University of California, San Francisco Medical Center

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

University of California, San Francisco 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 18 through 45, present fairly, in all material respects, the financial position of the University of California, San Francisco 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 17 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 the Management's Discussion and Analysis is to help readers better understand the University of California, San Francisco 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, San Francisco Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"). The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority delegated to the Medical Center Director by the Chancellor of the San Francisco campus.

The Medical Center serves as the principal clinical teaching site for the University of California San Francisco ("UCSF") School of Medicine, affiliated with the University of California since 1873. The mission of the Medical Center is Caring, Healing, Teaching and Discovering.

The Medical Center is licensed to provide inpatient care at Moffitt-Long Hospital on the 107-acre Parnassus campus and at UCSF Mount Zion, outpatient hospital care at the two hospital sites, and physician clinical care at those hospitals and other locations primarily in San Francisco. The Moffitt-Long Hospital includes UCSF Children's Hospital, a "hospital within a hospital" with more than 150 pediatric specialists practicing in more than 50 areas of medicine. The Medical Center is licensed to operate 722 beds. At June 30, 2009, the Medical Center had 658 available beds.

The Medical Center's financial statements include the activities of the UCSF Medical Group – the faculty practice plan for UCSF faculty physicians. The net revenues from clinical practice are recorded in net patient service revenue; the direct expenses of non-physician staff and non-labor expenses are included in operating expenses. Payments to the faculty for their professional services are classified as purchased services.

The Medical Center's primary service area is the City and County of San Francisco. Its secondary service area includes the eight Bay Area counties surrounding San Francisco: Alameda, Contra Costa, Marin, Monterey, San Mateo, Santa Clara, Solano, and Sonoma. The Medical Center also cares for patients from a tertiary service area including counties from Madera and Mariposa to the southeast, Yolo and Sacramento to the northeast, and San Joaquin and Stanislaus to the east. More than 90 percent of inpatient cases have historically originated from the 20 counties in these combined service areas.

The Medical Center provides care across the acuity spectrum, including basic care, moderate care, and highly complex care. The patient origin of the basic care population is heavily concentrated in the primary service area. Patients requiring moderate acute care are largely concentrated in the primary and secondary service area. High complexity care is provided to patients originating from a more widely dispersed geographic area.

Approximately 80 percent of the Medical Center's existing inpatient cases represent adults, while 20 percent are pediatric. From 2002 to 2007 the Medical Center's inpatient case volumes grew faster than healthcare market growth overall, indicating an increase in market share. By product line, the Medical Center experienced growth in almost all service lines – even those experiencing declining market trends.

The Medical Center continues to maintain an outstanding national reputation. The 2009 US News & World Report survey ranked UCSF Medical Center as the seventh best hospital in the nation.

According to the latest US News & World Report survey, UCSF Medical Center now ranks among the nation's top 10 programs in the following specialties: cancer care, diabetes & endocrine disorders, digestive disorders, geriatric care, gynecology, kidney disorders, neurology & neurosurgery, ophthalmology, respiratory disorders, rheumatology, and urology. UCSF Medical Center ranks among the top 20 programs in ear, nose and throat, psychiatry, and orthopedics.

UCSF Children's Hospital was ranked by U.S. News & World Report among the nation's best children's hospitals in nine pediatric specialties, making it one of the top-ranked facilities in California. Rather than provide an overall ranking for the nation's best children's hospitals, the 2009 Children's Hospital survey ranked the top 30 hospitals in 10 individual specialties — cancer, diabetes and endocrine disorders, digestive disorders, heart and heart surgery, kidney disorders, neonatal care, neurology and neurosurgery, orthopedics, respiratory disorders and urology. UCSF Children's Hospital was ranked in nine of the 10 specialties, and is one of only three facilities in California to earn rankings in this many areas.

In 2008 the Medical Center completed an update to the UCSF Clinical Enterprise Strategic Plan for 2008 through 2015 ("2008 Strategic Plan"). The key areas of focus in the 2008 Strategic Plan are Best Care, Clinical Growth, and Shared Accountability. Specific themes, initiatives and tactics are described below:

Best Care

Provide the Highest Quality of Care to Patients. Quality care is an area of traditional strength for UCSF. UCSF will focus on communicating results of its superior quality, patient safety and clinical outcomes to a broad external audience. Tactics to continue to provide the highest quality of care include a) focus on patient and referring physician satisfaction, b) decrease in wait time, c) coordination of patient tracking and d) enhancing service standards.

Create the next Generation UCSF Delivery Model. Clinical professionals are confronted with increased complexity, volume, and regulation. Tactics to develop an innovative flexible care delivery model include a) increasing the number of non-resident and mixed services to reduce reliance on the resident model, b) increasing residents in select departments, c) developing core teaching and non resident staffing models for inpatient units, and d) restructuring workflow on inpatient units to allow all clinical providers to spend more time with the patient.

Educate, Recruit and Retain the Best Talent. UCSF's current position in the top tier of hospitals nationally is largely due to the excellence of its faculty and staff. Tactics include a) investing in recruitment initiatives that enable UCSF to meet goals around clinical growth and patient mix, b) creating retention initiatives that allow UCSF to identify and develop the next generation of UCSF leadership, and c) continuing to strengthen the relationship between UCSF and its employees.

During 2009, some of the Best Care initiatives included:

- Continued emphasis on patient safety. The organization-wide goals for 2009 included reducing catheter-related blood stream infections ("CRBSI") in the Intensive Care Units ("ICU"), reducing adult hospital-acquired pressure ulcers, and developing an electronic tool for reconciling medications at points of transfer within the hospital. All three goals were measured and met. In addition to organization-wide goals, the Medical Center continued monthly reporting of adverse events, and rapid root cause analyses of events, trends, and unsafe conditions.
- Implementation of the first phase of a patient tracking system to improve patient flow.
- Implementation of an automated medication administration record to significantly reduce the risk of medication errors and allow monitoring of timely medication administration.
- Launch of a web-based patient portal to allow patients to request prescription refills and appointments, receive lab results, communicate with their doctors, access health education information, and create a personal health record in a secure environment. The portal also offers a setting that encourages colleague-to-colleague messaging and referrals.
- Continued emphasis on improvements in patient satisfaction. The Medical Center actively surveys patients and trends drivers of satisfaction by clinic and nursing unit, using the results to formulate training and other targeted improvements.
- Completion of two Model of Care pilot programs in Orthopaedics and Neurosciences, including development of care pathways, active discharge management for targeted patient populations, acceleration of key ancillary services, and improvement in provider and care staff coverage and communications.
- Launch of an online learning management system to support delivery, management, and tracking of learning events for physicians, trainees, and staff.. The program is coordinated with other UC Campuses and will allow sharing of relevant curriculum.
- Increased emphasis on communication up, down, and across the organization, including sharing results of the last employee survey, open office hours and town hall meetings with the Chief Executive Officer and Chief Operating Officer, and enhanced management training.

Clinical Growth

Maximize the Potential of UCSF Inpatient Facilities. To ensure that there is an interim inpatient growth opportunity for the clinical enterprise in the 2008 to 2015 timeframe UCSF will focus on improving utilization of inpatient facility assets on the Parnassus and Mount Zion campuses.

