# University of California, Los Angeles Medical Center

**Report on Audits of Financial Statements**
**For the Years Ended June 30, 2009 and 2008**

# University of California, Los Angeles 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 16 through 44, present fairly, in all material respects, the financial position of the University of California, Los Angeles 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 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 12, 2009

**Introduction**

The objective of Management's Discussion and Analysis is to help readers better understand the University of California, Los Angeles 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 the fiscal years ended June 30.

**Overview**

The University of California, Los Angeles Medical Center (the "Medical Center") is part of the University of California (the "University"). The Medical Center operates licensed beds facilities at the 456 bed Ronald Reagan UCLA Medical Center located in Westwood, the 315 bed Santa Monica – UCLA Medical Center and Orthopaedic Hospital located in Santa Monica, and the 74 bed Resnick Neuropsychiatric Hospital at UCLA located in Westwood. The financial statements also include the activities of Tiverton House, a 100-room hotel facility for patients and their families.

The Medical Center serves as the principal teaching site for the David Geffen School of Medicine at UCLA. The Medical Center's mission is to provide excellent patient care in support of the educational and scientific programs of the Schools of the UCLA Center for the Health Sciences, including the Schools of Medicine, Dentistry, Nursing and Public Health.

The Westwood campus opened in 1955 as a 320-bed hospital and expanded to 669 beds by 1967. On June 29, 2008 the construction of the Ronald Reagan 456-bed and Resnick Neuropsychiatric 74-bed state-of-the-art replacement hospital was completed and opened for patient care. The replacement hospital meets the State of California's SB 1953, The Hospital Facilities Seismic Safety Act.

The Medical Center offers patients of all ages comprehensive care, from routine to highly specialized medical and surgical treatment. In addition, the Westwood Campus is known for the wide range of its tertiary/quaternary care offerings that include Level I trauma care, regional neonatal and pediatric intensive care units, Neurosurgery/Neurology and organ transplantation.

The Santa Monica – UCLA Medical Center and Orthopaedic Hospital also serves the University's teaching and research missions while meeting the healthcare needs of Los Angeles's west side community. The Santa Monica facility features several nationally recognized clinical programs located within its seven-acre campus. Most of this medical center also is being replaced with the work progressing in phases. It is expected to be completed in calendar year 2010. UCLA entered a strategic alliance with Orthopaedic Hospital/Los Angeles. That alliance resulted in the relocation of Orthopaedic Hospital inpatient services to Santa Monica.

The Resnick Neuropsychiatric Hospital at UCLA is one of the leading centers for comprehensive patient care, research and education in the fields of mental and developmental disabilities. Located on the Westwood Campus, the hospital offers a full range of treatment options for patients needing inpatient, outpatient, or partial-day services.

The Tiverton House is a 100-room guest hotel for patients and their families.

Together, these sites enable the Medical Center to provide a full spectrum of services and attract the volume and diversity of patients necessary to meet its educational, clinical, research and community services missions.

The Medical Center continues to maintain its outstanding national reputation. The latest *US News and World Report* survey ranked the Medical Center as the third best hospital in the nation, and the "Best in the West" for the 20th consecutive year. According to this latest survey, UCLA ranked in the top 20 in 15 of the 16 specialty areas. In each of the following specialties, UCLA's national rankings are indicated: cancer at UCLA's Jonsson Comprehensive Cancer Center (11); diabetes and endocrine disorders (8); digestive disorders (5); ear, nose and throat (8); geriatrics (1); gynecology (10); heart and heart surgery (10); kidney disorders (7); neurology and neurosurgery (7); ophthalmology at UCLA's Jules Stein Eye Institute (5); orthopedics (13); psychiatry at the Resnick Neuropsychiatric Hospital at UCLA (5); respiratory disorders (17); rheumatology (5); and urology (4).

For the year ended June 30, 2009, the Medical Center reported net income before other changes in net assets of $115.8 million, generating a margin of 7.9 percent. The year ended with a cash position of $219.6 million. For 2008, net income before other changes in net assets was $33.3 million, including $21.9 million of transition costs and cash totaled $124.6 million.

Significant events during the year are highlighted below:

- *First Full Year in Ronald Reagan UCLA Medical Center*
  The Ronald Reagan UCLA Medical Center celebrated its one year anniversary on June 29th, 2009. The Medical Center's average occupancy was 96% for the year and patient satisfaction scores reached the 96th percentile in overall satisfaction.

- *Continued Development of Santa Monica-UCLA Medical Center and Orthopaedic Hospital*
  Development of the Santa Monica campus progressed during the year, with significant exterior and interior completion of the north-central and orthopedic wing. Construction is scheduled for completion at the end of calendar 2010 with occupancy in spring of 2011. Patient services continue to move from Westwood to Santa Monica, part of the ongoing process of reallocating services appropriately across the health system.

- *Changes in Payer Mix and Volume*
  The Medical Center did not experience any adverse payer mix despite the negative State and National economic downturn. Medicare patient days increased by 1.1% over prior year and Contract patient days decreased by 1.5% over prior year. Medicare and Contract are the highest-margin payers. Medi-Cal patient days increased by 5.5%. Medi-Cal is one of the lowest-margin payers but only represents 18.5% of the Medical Center's total patient days. Uninsured and Capitation days declined from prior year by 6.4% and 2.1% respectively. Uninsured and Capitation are also low-margin payers.

- *The Medical Center Renegotiated Major Third-Party Contracts*
  The Medical Center successfully renegotiated five of its largest contracts resulting in double digit increases and significant new revenue to the system.

- *Revenue Cycle Initiatives and Cash Collections*
  During 2009, the Medical Center continued to work on ways to improve its revenue and cash position through various revenue cycle initiatives. The Medical Center engaged the services of a large and prominent revenue cycle consulting firm for a system-wide improvement plan that focused on The Medical Center and the Faculty Practice Group. This engagement significantly improved revenue and cash collections. Cash collected on patient accounts increased by $193.5 million, or 18.5 percent, over 2008.

- *Interest Swap replacement*
  As a means to lower the Medical Center's borrowing costs, when compared against fixed-rate bonds at the time of issuance, the Medical Center entered into an interest rate swap agreement in 2007 in connection with its variable-rate Medical Center Pooled Revenue Bonds. Under the swap agreement, the Medical Center pays the swap counterparty a fixed interest rate payment and receives a variable rate interest rate payment that effectively changes the Medical Center's variable interest rate bonds to synthetic fixed rate bonds. The Medical Center's counterparty in the interest rate swap agreement was Lehman Brothers Special Financing Inc. on June 30, 2008. The guarantor was Lehman Brothers Holdings Inc. In September 2008, Lehman Brothers Holdings Inc. filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. In October 2008, Lehman Brothers Special Financing Inc. filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. As a result, in October 2008, the Medical Center terminated its existing swap agreement and substituted a new interest rate swap agreement with identical terms with a new counterparty, with the exception of certain additional collateral requirements. In conjunction with the swap termination, the Medical Center received $31.3 million from the new counterparty and made a termination payment of $25.3 million to Lehman Brothers Special Financing Inc. These payments were recorded as deferred costs of financing and will be amortized as interest expense over the term of the bonds.

- *Wage Increases and Staff Shortages*
  The nation-wide nursing shortage and shortage of other professional medical staff continues to impact significantly both the salary costs of hospital staff as well as the rate charged for staff employed from contracted registry agencies. The current nursing union contract increased the Medical Center's labor costs by approximately $12.7 million in fiscal year 2009. The Medical Center also experienced staff shortages in various technical positions requiring the use of expensive temporary labor. Temporary labor significantly spiked up in the first half of the fiscal year but was reduced in half by the end of the fiscal year. Overall, labor and benefit costs per hospital-paid employee increased by 4.4% percent over 2008.

- *Permanent Chief Executive Officer*
  Dr. David Feinberg was appointed as the Chief Executive Officer of the Medical Center. Dr. Feinberg was serving as the interim Chief Executive Officer prior to his appointment.

