributions from the University for funding from the State Public Works Board Bonds of \$50.6 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, interest paid of \$14.9 million, respectively. Additionally, proceeds from new debt issuance totaled \$333.6 million 2008, while the refinancing of outstanding debt decreased cash flows by \$324.3 million in 2008.

Cash flows from investing activities in 2009 and 2008 show that \$4.5 million and \$5.7 million was provided by interest income. Restricted assets for capital projects of \$66.0 million were used in 2008. Overall cash decreased to \$122.7 million in 2009 from \$176.5 million in 2008.

The following table shows key liquidity and capital ratios for 2009, 2008 and 2007:

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Days cash on hand	47	68	65
Days of revenue in accounts receivable	61	58	47
Capital investment (\$ in millions)	\$1,014	\$ 916	\$ 819
Debt service coverage ratio	2.6	2.5	3.5

Days cash on hand decreased to 47 days in 2009 from 68 days in 2008. 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 Medical Center's cash decreased due to the use of hospital reserves to pay for the construction of the new hospital pavilion.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2009, days in accounts receivable increased by 3 days to 61.

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 2009 is 2.6 versus 2.5 in 2008. In 2008, the Medical Center's ratio for 2008 was 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 1.0 required by the Bond Indenture for 2007.

# University of California, Davis Medical Center

## Management's Discussion and Analysis

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### Looking Forward

#### *The Hospital Facilities Seismic Safety Act ("SB 1953")*

During 2009, the UC Davis Medical Center's capital program continued to address the requirements in 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 2009 and 2008, \$42.0 million and \$42.2 million, respectively, were 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*

In 2005, 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 recently enacted federal economic stimulus package, which increases California's federal DSH allotment and the federal matching rate for FFS payments, will increase the net payment amounts under the waiver

## University of California, Davis Medical Center Management's Discussion and Analysis

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to the Medical Centers for the period October 2008 through December 2010. Although the 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.

### *Children's Hospital Bond Act of 2008*

In 2008, California voters passed Proposition 3 that enables the state of California to issue \$980 million in General Obligation bonds to fund capital improvement projects for children's hospitals. Each of the University medical centers is eligible for \$39 million of grant funding from this pool of funds. Grant funds must be used for capital projects associated with the care of children and must be used prior to June 30, 2018.

### *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.

Effective with the July 1, 2008 actuarial valuation, a new funding policy, including a three-year amortization period for any initial surplus, was adopted for the Plan. The new funding policy determines recommended total contributions based upon the Plan's Normal Cost adjusted for any surplus or underfunding, starting with the Plan Year beginning July 1, 2009. University and member contributions to the plan have generally not been required since November 1, 1990 for most membership classifications. Member pretax contributions made to the Plan are redirected to the University of California Defined Contribution plan on a mandatory basis.

The Regents has authorized the initial resumption of shared employer and employee contributions to the Plan beginning in the last quarter of 2010. The University will implement a multi-year contribution strategy under which shared employer and employee contribution rates will increase gradually over time, shared between the Medical Center and employees, based upon UCRP's current normal cost.

### **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, 2009 and 2008**  
**(Dollars in thousands)**

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	<u>2009</u>	<u>2008</u>
<b>Assets</b>		
Current assets:		
Cash	\$ 122,721	\$ 176,473
Restricted assets, held by trustee	954	848
Patient accounts receivable, net of estimated uncollectibles of \$34,586 and \$32,688, respectively	161,351	180,752
Other receivables, net of estimated uncollectibles of \$695 and \$300, respectively	36,251	22,212
Inventory	14,641	13,824
Prepaid expenses and other assets	<u>9,447</u>	<u>9,515</u>
Total current assets	345,365	403,624
Capital assets, net	1,014,077	916,211
Investments in joint ventures	20,444	16,313
Deferred costs of issuance	<u>2,751</u>	<u>2,879</u>
Total assets	<u>1,382,637</u>	<u>1,339,027</u>
<b>Liabilities</b>		
Current liabilities:		
Accounts payable and accrued expenses	36,376	47,003
Accrued salaries and benefits	74,772	70,217
Third-party payor settlements	47,507	33,835
Current portion of long-term debt and capital leases	27,010	25,939
Other liabilities	<u>11,902</u>	<u>11,213</u>
Total current liabilities	197,567	188,207
Long-term debt and capital leases, net of current portion	<u>391,125</u>	<u>402,501</u>
Total liabilities	<u>588,692</u>	<u>590,708</u>
<b>Net Assets</b>		
Invested in capital assets, net of related debt	579,838	464,101
Restricted:		
Expendable:		
Debt service	954	848
Unrestricted	<u>213,153</u>	<u>283,370</u>
Total net assets	<u>\$ 793,945</u>	<u>\$ 748,319</u>

