University of California,
Davis Medical Center

Financial Statements
For the Years Ended June 30, 2010 and 2009

University of California, Davis Medical Center
Index
June 30, 2010 and 2009

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying financial statements, as shown on pages 16 through 38, present fairly, in all material respects, the financial position of the University of California, Davis Medical Center (the "Medical Center"), a division of the University of California ("University"), at June 30, 2010 and 2009, 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, 2010 and 2009, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 11, 2010

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

Introduction

The objective of Management's Discussion and Analysis is to help readers better understand the University of California, Davis Medical Center's financial position and operating activities for the year ended June 30, 2010, with selected comparative information for the years ended June 30, 2009 and 2008. 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 (2008, 2009, 2010, 2011, etc.) in this discussion refer to fiscal years ended June 30.

Overview

The University of California, Davis 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 Davis campus.

The University of California, Davis Medical Center (the "Medical Center") has served as the principal clinical teaching site for the University of California, Davis ("UCD") School of Medicine since the school was founded in 1966. Initially the school used the Sacramento County hospital for clinical training, but in 1973 the University acquired the hospital outright and began operating it as the UC Davis Medical Center.

Licensed as a 613-bed general acute care hospital with 29 operating rooms, the Medical Center provides a full range of inpatient general acute and intensive care, and a full complement of ancillary, support and ambulatory services. These services are housed in about 3.8 million gross square feet of facilities, most of which are sited on the 140-acre campus in the City of Sacramento. Ambulatory care is provided at the hospital-based clinics and at the 16 Primary Care Network ("PCN") satellite clinics in the surrounding communities of Auburn, Carmichael, Davis, Elk Grove, Folsom, Rancho Cordova, Rocklin, Roseville, and Sacramento.

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

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

Inpatient and outpatient medical services are provided by the UC Davis Medical Group, with approximately 732 faculty and contract physicians, 680 residents and fellows, and 110 PCN physicians.

For the year ended June 30, 2010, 33,169 patients were admitted to the Medical Center, of which approximately 53.1 percent were admitted through the emergency room, and overall occupancy was approximately 82.1 percent. During the same period, there were 970,390 outpatient visits, of which 90.7 percent were visits to the Clinics and the PCN Sites and 5.7 percent were emergency room visits.

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

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2010, 2009 and 2008:

Statistics	2010	2009	2008
Licensed beds	613	613	577
Admissions	33,169	33,295	33,678
Average daily census	462	480	476
Discharges	33,111	33,230	33,584
Average length of stay	5.1	5.3	5.2
Case mix index	1.67	1.65	1.63
Patient days:			
Medicare (non-risk)	44,001	42,231	41,217
Medi-Cal (non-risk)	48,014	48,006	46,020
Commercial	292	121	278
County	10,239	13,324	14,340
Contracts (discounted/per-diem)	45,213	49,143	49,071
Contracts (capitated)*	18,833	20,526	21,594
Non-sponsored/self-pay	2,143	1,898	1,621
Total patient days	168,735	175,249	174,141
Outpatient visits:			
Hospital clinics	418,695	419,165	405,114
Primary care network	461,363	461,264	469,207
Home health and hospice	35,394	37,607	43,972
Emergency visits	54,938	55,238	55,758
Total visits	970,390	973,274	974,051

*Includes Medicare and Medi-Cal risk

Patient service revenue depends on inpatient occupancy levels, the complexity of care provided, the volume of outpatient visits, and the charges or negotiated payment rates for services provided. In 2010, admissions decreased by 126 or 0.4 percent as compared to 2009. The average length of stay decreased from 5.3 to 5.1 days due to a slight decline in patient days. Total outpatient visits decreased by 0.3 percent due primarily to a decline in home health and hospice visits. Primary care network visits remained flat in the current year and home health and hospice visits decreased due to a realignment of business strategy, serving patients being treated by the Medical Center only as compared to previous years when home health and hospice served all patients, even those not treated by the Medical Center.

In 2009, admissions decreased by 383 or 1.1 percent over 2008. Total outpatient visits were flat in 2009 as compared to 2008. The average length of stay increased from 5.2 to 5.3 days due to a slightly higher case mix index. Hospital based clinic visits increased 3.5 percent due to initiatives undertaken by management to improve patient access. Primary care network visits decreased by 1.7 percent in 2009 due to turnover of physicians and our ability to fill physician vacancies. Home health and hospice visits decreased due to the additional time required during each visit to capture patient data during the transition period to the new electronic medical record system.

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 2010 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Net patient service revenue	$ 1,098,565	$ 1,061,848	$ 1,014,318
Other operating revenue	13,649	15,519	14,857
Total operating revenue	1,112,214	1,077,367	1,029,175
Total operating expenses	1,040,479	1,019,452	976,766
Income from operations	71,735	57,915	52,409
Total non-operating expenses	(2,765)	(2,767)	(7,441)
Income before other changes in net assets	$ 68,970	$ 55,148	$ 44,968
Margin	6.2 percent	5.1 percent	4.4 percent
Other changes in net assets	$ (10,900)	$ (9,522)	$ 23,051
Increase in net assets	58,070	45,626	68,019
Net assets – beginning of year	793,945	748,319	680,300
Net assets – end of year	$ 852,015	$ 793,945	$ 748,319

Revenues

Total operating revenues for the year ended June 30, 2010 was $1,112.2 million, an increase of $34.8 million, or 3.2 percent, over 2009. Total operating revenues for 2009 was $1,077.4 million, an increase of $48.2 million or 4.7 percent, over 2008.

Net patient service revenue for 2010 increased by $36.7 million or 3.5 percent, over 2009. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medi-Cal and other third-party payors and have been estimated based on the terms of reimbursement and contracts currently in effect. Revenues increased in 2010 due to increases in contracted rates with third-party payors, one-time favorable cost report settlements and appeals of $4.2 million, and a higher case-mix index, offset by a decline in patient days. Net patient service revenue in 2009 increased by $47.5 million or 4.7 percent, over 2008. The increase in 2009 was primarily due to a slight increase in patient days, the higher case mix index, improved reimbursement from third-party payors and one-time favorable cost report settlements and appeals of $7.9 million.

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

The following table summarizes net patient service revenue for 2010, 2009 and 2008 (dollars in thousands):

Payor	2010	2009	2008
Contracts (discounted/per-diem)	$ 526,825	$ 522,340	$ 505,491
Medicare (non-risk)	240,193	205,835	186,471
Contracts (capitated)*	162,250	157,609	153,729
Medi-Cal (non-risk)	153,624	135,173	115,914
County	11,240	37,452	45,174
Non-sponsored/self-pay	2,428	2,542	5,668
Commercial	2,005	897	1,871
Total	$ 1,098,565	$ 1,061,848	$ 1,014,318

*Includes Medicare and Medi-Cal risk

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Medicare reimburses the Medical Center for allowable costs at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Settlements with the Medicare program for prior years cost reports are recognized in the year the settlement is resolved. Excluding settlement adjustments, net patient revenue for Medicare increased by $21.4 million over the prior fiscal year primarily due to higher patient days offset by a decrease in case mix from 1.98 in 2009 to 1.95 in 2010. In 2009, net patient revenue for Medicare increased by $11.4 million over 2008 primarily due to increased patient days and a higher case mix index for Medicare patients.

Medi-Cal fee-for-service ("FFS") inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 ("SB 1100"). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share ("DSH") payments, and Safety Net Care Pool ("SNCP"). Net patient revenue for Medi-Cal increased by $18.5 million and $19.3 million in 2010 and 2009, respectively, primarily due to the receipt of more waiver growth funding related to continued increases in the volume of Medi-Cal patients treated by the Medical Center.

In 2010, County net patient revenue decreased by $26.2 million or 70.0 percent primarily due to the continued effect of the County of Sacramento contract cancellation which occurred in the previous year. In 2009, County net patient revenue decreased by $7.7 million or 17.1 percent primarily due to cancellation of the contract with the County of Sacramento. The Medical Center continued to treat patients covered by the County, however, due to the economic environment, the County delayed authorization and payment for eligible patients.

The Medical Center has entered into agreements with numerous non-government third-party payors to provide patient care to beneficiaries under a variety of payment arrangements at contracted rates or per-diem rates, which are less than billed charges. In 2010, contracts net patient revenue discounted and per-diem contracts increased by $4.5 million or 0.9 percent over 2009 primarily due increased contract rates offset by declines in volumes as patients shifted toward the Medicare and Medi-Cal program due to the economic environment. In 2009, contracts net patient revenue increased by $16.8 million or 3.3 percent over 2008 primarily due to increased contract rates and slightly higher volumes.

Capitated contracts with health plans reimburse the Medical Center on a per-member-per-month basis, regardless of whether services are actually rendered. The Medical Center assumes a certain financial risk as the contract requires patient treatment for all covered services. In 2010, the net patient service revenue for contracts that are full-risk capitation increased by $4.6 million, or 2.9 percent, primarily due to higher contract rates offset by a 23.0 percent decline in enrollment. In 2009, the increase was $3.9 million or 2.5 percent, due primarily to increased enrollment and higher contract rates.

The non-sponsored/self-pay net revenue decreased by $0.1 million, or 4.5 percent, in 2010, and decreased by $3.1 million, or 55.2 percent, in 2009. This category fluctuates from year to year due to changes in the volume of uninsured patients and current overall economic conditions.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Salaries and wages	$ 498,063	$ 490,873	$ 472,640
Employee benefits	121,352	113,408	103,976
Professional services	79,326	80,347	76,283
Medical supplies	170,393	166,422	155,856
Other supplies and purchased services	86,066	84,967	93,686
Depreciation and amortization	59,575	57,372	57,562
Insurance	8,258	9,940	7,975
Other	17,446	16,123	8,788
Total operating expenses	$ 1,040,479	$ 1,019,452	$ 976,766

Total operating expenses increased by $21.0 million and $42.7 million in 2010 and 2009, respectively.

Salary and employee benefit expenses include wages paid to hospital employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance and other employee benefits. About one-half of the Medical Center's workforce, including nurses and employees providing ancillary services, expands or contracts with patient volumes. In 2010, salaries and wages grew by $7.2 million, or 1.5 percent, over the prior year due to slight increases in payroll for certain union represented employees offset by a slight reduction in full time equivalents due to cost control measures and forgoing annual salary adjustments for the remaining employee population. In 2009, salary and wages grew by $18.2 million or 3.9 percent due to higher patient volumes and cost control measures that limited the growth in full time equivalent employees and foregoing annual salary adjustments.

In 2010, employee benefit costs increased by $7.9 million or 7.0 percent over 2009. The increase is primarily due to a combination of $4.1 million in contributions to the University of California Retirement Plan ("UCRP") and higher health insurance premiums as a result of inflation. Increases in employee benefit costs for 2009 were $9.4 million or 9.1 percent. The increase is primarily due to higher health insurance premiums as a result of inflation.

Professional services include payments to the UC Davis School of Medicine for physician services in the hospital and clinics, payments to other health care providers for capitated patients, outside lab fees, organ acquisition fees, transcription and legal fees. Payments for professional services remained relatively unchanged over 2009. In 2009, professional services increased by $4.1 million or 5.3 percent over 2008 due to higher health care costs paid to other providers for capitated patients.

Medical supplies expense, including pharmaceuticals, for 2010 increased by $4.0 million or 2.4 percent over 2009. Medical supplies expense for 2009 increased by $10.6 million or 6.8 percent over 2008. Medical supplies are subject to significant inflationary pressures, due to escalating pharmaceutical costs and continued innovation in implants, prosthetics and other medical supplies. Supply costs have remained steady at 15.5, 15.7 and 15.4 percent in 2010, 2009 and 2008, respectively, as a percentage of net patient service revenue due to ongoing supply chain improvement initiatives undertaken by management.

Other supplies and purchased services include non-medical supplies and other purchased services. Other supplies and purchased services increased by $1.1 million or 1.3 percent over the prior year. Other supplies and purchased services decreased by $8.7 million or 9.3 percent in 2009 over 2008 due to reduced discretionary spending.

In 2010, depreciation and amortization expense increased by $2.2 million as compared to the prior year due primarily as a result of equipment purchases placed into service during the year. In 2009, depreciation and amortization expense decreased by $0.2 million as compared to the prior year. Most of the capital expenditures in 2010 and 2009 were related to the construction of the new hospital pavilion which is expected to be placed in service in early fiscal year 2011.

The Medical Center is insured through the University's malpractice, general liability, workers' compensation and health and welfare self-insurance programs. All claims and related expenses are paid from the University's self-insurance funds. Net insurance expense of $8.3 million was paid in 2010, $9.9 million in 2009, and $8.0 million in 2008 which represents the Medical Center's premiums for the self-insured programs. Due to favorable claims experience, the Medical Center received refunds of premiums for workers' compensation from the University of $6.2 million, $6.3 million, and $7.3 million in 2010, 2009, and 2008, respectively.

Other expenses increased in both 2010 and 2009 by $1.3 million and $7.3 million, respectively.

Income from Operations
The Medical Center reported income from operations of $71.7 million and operating revenue of $1,112.2 million, resulting in an operating margin of 6.2 percent in 2010 as compared to 5.1 percent and 4.4 percent in 2009 and 2008, respectively.

Non-operating Revenues (Expenses)
Non-operating revenue (expenses) include interest income and expense and the gain or loss on disposal of capital assets. Total non-operating expenses remained relatively unchanged at $2.8 million for 2010 and 2009.

In 2009, total non-operating expenses were $2.8 million compared to $7.4 million in 2008. The decrease was primarily related to capitalizing additional interest on the hospital pavilion which is in the process of being constructed.

Income before Other Changes in Net Assets
The Medical Center's income before other changes in net assets was $69.0 million in 2010 compared to $55.1 million and $45.0 million in 2009 and 2008, respectively.

Other Changes in Net Assets

The other changes in net assets for 2010, 2009 and 2008 include:

	2010	2009	2008
Contributions from University for building program	$ 16,289	$ 37,630	$ 50,576
Health system support	(29,719)	(48,783)	(10,557)
Transfers from university, net	2,530	1,631	(16,968)
Total other changes in net assets	$ (10,900)	$ (9,522)	$ 23,051

The lower section of the statement of revenues, expenses and changes in net assets shows the other changes to net assets in addition to the income or loss. Net assets are the difference between the total assets and total liabilities of the Medical Center. The other changes in net assets represent additional funds received and cash outflows for support and transfers to other university entities.

Included in the other changes in net assets for 2010 and 2009 are the following:

- Contributions from the University for the building program of $16.3 million are related to the Surgery and Emergency Pavilion project and represent funding from the State Public Works Board Bonds. In 2009, the contributions for the building program were $37.6 million.

- Health system support represents transfers primarily to the School of Medicine for academic and research support. The Medical Center transferred $29.7 million in 2010 and $48.8 million in 2009.

- Transfers from the University totaled $2.5 million and $1.6 million for 2010 and 2009, respectively.

In total, net assets increased for the year ended June 30, 2010 and 2009 by $58.1 million and $45.6 million, respectively.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Current assets:			
Cash	$ 91,819	$ 122,721	$ 176,473
Restricted assets	108	954	848
Patient accounts receivable (net)	171,777	161,351	180,752
Other current assets	80,624	60,339	45,551
Total current assets	344,328	345,365	403,624
Capital assets (net)	1,073,344	1,014,077	916,211
Other assets	23,507	23,195	19,192
Total assets	1,441,179	1,382,637	1,339,027
Current liabilities	203,714	197,567	188,207
Long-term debt	385,450	391,125	402,501
Total liabilities	589,164	588,692	590,708
Net assets:			
Invested in capital assets (net)	645,255	579,838	464,101
Restricted	108	954	848
Unrestricted	206,682	213,153	283,370
Total net assets	$ 852,015	$ 793,945	$ 748,319

Total current assets decreased in 2010 and 2009 by $1.0 million and $58.0 million, respectively.

Cash decreased by $30.9 million and $53.8 million in 2010 and 2009, respectively due to the use of cash for construction of the hospital pavilion, offset by the cash generated from operations in both years.

Net patient accounts receivable increased by $10.4 million in 2010 due to an increase in receivables associated with patients pending eligibility for the Medicare and Medi-Cal programs, there has been a slight slow down in collections in the current year and an increase in days in accounts receivable. In 2009, net patient accounts receivable decreased by $19.4 million due to an increased focus on collection efforts for patient accounts from third-party payors.

In 2010, other current assets, including non-patient receivables, inventory and prepaid expenses, increased by $19.9 million over the prior fiscal year due primarily in delays in payments from the State related to Medi-Cal programs. In 2009, other current assets increased by $14.8 million over 2008.

Other non-current assets remained relatively unchanged in 2010 from 2009. In 2009, other non-current assets increased by $4.0 million from 2008 due to income earned on joint venture investments.

Net capital assets increased by $59.3 million from 2009 to 2010 and $97.9 million from 2008 to 2009 primarily due to continued construction of the hospital pavilion, offset by depreciation expense.

Current liabilities increased by $6.1 million from 2009 to 2010 primarily due to increases in third-party payor settlements. Current liabilities increased by $9.4 million from 2008 to 2009 primarily due to an increase of $13.7 million in third-party payor settlements, an increase of $4.6 million in accrued salaries and benefits and a decrease in accounts payable and accrued expenses of $10.7 million.

Long-term debt decreased by $5.7 million from 2009 to 2010 and $11.4 million from 2008 to 2009. The decreases are primarily due to debt service payments.

Net assets invested in capital assets increased by $65.4 million and $115.8 million in 2010 and 2009, respectively. The increases are primarily due to increases in capital assets, net and decreases to long-term debt as payments are made.

Restricted assets remained relatively unchanged in 2009 when compared to 2008 at $1.0 million and $0.8 million, respectively; however, decreased to $0.1 million in 2010 primarily due to release of restrictions as debt proceeds were used for debt payments in accordance with the terms of the restrictions.

Unrestricted net asset changed primarily as a result of the changes above and the changes in net assets in 2010 and 2009.

Liquidity and Capital Resources

The Medical Center generated $108.0 million and $135.5 million from operating activities in 2010 and 2009, respectively.

Cash flows from non-capital financing activities show the Medical Center's cash was reduced by $27.2 million and $47.2 million in 2010 and 2009, respectively, primarily due to transfers to the University for health system support.

In 2010, cash flows from capital and related financing activities included the contributions from the University for funding from the State Public Works Board Bonds of $16.3 million, proceeds from financing loans of $24.5 million, purchases of capital assets of $112.0 million, principal payments on long-term debt and capital leases of $29.4 million, and interest paid of $19.1 million. In 2009, cash flows from capital and related financing activities included the contributions from the University for funding from the State Public Works Board Bonds of $37.6 million, proceeds from financing loans of $15.6 million, purchases of capital assets of $153.4 million, principal payments on long-term debt and capital leases of $27.7 million, and interest paid of $19.4 million.

In 2010, cash flows from investing activities include interest income of $3.1 million and distributions from joint ventures of $3.7 million; whereas, in 2009 the Medical Center received $4.5 million from interest income. Overall cash decreased to $91.8 million in 2010 from $122.7 million in 2009.

The following table shows key liquidity and capital ratios for 2010, 2009 and 2008:

	2010	2009	2008
Days cash on hand	33	47	68
Days of revenue in accounts receivable	63	61	58
Capital investment ($ in millions)	$1,073.3	$1,014.1	$916.2
Debt service coverage ratio	2.7	2.6	2.5

Days cash on hand decreased to 33 days in 2010 from 47 days in 2009. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash. The goal set by the University of California Office of the President is 60 days. The Medical Center's cash decreased due to the use of hospital reserves to pay for the construction of the new hospital pavilion.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2010, days in accounts receivable increased by 2 days to 63.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The Medical Center's ratios for 2010, 2009, and 2008 are 2.7, 2.6, and 2.5, respectively. The increase of 0.1 is due to an increase in funds available for debt service. The ratio is higher than the 1.0 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2010, the UC Davis Medical Center's capital program continued to address the requirements in State of California Senate Bill 1953 ("SB 1953"). The projected cost for the Medical Center, which will be compliant with the statutory requirements by January 1, 2013, is $227.4 million. The capital cost of compliance will be financed through the use of state lease revenue bond funds, Medical Center reserves and gift funds. In 2010 and 2009, $20.3 million and $42.0 million, respectively, were spent on these requirements.

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

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

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

Medicaid Reform
In 2005, California enacted Senate Bill 1100 ("SB 1100") to implement a federal Medicaid hospital financing waiver ("waiver") that governs fee-for-service inpatient hospital payments for its public hospitals, which include the Medical Center. 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 federal economic stimulus package enacted in 2009, 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. The current waiver expired in August 2010 and plans for a renewal are under discussion between the Center for Medicare and Medicaid Services ("CMS") and the state, the outcome of which cannot be determined. 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.

Hospital Fee Program
AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The University's medical centers, as designated public hospitals, are exempt from paying the "Quality Assurance Fee"; however, the University's medical centers are eligible to receive supplemental payments under the Hospital Fee Program.

Children's Hospital Bond Act of 2008
In 2008, California voters passed Proposition 3 that enables the state of California to issue $980 million in General Obligation bonds to fund capital improvement projects for children's hospitals. The Medical Center 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.

Health Care Reform Bill
On March 23, 2010, the Patient Protection and Affordable Care Act ("PPACA") was signed into law. On March 30, 2010 the Health Care and Education Reconciliation Act of 2010 was signed, amending the PPACA (collectively the "Affordable Care Act"). The Affordable Care Act addresses a broad range of topics affecting the health care industry, including a significant expansion of healthcare coverage. The coverage expansion is accomplished primarily through incentives for individuals to obtain and employers to provide health care coverage and an expansion in Medicaid eligibility. The Affordable Care Act also includes incentives for medical research and the use of electronic health records, changes designed to curb fraud, waste and abuse, and creates new agencies and demonstration projects to promote the innovation and efficiency in the healthcare delivery system. Some provisions of the health care reform legislation are effective immediately; others will be phased in through 2014. Further legislative policies are required for several provisions that will be effective in future years. The impact of this legislation will likely affect the Medical Centers, the effect of the changes that will be required in future years are not determinable at this time.

University of California Retirement and Other Post Employment Benefit Plans
UCRP costs are funded by a combination of investment earnings, employee member and employer contributions. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $1.9 billion or 94.8 percent funded. For the July 1, 2010, the funded ratio is expected to decrease to approximately 85 percent. The funding policy contributions related to campuses and medical centers in the July 1, 2009 actuarial valuation for 2010 are $1.6 billion, which represents 20.4 percent of covered compensation. Employer contributions for 2010 were $65 million. For 2011 the Regents authorized increasing the employer and employee contribution rates to UCRP. Contributions by employees will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University would be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These proposed changes would be subject to collective bargaining for union-represented employees. The Regents are scheduled to consider modifications to benefit design for pension benefits at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Currently, the University does not pre-fund retiree health benefits and provides for benefits on a pay-as-you-go basis. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $14.5 billion. The Regents are scheduled to consider modifications to eligibility and the University's share of contributions for retiree health care at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Cautionary Note Regarding Forward-Looking Statements

Certain information provided by the Medical Center, including written as outlined above or oral statements made by its representatives, may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, which address activities, events or developments that the Medical Center expects or anticipates will or may occur in the future contain forward-looking information.

In reviewing such information it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information. This forward-looking information is based upon various factors and was derived using various assumptions. The Medical Center does not undertake to update forward-looking information contained in this report or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.

University of California, Davis Medical Center
Statements of Net Assets
June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Assets		
Current assets:		
Cash	$ 91,819	$ 122,721
Restricted assets, held by trustee	108	954
Patient accounts receivable, net of estimated uncollectibles of $44,523 and $34,586, respectively	171,777	161,351
Other receivables, net of estimated uncollectibles of $203 and $695, respectively	55,992	36,251
Inventory	14,188	14,641
Prepaid expenses and other assets	10,444	9,447
Total current assets	344,328	345,365
Capital assets, net	1,073,344	1,014,077
Investments in joint ventures	20,884	20,444
Deferred costs of issuance	2,623	2,751
Total assets	1,441,179	1,382,637
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	35,313	36,376
Accrued salaries and benefits	74,194	74,772
Third-party payor settlements	51,619	47,507
Current portion of long-term debt and capital leases	29,475	27,010
Other liabilities	13,113	11,902
Total current liabilities	203,714	197,567
Long-term debt and capital leases, net of current portion	385,450	391,125
Total liabilities	589,164	588,692
Net Assets		
Invested in capital assets, net of related debt	645,225	579,838
Restricted:		
Expendable:		
Debt service	108	954
Unrestricted	206,682	213,153
Total net assets	$ 852,015	$ 793,945

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

University of California, Davis Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Net patient service revenue, net of provision for doubtful accounts of $59,573 and $54,977, respectively	$ 1,098,565	$ 1,061,848
Other operating revenue:		
Clinical teaching support	6,137	7,218
Other	7,512	8,301
Total other operating revenue	13,649	15,519
Total operating revenue	1,112,214	1,077,367
Operating expenses:		
Salaries and wages	498,063	490,873
UCRP, retiree health and other employee benefits	121,352	113,408
Professional services	79,326	80,347
Medical supplies	170,393	166,422
Other supplies and purchased services	86,066	84,967
Depreciation and amortization	59,575	57,372
Insurance	8,258	9,940
Other	17,446	16,123
Total operating expenses	1,040,479	1,019,452
Income from operations	71,735	57,915
Non-operating revenues (expenses):		
Interest income	3,118	4,483
Interest expense	(9,184)	(10,944)
Loss on disposal of capital assets	(588)	(431)
Other	3,889	4,125
Total non-operating expenses	(2,765)	(2,767)
Income before other changes in net assets	68,970	55,148
Other changes in net assets:		
Contributions from University for building program	16,289	37,630
Health system support	(29,719)	(48,783)
Transfers from University, net	2,530	1,631
Total other changes in net assets	(10,900)	(9,522)
Increase in net assets	58,070	45,626
Net assets – beginning of year	793,945	748,319
Net assets – end of year	$ 852,015	$ 793,945

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

University of California, Davis Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,072,510	$ 1,080,882
Payments to employees	(502,372)	(489,923)
Payments to suppliers	(349,870)	(351,213)
Payments for benefits	(121,352)	(113,408)
Other receipts, net	9,122	9,184
Net cash provided by operating activities	108,038	135,522
Cash flows from noncapital financing activities:		
Health system support	(29,719)	(48,783)
Transfers from University	2,530	1,631
Net cash used by noncapital financing activities	(27,189)	(47,152)
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	16,289	37,630
Proceeds from financing loan	24,485	15,634
Proceeds from sale of capital assets	525	682
Purchases of capital assets	(111,984)	(153,424)
Principal paid on long-term debt and capital leases	(29,378)	(27,687)
Interest paid on long-term debt and capital leases	(19,101)	(19,328)
Net cash used by capital and related financing activities	(119,164)	(146,493)
Cash flows from investing activities:		
Interest income received	3,118	4,483
Distributions from investments in joint ventures, net	3,721	190
Change in restricted assets	846	(106)
Non-operating expense	(272)	(196)
Net cash provided by investing activities	7,413	4,371
Net decrease in cash	(30,902)	(53,752)
Cash – beginning of year	122,721	176,473
Cash – end of year	$ 91,819	$ 122,721

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

University of California, Davis Medical Center
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 71,735	$ 57,915
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	59,575	57,372
Provision for doubtful accounts	59,573	54,977
Changes in operating assets and liabilities:		
Patient accounts receivable	(69,999)	(35,576)
Other receivables	(19,741)	(14,039)
Inventory	453	(817)
Prepaid expenses and other assets	(997)	68
Accounts payable and accrued expenses	2,694	(3,294)
Accrued salaries and benefits	(578)	4,555
Third-party payor settlements	4,112	13,672
Other liabilities	1,211	689
Net cash provided by operating activities	$ 108,038	$ 135,522
Supplemental noncash activities information:		
Capitalized interest	$ 11,728	$ 10,260
Amortization of deferred financing costs	2,631	2,735
Amortization of bond premium	948	987
Amortization of deferred costs of issuance	128	128
Property and equipment transfers from the University	29	92
Payables for property and equipment	13,206	16,963

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

1. Organization

The University of California, Davis Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"), an independent board composed of 26 members. The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority being delegated to the Medical Center Director by the Chancellor of the Davis campus. The Medical Center has 613 licensed beds.

2. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of the Medical Center have been prepared in accordance with accounting principles generally accepted in the United States of America, including all applicable statements of the Governmental Accounting Standards Board ("GASB"), and all statements of the Financial Accounting Standards Board through November 30, 1989. The proprietary fund method of accounting is followed and uses the economic resources measurement focus and the accrual basis of accounting. In addition, these statements follow generally accepted accounting principles applicable to the health care industry, which are included in the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Entities*, to the extent that these principles do not contradict GASB standards.

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, was adopted by the Medical Center during the fiscal year ended June 30, 2010. 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.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, was also adopted during the fiscal year ended June 30, 2010. GASB Statement No. 53 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 implementation of GASB Statement No. 51 and GASB Statement No. 53 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2010 and 2009.

Cash

All University operating entities maximize the returns on their cash balances by investing in a short-term investment pool ("STIP") managed by the Treasurer of The Regents. The Regents are responsible for managing the University's STIP and establishing investment policy, which is carried out by the Treasurer of The Regents.

2. Summary of Significant Accounting Policies (Continued)

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

The Medical Center's cash at June 30, 2010 and 2009 was $91,819 and $122,721, 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 2009-2010 annual report of the University.

Inventory
The Medical Center's inventory consists primarily of pharmaceuticals and medical supplies which are stated on a first-in, first-out basis at the lower of cost or market.

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

Capital Assets
The Medical Center's capital assets are reported at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. Equipment under capital lease is amortized over the shorter period of the lease term or the estimated useful life of the equipment. Lease amortization is included in depreciation and amortization expense. The range of the estimated useful lives for buildings and land improvements is 5 to 40 years and for equipment is 3 to 20 years. Interest on borrowings to finance facilities is capitalized during construction. University guidelines mandate that land purchased with Medical Center funds be recorded as an asset of the Medical Center. Land utilized by the Medical Center but purchased with other sources of funds is recorded as an asset of the University. Incremental costs, including salaries and employee benefits, directly related to the acquisition, development and installation of major software projects are included in the cost of the capital assets.

Investments in Joint Ventures
The Medical Center has entered into joint venture arrangements with various third party entities that include home health services, cancer center operations and a health maintenance organization. Investments in these joint ventures are recorded using the equity method.

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 statements of net assets. These costs are being amortized as interest expense over the remaining life of the defeased or refinanced bonds, whichever is shorter.

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

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

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

    - Nonexpendable – Net assets subject to externally imposed restrictions that must be retained in perpetuity by the Medical Center. The Medical Center had no restricted nonexpendable net assets at June 30, 2010 and 2009.

    - 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.

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 could 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.

Contributions from the University for the building program, 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.

Tax Exemption

The Regents of the University of California is recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (IRC). Because the University is a State institution, related income received by the University is also exempt from federal tax under IRC Section 115(a). In addition, the University is exempt from State income taxes imposed under the California Revenue and Taxation Code.

Use of Estimates

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

2. Summary of Significant Accounting Policies (Continued)

Reclassifications
Within the statement of cash flows, certain amounts within capital and related financing and investing activities were reclassified. The prior year amounts have been reclassified to conform with the current year presentation.

3. Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments at amounts different from the Medical Center's established rates. A summary of the payment arrangements with major third-party payors follows:

- ***Medicare*** – Medicare patient revenues include traditional reimbursement under Title XVIII of the Social Security Act (non-risk) or Medicare capitated contract revenue (risk).

  Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. The Medical Center does not believe that there are significant credit risks associated with the Medicare program.

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2003. The fiscal intermediary is in the process of conducting their audits of the 2004 and subsequent cost reports. The results of these audits have yet to be finalized and any amounts due to or from Medicare have not been determined. Estimated receivables and payables related to all open cost reporting periods are included on the statements of net assets as third-party payor settlements.

3. Net Patient Service Revenue (Continued)

- ***Medi-Cal*** – The Medicaid program is referred to as Medi-Cal in California. Medi-Cal fee-for-service ("FFS") inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 ("SB 1100"). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share ("DSH") payments, and Safety Net Care Pool ("SNCP"). For the years ended June 30, 2010 and 2009, the Medical Center recorded total Medi-Cal revenue of $153,624 and $135,173, respectively.