## Operating Statistics

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

| Statistics | 2009 | 2008 | 2007 |
|---|---|---|---|
| Admissions | 40,342 | 40,574 | 39,194 |
| Average daily census | 715 | 711 | 704 |
| Discharges | 40,258 | 40,741 | 39,261 |
| Average length of stay | 6.5 | 6.4 | 6.5 |
| Patient days: | | | |
| Medicare (non-risk) | 72,038 | 71,268 | 70,560 |
| Medi-Cal (non-risk/County) | 48,295 | 45,766 | 42,113 |
| Commercial | 2,191 | 2,048 | 2,493 |
| Contracts (discounted/per diem) | 122,017 | 123,836 | 123,033 |
| Contracts (capitated)* | 7,835 | 8,003 | 9,050 |
| Non-sponsored/self-pay (Uninsured) | 8,645 | 9,234 | 9,819 |
| Total Patient Days | 261,021 | 260,155 | 257,068 |
| Outpatient visits: | | | |
| Hospital clinics | 773,078 | 767,039 | 745,270 |
| Home health/hospice | 44,850 | 55,424 | 53,859 |
| Emergency visits | 76,739 | 66,626 | 67,181 |
| Total visits | 894,667 | 889,089 | 866,310 |

* includes Medicare (risk)

Total admissions decreased by 0.6 percent in 2009 compared to 2008, due to a decrease in surgery, pediatrics, neurosurgery and orthopedic cases. Total admissions increased by 3.5 percent in 2008 compared to 2007, due primarily to an increase in medicine, pediatrics, psychiatric and orthopedic cases.

Total patient days in 2009 increased by 866, or 0.3 percent, over 2008 due to an increase in Medi-Cal and Commercial payors. Total patient days in 2008 increased by 3,087, or 1.2 percent, over 2007. The largest percentage increase was in Medi-Cal. However, Capitated and Uninsured patient days decreased by 11.6 percent and 6.0 percent respectively.

Total outpatient visits increased in 2009 by 5,578, or 0.6 percent compared to 2008. This increase was primarily in Hospital Clinics and Emergency visits. Total outpatient visits increased in 2008 by 22,779, or 2.6 percent compared to 2007. This increase was primarily in Hospital Clinics and Home Health.

**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):

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Net patient service revenue | $ 1,401,847 | $ 1,162,561 | $ 1,070,021 |
| Other operating revenue | 64,068 | 64,557 | 62,855 |
| Total operating revenue | 1,465,915 | 1,227,118 | 1,132,876 |
| Total operating expenses | 1,331,930 | 1,169,260 | 1,081,403 |
| Income from operations | 133,985 | 57,858 | 51,473 |
| Total non-operating expenses | (18,213) | (24,564) | (10,771) |
| Income before other changes in net assets | $ 115,772 | $ 33,294 | $ 40,702 |
| Margin | 7.9 percent | 2.7 percent | 3.6 percent |
| Other changes in net assets | 43,160 | 64,606 | (46,546) |
| Net assets – beginning of year | 1,190,611 | 1,092,711 | 1,098,555 |
| Net assets – end of year | $ 1,349,543 | $ 1,190,611 | $ 1,092,711 |

**Revenues**

Total operating revenues for the year ended June 30, 2009 were $1,465.9 million, an increase of $238.8 million, or 19.5 percent, over 2008. Operating revenues for 2008 of $1,227.1 million increased by $94.2 million, or 8.3 percent, over 2007.

Net patient service revenue for 2009 increased by $239.3 million, or 20.6 percent, over 2008. The increase in 2009 was due to contract rate increases, clinical documentation improvements, consultant revenue cycle engagement, additional funding from the State for Medi-Cal patients and an increase in outpatient volume. Patient service revenues are net of bad debts and 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.

Net patient service revenue for 2008 increased by $92.5 million, or 8.6 percent, over 2007. The increase in 2008 was due to contract rate increases, increased volume for Medicare patients, new revenue cycle initiatives, additional funding from the State under the Medi-Cal waiver payment system and an increase in outpatient volume.

Other operating revenue consisted primarily of State Clinical Teaching Support Funds ("CTS") and other non-patient services such as contributions, cafeteria and campus revenues. The decrease in 2009 in other operating revenue was mainly due to investment losses in the Foundation assets. The increase in 2008 was due to various refunds and receipt of County Trauma funds.

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

| Payor | 2009 | 2008 | 2007 |
|---|---|---|---|
| Medicare (non-risk) | $ 327,054 | $ 297,443 | $ 278,502 |
| Medi-Cal (non-risk/County) | 139,954 | 114,606 | 102,257 |
| Commercial | 13,130 | 14,283 | 18,303 |
| Contracts (discounted/per diem) | 865,966 | 686,839 | 623,826 |
| Contracts (capitated)* | 35,146 | 33,234 | 31,451 |
| Non-sponsored/self-pay (Uninsured) | 20,597 | 16,156 | 15,682 |
| Total | $ 1,401,847 | $ 1,162,561 | $ 1,070,021 |

* Medicare (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. Net patient revenue for Medicare increased by $29.6 million over the prior fiscal year. This increase is primarily due to improvements in clinical documentation, increase in acuity and outlier cases. In 2008, net patient revenue for Medicare increased by $18.9 million over 2007. This increase was primarily due to an increase in case mix, outlier cases and prior year cost report settlement.

Payments for Medi-Cal patients are made on a per-diem basis for inpatient services while outpatient services are paid on a fixed-fee schedule. In 2006, California implemented a new Medi-Cal Fee-For-Service ("FFS") inpatient hospital payment system. In FY 2009, the Medical Center recorded additional Medi-Cal funding of $22.4 million of which $10.6 million is related to the prior year. In FY 2008, the Medical Center recorded additional Medi-Cal funding of $12.4 million of which $5.6 million is related to the prior year. The Medi-Cal revenue includes funding for covered outpatient services pursuant to California Assembly Bill 915. Also included are Medi-Cal patients referred by county facilities and reimbursed to the Medical Center at Medi-Cal rates.

In 2009, contract net patient revenue (discounted/per-diem) increased by $179.2 million, or 26 percent, due to rate increases, revenue cycle improvements and outpatient volume increases. In 2008, contract net patient revenue increased by $63.0 million, or 10.1 percent, due to contract rate increases, outpatient volume and revenue cycle initiatives.

The net patient service revenue for contracts that are full-risk capitation increased by $1.9 million, or 5.8 percent in 2009 and by $1.8 million, or 5.7 percent, in 2008.

In 2009, commercial net patient revenue decreased by $1.2 million, or 8.1 percent, due to volume. In 2008, commercial net patient revenue decreased by $4.0 million, or 22 percent, due to a decrease in volume.

The non-sponsored/self-pay net revenue increased from the prior year by $4.4 million and by $474 thousand. This category fluctuates from year to year depending on the volume and type of patients.

**Operating Expenses**

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

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Salaries and wages | $ 597,706 | $ 550,608 | $ 502,733 |
| Employee benefits | 137,402 | 122,716 | 113,482 |
| Professional services | 43,847 | 24,618 | 20,748 |
| Medical supplies | 204,800 | 184,419 | 183,306 |
| Other supplies and purchased services | 256,741 | 227,152 | 210,460 |
| Depreciation and amortization | 81,921 | 51,680 | 41,888 |
| Insurance | 9,513 | 8,067 | 8,786 |
| Total operating expenses | $ 1,331,930 | $ 1,169,260 | $ 1,081,403 |

Total operating expenses for 2009 were $1,332.0 million, an increase of $162.7 million, or 13.9 percent, over 2008. This change was primarily due to increased salary and employee benefits, professional services, increases in medical supplies and purchased services and increase in depreciation costs for the replacement hospital. Total operating expenses for 2008 increased by $87.9 million, or 8.1 percent, over 2007 due to increased salary and employee benefit costs, inflationary increases in medical supplies and increases in purchased services.

In 2009, salaries and wages grew by $47.1 million, or 8.6 percent, over the prior year due to increased volume and union negotiated salary rate increases. Temporary labor costs increased by $415 thousand, or 1.9 percent over 2008. In 2008, salaries and wages grew by $47.9 million, or 9.5 percent, over 2007 due to volume increases, negotiated union wage increases and merits increases. Temporary labor costs decreased by $3.1 million over 2007.