Match Patient Mix to UCSF's Mission and Program Capability. Programmatic and acuity mix drive the training programs, recruitment targets and care models. With demand projected to outpace available capacity in the 2008 to 2015 timeframe, it becomes vital for UCSF to match patient mix to core capabilities. Tactics include a) focusing on adult incremental growth in high and moderate complexity care, b) exceeding minimum volumes to support educational and research requirements, and c) committing to a set of institutional policies that are intended to manage UCSF's sponsor mix and ensure financial viability.

Expand Functional Ambulatory and Office Capacity. Expansion of ambulatory capacity can improve access and generate additional revenue. Tactics to expand ambulatory and office capacity include a) improving exam room utilization, b) ensuring that there is sufficient office space available to support projected growth of the clinical enterprise, and c) focusing on the development of ambulatory growth off the main campus.

Achieve More Effective UCSF Referral Outreach. Tactics include a) creating an institutional outreach oversight committee that will be responsible for prioritizing and coordinating future UCSF outreach initiatives, b) building relationships with community providers in Northern California to ensure patients are cared for in the appropriate care settings, and c) increasing awareness of the UCSF brand regionally.

During 2009 Clinical Growth initiatives included:

- Completion of remodeling of new nursing units adding an incremental 16 intensive care beds
- Continued development of the UCSF Mission Bay Hospital. In 2009, the Medical Center received approval from the University of California Board of Regents on the project's design, budget and environmental certification, established the project construction team and began selection of subcontractors, received certification for the environmental impact report, submitted structural plans to the Office of Statewide Health Planning and Development, initiated construction documents, and coordinated with government agencies and the community on helipad approval, the residential sound reduction program, and design approvals.
- Continued multi-year project to measure and improve exam room utilization in its outpatient clinics, resulting in increased patient throughput and access, along with increased patient satisfaction.
- Continued the three-year collaboration agreement with ValleyCare Health System in the Tri-Valley region of the East Bay to enhance health care services for women and children by expanding regional access to high-quality perinatal and pediatric care and to broaden the availability of specialty services.
- Entered into a five-year joint collaboration agreement with Mercy Medical Center ("Mercy") in Redding, California to increase cancer disease prevention and improve access to high quality, evidence-based care throughout Mercy's service area. The collaborative efforts between the two organizations are intended to provide patients with the best medical care as close to home as possible, while encouraging individuals to seek treatment at UCSF should they need highly advanced care that is not available locally.
- Construction of an Orthopaedic Institute to consolidate existing Orthopaedic Surgery subspecialties and allow for growth of clinical services and programs in Sports Medicine; Hand and Upper Extremity surgery; Foot and Ankle surgery; Spinal Pain Management procedures; and Orthotics and Prosthetics. The new facility will also include a diagnostic radiology facility on site to support surgical and clinical activities, and academic offices for faculty who primarily practice and spend their time at the Institute.

Shared Accountability

Define a Stronger Culture of Shared Accountability and Action. UCSF is renowned for its academic creativity and accomplishments. By adopting high standards, demanding transparency against results, and enabling a more cohesive decision making across the hospital and clinical faculty programs, UCSF will help ensure its initiatives are successfully implemented.

During 2009 Shared Accountability initiatives included:

- Coordinated long-term Campus-wide financial projections incorporating the Medical Center's Ten Year financial plan.
- Continued commitment to collaborative Capital planning, health system support oversight, and transparency in financial reporting across the clinical enterprise.
- Initial planning for a new model of shared governance across the clinical enterprise.

Operating Statistics

For 2009, the UCSF Medical Center reported income before other changes in net assets in excess of $80.1 million. Cash balances at June 30, 2009 were $127.5 million. Cash decreased $1.3 million in 2009 from a balance of $128.8 million in 2008 and decreased $54 million in 2008 from a balance of $182.8 in 2007.

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

Statistics	2009	2008	2007
Admissions	28,190	28,679	27,892
Average daily census	523	503	489
Discharges	28,591	28,789	28,367
Average length of stay	6.6	6.4	6.3
Patient days	190,870	184,060	178,544
Case mix index	1.94	1.90	1.84
Outpatient visits:			
Hospital clinic visits	735,713	722,728	695,640
Home health visits	17,717	16,491	16,001
Emergency visits	37,759	39,356	38,486
Total visits	791,189	778,575	750,127

Patient service revenue depends on inpatient occupancy levels, the complexity of the care provided, the volume of outpatient visits, and the charges or negotiated payment rates for services provided. Patient days increased by 6,810, or 3.7 percent, in 2009 and by 5,516, or 3.1 percent, in 2008 as demand for patient services continues to be strong. During 2009, the Medical Center opened 16 additional beds. The Medical Center's case mix index, a measure of the acuity of care, has continued to be above 1.80 for the past three years reflecting growth in highly complex care, including complex surgical cases and transplants. Hospital outpatient visits have also increased in each of the last two years: an increase of 12,614, or 1.6 percent, and 28,448, or 3.8 percent, in 2009 and 2008, respectively, from the previous year.

In addition to increased volumes, the Medical Center's rates – net revenue per patient day and net revenue per outpatient procedure or visit – improved from 2007 to 2008 and from 2008 to 2009.

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	$ 1,629,106	$ 1,457,023	$ 1,363,149
Other operating revenue	24,044	25,815	23,207
Total operating revenue	1,653,150	1,482,838	1,386,356
Total operating expenses	1,552,113	1,438,260	1,273,844
Income from operations	101,037	44,578	112,512
Total non-operating expenses	(20,954)	(3,014)	(1,670)
Income before other changes in net assets	$ 80,083	$ 41,564	$ 110,842
Margin	4.8 percent	2.8 percent	8.0 percent
Other changes in net assets	(28,110)	(7,920)	27
Net assets – beginning of year	708,785	675,141	564,272
Net assets – end of year	$ 760,758	$ 708,785	$ 675,141

Revenues

Total operating revenues for the year ended June 30, 2009 were $1,653 million, an increase of $170 million, or 11.5 percent, over 2008. Operating revenues for 2008 of $1,483 million increased by $96 million, or 7.0 percent, over 2007.

Net patient service revenue for 2009 increased by $172 million, or 11.8 percent, over 2008. The increase in 2009 was primarily due to increased patient volumes, an improvement in reimbursement rates and higher patient acuity. Net patient service revenue in 2008 increased by $94 million, or 6.9 percent, over 2007 primarily due to increased patient volumes and an improvement in reimbursement rates. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medi-Cal and other third-party payors and have been estimated based on the terms of reimbursement and contracts currently in effect.

Other operating revenue consisted primarily of State Clinical Teaching Support Funds ("CTS") and other non-patient services, including contributions, cafeteria revenues and vendor rebates.

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

Payor	2009	2008	2007
Medicare (non-risk)	$ 331,397	$ 309,967	$ 293,670
Medi-Cal (non-risk)	190,396	171,223	157,275
Contracts – commercial	1,051,007	920,239	861,100
Contracts (capitated)*	11,973	10,421	8,533
County/Uninsured	44,333	45,173	42,571
Total	$ 1,629,106	$ 1,457,023	$ 1,363,149

*Includes Medicare and Medi-Cal risk

The Medical Center receives most of its net patient service revenue from commercial contracts. Medicare and Medi-Cal together represent about a third of net patient service revenue.

Net revenue for Medicare beneficiaries increased $21.4 million, or 6.9 percent, from 2008 to 2009 and $16.3 million, or 5.5 percent, from 2007 to 2008. 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 labor costs. The Medical Center also receives additional payments to reimburse for the direct and indirect costs for graduate medical education, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system.