- ***Assembly Bill 915*** – State of California Assembly Bill ("AB") 915, *Public Hospital Outpatient Services Supplemental Reimbursement Program*, provides for supplemental reimbursement equal to the federal share of unreimbursed facility costs incurred by public hospital outpatient departments. This supplemental payment covers only Medi-Cal fee-for-service outpatient services. The supplemental payment is based on each eligible hospital's certified public expenditures ("CPE"), which are matched with federal Medicaid funds. For the years ended June 30, 2010 and 2009, the Medical Center recorded revenue of $8,715 and $5,581, respectively.

- ***Senate Bill 1732*** – State of California Senate Bill 1732 ("SB 1732") provides for supplemental Medi-Cal reimbursement to disproportionate share hospitals for costs (i.e., principal and interest) of qualified patient care capital construction. For the years ended June 30, 2010 and 2009, the Medical Center applied for and received additional revenue of $8,109 and $7,820, respectively. The amounts received are related to the reimbursement of costs for certain debt financed construction projects based on the Medical Center's Medi-Cal utilization rate.

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

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

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

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

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

- Certain health plans that have established a shared-risk pool where the Medical Center shares in any surplus associated with health care utilization as defined in the related contracts. Additionally, the Medical Center may assume the risk of certain health care utilization costs, as determined in the related agreements. Differences between the final contract settlement and the amount estimated as receivable or payable relating to the shared-risk arrangements are recorded in the year of final settlement.

- Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

The most common payment arrangement for inpatient services is a prospectively determined per-diem rate or case rate. The most common payment arrangement for outpatient care is a prospective payment system that uses ambulatory payment classifications.

Amounts due from Medicare and Medi-Cal represent 26.5 percent and 19.9 percent of net patient accounts receivable at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, net patient service revenue included $13.4 million and $23.8 million, respectively, due to favorable cost report settlements with Medicare, Medi-Cal, County Medical Services Program and changes in estimate for settlements related to SB 1100 for Medi-Cal.

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

	2010	2009
Contract (discounted or per diem)	$ 526,825	$ 522,340
Medicare (non-risk)	240,193	205,835
Medi-Cal (non-risk)	153,624	135,173
Contract (capitated)	125,981	111,740
Medicare (risk)	22,235	28,829
Medi-Cal (risk)	14,034	17,040
County	11,240	37,452
Non-sponsored/self-pay	2,428	2,542
Commercial	2,005	897
Total	$ 1,098,565	$ 1,061,848

(Dollars in thousands)

4. Charity Care

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

	2010	2009
Charity care at established rates	$ 212,026	$ 165,740
Estimated cost of charity care	$ 40,921	$ 34,060

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $143,105 and $135,083 for the years ended June 30, 2010 and 2009, respectively.

5. Restricted Assets, Held by Trustee

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

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

	2010	2009
Short-term, highly liquid investments	$ 108	$ 954

6. Capital Assets

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

	2008	Additions	Disposals	2009	Additions	Disposals	2010
Original Cost							
Land	$ 36,675	$ –	$ –	$ 36,675	$ –	$ –	$ 36,675
Buildings and improvements	727,870	24,526	(3,471)	748,925	444,313	–	1,193,238
Equipment	304,396	42,174	(17,239)	329,331	54,733	(15,550)	368,514
Construction in progress	316,975	89,078	–	406,053	(379,632)	–	26,421
Capital assets, at cost	$ 1,385,916	$ 155,778	$ (20,710)	$ 1,520,984	$ 119,414	$ (15,550)	$ 1,624,848

	2008	Depreciation	Disposals	2009	Depreciation	Disposals	2010
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 281,219	$ 25,019	$ (3,292)	$ 302,946	$ 25,080	$ –	$ 328,026
Equipment	188,486	32,353	(16,878)	203,961	34,495	(14,978)	223,478
Accumulated depreciation and amortization	$ 469,705	$ 57,372	$ (20,170)	$ 506,907	$ 59,575	$ (14,978)	$ 551,504
Capital assets, net	$ 916,211			$ 1,014,077			$ 1,073,344

6. Capital Assets (Continued)

Equipment under capital lease obligations and related accumulated amortization is $811 and $811 in 2009. The Medical Center did not have capital leases at June 30, 2010.

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

The Medical Center is currently making seismic improvements in order to be in compliance with Senate Bill 1953, the *Hospital Facilities Seismic Safety Act*. In 2010 and 2009, $20,274 and $42,027, respectively were spent on these requirements. A portion of the improvements is financed under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $11,395 and $32,892 for the years ended June 30, 2010 and 2009, respectively, are shown as Contributions from University for building program on 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:

	2010	2009
University of California Medical Center Pooled Revenue Bonds 2008 Series D, interest rates ranging from 2.5 percent to 5.5 percent, payable semi-annually, with annual principal payments through 2027	$ 295,560	$ 309,865
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 principal payments beginning in 2012 through 2047	65,000	65,000
University of California General Revenue Bonds 2003, interest rates from 2.0 percent to 5.25 percent, payable semi-annually, with annual principal payments through 2023	11,435	12,065
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.4 percent to 4.0 percent, payable through 2015	58,629	48,384
Capital lease obligations, primarily for computer software, with a fixed interest rate of 3.0 percent, payable through 2010, collateralized by underlying computer software	–	203
Unamortized bond premium	9,050	9,998
Unamortized deferred financing costs	(24,749)	(27,380)
Total debt and capital leases	414,925	418,135
Less: Current portion of debt and capital leases	(29,475)	(27,010)
Noncurrent portion of debt and capital leases	$ 385,450	$ 391,125

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, 2010 and 2009 was $20,912 and $21,299 respectively. Interest expense totaling $11,728 and $10,355 was capitalized during the years ended June 30, 2010 and 2009, respectively. The remaining $9,184 in 2010 and $10,944 in 2009 are reported as interest expense in the statements of revenues, expenses and changes in net assets. Investment income totaling $34 and $100 was capitalized during the years ended June 30, 2010 and 2009, respectively.

(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	Other Debt Obligations	Total
Year Ended June 30, 2010			
Current portion at June 30, 2009	$ 13,252	$ 13,758	$ 27,010
Reclassification from noncurrent	13,394	16,766	30,160
Principal payments	(14,935)	(14,443)	(29,378)
Amortization of bond premium	(948)	–	(948)
Amortization of deferred financing costs	2,631	–	2,631
Current portion at June 30, 2010	$ 13,394	$ 16,081	$ 29,475
Noncurrent portion at June 30, 2009	$ 356,296	$ 34,829	$ 391,125
New obligations	–	24,485	24,485
Reclassification to current	(13,394)	(16,766)	(30,160)
Noncurrent portion at June 30, 2010	$ 342,902	$ 42,548	$ 385,450
Year Ended June 30, 2009			
Current portion at June 30, 2008	$ 11,975	$ 13,964	$ 25,939
Reclassification from noncurrent	13,252	13,758	27,010
Principal payments	(13,723)	(13,964)	(27,687)
Amortization of bond premium	(987)	–	(987)
Amortization of deferred financing costs	2,735	–	2,735
Current portion at June 30, 2009	$ 13,252	$ 13,758	$ 27,010
Noncurrent portion at June 30, 2008	$ 369,548	$ 32,953	$ 402,501
New obligations	–	15,634	15,634
Reclassification to current	(13,252)	(13,758)	(27,010)
Noncurrent portion at June 30, 2009	$ 356,296	$ 34,829	$ 391,125

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

Medical Center Pooled Revenue Bonds are issued to provide financing to the University's medical centers and are collateralized by a joint and several pledge of the operating revenues, as defined in the indenture, of all five of the University's medical centers. The Medical Center Pooled Revenue Bond indenture requires the medical centers to set rates, charges and fees each year sufficient for the medical center operating revenues to pay for the annual principal and interest on the bonds and sets forth requirements for certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2010 are $1.55 billion of which $360,560 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, 2010 and 2009 were $5.94 billion and $5.56 billion, respectively.

General Revenue Bonds Series 2003, collateralized solely by general revenues of the University, finance certain Medical Center projects. The Medical Center is charged for its proportionate share of total principal and interest payments made on the General Revenue Bonds pertaining to Medical Center Projects.

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

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

(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, 2010 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Other Debt	Total Payments	Principal	Interest
2011	$ 32,711	$ 17,735	$ 50,446	$ 31,093	$ 19,353
2012	33,144	17,436	50,580	32,375	18,205
2013	32,806	14,077	46,883	29,669	17,214
2014	32,494	8,719	41,213	25,165	16,048
2015	32,152	4,485	36,637	21,589	15,048
2016 – 2020	155,319	–	155,319	93,134	62,185
2021 – 2025	142,588	–	142,588	104,858	37,730
2026 – 2030	63,389	–	63,389	49,339	14,050
2031 – 2035	18,534	–	18,534	9,590	8,944
2036 – 2040	18,538	–	18,538	11,960	6,578
2041 – 2045	18,539	–	18,539	14,905	3,634
2046 – 2048	7,419	–	7,419	6,947	472
Total future debt service	587,633	62,452	650,085	$ 430,624	$ 219,461
Less: Interest component of future payments	(215,638)	(3,823)	(219,461)		
Principal portion of future payments	371,995	58,629	430,624		
Adjusted by:					
Unamortized bond premium	9,050	–	9,050		
Unamortized deferred financing costs	(24,749)	–	(24,749)		
Total debt	$ 356,296	$ 58,629	$ 414,925		

Additional information on the revenue bonds can be obtained from the 2009-2010 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, 2010 and 2009 was $13,884 and $13,440, respectively. The terms of the operating leases extend through the year 2034.

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
2011	$ 13,152
2012	10,666
2013	8,659
2014	7,036
2015	4,792
2016 – 2034	13,302
Total	$ 57,607

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.

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 $3.12 and $3.09 per $100 of UCRP covered payroll resulting in Medical Center contributions of $13,851 and $13,488 for the years ended June 30, 2010 and 2009, respectively.

9. Retiree Health Plans (Continued)

The actuarial value of UCRHBT assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2009, the date of the latest actuarial valuation, were $76.9 million and $14.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $69.4 million at June 30, 2010. For the years ended June 30, 2010 and 2009, combined contributions from the University's campuses and medical centers were $283.5 million and $278.5 million, respectively, including an implicit subsidy of $49.5 million and $44.1 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.6 billion and $1.5 billion for the years ended June 30, 2010 and 2009. 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 $3.7 billion at June 30, 2010 increased by $1.4 billion and $1.2 billion for the years ended June 30, 2010 and 2009, 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 2009–2010 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 have 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 the average highest three years compensation, age, and years of service and are subject to limited cost-of-living increases.

Contributions to the UCRP may be made by the Medical Center and the employees. The rates for contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by the Medical Center and by the employees. Employee contributions by represented employees are subject to collective bargaining agreements. Medical Center and employee contributions were $4,100 and $2,150, respectively, during the year ended June 30, 2010. There were no required Medical Center or employee contributions for the year ended June 30, 2009.

10. Retirement Plans (Continued)

The actuarial value of UCRP assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2009, the date of the latest actuarial valuation, were $34.8 billion and $36.8 billion, respectively, resulting in a funded ratio of 94.8 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $34.6 billion and $32.3 billion at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, the University's campuses and medical centers contributed a combined $64.8 million and $0.4 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.6 billion for the year ended June 30, 2010. 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 $1.5 billion for the year ended June 30, 2010.

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 are not readily available. Additional information on the retirement plans can be obtained from the 2009–2010 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

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 program. 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 (refunds) premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $(671) and $208 for the years ended June 30, 2010 and 2009, respectively. During 2010 and 2009, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $6,210 and $6,310, respectively that reduced the overall workers' compensation cost for the year.

(Dollars in thousands)

11. University Self-insurance (Continued)

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $8,258 and $9,940 for the years ended June 30, 2010 and 2009, respectively.

12. Transactions with Other University Entities

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

	2010	2009
Professional services	$ 46,342	$ 46,858
Insurance	8,258	9,940
Salaries and employee benefits	–	208
Interest income (net)	(6,233)	(4,483)
Other supplies and purchased services	339	981
Total	$ 48,706	$ 53,504

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

The total net amount of payments made by the Medical Center to the University were $78,425 and $102,287 in 2010 and 2009, respectively. Of these amounts, $48,706 and $53,504 are reported as operating expenses for the years ended June 30, 2010 and 2009, respectively, and $29,719 and $48,783 are reported as health system support for the years ended June 30, 2010 and 2009, respectively.

13. 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.

13. Commitments and Contingencies (Continued)

The Medical Center 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 Medical Center's financial statements.

State of California Senate Bill 1953, *Hospital Facilities Seismic Safety Act*, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. The Medical Center received an extension to complete the required renovation that by January 1, 2013 all general acute care inpatient buildings must be life safe. In addition, by January 1, 2030, all general acute care inpatient buildings must be operational after an earthquake. Previously, the state of California's budget authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations. The Regents have approved the allocation of the $600,000 among the University's medical centers, of which $120,000 was allocated to the Medical Center. The Medical Center spent $11,395 and $32,892 of its allocation during the years ended June 30, 2010 and 2009, respectively, recorded in the statements of revenues, expenses and changes in net assets as a component of Contributions from University for building program. As of June 30, 2010, any repayments the Medical Center may be obligated to make under these financing arrangements are dependent upon continued appropriations for the lease payments to the University by the State.

The Medical Center has entered into various construction contracts. The remaining cost of these projects is estimated to be approximately $78,006, excluding interest, as of June 30, 2010.

14. Subsequent Event

AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The CDHS is responsible for obtaining approval from CMS on a distribution plan for funds. It is not anticipated that fees and payments would commence without federal approval, but if final federal approval is not obtained, any fees and payments made under the program would be refunded. The Medical Centers, as designated public hospitals, are exempt from paying the "Quality Assurance Fee"; however, the Medical Centers are eligible to receive supplemental payments under the Hospital Fee Program.

University of California, Irvine Medical Center

Financial Statements

For the Years Ended June 30, 2010 and 2009

University of California, Irvine Medical Center
Index
June 30, 2010 and 2009

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying financial statements, as shown on pages 16 through 39 present fairly, in all material respects, the financial position of the University of California, Irvine Medical Center (the "Medical Center"), a division of the University of California ("University"), at June 30, 2010 and 2009, 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, 2010 and 2009, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 11, 2010

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

Introduction

The objective of the Management's Discussion and Analysis is to help readers better understand the University of California, Irvine Medical Center's financial position and operating activities for the year ended June 30, 2010, with selected comparative information for the years ended June 30, 2009 and 2008. 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 (2008, 2009, 2010, 2011, etc.) in this discussion refer to the fiscal years ended June 30.

Overview

The University of California, Irvine Medical Center (the "Medical Center") serves as the principal clinical teaching site for the University of California, Irvine School of Medicine. In 1976, the University of California, Irvine Medical Center, formerly known as Orange County Hospital, was purchased by The Regents. It is Orange County's only academic medical center encompassing hospital-based and ambulatory patient care services, teaching, and clinical research.

The Medical Center is licensed to provide acute care hospital services in Orange, California, and is licensed to operate 412 beds in year 2010. The Medical Center serves as a major tertiary referral center for Orange County and is also the county's only Level I Trauma Center and Regional Burn Center. The phase I construction of the new UC Irvine Douglas Hospital was completed and opened for patient care in March 2009. Phase II will be complete at the end of 2011. The new 482,428-square-foot hospital will contain 424 licensed beds, including 236 beds in the new main hospital building, 107 beds in the existing medical center's tower, 67 neuropsychiatric beds, and 14 rehabilitation beds. The new replacement hospital will meet the State of California's SB 1953, The Hospital Facilities Seismic Safety Act.

Outpatient services are provided by the Medical Center, which has a clinical practice group of over 400 faculty physicians and surgeons, primarily at the main campus pavilion buildings, Chao Cancer Center, Gottschalk Medical Plaza on the Irvine Campus, and Family Health Centers at Anaheim and Santa Ana clinics. The two Family Health Centers in Santa Ana and Anaheim are the designated Federally Qualified Health Centers owned and operated by the Medical Center to serve the underserved population in Orange County.

These sites enable the Medical Center to provide a full scope of high quality patient care services and attract the volume and diversity of patients required to support the education and research programs of the School of Medicine. Together, these sites provide increased patient volumes, expanded market share, better serve the community, attract favorable payor mix, and generate a stable financial environment.

The Medical Center was selected as one of the best hospitals in the United States by *U.S. News & World Report* for the 10th consecutive year. Among the top 50 hospitals, the Medical Center's gynecology, urology, ear, nose and throat specialties were recognized.

For the year ended June 30, 2010, the Medical Center reported income before other changes in net assets of $33.6 million and generated a margin of 5.5 percent. Total operating revenue increased by 5.0 percent. Total operating expenses increased by 8.9 percent. The year ended with a cash position of $102.6 million.

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

- *Continued Development of Medical Center Renovation Projects*
  In December 2009, the Medical Center received bond proceeds from the issuance of the Series E and F Pooled Revenue Bonds. The Series E and F bonds were issued to finance the Phase II construction and related equipment. Phase II construction projects include the following: build out of 70,000 gross square feet of unfinished shell space located in the new Douglas Hospital, construction of the Clinical Lab Replacement Building, renovation of floors 2 and 3 in the University Hospital Tower, remolding of the Chao Cancer Center, and site improvement in regards to the demolition of the old hospital. The five projects are expected to be completed by January 2012.

- *Opening of Clinical Lab Replacement Building*
  The new Clinical Lab Replacement Building was completed and occupied in January 2010. The lab building has five stories and approximately 48,000 gross square foot, replacing the service laboratories and associated support spaces from Building 1 and 10 that are scheduled to be demolished.

- *Increase in labor costs*
  Labor costs continue to be adversely affected by the nationwide nursing shortage, compliance with legislation covering nurse staffing ratios, and increased premiums for employee healthcare. These combined factors had a significant impact on both the salary costs of hospital-employed nurses as well as the rates charged for nurses employed from nurse registry agencies. Overall, labor costs, including employee benefits for hospital-paid employees increased by 11.9 percent over 2009.

- *Change in Executive Management*
  Mr. Terry A. Belmont was appointed as the Chief Executive Officer of the Medical Center after serving as Interim Chief Executive Officer since March 2009. The Chief Financial Officer position was filled internally by Morris Frieling, who was the Senior Director of Budget and Decision Support Services.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2010, 2009 and 2008:

Statistics	2010	2009	2008
Licensed beds	412	392	444
Admissions	16,327	16,683	16,628
Average daily census	283	279	278
Discharges	16,389	16,793	16,719
Average length of stay	6.3	6.1	6.1
Case mix index	1.57	1.54	1.55
Patient days:			
Medicare (non-risk)	29,575	27,950	26,624
Medi-Cal (non-risk)	36,429	37,066	37,483
Commercial	343	1,406	1,078
Contracts (discounted/per diem)	27,221	26,282	25,631
County/uninsured	9,897	9,059	10,865
Total patient days	103,465	101,763	101,681
Outpatient visits:			
Ambulatory visits	476,372	494,417	492,392
Emergency room visits	34,788	33,625	32,030
Total visits	511,160	528,042	524,422

In 2010, total discharges slightly decreased by 2.0 percent, while patient days increased by 2.0 percent due to increases in surgery and medicine cases. Total ambulatory visits decreased by 4.0 percent and emergency visits increased by 3.0 percent, over the prior year.

In 2009, discharges and patient days remained stable compared to the prior year. In 2009, total ambulatory and emergency visits increased slightly by 3,620, or 1.0 percent, over the prior year, primarily in clinic visits.

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 2010 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Net patient service revenue	$ 589,631	$ 559,059	$ 502,829
Other operating revenue	24,011	25,278	23,614
Total operating revenue	613,642	584,337	526,443
Total operating expenses	577,542	530,099	481,906
Income from operations	36,100	54,238	44,537
Total non-operating revenue	(2,470)	(1,937)	2,537
Income before other changes in net assets	$ 33,630	$ 52,301	$ 47,074
Margin	5.5 percent	9.0 percent	9.0 percent
Other changes in net assets	(82,418)	38,986	50,665
Increase (decrease) in net assets	(48,788)	91,287	97,739
Net assets – beginning of year	630,948	539,661	441,922
Net assets – end of year	$ 582,160	$ 630,948	$ 539,661

Revenues
Total operating revenues for the year ended June 30, 2010 were $613.6 million, an increase of $29.3 million, or 5.0 percent, over 2009. Operating revenues for 2009 were $584.3 million, an increase of $57.9 million, or 11.0 percent, over 2008.

Net patient service revenue for 2010 increased by $30.6 million, or 5.5 percent, over the prior year. The increase in 2010 was due to a more favorable patient mix and improved collections resulting from ongoing contracting efforts and pricing strategies. Net patient service revenue for 2009 increased by $56.2 million, or 11.2 percent, over 2008. Patient service revenues are net of estimated allowances from contractual arrangements with Medicare, Medi-Cal, the County of Orange, and other third-party payors which have been estimated based on the principles of reimbursements and terms of the contracts currently in effect.

Other operating revenue consists primarily of State Clinical Teaching Support ("CTS") funds and other non-patient services such as referral lab, cafeteria and parking operations. In 2010, other operating revenue decreased by $1.3 million, or 5.0 percent, over 2009 due primarily to the decrease in various county funding. In 2008, other operating revenue increased by $1.7 million, or 7.1 percent, over 2008.

The following table summarizes net patient service revenue for 2010, 2009 and 2008 (dollars in thousands):

Payor	2010	2009	2008
Medicare (non-risk)	$ 152,524	$ 142,815	$ 129,580
Medi-Cal (non-risk)	141,540	126,888	118,695
Commercial	5,052	38,872	24,378
Contracts (discounted/per diem)	263,234	225,736	199,688
County	22,346	15,874	18,994
Uninsured	4,935	8,874	11,494
Total	$ 589,631	$ 559,059	$ 502,829

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments from Medicare for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Managed Medicare payments are paid on a per-diem or per-discharge basis. Net revenue for Medicare patients, including managed care patients, increased by $9.7 million from 2009 due primarily to increased patient days. In 2009, net revenue for Medicare patients increased by $13.2 million from 2008 due to increased Managed Medicare utilization and favorable Medicare settlements.

Payments for Medi-Cal patients are made on a cost-based per-diem basis for inpatient services and paid based on a fixed-fee schedule for outpatient services. Managed Medi-Cal patients are paid on a per-diem basis. Net revenue for Medi-Cal also includes supplemental funding in recognition of the Medical Center's indigent care and teaching activities. In 2010, net Medi-Cal revenue increased by $14.7 million over 2009 due to increase in per-diem rate and supplemental funding. In 2009, net Medi-Cal revenue increased by $8.2 million over 2008 due to the Medi-Cal per-diem rate increase. For the years ended June 30, 2010 and 2009, the Medical Center recorded additional revenue of $91.3 million and $74.2 million, respectively, from the Medi-Cal hospital waiver and Safety Net Care Pool ('SNCP") funding under Senate Bill 1100.

Net revenue for contracts maintained a stable growth by increasing $37.5 million from 2009 due to the Medical Center's continued efforts in contract negotiations and improved pricing strategies. In 2009, net revenue for contracts grew by $26.0 million from 2008.

Commercial net patient revenue decreased by $33.8 million, or 87 percent, compared to 2009. The decrease in volume is the result of insurers changing from traditional indemnity to managed care contract. In 2009, commercial net patient revenue increased by $14.5 million, or 59.5 percent, compared to 2008.

County patient service revenues includes payments from the County of Orange under the Medical Center's contract to provide emergency medical services to the county's indigent population and emergency and non-emergency medical services to County public health patients. Net revenue for County patient services increased by $6.5 million, or 40.8 percent, in 2010 and decreased by $3.1 million, or 16.4 percent, in 2009. This category fluctuates from year to year depending on the patient volume and type of patients. The uninsured net revenue decreased by $3.9 million, or 44.4 percent, in 2010 and by $2.6 million, or 22.8 percent, in 2009.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Salaries and wages	$ 256,865	$ 232,235	$ 224,212
Employee benefits	68,608	58,605	53,424
Professional services	2,195	1,975	1,462
Medical supplies	81,498	82,154	74,698
Other supplies and purchased services	122,275	118,738	105,347
Depreciation and amortization	43,565	33,941	20,877
Insurance	2,536	2,451	1,886
Total operating expenses	$ 577,542	$ 530,099	$ 481,906

During 2010, total operating expenses of $577.5 million increased by $47.4 million, or 8.9 percent, over the prior year. The change was due primarily to an increase in labor costs, increase in professional services, and increase in depreciation. Total operating expenses for 2009 increased by $48.2 million, or 10.0 percent, over the prior year due to primarily to an increase in labor costs, increased depreciation in facilities and equipment, and inflationary increases in purchased services and supplies.

Salary and wage expenses include wages paid to hospital employees, holiday and sick pay, payroll taxes, and workers' compensation insurance premiums. Amounts paid for nurse registry and other contract labor are included in other expenses. The total expenses paid for employee salaries and wages in 2010 increased by $24.6 million, or 10.6 percent, over the prior year due to increased in full time equivalent employees ("FTEs") and union negotiated salary rate increases. Salary and wages costs for 2009 increased by $8.0 million, or 3.6 percent, over 2008.

In 2010, increases in total benefits costs were $10 million, with health insurance benefits higher by $4.9 million, workers' compensation insurance premiums increased by $1.0 million, and pension costs higher by $2.0 million over 2009. Increases in total benefit costs in 2009 were $5.2 million, with health insurance benefits higher by $4.3 million, workers' compensation insurance premiums down $68 thousand, and all other benefit costs higher by $0.9 million over 2008.

Payments for professional services increased by $220 thousand, or 11.1 percent, over 2009 due to increase in contracted medical director expenses. In 2008, professional services increased by $513 thousand, or 35.1 percent, over 2008.

Medical supply expense for 2010 decreased by $656 thousand, or 0.8 percent, over the prior year due to continued cost reduction efforts. Medical supply expense increased by $7.5 million, or 10 percent, in 2009 over 2008.

Other supplies and purchased services expenses include nursing registry, residents, and the cost of medical and non-medical purchased services. These expenses increased by $3.5 million, or 3.0 percent, over 2009 due primarily to $1.3 million increase in non-medical supplies, $2.9 million increase in purchased services, and $645 thousand decrease in other costs. In 2009, other supplies and purchased services increased by $13.4 million, or 12.7 percent, over 2008 due primarily to $1.4 million increase in minor equipment and $5.3 million increase in facility costs as a result of the opening and moving to the UC Irvine Douglas Medical Center.

Depreciation and amortization expense increased by $9.6 million over the prior year. The increase is primarily due to the full year of depreciation for the New University Replacement hospital. In 2009, depreciation and amortization increased by $13.1 million over 2008 due primarily to the capitalization and depreciation of the UC Irvine Douglas Medical Center and the related new equipment.

Insurance expense of $2.5 million in 2010 and in 2009 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $85 thousand, or 3.5 percent, in 2010 and increased by $0.6 million, or 30.0 percent, in 2009.

Income from Operations
Income from operations decreased in the current year to $36.1 million from 54.2 million in the prior year. The $18.1 million decrease was the result of increases in operating expenses over the prior year. Specifically, depreciation expense increased in 2010 from a full year of depreciation from the new Douglas Hospital and employee benefits increased over prior year in the areas of health insurance, retirement, and worker's compensation expense.

Non-operating Revenues (Expenses)
Non-operating expenses, which include interest earned on invested cash balances, interest expenses on debt and losses from disposal or retirement of capital assets, increased by $533 thousand over 2009 due to interest payments on additional bonds issued, offset by increase in the Short Term Investment Pool ("STIP") income and the $1.9 million of the Build America Bonds federal interest subsidies. Non-operating revenues decreased by $4.5 million in 2009 over 2008, due primarily to a decrease in interest income on STIP balances and the increased losses from disposal of capital assets after the completion of the replacement hospital.

Income before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $33.6 million in 2010 as compared to $52.3 million in 2009 and $47.1 million in 2008. The Medical Center's net income decreased by $18.7 million in 2010 compared to the prior year**.**

Other Changes in Net Assets
The lower section of the statements of revenues, expenses and changes in net assets shows the other changes to net assets in addition to the income or loss. Net assets are the difference between the total assets and total liabilities. The other changes in net assets represent additional funds the Medical Center receives and cash outflow for support and transfers to other University entities.

Included in the other changes in net assets are the following:

- Health system support represents transfers primarily to the School of Medicine for academic and clinical support including the Primary Care Network. The Medical Center transferred $65.8 million in 2010 and $53.4 million in 2009.

- Donated assets of $17.9 million and $7.6 million in 2010 and 2009 respectively.

- Transfers (to) from the University of ($63.7 million) and $84.8 million in 2010 and 2009, respectively. The change is primarily due to payments of $99.4 million made by the Medical Center during 2010 to the campus to repay advances. In 2009 the Medical Center received $65.1 million of advance from the campus.

- Prop 61 and other funds of $29.1 million in 2010.

In total, the net assets decreased by $48.8 million in 2010. The majority of the decrease is due to the increase in health system support and the net transfers to the University. Net assets increased by $91.3 million to $630.9 million for 2009.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Current assets:			
Cash	$ 102,648	$ 73,353	$ 95,954
Patient accounts receivable (net)	74,140	74,785	63,924
Other current assets	53,734	30,882	31,131
Total current assets	230,522	179,020	191,009
Capital assets (net)	698,815	630,629	513,933
Other assets	105,780	6,875	14,495
Total assets	1,035,117	816,524	719,437
Current liabilities	122,402	95,940	91,554
Long-term debt	330,555	89,636	88,222
Total liabilities	452,957	185,576	179,776
Net assets:			
Invested in capital assets (net)	352,012	534,468	409,689
Restricted:			
Expendable:			
Capital projects	103,353	6,046	13,643
Unrestricted	126,795	90,434	116,329
Total net assets	$ 582,160	$ 630,948	$ 539,661

Total current assets increased by $51.5 million, or 28.8 percent, compared to 2009 due to the increase in cash and cash equivalents. In 2009, total current assets decreased by $12.0 million, or 6.3 percent, compared to the prior year. Total assets at June 30, 2010 were $218.6 million higher than 2009. Total assets at June 30, 2008 were $97.1 million higher than 2008.

Cash increased by $29.3 million, or 39.9 percent, in 2010 due primarily to the receipt of additional state funding and the receipt of $29.8 million in Prop 61 funds from the state for children's hospitals. Cash decreased by $22.6 million, or 23.6 percent, in 2009.

In 2010, net patient accounts receivable, net of estimated uncollectibles, decreased slightly by 0.9 percent from the prior year. In 2009, net patient accounts receivable increased by 17 percent from 2008. The methodology deployed in calculating the allowance for doubtful accounts is based on historical collection experience and current economic factors.

Other current assets, which include non-patient receivables, inventory, prepaid expenses and advances, increased by $22.9 million, or 74.0 percent, in 2010. The increase was primarily due to increase in receivables from the Medi-Cal Waiver program. In 2009, other current assets decreased slightly by $249 thousand, or 0.8 percent, due to a combined increase of $3.2 million increase in advances and prepaid expenses, offset by a $3.4 million decrease in other receivables and inventory.

Capital assets increased by $68.2 million, or 10.8 percent, in 2010 from the prior year primarily due to the expenditures in the Phase II construction projects. In 2009, capital assets grew by $116.7 million, or 22.7 percent, from 2008 due to the increase in equipment and building costs of the new replacement hospital.

Other assets, including restricted funds for the replacement hospital and the bond issuance costs, increased by $98.9 million, or 1,439 percent, in 2010 over the prior year. The significant increase is the bond proceeds from the issuance of two Revenue Bonds Series E and F in December 2010. Other assets decreased by $7.6 million, or 52.6 percent, in 2009 over 2008 due to the use of restricted cash for the construction of the replacement hospital.

In 2010, current liabilities increased by $26.5 million from the prior year due to higher accounts payable, increased accrued salaries and benefits, and a net increase in third party payor settlements. In 2009, current liabilities increased by $4.4 million from the prior year mainly due to the increase in vacation accrual and third party payor settlement, offset by decrease in other liabilities.

Long-term debt includes the 2007 Series A Pooled Revenue bonds, the 2009 Series E and Series F Pooled Revenue Bonds, and long-term capital leases. In 2010, long-term debt increased by $240.9 million from the prior year, as a result of additional borrowings from issuance of new bonds. In 2009, long-term debt increased by $1.4 million from the prior year, due to increase in long-term capital leases.

Net assets decreased by $48.8 million in 2010. The change in net assets includes the excess of revenues over expenses of $33.6 million, transfers to the University of $16.6 million, and the health system support of $65.8 million transferred to the School of Medicine. Net assets increased by $91.3 million in 2009.