In 2009, increases in total benefit costs were $14.7 million, with health insurance benefits higher by $7.7 million, workers' compensation insurance premiums down $1.6 million, and all other benefit costs higher by $8.5 million over 2008. Increases in total benefit costs in 2008 were $9.2 million, with health insurance benefits higher by $6.5 million, workers' compensation insurance premiums down $739 thousand and all other benefit costs higher by $3.4 million over 2007.

Payments for professional services increased by $19.2 million, or 78.1 percent, in 2009 from 2008. The increases were due to the fees paid for the new revenue cycle consulting engagement. In 2008, payments for professional services increased by $3.9 million, or 18.7 percent due to increases in legal expense and consulting fee for various consulting engagements.

Medical supply expense increased by $20.4 million or 11.1 percent due to an increase in prosthesis expenses for ventricle assist devices, increase in pharmaceutical expenses due to inflation of 7 percent and increases in supply cost in the operating room and Cath Labs due to volume and inflation. Medical supply expense increased in 2008 by $1.1 million, or 0.6 percent over 2007, due to supply reduction initiatives that began in 2008, utilization controls and better management of overall supply spending.

Other supplies and purchased services increased by $29.6 million, or 13.0 percent, over the prior year. The increase was primarily due to higher food expense in the new hospital, increased outside provider costs, increased utility expense in the new hospital and an increase in building and equipment rentals. Other supplies and purchased services increased $16.7 million, or 7.9 percent, in 2008 over 2007 due to an increase in the cost of transplant organs, increase in outside clinical lab services due to volume and an increase in collection services.

Depreciation and amortization expense increased by $30.2 million over 2008 due to depreciation costs on the replacement hospital. In 2008, depreciation and amortization expense increased by $9.8 million over 2007 due to the completion of Ronald Reagan Medical Center and several phases of Santa Monica Hospital.

Insurance expense of $9.5 million in 2009 and $8.1 million in 2008 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. In 2009, this expense increased by $1.4 million, or 17.9 percent, over 2008. In 2008, insurance expense decreased by $719 thousand, or 8.2 percent, over 2007.

**Non-operating Revenues (Expenses)**
Total non-operating expenses were $18.2 million for 2009 compared to $24.6 million in the prior year. The majority of this decrease was primarily due to transition costs related to the replacement hospital.

In 2008, total non-operating expenses were $24.6 million for 2008 compared to $10.8 million in the prior year. The majority of this increase was primarily due to an increase in replacement hospital transition expense of $16.4 million. The replacement hospital transition expense is composed of salary and consulting expenses related to the planning, coordination and logistics of moving to the replacement hospitals. The transition expense was partially offset by gift funds in 2007.

**Income before Other Changes in Net Assets**
The Medical Center's income before other changes in net assets was $115.8 million for 2009 compared to $33.3 million for 2008 and $40.7 million in 2007. The Medical Center's net income increased in 2009 mainly due to increases in net patient service revenues.

The Medical Center's income before other changes in net assets was $33.3 million for 2008 compared to $40.7 million for 2007. The Medical Center's net income decreased in 2008 mainly due to the increase in transition costs for the relocation to the replacement hospital.

**Other Changes in Net Assets**
The lower section of the statements 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 are the following:

- Proceeds received and receivable from the Federal Emergency Management Agency ("FEMA") for the hospitals' replacement projects were $110 thousand in 2009 and $2.1 million in 2008. The total anticipated funding from FEMA for the replacement hospitals' project is $556 million. The total received to date from FEMA is $523 million.

- In 2009, contributions from the University for the building program of $40.8 million are related to the hospitals' replacement projects and represent funding from the State Public Works Board Bonds totaling $0.2 million, state matching funds of $0.8 million and funding from the line of credit of $39.8 million.

  In 2008, contributions from the University for the building program of $10.9 million were related to the hospitals' replacement projects and represented funding from the State Public Works Board Bonds totaling $9.9 million, state matching funds of $1.8 million and funding from the line of credit of $(0.8) million.

- Donated assets represent gift funds that have been used for the hospitals' replacement. The gift funds are only recorded on the Medical Center's financial statements when an expenditure for the project has been incurred. In prior years, gift funds were used for the replacement hospital and increased the equity of the Medical Center. The Medical Center recorded $40.2 million and $117.5 million of gift funds in 2009 and 2008, respectively.

- Health system support represents transfers to the School of Medicine for academic and clinical support including the Primary Care Network. The Medical Center transferred $37.9 million in 2009 and $33.1 million in 2008.

In total, the net assets increased in 2009 by $158.9 million to $1,349.5 million. The majority of this increase was due to an increase in the overall cash balance and an increase in capital assets for the Santa Monica replacement hospital. In 2008, net assets increased by $97.9 million to $1,190.6 million. The majority of this increase was in capital assets due to increase in new equipment and the capitalization of the replacement hospital.

**Statements of Net Assets**

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

| | 2009 | 2008 | 2007 |
|---|---|---|---|
| Current assets: | | | |
| Cash | $ 219,604 | $ 124,596 | $ 120,978 |
| Patient accounts receivable (net) | 247,723 | 217,973 | 220,714 |
| Other current assets | 64,147 | 51,341 | 38,813 |
| Total current assets | 531,474 | 393,910 | 380,505 |
| Capital assets (net) | 1,625,852 | 1,567,561 | 1,427,158 |
| Other assets | 29,009 | 60,022 | 125,409 |
| Total assets | 2,186,335 | 2,021,493 | 1,933,072 |
| Current liabilities | 193,061 | 191,397 | 195,976 |
| Long-term debt | 643,731 | 639,485 | 644,385 |
| Total liabilities | 836,792 | 830,882 | 840,361 |
| Net assets: | | | |
| Invested in capital assets (net) | 1,046,892 | 988,051 | 866,283 |
| Restricted | 19,427 | 51,822 | 114,464 |
| Unrestricted | 283,224 | 150,738 | 111,964 |
| Total net assets | $1,349,543 | $ 1,190,611 | $ 1,092,711 |

Total current assets increased in 2009 by $137.6 million, or 34.9 percent, compared to 2008 due to an increase in cash and net patient accounts receivable. In 2008, total current assets increased by $13.4 million, or 3.5 percent, compared to 2007 due to an increase in cash of $3.6 million, a decrease in net patient accounts receivable of $2.7 million and an increase of $12.5 million in other current assets.

Cash increased by $95.0 million in 2009. This increase was mainly due to an increase in operating income and cash collections. Cash increased by $3.6 million in 2008 due mainly to an increase in working capital from operations.

Net patient accounts receivable increased by $29.8 million from 2008 due to contract rate increases and inpatient price increases. Net patient accounts receivable decreased by $2.7 million in 2008 due to increased cash collections. Cash collections increased by $193.5 million or 18.5 percent in 2009 and by $101.5 million or 10.7 percent in 2008.

In 2009, other current assets, including non-patient receivables, inventory and prepaid expenses, increased by $12.8 million over the prior fiscal year. The increase was primarily related to a receivable from the state for Medi-Cal waiver revenue. In 2008, other current assets increased by $12.5 million over 2007 due primarily to an increase in supply inventory of $6.6 million and other receivable by $5.1 million.

Capital assets increased by $58.3 million over 2008 with the majority of this increase related to the Santa Monica replacement hospital. Capital assets increased by $140.4 million over 2007 due to the hospitals' replacement projects. Most funding for these costs comes from FEMA, gift funds and contributions from the University.

Other assets, including the long-term portion of cash held by trustees, the Santa Monica Hospital Foundation assets, the restricted funds for the hospitals' replacement building projects and the bond issuance costs decreased by $31.0 million and $65.4 million in 2009 and 2008, respectively. The decrease in 2009 and 2008 is primarily due to the use of restricted cash for the building program.

Current liabilities increased by $1.7 million in 2009 due to an increase in accrued salaries and wages and a reduction in third party payor settlements. Current liabilities decreased by $4.6 million in 2008 due to a decrease in accounts payable of $5.1 million, an increase in accrued payroll of $11.4 million, a decrease in the current portion of long-term debt of $6.3 million, a decrease of $5.2 million in third-party payor settlement, and an increase of $611 thousand in other liabilities. Accounts payable decreased due to the timely processing of invoices and reduction in outstanding checks. The increase in accrued payroll is due to the timing of the pay periods.

