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.