Laws and regulations governing the Medicare program are complex and subject to interpretation. As a result, actual amounts could differ from the recorded estimates. During 2009, the Medical Center decreased its liability related to prior year third party settlements and loss contingencies by $19.5 million with a corresponding increase to net patient service revenue in the statements of revenues, expenses and changes in net assets. During 2008, the Medical Center decreased its liability related to prior year third party settlements and loss contingencies by $16.8 million with a corresponding increase to net patient service revenue in the statements of revenues, expenses and changes in net assets.

UCSF Medical Center continues to work with the Medicare fiscal intermediary to resolve open cost report issues. In addition to known Medicare receivables and payables, the Medical Center's financial statements include loss contingencies related to these open cost report issues, as required by generally accepted accounting principles.

Net revenue for Medi-Cal patients increased $19.2 million, or 11.2 percent, from 2008 to 2009 and $13.9 million, or 8.9 percent, from 2007 to 2008. Effective July 1, 2005 Medi-Cal fee-for-service ("FFS") inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 ("SB 1100"). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 is designed to protect baseline Medicaid funding for the Medical Center over the next five years – at a minimum the Medical Center will receive the Medicaid inpatient hospital payments received in 2005 adjusted for future utilization changes. SB 1100 also allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share ("DSH") payments, and Safety Net Care Pool ("SNCP"). The SNCP is a new federal allotment available under the waiver.

The increase in net revenue during 2009 for Medi-Cal was due to increased inpatient days year to year, improved reimbursement rates and increased supplemental funding, including stimulus amounts received under the American Recovery and Reinvestment Act of 2009. The increase in 2008 was due to increased inpatient days year to year, improved reimbursement rates and increased supplemental funding. Medi-Cal net revenues in 2009 and 2008 also include supplemental reimbursement for a portion of unreimbursed facility costs under the State of California Assembly Bill ("AB 915"). The Medical Center recorded $12.2 million in 2009 and $12.4 million in 2008 under AB 915.

Net revenue earned on commercial contracts increased $130.8 million, or 14.2 percent, from 2008 to 2009 and $59.1 million, or 6.9 percent, from 2007 to 2008. Health Maintenance Organizations (HMO's) and Preferred Provider Organizations (PPO's) usually reimburse the Medical Center at contracted discounts or per-diem rates. Net revenue from commercial contracts represented about 64.5 percent of total net patient service revenue in 2009, consistent with 63.2 percent in 2008 and consistent from 63.2 percent in 2007. Commercial inpatient days as well as the average yield – net revenue per inpatient day – increased in both 2009 and 2008. Commercial contract revenue for hospital clinic visits also increased in 2009 compared to 2008 and 2007.

Net revenue from capitation, which was exclusively for outpatient services, increased $1.6 million, or about 14.9 percent, in 2009 and $1.9 million, or about 22.1 percent, in 2008. Net revenue from non-sponsored patients and from the County decreased $0.8 million, or 1.9 percent, from 2008 to 2009 and increased $2.6 million, or 6.1 percent, from 2007 to 2008.

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	$ 642,416	$ 595,562	$ 516,898
Employee benefits	131,479	119,696	106,454
Professional services	25,196	24,238	20,394
Medical supplies	230,108	211,434	187,262
Other supplies and purchased services	388,187	365,088	331,273
Depreciation and amortization	67,707	60,711	55,968
Insurance	7,083	5,775	4,643
Other	59,937	55,756	50,952
Total operating expenses	$ 1,552,113	$ 1,438,260	$ 1,273,844

Total operating expenses were $1,552 million in 2009, up $113 million, or 7.9 percent, from 2008. Operating expenses increased in 2009 due to increased patient days, along with higher labor and medical supply costs. In 2008 operating expenses increased $164 million, or 12.9 percent, from 2007 primarily due to increased patient volumes, the impact on labor costs of the continued nursing shortage, higher costs associated with regulatory compliance, and inflationary pressures on pharmaceuticals and medical supplies.

During 2008, the California Department of Health Services ("DHS"), subsequently called the California Department of Public Health ("DPH") as surveying agent for the Centers for Medicare & Medicaid Services ("CMS") completed a series of unannounced surveys of the Medical Center's compliance with the CMS Conditions of Participation in the Medicare program. The surveys noted deficiencies in the Medical Center's compliance with the Conditions of Participation.

Many of the original deficiencies noted concerned medication distribution, administration, and documentation which have since been fully addressed. One form of remediation was to implement an automated medication administration record. To address deficiencies while the automated medication administration record was under development, the Medical Center added two staff to each nursing unit during each shift; one to ensure that physician medication orders were properly transcribed and transmitted to the pharmacy, and one to ensure that each pharmaceutical prescribed was administered timely and documented properly in the patient's medical record. The incremental staff added an average of 149 full-time equivalents ("FTE") and as many as 223 FTE for the period from August 2007 to June 2008. In addition to incremental labor costs, the Medical Center incurred professional fees, supplies, and maintenance costs to address deficiencies. Management estimates that in excess of $21 million in incremental costs were incurred in 2008 to address regulatory concerns. As the automated medication administration record was implemented, the incremental staff was no longer needed. At June 30, 2008 about half of the incremental staff was no longer needed. At June 30, 2009, 90% of the incremental staff was no longer needed.

During 2009, the Medical Center was resurveyed by CMS and found to be in compliance with all Conditions of Participation.

Salary and wage expense includes wages paid to Medical Center employees, holiday and sick pay, payroll taxes, and workers' compensation costs. About half of the Medical Center workforce, including nurses and employees providing ancillary services, expands or contracts with patient volumes. In 2009, salaries and wages grew by $46.9 million, or 7.9 percent, over the prior year primarily due increases in patient days and clinic visits. In 2008, salaries and wages increased by $78.7 million, or 15.2 percent, over 2007 due to increases in patient days, clinic visits and additional resources added during the year to address CMS survey deficiencies noted above. In addition, the nationwide shortage of skilled healthcare workers had a significant impact on both the salary costs of hospital-employed nurses as well as the rates charged for nurses employed from nurse registry agencies. The passage of Assembly Bill 394, which established licensed nurse to patient ratios added to the nursing shortage. Overall, labor costs per hospital-paid employee increased by 7.2 percent in 2009 over 2008 and increased 4.6 percent in 2008 over 2007. As a percentage of total operating revenue, salaries and employee benefits were 46.8 percent in 2009, 48.2 percent in 2008 and 45.0 percent in 2007.

In 2009, increases in total benefit costs were $11.8 million, with health insurance benefits higher by $9.2 million, workers' compensation insurance premiums lower by $0.8 million, and all other benefits higher by $3.4 million over 2008. Increases in total benefits costs in 2008 were $13.2 million, with health insurance benefits higher by $6.9 million, workers' compensation insurance premiums lower by $0.1 million, and all other benefit expense increased by $6.4 million over 2007.

Payments for professional services increased by $1.0 million, or 4.0 percent, in 2009 from 2008. The increases were primarily due to collection agency fees. In 2008, payments for professional services increased by $3.8 million or 18.9 percent due primarily to increases in consulting services and collection agency fees.

