University of California, Davis Medical Center

Financial Statements

For the Years Ended June 30, 2011 and 2010

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets, and cash flows, as shown on pages 16 through 19, 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, 2011 and 2010, and the 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, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

PricewaterhouseCoopers LLP

October 12, 2011

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, 2011, with selected comparative information for the years ended June 30, 2010 and 2009. 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 (2009, 2010, 2011, 2012, 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 CEO by the Chancellor of the Davis campus.

The "Medical Center" is the principal clinical teaching site for the University of California, Davis, ("UCD") School of Medicine, which was founded in 1966. The Betty Irene Moore School of Nursing at UC Davis, established in 2009, conducts research in collaboration with the Medical Center.

Licensed as a 645-bed general acute care hospital with 34 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 3.6 million gross square feet of facilities, most of which are located 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, Natomas, 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 Children's Hospital. It is the only provider of several tertiary/quaternary services between San Francisco and Portland, including Level 1 adult and pediatric trauma care, National Cancer Institute designated Cancer Center, and adult burn care.

The Medical Center participates in a variety of cooperative outreach activities with regional healthcare 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 Veterans Administration, 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 750 faculty and contract physicians, 690 residents and fellows, and 110 PCN physicians.

For the year ended June 30, 2011, 31,025 patients were admitted to the Medical Center, of which approximately 54.1 percent were admitted through the emergency room, and overall occupancy was approximately 81.1 percent. During the same period, there were 951,811 outpatient visits, of which 90.7 percent were visits to the clinics and the PCN sites and 6.1 percent were emergency room visits.

Significant events during the year are highlighted below:

Major expansion of hospital
The Medical Center expanded its operations into new facilities upon completion of the largest construction project ever undertaken in UC Davis history. The new facilities house four of the medical center's biggest departments: the Department of Emergency Medicine, the Department of Surgery, the Department of Pathology and Laboratory Medicine, and Food and Nutrition Services. The expansion includes urgently needed space for surgery, trauma, emergency and burn services. In addition, several ancillary departments, including laboratory, radiology, pharmacy and therapy services, are located in the new section of the Medical Center. The additional space is designed to expand facilities to meet programmatic requirements. The project is vital to compliance with the seismic safety requirements mandated by Senate Bill 1953 ("SB 1953"). The new hospital facilities replace space for the north and south wings of the hospital which are not seismically compliant. The added space encompasses 472,000 square feet and is the most technologically advanced building on UC Davis' Sacramento campus. The added space allows the medical center to better address the health needs of the community and accommodate an increasing demand for services.

Continuing expansion to meet mission, community needs
Several different construction projects are under way to ensure that the Medical Center has the resources and facilities to meet the needs of the community it serves. Key projects in progress are as follows:

- **PICU**: Under construction in formerly shelled space in the hospital, the new Pediatric Intensive Care unit (PICU) will replace two separate spaces currently in use; have twice as much floor space; and increase the number of beds from 16 to 24. The move-in date is November 2011.
- **Cancer Center expansion**: This 46,000-square-foot expansion will make room for the pediatric cancer program, now located in other buildings on campus. Consolidating the adult and pediatric programs will benefit both pediatric and adult patients. The adult hematology and oncology clinic, adult infusion pharmacy, and other clinical services will be enlarged as well. Move-in is scheduled for 2012.

Enhancement of national reputation
The Medical Center continues to enhance its standing as one of the leading academic health centers in the U.S. The Leapfrog Group ranked the Medical Center among its top 65 U.S. hospitals for 2010, a distinction that recognizes hospital performance in crucial areas of patient safety and quality. *U.S. News and World Report's* ranking of the top 50 hospitals in America includes the Medical Center, the only hospital in the Sacramento region on the list. Patient-satisfaction ratings are at an all-time high: The Medical Center has experienced four years of continuous improvement in patient satisfaction for its hospital, emergency department and clinics. In recognition of the Medical Center's "patient-centered medical home" approach designed to improve the patient experience, *Modern Healthcare* magazine awarded the Medical Center its Spirit of Excellence Award for Service.

Recognition for advanced use of Information Technology
The Medical Center's expansive, sophisticated use of information technology to improve patient safety and quality of care has achieved national recognition. *U.S. News and World Report* ranks the Medical Center among the nation's "Most Connected Hospitals for its accomplishments in this area. *Hospitals &*

Health Networks magazine's 2011 survey of "Health Care's Most Wired Institutions" lists the Medical Center, one of only six institutions in California to receive the designation on the assessment, which encompassed nearly 1,400 hospitals around the country. The Medical Center is among an elite 3 percent of American hospitals with an electronic health record that has specific, sophisticated technologies in place to help deliver high-quality and safe patient care. This recognition comes from the nonprofit Healthcare Information Management and Systems Society, which tracks 5,235 hospitals in the U.S.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2011, 2010 and 2009:

	2011	2010	2009
Licensed beds	645	613	613
Admissions	31,025	33,169	33,295
Average daily census	460	462	480
Discharges	31,184	33,111	33,230
Average length of stay	5.4	5.1	5.3
Patient days	167,738	168,735	175,249
Case mix index	1.70	1.67	1.65
Outpatient visits:			
Hospital clinics	408,142	418,695	419,165
Primary care network	455,367	461,363	461,264
Home health and hospice	30,279	35,394	37,607
Emergency visits	58,023	54,938	55,238
Total outpatient visits	951,811	970,390	973,274

In 2011, admissions decreased by 2,144, or 6.5 percent, as compared to 2010. The average length of stay increased to 5.4 days from 5.1 due to a slightly higher case mix index in 2011. The decrease in admissions related to obstetrics, pediatrics, and gastrointestinal surgery. Part of the decrease was anticipated due to the transition into the Medical Center's expanded facilities. Increases in the last part of the year helped offset the decreases during the move-in. The new expansion increased the licensed beds by 32.

Significant changes in payor mix include a 28 percent increase in patient days for contracts, a decrease of 13.8 percent in patient days for Medi-Cal and a 60 percent reduction of capitated patient days as a result of the cancelled Western Health Advantage Geographic Managed Care (WHA GMC) contract, as well as partial risk contracts replacing full risk contracts.

Total outpatient visits decreased by 1.9 percent due to decreases in hospital based clinic, primary care network and home health activities, offset by increases in emergency room visits. Hospital clinics that had the largest decreases included the pediatric primary clinic and OB-GYN. This was due primarily to the residual impact of the cancellation of the WHA GMC contract which resulted in an overall decline in Medi-Cal visits.

Statements of Revenues, Expenses and Changes in Net Assets

The following table summarizes the operating results for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Net patient service revenue	$ 1,247,655	$ 1,098,565	$ 1,061,848
Other operating revenue	12,342	13,649	15,519
Total operating revenue	1,259,997	1,112,214	1,077,367
Total operating expenses	1,170,279	1,040,479	1,019,452
Income from operations	89,718	71,735	57,915
Total net non-operating revenues (expenses)	27,911	(2,765)	(2,767)
Income before other changes in net assets	$ 117,629	$ 68,970	$ 55,148
Operating margin	9.3%	6.2%	5.1%
Other changes in net assets	$ (23,497)	$ (10,900)	$ (9,522)
Increase in net assets	94,132	58,070	45,626
Net assets – beginning of year	852,015	793,945	748,319
Net assets – end of year	$ 946,147	$ 852,015	$ 793,945

Revenues

Total operating revenue for the year ended June 30, 2011 were $1.26 billion, an increase of $147.8 million, or 13.3 percent, over 2010. Total operating revenue for the year ended June 30, 2010 was $1.11 billion, an increase of $34.8 million, or 3.2 percent, over 2009.

Net patient service revenue for 2011 increased by $149.1 million, or 13.6 percent, over 2010. Patient service revenue is 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. Revenue increased in 2011 due to increased contract payor mix and receipt of $16.8 million for managed care payments under the California Hospital Fee Program and $26.3 million for Medi-Cal Delivery System Reform Incentive Pool ("DSRIP"). Net patient service revenue for 2010 increased by $36.7 million, or 3.5 percent, over 2009. The increase in 2010 was primarily 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.