Liquidity and Capital Resources

The Medical Center generated $76.5 million and $84.2 million from operating activities in 2010 and 2009, respectively.

Cash flows from non-capital financing activities show the Medical Center's cash were reduced by $65.8 million and $53.4 million in 2010 and 2009 respectively, for transfers to the University as health system support.

In 2010 and 2009, cash flows from capital and related financing activities included state capital appropriations of $33.8 million outflow and $84.8 million inflow, proceeds from the 2009 debt issuance of $236 million, purchases of capital assets of $64.5 million and $133.7 million, principal payments on long-term debt and capital leases were $11.5 million and $10.7 million, and interest paid was $12.1 million and $4.2 million, respectively.

Cash flows from investment activities in 2010 and 2009 show that $1.8 million and $2.8 million was provided by interest income, respectively. Change in restricted assets was an increase of $97.3 million in 2010 and a decrease of $7.6 million in 2009.

Overall, cash on hand increased to $102.6 million in 2010 from $73.4 million in 2009. Cash on hand decreased to $73.4 million in 2009 from $96.0 million in 2008 due mainly to increased capital expenditures in the new hospital.

The following table shows key liquidity and capital ratios for 2010, 2009 and 2008:

	2010	2009	2008
Days cash on hand	69	54	76
Days of revenue in accounts receivable	50	54	53
Capital investment ($ in millions)	$112.1	$155.5	$154.5
Debt service coverage ratio	4.4	7.2	6.3

Days cash on hand increased to 69 days in 2010 from 54 days in 2009, and decreased to 54 days in 2009 from 76 days in 2008. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2010, net days in receivables decreased to 50 days as a result of improved cash collections. In 2009, net days in receivables increased by 1 day compared to 2008 due to the increase in commercial and contract billing activity.

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 2010 is 4.4 versus 7.2 in 2009. The decrease in debt service coverage ratio was due to a decrease of income from operations and an increase in long-term debt. In 2009, the Medical Center's ratio was 7.2 versus 6.3 in 2008 due to increased operating income. The debt service coverage ratio is higher than the 1.0 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2010, the UC Irvine Douglas Medical Center's capital program continued to address the requirements in the State of California Senate Bill 1953 ("SB 1953"). The project cost for the phase I construction of the Medical Center and the phase II improvement projects, which is now compliant with the requirements, is $635 million. The capital cost of compliance was financed through the use of state lease revenue bond funds, hospital reserves, gift funds, and debt. In 2010 and 2009, $58.0 million and $124.3 million, respectively were spent on these requirements.

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

Moreover, different Government Agents frequently interpret government regulations and other requirements differently. For example, Government Agents might disagree on a patient's principal medical diagnosis, the appropriate code for a clinical procedure, or many other matters. Such

disagreements might have a significant effect on the ultimate payout due from the government to fully recoup sums already paid. Governmental agencies may make changes in program interpretations, requirements, or "conditions of participation," some of which may have implications for amounts previously estimated. In addition to varying interpretation and evolving codification of the regulations, standards of supporting documentation and required data are subject to wide variation.

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

Medicaid Reform
In 2005, California enacted Senate Bill 1100 ("SB 1100") to implement a federal Medicaid hospital financing waiver ("waiver") that governs fee-for-service inpatient hospital payments for its public hospitals, which include the Medical Center. 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 federal economic stimulus package enacted in 2009, 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. The current waiver expired in August 2010 and plans for a renewal are under discussion between the Center for Medicare and Medicaid Services ("CMS") and the state, the outcome of which cannot be determined. 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.

Hospital Fee Program
AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The Medical Centers, as designated public hospitals, are exempt from paying the "Quality Assurance Fee"; however, the Medical Centers are eligible to receive supplemental payments under the Hospital Fee Program.

Children's Hospital Bond Act of 2008
In 2008, California voters passed Proposition 3 that enables the state of California to issue $980 million in General Obligation bonds to fund capital improvement projects for children's hospitals. The Medical Center 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.

Health Care Reform Bill
On March 23, 2010, the Patient Protection and Affordable Care Act ("PPACA") was signed into law. On March 30, 2010 the Health Care and Education Reconciliation Act of 2010 was signed, amending the PPACA (collectively the "Affordable Care Act"). The Affordable Care Act addresses a broad range of topics affecting the health care industry, including a significant expansion of healthcare coverage. The coverage expansion is accomplished primarily through incentives for individuals to obtain and employers to provide health care coverage and an expansion in Medicaid eligibility. The Affordable Care Act also includes incentives for medical research and the use of electronic health records, changes designed to curb fraud, waste and abuse, and creates new agencies and demonstration projects to promote the innovation and efficiency in the healthcare delivery system. Some provisions of the health care reform legislation are effective immediately; others will be phased in through 2014. Further legislative policies are required for several provisions that will be effective in future years. The impact of this legislation will likely affect the Medical Centers; the effect of the changes that will be required in future years are not determinable at this time.

University of California Retirement and Other Post Employment Benefit Plans
UCRP costs are funded by a combination of investment earnings, employee member and employer contributions. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $1.9 billion or 94.8 percent funded. For the July 1, 2010, the funded ratio is expected to decrease to approximately 85 percent. The funding policy contributions related to campuses and medical centers in the July 1, 2009 actuarial valuation for 2010 are $1.6 billion, which represents 20.4 percent of covered compensation. Employer contributions for 2010 were $65 million. For 2011 the Regents authorized increasing the employer and employee contribution rates to UCRP. Contributions by employees will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University would be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These proposed changes would be subject to collective bargaining for union-represented employees. The Regents are scheduled to consider modifications to benefit design for pension benefits at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Currently, the University does not pre-fund retiree health benefits and provides for benefits on a pay-as-you-go basis. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $14.5 billion. The Regents are scheduled to consider modifications to eligibility and the University's share of contributions for retiree health care at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Cautionary Note Regarding Forward-Looking Statements

Certain information provided by the Medical Center, including written, as outlined above, or oral statements made by its representatives, may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, which address activities, events or developments that the Medical Center expects or anticipates will or may occur in the future, contain forward-looking information.

In reviewing such information it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information. This forward-looking information is based upon various factors and was derived using various assumptions. The Medical Center does not undertake to update forward-looking information contained in this report or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.

University of California, Irvine Medical Center
Statements of Net Assets
June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Assets		
Current assets:		
Cash	$ 102,648	$ 73,353
Patient accounts receivable, net of estimated uncollectibles of $3,214 and $6,165, respectively	74,140	74,785
Other receivables	34,773	10,277
Inventory	12,865	13,061
Prepaid expenses and other assets	6,096	7,544
Total current assets	230,522	179,020
Restricted assets:		
Cash restricted for replacement hospital	103,353	6,046
Capital assets, net	698,815	630,629
Deferred costs of issuance	2,427	829
Total assets	1,035,117	816,524
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	27,613	18,677
Accrued salaries and benefits	41,635	37,553
Third-party payor settlements	38,547	28,726
Current portion of long-term debt and capital leases	13,053	10,594
Other liabilities	1,554	390
Total current liabilities	122,402	95,940
Long-term debt and capital leases, net of current portion	330,555	89,636
Total liabilities	452,957	185,576
Net Assets		
Invested in capital assets, net of related debt	352,012	534,468
Restricted:		
Expendable:		
Capital projects	103,353	6,046
Unrestricted	126,795	90,434
Total net assets	$ 582,160	$ 630,948

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

University of California, Irvine Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Net patient service revenue, net of provision for doubtful accounts of $3,344 and $4,621, respectively	$ 589,631	$ 559,059
Other operating revenue:		
Clinical teaching support	8,395	8,323
Other	15,616	16,955
Total other operating revenue	24,011	25,278
Total operating revenue	613,642	584,337
Operating expenses:		
Salaries and wages	256,865	232,235
UCRP, retiree health and other employee benefits	68,608	58,605
Professional services	2,195	1,975
Medical supplies	81,498	82,154
Other supplies and purchased services	122,275	118,738
Depreciation and amortization	43,565	33,941
Insurance	2,536	2,451
Total operating expenses	577,542	530,099
Income from operations	36,100	54,238
Non-operating revenues (expenses):		
Interest income	1,805	2,789
Interest expense	(5,971)	(1,274)
Build America bonds federal interest subsidies	1,924	–
Loss on disposal of capital assets	(228)	(3,452)
Total non-operating expenses	(2,470)	(1,937)
Income before other changes in net assets	33,630	52,301
Other changes in net assets:		
Health system support	(65,771)	(53,413)
Transfers from (to) University, net	(16,647)	92,399
Total other changes in net assets	(82,418)	38,986
Increase (decrease) in net assets	(48,788)	91,287
Net assets – beginning of year	630,948	539,661
Net assets – end of year	$ 582,160	$ 630,948

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

University of California, Irvine Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 600,097	$ 551,065
Payments to employees	(253,622)	(232,526)
Payments to suppliers	(200,432)	(203,724)
Payments for benefits	(67,769)	(56,860)
Other (disbursements) receipts, net	(1,747)	26,251
Net cash provided by operating activities	76,527	84,206
Cash flows from noncapital financing activities:		
Health system support	(65,771)	(53,413)
Net cash used for noncapital financing activities	(65,771)	(53,413)
Cash flows from capital and related financing activities:		
State capital appropriations	(33,842)	84,764
Proceeds from debt issuance	236,056	–
Bond issuance costs	(1,959)	–
Build America bonds federal interest subsidies	1,923	–
Purchases of capital assets	(64,489)	(133,726)
Principal paid on long-term debt and capital leases	(11,506)	(10,658)
Interest paid on long-term debt and capital leases	(12,142)	(4,160)
Net cash provided by (used in) capital and related financing activities	114,041	(63,780)
Cash flows from investing activities:		
Interest income received	1,805	2,789
Change in restricted assets	(97,307)	7,597
Net cash (used in) provided by investing activities	(95,502)	10,386
Net increase (decrease) in cash	29,295	(22,601)
Cash – beginning of year	73,353	95,954
Cash – end of year	$ 102,648	$ 73,353

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

University of California, Irvine Medical Center
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 36,100	$ 54,238
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	43,565	33,941
Provision for doubtful accounts	3,344	4,621
Changes in operating assets and liabilities:		
Patient accounts receivable	(2,699)	(15,482)
Other receivables	(24,496)	3,319
Inventory	196	86
Prepaid expenses and other assets	1,494	(3,156)
Accounts payable and accrued expenses	3,846	2,213
Accrued salaries and benefits	4,082	1,454
Third-party payor settlements	9,821	2,866
Other liabilities	1,274	106
Net cash provided by operating activities	$ 76,527	$ 84,206
Supplemental noncash activities information:		
Capitalized interest	$ 4,722	$ 2,898
Capital assets acquired through capital lease obligations	19,011	13,304
Amortization of bond premium	124	13
Amortization of deferred costs of issuance	47	17
Payables for property and equipment	(4,981)	3,472
Gifts of capital assets	17,922	7,635
Transfer of capital assets from (to) the University	(185)	(1,550)

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

1. Organization

The University of California, Irvine Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"), an independent board composed of 26 members. The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority being delegated to the Medical Center Director by the Chancellor of the Irvine campus. The Medical Center has 412 licensed beds for the year ended June 30, 2010.

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 Entities,* to the extent that these principles do not contradict GASB standards.

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, was adopted by the Medical Center during the fiscal year ended June 30, 2010. 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.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, was also adopted during the fiscal year ended June 30, 2010. GASB Statement No. 53 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 implementation of GASB Statement No. 51 and GASB Statement No. 53 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2010 and 2009.

2. Summary of Significant Accounting Policies (Continued)

Cash

All University operating entities maximize their returns on their cash balances by investing in a short-term investment pool ("STIP") managed by the Treasurer of The Regents. The Regents are responsible for managing the University's STIP and establishing investment policy, which is carried out by the Treasurer of The Regents.

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

The Medical Center's cash at June 30, 2010 and 2009 was $102,648 and $73,353, 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 2009-2010 annual report of the University.

Inventory

The Medical Center's inventory consists primarily of pharmaceuticals and medical supplies which are stated on a first-in, first-out basis at the lower of cost or market.

Prepaid Expenses and Other Assets

The Medical Center's prepaid expenses and other assets are primarily prepayments for pharmaceuticals and medical supplies, rent, equipment and maintenance contracts.

Restricted Assets, Replacement Hospital

Proceeds from the Medical Center Pooled Revenue Bonds are held by the Treasurer of The Regents. Bond proceeds remain on deposit with the Treasurer until the project is constructed. Restricted assets consist of short-term investments, recorded at cost, which approximates fair value.

Capital Assets

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

2. Summary of Significant Accounting Policies (Continued)

Capital Assets (Continued)
sources of funds is recorded as an asset of the University. Incremental costs including salaries and employee benefits, directly related to the acquisition, development and installation of major software projects are included in the cost of the capital assets.

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

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

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

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

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

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

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

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

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

2. Summary of Significant Accounting Policies (Continued)

Revenues and Expenses (Continued)
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 could change by a material amount in the near term.

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

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

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

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

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

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

Charity Care
The Medical Center provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rates. Amounts determined to qualify as charity care are not reported as net patient service revenue. The Medical Center also provides services to other indigent patients under publicly sponsored programs, which may

2. Summary of Significant Accounting Policies (Continued)

Charity Care (Continued)
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.

Tax Exemption
The Regents of the University of California is recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (IRC). Because the University is a State institution, related income received by the University is also exempt from federal tax under IRC Section 115(a). In addition, the University is exempt from State income taxes imposed under the California Revenue and Taxation Code.

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.

3. Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments at amounts different from the Medical Center's established rates. A summary of the payment arrangements with major third-party payors follows:

- ***Medicare*** – Medicare patient revenues include traditional reimbursement under Title XVIII of the Social Security Act (non-risk).

  Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. The Medical Center does not believe that there is significant credit risks associated with 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, 2002. The fiscal intermediary is in the process of conducting their audits of the 2003 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 years ended June 30, 2010 and 2009, the Medical Center recorded total Medi-Cal waiver revenue of $91,273 and $74,200, 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, 2010 and 2009, the Medical Center recorded revenue of $2,595 and $1,583, respectively.

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

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

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

  - Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

The most common payment arrangement for inpatient services is a prospectively determined per-diem rate or case rate. The most common payment arrangement for outpatient care is a prospective payment system that uses ambulatory payment classifications.

Amounts due from Medicare and Medi-Cal represent 17.5 percent and 20.9 percent of net patient accounts receivable for fiscal year at June 30, 2010. In 2009, the amount due from Medicare and Medi-Cal were 13.6 percent and 19.4 percent respectively.

For the years ended June 30, 2010 and 2009, net patient service revenue included unfavorable cost report settlements of $1,872 and favorable settlements of $4,632, respectively, primarily from Medicare and Medi-Cal Programs.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

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

	2010	2009
Medicare (non-risk)	$ 152,524	$ 142,815
Medi-Cal (non-risk)	141,540	126,888
Commercial	5,052	38,872
Contracts (discount/per diem)	263,234	225,736
County	22,346	15,873
Non-sponsored (uninsured)	4,935	8,875
Total	$ 589,631	$ 559,059

4. Charity Care

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

	2010	2009
Charity care at established rates	$ 71,703	$ 81,022
Estimated cost of charity care	$ 17,721	$ 17,956

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $14,209 and $15,681 for the years ended June 30, 2010 and 2009, respectively.

(Dollars in thousands)

5. Capital Assets

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

	2008	Additions	Disposals	2009	Additions	Disposals	2010
Original Cost							
Land	$ 7,394	$ –	$ –	$ 7,394	$ –	$ –	$ 7,394
Buildings and improvements	209,668	389,054	(1,852)	596,870	146,535	(245)	743,160
Equipment	143,086	39,736	(15,811)	167,011	37,632	(2,591)	202,052
Construction in progress	374,948	(273,290)	–	101,658	(72,016)	–	29,642
Capital assets, at cost	$ 735,096	$ 155,500	$ (17,663)	$ 872,933	$ 112,151	$ (2,836)	$ 982,248

	2008	Depreciation	Disposals	2009	Depreciation	Disposals	2010
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 140,243	$ 18,485	$ –	$ 158,728	$ 22,887	$ –	$ 181,615
Equipment	80,920	15,456	(12,800)	83,576	20,700	(2,458)	101,818
Accumulated depreciation and amortization	$ 221,163	$ 33,941	$ (12,800)	$ 242,304	$ 43,587	$ (2,458)	$ 283,433
Capital assets, net	$ 513,933			$ 630,629			$ 698,815

Equipment under capital lease obligations and related accumulated amortization was $73,695 and $32,206 in 2010, respectively, and $62,123 and $28,477 in 2009, respectively.

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

The Medical Center is currently making seismic improvements in order to be in compliance with Senate Bill 1953, the *Hospital Seismic Safety Act*. A portion of the improvements are financed under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $5,887 and $19,929 for the years ended June 30, 2010 and 2009, respectively, are included in Transfers from University for building program on the statements of revenues, expenses, and changes in net assets.

(Dollars in thousands)

6. Long-term Debt and Capital Leases

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

	2010	2009
University of California Medical Center Pooled Revenue Bonds 2009 Series E, net interest rates from 3.0 to 5.5 percent, payable semi-annually, with annual principal payments through 2038	$ 77,035	$ –
University of California Medical Center Pooled Revenue Bonds 2009 Series F "Build America Bonds", net interest rates after the 35 percent federal subsidy ranging from 4.2 percent to 4.28 percent, payable semi-annually, with annual principal payments beginning in 2021 through 2049	155,855	–
University of California Medical Center Pooled Revenue Bonds Series 2007 A, interest rates ranging from 4.5 percent to 5.0 percent, payable semi-annually, with annual principal payments beginning in 2012 through 2047	62,920	62,920
University of California General Revenue Bonds, interest rates from 4.0 to 5.125 percent, payable semi-annually, with annual principal payments through 2017	2,846	3,183
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 2.4 percent to 4.1 percent payable through 2015	41,490	33,647
Unamortized bond premium	3,462	480
Total debt and capital leases	343,608	100,230
Less: Current portion of debt and capital leases	(13,053)	(10,594)
Noncurrent portion of debt and capital leases	$ 330,555	$ 89,636

(Dollars in thousands)

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

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, 2010 and 2009 was $10,692 and $4,169, respectively. Interest expense totaling $4,722 and $2,898 was capitalized in each of the years ended June 30, 2010 and 2009. The remaining $5,971 in 2010 and $1,274 in 2009 are reported as interest expense in the statements of revenues, expenses, and changes in net assets. Investment income totaling $1,844 and $364 was capitalized during the years ended June 30, 2010 and 2009, respectively.

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

	Revenue Bonds	Capital Lease Obligations	Total
Year Ended June 30, 2010			
Current portion at June 30, 2009	$ 336	$ 10,258	$ 10,594
Reclassification from noncurrent	477	13,612	14,089
Principal payments	(338)	(11,168)	(11,506)
Amortization of bond premium	(124)	–	(124)
Current portion at June 30, 2010	$ 351	$ 12,702	$ 13,053
Noncurrent portion at June 30, 2009	$ 66,248	$ 23,388	$ 89,636
New obligations	232,890	19,011	251,901
Bond premium	3,107	–	3,107
Reclassification to current	(477)	(13,612)	(14,089)
Noncurrent portion at June 30, 2010	$ 301,768	$ 28,787	$ 330,555
Year Ended June 30, 2009			
Current portion at June 30, 2008	$ 321	$ 9,054	$ 9,375
Reclassification from noncurrent	351	11,539	11,890
Principal payments	(323)	(10,335)	(10,658)
Amortization of bond premium	(13)	–	(13)
Current portion at June 30, 2009	$ 336	$ 10,258	$ 10,594
Noncurrent portion at June 30, 2008	$ 66,599	$ 21,623	$ 88,222
New obligations	–	13,304	13,304
Reclassification to current	(351)	(11,539)	(11,890)
Noncurrent portion at June 30, 2009	$ 66,248	$ 23,388	$ 89,636

6. 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 sets forth requirements for certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2010 are $1.55 billion of which $295,810 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, 2010 and 2009 were $5.94 billion and $5.56 billion, respectively.

In December 2009, Medical Center Pooled Revenue Bonds Series E totaling $77,035 were issued specifically for the Medical Center to finance certain improvements to the Medical Center. Proceeds, including a bond premium of $3,166 were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through November 2011 and mature at various dates through 2038 and have a stated weighted average interest rate of 4.91 percent. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

In December 2009, Medical Center Pooled Revenue Bonds Series F totaling $155,855 were issued as taxable "Build America Bonds" specifically for the Medical Center to finance certain improvements to the Medical Center. Proceeds were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through November 2020 and mature at various dates through 2049. The taxable bonds have a stated weighted average interest rate of 6.57 percent and a net weighted average interest rate of 4.27 percent after the expected cash subsidy payment from the United States Treasury equal to 35 percent of the interest payable on the taxable bonds. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

In January 2007, Medical Center Pooled Revenue Bonds Series A totaling $62,920 were issued specifically for the Medical Center to finance certain improvements to the Medical Center. Proceeds, including a bond premium of $521 were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through November 2011 and mature at various dates through 2047 and have a stated weighted average interest rate of 4.55 percent. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

General Revenue Bonds, collateralized solely by general revenues of the University, finance certain Medical Center projects. The Medical Center is charged for its proportional share of total principal and interest payments made on the General Revenue Bonds pertaining to Medical Center projects.

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

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

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

(Dollars in thousands)

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

Future Debt Service

Future debt service payments for each of the five fiscal years subsequent to June 30, 2010 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Capital Lease Obligations	Total Payments	Principal	Interest
2011	$ 17,201	$ 13,826	$ 31,027	$ 13,052	$ 17,975
2012	23,605	12,459	36,064	18,513	17,551
2013	23,602	9,144	32,746	15,788	16,957
2014	23,609	5,480	29,089	12,672	16,418
2015	23,605	3,009	26,614	10,627	15,987
2016 – 2020	91,911	–	91,911	15,564	76,347
2021 – 2025	97,032	–	97,032	24,835	72,197
2026 – 2030	96,472	–	96,472	31,410	65,062
2031 – 2035	94,956	–	94,956	39,455	55,501
2036 – 2040	91,581	–	91,581	48,710	42,871
2041 – 2045	86,438	–	86,438	59,530	26,908
2046 – 2048	57,713	–	57,713	49,990	7,723
Total future debt service	$ 727,725	$ 43,918	$ 771,643	$ 340,146	$ 431,497
Less: Interest component of future payments	(429,069)	(2,428)	(431,497)		
Principal portion of future payments	298,656	41,490	340,146		
Adjusted by:					
Unamortized bond premium	3,462	–	3,462		
Total debt	$ 302,118	$ 41,490	$ 343,608		

Additional information on the revenue bonds can be obtained from the 2009-2010 annual report of the University.

7. Operating Leases

The Medical Center leases certain buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2010 and 2009 was $3,364 and $4,930, respectively. The terms of the operating leases extend through the year of 2019.

(Dollars in thousands)

7. Operating Leases (Continued)

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
2011	$ 1,968
2012	1,294
2013	764
2014	609
2015	609
2016 – 2019	1,827
Total	$ 7,071

8. Retiree Health Plans

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

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

Participating University locations, such as the Medical Center, are required to contribute at a rate assessed each year by the UCRHBT. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.12 and $3.09 per $100 of UCRP-covered payroll resulting in Medical Center contributions of $7.2 million and $6.5 million for the years ended June 30, 2010 and 2009, respectively.

8. Retiree Health Plans (Continued)

The actuarial value of UCRHBT assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2009, the date of the latest actuarial valuation, were $76.9 million and $14.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $69.4 million at June 30, 2010. For the years ended June 30, 2010 and 2009, combined contributions from the University's campuses and medical centers were $283.5 million and $278.5 million, respectively, including an implicit subsidy of $49.5 million and $44.1million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.6 billion and $1.5 billion for the years ended June 30, 2010 and 2009. 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 $3.7 billion at June 30, 2010 increased by $1.4 billion and $1.2 billion for the years ended June 30, 2010 and 2009, 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 2009–2010 annual reports of the University of California and the University of California Health and Welfare Program.

9. Retirement Plans

Substantially all full-time employees of the Medical Center participate in the University of California Retirement System ("UCRS") that is administered by the University. The UCRS consists of The University of California Retirement Plan ("UCRP"), a single employer defined benefit plan, and the University of California Retirement Savings Program ("UCRSP") that includes four defined contribution plans with several investment portfolios generally funded with employee non-elective and elective contributions. The Regents have the authority to establish and amend the benefit plans.

The UCRP provides lifetime retirement income, disability protection, and survivor benefits to eligible employees. Benefits are based on average highest three years compensation, age, and years of service and are subject to limited cost-of-living increases.

Contributions to the UCRP may be made by the Medical Center and the employees. The rates for contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by the Medical Center and by the employees. Employee contributions by represented employees are subject to collective bargaining agreements. Medical Center contributions were $2.0 million during the year ended June 30, 2010. There were no required Medical Center or employee contributions for the year ended June 30, 2009.

9. Retirement Plans (Continued)

The actuarial value of UCRP assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2009, the date of the latest actuarial valuation, were $34.8 billion and $36.8 billion, respectively, resulting in a funded ratio of 94.8 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $34.6 billion and $32.3 billion at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, the University's campuses and medical centers contributed a combined $64.8 million and $0.4 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.6 billion for the year ended June 30, 2010. 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 $1.5 billion for the year ended June 30, 2010.

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 2009–2010 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

10. University Self-insurance

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

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $5,107 and $5,041 for the years ended June 30, 2010 and 2009, respectively. During 2010 and 2009, as a result of actuarial analysis, the Medical Center received a refund of premiums of $1,613 and $2,572, respectively, from the University that reduced the overall workers' compensation cost for the year.

(Dollars in thousands)

10. University Self-insurance (Continued)

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $2,536 and $2,451 for the years ended June 30, 2010 and 2009, respectively.

11. Transactions with Other University Entities

Services purchased from the University include office and medical supplies, building maintenance, repairs and maintenance, administrative, treasury, medical services, and insurance. Services provided to the University include 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:

	2010	2009
Professional services	$ 2,195	$ 1,975
Other supplies and purchased services	25,122	24,457
Interest income (net)	(1,648)	(2,616)
Insurance	2,536	2,451
Administrative costs	(4,406)	(4,406)
Total	$ 23,799	$ 21,861

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

The total net amounts of payments made by the Medical Center to the University were $89,569 and $75,274 in 2010 and 2009, respectively. Of these amounts, $23,798 and $21,861 are reported as operating expenses for the years ended June 30, 2010 and 2009, respectively, and $65,771 and $53,413 are reported as health system support for the years ended June 30, 2010 and 2009, respectively.

12. Commitments and Contingencies

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

The Medical Center 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 Medical Center's 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 $235,000 was allocated to the Medical Center. The Medical Center spent $5,887 and $19,929 of its allocation during the years ended June 30, 2010 and 2009, respectively, recorded in the statements of revenues, expenses and changes in net assets as a component of Transfers from the University. As of June 30, 2010, any repayments the Medical Center may be obligated to make under these financing arrangements are dependent upon continued appropriations for the lease payments to the University by the state.

The construction of the Medical Center has two phases. The phase I construction was completed and is now in use. Phase II is now under construction. The total cost of the phase II construction and new equipment is currently estimated to be $242,200. The phase II projects will be funded from external financing.

At June 30, 2010, the Medical Center had outstanding commitments for capital expenditures in connection with the phase II projects of approximately $44,812. The Medical Center expects to fund these costs principally through external financing sources.

Gift funds used for construction total $18,609 and $1,700 for the years ended June 30, 2010 and 2009, respectively, and are reflected in the statements of revenues, expenses and changes in net assets. Additional gift funds and pledges received but not used as of June 30, 2010 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.

13. Subsequent Event

AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a “Quality Assurance Fee” and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State’s effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The CDHS is responsible for obtaining approval from CMS on a distribution plan for funds. It is not anticipated that fees and payments would commence without federal approval, but if final federal approval is not obtained, any fees and payments made under the program would be refunded. The Medical Centers, as designated public hospitals, are exempt from paying the “Quality Assurance Fee”; however, the Medical Centers are eligible to receive supplemental payments under the Hospital Fee Program.

University of California,
Los Angeles Medical Center

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For the Years Ended June 30, 2010 and 2009

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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 17 through 46 present fairly, in all material respects, the financial position of the University of California, Los Angeles Medical Center (the "Medical Center"), a division of the University of California (the "University"), at June 30, 2010 and 2009, 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, 2010 and 2009, 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.

As discussed in the significant accounting policies in the Notes to Financial Statements, the Medical Center adopted Governmental Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, as of July 1, 2009.

The Management's Discussion and Analysis on pages 2 through 16 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 11, 2010

University of California, Los Angeles Medical Center
Management's Discussion and Analysis

Introduction

The objective of Management's Discussion and Analysis is to help readers better understand the University of California, Los Angeles Medical Center's financial position and operating activities for the year ended June 30, 2010, with selected comparative information for the years ended June 30, 2009 and 2008. 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 (2008, 2009, 2010, 2011, etc.) in this discussion refer to the fiscal years ended June 30.

Overview

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

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

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

The Medical Center offers patients of all ages comprehensive care, from routine to highly specialized medical and surgical treatment. In addition, the Westwood Campus is known for the wide range of its tertiary/quaternary care offerings that include Level 1 trauma care, regional neonatal and pediatric intensive care units, Neurosurgery/Neurology and organ transplantation.

The Santa Monica – UCLA Medical Center and Orthopaedic Hospital also serves the University's teaching and research missions while meeting the healthcare needs of Los Angeles's west side community. The Santa Monica facility features several nationally recognized clinical programs located within its seven-acre campus. Most of this medical center also is being replaced with the work progressing in phases. It is expected to be completed in calendar year 2010 and occupied in summer/fall of 2011.

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

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

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

For the year ended June 30, 2010, the Medical Center reported income before other changes in net assets of $212.1 million, generating a margin of 13.4 percent. The year ended with a cash position of $406.0 million. For 2009, income before other changes in net assets was $115.8 million, generating a margin of 7.9 percent.

Significant events during the year are highlighted below:

- *The Medical Center continues to maintain its outstanding national reputation*
  The latest *U.S.News and World Report* Best Hospitals survey ranks Ronald Reagan UCLA Medical Center as one of the top five American hospitals, and the best hospital in the western United States for the 21st consecutive year. According to this latest survey, UCLA ranked in the top 20 in 15 of the 16 specialty areas. In each of the following specialties, UCLA's national rankings are indicated: cancer at UCLA's Jonsson Comprehensive Cancer Center (10); diabetes and endocrine disorders (5); ear, nose and throat (11); gastroenterology (8); geriatrics (2); gynecology (13); heart and heart surgery (8); kidney disorders (7); neurology and neurosurgery (7); ophthalmology at UCLA's Jules Stein Eye Institute (5); orthopaedics (19); psychiatry at the Resnick Neuropsychiatric Hospital at UCLA (6); pulmonology (18); rheumatology (6); and urology (4).

- *The Medical Center continued to excel in areas of quality, safety, and service*
  Ronald Reagan UCLA Medical Center received re-accreditation as a Level 1 trauma center by the American College of Surgeons. Quality improvement efforts have led to reductions in central line blood stream infection rates. Clinical care quality improvements continued, supporting adherence to evidence-based best practices for the management of patients with stroke, heart attack, and heart failure. To improve patient safety and reduce the chance for medication errors, projects were launched to roll out new "smart" infusion pumps, and a new medication bar-coding system. The Medical Center shined in its efforts to deliver compassionate, patient-centered care. Patient satisfaction scores at the Ronald Reagan UCLA Medical center reached the 97th percentile in Medicare's Hospital Consumer Assessment of Healthcare Providers and Systems ("HCAHPS") patient satisfaction survey, compared with all hospitals in the nation. The Ronald Reagan UCLA Medical Center reached a #1 ranking compared with all U.S. academic medical centers. Satisfaction scores continued to rise in Santa Monica and in the Neuropsychiatric hospital as well. Operations improvement efforts resulted in smoother workflows across multiple hospital system departments. Operating Room first case on-time starts improved, allowing for greater efficiency and service levels. Emergency Department patient turnaround times were reduced, supporting new heights in patient satisfaction scores in Westwood and Santa Monica. Support service areas continue to achieve benchmark performance in service levels and throughput, evidence by responsive turnaround times for patient escort, and dietary room service. These efforts and others further supported delivery of outstanding quality and patient satisfaction.