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, 2009 and 2008**  
**(Dollars in thousands)**

	<u>2009</u>	<u>2008</u>
Net patient service revenue, net of provision for doubtful accounts of \$54,977 and \$41,877, respectively	\$ 1,061,848	\$ 1,014,318
Other operating revenue:		
Clinical teaching support	7,218	7,789
Other	<u>8,301</u>	<u>7,068</u>
Total other operating revenue	<u>15,519</u>	<u>14,857</u>
Total operating revenue	<u>1,077,367</u>	<u>1,029,175</u>
Operating expenses:		
Salaries and wages	490,873	472,640
UCRP, retiree health and other employee benefits	113,408	103,976
Professional services	80,347	76,283
Medical supplies	166,422	155,856
Other supplies and purchased services	84,967	93,686
Depreciation and amortization	57,372	57,562
Insurance	9,940	7,975
Other	<u>16,123</u>	<u>8,788</u>
Total operating expenses	<u>1,019,452</u>	<u>976,766</u>
Income from operations	<u>57,915</u>	<u>52,409</u>
Non-operating revenues (expenses):		
Interest income	4,483	5,726
Interest expense	(10,944)	(16,936)
Loss on disposal of capital assets	(431)	(246)
Other	<u>4,125</u>	<u>4,015</u>
Total non-operating expenses	<u>(2,767)</u>	<u>(7,441)</u>
Income before other changes in net assets	<u>55,148</u>	<u>44,968</u>
Other changes in net assets:		
Contributions from University for building program	37,630	50,576
Health system support	(48,783)	(10,557)
Transfers from University, net	<u>1,631</u>	<u>(16,968)</u>
Total other changes in net assets	<u>(9,522)</u>	<u>23,051</u>
Increase in net assets	45,626	68,019
Net assets – beginning of year	<u>748,319</u>	<u>680,300</u>
Net assets – end of year	<u>\$ 793,945</u>	<u>\$ 748,319</u>

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, 2009 and 2008**  
**(Dollars in thousands)**

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	<u>2009</u>	<u>2008</u>
Cash flows from operating activities:		
Receipts from patients and third-party payors	\$ 1,080,882	\$ 977,086
Payments to employees	(489,923)	(457,145)
Payments to suppliers	(351,213)	(335,687)
Payments for benefits	(113,408)	(103,973)
Other receipts, net	<u>9,184</u>	<u>10,497</u>
Net cash provided by operating activities	<u>135,522</u>	<u>90,778</u>
Cash flows from noncapital financing activities:		
Health system support	(48,783)	(10,557)
Transfers from University	<u>1,631</u>	<u>2,213</u>
Net cash used by noncapital financing activities	<u>(47,152)</u>	<u>(8,344)</u>
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	37,630	50,576
Proceeds from debt issuance	–	333,626
Proceeds from financing loan	15,634	24,959
Proceeds from sale of capital assets	109	875
Bond issuance cost	–	(2,020)
Swap termination payment	–	(6,795)
Refinancing of outstanding debt	–	(324,275)
Purchases of capital assets	(163,111)	(174,046)
Principal paid on long-term debt and capital leases	(27,687)	(20,946)
Interest paid on long-term debt and capital leases	<u>(9,068)</u>	<u>(14,897)</u>
Net cash used by noncapital financing activities	<u>(146,493)</u>	<u>(132,943)</u>
Cash flows from investing activities:		
Interest income received	4,483	5,726
Distributions from investments in joint ventures, net	–	2,013
Change in restricted assets	(106)	65,938
Non-operating expense	<u>(6)</u>	<u>–</u>
Net cash provided by investing activities	<u>4,371</u>	<u>73,677</u>
Net (decrease) increase in cash	(53,752)	23,168
Cash – beginning of year	<u>176,473</u>	<u>153,305</u>
Cash – end of year	<u>\$ 122,721</u>	<u>\$ 176,473</u>

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, 2009 and 2008**  
**(Dollars in thousands)**