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 by payor for 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Contracts (discounted/per-diem)	$ 668,141	$ 526,825	$ 522,340
Medicare (non-risk)	249,200	240,193	205,835
Contracts (capitated)			
Medicare (risk)	62	22,235	28,829
Medi-Cal (risk)	(5)	14,034	17,040
Commercial Capitated	123,015	125,981	111,740
Medi-Cal (non-risk)	187,852	153,624	135,173
California Counties	12,739	11,240	37,452
Non-sponsored/self-pay	4,978	2,428	2,542
Commercial	1,673	2,005	897
Total	$ 1,247,655	$ 1,098,565	$ 1,061,848

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 Medicare cases are 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 $9 million, or 3.7 percent, over the prior fiscal year primarily due to an increase in admissions of 5.7 percent. In 2010, net patient revenue for Medicare increased by $34.3 million over 2009 primarily due to increased admissions of 10.7 percent offset by a decrease in case mix from 1.98 in 2009 to 1.95 in 2010.

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 $34.2 million and $18.5 million, or 22.2 percent and 13.6 percent, in 2011 and 2010, 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 2011, non-Sacramento County net patient revenue increased by $1.5 million, or 13.3 percent, primarily due to inpatient utilization for Yolo, Placer, and San Joaquin counties. Patient days are 437 days higher, or 15 percent, compared to 2010. In 2010, Counties 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. The Medical Center continued to treat patients covered by Sacramento County. However, due to contractual issues, 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 2011, net patient revenue for the contracts category increased by $141.3 million, or 26.8 percent, over 2010 primarily due to inpatient utilization for HMO and PPO third party payors. Patient days in the category increased by 3,774 days, or 7 percent, over 2010. The contracts net revenue was also impacted by partial risk contracts replacing full risk contracts. The $4.5 million, or 0.9 percent, increase in net patient revenue in 2010 over 2009 contract activity is attributed to increased contract rates, which offset declines in 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 2011, the net patient service revenue for contracts that are full-risk capitation decreased by $39.2 million, or 24.1 percent, primarily due to a shift from full risk to shared risk wherein only the professional fees are capitated. In 2010, the increase was $4.6 million, or 2.9 percent, due primarily to higher contract rates offset by a 23.0 percent decline in enrollment.

The non-sponsored/self-pay net revenue increased by $2.6 million, or 105 percent, in 2011, and decreased by $0.1 million, or 4.5 percent, in 2010. 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 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Salaries and wages	$ 538,809	$ 498,063	$ 490,873
Employee benefits	149,563	121,352	113,408
Professional services	87,460	79,326	80,347
Medical supplies	182,762	170,393	166,422
Other supplies and purchased services	104,840	86,066	84,967
Depreciation and amortization	77,760	59,575	57,372
Insurance	9,323	8,258	9,940
Other	19,762	17,446	16,123
Total	$ 1,170,279	$ 1,040,479	$ 1,019,452

Total operating expenses increased by $129.8 million and $21.0 million, or 12.5 percent and 2.0 percent, in 2011 and 2010, respectively.

Salary and employee benefits expenses include wages paid to Medical Center employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance, pension contributions and other employee benefits. About one-half of the Medical Center's work force, including nurses and employees providing ancillary services, expand and contract with patient volumes.

In 2011, salaries and wages grew by $40.7 million, or 8.2 percent, over the prior year. This increase includes $20.5 million, or 3.9 percent in salary increases and an increase of 263.9 full time equivalent employees, or 4.0 percent from the prior year, primarily in outpatient clinical staff, nursing, and perioperative services. In 2010, salaries and wages grew by $7.2 million, or 1.5 percent, over the prior year. This increase includes $16.6 million, or 3.5 percent in salary increases but a decrease of 127.2 full time equivalent employees, or 1.9 percent from the prior year.

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2011 increased $2.5 million, or 46.3 percent, over 2010 due to an increase in information technology consulting. Temporary labor costs for 2010 decreased $2.0 million, or 26.7 percent, over 2009 due to reducing reliance on medical transcription services resulting from increased reliance on the electronic medical record program.

In 2011, employee benefit costs increased by $28.2 million, or 23.2 percent, over 2010. Pension contributions were $18.9 million in 2011 as compared to $4.1 million in 2010 and zero in 2009. The Medical Center's health insurance and other employee benefit costs increased in 2011 as compared to 2010 by $12.8 million, or 10.9 percent, due to an increase in insurance premiums of $9.2 million and increases in other benefit costs of $3.6 million. The Medical Center's health insurance and other employee benefit costs increased in 2010 as compared to 2009 by $4.4 million or 3.9 percent, due to an increase in insurance premiums of $4.8 million and a slight decrease in other benefit costs of $0.4 million.

As a percentage of total operating revenue, salaries and employee benefits were 54.6 percent in 2011, 55.7 percent in 2010 and 56.1 percent in 2009. Overall labor costs decreased as a percent of operating revenues due to increases in net revenue.

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. In 2011, professional services increased by $8.1 million, or 10.2 percent, over 2010 due to a combination of increased physician fees and SOM support payments, organ acquisition fees for the kidney transplant program, and external laboratory testing offset by decreases in legal fees and transcription. The Medical Center purchased professional services from the UC Davis School of Medicine for the sum of $50.5 million in 2011, and $45.4 million in 2010. In 2010, payments for professional services remained relatively unchanged over 2009.

Medical supply expense for 2011, including pharmaceuticals, increased by $12.4 million, or 7.3 percent, over 2010. Medical supply expenses for 2010 increased by $4.0 million, or 2.4 percent, over 2009. The most significant increases occurred in the cost of pharmaceuticals, implants and lab and surgical supplies. 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 as a percentage of net patient service revenue have dropped slightly to 14.6 percent in 2011 from 15.5 percent in 2010, due to ongoing supply chain improvement initiatives undertaken by management.

Other supplies and purchased services include non-medical supplies and general purchased services. Other supplies and purchased services increased by $18.8 million, or 21.8 percent, over 2010 due to planned increases in advertising, consulting, and software maintenance. Marketing costs increased by $3.0 million and consulting expense increased by $4.0 million. Other supplies and purchased services increased by $1.1 million, or 1.3 percent, in 2010 over 2009.

In 2011, depreciation and amortization expense increased by $18.2 million, or 30.5 percent, as compared to the prior year due to completion of the hospital expansion. In 2010, depreciation and amortization expense increased by $2.2 million, or 3.8 percent, as compared to the prior year as a result of equipment purchases placed into service during the year. Most of the capital expenditures in 2010 were related to the construction of the new hospital expansion which was 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 $9.3 million was paid in 2011, $8.3 million in 2010, and $9.9 million in 2009, which represent the Medical Center's premiums for the self-insured programs. Due to favorable claims experiences, the Medical Center received refunds of premiums for workers' compensation from the University of $4.9 million, $6.2 million, and $6.3 million in 2011, 2010, and 2009, respectively.
Other expenses increased in both 2011 and 2010 by $2.3 million and $1.3 million, or 13.2 percent and 8.2 percent, respectively.

Income from Operations
The Medical Center reported income from operations of $89.7 million and operating revenue of $1,260.0 million, resulting in an operating margin of 9.3 percent in 2011 as compared to 6.2 percent and 5.1 percent in 2010 and 2009, respectively. Income from operations increased in the current year to $89.7 million from $71.7 million in the prior year.

Non-operating Revenues (Expenses)
Non-operating revenues (expenses) includes interest income and expenses, the gain or loss on disposal of capital assets and hospital fee program funds. In 2011, total non-operating expenses were $27.9 million compared to $2.8 million in non-operating revenues in 2010. The change was primarily due to the new hospital fee program funds.

Total non-operating expenses remained relatively unchanged at $2.8 million for 2010 and 2009.

Income before Other Changes in Net Assets
The Medical Center's income before other changes in net assets was $117.6 million in 2011 compared to $69.0 million and $55.1 million in 2010 and 2009, an increase of $48.6 million, or 70.4 percent, and $13.9 million, or 25.2 percent, respectively. The Medical Center's net income increased by $48.7 million in 2011 compared to the prior year.