Medical supply expense, including pharmaceuticals, totaled $230.1 million in 2009, up $18.7 million, or 8.8 percent, from the prior year. The increase was due to higher patient volumes and increases in pharmaceutical costs. In 2008, medical supplies, including pharmaceuticals, totaled $211.4 million, up $24.2 million, or 12.9 percent. Medical supplies increased in 2008 partly due to higher inpatient and clinic volumes. Medical supplies are subject to significant inflationary pressures, due to escalating pharmaceutical costs and continued innovation in implants, prosthetics, and other medical supplies. As a percentage of total operating revenue, medical supplies were 13.9 percent in 2009, down from 14.3 percent of operating revenue in 2008 and up from 13.5 percent in 2007.

Other supplies and purchased services totaled $388.2 million in 2009, up $23.1 million, or 6.3 percent, from 2008. Purchased services increased in 2009 primarily due to improved collection of professional fee billings which were passed through to the Medical Group. In 2008, these costs totaled $365.1 million in 2008, up $33.8 million, or 10.2 percent, from 2007 also due to improved collection of professional fee billings which were passed through to the Medical Group. Purchased services, including medical services, repairs and maintenance, administrative, treasury and insurance services, are reported net of services provided to affiliates, including physician office rentals, pharmaceuticals, billing services, medical supplies, and cafeteria services. Most of the cost of purchased services represents payments for professional services to faculty physicians for clinic operations.

Depreciation and amortization totaled $67.7 million in 2009, an increase of $7.0 million, or 11.5 percent, from the prior year, due to capital investment in facilities, systems, and equipment. In 2008, depreciation and amortization increased $4.7 million, or 8.5 percent, from 2007 due to capital investment in facilities, systems, and equipment.

Insurance expense totaled $7.1 million in 2009, up from $5.8 and $4.6 million in 2008 and 2007, respectively. The Medical Center is insured through the University's malpractice and general liability programs.

The Medical Center reported an operating margin of 6.1 percent in 2009 compared to an operating margin of 3.0 percent in 2008 and 8.1 percent in 2007. Excluding the adjustments related to developments in the Medicare cost reporting process, the Medical Center had operating margins of 5.9 percent, 1.9 percent and 5.7 percent in 2009, 2008 and 2007, respectively.

Non-operating Revenues (Expenses)
Non-operating expenses, net of non-operating revenues, totaled $21.0 million in 2009, up from $3.0 million in 2008 and from $1.7 million in 2007. Non-operating revenues and expenses include interest income and expense, and loss on disposals of capital assets. In 2009, interest income decreased due to lower invested cash balances and lower interest rates. The loss on disposal of capital assets increased as the Medical Center abandoned the development of portions of an electronic medical records system totaling $18.3 million. A project initially started in 2005 to develop a patient information system that included physician order entry capabilities, a pharmacy management system and other capabilities was discontinued. The original functionality of this system is not expected to be realized and was, therefore, recorded as a loss on disposal of an impaired asset. In 2008, interest income decreased, primarily reflecting lower invested cash balances and interest expense increased due to an increase in the balance of long term debt and capital lease obligations.

Income before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $80.1 million in 2009, compared to $41.6 million in 2008, and $110.8 million in 2007, an increase of $38.5 million and a decrease of $69.3 million, respectively. The Medical Center's net income increased in 2009 mainly due to higher patient volumes and improved reimbursement rates as well as improved labor efficiencies. In 2008, net income decreased primarily due to increased resources used to address regulatory issues identified by the CMS survey.

Other Changes in Net Assets
Items directly charged or credited to equity in 2009 include donations of $2.2 million – up from $1.3 million in 2008 and from $1.9 million in 2007 – and net program support transfers to the University of $30.3 million – up from $20.1 and $22.2 million in 2008 and 2007, respectively. Items directly charged or credited to equity in 2008 include state and federal capital appropriations of $10.8 million; donations of $1.3 million and net program support transfers to the University of $20.1 million. The resulting total change in net assets was a decrease of $28.1 million in 2009 and a decrease of $7.9 million in 2008.

Net program support transfers to the University were comprised of the following (dollars in thousands):

	2009	2008	2007
Net program support – School of Medicine	$ 30,284	$ 25,065	$ 22,232
Net program support – Land costs	–	(5,000)	–
Total	$ 30,284	$ 20,065	$ 22,232

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	$ 127,526	$ 128,842	$ 182,839
Patient accounts receivable (net)	291,110	269,788	262,011
Other current assets	51,903	36,729	39,344
Total current assets	470,539	435,359	484,194
Capital assets (net)	736,367	682,856	601,542
Other assets	14,468	12,811	12,404
Total assets	1,221,374	1,131,026	1,098,140
Current liabilities	188,801	165,220	173,669
Long-term debt and other liabilities	271,815	257,021	249,330
Total liabilities	460,616	422,241	422,999
Net assets			
Invested in capital assets (net)	462,741	426,809	366,727
Restricted	9,536	7,705	7,124
Unrestricted	288,481	274,271	301,290
Total net assets	$ 760,758	$ 708,785	$ 675,141

Total current assets increased $35.2 million, or 8.1 percent, from 2008 to 2009 primarily due to an increase in patient accounts receivable and an increase in deposits for equipment purchases. In 2008, total current assets decreased $48.8 million, or 10.1 percent, from 2007 primarily due to a decrease in cash.

Cash decreased $1.3 million, or 1.0 percent, during 2009 and decreased $54.0 million, or 29.5 percent, during 2008. The decrease in 2008 was primarily due to increased investment in capital net of related financing activities.

Net patient accounts receivable represented 61.9 percent of current assets at June 30, 2009, down from 62.0 and up from 54.1 percent of current assets at June 30, 2008 and 2007, respectively. In 2009, net patient account receivables increased by $21.3 million from the prior year. This increase was due to higher patient volumes and rates. In 2008, net patient account receivables increased by $7.8 million from the prior year also due to higher patient volumes and rates.

Net capital assets increased by $53.5 million from 2008 to 2009 due to continued investment in equipment, systems, infrastructure and development of land at Mission Bay. In 2008, net capital assets increased by $81.3 million from 2007 to 2008 as investment in equipment, systems, and infrastructure exceeded annual depreciation expense. In addition, the Medical Center also began incurring planning costs for the development of land at Mission Bay.

Current liabilities increased by $23.6 million from 2008 to 2009 primarily due to higher accounts payable balances and an increase in accrued salaries and benefits caused by a greater number of employees at higher average salary rates. In 2008, current liabilities decreased by $8.4 million from 2007 primarily due to a decrease of net third-party payor settlements and loss contingencies as amounts recorded as current liabilities in 2007 were paid or settled in 2008.

Long-term liabilities of $271.8 million at June 30, 2009, increased $14.8 million from June 30, 2008. Long term debt increased due to additional borrowings made during the year in excess of principal payments on long-term debt. Long-term liabilities of $257.0 million at June 30, 2008, increased $7.7 million from June 30, 2007, due to additional borrowings for capital leases exceeded payments. Third party payor settlements and loss contingencies decreased as the Medical Center reclassified certain amounts to current liabilities and decreased its liability related to prior year third-party settlements and loss contingencies by $21.0 million.

Net assets increased $52.0 million, or 7.3 percent, during 2009 and $33.6 million, or 5.0 percent, during 2008. Income for 2009 and 2008 totaled $80.1 and $41.6 million, respectively. Health system support, representing amounts paid by the Medical Center to fund other health system expenses such as School of Medicine operating activities, payments to support clinical research, and transfers to faculty practice plans, reduced net assets by $30.3 and $20.1 million in 2009 and 2008, respectively. Donations added $2.2 million and $1.3 million to net assets during 2009 and 2008, respectively. State and federal appropriations of $10.8 million were received in 2008 for seismic construction projects. As these projects have been completed, no amounts were received in 2009.