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	<u>2009</u>	<u>2008</u>
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	\$ 57,915	\$ 52,409
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	57,372	57,562
Provision for doubtful accounts	54,977	41,877
Changes in operating assets and liabilities:		
Patient accounts receivable	(35,576)	(69,267)
Other receivables	(14,039)	(8,814)
Inventory	(817)	(1,611)
Prepaid expenses and other assets	68	(257)
Accounts payable and accrued expenses	(3,294)	930
Accrued salaries and benefits	4,555	19,114
Third-party payor settlements	13,672	(1,028)
Other liabilities	<u>689</u>	<u>(137)</u>
Net cash provided by operating activities	<u>\$ 135,522</u>	<u>\$ 90,778</u>
Supplemental noncash activities information:		
Capitalized interest	\$ 10,260	\$ (686)
Amortization of deferred financing costs	2,735	1,966
Amortization of bond premium	987	198
Amortization of deferred costs of issuance	128	271
Property and equipment transfers from (to) University	92	(19,181)
Payables for property and equipment	16,963	24,296

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

# University of California, Davis Medical Center

## Notes to Financial Statements

### (Dollars in thousands)

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#### 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 613 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 standards.

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, was adopted by the Medical Center during the fiscal year ended June 30, 2009. 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. The implementation of Statement No. 49 had no effect on the Medical Center’s net assets or changes in net assets for the years ended June 30, 2009 and 2008.

##### *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, 2009 and 2008 was \$122,721 and \$176,473, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation.

**University of California, Davis Medical Center**  
**Notes to Financial Statements**  
**(Dollars in thousands)**

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**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 2008-2009 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.

***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 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 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.

**University of California, Davis Medical Center**  
**Notes to Financial Statements**  
**(Dollars in thousands)**

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**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, 2009 and 2008.
  - 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.

**University of California, Davis Medical Center**  
**Notes to Financial Statements**  
**(Dollars in thousands)**

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**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 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.



**University of California, Davis Medical Center**  
**Notes to Financial Statements**  
**(Dollars in thousands)**

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**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 the estimate or judgment is made and actual amounts could differ from those estimates.

***New Accounting Pronouncements***

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.

**University of California, Davis Medical Center**  
**Notes to Financial Statements**  
**(Dollars in thousands)**

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**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 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 has determined that implementation of Statements No. 51 and 53 will not have a significant effect 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 the Medicare program.

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, 2003. The fiscal intermediary is in the process of conducting their audits of the 2004 and subsequent cost reports. The results of these audits have yet to be finalized and any amounts due to or from Medicare have not been determined. Estimated receivables and payables related to all open cost reporting periods are included on the statements of net assets as third-party payor settlements.

**University of California, Davis Medical Center**  
**Notes to Financial Statements**  
**(Dollars in thousands)**

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

- **Medi-Cal** – The 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”). For the year ended June 30, 2009 and 2008, the Medical Center recorded total Medi-Cal revenue of \$135,173 and \$115,914, 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, 2009 and 2008, the Medical Center recorded revenue of \$5,581 and \$6,911, 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, 2009 and 2008, the Medical Center applied for and received additional revenue of \$7,820 and \$4,485, 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.
- **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.

**University of California, Davis Medical Center**  
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**3. Net Patient Service Revenue (Continued)**

- 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 21 percent and 24 percent of net patient accounts receivable at June 30, 2009 and 2008, respectively.

For the years ended June 30, 2009 and 2008, net patient service revenue included \$3.0 million and \$23.8 million, respectively, due to favorable cost report settlements with Medicare, Medi-Cal, County Medical Services Program and changes in estimate for settlements related to SB 1100 for Medi-Cal.

**University of California, Davis Medical Center**  
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**3. Net Patient Service Revenue (Continued)**

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

	<u>2009</u>	<u>2008</u>
Medicare (non-risk)	\$ 205,835	\$ 186,471
Medicare (risk)	28,829	28,981
Medi-Cal (non-risk)	135,173	115,914
Medi-Cal (risk)	17,040	13,540
Commercial	897	1,871
Contract (discounted or per diem)	522,340	505,491
Contract (capitated)	111,740	111,208
County	37,452	45,174
Non-sponsored/self-pay	<u>2,542</u>	<u>5,668</u>
Total	<u>\$ 1,061,848</u>	<u>\$ 1,014,318</u>

**4. Charity Care**

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

	<u>2009</u>	<u>2008</u>
Charity care at established rates	\$ 165,740	\$ 102,433
Estimated cost of charity care	\$ 34,060	\$ 21,101

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was \$135,083 and \$123,856 for the years ended June 30, 2009 and 2008, 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:

	<u>2009</u>	<u>2008</u>
Short-term, highly liquid investments	<u>\$ 954</u>	<u>\$ 848</u>

**University of California, Davis Medical Center**  
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**6. Capital Assets**

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

	<u>2007</u>	<u>Additions</u>	<u>Disposals</u>	<u>2008</u>	<u>Additions</u>	<u>Disposals</u>	<u>2009</u>
<b><u>Original Cost</u></b>							
Land	\$ 37,806	\$ -	\$ (1,131)	\$ 36,675	\$ -	\$ -	\$ 36,675
Buildings and improvements	736,496	19,384	(28,010)	727,870	24,526	(3,471)	748,925
Equipment	289,729	30,143	(15,476)	304,396	42,174	(17,239)	329,331
Construction in progress	<u>191,003</u>	<u>125,972</u>	<u>-</u>	<u>316,975</u>	<u>89,078</u>	<u>-</u>	<u>406,053</u>
Capital assets, at cost	<u>\$ 1,255,034</u>	<u>\$ 175,499</u>	<u>\$ (44,617)</u>	<u>\$ 1,385,916</u>	<u>\$ 155,778</u>	<u>\$ (20,710)</u>	<u>\$ 1,520,984</u>
	<u>2007</u>	<u>Depreciation</u>	<u>Disposals</u>	<u>2008</u>	<u>Depreciation</u>	<u>Disposals</u>	<u>2009</u>
<b><u>Accumulated Depreciation and Amortization</u></b>							
Buildings and improvements	\$ 264,671	\$ 26,227	\$ (9,679)	\$ 281,219	\$ 25,019	\$ (3,292)	\$ 302,946
Equipment	<u>171,787</u>	<u>31,335</u>	<u>(14,636)</u>	<u>188,486</u>	<u>32,353</u>	<u>(16,878)</u>	<u>203,961</u>
Accumulated depreciation and amortization	<u>\$ 436,458</u>	<u>\$ 57,562</u>	<u>\$ (24,315)</u>	<u>\$ 469,705</u>	<u>\$ 57,372</u>	<u>\$ (20,170)</u>	<u>\$ 506,907</u>
Capital assets, net	<u>\$ 818,576</u>			<u>\$ 916,211</u>			<u>\$ 1,014,077</u>

Equipment under capital lease obligations and related accumulated amortization is \$811 and \$811 in 2009, respectively, and \$811 and \$811 in 2008, 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 \$32,892 and \$42,230 for the years ended June 30, 2009 and 2008, 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.

**University of California, Davis Medical Center**  
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**8. Long-term Debt and Capital Leases**

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

	<u>2009</u>	<u>2008</u>
University of California Medical Center Pooled Revenue Bonds 2008 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	\$ 309,865	\$ 322,980
University of California Medical Center Pooled Revenue Bonds 2007 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 General Revenue Bonds 2003, interest rates from 2.0 percent to 5.25 percent, payable semi-annually, with annual principal payments through 2023	12,065	12,672
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.7 percent to 4.0 percent, payable through 2012	48,384	46,518
Capital lease obligations, primarily for computer software, with a fixed interest rate of 3.0 percent, payable through 2010, collateralized by underlying computer software	203	399
Unamortized bond premium	9,998	10,986
Unamortized deferred financing costs	<u>(27,380)</u>	<u>(30,115)</u>
Total debt and capital leases	418,135	428,440
Less: Current portion of debt and capital leases	<u>(27,010)</u>	<u>(25,939)</u>
Noncurrent portion of debt and capital leases	<u>\$ 391,125</u>	<u>\$ 402,501</u>

Interest expense associated with financing projects during construction, along with any investment income earned on bond proceeds during construction, is capitalized. Total interest expense during the years ended June 30, 2009 and 2008 was \$21,300 and \$20,000, respectively. Interest expense totaling \$10,400 and \$3,100 was capitalized during the years ended June 30, 2009 and 2008, respectively. The remaining \$10,900 in 2009 and \$16,900 in 2008 are reported as interest expense in the statements of revenues, expenses and changes in net assets. Investment income totaling \$100 and \$2,500 was capitalized during the years ended June 30, 2009 and 2008, respectively.