Other Changes in Net Assets

The other changes in net assets for 2011, 2010 and 2009 include:

	2011	2010	2009
Contributions from University for building program	$ 13,603	$ 16,289	$ 37,630
Health system support	(41,066)	(29,719)	(48,783)
Transfers from university, net	3,966	2,530	1,631
Total other changes in net assets	$ (23,497)	$ (10,900)	$ (9,522)

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 2011 and 2010 are the following:

- "Contributions from the University" for the building program of $13.6 million are related primarily to the new Parking Structure 3 project. In 2010, the contributions for the building program were $16.3 million and were related to the Surgery and Emergency Pavilion project and represent funding from the State Public Works Board Bonds.

- The Medical Center transferred net assets of $41.1 million and $29.7 million respectively in 2011 and 2010 to support academic, research and administrative services of the health system.

- Transfers from the University totaled $4.0 million and $2.5 million for 2011 and 2010, respectively.

In total, net assets increased for the year ended June 30, 2011 and 2010 by $94.1 million and $58.1 million, respectively.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Current assets:			
Cash	$ 105,584	$ 91,819	$ 122,721
Patient accounts receivable (net)	183,863	171,777	161,351
Other current assets	111,530	80,732	61,293
Total current assets	400,977	344,328	345,365
Capital assets (net)	1,111,322	1,073,344	1,014,077
Other assets	27,077	23,507	23,195
Total assets	1,539,376	1,441,179	1,382,637
Current liabilities	227,301	203,714	197,567
Long-term debt	365,928	385,450	391,125
Total liabilities	593,229	589,164	588,692
Net assets:			
Invested in capital assets (net)	693,467	645,225	579,838
Restricted	-	108	954
Unrestricted	252,680	206,682	213,153
Total net assets	$ 946,147	$ 852,015	$ 793,945

Total current assets increased in 2011 by $56.6 million, or 16.5 percent, and decreased in 2010 by $1.0 million, or 0.3 percent.

Cash increased in 2011 by $13.8 million or 15.0 percent due to increased cash from operations. In 2010, cash decreased by $30.9 million, or 25.2 percent.

Net patient accounts receivable, net of estimated uncollectible accounts, increased by $12.1 million, or 7.0 percent, in 2011 due to increase in Contract payor activity. In 2010, net patient accounts receivable increased by $10.4 million, or 6.5 percent, due to an increase in receivables associated with patients pending eligibility for the Medicare and Medi-Cal programs, a slight slow-down in collections and an increase in days in accounts receivable.

In 2011, other current assets, including non-patient receivables, inventory and prepaid expenses, increased by $30.8 million, or 38.1 percent, over the prior fiscal year due primarily to delays in payments from the state related to Medi-Cal programs. In 2010, other current assets increased by $19.4 million, or 31.7 percent, over 2009 due primarily to those same payment delays.

Other non-current assets increased by $4.0 million in 2011 from 2010 due to income earned on joint venture investments. In 2010, other non-current assets remained relatively unchanged from 2009. Net capital assets increased by $38.0 million, or 3.5 percent, from 2010 to 2011 and $59.3 million, or 5.8 percent, from 2009 to 2010 primarily due to continued construction of the hospital expansion, cancer center expansion and Davis tower, offset by depreciation expense.

Current liabilities increased by $23.6 million, or 11.6 percent, from 2010 to 2011 primarily due to accrued payroll and third-party payor settlements. Current liabilities increased by $6.1 million, or 3.1 percent, from 2009 to 2010 primarily due to increases in third-party payor settlements.

Long-term debt decreased by $19.5 million, or 5.1 percent, from 2010 to 2011 and $5.7 million, or 1.5 percent, from 2009 to 2010. The decreases are primarily due to debt service payments.

Net assets invested in capital assets increased by $48.2 million and $65.4 million, or 7.5 percent and 11.3 percent, in 2011 and 2010, respectively. The increases are primarily due to increases in capital assets, net and decreases to long-term debt as payments are made.

In 2011, restricted net assets decreased to $0 from $0.1 million in 2010; 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 2011 and 2010.

Liquidity and Capital Resources

The Medical Center generated $138.8 million and $108.0 million from operating activities in 2011 and 2010, respectively.

Cash flows from non-capital financing activities show the Medical Center's cash was reduced by $0.8 million and $27.2 million in 2011 and 2010, respectively, primarily due to transfers to the University for health system support, offset by grants received for the hospital fee program.

In 2011, cash flows from capital and related financing activities included the contributions from the University for funding the building program of $13.6 million, proceeds from financing loans of $17.3 million, purchases of capital assets of $106.1 million, principal payments on long-term debt and capital leases of $33.7 million, and interest paid of $19.0 million. In 2010, cash flows from capital and related financing activities included the contributions from the University for funding the building program 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 2011, cash flows from investing activities include interest income of $2.2 million and distributions from joint ventures of $0.3 million. In 2010 the Medical Center received $3.1 million from interest income and $3.7 million from distributions from joint ventures. Overall cash increased to $105.6 million, or 15.0 percent, in 2011 from $91.8 million in 2010.

The following table shows key liquidity and capital ratios for 2011, 2010 and 2009:

	2011	2010	2009
Days cash on hand	34	33	47
Days of revenue in accounts receivable	61	63	61
Capital investment ($ in millions)	$ 1,111	$ 1,073	$ 1,014
Debt service coverage ratio	3.9	2.7	2.6

Days cash on hand increased to 34 days in 2011 from 33 days in 2010, for a 3 percent increase. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash balances.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2011, days in accounts receivable decreased by 2 days to 61.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The Medical Center's ratios for 2011, 2010, and 2009 are 3.9, 2.7, and 2.6, respectively. The increase of 1.2 in debt service coverage in 2011 is due to increased net income and increased depreciation. The ratio is higher than the 1.0 required by the Bond Indenture.

Looking Forward

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

During 2011, 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 2011 and 2010, $21.1 million and $20.3 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.

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 were 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.

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. In November 2010, California received federal approval for a new five year waiver. State of California Assembly Bill 1066, signed in July 2011, contains the statutes to enact the terms of the new waiver program. Payments to the Medical Centers include a combination of Medi-Cal inpatient fee for service payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP") payments based upon costs. The Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health-care reform. Although the waiver is designed to ensure predictable reimbursement for the care of poor and indigent patients, the full financial impact of these changes in the future cannot be determined.

Meaningful Use of Electronic Health Records
The American Recovery and Reinvestment Act of 2009 established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. A hospital may receive an incentive payment for up to four years, from 2011 through 2015, by meeting a series of objectives that make use of EHR's potential related to the improvement of quality, efficiency and patient safety. Meaningful use is assessed on a year-by-year basis and requires attestation by the facility that the criteria have been satisfied. For the year ended June 30, 2011, the Medical Center did not receive any payments for the meaningful use of EHR technology.

Children's Hospital Bond Act of 2004
In 2004, California voters passed Proposition 61, which 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. As of June 30, 2011, the Medical Center has received $8.2 million in funding.

Children's Hospital Bond Act of 2008
In 2008, California voters passed Proposition 3, which 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. As of June 30, 2011, the Medical Center had not received any grant funding.

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, 2010 actuarial valuation was $5.4 billion or 86.2 percent funded. The total funding policy contributions in the July 1, 2010 actuarial valuations represent 23.25% of covered compensation. As of July 1, 2011, the funded ratio is expected to decrease to approximately 82.0 percent. At its September 2010 meeting, The Regents approved increasing the employer and employee contribution rates to UCRP. Contributions by members will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University will be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These contribution rates are below UCRP's total funding policy contributions. The Regents also approved a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55, but retain many of the current features of UCRP. The new tier would not offer lump sum cashouts, inactive member Cost of Living Adjustments (COLAs), or subsidized survivor annuities for spouses and domestic partners. These changes are subject to collective bargaining for union-represented employees.

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, 2010 actuarial valuation was $15.4 billion. The Regents approved a new eligibility formula for the Retiree Health Plan for all employees hired on or after July 1, 2013, and non-grandfathered members, that is based on a graduated formula using both a member's age and years of Retirement Plan service credit upon retirement, subject to collective bargaining for represented members.