Liquidity and Capital Resources

During 2009, the Medical Center generated $145.9 million in cash from operating activities. This represented an increase of $60.1 million, or 70.0 percent from 2008 to 2009, and a decrease of $44.2 million, or 34.0 percent, from 2007 to 2008. Cash received from patients and third-party payors totaled $1.6 billion in 2009, up $144.2 million, or 10.2 percent, from 2008. This amount totaled $1.4 billion in fiscal year 2008, up $104.7 million, or 8.0 percent, from 2007.

In 2009, cash flows from non-capital financing activities reduced cash by $30.3 million for transfers to the University for health system support. In 2008, cash flows from non-capital financing activities show the Medical Center's cash was reduced by $20.1 million for transfers to the University for health system support.

Cash used by capital and related financing activities totaled $120.7 million in 2009, compared to $127.3 million in 2008 and $88.5 million in 2007.

Cash used for capital and related financing activities decreased by $6.6 million from 2008 to 2009 and increased by $38.8 million from 2007 to 2008. Included in cash flows from capital and related financing activities for 2009 are purchases of capital assets of $138.8 million and gifts and donated funds of $2.2 million. Principal payments on long-term debt and capital leases were $21.3 million and interest paid was $7.8 million. In 2008, cash flows from capital and related financing activities included purchases of capital assets of $139.7 million, gifts and donated funds of $12.1 million, principal payments on long-term debt and capital leases of $16.4 million and interest paid of $10.3 million. In addition, the Medical Center borrowed $1.2 million in 2009 to purchase capital assets under capital leases compared to $3.3 million in 2008 and $6.7 million in 2007. These non-cash transactions are disclosed as supplemental non-cash activities in the statement of cash flows.

Cash flows from investment activities included $5.6 million and $8.2 million provided by interest income in 2009 and 2008, respectively. Overall cash decreased to $127.5 million in 2009 from $128.8 million in 2008 and decreased to $128.8 million in 2008 from $182.8 million in 2007.

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

	2009	2008	2007
Days cash on hand	31.4	34.1	54.8
Days of revenue in accounts receivables, net	65.2	67.8	70.2
Capital investment ($ in millions)	$140.3	$143.0	$154.7
Debt service coverage ratio	5.3	4.2	7.0

Days cash on hand decreased to 31.4 days in 2009 from 34.1 days in 2008 and decreased to 34.1 days in 2008 from 54.8 days in 2007. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash.

Days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2009, net days in receivables decreased 2.6 days to 65.2. In 2008, net days in receivables decreased 2.4 days to 67.8.

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 was 5.3 times versus 4.2 times in 2008. The increase was primarily due to the increase of income from operations. The Medical Center's ratio for 2008 was 4.2 times versus 7.0 times in 2007. The decrease in 2008 was due to a decrease of income from operations and a slight increase of debt. The ratios in 2009 and 2008 are higher than the 1.0 required by the Bond Indenture.

The Medical Center's decreased cash position in 2009 was primarily the result of the continued investment in capital equipment and infrastructure offset by the increase of income from operations. In 2008, the Medical Center's decreased cash position is primarily the result of an increase in capital investment.

During 2009, cash decreased by $1.3 million, or 1.0 percent, to $127.5 million. During 2008, cash decreased by $54.0 million, or 29.5 percent, to $128.8 million.

Looking Forward

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 2004 and 2008
In 2004, California voters passed Proposition 61 that enables the state of California to issue $750 million in General Obligation bonds to fund capital improvement projects for children's hospitals. Each of the University medical centers is eligible for $30 million of grant funding from this pool of funds. Grant funds must be used for capital projects associated with the care of children and must be used prior to June 30, 2014.

Additionally, 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, San Francisco Medical Center
Statements of Net Assets
June 30, 2009 and 2008
(Dollars in thousands)

	2009	2008
Assets		
Current assets:		
Cash	$ 127,526	$ 128,842
Patient accounts receivable, net of estimated uncollectibles of $22,802 and $20,089, respectively	291,110	269,788
Other receivables	1,927	375
Third-party payor settlements, net	1,415	–
Inventory	22,084	20,667
Prepaid expenses and other assets	26,477	15,687
Total current assets	470,539	435,359
Restricted assets:		
Donor funds	9,536	7,705
Capital assets, net	736,367	682,856
Deferred costs of issuance and other	4,932	5,106
Total assets	1,221,374	1,131,026
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	98,574	85,171
Accrued salaries and benefits	58,971	48,861
Third-party payor settlements, net	–	8,278
Current portion of long-term debt and capital leases	27,843	19,157
Other liabilities	3,413	3,753
Total current liabilities	188,801	165,220
Long-term debt and capital leases, net of current portion	245,783	229,490
Third-party payor settlements, net	26,032	27,531
Total liabilities	460,616	422,241
Net Assets		
Invested in capital assets, net of related debt	462,741	426,809
Restricted:		
Expendable:		
Capital projects	3,734	1,778
Other	5,802	5,927
Unrestricted	288,481	274,271
Total net assets	$ 760,758	$ 708,785

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

University of California, San Francisco 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 $43,006 and $23,862, respectively	$ 1,629,106	$ 1,457,023
Other operating revenue:		
Clinical teaching support	8,712	9,276
Other	15,332	16,539
Total other operating revenue	24,044	25,815
Total operating revenue	1,653,150	1,482,838
Operating expenses:		
Salaries and wages	642,416	595,562
UCRP, retiree health and other employee benefits	131,479	119,696
Professional services	25,196	24,238
Medical supplies	230,108	211,434
Other supplies and purchased services	388,187	365,088
Depreciation and amortization	67,707	60,711
Insurance	7,083	5,775
Other	59,937	55,756
Total operating expenses	1,552,113	1,438,260
Income from operations	101,037	44,578
Non-operating revenues (expenses):		
Interest income	5,566	8,162
Interest expense	(7,839)	(10,319)
Loss on disposal of capital assets	(18,681)	(857)
Total non-operating expenses	(20,954)	(3,014)
Income before other changes in net assets	80,083	41,564
Other changes in net assets:		
State and federal capital appropriations	–	10,818
Donated assets	2,174	1,327
Health system support	(30,284)	(20,065)
Total other changes in net assets	(28,110)	(7,920)
Increase in net assets	51,973	33,644
Net assets – beginning of year	708,785	675,141
Net assets – end of year	$ 760,758	$ 708,785

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

University of California, San Francisco 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	$ 1,564,449	$ 1,420,258
Payments to employees	(637,309)	(597,100)
Payments to suppliers	(698,525)	(656,693)
Payments for benefits	(127,220)	(114,490)
Other receipts, net	44,518	33,833
Net cash provided by operating activities	145,913	85,808
Cash flows from noncapital financing activities:		
Health system support	(30,284)	(20,065)
Net cash used by noncapital financing activities	(30,284)	(20,065)
Cash flows from capital and related financing activities:		
Proceeds from debt issuance	45,039	26,886
Proceeds from sale of capital assets	106	45
Purchases of capital assets	(138,843)	(139,669)
Principal paid on long-term debt and capital leases	(21,317)	(16,409)
Interest paid on long-term debt and capital leases	(7,839)	(10,319)
Gifts and donated funds	2,174	12,145
Net cash used by capital and related financing activities	(120,680)	(127,321)
Cash flows from investing activities:		
Interest income received	5,566	8,162
Change in restricted cash	(1,831)	(581)
Net cash provided by investing activities	3,735	7,581
Net decrease in cash	(1,316)	(53,997)
Cash – beginning of year	128,842	182,839
Cash – end of year	$ 127,526	$ 128,842