**University of California, Davis Medical Center**  
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**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:

	<b><u>Revenue Bonds</u></b>	<b><u>Other Debt Obligations</u></b>	<b><u>Total</u></b>
<b>Year Ended June 30, 2009</b>			
Current portion at June 30, 2008	\$ 11,975	\$ 13,964	\$ 25,939
Reclassification from noncurrent	13,252	13,758	27,010
Principal payments	(13,723)	(13,964)	(27,687)
Amortization of bond premium	(987)	–	(987)
Amortization of deferred financing costs	<u>2,735</u>	<u>–</u>	<u>2,735</u>
Current portion at June 30, 2009	<u>\$ 13,252</u>	<u>\$ 13,758</u>	<u>\$ 27,010</u>
Noncurrent portion at June 30, 2008	\$ 369,548	\$ 32,953	\$ 402,501
New obligations	–	15,634	15,634
Reclassification to current	<u>(13,252)</u>	<u>(13,758)</u>	<u>(27,010)</u>
Noncurrent portion at June 30, 2009	<u>\$ 356,296</u>	<u>\$ 34,829</u>	<u>\$ 391,125</u>
<b>Year Ended June 30, 2008</b>			
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	<u>1,966</u>	<u>–</u>	<u>1,966</u>
Current portion at June 30, 2008	<u>\$ 11,975</u>	<u>\$ 13,964</u>	<u>\$ 25,939</u>
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	<u>(317,413)</u>	<u>(13,671)</u>	<u>(331,084)</u>
Noncurrent portion at June 30, 2008	<u>\$ 369,548</u>	<u>\$ 32,953</u>	<u>\$ 402,501</u>



**University of California, Davis Medical Center**  
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**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, 2009 are \$1.04 billion of which \$374,865 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, 2009 and 2008 were \$5.56 billion and \$5.0 billion, respectively.

General Revenue Bonds Series 2003, collateralized solely by general revenues of the University, finance 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.

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.

**University of California, Davis Medical Center**  
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**8. 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, 2009 and thereafter are as follows:

<u>Year Ending June 30,</u>	<u>Revenue Bonds</u>	<u>Other Debt</u>	<u>Total Payments</u>	<u>Principal</u>	<u>Interest</u>
2010	\$ 33,019	\$ 15,162	\$ 48,181	\$ 28,693	\$ 19,488
2011	32,711	12,439	45,150	26,464	18,686
2012	33,144	12,140	45,284	27,604	17,680
2013	32,806	8,781	41,587	24,751	16,836
2014	32,494	3,423	35,917	20,096	15,821
2015 – 2019	157,182	–	157,182	90,614	66,568
2020 – 2024	145,997	–	145,997	103,140	42,857
2025 – 2029	86,564	–	86,564	69,085	17,479
2030 – 2034	18,536	–	18,536	9,170	9,366
2035 – 2039	18,538	–	18,538	11,445	7,093
2040 – 2044	18,536	–	18,536	14,260	4,276
2045 – 2048	<u>11,126</u>	<u>–</u>	<u>11,126</u>	<u>10,195</u>	<u>931</u>
Total future debt service	620,653	51,945	672,598	<u>\$ 435,517</u>	<u>\$ 237,081</u>
Less: Interest component of future payments	<u>(233,723)</u>	<u>(3,358)</u>	<u>(237,081)</u>		
Principal portion of future payments	386,930	48,587	435,517		
Adjusted by:					
Unamortized bond premium	9,998	–	9,998		
Unamortized deferred financing costs	<u>(27,380)</u>	<u>–</u>	<u>(27,380)</u>		
Total debt	<u>\$369,548</u>	<u>\$ 48,587</u>	<u>\$418,135</u>		

Additional information on the revenue bonds can be obtained from the 2008-2009 annual report of the University.

**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, 2009 and 2008 was \$13,440 and \$12,080, respectively. The terms of the operating leases extend through the year 2034.

**University of California, Davis Medical Center**  
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**9. Operating Leases (Continued)**

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

<u>Year Ending June 30,</u>	<u>Minimum Annual Lease Payments</u>
2010	\$ 12,696
2011	10,616
2012	8,250
2013	6,477
2014	5,072
2015 – 2034	<u>17,776</u>
Total	<u>\$ 60,887</u>

**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 and 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 \$3.09, \$2.86 and \$2.75 per \$100 of UCRP covered payroll resulting in Medical Center contributions of \$13,500, \$11,600 and \$10,300 for the years ended June 30, 2009, 2008 and 2007, respectively.