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Assets		
Current assets		
Cash	$ 105,584	$ 91,819
Restricted assets, held by trustee	-	108
Patient accounts receivable, net of estimated uncollectibles of $41,864 and $44,523, respectively	183,863	171,777
Other receivables, net of estimated uncollectibles of $12 and $203, respectively	84,773	55,992
Inventory	15,613	14,188
Prepaid expenses and other assets	11,144	10,444
Total current assets	400,977	344,328
Capital assets, net	1,111,322	1,073,344
Investments in joint ventures	24,593	20,884
Deferred costs of issuance	2,484	2,623
Total assets	1,539,376	1,441,179
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	39,843	35,313
Accrued salaries and benefits	85,053	74,194
Third-party payor settlements, net	58,201	51,619
Current portion of long-term debt and capital leases	34,191	29,475
Other liabilities	10,013	13,113
Total current liabilities	227,301	203,714
Long-term debt and capital leases, net of current portion	365,928	385,450
Total liabilities	593,229	589,164
Net Assets		
Invested in capital assets, net of related debt	693,467	645,225
Restricted:		
Expendable:		
Debt service	-	108
Unrestricted	252,680	206,682
Total net assets	$ 946,147	$ 852,015

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Net patient service revenue, net of provision for doubtful accounts of $78,723 and $54,573, respectively	$ 1,247,655	$ 1,098,565
Other operating revenue:		
Clinical teaching support	3,299	6,137
Other	9,043	7,512
Total other operating revenue	12,342	13,649
Total operating revenue	1,259,997	1,112,214
Operating expenses:		
Salaries and wages	538,809	498,063
UCRP, retiree health and other employee benefits	149,563	121,352
Medical supplies	182,762	170,393
Professional services	87,460	79,326
Other supplies and purchased services	104,840	86,066
Depreciation and amortization	77,760	59,575
Insurance	9,323	8,258
Other	19,762	17,446
Total operating expenses	1,170,279	1,040,479
Income from operations	89,718	71,735
Non-operating revenues (expenses):		
Hospital fee program grants	36,336	-
Interest income	2,185	3,118
Interest expense	(15,832)	(9,184)
Loss on disposal of capital assets	(40)	(588)
Other	5,262	3,889
Total net non-operating revenues (expenses)	27,911	(2,765)
Income before other changes in net assets	117,629	68,970
Other changes in net assets:		
Contributions from University for building program	13,603	16,289
Health system support	(41,066)	(29,719)
Transfers from University, net	3,966	2,530
Total other changes in net assets	(23,497)	(10,900)
Increase in net assets	94,132	58,070
Net assets – beginning of year	852,015	793,945
Net assets – end of year	$ 946,147	$ 852,015

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,212,154	$ 1,072,510
Payments to employees	(532,298)	(502,372)
Payments to suppliers	(409,685)	(349,870)
Payments for benefits	(149,563)	(121,352)
Other receipts, net	18,147	9,122
Net cash provided by operating activities	138,755	108,038
Cash flows from noncapital financing activities:		
Health system support	(41,066)	(29,719)
Grants from the hospital fee program	36,336	-
Transfers from University	3,966	2,530
Net cash used by noncapital financing activities	(764)	(27,189)
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	13,603	16,289
Proceeds from financing loan	17,278	24,485
Proceeds from sale of capital assets	81	525
Purchases of capital assets	(106,135)	(111,984)
Principal paid on long-term debt and capital leases	(33,695)	(29,378)
Interest paid on long-term debt and capital leases	(18,964)	(19,101)
Net cash used by capital and related financing activities	(127,832)	(119,164)
Cash flows from investing activities:		
Interest income received	2,185	3,118
Distributions from investments in joint ventures, net	250	3,721
Change in restricted assets	108	846
Non-operating revenues (expenses)	1,063	(272)
Net cash provided by investing activities	3,606	7,413
Net increase (decrease) in cash	13,765	(30,902)
Cash – beginning of year	91,819	122,721
Cash – end of year	$ 105,584	$ 91,819

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 89,719	$ 71,735
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	77,760	59,575
Provision for doubtful accounts	78,723	59,573
Changes in operating assets and liabilities:		
Patient accounts receivable	(90,809)	(69,999)
Other receivables	(28,541)	(19,741)
Inventory	(1,425)	453
Prepaid expenses and other assets	(700)	(997)
Accounts payable and accrued expenses	-	2,694
Accrued salaries and benefits	10,859	(578)
Third-party payor settlements	6,582	4,112
Other liabilities	(3,413)	1,211
Net cash provided by operating activities	$ 138,755	$ 108,038
Supplemental noncash activities information:		
Amortization of deferred financing costs	2,524	$ 2,631
Amortization of bond premium	913	948
Amortization of deferred costs of issuance	139	128
Property and equipment transfers from the University	179	29
Payables for property and equipment	17,736	13,206

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 Chief Executive Officer by the Chancellor of the Davis campus. The Medical Center has 645 licensed beds, hospital-based clinics located on the Sacramento campus, and sixteen satellite clinics in surrounding communities.

The financial statements of the Medical Center 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.

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). 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, was adopted by the Medical Center during the year ended June 30, 2011. This Statement incorporates into GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedures that were issued on or before November 30, 1989. Implementation of Statement No. 62 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2011 and 2010.

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, 2011 and 2010 was $105,584 and $91,819, 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 2010–2011 annual report of the University.

Restricted Assets, Held by Trustee

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 are deposited in STIP.

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 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. 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 on borrowings to finance facilities is capitalized during construction, net of any investment income earned on tax-exempt borrowings during the temporary investment of project-related borrowings.

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.

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, 2011 and 2010.

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

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

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

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

Use of Estimates

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

New Accounting Pronouncements
In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, effective for the University's fiscal year beginning July 1, 2011. This Statement requires the Medical Center to report the activities for certain public-private partnerships as service concession arrangements in the financial statements. Service concession arrangements are recorded when the arrangements meet certain criteria which include building and operating a facility, obtaining the right to collect fees from third parties, and transferring ownership of the facility to the Medical Center at the end of the arrangement. The Medical Center is evaluating the effect that Statement No. 60 will have on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the University's fiscal year beginning July 1, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements. The University is evaluating the effect that Statement No. 63 will have on its financial statements.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the University's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for termination hedge accounting. The University is evaluating the effect that Statement No. 64 will have on its financial statements.

3. Net Patient Service Revenue

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

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

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

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through

June 30, 2003. The fiscal intermediary is in the process of conducting their audits of the 2004 and subsequent cost reports. The results of these audits have yet to be finalized and any amounts due to or from Medicare have not been determined. Estimated receivables and payables related to all open cost reporting periods are included on the statements of net assets as third-party payor settlements.

- ***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 legislation enacted by the State of California. Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. The total payments made to the Medical Center will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP"). Effective November 2010, the Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. For the years ended June 30, 2011 and 2010, the Medical Center recorded total Medi-Cal revenue of $189,814 and $153,624, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by as amended by AB 1653 on September 8, 2010, established 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 makes supplemental payments to hospitals for various health care services and supports the state's effort to maintain health care coverage for children. The Medical Center, designated as a public hospital, is exempt from paying the "Quality Assurance Fee"; however, the Medical Center received supplemental payments under the Hospital Fee Program. For the year ended June 30, 2011, the Medical Center received $16,850, which has been reported as net patient revenue and $36,336 as a state grant which has been reported as non-operating revenue.

- ***Assembly Bill 915*** – State of California Assembly Bill 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, 2011 and 2010, the Medical Center recorded revenue of $14,556 and $8,715, 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, 2011 and 2010, the Medical Center applied for and received additional revenue of $8,178 and $8,109, 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.

    - 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 represent 13.8 percent and 13.5 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively. Amounts due from Medi-Cal represent 9.1 percent and 13.0 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, net patient service revenue included $0.9 million and $13.4 million, respectively, due to favorable cost report settlements with Medicare, Medi-Cal, County Medical Services Program and changes in estimate for settlements related to Medi-Cal.