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

- *Changes in Payor Mix and Volume*
  The Medical Center did not experience any adverse payor mix change despite the negative state and national economic downturn. Medicare patient days increased by 1.7 percent over prior year and Contract patient days increased by 0.1 percent over prior year. Medicare and Contract are the highest-margin payors. Medi-Cal patient days increased by 1.2 percent. Medi-Cal is one of the lowest-margin payors but only represents 18.6 percent of the Medical Center's total patient days. Uninsured and Capitation days declined from prior year by 7.2 percent and 0.3 percent respectively. Uninsured and Capitation are also low-margin payors.

- *The Medical Center Renegotiated Major Third-Party Contracts*
  The Medical Center renegotiated two of its largest contracts resulting in double digit increases and bringing significant new revenue to the system. Also renegotiated, with very strong results, were three of the health systems top seven payor Transplant Center of Excellence contracts. In addition, a new nationwide Transplant Center of Excellence contract was established. This contract provides transplant coverage to purchasers of specialized healthcare coverage (e.g. self insured employers). Four hospital system contracts were terminated because of low volume and poor financial results.

- *Revenue Cycle Initiatives and Cash Collections*
  During 2010, the Medical Center continued to work on ways to improve its revenue and cash position through various revenue cycle initiatives. The revenue cycle consulting services that began in 2009 continued on into 2010 with great success. This engagement significantly improved revenue and cash collections. Cash collected on patient accounts increased by $186.2 million, or 15.0 percent, over 2009.

- *The Medical Center issued New Debt*
  In December 2009, Medical Center Pooled Revenue Bonds totaling $146.0 million were issued as taxable "Build America Bonds" specifically for the Medical Center to finance certain improvements. Proceeds were used to pay for project construction.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2010, 2009 and 2008:

Statistics	2010	2009	2008
Licensed beds	845	845	1,120
Admissions	40,220	40,342	40,574
Average daily census	718	715	711
Discharges	40,211	40,258	40,741
Average length of stay	6.5	6.5	6.4
Case mix index	1.90	1.92	1.81
Patient days:			
Medicare (non-risk)	73,282	72,038	71,268
Medi-Cal (non-risk/County)	48,884	48,295	45,766
Commercial	1,731	2,191	2,048
Contracts (discounted/per diem)	122,107	122,017	123,836
Contracts (capitated)*	7,271	7,835	8,003
Non-sponsored/self-pay (Uninsured)	8,620	8,645	9,234
Total Patient Days	261,895	261,021	260,155
Outpatient visits:			
Hospital clinics	788,287	773,078	767,039
Home health/hospice	–	44,850	55,424
Emergency visits	81,383	76,739	66,626
Total visits	869,670	894,667	889,089

* includes Medicare (risk)

Total admissions decreased by 0.3 percent in 2010 compared to 2009, due to a decrease in surgery and orthopedic cases. Total admissions decreased by 0.6 percent in 2009 compared to 2008, due to a decrease in surgery, pediatrics, neurosurgery and orthopedic cases.

Total patient days in 2010 increased by 874, or 0.3 percent, over 2009 due to an increase in Medicare days. Total patient days in 2009 increased by 866, or 0.3 percent, over 2008 due to an increase in Medi-Cal and Commercial days. However, Capitated and Uninsured patient days decreased by 7.2 percent and 0.3 percent respectively.

Total outpatient visits decreased in 2010 by 24,997, or 2.8 percent compared to 2009. This decrease was primarily due to Home health and hospice. The Medical Center closed its Home Health business at the beginning of the year. Total outpatient visits increased in 2009 by 5,578, or 0.6 percent compared to 2008. This increase was primarily in Hospital Clinics and Emergency visits.

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 2010 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Net patient service revenue	$ 1,527,157	$ 1,401,847	$ 1,162,561
Other operating revenue	60,326	64,068	64,557
Total operating revenue	1,587,483	1,465,915	1,227,118
Total operating expenses	1,363,893	1,331,930	1,169,260
Income from operations	223,590	133,985	57,858
Total non-operating expenses	(11,508)	(18,213)	(24,564)
Income before other changes in net assets	$ 212,082	$ 115,772	$ 33,294
Margin	13.4 percent	7.9 percent	2.7 percent
Other changes in net assets	(78,833)	43,160	64,606
Increase in net assets	133,249	158,932	97,900
Net assets – beginning of year	1,349,543	1,190,611	1,092,711
Net assets – end of year	$ 1,482,792	$ 1,349,543	$ 1,190,611

Revenues
Total operating revenues for the year ended June 30, 2010 were $1,587.5 million, an increase of $121.6 million, or 8.3 percent, over 2009. Operating revenues for 2009 of $1,465.9 million increased by $238.8 million, or 19.5 percent, over 2008.

Net patient service revenue for 2010 increased by $125.3 million, or 8.9 percent, over 2009. The increase in 2010 was due to contract rate increases, improvement in the revenue cycle, higher number of Medicare cases, additional funding under the State's Medi-Cal program and outpatient volume. Patient service revenues are net of bad debts and estimated allowances from contractual arrangements with Medicare, Medi-Cal and other third-party payors and have been estimated based on the terms of reimbursement and contracts currently in effect.

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

Other operating revenue consisted primarily of State Clinical Teaching Support Funds ("CTS") and other non-patient services such as contributions, cafeteria and campus revenues. The decrease in 2010 in other operating revenue was mainly in Clinical Teaching Support Funds due to the State's budget reductions. The decrease in 2009 in other operating revenue was mainly due to investment losses in the Foundation assets.

The following table summarizes net patient service revenue for 2010, 2009 and 2008 (dollars in thousands):

Payor	2010	2009	2008
Medicare (non-risk)	$ 358,954	$ 327,054	$ 297,443
Medi-Cal (non-risk/County)	151,669	139,954	114,606
Commercial	11,247	13,130	14,283
Contracts (discounted/per diem)	955,050	865,966	686,839
Contracts (capitated)*	33,283	35,146	33,234
Non-sponsored/self-pay (Uninsured)	16,954	20,597	16,156
Total	$ 1,527,157	$ 1,401,847	$ 1,162,561

* includes Medicare (risk)

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Medicare reimburses the Medical Center for allowable costs at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Settlements with the Medicare program for prior years' cost reports are recognized in the year the settlement is resolved. Net patient revenue for Medicare increased by $31.9 million over the prior fiscal year. This increase is primarily due to increase in utilization and adjustment to reserves for favorable cost report settlements. In 2009, net patient revenue for Medicare increased by $29.6 million over 2008. This increase is primarily due to volume, rate increase and favorable settlements.

Payments for Medi-Cal patients are made on a per-diem basis for inpatient services while outpatient services are paid on a fixed-fee schedule. In 2006, California implemented a new Medi-Cal Fee-For-Service ("FFS") inpatient hospital payment system. In FY 2010, the Medical Center recorded additional Medi-Cal net funding of $10.3 million. In FY 2009, the Medical Center recorded additional Medi-Cal funding of $22.4 million of which $10.6 million is related to the prior year. The Medi-Cal revenue includes funding for covered outpatient services pursuant to California Assembly Bill 915. Also included are Medi-Cal patients referred by county facilities and reimbursed to the Medical Center at Medi-Cal rates.

In 2010, contract net patient revenue (discounted/per-diem) increased by $89.1 million, or 10.3 percent, due to rate increases and revenue cycle improvements. In 2009, contract net patient revenue (discounted/per-diem) increased by $179.2 million, or 26 percent, due to rate increases, revenue cycle improvements and outpatient volume increases.

The net patient service revenue for contracts that are full-risk capitation decreased by $1.9 million, or 5.3 percent in 2010 and by $1.9 million, or 5.8 percent, in 2009.

In 2010, commercial net patient revenue decreased by $1.9 million, or 14.3 percent, due to a decrease in volume. In 2009, commercial net patient revenue decreased by $1.2 million, or 8.1 percent, due to a decrease in volume.

The non-sponsored/self-pay net revenue decreased from the prior year by $3.6 million. This category fluctuates from year to year depending on the volume and type of patients.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Salaries and wages	$ 606,069	$ 597,706	$ 550,608
Employee benefits	152,195	137,402	122,716
Professional services	51,717	43,847	24,618
Medical supplies	203,004	204,800	184,419
Other supplies and purchased services	255,917	256,741	227,152
Depreciation and amortization	85,873	81,921	51,680
Insurance	9,118	9,513	8,067
Total operating expenses	$ 1,363,893	$ 1,331,930	$ 1,169,260

Total operating expenses for 2010 were $1,363.9 million, an increase of $31.9 million, or 2.4 percent, over 2009. This change was primarily due to an increase in salaries and employee benefits. Total operating expenses for 2009 increased by $162.7 million, or 13.9 percent, over 2008 due to increased salary and employee benefits, professional services, increases in medical supplies and purchased services and increase in depreciation costs for the replacement hospital.

In 2010, salaries and wages grew by $8.4 million, or 1.4 percent, over the prior year due to an increase in union and non-represented salary rate increases by $26 million that was offset by a reduction in full time equivalents by $17.6 million. Temporary labor costs decreased by $14.4 million, or 66.2 percent, over 2009. In 2009, salaries and wages grew by $47.1 million, or 8.6 percent, over the prior year due to increased volume and union negotiated salary rate increases. Temporary labor costs increased by $415.0 thousand, or 1.9 percent, over 2008.

In 2010, increases in total benefit costs were $14.8 million, with health insurance benefits higher by $8.9 million, workers' compensation insurance premiums up $855 thousand, and all other benefit costs higher by $5.0 million over 2009. Increases in total benefit costs in 2009 were $14.7 million, with health insurance benefits higher by $7.7 million, workers' compensation insurance premiums down $1.6 million and all other benefit costs higher by $8.5 million over 2008.

Payments for professional services increased by $7.9 million, or 17.9 percent, in 2010 from 2009. The increases were due to an increase in legal fees by $15.2 million for the replacement hospital that was offset by a decrease of $7.3 million in consulting fee due to the completion of the revenue cycle engagement. In 2009, payments for professional services increased by $19.2 million, or 78.1 percent due to the fees paid for the new revenue cycle consulting engagement.

Medical supply expense decreased by $1.8 million or 0.9 percent due to various cost reduction initiatives achieved during the fiscal year and a decrease in pharmaceuticals due to a change in pricing structure. Medical supply expense increased in 2009 by $20.4 million, or 11.1 percent over 2008, due to an increase in prosthesis expenses for ventricle assist devices, increase in pharmaceutical expenses due to inflation of 7.0 percent and increases in supply cost in the operating room and Cath Labs due to volume and inflation.

Other supplies and purchased services decreased by $824 thousand, or 0.3 percent, over the prior year. The decrease was primarily in the utility expense due to reduced consumption and the decommissioning of spaces in the old hospital. Other supplies and purchased services increased $29.6 million, or 13.0 percent, in 2009 over 2008 due to higher food expense in the new hospital, increased outside provider costs, increased utility expense in the new hospital and an increase in building and equipment rentals.

Depreciation and amortization expense increased by $4.0 million, or 4.8 percent, over 2009 due an increase in equipment depreciation. In 2009, depreciation and amortization expense increased by $30.2 million, or 36.9 percent, over 2008 due to depreciation costs on the replacement hospital.

Insurance expense of $9.1 million in 2010 and $9.5 million in 2009 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. In 2010, this expense decreased by $395 thousand, or 4.2 percent, over 2009. In 2009, insurance expense increased by $1.4 million, or 17.9 percent, over 2008.

Non-operating Revenues (Expenses)
Total non-operating revenues (expenses) were $(11.5) million for 2010 compared to $(18.2) million in the prior year. The majority of this decrease was primarily due to an increase in short-term investment pool interest income (STIP).

In 2009, total non-operating revenue (expenses) were $(18.2) million compared to $(24.6) million in 2008. The majority of this decrease was primarily due to transition costs related to the replacement hospital.

Income before Other Changes in Net Assets
The Medical Center's income before other changes in net assets was $212.1 million for 2010 compared to $115.8 million for 2009 and $33.3 million in 2008. The Medical Center's net income increased in 2010 and 2009 mainly due to increases in net patient service revenues.

Other Changes in Net Assets
The lower section of the statements of revenues, expenses and changes in net assets shows the other changes to net assets in addition to the income or loss. Net assets are the difference between the total assets and total liabilities. The other changes in net assets represent additional funds the Medical Center receives and cash outflow for support and transfers to other university entities.

Included in the other changes in net assets for 2010 are the following:

- Proceeds received and receivable from the Federal Emergency Management Agency ("FEMA") for the hospitals' replacement projects were $626 thousand in 2010 and $110 thousand in 2009. The total anticipated funding from FEMA for the replacement hospitals' project is $556 million. The total received to date from FEMA is $523 million.

  In 2010, contributions from the University for the building program of $21.5 million are related to the hospitals' replacement projects and represent funding from the line of credit. In 2009, contributions from the University for the building program of $40.8 million are related to the hospitals' replacement projects and represent funding from the State Public Works Board Bonds totaling $0.2 million, state matching funds of $0.8 million and funding from the line of credit of $39.8 million.

- Donated assets represent gift funds that have been used for the hospitals' replacement. The gift funds are only recorded on the Medical Center's financial statements when an expenditure for the project has been incurred. In prior years, gift funds were used for the replacement hospital and increased the equity of the Medical Center. The Medical Center recorded $14.3 million and $40.2 million of gift funds in 2010 and 2009, respectively.

- Health system support represents transfers to the School of Medicine for academic and clinical support including the Primary Care Network. The Medical Center transferred $56.2 million in 2010 and $37.9 million in 2009.

- Transfer to University for building program of $(59.0) million in 2010 represents the Medical Center replenishing borrowed funds to the gift accounts and the Chancellor's contingency funds from the bond proceeds.

In total, the net assets increased in 2010 by $133.2 million to $1,482.8 million. The majority of this increase was due an increase in cash balance. In 2009, net assets increased by $158.9 million to $1,349.5 million. The majority of this increase was due to an increase in the overall cash balance and an increase in capital assets for the Santa Monica replacement hospital.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Current assets:			
Cash	$ 406,034	$ 219,604	$ 124,596
Patient accounts receivable (net)	246,961	247,723	217,973
Other current assets	81,652	64,147	51,341
Total current assets	734,647	531,474	393,910
Capital assets (net)	1,692,645	1,625,852	1,567,561
Other assets	144,446	68,940	60,022
Total assets	2,571,738	2,226,266	2,021,493
Current liabilities	249,216	193,061	191,397
Long-term debt	787,066	643,731	639,485
Other liabilites	52,664	39,931	–
Total liabilities	1,088,946	876,723	830,882
Net assets:			
Invested in capital assets (net)	916,942	1,046,892	988,051
Restricted	81,247	19,427	51,822
Unrestricted	484,603	283,224	150,738
Total net assets	$ 1,482,792	$ 1,349,543	$ 1,190,611

Total current assets increased in 2010 by $203.2 million, or 38.2 percent, compared to 2009 due an increase in cash and other current assets. In 2009, total current assets increased by $137.6 million, or 34.9 percent, compared to 2008 due to an increase in cash and net patient accounts receivable.

Cash increased by $186.4 million in 2010. This increase was mainly due to an increase in operating income as well as improved cash collections due to the efforts from the revenue cycle engagement. Cash increased by $95.0 million in 2009 due mainly to an increase in operating income and cash collections.

Net patient accounts receivable decreased by $762 thousand from 2009 due to cash collection efforts. Net patient accounts receivable increased by $29.8 million in 2009 due to contract rate increases and inpatient price increases. Cash collections increased by $186.2 million or 15.0 percent in 2010 and by $193.5 million or 18.5 percent in 2009.

In 2010, other current assets, including non-patient receivables, inventory and prepaid expenses, increased by $17.5 million over the prior fiscal year. The increase was primarily related to a receivable from the State for Medi-Cal Waiver funding and outpatient funding under AB915. In 2009, other current assets increased by $12.8 million over 2008 due primarily to a receivable from the state for Medi-Cal waiver revenue.

Capital assets increased by $66.8 million over 2009 due to the construction of the Santa Monica replacement hospital. Capital assets increased in 2009 by $58.3 million over 2008 with the majority of this increase related to the Santa Monica replacement hospital.

Other assets, including the long-term portion of cash held by trustees, the Santa Monica Hospital Foundation assets, the restricted funds for the hospitals' replacement building projects and the bond issuance costs increased by $75.5 million and $8.9 million in 2010 and 2009, respectively. The increase in 2010 is primarily due to the increase in restricted cash for the building program and the bond interest swap fair value.

Current liabilities increased by $56.2 million in 2010 due to an increase in accrued salaries and wages, accounts payable and accrued liabilities of $48.0 million due to the final settlement of the construction costs of the Reagan building. Current liabilities increased by $1.7 million in 2009 due to an increase in accrued salaries and wages and a reduction in third party payor settlements.

Long-term debt includes the 2004 Series A and Series B Hospital Revenue Bonds, 2003 General Revenue Bonds, 2002 Hospital Revenue Bonds, 2007 Hospital Revenue Bonds, and long-term capital leases. The Medical Center also financed $8.8 million and $8.4 million of capital equipment through leases during 2010 and 2009, respectively. The note payable to campus is for long-term operating capital needs.

Liquidity and Capital Resources

The Medical Center generated $293.8 million and $178.4 million from operating activities in 2010 and 2009, respectively.

In 2010, cash flows from non-capital financing activities show the Medical Center's cash was decreased by $16.1 million over 2009 due to transfers to the University for health system support and general support. In 2009, cash flows from non-capital financing activities show the Medical Center's cash was increased by $11.5 million over 2008 for transfers to the University for health system support and general support and $5.6 million for the replacement hospital transition costs.

In 2010 and 2009, cash flows from capital and related financing activities included the proceeds from State funds of $378 thousand and $0 thousand, contributions from the University for funding from the State Public Works Board Bonds $21.5 million and $40.8 million, purchase of capital assets (including construction in process for replacement hospitals) $90.3 million and $132.7 million, proceeds from new debt of $146 million and $0 million, bond costs of $1.2 million and $0 million, principal payments on long-term debt and capital leases of $11.1 million and $15.2 million, interest payments of $18.8 million and $17.9 million, and replenishment of campus gift funds of $14.3 million and $40.2 million, respectively.

Cash flows from investing activities in 2010 and 2009 show that $10.2 million and $6.5 million was provided by interest income, $(57.0) million and $21.9 million from a change in restricted assets, primarily proceeds from debt for the building project, and $(4.9) million and $10.5 million from the Santa Monica Foundation, respectively.

Overall cash increased to $406.0 million in 2010 from $219.6 million in 2009.

The following table shows key liquidity and capital ratios for 2010, 2009 and 2008:

	2010	2009	2008
Days cash on hand	116	64	41
Days of revenue in accounts receivable	55	58	67
Capital investment ($ in millions)	$90.3	$132.7	$225.4
Debt service coverage ratio	5.9	5.7	2.2

Days cash on hand increased to 116 days in 2010 from 64.1 days in 2009 and 40.8 days in 2008. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash. The goal set by the University of California Office of the President is 60 days.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2010, days in accounts receivable decreased to 55. The main reason for this decrease was due to the ongoing efforts of the revenue cycle engagement and cash collection efforts. In 2009, days in accounts receivable decreased to 58. The main reason for this decrease was due to increased cash collections and revenue cycle improvements.

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 2010 is 5.9 versus 5.7 in 2009. The increase was due to the increase in net income for the year. In 2009, the Medical Center's ratio is 5.7 versus 2.2 in 2008. The increase was due to the increase in net income for the year. This ratio is higher than the 1.1 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2010, the UCLA Medical Center's capital program continued to address the requirements in State of California Senate Bill 1953 ("SB 1953"). The projected cost for the Santa Monica-UCLA Medical Center and Orthopaedic Hospital, which will be compliant with the requirements by 2011, is $565 million. The capital cost of compliance will be financed through the use of state lease revenue bond funds, FEMA funds, Hospital Reserves, gift funds and debt. In 2010, $61.5 million was spent on these requirements.

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

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

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

Medicaid Reform
In 2005, California enacted Senate Bill 1100 ("SB 1100") to implement a federal Medicaid hospital financing waiver ("waiver") that governs fee-for-service inpatient hospital payments for its public hospitals, which include the Medical Center. 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 federal economic stimulus package enacted in 2009, 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. The current waiver expired in August 2010 and plans for a renewal are under discussion between the Center for Medicare and Medicaid Services ("CMS") and the state, the outcome of which cannot be determined. 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.

Hospital Fee Program
AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The University's medical centers, as designated public hospitals, are exempt from paying the "Quality Assurance Fee"; however, the University's medical centers are eligible to receive supplemental payments under the Hospital Fee Program.

Children's Hospital Bond Act of 2008
In 2008, California voters passed Proposition 3 that enables the state of California to issue $980 million in General Obligation bonds to fund capital improvement projects for children's hospitals. The Medical Center 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.

Health Care Reform Bill
On March 23, 2010, the Patient Protection and Affordable Care Act ("PPACA") was signed into law. On March 30, 2010 the Health Care and Education Reconciliation Act of 2010 was signed, amending the PPACA (collectively the "Affordable Care Act"). The Affordable Care Act addresses a broad range of topics affecting the health care industry, including a significant expansion of healthcare coverage. The coverage expansion is accomplished primarily through incentives for individuals to obtain and employers to provide health care coverage and an expansion in Medicaid eligibility. The Affordable Care Act also includes incentives for medical research and the use of electronic health records, changes designed to curb fraud, waste and abuse, and creates new agencies and demonstration projects to promote the innovation and efficiency in the healthcare delivery system. Some provisions of the health care reform legislation are effective immediately; others will be phased in through 2014. Further legislative policies are required for several provisions that will be effective in future years. The impact of this legislation will likely affect the Medical Center; the effect of the changes that will be required in future years are not determinable at this time.

University of California Retirement and Other Post Employment Benefit Plans
UCRP costs are funded by a combination of investment earnings, employee member and employer contributions. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $1.9 billion or 94.8 percent funded. For the July 1, 2010, the funded ratio is expected to decrease to approximately 85 percent. The funding policy contributions related to campuses and medical centers in the July 1, 2009 actuarial valuation for 2010 are $1.6 billion, which represents 20.4 percent of covered compensation. Employer contributions for 2010 were $65 million. For 2011 the Regents authorized increasing the employer and employee contribution rates to UCRP. Contributions by employees will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University would be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These proposed changes would be subject to collective bargaining for union-represented employees. The Regents are scheduled to consider modifications to benefit design for pension benefits at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Currently, the University does not pre-fund retiree health benefits and provides for benefits on a pay-as-you-go basis. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $14.5 billion. The Regents are scheduled to consider modifications to eligibility and the University's share of contributions for retiree health care at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Cautionary Note Regarding Forward-Looking Statements

Certain information provided by the Medical Center, including written as outlined above or oral statements made by its representatives, may contain forward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, which address activities, events or developments that the Medical Center expects or anticipates, will or may occur in the future contain forward-looking information.

In reviewing such information it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information. This forward-looking information is based upon various factors and was derived using various assumptions. The Medical Center does not undertake to update forward-looking information contained in this report or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.

University of California, Los Angeles Medical Center
Statements of Net Assets
June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Assets		
Current assets:		
Cash	$ 406,034	$ 219,604
Patient accounts receivable, net of estimated uncollectibles of $93,523 and $85,518, respectively	246,961	247,723
Other receivables, net of estimated uncollectibles of $93 and $93, respectively	43,506	27,438
Inventory	23,016	22,582
Prepaid expenses and other assets	15,130	14,127
Total current assets	734,647	531,474
Restricted assets:		
Cash restricted for replacement hospital	62,651	5,684
Donor funds	18,596	13,743
Capital assets, net	1,692,645	1,625,852
Deferred costs of issuance	6,329	5,343
Other assets	56,870	44,170
Total assets	2,571,738	2,226,266
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	124,065	78,030
Accrued salaries and benefits	95,915	86,354
Third-party payor settlements	13,021	13,554
Current portion of long-term debt and capital leases	10,972	10,227
Other liabilities	5,243	4,896
Total current liabilities	249,216	193,061
Note payable to campus	75,000	75,000
Long-term debt and capital leases, net of current portion	712,066	568,731
Other liabilities	52,664	39,931
Total liabilities	1,088,946	876,723
Net Assets		
Invested in capital assets, net of related debt	916,943	1,046,892
Restricted:		
Nonexpendable:		
Endowments	337	337
Expendable:		
Capital projects	67,806	6,698
Other	13,104	12,392
Unrestricted	484,602	283,224
Total net assets	$ 1,482,792	$ 1,349,543

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

University of California, Los Angeles Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Net patient service revenue, net of provision for doubtful accounts of $38,844 and $34,055, respectively	$ 1,527,157	$ 1,401,847
Other operating revenue:		
Clinical teaching support	12,981	21,635
Other	47,345	42,433
Total other operating revenue	60,326	64,068
Total operating revenue	1,587,483	1,465,915
Operating expenses:		
Salaries and wages	606,069	597,706
UCRP, retiree health and other employee benefits	152,195	137,402
Professional services	51,717	43,847
Medical supplies	203,004	204,800
Other supplies and purchased services	255,917	256,741
Depreciation and amortization	85,873	81,921
Insurance	9,118	9,513
Total operating expenses	1,363,893	1,331,930
Income from operations	223,590	133,985
Non-operating revenues (expenses):		
Interest income	10,178	6,467
Interest expense	(19,275)	(18,581)
Replacement hospital transition expense/equipment transfer to University	(2,923)	(5,085)
Build America bonds federal interest subsidies	1,627	–
Loss on disposal of capital assets	(1,115)	(1,014)
Total non-operating expenses	(11,508)	(18,213)
Income before other changes in net assets	212,082	115,772
Other changes in net assets:		
Proceeds received or receivable from FEMA	626	110
Contributions from University for building program	21,483	40,819
Donated assets	14,299	40,203
Health system support	(56,217)	(37,932)
Transfer to University for building program	(59,024)	(40)
Total other changes in net assets	(78,833)	43,160
Increase in net assets	133,249	158,932
Net assets – beginning of year	1,349,543	1,190,611
Net assets – end of year	$ 1,482,792	$ 1,349,543

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

University of California, Los Angeles Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,527,697	$ 1,359,312
Payments to employees	(601,838)	(596,745)
Payments to suppliers	(520,329)	(500,492)
Payments for benefits	(146,865)	(126,669)
Other receipts, net	35,140	43,024
Net cash provided by operating activities	293,805	178,430
Cash flows from noncapital financing activities:		
Health system support	(56,217)	(37,932)
Replacement hospital transition costs	(2,923)	(5,125)
Net cash used for noncapital financing activities	(59,140)	(43,057)
Cash flows from capital and related financing activities:		
Proceeds from State funds	378	–
Proceeds from contributions from University for building program	21,483	40,819
Proceeds from debt issuance	146,000	–
Bond issuance cost	(1,164)	–
Proceeds received from interest rate swap	–	31,348
Payment for interest rate swap	–	(25,336)
Interest rate swap fee	–	(434)
Build America bonds federal interest subsidies	1,627	–
Purchases of capital assets	(90,333)	(132,682)
Principal paid on long-term debt and capital leases	(11,058)	(15,196)
Interest paid on long-term debt and capital leases	(18,801)	(17,949)
Transfer to University for building program	(59,024)	–
Gifts and donated funds	14,299	40,203
Net cash provided by (used for) capital and related financing activities	3,407	(79,227)
Cash flows from investing activities:		
Interest income received	10,178	6,467
Change in restricted assets, held by trustee	(56,967)	21,886
Change in Foundation investments	(4,853)	10,509
Net cash (used for) provided by investing activities	(51,642)	38,862
Net increase in cash	186,430	95,008
Cash – beginning of year	219,604	124,596
Cash – end of year	$ 406,034	$ 219,604

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

University of California, Los Angeles Medical Center
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 223,590	$ 133,985
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	85,873	81,921
Provision for doubtful accounts	38,844	34,055
Changes in operating assets and liabilities:		
Patient accounts receivable	(38,082)	(63,805)
Other receivables	(16,068)	(11,531)
Inventory	(434)	92
Prepaid expenses and other assets	(970)	(2,749)
Accounts payable and accrued expenses	(8,323)	10,371
Accrued salaries and benefits	9,561	11,695
Third-party payor settlements	(533)	(12,498)
Other liabilities	347	(3,106)
Net cash provided by operating activities	$ 293,805	$ 178,430
Supplemental noncash activities information:		
Capitalized interest	$ 14,453	$ 10,996
Capital assets acquired through capital lease obligations	8,842	8,434
Reimbursement pending from FEMA	248	(110)
Change in fair value of interest rate swaps classified as hedging derivatives	(12,733)	(8,583)
Amortization of deferred financing costs	387	289
Amortization of bond premium	91	91
Amortization of deferred cost of issuance	178	144
Payables for property and equipment	54,358	–

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

1. Organization

The University of California, Los Angeles Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"), an independent board composed of 26 members. The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority being delegated to the Vice Chancellor, Medical Sciences by the Chancellor of the Los Angeles campus. The Medical Center operates licensed bed facilities including the 456-bed Ronald Reagan UCLA Medical Center, the 315-bed Santa Monica – UCLA Medical Center and Orthopaedic Hospital, and the 74-bed Resnick Neuropsychiatric Hospital at UCLA. The financial statements also include the activities of Tiverton House, a 100-room facility for patients and their families.

2. Summary of Significant Accounting Policies

Basis of Presentation

The financial statements of the Medical Center have been prepared in accordance with accounting principles generally accepted in the United States of America, including all applicable statements of the Governmental Accounting Standards Board ("GASB"), and all statements of the Financial Accounting Standards Board through November 30, 1989. The proprietary fund method of accounting is followed and uses the economic resources measurement focus and the accrual basis of accounting. In addition, these statements follow generally accepted accounting principles applicable to the health care industry, which are included in the American Institute of Certified Public Accountants' Audit and Accounting Guide, *Health Care Entities*, to the extent that these principles do not contradict GASB standards.

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, was adopted by the Medical Center during the fiscal year ended June 30, 2010. This Statement requires capitalization of identifiable intangible assets in the statements of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life. Implementation of Statement No. 51 had no effect on the Medical Center's net assets for the years ended June 30, 2010 and 2009.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, was also adopted during the fiscal year ended June 30, 2010. GASB Statement No. 53 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.

(Dollars in thousands)

2. Summary of Significant Accounting Policies (Continued)

The Medical Center has determined that its interest rate swaps entered into in conjunction with certain Medical Center Pooled Revenue Bonds are hybrid instruments under GASB Statement No. 53. At the time of pricing the interest rate swaps in October 2008, the fixed rate on each of the swaps was off-market such that the Medical Center received an upfront payment. As such, the swaps are comprised of a derivative instrument, an at-the-market swap, and a companion instrument, a borrowing, represented by the upfront payment. The at-the-market swap is an effective hedge under the Consistent Critical Terms method. The unamortized portion of the borrowing is $31,348 at June 30, 2009, prior to the adoption of Statement No. 53.

In accordance with GASB Statement No. 53, retrospective application is required. However, there was no cumulative effect on the previously reported net assets as of July 1, 2008.

The Medical Center restated the 2009 statement of net assets for purposes of presenting comparative information to the year ended June 30, 2010. The effect of the change on the Medical Center's financial statements for the year ended June 30, 2009 from the adoption of GASB Statement No. 53 was to increase liabilities by $39,931 for the negative fair value of the interest rate swap and increase assets by $39,931 to defer the negative fair value from the application of hedge accounting as follows:

	Year Ended June 30, 2009		
	As Previously Reported	Effect of Adoption of Statement No. 53	As Restated
Statement of Net Assets			
Other assets	$ 4,239	$ 39,931	$ 44,170
Total assets	2,186,335	39,931	2,226,306
Other liabilities	–	39,931	39,931
Total liabilities	836,792	39,931	876,723

In addition, the Medical Center reclassified the unamortized portion of the borrowing totaling $31,040 from deferred financing costs to debt. Since deferred financing costs are reported as a component of debt, there was no effect on the net assets as originally reported.

2. Summary of Significant Accounting Policies (Continued)

Cash

All University operating entities maximize the returns on their cash balances by investing in a short-term investment pool ("STIP") managed by the Treasurer of The Regents. The Regents are responsible for managing the University's STIP and establishing investment policy, which is carried out by the Treasurer of The Regents.

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

The Medical Center's cash at June 30, 2010 and 2009 was $406,034 and $219,604, 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 2009-2010 annual report of the University.