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

University of California, San Francisco 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	$ 101,037	$ 44,578
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	67,707	60,711
Provision for doubtful accounts	43,006	23,862
Changes in operating assets and liabilities:		
Patient accounts receivable	(64,328)	(31,639)
Other receivables	(1,552)	(69)
Inventory	(1,417)	(258)
Prepaid expenses and other assets	(10,521)	3,213
Accounts payable and accrued expenses	13,403	5,856
Accrued salaries and benefits	10,110	3,668
Third-party payor settlements	(11,192)	(24,324)
Other liabilities	(340)	210
Net cash provided by operating activities	$ 145,913	$ 85,808
Supplemental noncash activities information:		
Capitalized interest	$ 3,052	$ –
Capital assets acquired through capital lease obligations	1,162	3,258
Amortization of deferred financing costs	114	116
Amortization of bond premium	19	19
Amortization of deferred costs of issuance	153	155
Payables for property and equipment	16,906	13,902

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

1. Organization

The University of California, San Francisco Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"), an independent board composed of 26 members. The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority being delegated to the Medical Center Director by the Chancellor of the San Francisco campus. The Medical Center principally consists of inpatient (722 licensed beds and 658 available beds) and outpatient hospital operations, conducted at the Moffitt-Long Hospital and the Mount Zion Hospital.

The University of California San Francisco (UCSF) Medical Group faculty practice utilizes the hospital-based clinic model. Accordingly, the Medical Center's financial statements include the activities of the UCSF Medical Group. The net revenues from clinical practice are recorded in net patient service revenue; the direct expenses of non-physician staff and non-labor expenses are included in operating expenses. Payments to the faculty for their professional services are classified as purchased services.

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. As of June 30, 2009, $11,537 of unspent loan proceeds was included in the Medical Center's cash balance. These balances will be spent on qualifying project costs.

The Medical Center's cash at June 30, 2009 and 2008 was $127,526 and $128,842, 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, medical supplies and printed forms, which are stated on a first-in, first-out basis at the lower of cost or market.

Prepaid Expenses and Other Assets
The Medical Center's prepaid expenses and other assets are primarily prepayments for pharmaceutical and medical supplies, rent, equipment and maintenance contracts.

Restricted Assets, Donor Funds
Donor funds are held and invested by the Treasurer of The Regents for use by the Medical Center for certain donor-restricted purposes. Funds are recorded at fair value, which approximates cost. The amounts held at June 30, 2009 and 2008 by the Treasurer's Office were $9,536 and $7,705, respectively.

Capital Assets
The Medical Center's capital assets are reported at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. Equipment under capital lease is amortized over the shorter period of the lease term or the estimated useful life of the equipment. Lease amortization is included in depreciation and amortization expense. The range of the estimated useful lives for buildings and land improvements is 10 to 40 years and for equipment is 3 to 20 years. Interest on borrowings to finance facilities is capitalized during construction. University guidelines mandate that land purchased with Medical Center funds be recorded as an asset of the Medical Center. Land utilized by the Medical Center but purchased with other sources of funds is recorded as an asset of the University. Incremental costs, including salaries and employee benefits, directly related to the acquisition, development and installation of major software projects are included in the cost of the capital assets.

2. Summary of Significant Accounting Policies (Continued)

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. This is reflected as unamortized deferred financing costs which are included as an offset to the current and noncurrent portion of long-term debt, as appropriate, in the Medical Center's statement of net assets. These costs are being amortized as interest expense over the remaining life of the defeased or refinanced bonds, whichever is shorter.

Net Assets
Net assets are required to be classified for accounting and reporting purposes in the following categories:

- Invested in capital assets, net of related debt – Capital assets, net of accumulated depreciation, reduced by outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

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

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

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

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

2. Summary of Significant Accounting Policies (Continued)

Revenues and Expenses
Revenues received in conducting the programs and services of the Medical Center are presented in the financial statements as operating revenue. Revenues include professional fees earned by the faculty physicians practicing as the UCSF Medical Group.

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

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

Non-operating revenue and expense includes interest income and expense and the gain or loss on the disposal of capital assets.

State capital appropriations, health system support, donated assets and other transactions with the University are classified as other changes in net assets.

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

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

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

2. Summary of Significant Accounting Policies (Continued)

Charity Care

The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as net patient service revenue. The Medical Center also provides services to other indigent patients under publicly sponsored programs, which may reimburse at amounts less than the cost of the services provided to the recipients. The difference between the cost of services provided to these indigent persons and the expected reimbursement is included in the estimated cost of charity care.

Transactions with the University and University Affiliates

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

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

Compensated Absences

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

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 is 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.

2. Summary of Significant Accounting Policies (Continued)

Tax Exemption
The Regents of the University of California is a California public corporation qualified as a tax-exempt organization under the provisions of Section 501(c)(3) of the Internal Revenue Code and is exempt from federal and state income taxes on related income.

Use of Estimates
The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Although management believes these estimates and assumptions are reasonable, they are based upon information available at the time the estimate or judgment is made and actual amounts could differ from those estimates.

New Accounting Pronouncements
In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for the Medical Center's fiscal year beginning July 1, 2009. This statement requires capitalization of identifiable intangible assets in the statement of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life. 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 swap is a derivative instrument under Statement No. 53. The Medical Center's evaluation of the interest rate swap has concluded that it is an effective hedge for the Medical Center Pooled Revenue Bonds, Series B, under both the Synthetic Instrument and Dollar-Offset methods. As a result, upon implementation of Statement No. 53 beginning July 1, 2009, the negative fair value of the interest rate swap of ($8,173) 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. Professional services are reimbursed based on a fee schedule. The Medical Center does not believe that there are significant credit risks associated with the Medicare program.

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2001. The fiscal intermediary is in the process of conducting their audits of the 2002 and subsequent cost reports. The results of these audits have yet to be finalized and any amounts due to or from Medicare have not been determined. Estimated receivables and payables related to all open cost reporting periods are included on the statements of net assets as third-party payor settlements.

- ***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 $190,396 and $171,223, 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 $12,244 and $12,443, 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 primarily for professional services 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.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

The most common payment arrangement for inpatient services is a prospectively determined per-diem rate, with stop loss provision if the charges exceed a negotiated amount. The most common payment arrangements for outpatient care are a negotiated discount from charges, and a prospectively determined fee schedule.

Amounts due from Medicare and Medi-Cal represent 19.5 percent and 21.3 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 $20,451 and $20,983, respectively, due to favorable cost report settlements with Medicare and changes in estimates for settlements related to SB 1100 for Medi-Cal.

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

	2009	2008
Medicare (non-risk)	$ 331,397	$ 309,967
Medicare (risk)	8,437	6,590
Medi-Cal (non-risk)	190,396	171,223
Commercial	36,011	34,579
Contract (discounted or per diem)	1,014,996	885,660
Contract (capitated)	3,536	3,831
County	15,678	16,620
Non-sponsored/self-pay	28,655	28,553
Total	$ 1,629,106	$ 1,457,023

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	$ 37,952	$ 38,954
Estimated cost of charity care	$ 10,511	$ 11,252

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $83,984 and $111,482 for the years ended June 30, 2009 and 2008, respectively.