Long-term debt includes the 2004 Series A and Series B Hospital Revenue Bonds, 2003 General Revenue Bonds, 2002 Hospital Revenue Bonds, 2007 Hospital Revenue Bonds, and long-term capital leases. The Medical Center also financed $8.4 million and $7.7 million of capital equipment through leases during 2009 and 2008, respectively. The note payable to campus is for long-term operating capital needs.

**Liquidity and Capital Resources**

The Medical Center generated $178.4 million and $100.7 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 increased by $11.5 million over 2008 for transfers to the University for health system support and general support and $5.6 million for the replacement hospital transition costs. In 2008, cash flows from non-capital financing activities were reduced by $33.1 million for transfers to the University for health system support and general support and $21.9 million for the replacement hospital transition costs.

In 2009 and 2008, cash flows from capital and related financing activities included the proceeds from FEMA $0 and $12.5 million, contributions from the University for funding from the State Public Works Board Bonds $40.8 million and $10.9 million, purchase of capital assets (including construction in process for replacement hospitals) $132.7 million and $225.4 million, proceeds from refinanced new debt of $0 million and $197.0 million, bond costs $0 million and $2.7 million, refinancing of outstanding debt $0 and $194.4 million, principal payments on long-term debt and capital leases $15.2 million and $17.6 million, interest payments $17.9 million and $9.4 million, and replenishment of campus gift funds $40.2 million and $117.5 million, respectively.

Cash flows from investing activities in 2009 and 2008 show that $6.5 million and $6.3 million was provided by interest income, $21.9 million and $62.4 million from a change in restricted assets, primarily proceeds from debt for the building project, and $10.5 million and $703 thousand from the Santa Monica Foundation, respectively.

Overall cash increased to $219.6 million in 2009 from $124.6 million in 2008.

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

| | **2009** | **2008** | **2007** |
|---|---|---|---|
| Days cash on hand | 64.1 | 40.8 | 42.5 |
| Days of revenue in accounts receivable | 58.0 | 67.0 | 72.0 |
| Capital investment ($ in millions) | $132.7 | $225.4 | $210.0 |
| Debt service coverage ratio | 5.7 | 2.2 | 1.9 |

Days cash on hand increased to 64.1 days in 2009 from 40.8 days in 2008 and decreased to 40.8 days in 2008 from 42.5 days in 2007. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash. The goal set by the University of California Office of the President is 60 days.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2009, days in accounts receivable decreased to 58.0. The main reason for this decrease was due to increased cash collections and revenue cycle improvements. In 2008, days in accounts receivable decreased to 67 due to the ongoing Revenue Cycle process improvements and increased cash collections.

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 5.7 versus 2.2 in 2008. The increase was due to the increase in net income for the year. In 2008, the Medical Center's ratio is 2.2 versus 1.9 in 2007. The increase was due to increased operating income. This ratio is higher than the 1.1 required by the Bond Indenture.

The Medical Center will continue to be challenged with cash management and capital needs as it completes the replacement hospital for the Santa Monica campus, funds on-going capital needs, begins implementation of a system-wide electronic medical record and resume contributions to the retirement plan in 2010.

## Looking Forward

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

During 2009, the UCLA Medical Center's capital program continued to address the requirements in State of California Senate Bill 1953 ("SB 1953"). The projected cost for the Santa Monica-UCLA Medical Center and Orthopaedic Hospital, which will be compliant with the requirements by 2011, is $424 million. The capital cost of compliance will be financed through the use of state lease revenue bond funds, Federal Emergency Management Administration ("FEMA") funds, Hospital Reserves, gift funds and the debt. In 2009, $74.6 million was spent on these requirements.

*Payments from Federal and State Health Care Programs*
Entities doing business with governmental payors, including Medicare and Medicaid (Medi-Cal in California), are subject to risks unique to the government-contracting environment that are difficult to anticipate and quantify. Revenues are subject to adjustment as a result of examination by government agencies as well as auditors, contractors, and intermediaries retained by the federal, state, or local governments (collectively "Government Agents"). Resolution of such audits or reviews often extends (and in some cases does not even commence until) several years beyond the year in which services were rendered and/or fees received.

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

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

*Medicaid Reform*
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 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, Los Angeles Medical Center
## Statements of Net Assets
## June 30, 2009 and 2008
## (Dollars in thousands)

| | 2009 | 2008 |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash | $ 219,604 | $ 124,596 |
| Patient accounts receivable, net of estimated uncollectibles of $85,518 and $63,420, respectively | 247,723 | 217,973 |
| Other receivables, net of estimated uncollectibles of $93 and $93, respectively | 27,438 | 15,907 |
| Inventory | 22,582 | 22,674 |
| Prepaid expenses and other assets | 14,127 | 12,760 |
| Total current assets | 531,474 | 393,910 |
| Restricted assets: | | |
| Cash restricted for replacement hospital | 5,684 | 27,570 |
| Donor funds | 13,743 | 24,252 |
| Capital assets, net | 1,625,852 | 1,567,561 |
| Deferred costs of issuance | 5,343 | 5,487 |
| Other assets | 4,239 | 2,713 |
| Total assets | 2,186,335 | 2,021,493 |
| **Liabilities** | | |
| Current liabilities: | | |
| Accounts payable and accrued expenses | 78,030 | 67,659 |
| Accrued salaries and benefits | 86,354 | 74,659 |
| Third-party payor settlements | 13,554 | 26,052 |
| Current portion of long-term debt and capital leases | 10,227 | 15,025 |
| Other liabilities | 4,896 | 8,002 |
| Total current liabilities | 193,061 | 191,397 |
| Note payable to campus | 75,000 | 75,000 |
| Long-term debt and capital leases, net of current portion | 568,731 | 564,485 |
| Total liabilities | 836,792 | 830,882 |
| **Net Assets** | | |
| Invested in capital assets, net of related debt | 1,046,892 | 988,051 |
| Restricted: | | |
| Nonexpendable: | | |
| Endowments | 337 | 337 |
| Expendable: | | |
| Capital projects | 6,698 | 35,524 |
| Other | 12,392 | 15,961 |
| Unrestricted | 283,224 | 150,738 |
| Total net assets | $ 1,349,543 | $ 1,190,611 |

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

# University of California, Los Angeles Medical Center
## Statements of Revenues, Expenses and Changes in Net Assets
## For the Years Ended June 30, 2009 and 2008
## (Dollars in thousands)

| | 2009 | 2008 |
|---|---|---|
| Net patient service revenue, net of provision for doubtful accounts of $34,055 and $33,090, respectively | $ 1,401,847 | $ 1,162,561 |
| Other operating revenue: | | |
| Clinical teaching support | 21,635 | 21,840 |
| Other | 42,433 | 42,717 |
| Total other operating revenue | 64,068 | 64,557 |
| Total operating revenue | 1,465,915 | 1,227,118 |
| Operating expenses: | | |
| Salaries and wages | 597,706 | 550,608 |
| UCRP, retiree health and other employee benefits | 137,402 | 122,716 |
| Professional services | 43,847 | 24,618 |
| Medical supplies | 204,800 | 184,419 |
| Other supplies and purchased services | 256,741 | 227,152 |
| Depreciation and amortization | 81,921 | 51,680 |
| Insurance | 9,513 | 8,067 |
| Total operating expenses | 1,331,930 | 1,169,260 |
| Income from operations | 133,985 | 57,858 |
| Non-operating revenues (expenses): | | |
| Interest income | 6,467 | 6,348 |
| Interest expense | (18,581) | (11,304) |
| Replacement hospital transition expense | (5,085) | (21,882) |
| (Loss) gain on disposal of capital assets | (1,014) | 2,274 |
| Total non-operating expenses | (18,213) | (24,564) |
| Income before other changes in net assets | 115,772 | 33,294 |
| Other changes in net assets: | | |
| Proceeds received or receivable from FEMA | 110 | 2,092 |
| Contributions from University for building program | 40,819 | 10,905 |
| Donated assets | 40,203 | 117,524 |
| Health system support | (37,932) | (33,125) |
| Transfer to University for building program | (40) | (32,790) |
| Total other changes in net assets | 43,160 | 64,606 |
| Increase in net assets | 158,932 | 97,900 |
| Net assets – beginning of year | 1,190,611 | 1,092,711 |
| Net assets – end of year | $ 1,349,543 | $ 1,190,611 |