Inventory

The Medical Center's inventory consists primarily of pharmaceuticals and medical supplies which are stated on a first-in, first-out basis at the lower of cost or market.

Prepaid Expenses and Other Assets

The Medical Center's prepaid expenses are primarily prepayments for pharmaceuticals and medical supplies, rent, equipment and maintenance contracts.

Restricted Assets, Cash Restricted for Replacement Hospitals

Proceeds from the Medical Center Pooled Revenue Bonds are held by the Treasurer of The Regents. Bond proceeds remain on deposit with the Treasurer until the project is constructed. Restricted assets consist of short-term investments, recorded at cost, which approximates fair value.

Restricted Assets, Donor Funds

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

2. Summary of Significant Accounting Policies (Continued)

Capital Assets

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

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. These derivative financial instruments are agreements that 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.

At the time of pricing the interest rate swaps, the fixed rate on each of the swaps was off-market such that the Medical Center received an upfront payment. As such, the swaps are comprised of a derivative instrument, an at-the-market swap, and a companion instrument, a borrowing, represented by the upfront payment.

Interest rate swaps are recorded at fair value as either assets or liabilities in the statements of net assets. The Medical Center has determined the at the market interest rate swaps are hedging derivatives that hedge future cash flows. Under hedge accounting, changes in the fair value are considered to be deferred inflows (for hedging derivatives with positive fair values) or deferred outflows (for hedging derivatives with negative fair values). Deferred inflows are included with other liabilities and deferred outflows with other assets in the statements of net assets.

The unamortized amount of the borrowing is included in the current and noncurrent portion of debt and amortized as interest expense over the term of the bonds.

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.

2. Summary of Significant Accounting Policies (Continued)

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

Deferred Financing Costs
Refinancing or defeasance of previously outstanding debt has resulted in deferred financing costs comprised of the difference between the reacquisition price and the net carrying amount of the old debt. In addition, the net gain on the termination and replacement of an interest rate swap contract with similar terms has also resulted in deferred financing costs. Unamortized deferred financing costs are included with the current and noncurrent portion of long-term debt, as appropriate, in the Medical Center's statements of net assets. These costs are being amortized as interest expense over the remaining life of the defeased or refinanced bonds, whichever is shorter.

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

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

- 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.

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 could change by a material amount in the near term.

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

Non-operating revenue and expense includes interest income and expense, replacement hospital transition expenses and the gain or loss on the disposal of capital assets.

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

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.

Tax Exemption
The Regents of the University of California is recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (IRC). Because the University is a State institution, related income received by the University is also exempt from federal tax under IRC Section 115(a). In addition, the University is exempt from State income taxes imposed under the California Revenue and Taxation Code.

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.

3. Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments at amounts different from the Medical Center's established rates. A summary of the payment arrangements with major third-party payors follows:

- ***Medicare*** – Medicare patient revenues include traditional reimbursement under Title XVIII of the Social Security Act (non-risk) or Medicare capitated contract revenue (risk).

  Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. The Medical Center does not believe that there are significant credit risks associated with the Medicare program**.**

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center hospitals' (the Ronald Reagan UCLA Medical Center, the Santa Monica – UCLA Medical Center and Orthopaedic Hospital, and the Resnick Neuropsychiatric Hospital at UCLA) Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2003 for the Ronald Reagan UCLA Medical Center, June 30, 2007 for Santa Monica and June 30, 2008 for Resnick Neuropsychiatric Hospitals. The fiscal intermediary is in the process of conducting their audits of the 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 years ended June 30, 2010 and 2009, the Medical Center recorded total Medi-Cal revenue of $151,669 and $139,954, 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, 2010 and 2009, the Medical Center recorded revenue of $13,535 and $6,835, respectively.

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

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

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

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

  - Certain health plans that have established a shared-risk pool where the Medical Center shares in any surplus associated with health care utilization as defined in the related contracts. Additionally, the Medical Center may assume the risk of certain health care utilization costs, as determined in the related agreements. Differences between the final contract settlement and the amount estimated as receivable or payable relating to the shared-risk arrangements are recorded in the year of final settlement.

  - Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

The most common payment arrangement for inpatient services is a prospectively determined per-diem rate or case rate. The most common payment arrangement for outpatient care is a prospective payment system that uses ambulatory payment classifications.

Amounts due from Medicare and Medi-Cal represent 24.0 percent and 21.0 percent of net patient accounts receivable at June 30, 2010 and 2009, respectively.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

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

	2010	2009
Medicare (non-risk)	$ 358,954	$ 327,054
Medicare (risk)	33,283	35,146
Medi-Cal (non-risk)	151,669	139,954
Commercial	11,247	13,130
Contract (discounted or per diem)	955,050	865,966
Non-sponsored/self-pay (uninsured)	16,954	20,597
Total	$ 1,527,157	$ 1,401,847

4. Charity Care

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

	2010	2009
Charity care at established rates	$ 20,797	$ 29,191
Estimated cost of charity care	$ 6,517	$ 9,183

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $50,216 and $66,092 for the years ended June 30, 2010 and 2009, respectively.

5. Restricted Assets, Donor Funds

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

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

	2010	2009
Mutual funds	$ 13,247	$ 8,273
Real property	2,100	2,100
Charitable remainder trusts	3,249	3,370
Total	$ 18,596	$ 13,743

(Dollars in thousands)

5. Restricted Assets, Donor Funds (Continued)

Donor restricted funds are available for the following purposes:

	2010	2009
Capital purposes	$ 5,155	$ 1,014
Endowments	337	337
Operations	13,104	12,392
Total	$ 18,596	$ 13,743

6. Capital Assets

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

	2008	Additions	Disposals	2009	Additions	Disposals	2010
Original Cost							
Land	$ 12,098	$ –	$ –	$ 12,098	$ 1,845	$ –	$ 13,943
Buildings and improvements	1,220,232	92,260	–	1,312,492	50,669	–	1,363,161
Equipment	312,912	82,699	(33,674)	361,937	31,982	(28,833)	365,086
Construction in progress	343,823	(33,733)	–	310,090	69,285	–	379,375
Capital assets, at cost	$1,889,065	$ 141,226	$ (33,674)	$ 1,996,617	$ 153,781	$ (28,833)	$ 2,121,565

	2008	Depreciation	Disposals	2009	Depreciation	Disposals	2010
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 127,071	$ 48,979	$ (349)	$ 175,701	$ 36,881	$ (203)	$ 212,379
Equipment	194,433	32,942	(32,311)	195,064	48,992	(27,515)	216,541
Accumulated depreciation and amortization	$ 321,504	$ 81,921	$ (32,660)	$ 370,765	$ 85,873	$ (27,718)	$ 428,920
Capital assets, net	$ 1,567,561			$ 1,625,852			$ 1,692,645

Equipment under capital lease obligations and related accumulated amortization is $87,434 and $61,206 in 2010, respectively, and $85,877 and $59,557 in 2009, respectively.

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

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

6. Capital Assets (Continued)

The new Ronald Reagan UCLA Medical Center was completed and occupied on June 29, 2008. The Santa Monica – Medical Center and Orthopaedic Hospital is still under construction. Both projects are required in order to be in compliance with Senate Bill 1953, the *Hospital Facilities Seismic Safety Act*. A portion of the construction is financed by the University under a lease-revenue bond with the State of California Public Works Board. These amounts totalled $0 and $175 for the years ended June 30, 2010 and 2009, respectively, and are included in Contributions from University for building program on the statements of revenues, expenses and changes in net assets.

7. Note Payable to Campus

The Medical Center has an internal line of credit in the amount of $75,000 from the Chancellor. The line of credit expires in February 2014 and accrues interest at the STIP rate of an annual average of 2.48 percent for the year ended June 30, 2010. As of June 30, 2010 and June 30, 2009, $75,000 was outstanding. Interest expense for the years ended June 30, 2010 and 2009 was $1,871 and $2,500, respectively.

(Dollars in thousands)

8. Long-term Debt and Capital Leases

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

	2010	2009
University of California Medical Center Pooled Revenue Bonds 2009 Series E and F "Build America Bonds", net interest rates after the 35 percent federal subsidy ranging from 3.0 percent to 6.6 percent, payable semi-annually, with annual principal payments beginning in 2020 through 2049	$ 146,000	–
University of California Medical Center Pooled Revenue Bonds 2007 Series A, interest rates ranging from 4.3 percent to 5.0 percent, payable semi-annually, with annual principal payments beginning in 2012 through 2047	250,000	$ 250,000
University of California Medical Center Pooled Revenue Bonds 2007 Series C, variable interest rate, with annual principal payments through 2047	197,030	197,030
University of California Hospital Revenue Bonds 2004 (University of California, Los Angeles Medical Centers, Series A and B), interest rates from 2.0 percent to 5.5 percent, payable semi-annually, with annual principal payments through 2039	86,500	89,155
University of California General Revenue Bonds 2003, interest rates from 2.0 percent to 5.3 percent, payable semi-annually, with annual principal payments through 2023	9,346	9,861
Capital lease obligations, with fixed interest rates ranging from 2.9 percent to 9.4 percent, payable through 2014, collateralized by underlying equipment	24,833	23,857
The University Pool 2 Loan, interest rate of 5.7 percent payable annually, with annual principal payments through 2019	233	255
Other borrowing	30,573	31,040
Unamortized bond premium	2,613	2,704
Unamortized deferred financing costs	(24,090)	(24,944)
Total debt and capital leases	723,038	578,958
Less: Current portion of debt and capital leases	(10,972)	(10,227)
Noncurrent portion of debt and capital leases	$ 712,066	$ 568,731

(Dollars in thousands)

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

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, 2010 and 2009 was $30,048 and $25,446, respectively. Interest expense totaling $14,504 and $11,435 was capitalized during the years ended June 30, 2010 and 2009, respectively. The remaining $15,544 in 2010 and $14,011 in 2009 are reported as interest expense in the statements of revenues, expenses and changes in net assets. Investment income totaling $(147) and $(439) was capitalized during the years ended June 30, 2010 and 2009, respectively.

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

	Revenue Bonds	Capital Lease Obligations	Other Borrowings	Total
Year Ended June 30, 2010				
Current portion at June 30, 2009	$ 2,428	$ 7,332	$ 467	$ 10,227
Reclassification from noncurrent	2,577	8,436	494	11,507
Principal payments	(3,192)	(7,866)	–	(11,058)
Amortization of bond premium	(91)	–	–	(91)
Amortization of deferred financing costs	854	–	(467)	387
Current portion at June 30, 2010	$ 2,576	$ 7,902	$ 494	$ 10,972
Noncurrent portion at June 30, 2009	$ 521,633	$ 16,525	$ 30,573	$ 568,731
New obligations	146,000	8,842	–	154,842
Reclassification to current	(2,577)	(8,436)	(494)	(11,507)
Noncurrent portion at June 30, 2010	$ 665,056	$ 16,931	$ 30,079	$ 712,066

(Dollars in thousands)

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

	Revenue Bonds	Capital Lease Obligations	Other Borrowings	Total
Year Ended June 30, 2009				
Current portion at June 30, 2008	$ 3,149	$ 11,876	$ –	$ 15,025
Reclassification from noncurrent	1,845	7,580	775	10,200
Principal payments	(3,072)	(12,124)	–	(15,196)
Amortization of bond premium	(91)	–	–	(91)
Amortization of deferred financing costs	597	–	(308)	289
Current portion at June 30, 2009	$ 2,428	$ 7,332	$ 467	$ 10,227
Noncurrent portion at June 30, 2008	$ 548,814	$ 15,671	$ –	$ 564,485
New obligations	–	8,434	31,348	39,782
Deferred financing costs-terminated bond swap	(25,336)	–	–	(25,336)
Reclassification to current	(1,845)	(7,580)	(775)	(10,200)
Noncurrent portion at June 30, 2009	$ 521,633	$ 16,525	$ 30,573	$ 568,731

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 sets forth requirements for certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2010 are $1.55 billion of which $593.0 million are specifically for capital projects at the Medical Center. Combined operating revenues of the University's five medical centers for the years ended June 30, 2010 and 2009 were $5.94 billion and $5.56 billion, respectively.

In December 2009, Medical Center Pooled Revenue Bonds totaling $146.0 million were issued as taxable "Build America Bonds" specifically for the Medical Center to finance certain improvements to the Medical Center. Proceeds, including a bond premium of $2.0 thousand were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through May 2020 and mature at various dates through 2049. The taxable bonds have a stated weighted average interest rate of 6.57 percent and a net weighted average interest rate of 4.27 percent after the expected cash subsidy payment from the United States Treasury which is equal to 35 percent of the interest payable on the taxable bonds. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

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

University of California Hospital Revenue Bonds 2004 series have also financed certain improvements at the Medical Center. The Hospital Revenue Bonds are collateralized solely by revenues of the Medical Center. In addition, under the bond indentures, the Medical Center is required to maintain a debt service ratio of 1.1 to 1.0 and has limitations as to additional borrowings and the purchase or sale of assets.

General Revenue Bonds issued by the University, collateralized solely by general revenues of the University, finance certain Medical Center projects. The Medical Center is charged for its proportionate share of total principal and interest payments made on the General Revenue Bonds pertaining to the Medical Center projects.

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

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.

Interest Rate Swap Agreements

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.

At the time of pricing the interest rate swaps, the fixed rate on each of the swaps was off-market such that the Medical Center received an upfront payment. As such, the swaps are comprised of a derivative instrument, an at-the-market swap, and a companion instrument, a borrowing, represented by the upfront payment. The unamortized amount of the borrowing is $30,573 and $31,040 at June 30, 2010 and 2009, respectively.

(Dollars in thousands)

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

Interest Rate Swap Agreements (Continued)

The notional amounts, fair value of the interest rate swap outstanding and the change in fair value for June 30, 2010 and 2009 are as follows:

Notional Amount		Fair Value – Positive (Negative)			Changes in Fair Value		
2010	2009	Classification	2010	2009	Classification	2010	2009
$189,775	$189,775	Other assets (liabilities)	($52,664)	($39,931)	Deferred (inflows) / outflows	($12,733)	($8,583)

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, 2010 or 2009.

Objective and Terms. Under the swap agreement, the Medical Center pays the swap counterparty a fixed interest rate payment and receives a variable rate interest payment that effectively changes the Medical Center's variable interest rate bonds to synthetic fixed rate bonds.

The Medical Center has determined the at the market interest rate swap is a hedging derivative that hedge future cash flows. 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.

Additional terms with respect to the outstanding swap and the fair value at June 30, 2010, along with the credit rating of the counterparty, are as follows:

Terms	Effective Date	Maturity Date	Cash Paid or Received	Counterparty Credit Rating
Pay fixed 4.6873 percent; receive 67 percent of 1-Month LIBOR* + 0.73 percent**	2008	2047	None	Aa3/AA

* London Interbank Offered Rate (LIBOR)

** Weighted average spread

Credit Risk. The Medical Center could be exposed to credit risk if the counterparty to the swap contract is unable to meet the terms of the contracts. 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 swap contract's fair value, less any collateral held by the Medical Center provided by the counterparty. Swap contracts with negative fair values are not exposed to credit risk.

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

Interest Rate Swap Agreements (Continued)

Depending on the fair value related to the swap with the $189.775 million notional amount, the University may be entitled to receive collateral from the counterparty to the extent the positive fair value exceeds $35.0 million, or be obligated to provide collateral to the counterparty if the negative fair value of the swap exceeds $50.0 million. On July 1, 2010, the University deposited collateral of $1.85 million with the counterparty, and on July 2, 2010, additional collateral of $0.8 million was deposited by the University.

Although the Medical Center has entered into the interest rate swap contract with a creditworthy financial institution to hedge its variable-rate debt, there is credit risk for losses in the event of non-performance by counterparties or unfavorable interest rate movements.

Interest rate risk. There is a risk the value of the interest rate swap will decline because of changing interest rates. The values of interest rate swaps with longer maturity dates tend to be more sensitive to changing interest rates and, therefore, more volatile than those with shorter maturities.

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

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

(Dollars in thousands)

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

Future Debt Service and Interest Rate Swaps

Future debt service payments for the Medical Center's fixed and variable-rate debt and net receipts or payments on associated hedging derivative interest rate swaps for each of the five fiscal years subsequent to June 30, 2010 and thereafter are shown below. Although not a prediction by the Medical Center of the future interest rate cost of the variable rate bonds or the impact of the interest rate swaps, these amounts assume that current interest rates on variable rate bonds and the current reference rates of the interest rate swaps will remain the same. As these rates vary, variable-rate bond interest payments and net interest rate swap payments will vary.

Year Ending June 30,	Revenue Bonds	Capital Lease Obligations	Total Payments	Principal	Interest
2011	$ 38,552	$ 8,809	$ 47,361	$ 11,241	$ 36,120
2012	41,307	7,595	48,902	13,262	35,640
2013	41,669	5,559	47,228	12,161	35,067
2014	41,678	3,553	45,231	10,713	34,518
2015	41,678	1,306	42,984	8,953	34,031
2016 – 2020	210,824		210,824	47,111	163,713
2021 – 2025	215,704	–	215,704	66,527	149,177
2026 – 2030	210,226	–	210,226	79,085	131,141
2031 – 2035	207,942	–	207,942	99,045	108,897
2036 – 2040	205,126	–	205,126	123,685	81,441
2041 – 2045	201,513	–	201,513	154,165	47,348
2046 – 2048	97,189	–	97,189	87,995	9,194
Total future debt service	1,553,408	26,822	1,580,230	$ 713,943	$ 866,287
Less: Interest component of future payments	(864,298)	(1,989)	(866,287)		
Principal portion of future payments	689,110	24,833	713,943		
Adjusted by:					
Unamortized bond premium	2,612	–	2,612		
Unamortized deferred financing costs	6,483	–	6,483		
Total debt	$ 698,205	$ 24,833	$ 723,038		

Additional information on the revenue bonds can be obtained from the 2009-2010 annual report of the University.

(Dollars in thousands)

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

Future Debt Service and Interest Rate Swaps (Continued)

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, 2010, 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
2011	–	1,923	6,943	8,866
2012	–	1,923	6,943	8,866
2013	–	1,923	6,943	8,866
2014	–	1,923	6,943	8,866
2015	–	1,923	6,943	8,866
2016 – 2020	–	9,614	4,717	44,331
2021 – 2025	10,555	9,522	34,343	54,420
2026 – 2030	21,055	8,775	31,324	61,154
2031 – 2035	26,345	7,704	27,108	61,157
2036 – 2040	37,040	6,300	21,815	65,155
2041 – 2045	64,510	3,769	12,838	81,117
2046 – 2047	30,270	495	1,674	32,439
Total	$ 189,775	$ 55,794	$ 198,534	$ 444,103

9. Operating Leases

The Medical Center leases certain buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2010 and 2009 was $7,621 and $7,924, respectively. The terms of the operating leases extend through the year 2016.

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

Year Ending June 30,	Minimum Annual Lease Payments
2011	$ 9,402
2012	9,454
2013	7,001
2014	5,600
2015	4,343
2016 – 2020	23,746
Total	$ 59,546

10. Retiree Health Plans

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

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

Participating University locations, such as the Medical Center, are required to contribute at a rate assessed each year by the UCRHBT. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.12 and $3.09 per $100 of UCRP covered payroll resulting in Medical Center contributions of $16,200 and $15,400 for the years ended June 30, 2010 and 2009, 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, 2009, the date of the latest actuarial valuation, were $76.9 million and $14.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $69.4 million at June 30, 2010. For the years ended June 30, 2010 and 2009, combined contributions from the University's campuses and medical centers were $283.5 million and $278.5 million, respectively, including an implicit subsidy of $49.5 million and $44.1 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.6 billion and $1.5 billion for the years ended June 30, 2010 and 2009. 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 $3.7 billion at June 30, 2010 increased by $1.4 billion and $1.2 billion for the years ended June 30, 2010 and 2009, 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 2009–2010 annual reports of the University of California and the University of California Health and Welfare Program.

11. Retirement Plans

Substantially all full-time employees of the Medical Center participate in the University of California Retirement System ("UCRS") that is administered by the University. The UCRS consists of The University of California Retirement Plan ("UCRP"), a single employer defined benefit plan, and the University of California Retirement Savings Program ("UCRSP") that includes four defined contribution plans with several investment portfolios generally funded with employee non-elective and elective contributions. The Regents has the authority to establish and amend the benefit plans.

The UCRP provides lifetime retirement income, disability protection, and survivor benefits to eligible employees. Benefits are based on average highest three years compensation, age, and years of service and are subject to limited cost-of-living increases.

Contributions to the UCRP may be made by the Medical Center and the employees. The rates for contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by the Medical Center and by the employees. Employee contributions by represented employees are subject to collective bargaining agreements. Medical Center and employee contributions were $4,581 and $2,291, respectively, during the year ended June 30, 2010. There were no required Medical Center or employee contributions for the year ended June 30, 2009.

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, 2009, the date of the latest actuarial valuation, were $34.8 billion and $36.8 billion, respectively, resulting in a funded ratio of 94.8 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $34.6 billion and $32.3 billion at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, the University's campuses and medical centers contributed a combined $64.8 and $0.4 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.6 billion for the year ended June 30, 2010. 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 $1.5 billion for the year ended June 30, 2010.

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.

(Dollars in thousands)

11. Retirement Plans (Continued)

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 2009–2010 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

12. University Self-insurance

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

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $13,970 and $13,128 for the years ended June 30, 2010 and 2009, respectively. During 2010 and 2009, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $0 and $1,413, respectively.

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $9,118 and $9,513 for the years ended June 30, 2010 and 2009, respectively.

13. Transactions with Other University Entities

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

	2010	2009
Professional services	$ 11,843	$ 10,388
Medical supplies	(2,318)	(2,168)
Other supplies and purchased services	63,553	52,487
Interest income (net)	(7,077)	(3,982)
Insurance	8,982	9,513
Total	$ 74,983	$ 66,238

(Dollars in thousands)

13. Transactions with Other University Entities (Continued)

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

The total net amount of payments made by the Medical Center to the University were $131,200 and $104,170 in 2010 and 2009, respectively. Of these amounts, $74,983 and $66,238 are reported as operating expenses for the years ended June 30, 2010 and 2009, respectively, and $56,217 and $37,932 are reported as health system support for the years ended June 30, 2010 and 2009, respectively.

14. Federal Emergency Management Administration

The Medical Center was affected by the January 1994 Northridge earthquake. As a result, the Medical Center negotiated with the Federal Emergency Management Agency ("FEMA") and with the state of California for grant funds for the replacement of the UCLA Medical Center and the Santa Monica-UCLA Medical Center. The Medical Center received approval for grant funds as follows:

	FEMA	State of California	Total
UCLA Medical Center	$ 439.7	$ 43.9	$ 483.6
Santa Monica – Medical Center*	72.1	–	72.1
	$ 511.8	$ 43.9	$ 555.7

*includes the Orthopaedic Hospital funds; see Note 15

Under the terms of the agreement, the Medical Center will be reimbursed for eligible costs of rebuilding the acute care facilities. The Medical Center capitalizes construction costs based on cash receipts and pending reimbursements from FEMA. For the years ended June 30, 2010 and 2009, no cash was received from FEMA. As such, outstanding receivables of $33,266 and $33,018, respectively, remain to be collected.

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

(Dollars in thousands)

15. Commitments and Contingencies

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

The Medical Center 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 Medical Center's financial statements.

State of California Senate Bill 1953, *Hospital Facilities Seismic Safety Act*, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. By January 1, 2030, all general acute care inpatient buildings must be operational after an earthquake. Previously, the state of California's budget authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations. The Regents have approved the allocation of the $600,000 among the University's medical centers, of which $182,000 was allocated to the Medical Center. The Medical Center spent $0 and $175 of its allocation during the years ended June 30, 2010 and 2009, respectively, recorded in the statements of revenues, expenses and changes in net assets as a component of Contributions from University for building program. As of June 30, 2010, any repayments the Medical Center may be obligated to make under these financing arrangements are dependent upon continued appropriations for the lease payments to the University by the state.

The replacement hospital at the UCLA Medical Center was completed and placed in service in June 2008. The Santa Monica – Medical Center is still under construction. The total cost of these Medical Center projects is currently estimated to be $1.5 billion, excluding interest. The estimated financing sources for the replacement hospitals are estimated as follows:

FEMA	$ 511,803
State Matching Funds	43,886
Gift Funds	92,756
State Lease Revenue Bonds	181,957
Medical Center Revenue Bond 2004	172,428
Medical Center Revenue Bond 2007	249,367
Medical Center Revenue Bond 2009	144,679
State Children's Hospital Program Grant	29,827
Hospital Reserves	47,309
Total	$ 1,474,012

15. Commitments and Contingencies (Continued)

Gift funds used for construction totaling $14,299 and $40,203 for the years ended June 30, 2010 and 2009, respectively, and are reflected in the statements of revenues, expenses and changes in net assets. Additional gift funds and pledges received but not used as of June 30, 2010 are not included in the financial statements of the Medical Center. These gifts and pledges are included in the financial statements of the University and transferred to the Medical Center when used.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately $16.0 million, excluding interest, as of June 30, 2010.

16. Subsequent Event

AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a “Quality Assurance Fee” and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State’s effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The CDHS is responsible for obtaining approval from CMS on a distribution plan for funds. It is not anticipated that fees and payments would commence without federal approval, but if final federal approval is not obtained, any fees and payments made under the program would be refunded. The University's medical centers, as designated public hospitals, are exempt from paying the “Quality Assurance Fee”; however, the University's medical centers are eligible to receive supplemental payments under the Hospital Fee Program.

University of California,
San Diego Medical Center
Financial Statements
For the Years Ended June 30, 2010 and 2009

University of California, San Diego Medical Center
Index
June 30, 2010 and 2009

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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 41, present fairly, in all material respects, the financial position of the University of California, San Diego Medical Center (the "Medical Center"), a division of the University of California (the "University"), at June 30, 2010 and 2009, 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, 2010 and 2009, 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 11, 2010

University of California, San Diego Medical Center
Management's Discussion and Analysis

Introduction

The objective of the Management's Discussion and Analysis is to help readers better understand the University of California, San Diego Medical Center's financial position and operating activities for the year ended June 30, 2010, with selected comparative information for the years ended June 30, 2009 and 2008. 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 (2008, 2009, 2010, 2011, etc.) in this discussion refer to the fiscal years ended June 30.

Overview

The University of California, San Diego Medical Center (the "Medical Center") serves as the principal clinical teaching site for the University of California, San Diego ("UCSD") School of Medicine, established by The Regents of the University of California ("The Regents") in 1962. It is San Diego County's only academic medical center encompassing hospital-based and ambulatory patient care services, teaching, and clinical research.

The Medical Center is licensed to provide acute care hospital services at two sites, Hillcrest and La Jolla, and provides psychiatric services for children and adolescents at the 35 bed child and adolescent psychiatric unit located at Alvarado Hospital. The Hillcrest site, located in central San Diego, is licensed to operate 398 beds. As the Medical Center's principal teaching hospital, it is the focal point for UCSD's education and community services missions, and serves as a major tertiary referral center for San Diego and Imperial Counties. It is one of two of the county's Level I Trauma Centers and the only Regional Burn Center.

John M. and Sally B. Thornton Hospital ("Thornton Hospital"), which opened in July 1993, is licensed to operate 119 beds and is located in La Jolla on the UCSD campus. It is a general medical/surgical facility and is also the principal location of the Medical Center's cancer services.

Outpatient services are provided by the UCSD Medical Group, which has a clinical practice of over 340 faculty physicians, primarily at the UCSD Ambulatory Care Center and Lewis Street Center in Hillcrest and at the Perlman Ambulatory Care Center in La Jolla. In addition, the UCSD Cancer Center on the East Campus serves as the primary site for outpatient clinical oncology care encompassing prevention, diagnosis, prognosis, treatment, education, rehabilitation and after-care.

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

For the fiscal year ended June 30, 2010, the Medical Center reported income before changes in net assets of $112.9 million and generated a total margin of 13.5 percent. Total operating revenues increased by 6.4 percent over the prior year due to a modest increase in patient volumes, revenue cycle initiatives, strategic pricing, and contract improvements while operating expenses increased by 4.8 percent due to wage increases, and inflationary increases in pharmaceuticals and supplies.

The Medical Center's cash position remained strong despite using $113.6 million for capital expenditures to renovate, expand, and replace existing facilities and invest in new technology.

The Medical Center's operating revenues reflect increased utilization of outpatient services in key ancillary areas including surgery, radiation oncology, imaging and infusion, and continued focus on maximizing collections through revenue cycle initiatives, contracting and pricing strategies. Labor costs continue to reflect new employees hired to replace temporary help and contract labor as well as increased premiums for employee healthcare and the resumption of pension contributions by the Medical Center. Medical and other supply costs reflect the impact of new technologies and inflation.

As part of its overall strategic plan, management continues to focus on its financial goal of generating margins to reinvest in clinical initiatives by optimizing reimbursement, improving efficiency, managing resources and costs, and developing comprehensive capital and development plans to ensure adequate funds are available to support its facilities renovation and expansion needs. Growth of patient volumes and expansion of targeted service lines, including surgery, oncology and cardiovascular services, and expansion of the Medical Center's facilities to create capacity and support growth are also key elements of the overall strategic plan.

- *Optimizing net patient service revenue*
  Revenue cycle improvements remained a major focus in 2010. These initiatives include automating workflow and developing standard reporting of performance in all areas of the revenue cycle including patient access, care management, charge description master/pricing, and patient financial services.

  The Medical Center also continued strategic pricing initiatives through 2010, working with the same outside consulting group as in 2009 to review and revise pricing to maintain and improve its competitive market position.

  The results of the revenue cycle improvements in 2010 were process redesign that promoted better controls on the front end process. This in turn reduced manual billing tasks and improved collections by reducing third party payor denials. Care management and patient financial services workflows were also automated. These efforts contributed to a reduction in the Medical Center's denial rate to 7.9 percent in 2010 as compared to 8.3 percent in 2009, and the holding of gains from the prior year in the reduction of days outstanding in patient accounts receivable.

  In order to keep up with the change in the market and technology and the recent trends towards reduced lengths of stay and a shift from the inpatient to outpatient setting, contracting efforts focused on targeting outpatient reimbursement, increased inpatient per diems in specific services lines, and lowering not to exceed caps that are in place for services reimbursed at a percent of charges. The Medical Center was successful in adding surgical per diems to all agreements. Throughout 2010 the Medical Center continued to participate with other University of California medical centers in systemwide efforts to ensure successful contract negotiations with key payors.

- *Managing resources and costs*
  During 2010, the Medical Center's efforts to manage labor costs included flexed staffing based on patient volumes, rigorous review of vacant positions, and a focus on reducing the use of premium labor. As a result of these efforts, the Medical Center experienced a decrease in the use of nurse travelers that is reflected in a decrease in temporary help expense of $8.4 million compared to 2009.

  Managing medical and other supply costs is also a priority for Medical Center management.

  During 2010, the Medical Center participated in all eight standardized programs offered to members of the University Healthcare Consortium ("UHC") and provided all supply purchase history to UHC on a quarterly basis for review and analysis. These efforts resulted in increased vendor rebates and indentified further opportunities for supply chain savings. The Medical Center also collaborated with the other four UC Medical Centers to identify supply commodities with the most disparity in cost. Negotiations continue with vendors to offer consistent pricing to all UC Medical Centers.

  Other actions taken during 2010 include standardization of the receipt and delivery of products at both hospitals, and ongoing education and training of purchasing staff on contract and negotiation skills. Management estimates that these initiatives resulted in supply cost savings of approximately $4.7 million during 2010.

  In 2011 the Medical Center will continue to submit data quarterly to UHC Spendlink and Emergency Care Research Institute ("ECRI") for benchmarking of our prices against other medical centers and will proceed with renegotiating contracts where opportunities have already been identified.

- *Facilities planning*
  At the March 25, 2010 meeting of the University of California Board of Regents, the Medical Center received budget and financing approval for Jacobs Medical Center on the La Jolla campus. The project includes capacity for 245 beds, 11 operating rooms, a new stand-alone central plant, and the renovation of various portions of the existing hospital. The approval of this $663.8 million project included up to $356.8 million in external financing with the remainder of the funding coming from gifts, hospital reserves and other sources. Construction is expected to begin in 2013 with occupancy in 2016.

  During 2010, work continued on the Thornton Cardiovascular Center expansion. This project includes 54 ICU and step-down beds, cardiac catheterization rooms, operating rooms, patient exam rooms, an expanded emergency department, and expansion of the central plant. Construction is expected to be complete in December 2010 with occupancy expected in April 2011.