(Dollars in thousands)

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.

Donor funds are comprised of cash and are restricted for the following purposes:

	2009	2008
Capital projects	$ 3,734	$ 1,778
General	5,802	5,927
Total	$ 9,536	$ 7,705

Additional gifts and pledges received but not used for the construction of a mothers' and children's hospital and cancer hospital 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.

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	$ 99,132	$ 1,146	$ –	$ 100,278	$ 80	$ –	$ 100,358
Buildings and improvements	652,139	29,725	–	681,864	102,461	–	784,325
Equipment	305,862	45,136	(25,465)	325,533	28,304	(16,253)	337,584
Construction in progress	75,357	67,025	–	142,382	9,443	(18,305)	133,520
Capital assets, at cost	$1,132,490	$ 143,032	$ (25,465)	$1,250,057	$ 140,288	$ (34,558)	$1,355,787

	2007	Depreciation	Disposals	2008	Depreciation	Disposals	2009
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 347,121	$ 28,947	$ –	$ 376,068	$ 33,892	$ –	$ 409,960
Equipment	183,828	31,764	(24,459)	191,133	33,815	(15,488)	209,460
Accumulated depreciation and amortization	$ 530,949	$ 60,711	$ (24,459)	$ 567,201	$ 67,707	$ (15,488)	$ 619,420
Capital assets, net	$ 601,541			$ 682,856			$ 736,367

6. Capital Assets (Continued)

Equipment under capital lease obligations and related accumulated amortization is $83,213 and $30,732 in 2009, respectively, and $69,970 and $22,237 in 2008, respectively.

The University has acquired certain facilities and equipment under capital leases with the State of California Public Works Board. These facilities and equipment were contributed at cost by the University to the Medical Center to support the operations of the Medical Center. Principal and interest payments required under the leases are the obligations of the University and are not reflected in the financial statements of the Medical Center.

The Medical Center made seismic improvements in order to be in compliance with Senate Bill 1953, the *Hospital Facilities Seismic Safety Act*. A portion of the improvements was financed under a lease revenue bond with the State of California Public Works Board. For the year ending June 30, 2008, $8,980 is included in state and federal capital appropriations on the statements of revenues, expenses and changes in net assets. No amounts were received in the year ending June 30, 2009.

During 2009, a project to develop a patient information system that included physician order entry capabilities, a pharmacy management system and other capabilities was discontinued. The original functionality of this system is not expected to be realized and was therefore deemed to be an impaired asset. The impairment loss of $18,300 is included in loss on disposal of capital assets in the non-operating expense section of the statements of revenues, expenses and changes in net assets.

(Dollars in thousands)

7. 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 4.5 percent to 5.0 percent, payable semi-annually, with annual principle payments beginning in 2012 through 2047	$ 44,020	$ 44,020
University of California Medical Center Pooled Revenue Bonds 2007 Series B, variable rate bonds, with annual principal payments through 2032	91,215	93,730
Capital lease obligations, primarily for land, computer equipment, medical equipment and leasehold improvements with fixed interest rates of 2.27 percent to 5.85 percent, payable through 2019, collateralized by underlying equipment	135,737	111,812
Commercial paper, interim financing for construction through the University of California	3,473	–
Unamortized bond premium	701	719
Unamortized deferred financing costs	(1,520)	(1,634)
Total debt and capital leases	273,626	248,647
Less: Current portion of debt and capital leases	(27,843)	(19,157)
Noncurrent portion of debt and capital leases	$ 245,783	$ 229,490

Interest expense associated with financing projects during construction, along with any investment income earned on bond proceeds during construction, is capitalized. Total interest expense during the years ended June 30, 2009 and 2008 was $10,891 and 10,319, respectively. Interest expense totaling $3,052 was capitalized during the year ended June 30, 2009. No interest expense was capitalized in the year ended June 30, 2008. The remaining $7,839 in 2009 and $10,319 in 2008 are reported as interest expense in the statements of revenues, expenses and changes in net assets.

(Dollars in thousands)

7. 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	Commercial Paper	Total
Year Ended June 30, 2009				
Current portion at June 30, 2008	$ 2,420	$ 16,737	$ –	$ 19,157
Reclassification from noncurrent	2,512	23,923	3,473	29,908
Principal payments	(2,515)	(18,802)	–	(21,317)
Amortization of bond premium	(19)	–	–	(19)
Amortization of deferred financing costs	114	–	–	114
Current portion at June 30, 2009	$ 2,512	$ 21,858	$ 3,473	$ 27,843
Noncurrent portion at June 30, 2008	$ 134,416	$ 95,074	$ –	$ 229,490
New obligations	–	42,728	3,473	46,201
Reclassification to current	(2,512)	(23,923)	(3,473)	(29,908)
Noncurrent portion at June 30, 2009	$ 131,904	$ 113,879	$ –	$ 245,783
Year Ended June 30, 2008				
Current portion at June 30, 2007	$ 2,327	$ 12,553	$ –	$ 14,880
Reclassification from noncurrent	2,420	18,168	–	20,588
Principal payments	(2,425)	(13,984)	–	(16,409)
Amortization of bond premium	(18)	–	–	(18)
Amortization of deferred financing costs	116	–	–	116
Current portion at June 30, 2008	$ 2,420	$ 16,737	$ –	$ 19,157
Noncurrent portion at June 30, 2007	$ 136,836	$ 83,099	$ –	$ 219,935
New obligations	–	30,143	–	30,143
Reclassification to current	(2,420)	(18,168)	–	(20,588)
Noncurrent portion at June 30, 2008	$ 134,416	$ 95,074	$ –	$ 229,490

7. 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 $135,235 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 January 2007, Medical Center Pooled Revenue Bonds totaling $140,175 were issued specifically for the Medical Center, $44,020 with a fixed interest rate and $96,155 with a variable interest rate, to refinance outstanding debt and to purchase land. The bonds, with a fixed interest rate, require interest only payments through May 2012. Proceeds, including a bond premium of $746, together with certain Medical Center funds, were used to refund $93,010 of outstanding revenue bonds. The bonds mature at various dates through 2047. The fixed rate bonds have a weighted average interest rate of 4.55 percent.

The Medical Center entered into a land lease for approximately 10 acres of undeveloped land at Mission Bay, the site of a proposed new hospital campus. The lease includes base rent payments of $3,000 per year through 2013, after which the base rent will be $2,800 per year, escalated starting in 2015 by the changes in the Consumer Price Index (CPI) with a minimum increase of 2 percent and a maximum increase of 5 percent. The lease expires on December 31, 2103.

The Medical Center anticipates that it will exercise its option to purchase the land on January 1, 2014. As a result, the Medical Center has accounted for the lease as a capital lease by recording an increase in capital assets and an obligation for the present value of annual lease payments for the period until the first option to purchase.

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

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

(Dollars in thousands)

7. 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	$91,215	2007	2032	Pay 3.5897%; receive 58% of 1-month LIBOR* + 0.48%**	$ (8,173)	A2/A

* 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.

There are no collateral requirements related to the swap.

(Dollars in thousands)

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

Interest Rate Swap Agreements (Continued)

Basis Risk. There is a risk that the basis for the variable payment received will not match the variable payment on the bonds that exposes the Medical Center to basis risk whenever the interest rates on the bonds are reset. The interest rate on the bonds is a tax-exempt interest rate, while the basis of the variable receipt on the interest rate swap is taxable. Tax-exempt interest rates can change without a corresponding change in the LIBOR rate due to factors affecting the tax-exempt market which do not have a similar effect on the taxable market. For example, the swaps expose the Medical Center to risk if reductions in the federal personal income tax cause the relationship between the variable interest rate on the bonds to be greater than 58 percent of the 30 day LIBOR, plus .48 percent.