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

# University of California, Los Angeles Medical Center
## Statements of Cash Flows
## For the Years Ended June 30, 2009 and 2008
## (Dollars in thousands)

| | 2009 | 2008 |
|---|---|---|
| Cash flows from operating activities: | | |
| Receipts from patients and third-party payors | $ 1,359,312 | $ 1,159,320 |
| Payments to employees | (596,745) | (542,779) |
| Payments to suppliers | (500,492) | (448,087) |
| Payments for benefits | (126,669) | (119,171) |
| Other receipts, net | 43,024 | 51,404 |
| Net cash provided by operating activities | 178,430 | 100,687 |
| Cash flows from noncapital financing activities: | | |
| Health system support | (37,932) | (33,125) |
| Replacement hospital transition costs/equip transfer to university | (5,125) | (21,882) |
| Net cash used by noncapital financing activities | (43,057) | (55,007) |
| Cash flows from capital and related financing activities: | | |
| Proceeds from FEMA | – | 12,547 |
| Proceeds from contributions from University for building program | 40,819 | 10,905 |
| Proceeds from debt issuance | – | 197,030 |
| Bond issuance cost | – | (2,738) |
| Proceeds received from interest rate swap | 31,348 | – |
| Payment for interest rate swap | (25,336) | – |
| Interest rate swap fee | (434) | – |
| Refinancing of outstanding debt | – | (194,408) |
| Purchases of capital assets | (132,682) | (225,399) |
| Principal paid on long-term debt and capital leases | (15,196) | (17,579) |
| Interest paid on long-term debt and capital leases | (17,949) | (9,432) |
| Gifts and donated funds | 40,203 | 117,524 |
| Net cash used by capital and related financing activities | (79,227) | (111,550) |
| Cash flows from investing activities: | | |
| Interest income received | 6,467 | 6,348 |
| Change in restricted assets, held by trustee | 21,886 | 62,437 |
| Change in Foundation investments | 10,509 | 703 |
| Net cash provided by investing activities | 38,862 | 69,488 |
| Net increase in cash | 95,008 | 3,618 |
| Cash – beginning of year | 124,596 | 120,978 |
| Cash – end of year | $ 219,604 | $ 124,596 |

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

# University of California, Los Angeles Medical Center
## Statements of Cash Flows (Continued)
## For the Years Ended June 30, 2009 and 2008
## (Dollars in thousands)

| | 2009 | 2008 |
|---|---|---|
| Reconciliation of income from operations to net cash provided by operating activities: | | |
| Income from operations | $ 133,985 | $ 57,858 |
| Adjustments to reconcile income from operations to net cash provided by operating activities: | | |
| Depreciation and amortization expense | 81,921 | 51,680 |
| Provision for doubtful accounts | 34,055 | 33,090 |
| Changes in operating assets and liabilities: | | |
| Patient accounts receivable | (63,805) | (30,349) |
| Other receivables | (11,531) | (5,086) |
| Inventory | 92 | (6,584) |
| Prepaid expenses and other assets | (2,749) | (1,628) |
| Accounts payable and accrued expenses | 10,371 | (5,078) |
| Accrued salaries and benefits | 11,695 | 11,375 |
| Third-party payor settlements | (12,498) | (5,202) |
| Other liabilities | (3,106) | 611 |
| Net cash provided by operating activities | $ 178,430 | $ 100,687 |
| Supplemental noncash activities information: | | |
| Capitalized interest | $ 10,996 | $ 19,740 |
| Capital assets acquired through capital lease obligations | 8,434 | 7,657 |
| Reimbursement pending from FEMA | 33,018 | 32,908 |
| Amortization of deferred financing costs | 289 | 14 |
| Amortization of bond premium | 91 | 91 |
| Transfer of capital assets to University | – | 31,822 |

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

## 1. Organization

The University of California, Los Angeles 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 Vice Chancellor, Medical Sciences by the Chancellor of the Los Angeles campus. The Medical Center operates licensed bed facilities including the 456 bed Ronald Reagan UCLA Medical Center, the 315 bed Santa Monica – UCLA Medical Center and Orthopaedic Hospital, and the 74 bed Resnick Neuropsychiatric Hospital at UCLA. The financial statements also include the activities of Tiverton House, a 100-room facility for patients and their families.

## 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.

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

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

The Medical Center's cash at June 30, 2009 and 2008 was $219,604 and $124,596, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation.

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

Additional information on cash and investments can be obtained from the 2008-2009 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 are primarily prepayments for pharmaceuticals and medical supplies, rent, equipment and maintenance contracts.

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

***Restricted Assets, Donor Funds***
Santa Monica Foundation investments are recorded at fair value, which approximates cost. Pledges and charitable remainder trusts are discounted using a risk free rate of interest, and are recorded at net realizable value. Real property is recorded at cost.

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

***Capital Assets***

The Medical Center's capital assets are reported at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. Equipment under capital leases are amortized over the shorter period of the lease term or the estimated useful life of the equipment. Lease amortization is included in depreciation and amortization expense. The range of the estimated useful lives for buildings and land improvements is 10 to 40 years and for equipment is 5 to 20 years. Interest on borrowings to finance facilities is capitalized during construction. University guidelines mandate that land purchased with Medical Center funds be recorded as an asset of the Medical Center. Land utilized by the Medical Center but purchased with other sources of funds is recorded as an asset of the University. Incremental costs, including salaries and employee benefits, directly related to the acquisition, development and installation of major software projects are included in the cost of the capital 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.

***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. In addition, the net gain on the termination and replacement of an interest rate swap contract with similar terms has also resulted in deferred financing costs. Unamortized deferred financing costs are included with the current and noncurrent portion of long-term debt, as appropriate, in the Medical Center's statements 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.

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

***Net Assets (Continued)***

- Restricted – The Medical Center classifies net assets resulting from transactions with purpose restrictions as restricted net assets until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.

    - Nonexpendable – Net assets subject to externally imposed restrictions that must be retained in perpetuity by the Medical Center.

    - Expendable – Net assets whose use by the Medical Center is subject to externally imposed restrictions that can be fulfilled by actions of the Medical Center pursuant to those restrictions or that expire by the passage of time.

- Unrestricted – Net assets that are neither restricted nor invested in capital assets, net of related debt. Unrestricted net assets may be designated for specific purposes by management or The Regents. *S*ubstantially all unrestricted net assets are allocated for operating initiatives or programs, or for capital programs.

***Revenues and Expenses***

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

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

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, replacement hospital transition expenses and the gain or loss on the disposal of capital assets.

State capital appropriations, health system support, proceeds received or receivable from Federal Emergency Management Agency (FEMA), donated assets and other transactions with the University are classified as other changes in net assets.

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

***Retiree Health Benefits Expense***

The University established the University of California Retiree Health Benefit Trust ("UCRHBT") to allow certain University locations and affiliates, including the Medical Center, to share the risks, rewards and costs of providing for retiree health benefits and to accumulate funds on a tax-exempt basis under an arrangement segregated from University assets.

The 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.

***Transactions with the University and University Affiliates***

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

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

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

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

***Interest Rate Swap Agreements***
The Medical Center has entered into interest rate swap agreements to limit the exposure of its variable rate debt to changes in market interest rates. Interest rate swap agreements involve the exchange with a counterparty of fixed and variable rate interest payments periodically over the life of the agreement without exchange of the underlying notional principal amounts. The difference to be paid or received is recognized over the life of the agreements as an adjustment to interest expense. The Medical Center's counterparty is a major financial institution.

In accordance with GASB standards, the fair value of the interest rate swap agreements are not recognized in the Medical Center's statements of net assets and changes in fair value are not recognized in the statements of revenues, expenses and changes in net assets.