  During 2010, the Medical Center spent $99.8 million on facilities renovation and improvement projects, which included $38.4 million funded with hospital cash reserves, $1.9 million funded with State lease revenue bonds under The Hospital Facilities Seismic Safety Act ("SB1953"), $58.5 million of proceeds from bond issued for the Thornton Expansion/Cardiovascular project, and $1.0 of donated and other funds. An additional $33.1 million was spent for equipment, information systems and new technology, which included $19.5 million funded with hospital cash reserves and $13.6 million acquired under capital lease obligations.

  At June 30, 2010, the Medical Center's financial statements include capital assets of $550.7 million.

- *Information Technology Initiatives*
  Adopting new technologies to support operational, clinical and research excellence is a strategic priority for the Medical Center.

  During 2010, to support our clinical providers, the Medical Center focused on the implementation of a sophisticated electronic medical record ("EMR") system in the inpatient setting. This complements the work done in 2009 to bring the EMR across our ambulatory clinics, enabling providers to have on line and up to date access to clinical information for their patients. The Medical Center expects to have a totally integrated EMR across the inpatient and outpatient setting as well as the Moores Cancer Center towards the end of 2010. This also includes a clinical data warehouse that supports quality measures, reporting, and clinical trials and other research.

  Our efforts to ensure excellence in information technology tools have earned the Medical Center important and highly visible national recognition including awards for achieving HIMSS Stage 6 EMR adoption at both hospital sites. In addition the Medical Center has once again been named a winner of the nationally recognized "Most Wired" and "Most Wireless" award by the Hospitals and Health Network publication. Management believes that our health information technology deployment is very much aligned with the goals defined in the American Reinvestment and Recovery Act ("ARRA") Health Information Technology ("HIT") act and that our HIT systems meet the requirement of being "certified" and can demonstrate "meaningful use".

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2010, 2009 and 2008:

Statistics	2010	2009	2008
Licensed beds	552	552	540
Admissions	24,216	23,339	23,194
Average daily census	369	367	374
Discharges	23,706	23,219	23,057
Average length of stay	5.8	5.9	5.9
Case mix index	1.63	1.69	1.61
Patient days:			
Medicare (non-risk)	33,854	33,229	31,822
Medi-Cal (non-risk)	36,912	36,892	37,613
Contracts – Commercial	49,487	48,518	50,596
County/Uninsured	14,602	15,232	16,712
Total patient days	134,855	133,871	136,743
Outpatient visits:			
Clinic visits	536,188	520,491	473,284
Emergency room visits	60,160	60,551	60,392
Total outpatient visits	596,348	581,042	533,676

Admissions increased by 3.8 percent in 2010 compared to 2009, while average length of stay decreased to 5.8 days.

Discharges increased by approximately 2.1 percent in 2010 compared to 2009 with increased cases from the surgery, neuroscience, medicine, and pediatrics departments. These increases were partially offset by a further decrease in the county-wide birth rate. In 2009, discharges increased by approximately 0.7 percent compared to 2008 with increased cases in the cancer and cardiovascular service lines of 6.8 percent and 9.5 percent, respectively. These increases were partially offset by an 11.3 percent decrease in discharges in the women and infants service line due primarily to a decrease in the county-wide birth rate.

Total patient days increased by 0.7 percent in 2010 compared to 2009 due to increased admissions offset by a reduction in overall length of stay. Total patient days decreased in 2009 by 2.1 percent over 2008 due to a reduction in average length of stay.

The increase in Medicare patient days in 2010 is due primarily to an increase of 10.8 percent in admissions offset by a decrease of 8.0 percent in length of stay. The increase in patient days in 2009 for Medicare is due primarily in an increase in admissions, which is partially offset by a 4.4 percent decrease in length of stay.

In 2010, the patient days, admissions, and length of stay for Medi-Cal are consistent with prior year levels. In 2009, the decrease in patient days for Medi-Cal is due to both a decrease in admissions and a decrease in length of stay.

The increase in patient days for Contracts – Commercial in 2010 is due a decrease in admissions of 3.4 percent offset by an increase in length of stay. The decrease in patient days for Contracts – Commercial in 2009 is due to a decrease in admissions, which is partially offset by a 2.6 percent increase in length of stay.

The decrease in County/Uninsured patient days in 2010 is due primarily to increased admissions offset by a decrease in length of stay of 9.1 percent. In 2009, the decrease in patient days for County/Uninsured is due an 11.2 percent decrease in admissions.

Outpatient clinic visits increased by 3.0 percent in 2010 from 2009. Emergency room visits decreased by 0.6 percent from 2009. Outpatient clinic visits increased by 10.0 percent in 2009 from 2008. This increase is due primarily to a 19.9 percent increase in visits at the UCSD Cancer Center, partially offset by the transfer of a University staff midwife comprehensive health center to a community provider. Emergency room visits increased by 0.3 percent from 2008.

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 2010 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Net patient service revenue	$ 820,107	$ 770,679	$ 702,279
Other operating revenue	14,182	13,778	14,330
Total operating revenue	834,289	784,457	716,609
Total operating expenses	723,454	690,121	655,509
Income from operations	110,835	94,336	61,100
Total non-operating revenues	2,037	1,653	173
Income before other changes in net assets	$ 112,872	$ 95,989	$ 61,273
Margin	13.5 percent	12.2 percent	8.6 percent
Other changes in net assets	(35,742)	(13,037)	(4,851)
Increase in net assets	77,130	82,952	56,422
Net assets – beginning of year	568,892	485,940	429,518
Net assets – end of year	$ 646,022	$ 568,892	$ 485,940

Revenues
Total operating revenues for the year ended June 30, 2010 were $834.3 million, an increase of $49.8 million, or 6.4 percent, over 2009. Total operating revenues for the year ended June 30, 2009 were $784.5 million, an increase of $67.8 million, or 9.5 percent, over 2008.

Net patient service revenue for 2010 increased by $49.4 million, or 6.4 percent, over 2009. The increase in 2010 over 2009 was due to increased outpatient volumes, contract price increases, and improved collections. Net patient service revenue in 2009 increased by $68.4 million, or 9.7 percent, over 2008 due to increased outpatient volumes, improved collections, an increase in the Medicare case mix index, and additional Medi-Cal funds made available under the American Recovery and Reinvestment Act.

Net patient service revenue is reported net of estimated allowances under contractual arrangements with Medicare, Medi-Cal, the County of San Diego, and other third-party payors and has been estimated based on the principles of reimbursements and terms of the contracts currently in effect.

Other operating revenue consists primarily of Clinical Teaching Support ("CTS") funds, joint venture income accounted for under the equity method, and other non-patient services such as cafeteria operations. The increase in 2010 in other operating revenue was due to increased joint venture income offset by reduced State funding for Clinical Teaching Support. The decrease in 2009 in other operating revenue was due primarily to reduced state funding for Clinical Teaching Support.

The following table summarizes net patient service revenue for 2010, 2009 and 2008 (dollars in thousands):

Payor	2010	2009	2008
Medicare (non-risk)	$ 179,436	$ 159,861	$ 147,494
Medi-Cal (non-risk)	169,218	185,605	158,636
Contracts – commercial	444,272	395,361	366,016
County/Uninsured	27,181	29,852	30,133
Total	$ 820,107	$ 770,679	$ 702,279

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system.

Net revenues for Medicare patients increased in 2010 by $19.6 million from 2009. Medicare inpatient net revenue for 2010 increased by $15.6 million, or 13.9 percent, over 2009 due primarily to a 10.8 percent increased in discharges and prior year settlements. Medicare outpatient net revenues for 2010 increased by $4.0 million or 8.4 percent over 2009, due to increased patient activity. Net revenues also includes reimbursement for prior year settlements and other adjustments of $8.5 million in 2010 compared to $0.7 million in 2009 and $9.6 million in 2008.

Net revenues for Medicare patients increased in 2009 by $12.4 million from 2008. Inpatient net revenues for 2009 increased by $6.7 million, or 6.4 percent, over 2008 primarily due to a 7.0 percent increase in discharges and a 6.5 percent increase in case mix index. Medicare outpatient net revenues for 2009 increased by $5.5 million or 13.4 percent over 2008 due to an increase in patient activity.

In 2006, the State implemented a new Medicaid fee-for-service inpatient payment system. Under SB1100, the legislation enacting the new federal Medicaid hospital financing waiver in California, payments for inpatient services include a combination of fee-for-service payments, Disproportionate Share ("DSH") payments and Safety Net Care Pool ("SNCP") payments.

Total Medi-Cal net revenues for 2010 decreased by $16.4 million over 2009 as a result of two factors related to the Medicaid hospital waiver. First, current year inpatient net revenue from the waiver decreased $8.9 million due to the overall decrease in Medi-Cal and uninsured costs reported to the State, and second, prior year amounts decreased $7.5 million. In 2009, total Medi-Cal net revenue increased by $27.0 million over 2008 due primarily to an increase in funds made available through the Medicaid hospital waiver and an increase in outpatient supplemental payments.

Inpatient Medi-Cal net revenues for 2010 decreased by $16.1 million from 2009 due primarily to the same two factors described in the preceding paragraph. Inpatient net revenues for 2009 increased by $20.7 million from 2008 due primarily to an increase in federal matching funds made available under the American Recovery and Reinvestment Act and prior year adjustments to revenue.

In 2010, outpatient Medi-Cal net revenues decreased by $0.3 million from 2009 because Medi-Cal retail pharmacy revenues decreased by $3.3 million as a result of a new Medi-Cal payment policy that requires 340(b) drug cost savings to be returned to the State. This was largely offset by $2.7 million more in supplemental payments under Assembly Bill 915, *the Public Hospital Outpatient Services Supplemental Reimbursement Program*. In 2009, outpatient Medi-Cal net revenue increased by $6.3 million from 2008 due to recognition of $6.3 million more supplemental payments under Assembly Bill 915 in 2009 compared to 2008.

Net revenues for contracts – commercial increased by $48.9 million over 2009 due primarily to increased patient volume and the impact of the Medical Center's ongoing revenue cycle initiatives, contracting efforts and strategic pricing. The $29.3 million increase in 2009 over 2008 is due primarily to an increase in outpatient activity and the impact of the Medical Center's ongoing revenue cycle initiatives, contracting efforts and strategic pricing.

County/Uninsured patient service revenues includes payments from the County of San Diego under the Medical Center's contract to provide emergency medical services to the county's indigent population and emergency and non-emergency medical services to County custodial patients. Net revenue for County/Uninsured decreased by $2.7 million from 2009 due primarily to decreased patient volume. The $0.3 million decrease in 2009 over 2008 is due primarily to a reduction in patient days.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Salaries and wages	$ 300,890	$ 278,809	$ 261,726
Employee benefits	98,868	86,204	77,045
Professional services	32,211	30,054	26,170
Medical supplies	162,490	164,592	152,732
Other supplies and purchased services	91,973	95,139	105,432
Depreciation and amortization	32,181	29,763	27,598
Insurance	4,841	5,560	4,806
Total operating expenses	$ 723,454	$ 690,121	$ 655,509

Total operating expenses for 2010 of $723.5 million increased by $33.3 million, or 4.8 percent, over 2009 due to increased admissions, increased clinic visits, the impact of inflation, and increased depreciation expense. Total operating expenses for 2009 of $690.1 million increased by $34.6 million, or 5.3 percent, over 2008 due primarily to increased outpatient volumes, the impact of inflation, and increased depreciation expense.

Salary and wage expenses include wages paid to hospital employees and holiday and sick pay. Amounts paid for nurse registry and other contract labor is included in other expenses. The total paid for salaries and wages in 2010 increased by $22.1 million, or 7.9 percent, over 2009 due primarily to staff replacing contract labor (offset by a reduction in contract labor expense) and other increases. In 2009, salaries and wages increased by $17.1 million due to increases in wages and a 5.4 percent increase in FTEs.

In 2010, employee benefits expense increased by $12.7 million, or 14.7 percent, over 2009 due to increased employee healthcare premiums and the restart of pension contributions by the Medical Center. Employee benefits expense increased by $9.2 million, or 11.9 percent, in 2009 over 2008 due to an increase in employee healthcare premiums. Employee benefit expense for 2010, 2009 and 2008 also include a retrospective rebate of workers compensation premiums from the University of $4.6 million, $5.8 million and $7.1 million, respectively.

Payments for professional services increased by $2.2 million, or 7.2 percent, in 2010 compared to 2009 primarily due to the provision of new services, and $3.9 million, or 14.8 percent, in 2009 compared to 2008 due to the provision of new services.

In 2010, medical supply expense decreased by $2.1 million, or 1.3 percent, over 2009 due primarily to a $3.0 million or 6.2 percent decrease in surgical supply and implant costs. Pharmaceuticals increased by $2.0 million or 7.9 percent over 2009. Medical supply expense for 2009 increased by $11.9 million, or 7.8 percent, over 2008 with increases in pharmaceutical costs of $5.0 million and surgical supply and implant costs of $5.1 million. These increases in 2009 were the result of an increase in patient volumes and the impact of inflation.

Other supplies and purchased services expense decreased in 2010 by $3.2 million, or 3.3 percent, over 2009 due primarily to an $8.4 million or 53.7 percent decrease in temporary help expense, offset by a $4.9 million or 18.7 percent increase in maintenance expense. Other supplies and purchased services expense for 2009 decreased by $10.3 million, or 9.8 percent, over 2008 due to a decrease in outside consulting expense related to the revenue cycle initiative and decreased expenditures for facilities equipment maintenance and improvements.

Depreciation and amortization increased by $2.4 million, or 8.1 percent, in 2010 compared to 2009 and by $2.2 million, or 7.8 percent, in 2009 compared to 2008 due to increased capital expenditures.

Insurance expense totaled $4.8 million in 2010, compared to $5.6 and $4.8 million in 2009 and 2008, respectively. The Medical Center is insured through the University's malpractice and general liability programs.

Non-operating Revenues (Expenses)
Non-operating revenues, which includes interest earned on invested cash balances, federal subsidies on projects funded with Build America Bonds, interest expense on debt, and losses from disposal or retirement of capital assets, increased by $0.4 million from 2009. Non-operating revenues for 2009 increased by $1.5 million from 2008. This increase is due primarily to a $2.9 million decrease in interest expense offset partially by a $1.4 million decrease in interest income on average daily invested cash. The decrease in interest expense is due to an increase in capitalized interest on construction projects funded with unrestricted funds. The decrease in interest income is due to both a decrease in the average daily invested cash balance and a decrease in the average short term investment pool earning rate.

Income before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $112.9 million in 2010 compared to $96.0 million in 2009 and $61.3 million in 2008.

Other Changes in Net Assets
The lower section of the statements of revenues, expenses and changes in net assets shows the other changes to net assets in addition to the income or loss. Net assets are the difference between the total assets and total liabilities. The other changes in net assets represent additional funds the Medical Center receives and cash outflow for support and transfers to other university entities.

Included in the other changes in net assets in 2010 and 2009 are the following:

- Proceeds from state capital appropriations of $0 million and $1.9 million, respectively.

- Donated assets of $1.6 million and $1.8 million, respectively.

- Health system support represents transfers primarily to the School of Medicine for academic and clinical support including support for the School of Medicine's primary care activities. The Medical Center transferred $39.3 million and $32.9 million, respectively.

- Transfers from the University of $2.0 million and $16.6 million, respectively.

In total, the net assets increased for the year ended June 30, 2010 by $77.1 million to $646.0 million. In 2009, net assets increased by $83.0 million to $568.9 million.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Current assets:			
Cash	$ 185,295	$ 150,789	$ 132,348
Patient accounts receivable (net)	139,756	123,060	130,658
Other current assets	51,195	51,475	50,951
Total current assets	376,246	325,324	313,957
Restricted assets	36,429	–	–
Capital assets (net)	550,675	450,805	362,821
Other assets	9,075	5,958	4,819
Total assets	972,425	782,087	681,597
Current liabilities	116,497	130,208	104,508
Long-term debt	209,906	82,987	91,149
Total liabilities	326,403	213,195	195,657
Net assets:			
Invested in capital assets (net)	321,699	320,904	258,570
Restricted	36,429	–	–
Unrestricted	287,894	247,988	227,370
Total net assets	$ 646,022	$ 568,892	$ 485,940

Total current assets increased by $50.9 million in 2010 over 2009. Total current assets at June 30, 2009 were $11.4 million higher than the previous year.

Cash increased by $34.5 million in 2010. The increase was primarily due to cash from operations and investing activities exceeding the cash used for capital investments and non-capital financing. In 2009, cash increased by $18.4 million over 2008. The increase was primarily due to cash from operations and investing exceeded cash used for capital investments and non-capital financing.

Patient accounts receivable, net of estimated uncollectibles, increased by 13.6 percent in 2010 over 2009 due primarily to increased patient activity and a small increase in days outstanding in accounts receivable. The decrease in days outstanding in accounts receivable in 2009 was due to improved collections resulting from revenue cycle initiatives. In 2009, net patient accounts receivable decreased by 5.8 percent over 2008 due to an 11 day decrease in days outstanding in account receivable.

In 2010, other current assets, which include third party payor settlement, non-patient receivables, inventory, and prepaid expenses were consistent with 2009 levels. In 2009, other current assets increased by $0.5 million, or 1.0 percent, from 2008 due to the following: third party payor settlements and other receivables decreased by $1.5 million due primarily to collection of prior year amounts due from affiliated institutions for house staff rotations; the total value of the Medical Center's pharmaceutical and supply inventories increased by $1.0 million due to the impact of inflation; and prepaid expenses increased by $1.0 million due to increases in prepaid equipment maintenance and building rent.

Capital assets increased by 22.2 percent in 2010 over 2009 due primarily to an increase in capital spending on the Thornton Expansion/Cardiovascular Center project. Capital assets increased by 24.2 percent in 2009 over 2008 due to an increase in capital spending on seismic safety work at the Hillcrest site, increased expenditures on the Thornton Expansion/Cardiovascular Center project, and increased expenditures for major clinical equipment in radiology, cardiology, and radiation oncology.

Restricted assets represents unspent proceeds of $36.4 million from the December 2009 bond issue that are held by the trustee. This money is restricted for use on the construction of the Thornton Expansion/Cardiovascular Center project, which is expected to be completed in December 2010.

In 2010, other assets increased by $3.1 million from the prior year due primarily to an increase in the investment in joint ventures. In 2009, other assets increased by $1.1 million from the prior year due primarily to an increase in investment in joint ventures.

Current liabilities decreased by $13.7 million, or 10.5 percent, from 2009 due primarily to repayment of commercial paper advances to partially fund construction of the Thornton Expansion/Cardiovascular Center project offset by increases in accounts payable and other accrued expenses. Current liabilities increased by $25.7 million, or 24.6 percent, in 2009 over 2008 due primarily to a $34.6 million increase in the current portion of long-term debt, offset by an $8.9 million decrease in accounts payable, third party payor settlement and other accrued expenses. The increase in the current portion of long-term debt is due primarily to $34.3 million of commercial paper borrowing from the University for interim financing for the Thornton Expansion/Cardiovascular Center project. The decrease in other current liabilities is due primarily to a decrease in days outstanding in accounts payable.

Long-term debt in 2010 increased by $126.9 million from the prior year due to borrowing of $123,715 for the Thornton Expansion/Cardiovascular project and two new capital leases for equipment offset by principal payments. In 2009 long-term debt decreased by $8.2 million from the prior year due as principal payments exceeded new borrowings.

Net assets increased by $77.1 million in 2010 over the prior year. The change in net assets includes excess of revenues over expenses of $112.9 million, receipt of $1.6 million of donated assets, and $2.0 million of transfer from the University. These increases to net assets were reduced by the transfer of approximately $39.3 million of funds to the University as health system support. During fiscal years 2009 and 2008, the Medical Center transferred $32.9 million and $31.1 million of funds to the University as health system support, respectively.

Liquidity and Capital Resources

During 2010, the Medical Center generated $140.8 million of cash from operations and expended of $34.1 million on investing activities. Capital expenditures for equipment, facilities, and information systems totaled $113.6 million, of which $1.9 million was acquired with state lease revenue bond funds under the Hospital Facilities Seismic Safety Act ("SB1953"), $1.6 million was acquired with donated funds, and $13.6 million was acquired under capital lease obligations.

In 2010, cash used for debt repayments was $65.0 million. An additional $39.3 million of funds were transferred to the University as health system support to fund clinical program development and activities of the School of Medicine and other areas of health sciences.

The following table shows key liquidity and capital ratios for 2010, 2009 and 2008:

	2010	2009	2008
Days cash on hand	97	83	77
Days of revenue in accounts receivable	63	61	72
Capital investment ($ in millions)	$113.6	$117.9	$71.6
Debt service coverage ratio	11.1	13.5	7.8

Days cash on hand increased from 83 days at June 30, 2009 to 97 days at June 30, 2010.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2010, net days in receivables increased 2 days to 63 in the revenue cycle process especially on the "front end" of the process related to patient access and admissions as well as to a modest increase in patient volume. Overall the large reduction in days of revenue in accounts receivable that was accomplished during 2009 were held in 2010.

The debt service coverage ratio for 2010 was 11.1 times debt service compared to 13.5 times debt service in 2009. Total debt service payments were $10.0 million in 2010 and $13.2 million in 2009. This ratio is higher than the 1.2 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2010, the UC San Diego Medical Center's capital program continued to address the requirements in State of California Senate Bill 1953 ("SB 1953"). The projected cost for the Medical Center, which will be compliant with the statutory requirements by January 1, 2013, is $48 million. The capital cost of compliance will be financed through the use of state lease revenue bond funds and Hospital Reserves. In 2010 and 2009, $1.9 million and $16.3 million, respectively, were spent on these requirements.

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

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

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

Medicaid Reform
In 2005, California enacted Senate Bill 1100 ("SB 1100") to implement a federal Medicaid hospital financing waiver ("waiver") that governs fee-for-service inpatient hospital payments for its public hospitals, which include the Medical Center. 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 federal economic stimulus package enacted in 2009, 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. The current waiver expired in August 2010 and plans for a renewal are under discussion between the Center for Medicare and Medicaid Services ("CMS") and the state, the outcome of which cannot be determined. 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.

Hospital Fee Program
AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The Medical Centers, as designated public hospitals, are exempt from paying the "Quality Assurance Fee"; however, the Medical Centers are eligible to receive supplemental payments under the Hospital Fee Program.

Children's Hospital Bond Act of 2008
In 2008, California voters passed Proposition 3 that enables the state of California to issue $980 million in General Obligation bonds to fund capital improvement projects for children's hospitals. The Medical Center 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.

Health Care Reform Bill
On March 23, 2010, the Patient Protection and Affordable Care Act (PPACA) was signed into law. On March 30, 2010 the Health Care and Education Reconciliation Act of 2010 was signed, amending the PPACA (collectively the "Affordable Care Act"). The Affordable Care Act addresses a broad range of topics affecting the health care industry, including a significant expansion of healthcare coverage. The coverage expansion is accomplished primarily through incentives for individuals to obtain and employers to provide health care coverage and an expansion in Medicaid eligibility. The Affordable Care Act also includes incentives for medical research and the use of electronic health records, changes designed to curb fraud, waste and abuse, and creates new agencies and demonstration projects to promote the innovation and efficiency in the healthcare delivery system. Some provisions of the health care reform legislation are effective immediately; others will be phased in through 2014. Further legislative policies are required for several provisions that will be effective in future years. The impact of this legislation will likely affect the Medical Centers, the effect of the changes that will be required in future years are not determinable at this time.

University of California Retirement and Other Post Employment Benefit Plans
UCRP costs are funded by a combination of investment earnings, employee member and employer contributions. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $1.9 billion or 94.8 percent funded. For the July 1, 2010, the funded ratio is expected to decrease to approximately 85 percent. The funding policy contributions related to campuses and medical centers in the July 1, 2009 actuarial valuation for 2010 are $1.6 billion, which represents 20.4 percent of covered compensation. Employer contributions for 2010 were $65 million. For 2011 the Regents authorized increasing the employer and employee contribution rates to UCRP. Contributions by employees will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University would be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These proposed changes would be subject to collective bargaining for union-represented employees. The Regents are scheduled to consider modifications to benefit design for pension benefits at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Currently, the University does not pre-fund retiree health benefits and provides for benefits on a pay-as-you-go basis. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $14.5 billion. The Regents are scheduled to consider modifications to eligibility and the University's share of contributions for retiree health care at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

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 Diego Medical Center
Statements of Net Assets
June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Assets		
Current assets:		
Cash	$ 185,295	$ 150,789
Patient accounts receivable, net of estimated uncollectibles of $48,799 and $36,449, respectively	139,756	123,060
Other receivables, net of estimated uncollectibles of $202 and $191, respectively	13,028	8,848
Third-party payor settlements	13,319	18,847
Inventory	14,591	13,551
Prepaid expenses and other assets	10,257	10,229
Total current assets	376,246	325,324
Restricted Assets:		
Cash restricted for construction projects	36,429	–
Capital assets, net	550,675	450,805
Deferred costs of issuance	2,521	1,515
Prepaid expenses and other assets, net of current portion	6,554	4,443
Total assets	972,425	782,087
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	59,789	45,940
Accrued salaries and benefits	45,964	39,271
Third-party payor settlements	747	1,840
Current portion of long-term debt and capital leases	9,997	43,157
Total current liabilities	116,497	130,208
Long-term debt and capital leases, net of current portion	209,906	82,987
Total liabilities	326,403	213,195
Net Assets		
Invested in capital assets, net of related debt	321,699	320,904
Restricted:		
Expendable:		
Capital Projects	36,429	–
Unrestricted	287,894	247,988
Total net assets	$ 646,022	$ 568,892

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

University of California, San Diego Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Net patient service revenue, net of provision for doubtful accounts of $74,003 and $64,755, respectively	$ 820,107	$ 770,679
Other operating revenue:		
Clinical teaching support	6,146	7,853
Other	8,036	5,925
Total other operating revenue	14,182	13,778
Total operating revenue	834,289	784,457
Operating expenses:		
Salaries and wages	300,890	278,809
UCRP, retiree health and other employee benefits	98,868	86,204
Professional services	32,211	30,054
Medical supplies	162,490	164,592
Other supplies and purchased services	91,973	95,139
Depreciation and amortization	32,181	29,763
Insurance	4,841	5,560
Total operating expenses	723,454	690,121
Income from operations	110,835	94,336
Non-operating revenues (expenses):		
Interest income	4,463	3,688
Interest expense	(3,364)	(1,740)
Build America bonds federal interest subsidies	1,365	–
Loss on disposal of capital assets	(427)	(295)
Total non-operating revenues	2,037	1,653
Income before other changes in net assets	112,872	95,989
Other changes in net assets:		
State capital appropriations	–	1,918
Donated assets	1,614	1,849
Health system support	(39,314)	(32,907)
Transfers from University, net	1,958	16,627
Other	–	(524)
Total other changes in net assets	(35,742)	(13,037)
Increase in net assets	77,130	82,952
Net assets – beginning of year	568,892	485,940
Net assets – end of year	$ 646,022	$ 568,892

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

University of California, San Diego Medical Center
Statements of Cash Flows
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 807,846	$ 784,494
Payments to employees	(333,043)	(315,045)
Payments to suppliers	(305,165)	(328,332)
Payments for benefits	(80,911)	(70,116)
Other receipts, net	52,043	52,095
Net cash provided by operating activities	140,770	123,096
Cash flows from noncapital financing activities:		
Health system support	(39,314)	(32,907)
Net cash used for noncapital financing activities	(39,314)	(32,907)
Cash flows from capital and related financing activities:		
State capital appropriations	–	1,918
Transfers from the University	1,958	16,627
Proceeds from debt issuance	145,297	34,314
Proceeds from the sale of capital assets	14	4
Bond issuance costs	(1,132)	–
Build America bonds federal interest subsidies	1,365	–
Purchases of capital assets	(113,580)	(117,890)
Principal paid on long-term debt and capital leases	(65,022)	(8,726)
Interest paid on long-term debt and capital leases	(3,349)	(1,721)
Gifts and donated funds	1,614	1,849
Other	–	(525)
Net cash used for capital and related financing activities	(32,835)	(74,150)
Cash flows from investing activities:		
Change in Restricted assets	(36,429)	–
Interest income received	4,463	3,688
Investments in joint venture	(2,149)	(1,286)
Net cash (used in) provided by investing activities	(34,115)	2,402
Net increase in cash	34,506	18,441
Cash – beginning of year	150,789	132,348
Cash – end of year	$ 185,295	$ 150,789

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

University of California, San Diego Medical Center
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2010 and 2009
(Dollars in thousands)

	2010	2009
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 110,835	$ 94,336
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	32,181	29,763
Provision for doubtful accounts	74,003	64,755
Changes in operating assets and liabilities:		
Patient accounts receivable	(90,699)	(57,157)
Other receivables	(4,180)	10,597
Inventory	(1,040)	(1,027)
Prepaid expenses and other assets	10	(989)
Accounts payable and accrued expenses	8,532	(11,262)
Accrued salaries and benefits	6,693	1,310
Third-party payor receivable settlements	5,528	(9,070)
Third-party payor payable settlements	(1,093)	1,840
Net cash provided by operating activities	$ 140,770	$ 123,096
Supplemental noncash activities information:		
Capitalized interest	$ 5,447	$ 2,964
Capital assets acquired through capital lease obligations	13,595	985
Amortization of bond premium	111	93
Amortization of deferred costs of issuance	126	112

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

1. Organization

The University of California, San Diego 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 Diego campus. The Medical Center operates licensed bed facilities as follows: the 398 bed UCSD Medical Center in Hillcrest, near downtown San Diego, the 119 bed John M. and Sally B. Thornton Hospital ("Thornton Hospital") located in La Jolla, and the 35 bed child and adolescent programs at Alvarado Hospital.

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 Entities*, to the extent that these principles do not contradict GASB standards.

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, was adopted by the Medical Center during the fiscal year ended June 30, 2010. 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.

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, was also adopted during the fiscal year ended June 30, 2010. GASB Statement No. 53 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 implementation of GASB Statement No. 51 and GASB Statement No. 53 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2010 and 2009.

2. Summary of Significant Accounting Policies (Continued)

Cash

All University operating entities maximize the returns on their cash balances by investing in a short-term investment pool ("STIP") managed by the Treasurer of The Regents. The Regents are responsible for managing the University's STIP and establishing investment policy, which is carried out by the Treasurer of The Regents.

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

The Medical Center's cash at June 30, 2010 and 2009 was $185,295 and $150,789, 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 2009-2010 annual report of the University.

Inventory

The Medical Center's inventory consists primarily of pharmaceuticals and medical supplies which are stated on a first-in, first-out basis at the lower of cost or market.

Prepaid Expenses and Other Assets

The Medical Center's prepaid expenses and other assets are primarily prepayments for pharmaceuticals and medical supplies, rent, equipment and maintenance contracts. Also included in other assets, are joint venture arrangements with various third party entities that include providing bone marrow transplantation services and ambulatory surgery services of which the Medical Center does not have control of its activities.

Restricted Assets, Cash Held for Construction

Proceeds from the Medical Center Pooled Revenue Bonds are held by the Treasurer of The Regents. Bond proceeds remain on deposit with the Treasurer until the project is constructed. Restricted assets consist of short-term investments, recorded at cost, which approximates fair value.

Capital Assets

The Medical Center's capital assets are reported at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. Equipment under capital leases is amortized over the shorter period of the lease term or the estimated useful life of the equipment. Lease amortization is included in depreciation and amortization expense. The range of the estimated useful lives for buildings and land improvements is 10 to 40 years and for equipment is

2. Summary of Significant Accounting Policies (Continued)

Capital Assets (Continued)
3 to 20 years. Interest on borrowings and imputed interest on excess operating funds used to finance facilities is capitalized during construction. University guidelines mandate that land purchased with Medical Center funds be recorded as an asset of the Medical Center. Land utilized by the Medical Center but purchased with other sources of funds is recorded as an asset of the University. Incremental costs, including salaries and employee benefits, directly related to the acquisition, development and installation of major software projects are included in the cost of the capital assets.

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

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

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, 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.

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 could 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.

Tax Exemption

The Regents of the University of California is recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (IRC). Because the University is a State institution, related income received by the University is also exempt from federal tax under IRC Section 115(a). In addition, the University is exempt from State income taxes imposed under the California Revenue and Taxation Code.

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.