(Dollars in thousands)

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

	2011	2010
Contract (discounted or per diem)	$ 668,136	$ 526,825
Medicare (non-risk)	249,200	240,193
Medi-Cal (non-risk)	187,852	153,624
Contract (capitated)	123,015	125,981
Medicare (risk)	62	22,235
Medi-Cal (risk)	-	14,034
County	12,739	11,240
Non-sponsored/self-pay	4,978	2,428
Commercial	1,673	2,005
Total	$ 1,247,655	$ 1,098,565

4. Charity Care

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

	2011	2010
Charity care at established rates	$ 232,742	$ 212,026
Estimated cost of charity care	40,171	40,921

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $164,317 and $143,105 for the years ended June 30, 2011 and 2010, 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:

	2011	2010
Short-term, highly liquid investments	$ -	$ 108

(Dollars in thousands)

6. Capital Assets

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

	2010	Additions	Disposals	2011
Original Cost				
Land	$ 36,675	$ -	$ -	$ 36,675
Buildings and improvements	1,193,238	33,593	(342)	1,226,489
Equipment	368,514	50,131	(23,742)	394,903
Construction in progress	26,421	31,954	(7)	58,368
Capital assets, at cost	$ 1,624,848	$ 115,678	$ (24,091)	$ 1,716,435
	2010	**Depreciation**	**Disposals**	**2011**
Accumulated Depreciation				
Buildings and improvements	$ 328,026	$ 35,172	$ (343)	$ 362,855
Equipment	223,478	42,588	(23,808)	242,258
Accumulated depreciation	551,504	$ 77,760	$ (24,151)	605,113
Capital assets, net	$ 1,073,344			$ 1,111,322

	2009	Additions	Disposals	2010
Original Cost				
Land	$ 36,675	$ -	$ -	$ 36,675
Buildings and improvements	748,925	444,313	-	1,193,238
Equipment	329,331	54,733	(15,550)	368,514
Construction in progress	406,053	(379,632)	-	26,421
Capital assets, at cost	$ 1,520,984	$ 119,414	$ (15,550)	$ 1,624,848
	2009	**Depreciation**	**Disposals**	**2010**
Accumulated Depreciation				
Buildings and improvements	$ 302,946	$ 25,080	$ -	$ 328,026
Equipment	203,961	34,495	(14,978)	223,478
Accumulated depreciation	506,907	$ 59,575	$ (14,978)	551,504
Capital assets, net	$ 1,014,077			$ 1,073,344

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 2011 and 2010, $21,115 and $20,274, 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 $0 and $11,395 for the years ended June 30, 2011 and 2010, 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:

	2011	2010
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	$ 281,205	$ 295,560
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	64,059	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	10,777	11,435
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.4 percent to 4.0 percent, payable through 2015	58,165	58,629
	414,206	430,624
Unamortized bond premium	8,137	9,050
Unamortized deferred financing costs	(22,224)	(24,749)
Total debt and capital leases	400,119	414,925
Less: Amounts due within one year	(34,191)	(29,475)
Noncurrent portion of debt and capital leases	$ 365,928	$ 385,450

Total interest expense during the years ended June 30, 2011 and 2010 was $21,026 and $20,912 respectively. Interest expense totaling $5,194 and $11,728 was capitalized during the years ended June 30, 2011 and 2010, respectively. The remaining $15,832 in 2011 and $9,184 in 2010 are reported as interest expense in the statements of revenues, expenses and changes in net assets. Investment income totaling $0 and $34 was capitalized during the years ended June 30, 2011 and 2010, respectively.

In February 2011, the Medical Center retired $941 of Medical Center Pooled Revenue Bonds recognizing a gain of $212 on the Statement of revenues, expenses and changes in net assets. The Medical Center has a payable to the University of $735 reported in other current liabilities. The retirements were financed through the University's commercial paper program. The Medical Center has a payable to the University for the cost of the retirements. The payable bears interest at the commercial paper rate and is due on demand when the University refinances these commercial paper proceeds into long-term bonds.

(Dollars in thousands)

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, 2011			
Long-term debt and capital leases at June 30, 2010	$ 356,296	$ 58,629	$ 414,925
New obligations		17,278	17,278
Principal payments	(15,953)	(17,742)	(33,695)
Amortization of bond premium	(913)	-	(913)
Amortization of deferred financing costs	2,524	-	2,524
Long-term debt and capital leases at June 30, 2011	341,954	58,165	400,119
Less: Current portion of long-term debt and capital leases	(14,528)	(19,663)	(34,191)
Noncurrent portion of long-term debt and capital leases as June 30, 2011	$ 327,426	$ 38,502	$ 365,928
Year ended June 30, 2010			
Long-term debt and capital leases at June 30, 2009	$ 369,548	$ 48,587	$ 418,135
New obligations		24,485	24,485
Principal payments	(14,935)	(14,443)	(29,378)
Amortization of bond premium	(948)	-	(948)
Amortization of deferred financing costs	2,631	-	2,631
Long-term debt and capital leases at June 30, 2010	356,296	58,629	414,925
Less: Current portion of long-term debt and capital leases	(13,394)	(16,081)	(29,475)
Noncurrent portion of long-term debt and capital leases as June 30, 2010	$ 342,902	$ 42,548	$ 385,450

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, 2011 are $2.26 billion of which $345,264 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, 2011 and 2010 were $6.48 billion and $5.94 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.

(Dollars in thousands)

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.

Future Debt Service

Future debt service payments for each of the five fiscal years subsequent to June 30, 2011 and thereafter are as follows:

Year Ending June 30	Revenue Bonds	Other Debt	Total Payments	Principal	Interest
2012	$ 33,101	$ 21,053	$ 54,154	$ 35,741	$ 18,413
2013	32,764	17,694	50,458	33,093	17,365
2014	32,452	12,336	44,788	28,649	16,138
2015	32,110	8,100	40,210	25,134	15,075
2016	31,765	1,808	33,573	19,410	14,164
2017 – 2021	153,185	-	153,185	95,797	57,388
2022 – 2026	138,880	-	138,880	106,568	32,312
2027 – 2031	40,498	-	40,498	29,105	11,393
2032 – 2036	18,322	-	18,322	10,025	8,297
2037 – 2041	18,328	-	18,328	12,500	5,828
2042 – 2046	18,327	-	18,327	15,575	2,752
2047 – 2048	2,724	-	2,724	2,609	116
Total future debt service	552,456	60,991	613,447	$ 414,206	$ 199,241
Less: Interest component of future payments	(196,415)	(2,826)	(199,241)		
Principal portion of future payments	356,041	58,165	414,206		
Adjusted by:					
Unamortized bond premium	8,137	-	8,137		
Unamortized deferred financing costs	(22,224)	-	(22,224)		
Total debt	$ 341,954	$ 58,165	$ 400,119		

(Dollars in thousands)

Additional information on the revenue bonds can be obtained from the 2010–2011 annual report of the University.

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, 2011 and 2010 was $13,307 and $13,884, 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
2012	$ 11,601
2013	9,490
2014	7,375
2015	4,965
2016	2,799
2017 – 2034	10,881
Total	$ 47,111

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 University. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.31 and $3.12 per $100 of

UCRP covered payroll resulting in Medical Center contributions of $15,644 and $13,851 and $13,488 for the years ended June 30, 2011 and 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, 2010, the date of the latest actuarial valuation, were $74.5 million and $15.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $71.3 million at June 30, 2011. For the years ended June 30, 2011 and 2010, combined contributions from the University's campuses and medical centers were $314.7 million and $283.5 million, respectively, including an implicit subsidy of $54.9 million and $49.5 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.8 billion and $1.6 billion for the years ended June 30, 2011 and 2010. 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 $5.1 billion at June 30, 2011 increased by $1.4 billion for the years ended June 30, 2011 and 2010, 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 2010–2011 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 $18,900 and $7,664, respectively, during the year ended June 30, 2011. Medical Center and employee contributions were $4,100 and $2,150, respectively, during the year ended June 30, 2010.

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, 2010, the date of the latest actuarial valuation, were $33.7 billion and $39.1 billion, respectively, resulting in a funded ratio of 86.2 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $41.9 billion and $34.6 billion at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, the University's campuses and medical centers contributed a combined $1.4 billion and $64.8 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.7 billion for the year ended June 30, 2011. 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 $239.2 million for the year ended June 30, 2011.