***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.

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

***New Accounting Pronouncements***

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for the Medical Center's fiscal year beginning July 1, 2009. This statement requires capitalization of identifiable intangible assets in the statements of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life. The Medical Center has determined that implementation of Statement No. 51 will not have a significant effect on its financial statements.

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 its interest rate swaps are hybrid instruments under Statement No. 53. At the time of pricing the interest rate swaps in October 2008, the fixed rate on each of the Swaps was off-market such that the Medical Center received an upfront payment. As such, the swaps are comprised of a derivative instrument, an "At-the-Market Swap," and a companion instrument, a "Borrowing," represented by the upfront payment. At June 30, 2009, under existing accounting principles the negative fair value of the interest rate swaps totaling ($39,931) is disclosed in the footnotes to the financial statements, although not recorded in the statements of net assets. The upfront payment has been recorded as deferred financing costs in the statements of net assets. The unamortized amount of the up front payment included in deferred financing costs is $31,040 at June 30, 2009.

The Medical Center's evaluation of the "At-the-Market Swap" has concluded that it is an effective hedge for the Medical Center Pooled Revenue Bonds, Series C, under the Consistent Critical Terms method. As a result, upon implementation of Statement No. 53 beginning July 1, 2009, the negative fair value of the "At-the-Market Swap" of ($39,931) at June 30, 2009 will be recorded and deferred on the statements of net assets.

## 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 hospitals' (the Ronald Reagan UCLA Medical Center, the Santa Monica – UCLA Medical Center and Orthopaedic Hospital, and the Resnick Neuropsychiatric Hospital at UCLA) Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2002 for the Ronald Reagan UCLA Medical Center, June 30, 2007 for Santa Monica and June 30, 2005 for Resnick Neuropsychiatric Hospitals.

- ***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 $139,954 and $114,606, respectively.

## 3. Net Patient Service Revenue (Continued)

- ***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 $6,835 and $5,745, respectively.

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

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

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

    - 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.

**(Dollars in thousands)**

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

Amounts due from Medicare and Medi-Cal represent 21.0 percent and 24.0 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 favorable cost report settlements of $0 and $9,308 thousand, respectively, from Medicare and Medi-Cal.

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

| | 2009 | 2008 |
|---|---|---|
| Medicare (non-risk) | $ 327,054 | $ 297,443 |
| Medicare (risk) | 35,146 | 33,234 |
| Medi-Cal (non-risk) | 139,954 | 114,606 |
| Commercial | 13,130 | 14,283 |
| Contract (discounted or per diem) | 865,966 | 686,839 |
| Non-sponsored/self-pay (uninsured) | 20,597 | 16,156 |
| Total | $ 1,401,847 | $ 1,162,561 |

### 4. Charity Care

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

| | 2009 | 2008 |
|---|---|---|
| Charity care at established rates | $ 29,191 | $ 21,078 |
| Estimated cost of charity care | $ 9,183 | $ 7,436 |

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $66,092 and $46,802 for the years ended June 30, 2009 and 2008, respectively.

### 5. Restricted Assets, Donor Funds

Restricted assets due to donor restrictions are invested and remitted to the Medical Center in accordance with the donor's wishes. Securities are held by the trustee in the name of the University. The trust agreements permit trustees to invest in equity and fixed income securities, in addition to real property.

**(Dollars in thousands)**

## 5. Restricted Assets, Donor Funds (Continued)

The composition of restricted assets for the years ended June 30 is as follows:

| | 2009 | 2008 |
|---|---|---|
| Mutual funds | $ 8,273 | $ 17,528 |
| Real property | 2,100 | 2,100 |
| Charitable remainder trusts | 3,370 | 4,624 |
| Total | $ 13,743 | $ 24,252 |

Donor restricted funds are available for the following purposes:

| | 2009 | 2008 |
|---|---|---|
| Capital purposes | $ 1,014 | $ 7,954 |
| Endowments | 337 | 337 |
| Operations | 12,392 | 15,961 |
| Total | $ 13,743 | $ 24,252 |

## 6. Capital Assets

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

| | 2007 | Additions | Disposals | 2008 | Additions | Disposals | 2009 |
|---|---|---|---|---|---|---|---|
| **Original Cost** | | | | | | | |
| Land | $ 12,098 | $ – | $ – | $ 12,098 | $ – | $ – | $ 12,098 |
| Buildings and improvements | 442,506 | 1,006,240 | (228,514) | 1,220,232 | 92,260 | – | 1,312,492 |
| Equipment | 293,119 | 85,305 | (65,512) | 312,912 | 82,699 | (33,674) | 361,937 |
| Construction in progress | 1,213,736 | (869,913) | – | 343,823 | (33,733) | – | 310,090 |
| Capital assets, at cost | $ 1,961,459 | $ 221,632 | $(294,026) | $1,889,065 | $ 141,226 | $ (33,674) | $ 1,996,617 |

| | 2007 | Depreciation | Disposals | 2008 | Depreciation | Disposals | 2009 |
|---|---|---|---|---|---|---|---|
| **Accumulated Depreciation and Amortization** | | | | | | | |
| Buildings and improvements | $ 312,209 | $ 692 | $(185,830) | $ 127,071 | $ 48,979 | $ (349) | $ 175,701 |
| Equipment | 222,092 | 50,988 | (78,647) | 194,433 | 32,942 | (32,311) | 195,064 |
| Accumulated depreciation and amortization | $ 534,301 | $ 51,680 | $(264,477) | $ 321,504 | $ 81,921 | $ (32,660) | $ 370,765 |
| Capital assets, net | $ 1,427,158 | | | $ 1,567,561 | | | $ 1,625,852 |

## 6. Capital Assets (Continued)

Equipment under capital lease obligations and related accumulated amortization is $85,877 and $59,557 in 2009, respectively, and $81,560 and $54,007 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.

Donated assets represent gift funds that have been used for the hospitals' replacement. The gift funds are only recorded on the Medical Center's financial statements when expenditures for the project have been incurred.

The new Ronald Reagan UCLA Medical Center was completed and occupied on June 29, 2008. The Santa Monica – Medical Center and Orthopaedic Hospital is still under construction. Both projects are required in order to be in compliance with Senate Bill 1953, the *Hospital Facilities Seismic Safety Act*. A portion of the construction is financed by the University under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $175 and $9,929 for the years ending June 30, 2009 and 2008, respectively, are included in Contributions from University for building program on the statements of revenues, expenses and changes in net assets.

In conjunction with the relocation in June 2008 to the new Ronald Reagan UCLA Medical Center, a majority of the old hospital space was transferred back to the campus. As a result, the net book value of capital assets at June 30, 2008 was decreased by $31,822. The Medical Center continues to occupy approximately 256,537 of assignable square feet in the old hospital for clinical services.

## 7. Note Payable to Campus

The Medical Center has an internal line of credit in the amount of $75,000 from the Chancellor. The line of credit expires in February 2014 and accrues interest at the STIP rate of 3.3 percent at June 30, 2009. As of June 30, 2009, $75,000 was outstanding. Interest expense for the years ended June 30, 2009 and 2008 was $2,500 and $3,300, respectively.