3. Net Patient Service Revenue

The Medical Center has agreements with third-party payors that provide for payments at amounts different from the Medical Center's established rates. A summary of the payment arrangements with major third-party payors follows:

- ***Medicare*** – Medicare patient revenues include traditional reimbursement under Title XVIII of the Social Security Act (non-risk).

  Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. The Medical Center does not believe that there 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, 2004. The fiscal intermediary is in the process of conducting their audits of the 2005 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 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"). For the year ended June 30, 2010 and 2009, the Medical Center recorded total Medi-Cal revenue of $169,218 and $185,605, 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, 2010 and 2009, the Medical Center recorded revenue of $16,055 and $15,116 respectively.

- ***Senate Bill 1732*** – State of California Senate Bill 1732 ("SB 1732") provides for supplemental Medi-Cal reimbursement to disproportionate share hospitals for costs (i.e., principal and interest) of qualified patient care capital construction. For the years ended June 30, 2010 and 2009, the Medical Center applied for and received additional revenue of $1,950 and $1,950, respectively. The amounts received are related to the reimbursement of costs for certain debt financed construction projects based on the Medical Center's Medi-Cal utilization rate.

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

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

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

  - Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

The most common payment arrangement for inpatient services is a prospectively determined per-diem rate or case rate. The most common payment arrangement for outpatient care is a prospective payment system that uses ambulatory payment classifications.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

Amounts due from Medicare and Medi-Cal represent 18 percent and 17 percent of net patient accounts receivable at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, net patient service revenue included $8.5 million and $0.7 million, respectively, due to cost report settlements with Medicare, Medi-Cal and the County Medical Services Program.

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

	2010	2009
Medicare (non-risk)	$ 179,436	$ 159,861
Medi-Cal (non-risk)	169,218	185,605
Commercial	8,562	10,704
Contract (discounted or per diem)	435,710	384,657
County	19,627	21,598
Non-sponsored/self-pay	7,554	8,254
Total	$ 820,107	$ 770,679

4. Charity Care

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

	2010	2009
Charity care at established rates	$ 100,429	$ 92,179
Estimated cost of charity care	$ 26,086	$ 28,235

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $15,757 and $13,369 for the years ended June 30, 2010 and 2009, respectively.

(Dollars in thousands)

5. Capital Assets

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

	2008	Additions	Disposals	2009	Additions	Disposals	2010
Original Cost							
Land	$ 4,550	$ –	$ –	$ 4,550	$ –	$ –	$ 4,550
Buildings and improvements	382,551	11,586	(101)	394,036	80,412	–	474,448
Equipment	124,609	25,132	(7,507)	142,234	33,135	(5,193)	170,176
Construction in progress	85,999	81,328	–	167,327	18,945	–	186,272
Capital assets, at cost	$ 597,709	$ 118,046	$ (7,608)	$ 708,147	$ 132,492	$ (5,193)	$ 835,446

	2008	Depreciation	Disposals	2009	Depreciation	Disposals	2010
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 164,254	$ 15,325	$ (101)	$ 179,478	$ 15,738	$ –	$ 195,216
Equipment	70,634	14,438	(7,208)	77,864	16,443	(4,752)	89,555
Accumulated depreciation and amortization	$ 234,888	$ 29,763	$ (7,309)	$ 257,342	$ 32,181	$ (4,752)	$ 284,771
Capital assets, net	$ 362,821			$ 450,805			$ 550,675

Equipment under capital lease obligations and related accumulated amortization is $29,362 and $12,813 in 2010, respectively, and $19,065 and $10,196 in 2009, respectively.

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

The Medical Center is currently making seismic improvements in order to be in compliance with Senate Bill 1953, the *Hospital Facilities Seismic Safety Act*. A portion of the improvements will be financed under a lease revenue bond with the State of California Public Works Board. These amounts totaling $1,945 and $16,340 for the years ended June 30, 2010 and 2009, respectively, are included in Transfers from University for building program on the statements of revenues, expenses and changes in net assets.

(Dollars in thousands)

6. Long-term Debt and Capital Leases

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

	2010	2009
University of California Medical Center Pooled Revenue Bonds 2009 Series F, "Build America Bonds", net interest rates after the 35 percent federal subsidy ranging from 4.2 percent to 4.3 percent, payable semi-annually, with annual principal payments beginning in 2021 through 2049	$ 110,355	$ –
University of California Medical Center Pooled Revenue Bonds 2009 Series E, interest rates ranging from 3.0 percent to 5.5 percent, payable semi-annually, with annual principal payments beginning in 2021 through 2038	13,360	–
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 principal payments beginning in 2012 through 2047	19,230	19,230
University of California Hospital Revenue Bonds 2000, interest rates from 4.125 percent to 10 percent, payable semi-annually, with annual principal payments through 2019	44,535	47,935
University of California General Revenue Bonds 2003 Series B, interest rates from 2.0 percent to 5.25 percent, payable semi-annually, with annual principal payments through 2023	12,731	13,641
University of California Commercial Paper Program, interim financing for construction through the University of California	–	34,314
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 3.28 percent to 7.79 percent, payable through February 2010, collateralized by underlying equipment	17,775	9,893
Unamortized bond premium	1,917	1,131
Total debt and capital leases	219,903	126,144
Less: Current portion of debt and capital leases	(9,997)	(43,157)
Noncurrent portion of debt and capital leases	$ 209,906	$ 82,987

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

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, 2010 and 2009 was $8,811 and $4,704, respectively. Interest expense totaling $5,447 and $2,964 was capitalized during the years ended June 30, 2010 and 2009, respectively. The remaining $3,364 in 2010 and $1,740 in 2009 are reported as interest expense in the statements of revenues, expenses and changes in net assets.

(Dollars in thousands)

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

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

	Revenue Bonds	Capital Lease Obligations	Commercial Paper	Total
Year Ended June 30, 2010				
Current portion at June 30, 2009	$ 4,402	$ 4,441	$ 34,314	$ 43,157
Reclassification from noncurrent	4,642	6,645	20,686	31,973
Principal payments	(4,309)	(5,713)	(55,000)	(65,022)
Amortization of bond premium	(111)	–	–	(111)
Current portion at June 30, 2010	$ 4,624	$ 5,373	$ –	$ 9,997
Noncurrent portion at June 30, 2009	$ 77,535	$ 5,452	$ –	$ 82,987
New obligations	123,715	13,595	20,686	157,996
Bond Premium	896	–	–	896
Reclassification to current	(4,642)	(6,645)	(20,686)	(31,973)
Noncurrent portion at June 30, 2010	$ 197,504	$ 12,402	$ –	$ 209,906
Year Ended June 30, 2009				
Current portion at June 30, 2008	$ 4,229	$ 4,286	$ –	$ 8,515
Reclassification from noncurrent	4,402	4,745	34,314	43,461
Principal payments	(4,136)	(4,590)	–	(8,726)
Amortization of bond premium	(93)	–	–	(93)
Current portion at June 30, 2009	$ 4,402	$ 4,441	$ 34,314	$ 43,157
Noncurrent portion at June 30, 2008	$ 81,937	$ 9,212	$ –	$ 91,149
New obligations	–	985	34,314	35,299
Reclassification to current	(4,402)	(4,745)	(34,314)	(43,461)
Noncurrent portion at June 30, 2009	$ 77,535	$ 5,452	$ –	$ 82,987

Medical Center Pooled Revenue Bonds are issued to provide financing to the University's medical centers and are collateralized by a joint and several pledge of the operating revenues, as defined in the indenture, of all five of the University's medical centers. The Medical Center Pooled Revenue Bond indenture requires the medical centers to set rates, charges and fees each year sufficient for the medical center operating revenues to pay for the annual principal and interest on the bonds and sets forth requirements for certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2010 are $1.55 billion of which $142.9 million are specifically for capital projects at the Medical Center. Combined operating revenues of the University's five medical centers for the years ended June 30, 2010 and 2009 were $5.94 billion and $5.56 billion, respectively.

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

In December 2009, Medical Center Pooled Revenue Bonds totaling $123.7 million were issued as taxable "Build America Bonds" specifically for the Medical Center to finance the Cardiovascular Center at the Thornton Hospital location in La Jolla. Proceeds including a bond premium of $895 thousand were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through May 2020 and mature at various dates through 2049. The taxable bonds have a stated weighted average interest rate of 6.57 percent and a net weighted average interest rate of 4.27 percent after the expected cash subsidy payment from the United States Treasury equal to 35 percent of the interest payable on the taxable bonds. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

In January 2007, Medical Center Pooled Revenue Bonds totaling $19,230 were issued specifically for the Medical Center to refinance a portion of the UCSD Cancer Center construction costs. Proceeds, including a bond premium of $243, were used to pay for issuance costs and repay interim commercial paper financing prior to the issuance of the bonds. The bonds require interest only payments through November 2011, mature at various dates through 2047 and have a weighted average interest rate of 4.55 percent.

University of California Hospital Revenue Bonds have also been used to finance certain improvements at the Medical Center. The Hospital Revenue Bonds are collateralized solely by revenues of the Medical Center. Under the bond indenture, the Medical Center is required to maintain a debt service coverage ratio of not less than 1.2 and between 1.2 and 2.0 depending upon various circumstances, and has limitations as to additional borrowings, the purchase or sale of business assets and the disposition of liquid assets.

General Revenue Bonds Series 2003, collateralized solely by general revenues of the University, finance certain Medical Center projects. The Medical Center is charged for its proportional share of total principal and interest payments made on the General Revenue Bonds pertaining to Medical Center projects.

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

(Dollars in thousands)

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

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

Future Debt Service

Future debt service payments for each of the five fiscal years subsequent to June 30, 2010 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Capital Lease Obligations	Total Payments	Principal	Interest
2011	$ 10,933	$ 5,889	$ 16,822	$ 9,875	$ 6,947
2012	16,310	4,723	21,033	9,295	11,738
2013	16,303	3,918	20,221	8,865	11,356
2014	15,997	2,953	18,950	7,962	10,988
2015	15,984	1,469	17,453	6,804	10,649
2016 – 2020	79,836	–	79,836	31,148	48,688
2021 – 2025	63,850	–	63,850	21,742	42,108
2026 – 2030	58,786	–	58,786	22,975	35,811
2031 – 2035	56,199	–	56,199	28,330	27,869
2036 – 2040	52,820	–	52,820	34,765	18,055
2041 – 2045	40,242	–	40,242	34,170	6,072
2046 – 2048	2,195	–	2,195	2,055	140
Total future debt service	429,455	18,952	448,407	$ 217,986	$230,421
Less: Interest component of future payments	(229,245)	(1,176)	(230,421)		
Principal portion of future payments	200,210	17,776	217,986		
Adjusted by:					
Unamortized bond premium	1,917	–	1,917		
Total debt	$ 202,127	$ 17,776	$ 219,903		

Additional information on the revenue bonds can be obtained from the 2009-2010 annual report of the University.

(Dollars in thousands)

7. Operating Leases

The Medical Center leases buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2010 and 2009 was $6,138 and $4,581, respectively. The terms of the operating leases extend through the year 2016.

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

Year Ending June 30,	Minimum Annual Lease Payments
2011	$ 5,239
2012	4,305
2013	3,742
2014	2,665
2015	2,079
2016	1,144
Total	$ 19,174

8. Retiree Health Plans

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

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

Participating University locations, such as the Medical Center, are required to contribute at a rate assessed each year by the UCRHBT. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.12 and $3.09 per $100 of UCRP-covered payroll resulting in Medical Center contributions of $8,400 and $7,800 for the years ended June 30, 2010 and 2009, respectively.

8. Retiree Health Plans (Continued)

The actuarial value of UCRHBT assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2009, the date of the latest actuarial valuation, were $76.9 million and $14.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $69.4 million at June 30, 2010. For the years ended June 30, 2010 and 2009, combined contributions from the University's campuses and medical centers were $283.5 million and $278.5 million, respectively, including an implicit subsidy of $49.5 million and $44.1 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.6 billion and $1.5 billion for the years ended June 30, 2010 and 2009. 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 $3.7 billion at June 30, 2010 increased by $1.4 billion and $1.2 billion for the years ended June 30, 2010 and 2009, 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 2009–2010 annual reports of the University of California and the University of California Health and Welfare Program.

9. Retirement Plans

Substantially all full-time employees of the Medical Center participate in the University of California Retirement System ("UCRS") that is administered by the University. The UCRS consists of The University of California Retirement Plan ("UCRP"), a single employer defined benefit plan, and the University of California Retirement Savings Program ("UCRSP") that includes four defined contribution plans with several investment portfolios generally funded with employee non-elective and elective contributions. The Regents has the authority to establish and amend the benefit plans.

The UCRP provides lifetime retirement income, disability protection, and survivor benefits to eligible employees. Benefits are based on average highest three years compensation, age, and years of service and are subject to limited cost-of-living increases.

Contributions to the UCRP may be made by the Medical Center and the employees. The rates for contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by the Medical Center and by the employees. Employee contributions by represented employees are subject to collective bargaining agreements. Medical Center and employee contributions were $2,497 and $775, respectively, during the year ended June 30, 2010. There were no required Medical Center or employee contributions for the year ended June 30, 2009.

9. Retirement Plans (Continued)

The actuarial value of UCRP assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2009, the date of the latest actuarial valuation, were $34.8 billion and $36.8 billion, respectively, resulting in a funded ratio of 94.8 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $34.6 billion and $32.3 billion at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, the University's campuses and medical centers contributed a combined $64.8 million and $0.4 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.6 billion for the year ended June 30, 2010. 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 $1.5 billion for the year ended June 30, 2010.

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 2009–2010 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

10. University Self-insurance

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

(Dollars in thousands)

10. University Self-insurance (Continued)

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $949 and $629 for the years ended June 30, 2010 and 2009, respectively. During 2010 and 2009, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $4,601 and $5,812, 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 $4,841 and $5,560 for the years ended June 30, 2010 and 2009, respectively.

11. Transactions with Other University Entities

Services purchased from the University include office and medical supplies, building maintenance, repairs and maintenance, administrative, treasury, medical services, and insurance. Services provided to the University include 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:

	2010	2009
Salaries and employee benefits	$ 3,714	$ 2,570
Professional services	32,211	30,054
Medical supplies	(1,087)	(1,029)
Other supplies and purchased services	(9,482)	(10,234)
Interest income (net)	(3,785)	(5,446)
Insurance	4,841	5,560
Total	$ 26,412	$ 21,475

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

The total net amount of payments made by the Medical Center to the University were $65,726 and $53,382 in 2010 and 2009, respectively. Of these amounts, $26,412 and $21,475 are reported as operating expenses for the years ended June 30, 2010 and 2009, respectively, and $39,314 and $32,907 are reported as health system support for the years ended June 30, 2010 and 2009, respectively.

12. State Funds for Capital Acquisitions

The 2000 State Budget Act provided $50 million in state capital appropriations for non-seismic capital improvement (i.e., infrastructure) projects at the University's medical centers. The Medical Center was allocated $25 million of the $50 million state capital appropriation. During fiscal years 2010 and 2009, $0 and $1,918, respectively, was expended and received by the Medical Center and reflected as a state capital appropriation in the statements of revenues, expenses and changes in net assets.

13. 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 Medical Center 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 Medical Center's financial statements.

State of California Senate Bill 1953, *Hospital Facilities Seismic Safety Act*, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. The Medical Center has received an extension to January 1, 2013 to complete the required renovations. 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 $40,000 was allocated to the Medical Center. The Medical Center spent $2,000 and $16,340 of its allocation during the years ended June 30, 2010 and 2009, respectively, recorded in the statements of revenues, expenses and changes in net assets as a Transfer from University. As of June 30, 2010, any repayment the Medical Center may be obligated to make under these financing arrangements are dependent upon continued appropriations for the lease payments to the University by the State.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately $123 million, excluding interest, as of June 30, 2010.

14. Subsequent Event

AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a “Quality Assurance Fee” and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State’s effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The CDHS is responsible for obtaining approval from CMS on a distribution plan for funds. It is not anticipated that fees and payments would commence without federal approval, but if final federal approval is not obtained, any fees and payments made under the program would be refunded. The Medical Centers, as designated public hospitals, are exempt from paying the “Quality Assurance Fee”; however, the Medical Centers are eligible to receive supplemental payments under the Hospital Fee Program.

University of California,
San Francisco Medical Center
Financial Statements
For the Years Ended June 30, 2010 and 2009

University of California, San Francisco Medical Center
Index
June 30, 2010 and 2009

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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 19 through 46, 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, 2010 and 2009, 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, 2010 and 2009, 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 18 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 11, 2010

University of California, San Francisco Medical Center
Management's Discussion and Analysis

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, 2010, with selected comparative information for the years ended June 30, 2009 and 2008. 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 (2008, 2009, 2010, 2011, 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. Consistently ranked among the nation's top medical schools, the UCSF School of Medicine earns its greatest distinction from its outstanding faculty – among them are four Nobel laureates, 71 Institute of Medicine members, 58 American Academy of Arts and Sciences members, 42 National Academy of Sciences members, and 17 Howard Hughes Medical Institute investigators. In 2010, U.S. News & World Report ranked the UCSF School of Medicine fourth nationally for its research training and fifth for its primary care training – the only medical school in the country ranked in the top five in both categories.

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 Benioff 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, 2010, the Medical Center had 660 available beds.

The Medical Center's financial statements include the activities of the UCSF Medical Group – the faculty practice plan for UCSF faculty physicians ("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.

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: basic care, moderate care, and highly complex care, including transplants, neurosurgery, and cancer treatment. 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 2003 to 2008 – the last year for which California-wide hospital data is available – 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 2010-2011 U.S. News & World Report survey of America's best hospitals ranked UCSF Medical Center as the seventh best hospital in the nation. The survey score summarizes overall quality of inpatient care, including balance of nurses to patients, mortality, patient safety, reputation, procedure volume and care-related measures such as technology and patient services.

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, gynecology, kidney disorders, neurology & neurosurgery, ophthalmology, pulmonology, rheumatology, and urology.

UCSF Benioff Children's Hospital was ranked by U.S. News & World Report among the nation's best children's hospitals in eight 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 2010-2011 Children's Hospital survey ranked among the top 30 hospitals in 10 individual specialties – cancer, diabetes and endocrinology, gastroenterology, heart and heart surgery, kidney care, neonatology, neurology and neurosurgery, orthopedics, pulmonology, and urology.

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, tactics, and initiatives 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 focus on patient and referring physician satisfaction, decrease in wait time, coordination of patient tracking, and 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 increasing the number of non-resident and mixed services to reduce reliance on the resident model, increasing residents in select departments, developing core teaching and non-resident staffing models for inpatient units, and 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 investing in recruitment initiatives that enable UCSF to meet goals around clinical growth and patient mix, creating retention initiatives that allow UCSF to identify and develop the next generation of UCSF leadership, and continuing to strengthen the relationship between UCSF and its employees.

During 2010, some of the Best Care initiatives included:

- Continued emphasis on patient safety. The organization-wide goals for 2010 included further reducing central line-related bloodstream infections in the Intensive Care Units, further reducing hospital-acquired pressure ulcers in adult patients, and piloting 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.

- Design, development and construction of a state-of-the-art off-site pharmacy production facility to improve patient safety, to automate inventory control and reordering, and to produce certain pharmaceuticals currently outsourced. The pharmacy production facility will open during fiscal year 2011 and will enable bar-coded medication administration.

- Launch of an enterprise-wide electronic medical records project to replace the previous project (see note 6 to the audited financial statements). During 2010, the Medical Center entered into a contract with the vendor, created the dedicated project team including internal staff and supplemental contract staff, conducted visioning sessions, sent the project team to training, refined the scope and timing of implementation, and created the project plan.

- Continued optimization of the patient/bed tracking system to improve patient flow.

- Enhancement of the web-based patient portal to allow on-line patient payments.

- 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.

- Continued 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 time frame, 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 target, and care models. With demand projected to outpace available capacity in the 2008 to 2015 timeframe, it becomes vital for UCSF to match patient service mix to core capabilities. Tactics include focusing on adult incremental growth in high and moderate complexity care, exceeding minimum volumes to support educational and research requirements, and committing to a set of institutional policies that are intended to 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 improving exam room utilization, ensuring that there is sufficient office space available to support projected growth of the clinical enterprise, and focusing on the development of ambulatory growth off the main campus.

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

During 2010, Clinical Growth initiatives included:

- Continued development of the UCSF Mission Bay Hospital. The scope of the UCSF Medical Center Mission Bay Clinical Facilities includes construction of approximately 878,000 gross square feet to accommodate a 289-bed inpatient building for Children's, Women's and Cancer hospitals, an outpatient building with a helipad, an energy center, and site improvements including parking and site infrastructure. In 2010, the Medical Center:

    - completed the hospital design and virtually constructed the hospital in 3-D using innovative Building Information Management (BIM) software at the Integrated Center for Design and Construction (ICDC), a group of over 100 staff from UCSF, the general contractor, and subcontractors.
    - submitted all major hospital design packages to the State of California Office of Statewide Hospital Planning and Development (OSHPD) for regulatory approval.
    - secured approval from the San Francisco Board of Supervisors of a resolution that allows operation of a helipad.
    - continued site preparation, demolishing a warehouse structure and billboard, and beginning mass excavation and re-compacting of the soil.
    - installed auger cast structural piles for OSHPD testing and approval.
    - completed development of major architectural details, selection of interior materials, and design and selection of interior palette and patterns. The design builds upon four concepts previously developed: kaleidoscope as a metaphor, connection to the environment, universal appeal along with personal choice, and discovery and engagement.

- built full-scale mock-up rooms, including an outpatient exam room, an acute care adult room, an intensive care nursery room, and an operating room. Tours of mock-up rooms were arranged for clinical staff, administrative and support staff, and for patients and families to provide practical feedback.
- reduced the budget for project by $166 million, through value reengineering, innovative ideas from the ICDC, and market-based pricing.
- continued its capital campaign to raise $600 million. As of June 30, 2010, pledges to the campaign totaled $322 million, with $92 million collected, giving the project the distinction of being the only capital project in UC history to receive two nine-figure gifts.
- prepared a funding plan and resolution for a budget reduction. Subsequent to 2010, on September 16, 2010, The Regents of the University of California approved an amendment to the capital budget and external, interim, and stand-by financing for the project.

- Launch of a workgroup to plan for the growth of inpatient services on the 6th, 7th, and 15th floors of the Moffitt-Long Hospital, available when the UCSF Benioff Children's Hospital moves to Mission Bay, as well as outpatient growth at Mount Zion. The workgroup includes hospital and physician leadership.

- Launch of a project to study and improve access to faculty practice clinics with an emphasis to improve service to patients and referring physicians.

- 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.

- Continued the five-year joint collaboration agreement with Mercy Medical Center ("Mercy") in Redding, California and St. Helena Hospital in St. Helena, 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.

- Opening 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 also includes 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 Orthopaedic 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 2010, 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.

- Launch of a new model of shared governance across the clinical enterprise.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2010, 2009 and 2008:

Statistics	2010	2009	2008
Licensed beds	722	722	706
Admissions	29,087	28,190	28,679
Average daily census	500	523	503
Discharges	29,098	28,591	28,789
Average length of stay	6.3	6.6	6.4
Patient days	182,641	190,870	184,060
Case mix index	1.92	1.94	1.90
Outpatient visits:			
Hospital clinic visits	752,635	735,713	722,728
Home health visits	18,468	17,717	16,491
Emergency visits	36,426	37,759	39,356
Total visits	807,529	791,189	778,575

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 decreased by 8,229, or 4.3 percent, in 2010 and increased by 6,810, or 3.7 percent, in 2009. The Medical Center continued to grow inpatient admissions and outpatient visits in 2010. With efforts in improved patient flow, the average length of stay declined in 2010 and, therefore, the Medical Center's average patient census decreased. The Medical Center's case mix index, a measure of the acuity of care, has continued to be above 1.90 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 16,340, or 2.1 percent, and 12,614, or 1.6 percent, in 2010 and 2009, respectively, from the previous year.

In addition to increased volume of outpatient visits, the Medical Center's rates – net revenue per patient day and net revenue per outpatient procedure or visit – improved from 2008 to 2009 and from 2009 to 2010.

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 2010 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Net patient service revenue	$ 1,766,688	$ 1,629,106	$ 1,457,023
Other operating revenue	21,069	24,044	25,815
Total operating revenue	1,787,757	1,653,150	1,482,838
Total operating expenses	1,637,178	1,552,113	1,438,260
Income from operations	150,579	101,037	44,578
Total non-operating expenses	(1,474)	(20,954)	(3,014)
Income before other changes in net assets	$ 149,105	$ 80,083	$ 41,564
Margin	8.3 percent	4.8 percent	2.8 percent
Other changes in net assets	22,066	(28,110)	(7,920)
Increase in net assets	171,171	51,973	33,644
Net assets – beginning of year	760,758	708,785	675,141
Net assets – end of year	$ 931,929	$ 760,758	$ 708,785

Revenues
Total operating revenues for 2010 were $1,788 million, an increase of $135 million, or 8.1 percent, over 2009. Operating revenues for 2009 of $1,653 million increased by $170 million, or 11.5 percent, over 2008.

Net patient service revenue for 2010 increased by $138 million, or 8.5 percent, over 2009. The increase in 2010 was primarily due to an increase of outpatient volumes and an improvement in inpatient and outpatient reimbursement rates. Net patient service revenue in 2009 increased by $172 million, or 11.8 percent, over 2008 primarily due to increased patient volumes, an improvement in reimbursement rates and higher patient acuity.

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 2010, 2009 and 2008 (dollars in thousands):

Payor	2010	2009	2008
Medicare (non-risk)	$ 356,344	$ 331,397	$ 309,967
Medi-Cal (non-risk)	202,936	190,396	171,223
Contracts – commercial	1,144,254	1,051,007	920,239
Contracts (capitated)*	11,381	11,973	10,421
County/Uninsured	51,773	44,333	45,173
Total	$ 1,766,688	$ 1,629,106	$ 1,457,023

*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 $24.9 million, or 7.5 percent, from 2009 to 2010 and $21.4 million, or 6.9 percent, from 2008 to 2009. 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. 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. During 2010, the Medical Center decreased its net liability related to prior year third party settlements and loss contingencies by $6.8 million with a corresponding increase to net patient service revenue in the statements of revenues, expenses and changes in net assets. During 2009, the Medical Center decreased its net 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.

Net revenue for Medi-Cal patients increased $12.5 million, or 6.6 percent, from 2009 to 2010 and $19.2 million, or 11.2 percent, from 2008 to 2009. 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 increase in net revenue during 2010 for Medi-Cal was due to improved reimbursement rates, including stimulus amounts received under the American Recovery and Reinvestment Act of 2009. The increase in 2009 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. Medi-Cal net revenues in 2010 and 2009 also include supplemental reimbursement for a portion of unreimbursed facility costs under the State of California Assembly Bill ("AB 915").

Net revenue earned on commercial contracts increased $93.2 million, or 8.9 percent, from 2009 to 2010 and $130.8 million, or 14.2 percent, from 2008 to 2009. Health Maintenance Organizations (HMO's) and Preferred Provider Organizations (PPO's) usually reimburse the Medical Center at contracted discount or per-diem rates. Net revenue from commercial contracts represented about 64.8 percent of total net patient service revenue in 2010, consistent with 64.5 percent in 2009 and 63.2 percent in 2008. Commercial inpatient days as well as the average yield – net revenue per inpatient day – increased in both 2010 and 2009. Commercial contract revenue for hospital clinic visits also increased in 2010 compared to 2009 and 2008.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Salaries and wages	$ 652,506	$ 642,416	$ 595,562
Employee benefits	141,248	131,479	119,696
Professional services	24,665	25,196	24,238
Medical supplies	245,015	230,108	211,434
Other supplies and purchased services	424,973	388,187	365,088
Depreciation and amortization	77,790	67,707	60,711
Insurance	7,288	7,083	5,775
Other	63,693	59,937	55,756
Total operating expenses	$ 1,637,178	$ 1,552,113	$ 1,438,260

Total operating expenses were $1,637 million in 2010, up $85 million, or 5.5 percent, from 2009. Operating expenses increased in 2010 due to higher labor and medical supply costs, along with higher medical services purchased from the University. Depreciation expense has also increased as capital investments in equipment and infrastructure have grown in 2010. In 2009, operating expenses increased $113 million, or 7.9 percent, from 2008 primarily due to increased patient days, along with higher labor and medical supply costs.

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. The Medical Center incurred significant costs during 2008 to address deficiencies. During 2009, CMS resurveyed and found the Medical Center to be fully in compliance.

Salaries and wages include compensation paid to Medical Center employees, and amounts paid to temporary and registry contractors. About half of the Medical Center workforce, including most nurses and employees providing ancillary services, expands or contracts with patient volumes. In 2010, salaries and wages grew by $10.1 million, or 1.6 percent, over the prior year primarily due to wage increases. In 2009, salaries and wages increased by $46.9 million, or 7.9 percent, over 2008, primarily due to increases in patient days and clinic visits. 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 temporary and registry contractors. Overall, labor costs per hospital-paid employee increased by 3.1 percent in 2010 over 2009 and increased 7.2 percent in 2009 over 2008. As a percentage of total operating revenue, salaries and employee benefits were 44.4 percent in 2010, 46.8 percent in 2009 and 48.2 percent in 2008.

In 2010, employee benefits increased $9.8 million, primarily due to higher health insurance costs and pension costs, net of lower workers' compensation costs. During the last quarter of 2010, the University resumed pension funding with employer contributions of 4 percent of covered wages. In 2009, employee benefits increased $11.8 million, primarily due to higher health insurance costs, net of lower workers' compensation costs.

Medical supplies including pharmaceuticals, totaled $245.0 million in 2010, up $14.9 million, or 6.5 percent, from 2009, primarily due to pharmaceutical costs. In 2009, medical supplies, including pharmaceuticals, totaled $230.1 million, up $18.7 million, or 8.8 percent. Medical supplies increased in 2009 partly due to higher patient volumes and increases in pharmaceutical costs. 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 13.7 percent in 2010, down from 13.9 percent of operating revenue in 2009 and 14.3 percent in 2008. The Medical Center has ongoing initiatives to control supply utilization and to negotiate competitive pricing.

Other supplies and purchased services totaled $425.0 million in 2010, up $36.8 million, or 9.4 percent, from 2009. Purchased services increased in 2010 primarily due to improved collection of professional fee billings which were passed through to the UCSF Medical Group. In 2009, these costs totaled $388.2 million in 2009, up $23.1 million, or 6.3 percent, from 2008 also due to improved collection of professional fee billings which were passed through to the UCSF 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.

Depreciation and amortization totaled $77.8 million in 2010, an increase of $10.1 million, or 14.9 percent, from the prior year, due to capital investment in facilities, systems, and equipment. In 2009, depreciation and amortization increased $7.0 million, or 11.5 percent, from 2008 due to capital investment in facilities, systems, and equipment.

Insurance expense totaled $7.3 million in 2010, up from $7.1 million and $5.8 million in 2009 and 2008, respectively. The Medical Center is insured through the University's malpractice and general liability programs.

The Medical Center reported an operating margin of 8.3 percent in 2010 compared to an operating margin of 6.1 percent in 2009 and 3.0 percent in 2008. As noted above, the operating margin in 2008 was impacted by the additional costs incurred to remedy regulatory issues.

Non-operating Revenues (Expenses)
Non-operating expenses, net of non-operating revenues, totaled $1.5 million in 2010, compared to $21.0 million in 2009, and $3.0 million in 2008. Non-operating revenues and expenses include interest income and expense, and loss on disposals of capital assets. In 2010, interest income increased due to higher invested cash balances. The 2009 non-operating expenses included a write-off of $18.3 million in capital assets as the Medical Center abandoned the development of portions of an electronic medical record system (see note 6 to the audited financial statements).

Income before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $149.1 million in 2010, compared to $80.1 million in 2009, and $41.6 million in 2008, an increase of $69.0 million and an increase of $38.5 million, respectively. The Medical Center's net income increased in 2010 mainly due to improved reimbursement rates as well as operating efficiencies. In 2009, net income improved primarily due to higher patient volumes, improved reimbursement rates, and, operating efficiencies, net of the disposal of capital assets. The 2008 income before other changes was negatively impacted by additional costs incurred to remedy regulatory issues.

Other Changes in Net Assets
Items directly charged or credited to equity in 2010 included donations of $59.1 million and net program support transfers to the University of $37.1 million. Items directly charged or credited to equity in 2009 include donations of $2.2 million and net program support transfers to the University of $30.3 million. The resulting total change in net assets was an increase of $22.0 million in 2010 and a decrease of $28.1 million in 2009.