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 2010–2011 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 $(285) and $(671) for the years ended June 30, 2011 and 2010, respectively. During 2011 and 2010, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $4,916 and $6,210, respectively that reduced the overall workers' compensation cost for the year.

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $9,323 and $8,258 for the years ended June 30, 2011 and 2010, respectively.

(Dollars in thousands)

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:

	2011	2010
Professional services	$ 50,514	$ 46,342
Insurance	9,323	8,258
Salaries and employee benefits	-	-
Interest income (net)	(13,647)	(6,233)
Other supplies and purchased services	1,305	339
Total	$ 47,495	$ 48,706

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, and 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 $88,561 and $78,425 in 2011 and 2010, respectively. Of these amounts, $47,495 and $48,706 are reported as operating expenses for the years ended June 30, 2011 and 2010, respectively, and $41,066 and $29,719 are reported as health system support for the years ended June 30, 2011 and 2010, 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.

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.

The state of California authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations for the medical centers, of which $120,000 was allocated to the Medical Center. 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 $52,714, excluding interest, as of June 30, 2011.

University of California,
Irvine Medical Center
Financial Statements
For the Years Ended June 30, 2011 and 2010

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets, and cash flows, as shown on pages 14 through 17 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, 2011 and 2010, and the 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, 2011 and 2010, 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 13 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 12, 2011

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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, 2011, with selected comparative information for the years ended June 30, 2010 and 2009. 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 (2009, 2010, 2011, 2012, 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 417 beds in year 2011. 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 completed at the end of 2012. 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 meets 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 11th consecutive year. Among the top 50 hospitals, the Medical Center's gynecology, urology, cancer, and nephrology specialties were recognized as among the best in the country.

For the year ended June 30, 2011, the Medical Center reported income before other changes in net assets of $85.2 million and generated a margin of 12.2 percent. Total operating revenue increased by 13.9 percent. Total operating expenses increased by 7.5 percent. The year ended with a cash position of $175.7 million.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2011, 2010 and 2009:

	2011	2010	2009
Licensed beds	417	412	392
Admissions	16,365	16,327	16,683
Average daily census	281	283	279
Discharges	16,424	16,389	16,793
Average length of stay	6.2	6.3	6.1
Patient days	102,400	103,465	101,763
Case mix index	1.59	1.57	1.54
Outpatient visits:			
Ambulatory visits	474,448	476,372	494,417
Emergency visits	35,622	34,788	33,625
Total visits	510,070	511,160	528,042

In 2011, total discharges slightly increased by 0.2 percent, while patient days decreased by 1.0 percent due to a slight decrease in gynecology and pediatric days. Total ambulatory visits decreased by 0.4 percent and emergency visits increased by 2.4 percent, over the prior year.

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.

Statements of Revenues, Expenses and Changes in Net Assets

The following table summarizes the operating results for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Net patient service revenue	$ 675,211	$ 589,631	$ 559,059
Other operating revenue	23,926	24,011	25,278
Total operating revenue	699,137	613,642	584,337
Total operating expenses	620,864	577,542	530,099
Income from operations	78,273	36,100	54,238
Total net non-operating revenues (expenses)	6,881	(2,470)	(1,937)
Income before other changes in net assets	$ 85,154	$ 33,630	$ 52,301
Operating margin	12.2%	5.5%	9.0%
Other changes in net assets	$ (47,125)	$ (82,418)	$ 38,986
Increase (decrease) in net assets	38,029	(48,788)	91,287
Net assets – beginning of year	582,160	630,948	539,661
Net assets – end of year	$ 620,189	$ 582,160	$ 630,948

Revenues

Total operating revenues for the year ended June 30, 2011 were $699.1 million, an increase of $85.5 million, or 13.9 percent, over 2010. Operating revenues for 2010 were $613.6 million, an increase of $29.3 million, or 5.0 percent, over 2009.

Net patient service revenue for 2011 increased by $85.6 million, or 14.5 percent, over the prior year. The significant increase in 2011 was the result of the Medi-Cal Supplemental funding and improved contract rates. Net patient service revenue for 2010 increased by $30.6 million, or 5.5 percent, over 2009. The increase in 2010 was due to a more favorable patient mix and improved collections resulting from ongoing contracting efforts and pricing strategies. 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 2011, other operating revenue decreased slightly by $85 thousand, or 0.4 percent, over 2010 due primarily to decrease in miscellaneous non-patient revenues. 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.

The following table summarizes net patient service revenue for 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Medicare (non-risk)	$ 146,485	$ 152,524	$ 142,815
Medi-Cal (non-risk)	179,148	141,540	126,888
Contracts (discounted/per diem)	315,886	263,234	225,736
Commercial	6,908	5,052	38,872
County	21,779	22,346	15,874
Uninsured	5,005	4,935	8,874
Total	$ 675,211	$ 589,631	$ 559,059

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, decreased by $6.0 million, or 4.0 percent, from 2010 due primarily to decrease in patient days. In 2010, net revenue for Medicare patients increased by $9.7 million, or 6.8 percent, from 2009 due primarily to increased patient days.

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 2011, net Medi-Cal revenue increased by $37.6 million, or 26.6 percent, over 2010 due to increase in supplemental funding. In 2010, net Medi-Cal revenue increased by $14.7 million, or 11.5 percent, over 2009. For the year ended June 30, 2011, the Medical Center recorded revenue of $118.8 million from the Medi-Cal hospital waiver and Safety Net Care Pool ('SNCP") funding under Senate Bill 1100 and the Hospital Program Fee under Assembly Bill 1383. The Medi-Cal hospital waiver and Safety Net Care Pool funding was $91.3 million for year 2010.

Net revenue for contracts increased $52.7 million, or 20.0 percent, from 2010 due to the Medical Center's continued efforts in contract negotiations and improved pricing strategies. In 2010, net revenue for contracts grew by $37.5 million, or 16.6 percent, from 2009.

Commercial net patient revenue increased by $1.9 million, or 36.7 percent, compared to 2010. The change in volume is the result of improved reimbursement rate. In 2010, commercial net patient revenue decreased by $33.8 million, or 87 percent, compared to 2009.

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 decreased by $0.6 million, or 2.5 percent, in 2011 and increased by $6.5 million, or 40.8 percent, in 2010. This category fluctuates from year to year depending on the patient volume and type of patients. The uninsured net revenue increased slightly by $70 thousand, or 1.4 percent, in 2011 and by $3.9 million, or 44.4 percent, in 2010.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Salaries and wages	$ 270,018	$ 256,865	$ 232,235
Employee benefits	83,052	68,608	58,605
Professional services	2,252	2,195	1,975
Medical supplies	88,522	81,498	82,154
Other supplies and purchased services	119,256	122,275	118,738
Depreciation and amortization	52,850	43,565	33,941
Insurance	4,914	2,536	2,451
Total	$ 620,864	$ 577,542	$ 530,099

During 2011, total operating expenses of $620.9 million increased by $43.3 million, or 7.5 percent, over the prior year. The change was due primarily from increases in salaries, benefits, medical supplies, and depreciation. Total operating expenses for 2010 increased by $47.4 million, or 8.9 percent, over the prior year due to primarily increases in labor costs, purchased services, and depreciation.

Salary and employee benefits expenses include wages paid to Medical Center employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance, pension contributions and other employee benefits. About one-half of the Medical Center's work force, including nurses and employees providing ancillary services, expand and contract with patient volumes.

In 2011, salaries and wages grew by $13.2 million, or 5.1 percent, over the prior year. This increase includes $8.0 million, or 3.1 percent in salary increases and an increase of 75 full time equivalent employees, or 2.0 percent from the prior year. In 2010, salaries and wages grew by $24.6 million, or 10.6 percent, over the prior year. This increase includes $12.7 million, or 5.7 percent in salary increases and an increase of 177 full time equivalent employees, or 4.9 percent from the prior year.

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2011 decreased $164 thousand, or 12.3 percent, over 2010. Temporary labor costs for 2010 decreased $1.2 million, or 47.9 percent, over 2009 due to completion of the New University Hospital.