**University of California, Davis Medical Center**  
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**10. Retiree Health Plans (Continued)**

The actuarial value of UCRHBT assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2008, the date of the latest actuarial valuation, were \$51,221 and \$13.30 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were \$74,370 at June 30, 2009. For the years ended June 30, 2009 and 2008, combined contributions from the University's campuses and medical centers were \$278,507 and \$268,102, respectively, including an implicit subsidy of \$44,079 and \$43,036, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was \$1.50 billion and \$1.36 billion for the years ended June 30, 2009 and 2008. As a result of contributions that were less than the retiree health benefit expense, the University's obligation for retiree health benefits attributable to its campuses and medical centers totaling \$2.31 billion at June 30, 2009 increased by \$1.23 billion and \$1.09 billion for the years ended June 30, 2009 and 2008, respectively.

Information related to plan assets and liabilities as they relate to individual campuses and medical centers is not readily available. Additional information on the retiree health plans can be obtained from the 2008–2009 annual reports of the University of California and the University of California Health and Welfare Program.

**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 four defined contribution plans with several investment portfolios generally funded with employee non-elective and elective contributions. The Regents has the authority to establish and amend the benefit plans.

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 contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by the Medical Center and by the employees. Employee contributions by represented employees are subject to collective bargaining agreements. As a result of the funded status of the UCRP, during the years ended June 30, 2009 and 2008, there were no required Medical Center or employee contributions.

**University of California, Davis Medical Center**  
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**11. Retirement Plans (Continued)**

The actuarial value of UCRP assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2008, the date of the latest actuarial valuation, were \$35.61 billion and \$34.45 billion, respectively, resulting in a funded ratio of 103.4 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were \$32.26 billion and \$42.02 billion at June 30, 2009 and 2008, respectively.

The University utilizes asset allocation strategies that are intended to optimize the UCRP's investment returns over time in accordance with investment objectives and at acceptable levels of risk. However, the financial markets, both domestically and internationally, deteriorated subsequent to July 1, 2008. As a result, the funded ratio as of the July 1, 2009 actuarial valuation for the campuses and medical centers is approximately 94.8 percent.

For the years ended June 30, 2009 and 2008, the University's campuses and medical centers contributed a combined \$442 and \$2,657, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was \$69,131 million for the year ended June 30, 2009. As a result of contributions that were less than the UCRP benefits expense, the University's obligation for UCRP benefits attributable to its campuses and medical centers increased by \$68,696 for the year ended June 30, 2009. For the year ended June 30, 2008, contributions from the University's campuses and medical centers was equivalent to the annual UCRP benefits expense. As a result, there was no obligation for UCRP benefits at June 30, 2008.

The UCRSP plans (DC Plan, Supplemental 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 Supplemental DC Plan accepts employer contributions on behalf of certain qualifying employees. The 403(b) and 457(b) plans accept pre-tax employee contributions and 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 plan assets and liabilities as they relate to individual campuses and medical centers is not readily available. Additional information on the retirement plans can be obtained from the 2008–2009 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

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**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.

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were \$208 and \$975 for the years ended June 30, 2009 and 2008, respectively. During 2009 and 2008, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of \$6,310 and \$7,319, 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 \$9,940 and \$7,975 for the years ended June 30, 2009 and 2008, 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:

	<u>2009</u>	<u>2008</u>
Salaries and employee benefits	\$ 208	\$ 975
Professional services	46,858	40,718
Other supplies and purchased services	981	3,676
Interest income (net)	(4,483)	(5,726)
Insurance	<u>9,940</u>	<u>7,975</u>
Total	<u>\$ 53,504</u>	<u>\$ 47,618</u>

**University of California, Davis Medical Center**  
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**13. Transactions with Other University Entities (Continued)**

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

The total net amount of payments made by the Medical Center to the School of Medicine were \$102,287 and \$58,175 in 2009 and 2008, respectively. Of these amounts, \$53,504 and \$47,618 are reported as operating expenses for the years ended June 30, 2009 and 2008, respectively, and \$48,783 and \$10,557 are reported as health system support for the years ended June 30, 2009 and 2008, 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 \$600,000 in lease-revenue bond funds for earthquake safety renovations. The Regents have approved the allocation of the \$600,000 among the University’s medical centers, of which \$120,000 was allocated to the Medical Center. The Medical Center spent \$32,892 and \$42,230 of its allocation during the years ended June 30, 2009 and 2008, respectively, recorded in the statements of revenues, expenses and changes in net assets as a component of Contributions from University for building program. As of June 30, 2009, any repayment the Medical Center may be obligated for under these financing arrangements is still being determined.

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**14. Commitments and Contingencies (Continued)**

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately \$14,600, excluding interest, as of June 30, 2009.