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 credit quality ratings, as issued by Moody's or Standard & Poor's, for either the underlying Medical Center Pooled Revenue Bonds or the swap counterparty fall below either Baa2/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 Merrill Lynch Capital Services, Inc. on June 30, 2008. In January 2009, Bank of America Corporation completed its acquisition of Merrill Lynch & Co. and is now the successor counterparty.

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	$ 123	$ 2,667	$ 5,395
2011	2,695	119	2,590	5,404
2012	2,800	116	2,511	5,427
2013	2,895	112	2,429	5,436
2014	3,000	108	2,344	5,452
2015 – 2019	16,735	476	10,328	27,539
2020 – 2024	20,015	354	7,682	28,051
2025 – 2029	23,930	208	4,519	28,657
2030 – 2032	16,540	44	947	17,531
Total	$ 91,215	$ 1,660	$ 36,017	$128,892

(Dollars in thousands)

7. 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	Commercial Paper	Total Payments	Principal	Interest
2010	$ 7,888	$ 27,930	$ 3,473	$ 39,291	$ 27,936	$ 11,355
2011	7,884	25,901	–	33,785	23,323	10,462
2012	8,378	21,119	–	29,497	19,848	9,649
2013	7,965	17,426	–	25,391	16,858	8,533
2014	8,162	56,091	–	64,253	57,553	6,700
2015 – 2019	41,914	10,206	–	52,120	29,052	23,068
2020 – 2024	41,967	–	–	41,967	23,955	18,012
2025 – 2029	42,026	–	–	42,026	28,865	13,161
2030 – 2034	30,880	–	–	30,880	22,750	8,130
2035 – 2039	12,548	–	–	12,548	7,745	4,803
2040 – 2044	12,555	–	–	12,555	9,660	2,895
2045 – 2048	7,530	–	–	7,530	6,900	630
Total future debt service	229,697	158,673	3,473	391,843	$ 274,445	$ 117,398
Less: Interest component of future payments	(94,462)	(22,936)	–	(117,398)		
Principal portion of future payments	135,235	135,737	3,473	274,445		
Adjusted by:						
Unamortized bond premium	701	–	–	701		
Unamortized deferred financing costs	(1,520)	–	–	(1,520)		
Total debt	$ 134,416	$ 135,737	$ 3,473	$ 273,626		

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

(Dollars in thousands)

8. 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 $20,909 and $18,778, respectively. The terms of the operating lease extend through the year 2071.

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

Year Ending June 30,	Minimum Annual Lease Payments
2010	$ 15,036
2011	13,263
2012	11,742
2013	9,863
2014	6,284
2015 – 2019	18,664
2020 – 2071	11,850
Total	$ 86,702

Operating leases include a long-term lease for land with a term of 75 years expiring in the year 2071, with an annual lease cost of approximately $176. Amounts payable under this lease are reflected above and represent the total lease payments through 2071.

9. 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.

9. Retiree Health Plans (Continued)

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 $17,300, $14,800 and $12,800 for the years ended June 30, 2009, 2008 and 2007, respectively.

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.

10. 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.

10. Retirement Plans (Continued)

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.

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)

11. 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 $11,375 and $12,168 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 $4,927 and $5,828, respectively, that reduced the overall workers' compensation cost for the year.

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $7,083 and $5,775 for the years ended June 30, 2009 and 2008, respectively.

12. 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
Salaries and employee benefits	$ (4,844)	$ (3,370)
Medical supplies	(4,432)	(5,471)
Other supplies and purchased services	304,149	283,927
Interest income (net)	(5,566)	(8,162)
Insurance	7,083	5,775
Total	$ 296,390	$ 272,699

(Dollars in thousands)

12. Transactions with Other University Entities (Continued)

As presented in Note 1, the Medical Center Financial Statements include the activities of the UCSF Medical Group faculty practice. Payments to the School of Medicine for faculty clinical time comprise the largest component of inter-entity purchased services. Payments represent cash collected less certain cost allocations. Other 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 revenues, 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, 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 University were $326,674 and $292,764 in 2009 and 2008, respectively. Of these amounts, $296,390 and $272,699 are reported as operating expenses for the years ended June 30, 2009 and 2008, respectively, and $30,284 and $20,065 are reported as health system support for the years ended June 30, 2009 and 2008, respectively.

13. Segment Information

As discussed in Note 1, the Medical Center's financial statements include the activities of the UCSF Medical Group. Condensed financial statement information related to the faculty practices of the UCSF Medical Group and the Medical Center Hospital Practice for the years ended June 20, 2009 and 2008 is as follows:

Year Ended June 30, 2009

	Hospital Practice	UCSF Medical Group	Total
Operating revenues	$ 1,314,499	$ 338,651	$ 1,653,150
Operating expenses	1,213,406	338,707	1,552,113
Net non-operating expenses	20,954	–	20,954
Income before other changes in net assets	$ 80,139	$ (56)	$ 80,083

Year Ended June 30, 2008

	Hospital Practice	UCSF Medical Group	Total
Operating revenues	$ 1,175,817	$ 307,021	$ 1,482,838
Operating expenses	1,127,359	310,901	1,438,260
Net non-operating expenses	3,014	–	3,014
Income before other changes in net assets	$ 45,444	$ (3,880)	$ 41,564

14. Commitments and Contingencies

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

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

State of California Senate Bill 1953, *Hospital Facilities Seismic Safety Act*, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. 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 $25,000 was allocated to the Medical Center. The Medical Center spent the final $12,838 of its allocation during the year ended June 30, 2009. During fiscal year 2008, the Medical Center received $8,980 of its allocation and is recorded in the statement of revenues, expenses and changes in net assets as a component of state and federal capital appropriations. No amounts were spent or received during the year ended June 30, 2009. As of June 30, 2009, any repayment the Medical Center may be obligated for under these financing arrangements is still being determined.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately $11,300, excluding interest, as of June 30, 2009.

Concurrent with execution of the land lease described in Note 7, the Regents entered into a Disposition and Development Agreement with the Redevelopment Agency of the City and County of San Francisco (Agency) under which the Agency sold and conveyed a 1.6 acre of land at Mission Bay to the Regents for $5,000. The Regents agreed to develop an affordable housing project, at the Regent's expense, subject to design review, and to operate the project in accordance with affordability and other leasing restrictions. The Disposition and Development Agreement specifies that a default under the agreement allows the Agency to terminate the grant deed, obtain a reconveyance of the site, and to receive liquidated damages of an additional $5,000.

14. Commitments and Contingencies (Continued)

During 2007 the Medical Center purchased several parcels of land contiguous with the land under lease at Mission Bay. The Agency intends to sell and convey an additional acre of land at Mission Bay to the Regents for $1,155. The Regents intend to enter into a Disposition and Development Agreement with the Agency under which the Regents will agree to develop additional affordable housing, at the Regent's expense, subject to design review, and to operate the project in accordance with affordability and other leasing restrictions. The Disposition and Development Agreement will specify that a default under the agreement allows the Agency to terminate the grant deed, obtain a reconveyance of the site, and to receive liquidated damages of an additional $2,400.