In 2011, employee benefit costs increased by $14.4 million, or 21.1 percent, over 2010. Pension contributions were $9.4 million of in 2011 as compared to $2.2 million in 2010 and zero in 2009. The Medical Center's health insurance and other employee benefit costs increased in 2011 as compared to 2010 by $7.2 million, or 10.9 percent, due to an increase in insurance premiums of $5.0 million and increases in other benefit costs of $2.2 million. The Medical Center's health insurance and other employee benefit costs increased in 2010 as compared to 2009 by $8.0 million, or 13.6 percent, due to an increase in insurance premiums of $6.0 million and increases in other benefit costs of $2.0 million.

As a percentage of total operating revenue, salaries and employee benefits were 56.9 percent in 2011, 56.4 percent in 2010 and 54.9 percent in 2009. Overall labor costs increased as a percent of operating revenues due to bargaining unit increases as well as increase in full time equivalent employees.

Payments for professional services increased slightly by $57 thousand, or 2.6 percent, over 2010 due to increase in contracted medical director expenses. In 2010, professional services increased by $0.2 million, or 11.1 percent, over 2009.

Medical supply expense for 2011 increased by $7.0 million, or 8.6 percent, over the prior year due to inflationary increase in medical supplies and pharmaceutical costs, as well as higher acuity level of patients. Medical supply expense decreased by $0.7 million, or 0.8 percent, in 2010 due to continued cost reduction efforts 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 decreased by $3.0 million, or 2.5 percent, over 2010 due primarily to $4.2 million decrease in registry, $1.5 million decrease in minor equipment, and $2.7 million increase in other costs. In 2010, other supplies and purchased services 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 $0.6 million decrease in other costs.

Depreciation and amortization expense increased by $9.3 million, or 21.3 percent, over the prior year. The increase is primarily due to depreciation of the new Clinical Lab Building and related equipment. In 2010, depreciation and amortization increased by $9.6 million, or 28.4 percent, over 2009 due primarily to the full year of depreciation for the New University Replacement hospital.

Insurance expense of $4.9 million in 2011 and $2.5 million in 2010 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $2.4 million, or 93.8 percent, in 2011 and increased by $0.1 million, or 3.5 percent, in 2010.

Income from Operations
The Medical Center reported income from operations of $78.3 million and operating revenue of $699.1 million, resulting in an operating margin of 12.2 percent in 2011 as compared to 5.5 percent and 9.0 percent in 2010 and 2009, respectively. Income from operations increased in the current year to $78.3 million from $36.1 million in the prior year. The $42.2 million or 116.8 percent increase was the result of increased in Medi-Cal supplemental funding and improved contract rates.

Non-operating Revenues (Expenses)

Non-operating revenues (expenses), which include interest earned on invested cash balances, interest expenses on debt, and losses from disposal or retirement of capital assets, increased by $9.4 million over 2010 due mainly to the additional Medi-Cal Provider Fee funding received. Non-operating revenues increased by $0.5 million in 2010 over 2009, due to interest payments on additional bonds issued, offset by increase in the STIP income and the $1.9 million of Build America Bonds federal interest subsidies.

Income before Other Changes in Net Assets

The Medical Center reported income before other changes in net assets of $85.2 million in 2011 as compared to $33.6 million in 2010 and $52.3 million in 2009, an increase of $51.6 million, or 153.6 percent, and a decrease of $18.7 million, or 35.8 percent, respectively. The Medical Center's net income increased by $51.6 million in 2011 compared to the prior year mainly due to the additional Medi-Cal supplemental funding.

Other Changes in Net Assets

The other changes in net assets for 2011, 2010 and 2009 include:

	2011	2010	2009
Health system support	$ (48,147)	$ (65,771)	$ (53,413)
Transfers from (to) university, net	1,022	(16,647)	92,399
Total other changes in net assets	$ (47,125)	$ (82,418)	$ 38,986

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 $48.1 million in 2011 and $65.8 million in 2010.

- Transfers from University included donated assets of $1.8 million and other expended funds of $0.8 million in 2011. Transfers to University were $16.6 million in 2010.

In total, the net assets increased by $38.0 million in 2011. The majority of the increase is due to an increase in overall cash balance. Net assets decreased by $48.8 million to $582.2 million for 2010.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Current assets:			
Cash	$ 175,692	$ 102,648	$ 73,353
Patient accounts receivable (net)	96,868	74,140	74,785
Other current assets	34,922	53,734	30,882
Total current assets	307,482	230,522	179,020
Capital assets (net)	712,025	698,815	630,629
Other assets	64,342	105,780	6,875
Total assets	1,083,849	1,035,117	816,524
Current liabilities	133,035	122,402	95,940
Long-term debt	330,625	330,555	89,636
Total liabilities	463,660	452,957	185,576
Net assets:			
Invested in capital assets (net)	367,057	352,012	534,468
Restricted:			
Expendable:			
Capital projects	61,995	103,353	6,046
Unrestricted	191,137	126,795	90,434
Total net assets	$ 620,189	$ 582,160	$ 630,948

Total current assets increased by $77.0 million, or 33.4 percent, compared to 2010 due to the increase in cash and cash equivalents. In 2010, total current assets increased by $51.5 million, or 28.8 percent, compared to the prior year. Total assets at June 30, 2011 were $48.7 million higher than 2010. Total assets at June 30, 2010 were $218.6 million higher than 2009.

Cash increased by $73.0 million, or 71.2 percent, in 2011 due to the additional Medi-Cal supplemental payments under Assembly Bill 1383. 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.

Net patient accounts receivable, net of estimated uncollectibles, increased by $22.7 million, or 30.7 percent, in 2011 due to higher net patient revenues. In 2010, net patient accounts receivable decreased slightly by $0.6 million, or 0.9 percent. 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, decreased by $18.8 million, or 35.0 percent, in 2011. The decrease was primarily due to Medi-Cal waiver funding payments reducing the related receivables from prior year. In 2010, other current assets increased by $22.9 million, or 74.0 percent, due to an increase in receivables from the Medi-Cal Waiver program.

Capital assets increased by $13.2 million, or 1.9 percent, in 2011 from the prior year primarily due to the continued Phase II construction. In 2010, capital assets grew by $68.2 million, or 10.8 percent, from the prior year primarily due to the expenditures in the Phase II construction projects.

Other assets, including restricted funds for the replacement hospital and the bond issuance costs, decreased by $41.4 million, or 39.2 percent in 2011, due primarily to the bond construction expenditures and interest payments. In 2010, other assets increased by $98.9 million, or 1,439 percent, 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.

In 2011, current liabilities increased by $10.6 million from the prior year due mainly to the increase in salaries and benefits payable and increase in third party settlements. 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.

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 2011, long-term debt increased slightly by $70 thousand, from the prior year. In 2010, long-term debt increased by $240.9 million, or 269 percent, from the prior year, as a result of additional borrowings from issuance of new bonds.

Net assets increased by $38.0 million, or 6.5 percent, in 2011. The change in net assets includes the excess of revenues over expenses of $85.1 million, transfers to the University of $1.0 million, and the health system support of $48.1 million transferred to the School of Medicine. Net assets decreased by $48.8 million, or 7.7 percent, in 2010.

Liquidity and Capital Resources

The Medical Center generated $144.4 million and $76.5 million from operating activities in 2011 and 2010, respectively.

Cash flows from non-capital financing activities show the Medical Center's cash were reduced to $34.2 million and $65.8 million in 2011 and 2010 respectively, for $48.1million transfers to the University as health system support and offset by $13.9 million grants received for the Hospital Fee Program.

In 2011 and 2010, cash flows from capital and related financing activities included purchases of capital assets of $52.3 million and $64.5 million, principal payments on long-term debt and capital leases were $14.0 million and $11.5 million, and interest paid was $18.6 million and $12.1 million, respectively.

Cash flows from investment activities in 2011 and 2010 show that $3.0 million and $1.8 million was provided by interest income, respectively. Change in restricted assets was a decrease of $41.4 million in 2010 and an increase of $97.3 million in 2010.

Overall, cash on hand increased to $175.7 million in 2011 from $102.6 million in 2010. Cash on hand increased to $102.6 million in 2010 from $73.4 million in 2009.