**(Dollars in thousands)**

## 8. Long-term Debt and Capital Leases

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

| | 2009 | 2008 |
|---|---|---|
| University of California Medical Center Pooled Revenue Bonds 2007 Series A, interest rates ranging from 4.3 percent to 5.0 percent, payable semi-annually, with annual principle payments beginning in 2012 through 2047 | $ 250,000 | $ 250,000 |
| University of California Medical Center Pooled Revenue Bonds 2007 Series C, variable interest rate, with annual principal payments through 2047 | 197,030 | 197,030 |
| University of California Hospital Revenue Bonds 2004 (University of California, Los Angeles Medical Centers, Series A and B), interest rates from 2.0 percent to 5.5 percent, payable semi-annually, with annual principal payments through 2039 | 89,155 | 91,710 |
| University of California General Revenue Bonds 2003, interest rates from 2.0 percent to 5.3 percent, payable semi-annually, with annual principal payments through 2023 | 9,861 | 10,357 |
| Capital lease obligations, with fixed interest rates ranging from 2.9 percent to 9.4 percent, payable through 2014, collateralized by underlying equipment | 23,857 | 27,547 |
| The University Pool 2 Loan, interest rate of 5.7 percent payable annually, with annual principal payments through 2019 | 255 | 275 |
| Unamortized bond premium | 2,704 | 2,795 |
| Unamortized deferred financing costs | 6,096 | (204) |
| Total debt and capital leases | 578,958 | 579,510 |
| Less: Current portion of debt and capital leases | (10,227) | (15,025) |
| Noncurrent portion of debt and capital leases | $ 568,731 | $ 564,485 |

### (Dollars in thousands)

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

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

| | Revenue Bonds | Capital Lease Obligations | Total |
|---|---|---|---|
| **Year Ended June 30, 2009** | | | |
| Current portion at June 30, 2008 | $ 3,149 | $ 11,876 | $ 15,025 |
| Reclassification from noncurrent | 2,620 | 7,580 | 10,200 |
| Principal payments | (3,072) | (12,124) | (15,196) |
| Amortization of bond premium | (91) | – | (91) |
| Amortization of deferred financing costs | 289 | – | 289 |
| Current portion at June 30, 2009 | $ 2,895 | $ 7,332 | $ 10,227 |
| Noncurrent portion at June 30, 2008 | $ 548,814 | $ 15,671 | $ 564,485 |
| New obligations | – | 8,434 | 8,434 |
| Deferred financing costs-new bond swap | 31,348 | – | 31,348 |
| Deferred financing costs-terminated bond swap | (25,336) | – | (25,336) |
| Reclassification to current | (2,620) | (7,580) | (10,200) |
| Noncurrent portion at June 30, 2009 | $ 552,206 | $ 16,525 | $ 568,731 |
| **Year Ended June 30, 2008** | | | |
| Current portion at June 30, 2007 | $ 5,936 | $ 15,374 | $ 21,310 |
| Reclassification from noncurrent | 197,711 | 11,876 | 209,587 |
| Defeased 2002 and 2004 revenue bonds | (188,190) | – | (188,190) |
| Write off of unamortized bond premium | (10,026) | – | (10,026) |
| Principal payments | (2,205) | (15,374) | (17,579) |
| Amortization of bond premium | (91) | – | (91) |
| Amortization of deferred financing costs | 14 | – | 14 |
| Current portion at June 30, 2008 | $ 3,149 | $ 11,876 | $ 15,025 |
| Noncurrent portion at June 30, 2007 | $ 549,495 | $ 19,890 | $ 569,385 |
| New obligations | 197,030 | 7,657 | 204,687 |
| Reclassification to current | (197,711) | (11,876) | (209,587) |
| Noncurrent portion at June 30, 2008 | $ 548,814 | $ 15,671 | $ 564,485 |

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

Medical Center Pooled Revenue Bonds are issued to finance the University's medical centers and are collateralized by a joint and several pledge of the operating revenues, as defined in the indenture, of all five of the University's medical centers. The Medical Center Pooled Revenue Bond indenture requires the medical centers to set rates, charges and fees each year sufficient for the medical center operating revenues to pay for the annual principal and interest on the bonds and certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2009 are $1.04 billion of which $447,000 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.

In July 2007, Medical Center Pooled Revenue Bonds, Series 2007 C totaling $197.0 million, $7.3 million with a fixed interest rate and $189.7 million with a variable interest rate, were issued specifically for the Medical Center to refinance certain improvements to the Medical Center. Proceeds were used to refund $188.2 million of 2002 and 2004 Hospital Revenue Bonds. The bonds mature at various dates through 2047. The fixed rate bonds have a weighted average interest rate of 4.3 percent. Aggregate debt service payments on the refunded bonds increased by $152.6 million due to the extension of maturities over the next 40 years and the Medical Center achieved an economic gain of $1.5 million.

In January 2007, Medical Center Pooled Revenue Bonds, Series 2007 A totaling $250,000 were issued specifically for the Medical Center to finance or refinance certain improvements to the Medical Center. Proceeds, including a bond premium of $2,079, were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through November 2011, mature at various dates through 2047 and have a weighted average interest rate of 4.6 percent.

University of California Hospital Revenue Bonds 2004 series have also financed certain improvements at the Medical Center. The Hospital Revenue Bonds are collateralized solely by revenues of the Medical Center. In addition, under the bond indentures, the Medical Center is required to maintain a debt service ratio of 1.1 to 1 and has limitations as to additional borrowings and the purchase or sale of assets.

General Revenue Bonds issued by the University, 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 the Medical Center projects.

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

**(Dollars in thousands)**

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

***Interest Rate Swap Agreements***

*Objectives.* As a means to lower the Medical Center's borrowing costs, when compared against fixed-rate bonds at the time of issuance, the Medical Center entered into an interest rate swap agreement in connection with its variable-rate Medical Center Pooled Revenue Bonds. Under the swap agreement, the Medical Center pays the swap counterparty a fixed interest rate payment and receives a variable rate interest rate payment that effectively changes the Medical Center's variable interest rate bonds to synthetic fixed rate bonds.

*Terms.* The notional amount of the swap matches the principal amount of the variable-rate Medical Center Pooled Revenue Bonds. The Medical Center's swap agreement contains scheduled reductions to outstanding notional amounts that match scheduled reductions in the variable-rate bonds.

The terms of the outstanding swap and the fair value at June 30, 2009 are as follows:

| Type | Notional Amount | Effective Date | Maturity Date | Terms | Fair Value | Counterparty Credit Rating |
|---|---|---|---|---|---|---|
| Pay fixed; receive variable | $189,775 | 2008 | 2047 | Pay 4.6873%; receive 67% of 3-month LIBOR* + 0.73%** | $(39,931) | Aa1/AA |

* London Interbank Offered Rate (LIBOR)
** Weighted average spread

*Fair Value.* There is a risk that the fair value of the swap will become negative as a result of market conditions. Because swap rates have changed since execution of the swap, financial institutions have estimated the fair value using quoted market prices when available or a forecast of expected discounted future net cash flows. The fair value of the interest rate swap is the estimated amount the Medical Center would have either (paid) or received if the swap agreement was terminated on June 30, 2009.

*Credit Risk.* Although the Medical Center has entered into the interest rate swap with a creditworthy financial institution, there is credit risk for losses in the event of non-performance by the counterparty or unfavorable interest rate movements. Swap contracts with positive fair values are exposed to credit risk. The Medical Center faces a maximum possible loss equivalent to the amount of the derivative's fair value. Swap contracts with negative fair values are not exposed to credit risk.

Depending on the fair value of the swap, the Medical Center may be entitled to receive collateral from the counterparty to the extent the positive fair value exceeds $35.0 million, or be obligated to provide collateral to the counterparty if the negative fair value of the swap exceeds $50.0 million.

*Basis Risk.* There is no basis or tax risk related to the swap since the variable rate the Medical Center pays to the bond holders matches the variable rate payments received from the swap counterparty.

**(Dollars in thousands)**

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

***Interest Rate Swap Agreements (Continued)***
*Termination Risk.* There is termination risk for losses in the event of non-performance by the counterparty in an adverse market resulting in cancellation of the synthetic interest rate and returning the interest rate payments to the variable interest rates on the bonds. In addition, the swap may be terminated if the Medical Center Pooled Revenue Bonds credit quality rating, as issued by Moody's or Standard & Poor's, falls below Baa1/BBB+, or if the swap counterparty's rating falls below Baa1/BBB+. At termination, the Medical Center may also owe a termination payment if there is a realized loss based on the fair value of the swap.

The Medical Center's counterparty in the interest rate swap agreement was Lehman Brothers Special Financing Inc. on June 30, 2008. The guarantor was Lehman Brothers Holdings Inc. In September 2008, Lehman Brothers Holdings Inc. filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. In October 2008, Lehman Brothers Special Financing Inc. filed for bankruptcy under Chapter 11 of the U.S. Bankruptcy Code. As a result, in October 2008, the Medical Center terminated its existing swap agreement and substituted a new interest rate swap agreement with identical terms with a new counterparty, with the exception of certain additional collateral requirements. In conjunction with the swap termination, the Medical Center received $31,348 from the new counterparty and made a termination payment of $25,336 to Lehman Brothers Special Financing Inc. These payments were recorded as deferred costs of financing and will be amortized as interest expense over the term of the bonds.