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

	2010	2009	2008
Net program support – School of Medicine	$ 37,066	$ 30,284	$ 25,065
Net program support – Land costs	–	–	(5,000)
Total	$ 37,066	$ 30,284	$ 20,065

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2010, 2009 and 2008 (dollars in thousands):

	2010	2009	2008
Current assets			
Cash	$ 217,192	$ 127,526	$ 128,842
Patient accounts receivable (net)	302,481	291,110	269,788
Other current assets	71,188	51,903	36,729
Total current assets	590,861	470,539	435,359
Capital assets (net)	824,471	736,367	682,856
Other assets	28,933	22,641	12,811
Total assets	1,444,265	1,229,547	1,131,026
Current liabilities	198,794	188,801	165,220
Long-term debt	262,810	245,783	229,490
Other liabilities	50,732	34,205	27,531
Total liabilities	512,336	468,789	422,241
Net assets			
Invested in capital assets (net)	531,091	462,741	426,809
Restricted	12,759	9,536	7,705
Unrestricted	388,079	288,481	274,271
Total net assets	$ 931,929	$ 760,758	$ 708,785

Total current assets increased $120.3 million, or 25.6 percent, from 2009 to 2010 primarily due to an increase of cash and an increase in patient accounts receivable and third party payor settlements. In 2009, total current assets increased $35.2 million, or 8.1 percent, from 2008 primarily due to an increase in patient accounts receivable and an increase in deposits for equipment purchases.

Cash increased $89.7 million, or 70.3 percent, during 2010 and decreased $1.3 million, or 1.0 percent, during 2009. The increase in 2010 was primarily due to cash provided by operations.

Net patient accounts receivable represented 51.2 percent of current assets at June 30, 2010, down from 61.9 and down from 62.0 percent of current assets at June 30, 2009 and 2008, respectively. In 2010, net patient account receivables increased by $11.4 million from the prior year. This increase was due to higher outpatient volumes and higher rates. In 2009, net patient account receivables increased by $21.3 million from the prior year due to higher patient volumes and rates.

Net capital assets increased by $88.1 million from 2009 to 2010 due to continued investment in equipment, systems, infrastructure and development of land at Mission Bay. In 2008, net capital assets increased by $53.5 million from 2008 to 2009 also due to investment in equipment, systems, infrastructure and development of land at Mission Bay.

Current liabilities increased by $10.0 million from 2009 to 2010 primarily due to higher accounts payable balances and an increase of long-term debt payments due in the coming fiscal year. In 2009, current liabilities increased by $23.6 million from 2008 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.

Long-term liabilities of $313.5 million at June 30, 2010, increased $33.6 million from June 30, 2009. 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 $271.8 million at June 30, 2009, increased $14.8 million from June 30, 2008, due to additional borrowings made during the year in excess of principal payments on long-term debt. Third party payor settlements and loss contingencies increased as the Medical Center reclassified certain amounts to current assets.

Net assets increased $171.2 million, or 22.5 percent, during 2010 and $52.0 million, or 7.3 percent, during 2009. Income for 2010 and 2009 totaled $149.1 million and $80.1 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 $37.1 million and $30.3 million in 2010 and 2009, respectively. Donations added $59.1 million and $2.2 million to net assets during 2010 and 2009, respectively.

Liquidity and Capital Resources

During 2010, the Medical Center generated $218.5 million in cash from operating activities. This represented an increase of $72.6 million, or 49.8 percent from 2009 to 2010, and an increase of $60.1 million, or 70.0 percent from 2008 to 2009. Cash received from patients and third-party payors totaled $1.7 billion in 2010, up $170.1 million, or 10.9 percent, from 2009. This amount totaled $1.6 billion in fiscal year 2009, up $144.2 million, or 10.2 percent, from 2008.

In 2010 and 2009, cash flows from non-capital financing activities reduced cash by $37.1 million and $30.3 million, respectively, for transfers to the University for health system support.

Cash used by capital and related financing activities totaled $97.2 million in 2010, compared to $120.7 million in 2009 and $127.3 million in 2008.

Cash used for capital and related financing activities decreased by $23.5 million from 2009 to 2010 and decreased by $6.6 million from 2008 to 2009. The Medical Center purchased capital assets of $168.5 million in 2010 and received donated funds of $59.1 million. Principal payments on long-term debt and capital leases totaled $30.1 million in 2010 and interest paid was $7.7 million. In 2009, cash flows from capital and related financing activities included purchases of capital assets of $138.8 million, donated funds of $2.2 million, principal payments on long-term debt and capital leases of $21.3 million and interest paid of $7.8 million.

Cash flows from investment activities included $8.6 million and $5.6 million provided by interest income in 2010 and 2009, respectively. Overall cash increased to $217.2 million in 2010 from $127.5 million in 2009 and decreased to $127.5 million in 2009 from $128.8 million in 2008.

The following table shows key liquidity and capital ratios for 2010, 2009 and 2008:

	2010	2009	2008
Days cash on hand	51	31	34
Days of revenue in accounts receivables, net	63	65	68
Capital investment ($ in millions)	$168.5	$140.3	$143.0
Debt service coverage ratio	6.2	5.3	4.2

Days cash on hand increased to 51 days in 2010 from 31 days in 2009 and decreased to 31 days in 2009 from 34 days in 2008. 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 2010, net days in receivables decreased 2 days to 63. In 2009, net days in receivables decreased 3 days to 65.

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 2010 was 6.2 times versus 5.3 times in 2009. The increase was primarily due to the increase of income from operations. 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 ratios in 2010 and 2009 are higher than the 1.0 required by the Bond Indenture.

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 enacted Senate Bill 1100 ("SB 1100") to implement a federal Medicaid hospital financing waiver ("waiver") that governs fee-for-service inpatient hospital payments for its public hospitals, which include the Medical Center. 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 federal economic stimulus package enacted in 2009, which increases California's federal DSH allotment and the federal matching rate for FFS payments, increase the net payment amounts under the waiver to the University's medical centers for the period October 2008 through December 2010. The current waiver expired in August 2010 and plans for a renewal are under discussion between the Center for Medicare and Medicaid Services ("CMS") and the state, the outcome of which cannot be determined. 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.

Hospital Fee Program
AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State's effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The University's medical centers, as designated public hospitals, are exempt from paying the "Quality Assurance Fee"; however, the University's medical centers are eligible to receive supplemental payments under the Hospital Fee Program.

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. The Medical Center 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's 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.

Health Care Reform Bill

On March 23, 2010, the Patient Protection and Affordable Care Act ("PPACA") was signed into law. On March 30, 2010, the Health Care and Education Reconciliation Act of 2010 was signed, amending the PPACA (collectively, the "Affordable Care Act"). The Affordable Care Act addresses a broad range of topics affecting the health care industry, including a significant expansion of health care coverage. The coverage expansion is accomplished primarily through incentives for individuals to obtain and employers to provide health care coverage and an expansion in Medicaid eligibility. The Affordable Care Act also includes incentives for medical research and the use of electronic health records, changes designed to curb fraud, waste and abuse, and creates new agencies and demonstration projects to promote the innovation and efficiency in the healthcare delivery system. Some provisions of the health care reform legislation are effective immediately; others will be phased in through 2014. Further legislative policies are required for several provisions that will be effective in future years. The impact of this legislation will likely affect the University's medical centers; the effect of the changes that will be required in future years are not determinable at this time.

University of California Retirement and Other Post Employment Benefit Plans

UCRP costs are funded by a combination of investment earnings, employee member and employer contributions. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $1.9 billion or 94.8 percent funded. For the July 1, 2010, the funded ratio is expected to decrease to approximately 85 percent. The funding policy contributions related to campuses and medical centers in the July 1, 2009 actuarial valuation for 2010 are $1.6 billion, which represents 20.4 percent of covered compensation. Employer contributions for 2010 were $64.8 million. For 2011 the Regents authorized increasing the employer and employee contribution rates to UCRP. Contributions by employees will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University would be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These proposed changes would be subject to collective bargaining for union-represented employees. The Regents are scheduled to consider modifications to benefit design for pension benefits at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

Currently, the University does not pre-fund retiree health benefits and provides for benefits on a pay-as-you-go basis. The unfunded liability for the campuses and medical centers as of July 1, 2009 actuarial valuation was $14.5 billion. The Regents are scheduled to consider modifications to eligibility and the University's share of contributions for retiree health care at meetings during the Fall 2010. The modifications to be considered include recommendations by the Post-Employment Benefits Task Force, which submitted its report to the University President in August 2010.

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, 2010 and 2009
(Dollars in thousands)

	2010	2009
Assets		
Current assets:		
Cash	$ 217,192	$ 127,526
Patient accounts receivable, net of estimated uncollectibles of $20,350 and $22,802, respectively	302,481	291,110
Other receivables	154	1,927
Third-party payor settlements, net	18,454	1,415
Inventory	24,557	22,084
Prepaid expenses and other assets	28,023	26,477
Total current assets	590,861	470,539
Restricted assets:		
Donor funds	12,759	9,536
Capital assets, net	824,471	736,367
Deferred costs of issuance and other	16,174	13,105
Total assets	1,444,265	1,229,547
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	101,686	98,574
Accrued salaries and benefits	61,590	58,971
Current portion of long-term debt and capital leases	30,570	27,843
Other liabilities	4,948	3,413
Total current liabilities	198,794	188,801
Long-term debt and capital leases, net of current portion	262,810	245,783
Third-party payor settlements, net	39,314	26,032
Other liabilities	11,418	8,173
Total liabilities	512,336	468,789
Net Assets		
Invested in capital assets, net of related debt	531,091	462,741
Restricted:		
Expendable:		
Capital projects	7,787	3,734
Other	4,972	5,802
Unrestricted	388,079	288,481
Total net assets	$ 931,929	$ 760,758

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, 2010 and 2009
(Dollars in thousands)

	2010	2009
Net patient service revenue, net of provision for doubtful accounts of $37,415 and $43,006, respectively	$ 1,766,688	$ 1,629,106
Other operating revenue:		
Clinical teaching support	3,796	8,712
Other	17,273	15,332
Total other operating revenue	21,069	24,044
Total operating revenue	1,787,757	1,653,150
Operating expenses:		
Salaries and wages	652,506	642,416
UCRP, retiree health and other employee benefits	141,248	131,479
Professional services	24,665	25,196
Medical supplies	245,015	230,108
Other supplies and purchased services	424,973	388,187
Depreciation and amortization	77,790	67,707
Insurance	7,288	7,083
Other	63,693	59,937
Total operating expenses	1,637,178	1,552,113
Income from operations	150,579	101,037
Non-operating revenues (expenses):		
Interest income	8,576	5,566
Interest expense	(7,720)	(7,839)
Build America bonds federal interest subsidies	241	–
Loss on disposal of capital assets	(2,571)	(18,681)
Total non-operating expenses	(1,474)	(20,954)
Income before other changes in net assets	149,105	80,083
Other changes in net assets:		
Donated assets	59,132	2,174
Health system support	(37,066)	(30,284)
Total other changes in net assets	22,066	(28,110)
Increase in net assets	171,171	51,973
Net assets – beginning of year	760,758	708,785
Net assets – end of year	$ 931,929	$ 760,758

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, 2010 and 2009
(Dollars in thousands)

	2010	2009
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,734,564	$ 1,564,449
Payments to employees	(650,956)	(637,309)
Payments to suppliers	(764,994)	(698,525)
Payments for benefits	(139,435)	(127,220)
Other receipts, net	39,351	44,518
Net cash provided by operating activities	218,530	145,913
Cash flows from noncapital financing activities:		
Health system support	(37,066)	(30,284)
Net cash used by noncapital financing activities	(37,066)	(30,284)
Cash flows from capital and related financing activities:		
Proceeds from debt issuance	49,889	45,039
Bond issuance cost	(97)	–
Build America bonds federal interest subsidies	241	–
Proceeds from sale of capital assets	67	106
Purchases of capital assets	(163,877)	(138,843)
Principal paid on long-term debt and capital leases	(30,131)	(21,317)
Interest paid on long-term debt and capital leases	(12,375)	(7,839)
Gifts and donated funds	59,132	2,174
Net cash used by capital and related financing activities	(97,151)	(120,680)
Cash flows from investing activities:		
Interest income received	8,576	5,566
Change in restricted cash	(3,223)	(1,831)
Net cash provided by investing activities	5,353	3,735
Net increase (decrease) in cash	89,666	(1,316)
Cash – beginning of year	127,526	128,842
Cash – end of year	$ 217,192	$ 127,526

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, 2010 and 2009
(Dollars in thousands)

	2010	2009
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 150,579	$ 101,037
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	77,790	67,707
Provision for doubtful accounts	37,415	43,006
Changes in operating assets and liabilities:		
Patient accounts receivable	(48,786)	(64,328)
Other receivables	1,773	(1,552)
Inventory	(2,473)	(1,417)
Prepaid expenses and other assets	(1,277)	(10,521)
Accounts payable and accrued expenses	3,112	13,403
Accrued salaries and benefits	2,619	10,110
Third-party payor settlements	(3,757)	(11,192)
Other liabilities	1,535	(340)
Net cash provided by operating activities	$ 218,530	$ 145,913
Supplemental noncash activities information:		
Capitalized interest	$ 4,655	$ 3,052
Capital assets acquired through capital lease obligations	-	1,162
Change in fair value of interest rate swap agreements	(3,245)	(4,858)
Amortization of deferred financing costs	113	114
Amortization of bond premium	20	19
Amortization of deferred costs of issuance	153	153
Payables for property and equipment	13,648	16,906

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 660 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 Entities,* to the extent that these principles do not contradict GASB standards.

GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, was adopted by the Medical Center during the fiscal year ended June 30, 2010. 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. Implementation of GASB Statement No. 51 had no effect on the Medical Center's net assets for the years ended June 30, 2010 and 2009.

(Dollars in thousands)

2. Summary of Significant Accounting Policies (Continued)

GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, was also adopted during the fiscal year ended June 30, 2010. GASB Statement No. 53 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 determined that its interest rate swap agreements entered into in conjunction with certain Medical Center Pooled Revenue Bonds are derivative instruments that meet the criteria of an effective hedge.

In accordance with GASB Statement No. 53, retrospective application is required. However, there was no cumulative effect on the previously reported net assets as of July 1, 2008.

The Medical Center restated the 2009 statement of net assets for purposes of presenting comparative information to the year ended June 30, 2010. The effect on the change on the Medical Center's financial statements for the year ended June 30, 2009 from the adoption of GASB Statement No. 53 was to increase liabilities by $8,173 for the negative fair value of the interest rate swap and increase assets by $8,173 to defer the negative fair value from the application of hedge accounting as follows:

	Year Ended June 30, 2009		
	As Previously Reported	Effect of Adoption of Statement No. 53	As Restated
Statement of Net Assets			
Deferred costs of issuance and other	$ 4,932	$ 8,173	$ 13,105
Total assets	1,221,374	8,173	1,229,547
Other liabilities	–	8,173	8,173
Total liabilities	460,616	8,173	468,789

Cash

All University operating entities maximize the returns on their cash balances by investing in a short-term investment pool ("STIP") managed by the Treasurer of The Regents. The Regents are responsible for managing the University's STIP and establishing investment policy, which is carried out by the Treasurer of The Regents.

Substantially all of the Medical Center's cash is deposited into the STIP. All Medical Center deposits into the STIP are considered demand deposits. Unrealized gains and losses associated with the fluctuation in the fair value of the investments included in the STIP (and predominately held to maturity) are not recorded by each operating entity but are absorbed by the University, as the manager of the pool. As of June 30, 2010, $11,460 of unspent loan proceeds was included in the Medical Center's cash balance.

2. Summary of Significant Accounting Policies (Continued)

Cash (Continued)
The Medical Center's cash at June 30, 2010 and 2009 was $217,192 and $127,526, 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 2009-2010 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, 2010 and 2009 by the Treasurer's Office were $12,759 and $9,536, 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.

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. These derivative financial instruments are agreements that 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.

2. Summary of Significant Accounting Policies (Continued)

Interest Rate Swap Agreements (Continued)
Interest rate swaps are recorded at fair value as either assets or liabilities in the statement of net assets. The Medical Center has determined the interest rate swaps are hedging derivatives that hedge future cash flows. Under hedge accounting, changes in the fair value are considered to be deferred inflows (for hedging derivatives with positive fair values) or deferred outflows (for hedging derivatives with negative fair values). Deferred inflows are included with other liabilities and deferred outflows with other assets in the statement of net assets.

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

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

Deferred Financing Costs
Refinancing or defeasance of previously outstanding debt has resulted in deferred financing costs comprised of the difference between the reacquisition price and the net carrying amount of the old debt. 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.

2. Summary of Significant Accounting Policies (Continued)

Net Assets (Continued)

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

Revenues and Expenses

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

2. Summary of Significant Accounting Policies (Continued)

UCRP Benefits Expense

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

Charity Care

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

Transactions with the University and University Affiliates

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

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

Compensated Absences

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

Tax Exemption

The Regents of the University of California is recognized as a tax-exempt organization under Section 501(c)(3) of the Internal Revenue Code (IRC). Because the University is a State institution, related income received by the University is also exempt from federal tax under IRC Section 115(a). In addition, the University is exempt from State income taxes imposed under the California Revenue and Taxation Code.

2. Summary of Significant Accounting Policies (Continued)

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.

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, 2002. The fiscal intermediary is in the process of conducting their audits of the 2003 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.

3. Net Patient Service Revenue (Continued)

- ***Medi-Cal*** – The Medicaid program is referred to as Medi-Cal in California. Medi-Cal fee-for-service ("FFS") inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 ("SB 1100"). Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. SB 1100 allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share ("DSH") payments, and Safety Net Care Pool ("SNCP"). For the years ended June 30, 2010 and 2009, the Medical Center recorded total Medi-Cal revenue of $202,936 and $190,396, respectively.

- ***Assembly Bill 915*** – State of California Assembly Bill ("AB") 915, *Public Hospital Outpatient Services Supplemental Reimbursement Program*, provides for supplemental reimbursement equal to the federal share of unreimbursed facility costs incurred by public hospital outpatient departments. This supplemental payment covers only Medi-Cal fee-for-service outpatient services. The supplemental payment is based on each eligible hospital's certified public expenditures ("CPE"), which are matched with federal Medicaid funds. For the years ended June 30, 2010 and 2009, the Medical Center recorded revenue of $12,319 and $12,244, 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.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

- Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

The most common payment arrangement for inpatient services is a prospectively determined per-diem rate or case 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 19.4 percent and 19.5 percent of net patient accounts receivable at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, net patient service revenue included $10,805 and $20,451, 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:

	2010	2009
Medicare (non-risk)	$ 356,344	$ 331,397
Medicare (risk)	9,126	8,437
Medi-Cal (non-risk)	202,936	190,396
Commercial	34,173	36,011
Contract (discounted or per diem)	1,110,081	1,014,996
Contract (capitated)	2,255	3,536
County	18,157	15,678
Non-sponsored/self-pay	33,616	28,655
Total	$ 1,766,688	$ 1,629,106

4. Charity Care

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

	2010	2009
Charity care at established rates	$ 41,044	$ 37,952
Estimated cost of charity care	$ 11,371	$ 10,511

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $89,171 and $83,984 for the years ended June 30, 2010 and 2009, 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:

	2010	2009
Capital projects	$ 7,787	$ 3,734
General	4,972	5,802
Total	$ 12,759	$ 9,536

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, 2010 and 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:

	2008	Additions	Disposals	2009	Additions	Disposals	2010
Original Cost							
Land	$ 100,278	$ 80	$ –	$ 100,358	$ 2,219	$ –	$ 102,577
Buildings and improvements	681,864	102,461	–	784,325	56,005	–	840,330
Equipment	325,533	28,304	(16,253)	337,584	44,435	(46,694)	335,325
Construction in progress	142,382	9,443	(18,305)	133,520	66,039	(1,990)	197,569
Capital assets, at cost	$1,250,057	$ 140,288	$ (34,558)	$1,355,787	$ 168,698	$ (48,684)	$1,475,801

	2008	Depreciation	Disposals	2009	Depreciation	Disposals	2010
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 376,068	$ 33,892	$ –	$ 409,960	$ 38,416	$ –	$ 448,376
Equipment	191,133	33,815	(15,488)	209,460	39,374	(45,880)	202,954
Accumulated depreciation and amortization	$ 567,201	$ 67,707	$ (15,488)	$ 619,420	$ 77,790	$ (45,880)	$ 651,330
Capital assets, net	$ 682,856			$ 736,367			$ 824,471

Equipment under capital lease obligations and related accumulated amortization is $107,480 and $45,859 in 2010, respectively, and $83,213 and $30,732 in 2009, respectively.

6. Capital Assets (Continued)

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.

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:

	2010	2009
University of California Medical Center Pooled Revenue Bonds 2009 Series F "Build America Bonds", net interest rates after the 35 percent federal subsidy ranging from 4.2 percent to 4.3 percent, payable semi-annually, with annual principal payments beginning in 2021 through 2049	$ 19,620	$ –
University of California Medical Center Pooled Revenue Bonds 2009 Series E, interest rates ranging from 3.0 percent to 5.5 percent, payable semi-annually, with annual principal payments beginning in 2012 through 2038	1,680	–
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 principal 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	88,610	91,215
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	140,272	135,737
Commercial paper, interim financing for construction through the University of California	–	3,473
Unamortized bond premium	751	701
Unamortized deferred financing costs	(1,573)	(1,520)
Total debt and capital leases	293,380	273,626
Less: Current portion of debt and capital leases	(30,570)	(27,843)
Noncurrent portion of debt and capital leases	$ 262,810	$ 245,783

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, 2010 and 2009 was $12,375 and $10,891, respectively. Interest expense totaling $4,655 and $3,052 was capitalized during the years ended June 30, 2010 and 2009,

(Dollars in thousands)

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

respectively. The remaining $7,720 in 2010 and $7,839 in 2009 are reported as interest expense in the statements of revenues, expenses and changes in net assets.

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, 2010				
Current portion at June 30, 2009	$ 2,512	$ 21,858	$ 3,473	$ 27,843
Reclassification from noncurrent	2,603	30,163	–	32,766
Principal payments	(2,605)	(24,054)	(3,473)	(30,132)
Amortization of bond premium	(20)	–	–	(20)
Amortization of deferred financing costs	113	–	–	113
Current portion at June 30, 2010	$ 2,603	$ 27,967	$ –	$ 30,570
Noncurrent portion at June 30, 2009	$ 131,904	$ 113,879	$ –	$ 245,783
New obligations	21,300	28,589	–	49,889
Bond premium	70	–	–	70
Deferred financing costs	(166)	–	–	(166)
Reclassification to current	(2,603)	(30,163)	–	(32,766)
Noncurrent portion at June 30, 2010	$ 150,505	$ 112,305	$ –	$ 262,810
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

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 University's 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 sets forth requirements for certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2010 are $1.55 billion of which $153,930 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, 2010 and 2009 were $5.94 billion and $5.56 billion, respectively.

In December 2009, Medical Center Pooled Revenue Bonds totaling $21,300, including $19,620 of taxable "Build America Bonds" and $1,680 of tax-exempt bonds, were issued specifically for the Medical Center to finance certain improvements to the Medical Center. Proceeds, including a bond premium of $70 were used to pay for project construction and issuance costs and repay interim financing incurred prior to the issuance of the bonds. The bonds require interest only payments through November 2012 and mature at various dates through 2049. The taxable bonds have a stated weighted average interest rate of 6.6 percent and a net weighted average interest rate of 4.3 percent after the expected cash subsidy payment from the United States Treasury equal to 35 percent of the interest payable on the taxable bonds. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds.

The Medical Center Pooled Revenue Bonds 2007 Series B totaling $88,610 are variable rate demand obligations subject to daily remarketing. The Medical Center has entered into a standby bond purchase agreement if a failed remarketing were to occur. If a failed remarketing were to occur and redemption of any of the bonds is required, the Medical Center has access to the hospital working capital program from the University described below.

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 has an option to purchase the land on January 1, 2014 and 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.

(Dollars in thousands)

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

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

Interest Rate Swap Agreements

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.

The notional amounts, fair value of the interest rate swap outstanding and the change in fair value for June 30, 2010 and 2009 are as follows:

Notional Amount		Fair Value – Positive (Negative)			Changes in Fair Value		
2010	2009	Classification	2010	2009	Classification	2010	2009
$88,610	$91,215	Other liabilities	($11,418)	($8,173)	Deferred inflows	($3,245)	($4,858)

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, 2010 or 2009.

Objective and Terms. Under the swap agreement, the Medical Center pays the swap counterparty a fixed interest rate payment and receives a variable rate interest rate payment that effectively changes the Medical Center's variable interest rate bonds to synthetic fixed rate bonds.

The Medical Center has determined the interest rate swap is a hedging derivative that hedge future cash flows. 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.

(Dollars in thousands)

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

Interest Rate Swap Agreements (Continued)

Additional terms with respect to the outstanding swap and the fair value at June 30, 2010, along with the credit rating of the counterparty, are as follows:

Terms	Effective Date	Maturity Date	Cash Paid or Received	Counterparty Credit Rating
Pay fixed 3.5897 percent; receive 58 percent of 1-Month LIBOR* + 0.48 percent**	2007	2032	None	Aa1/AA

* London Interbank Offered Rate (LIBOR)

** Weighted average spread

Credit Risk. The Medical Center could be exposed to credit risk if the counterparty to the swap contract is unable to meet the terms of the contracts. 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 swap contract's fair value, less any collateral held by the Medical Center provided by the counterparty. There are no collateral requirements related to the swap. Swap contracts with negative fair values are not exposed to credit risk.

Although the Medical Center has entered into the interest rate swap contract with a creditworthy financial institution to hedge its variable-rate debt, there is credit risk for losses in the event of non-performance by counterparties.

Interest rate risk. There is a risk the value of the interest rate swap will decline because of changing interest rates. The values of interest rate swaps with longer maturities date tend to be more sensitive to changing interest rates and, therefore, more volatile than those with shorter maturities.

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.

(Dollars in thousands)

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

Future Debt Service and Interest Rate Swaps

Future debt service payments for each of the five fiscal years subsequent to June 30, 2010 and thereafter are shown below.

Year Ending June 30,	Revenue Bonds	Capital Lease Obligations	Total Payments	Principal	Interest
2011	$ 9,244	$ 33,734	$ 42,978	$ 30,662	$ 12,316
2012	9,817	28,953	38,770	27,422	11,348
2013	9,400	22,939	32,339	22,260	10,079
2014	9,598	59,285	68,883	60,722	8,161
2015	9,805	6,339	16,144	9,643	6,501
2016 – 2020	49,475	7,060	56,535	27,953	28,582
2021 – 2025	50,664	–	50,664	27,320	23,344
2026 – 2030	49,928	–	49,928	32,375	17,553
2031 – 2035	32,558	–	32,558	20,670	11,888
2036 – 2040	19,716	–	19,716	11,705	8,011
2041 – 2045	19,245	–	19,245	14,525	4,720
2046 – 2048	9,942	–	9,942	8,945	997
Total future debt service	$ 279,392	$ 158,310	$ 437,702	$ 294,202	$ 143,500
Less: Interest component of future payments	(125,462)	(18,038)	(143,500)		
Principal portion of future payments	$ 153,930	$ 140,272	$ 294,202		
Adjusted by:					
Unamortized bond premium	751	–	751		
Unamortized deferred financing costs	(1,573)	–	(1,573)		
Total debt	$ 153,108	$ 140,272	$ 293,380		

Additional information on the revenue bonds can be obtained from the 2009-2010 annual report of the University.

(Dollars in thousands)

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

Future Debt Service and Interest Rate Swaps (Continued)

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, 2010, debt service requirements of the variable rate debt and net swap payments are as follows:

Year Ending June 30,	Variable-Rate Bond: Principal	Variable-Rate Bond: Interest	Interest Rate Swap, Net	Total
2011	$ 2,695	$ 102	$ 2,571	$ 5,368
2012	2,800	99	2,493	5,392
2013	2,895	95	2,411	5,401
2014	3,000	92	2,326	5,418
2015	3,110	89	2,239	5,438
2016 – 2019	17,350	386	9,765	27,501
2020 – 2024	20,740	278	7,042	28,060
2025 – 2029	24,800	150	3,788	28,738
2030 – 2032	11,220	19	472	11,711
Total	$ 88,610	$ 1,310	$ 33,107	$ 123,027

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, 2010 and 2009 was $23,288 and $20,909, respectively.

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
2011	$ 16,587
2012	12,437
2013	10,558
2014	6,979
2015	3,794
2016 – 2020	19,046
2021 – 2022	4,671
Total	$ 74,072

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.

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 $3.12 and $3.09 per $100 of UCRP covered payroll resulting in Medical Center contributions of $18,200 and $17,300 for the years ended June 30, 2010 and 2009, 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, 2009, the date of the latest actuarial valuation, were $76.9 million and $14.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $69.4 million at June 30, 2010. For the years ended June 30, 2010 and 2009, combined contributions from the University's campuses and medical centers were $283.5 million and $278.5 million, respectively, including an implicit subsidy of $49.5 million and $44.1 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.6 billion and $1.5 billion for the years ended June 30, 2010 and 2009. 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 $3.7 billion at June 30, 2010 increased by $1.4 billion and $1.2 billion for the years ended June 30, 2010 and 2009, 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 2009–2010 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.

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. Medical Center and employee contributions were $5,372 and $1,618, respectively, during the year ended June 30, 2010. There were no required Medical Center or employee contributions for the year ended June 30, 2009.

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, 2009, the date of the latest actuarial valuation, were $34.8 billion and $36.8 billion, respectively, resulting in a funded ratio of 94.8 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $34.6 billion and $32.3 billion at June 30, 2010 and 2009, respectively.

For the years ended June 30, 2010 and 2009, the University's campuses and medical centers contributed a combined $64.8 million and $0.4 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.6 billion for the year ended June 30, 2010. 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 $1.5 billion for the year ended June 30, 2010.

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.

(Dollars in thousands)

10. Retirement Plans (Continued)

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 2009–2010 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

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 $9,732 and $11,375 for the years ended June 30, 2010 and 2009, respectively. During 2010 and 2009, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $6,374 and $4,927, 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 $7,288 and $7,083 for the years ended June 30, 2010 and 2009, 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:

	2010	2009
Salaries and employee benefits	$ 4,530	$ (4,844)
Medical supplies	(4,570)	(4,432)
Other supplies and purchased services	333,790	304,149
Interest income (net)	(8,576)	(5,566)
Insurance	7,288	7,083
Total	$ 332,462	$ 296,390

(Dollars in thousands)

12. Transactions with Other University Entities (Continued)

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 $369,528 and $326,674 in 2010 and 2009, respectively. Of these amounts, $332,462 and $296,390 are reported as operating expenses for the years ended June 30, 2010 and 2009, respectively, and $37,066 and $30,284 are reported as health system support for the years ended June 30, 2010 and 2009, respectively.

13. Segment Information

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 30, 2010 and 2009 is as follows:

Year Ended June 30, 2010

	Hospital Practice	UCSF Medical Group	Total
Operating revenues	$ 1,422,085	$ 365,672	$ 1,787,757
Operating expenses	1,271,618	365,560	1,637,178
Net non-operating expenses	1,474	–	1,474
Income before other changes in net assets	$ 148,993	$ 112	$ 149,105

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

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 Medical Center 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 Medical Center's 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. As of June 30, 2010, any repayments the Medical Center may be obligated to make under these financing arrangements are dependent upon continued appropriations for the lease payments to the University by the State.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately $106,300, excluding interest, as of June 30, 2010.

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.

The Medical Center owns 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.

15. Subsequent Event

AB 1383 of 2009, as amended by AB 1653 on September 8, 2010, establishes a series of Medicaid supplemental payments funded through a “Quality Assurance Fee” and a "Hospital Fee Program", which are imposed on certain California hospitals. The effective date of the Hospital Fee Program is April 1, 2009 through December 31, 2010 and is predicated in part on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee Program would make supplemental payments to hospitals for various health care services and support the State’s effort to maintain health care coverage for children. Supplemental payments are anticipated to be made by California Department of Health Care Services ("CDHS") before December 31, 2010. The CDHS is responsible for obtaining approval from CMS on a distribution plan for funds. It is not anticipated that fees and payments would commence without federal approval, but if final federal approval is not obtained, any fees and payments made under the program would be refunded. The University's medical centers, as designated public hospitals, are exempt from paying the “Quality Assurance Fee”; however, the University's medical centers are eligible to receive supplemental payments under the Hospital Fee Program.