As rates vary, variable rate bond interest payments and net swap payments will vary. Although not a prediction by the Medical Center of the future interest cost of the variable rate bonds or the impact of the interest rate swaps, using rates as of June 30, 2009, debt service requirements of the variable rate debt and net swap payments are as follows:

| | Variable-Rate Bond | | | |
|---|---|---|---|---|
| Year Ending June 30, | Principal | Interest | Interest Rate Swap, Net | Total |
| 2010 | $ 2,605 | $ 2,615 | $ 9,042 | $ 14,262 |
| 2011 | 2,695 | 2,611 | 8,965 | 14,271 |
| 2012 | 2,800 | 2,608 | 8,886 | 14,294 |
| 2013 | 2,895 | 2,604 | 8,804 | 14,303 |
| 2014 | 3,000 | 2,600 | 8,719 | 14,319 |
| 2015 – 2019 | 16,735 | 12,934 | 42,201 | 71,870 |
| 2020 – 2024 | 26,895 | 12,771 | 39,442 | 79,108 |
| 2024 – 2029 | 44,065 | 11,790 | 33,952 | 89,807 |
| 2030 – 2034 | 41,725 | 10,283 | 26,682 | 78,690 |
| 2035 – 2039 | 31,580 | 8,494 | 21,091 | 61,165 |
| 2040 – 2044 | 61,605 | 5,651 | 13,857 | 81,113 |
| 2045 – 2047 | 44,390 | 1,246 | 3,028 | 48,664 |
| Total | $280,990 | $ 76,207 | $224,669 | $581,866 |

**(Dollars in thousands)**

## 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:

| Year Ending June 30, | Revenue Bonds | Capital Lease Obligations | Total Payments | Principal | Interest |
|---|---|---|---|---|---|
| 2010 | $ 29,047 | $ 8,202 | $ 37,249 | $ 10,523 | $ 26,726 |
| 2011 | 29,044 | 6,850 | 35,894 | 9,592 | 26,302 |
| 2012 | 31,798 | 5,635 | 37,433 | 11,544 | 25,889 |
| 2013 | 32,161 | 3,600 | 35,761 | 10,371 | 25,390 |
| 2014 | 32,169 | 1,593 | 33,762 | 8,848 | 24,914 |
| 2015 – 2019 | 160,804 | – | 160,804 | 42,438 | 118,366 |
| 2020 – 2024 | 157,678 | – | 157,678 | 51,232 | 106,446 |
| 2025 – 2029 | 152,411 | – | 152,411 | 58,690 | 93,721 |
| 2030 – 2034 | 152,413 | – | 152,413 | 73,995 | 78,418 |
| 2035 – 2039 | 152,410 | – | 152,410 | 92,870 | 59,540 |
| 2040 – 2044 | 152,417 | – | 152,417 | 116,465 | 35,952 |
| 2045 – 2048 | 91,444 | – | 91,444 | 83,590 | 7,854 |
| Total future debt service | 1,173,796 | 25,880 | 1,199,676 | $ 570,158 | $ 629,518 |
| Less: Interest component of future payments | (627,495) | (2,023) | (629,518) | | |
| Principal portion of future payments | 546,301 | 23,857 | 570,158 | | |
| Adjusted by: | | | | | |
| Unamortized bond premium | 2,704 | – | 2,704 | | |
| Unamortized deferred financing costs | 6,096 | – | 6,096 | | |
| Total debt | $ 555,101 | $ 23,857 | $ 578,958 | | |

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

**(Dollars in thousands)**

## 9. Operating Leases

The Medical Center leases certain buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2009 and 2008 was $7,924 and $6,807, respectively. The terms of the operating leases extend through the year 2015.

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

| Year Ending June 30, | Minimum Annual Lease Payments |
|---|---|
| 2010 | $ 6,682 |
| 2011 | 5,675 |
| 2012 | 5,486 |
| 2013 | 5,253 |
| 2014 | 2,818 |
| 2015 | 15,874 |
| Total | $ 41,788 |

## 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 $15,400, $13,000 and $11,200 for the years ended June 30, 2009, 2008 and 2007, respectively.

## 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.

## 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 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.

**(Dollars in thousands)**

## 12. University Self-insurance

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

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $13,128 and $14,735 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 $1,413 and $1,495, 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 $9,513 and $8,067 for the years ended June 30, 2009 and 2008, respectively.

## 13. Transactions with Other University Entities

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

| | 2009 | 2008 |
|---|---|---|
| Professional services | $ 10,388 | $ 11,826 |
| Medical supplies | (2,168) | (2,198) |
| Other supplies and purchased services | 52,487 | 40,048 |
| Interest income (net) | (3,982) | (3,042) |
| Insurance | 9,513 | 8,067 |
| Total | $ 66,238 | $ 54,701 |

(Dollars in thousands)

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

Additionally, the Medical Center makes payments to the University of California, Los Angeles 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 $104,170 and $87,826 in 2009 and 2008, respectively. Of these amounts, $66,238 and $54,701 are reported as operating expenses for the years ended June 30, 2009 and 2008, respectively, and $37,932 and $33,125 are reported as health system support for the years ended June 30, 2009 and 2008, respectively.

## 14. Federal Emergency Management Administration

The Medical Center negotiated with the Federal Emergency Management Agency ("FEMA") and with the state of California for grant funds for the replacement of the UCLA Medical Center and the Santa Monica-UCLA Medical Center. The Medical Center received approval for grant funds as follows:

| | FEMA | State of California |
|---|---|---|
| UCLA Medical Center | $ 439.7 | $ 43.9 |
| Santa Monica – Medical Center* | 72.1 | – |
| | $ 511.8 | $ 43.9 |

*includes the Orthopaedic Hospital funds; see Note 15

Under the terms of the agreement, the Medical Center will be reimbursed for eligible costs of rebuilding the acute care facilities. The Medical Center capitalizes construction costs based on cash receipts and pending reimbursements from FEMA. For the years ended June 30, 2009 and 2008, total cash received from FEMA was $0 and $12,548, respectively.

The grants are subject to final settlement after completion of construction and submission of reports and audits thereof by FEMA. If the results of the audit determine that the construction costs incurred were ineligible for reimbursement, the University would be required to find alternative financing sources. As of June 30, 2009, FEMA has not completed any audits.

**(Dollars in thousands)**

## 15. Commitments and Contingencies

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

The University is contingently liable in connection with certain claims and contracts, including those currently in litigation, arising out of the normal course of its activities. Management and General Counsel are of the opinion that the outcome of such matters will not have a material effect on the financial statements.

State of California Senate Bill 1953, *Hospital Facilities Seismic Safety Act*, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. By January 1, 2030, all general acute care inpatient buildings must be operational after an earthquake. Previously, the state of California's budget authorized the University to use $600,000 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 $182,000 was allocated to the Medical Center. The Medical Center spent $175 and $9,929 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.

The replacement hospital at the UCLA Medical Center was completed and placed in service in June 2008. The Santa Monica – Medical Center is still under construction. The total cost of these Medical Center projects is currently estimated to be $1.4 billion, excluding interest. The estimated financing sources for the replacement hospitals are estimated as follows:

| | |
|---|---|
| FEMA | $ 511,803 |
| State Matching Funds | 43,886 |
| Gift Funds | 93,729 |
| State Lease Revenue Bonds | 181,957 |
| Medical Center Revenue Bond 2004 | 172,428 |
| Medical Center Revenue Bond 2007 | 248,551 |
| State Children's Hospital Program Grant | 29,828 |
| Hospital Reserves | 8,010 |
| Campus Funds | 822 |
| Proposed Medical Center revenue bonds | 145,000 |
| Total | $ 1,436,014 |

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

Gift funds used for construction totaling $40,200 and $117,500 for the years ended June 30, 2009 and 2008, respectively, and are reflected in the statements of revenues, expenses and changes in net assets. Additional gift funds and pledges received but not used as of June 30, 2009 are not included in the financial statements of the Medical Center. These gifts and pledges are included in the financial statements of the University and transferred to the Medical Center when used.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately $97,900, excluding interest, as of June 30, 2009.