The following table shows key liquidity and capital ratios for 2011, 2010 and 2009:

	2011	2010	2009
Days cash on hand	110	69	54
Days of revenue in accounts receivable	60	50	54
Capital investment ($ in millions)	$ 712	$ 699	$ 631
Debt service coverage ratio	5.0	4.4	7.2

Days cash on hand increased to 110 days in 2011 from 69 days in 2010 for a 59.4 percent increase. In 2010, days cash on hand increased to 69 days in 2010 from 54 days for a 27.8 percent increase. 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 2011, net days in receivables increased to 60 days. In 2010, net days in receivables decreased to 50 days as a result of improved cash collections.

Debt service coverage ratio measures the amount of funds available to cover the principal and interest on long-term debt. The Medical Center's ratios for 2011, 2010, and 2009 are 5.0, 4.4 and 7.2, respectively. The increase of 0.6 in debt service coverage in 2011 is the result of the increase in net income. The decrease in debt service coverage ratio of 2.8 was due to a decrease of income from operations and an increase in long-term debt. 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 2011, 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 Medical Center, which will be compliant with the requirements by January 1, 2013, 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 2011 and 2010, $11.9 million and $58.0 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.

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 were 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.

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. In November 2010, California received federal approval for a new five year waiver. State of California Assembly Bill 1066, signed in July 2011, contains the statutes to enact the terms of the new waiver program. Payments to the Medical Centers include a combination of Medi-Cal inpatient fee for service payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments and Safety Net Care Pool ("SNCP") payments based upon costs. The Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. Although the waiver is designed to ensure predictable reimbursements for the care of poor and indigent patients, the full financial impact of these changes in the future cannot be determined.

Meaningful Use of Electronic Health Records

The American Recovery and Reinvestment Act of 2009 established one-time incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. A hospital may receive an incentive payment for up to four years, from 2011 through 2015, by meeting a series of objectives that make use of EHR's potential related to the improvement of quality, efficiency and patient safety. Meaningful use is assessed on a year-by-year basis and requires attestation by the facility that the criteria have been satisfied. For the year ended June 30, 2011, the Medical Center did not receive any payments for the meaningful use of EHR technology.

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. As of June 30, 2011, the Medical Center did not receive the Proposition 3 funding.

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, 2010 actuarial valuation was $5.4 billion or 86.2 percent funded. The total funding policy contributions in the July 1, 2010 actuarial valuations represent 23.25% of covered compensation. As of July 1, 2011, the funded ratio is expected to decrease to approximately 82.0 percent. At its September 2010 meeting, The Regents approved increasing the employer and employee contribution rates to UCRP. Contributions by members will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University will be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These contribution rates are below UCRP's total funding policy contributions. The Regents also approved a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55, but retain many of the current features of UCRP. The new tier would not offer lump sum cashouts, inactive member Cost of Living Adjustments (COLAs), or subsidized survivor annuities for spouses and domestic partners. These changes are subject to collective bargaining for union-represented employees.

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, 2010 actuarial valuation was $15.4 billion. The Regents approved a new eligibility formula for the Retiree Health Plan for all employees hired on or after July 1, 2013, and non-grandfathered members, that is based on a graduated formula using both a member's age and years of Retirement Plan service credit upon retirement, subject to collective bargaining for represented members.

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.

University of California, Irvine Medical Center
Statements of Net Assets
June 30, 2011 and 2010
(Dollars in thousands)

	2011	2010
Assets		
Current assets		
Cash	$ 175,692	$ 102,648
Patient accounts receivable, net of estimated uncollectibles of $3,309 and $3,214, respectively	96,868	74,140
Other receivables	12,193	34,773
Inventory	13,565	12,865
Prepaid expenses and other assets	9,164	6,096
Total current assets	307,482	230,522
Restricted assets:		
Cash restricted for replacement hospital	61,995	103,353
Capital assets, net	712,025	698,815
Deferred costs of issuance	2,347	2,427
Total assets	1,083,849	1,035,117
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	21,193	27,613
Accrued salaries and benefits	46,605	41,635
Third-party payor settlements, net	49,462	38,547
Current portion of long-term debt and capital leases	14,303	13,053
Other liabilities	1,472	1,554
Total current liabilities	133,035	122,402
Long-term debt and capital leases, net of current portion	330,625	330,555
Total liabilities	463,660	452,957
Net Assets		
Invested in capital assets, net of related debt	367,057	352,012
Restricted:		
Expendable:		
Capital projects	61,995	103,353
Unrestricted	191,137	126,795
Total net assets	$ 620,189	$ 582,160

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Net patient service revenue, net of provision for doubtful accounts of $9,742 and $3,344, respectively	$ 675,211	$ 589,631
Other operating revenue:		
Clinical teaching support	8,474	8,395
Other	15,452	15,616
Total other operating revenue	23,926	24,011
Total operating revenue	699,137	613,642
Operating expenses:		
Salaries and wages	270,018	256,865
UCRP, retiree health and other employee benefits	83,052	68,608
Professional services	2,252	2,195
Medical supplies	88,522	81,498
Other supplies and purchased services	119,256	122,275
Depreciation and amortization	52,850	43,565
Insurance	4,914	2,536
Total operating expenses	620,864	577,542
Income from operations	78,273	36,100
Non-operating revenues (expenses):		
Hospital fee program grants	13,901	-
Interest income	3,038	1,805
Interest expense	(13,445)	(5,971)
Build America bonds federal interest subsidies	3,438	1,924
Other Nonoperating expenses	(51)	(228)
Total net non-operating revenues (expenses)	6,881	(2,470)
Income before other changes in net assets	85,154	33,630
Other changes in net assets:		
Health system support	(48,147)	(65,771)
Transfers from (to) University, net	1,022	(16,647)
Total other changes in net assets	(47,125)	(82,418)
Increase (decrease) in net assets	38,029	(48,788)
Net assets – beginning of year	582,160	630,948
Net assets – end of year	$ 620,189	$ 582,160

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 663,398	$ 600,097
Payments to employees	(266,660)	(253,622)
Payments to suppliers	(212,430)	(200,432)
Payments for benefits	(81,439)	(67,769)
Other (disbursements) receipts, net	41,509	(1,747)
Net cash provided by operating activities	144,378	76,527
Cash flows from noncapital financing activities:		
Health system support	(48,147)	(65,771)
Grants from the hospital fee program	13,901	-
Net cash used by noncapital financing activities	(34,246)	(65,771)
Cash flows from capital and related financing activities:		
State capital appropriations	-	(33,842)
Proceeds from debt issuance	-	236,056
Bond issuance costs	(51)	(1,959)
Build America bonds federal interest subsidies	3,438	1,923
Purchases of capital assets	(52,290)	(64,489)
Principal paid on long-term debt and capital leases	(13,992)	(11,506)
Interest paid on long-term debt and capital leases	(18,588)	(12,142)
Net cash provided (used) by capital and related financing activities	(81,483)	114,041
Cash flows from investing activities:		
Interest income received	3,037	1,805
Change in restricted assets	41,358	(97,307)
Net cash provided (used) by investing activities	44,395	(95,502)
Net increase in cash	73,044	29,295
Cash – beginning of year	102,648	73,353
Cash – end of year	$ 175,692	$ 102,648

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 78,273	$ 36,100
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	52,850	43,565
Provision for doubtful accounts	9,742	3,344
Changes in operating assets and liabilities:		
Patient accounts receivable	(32,470)	(2,699)
Other receivables	22,580	(24,496)
Inventory	(700)	196
Prepaid expenses and other assets	(3,068)	1,494
Accounts payable and accrued expenses	1,368	3,846
Accrued salaries and benefits	4,970	4,082
Third-party payor settlements	10,915	9,821
Other liabilities	(82)	1,274
Net cash provided by operating activities	$ 144,378	$ 76,527
Supplemental noncash activities information:		
Capital assets acquired through capital lease obligations	17,065	$ 19,011
Amortization of bond premium	124	124
Amortization of deferred costs of issuance	81	47
Payables for property and equipment	7,788	(4,981)
Gifts of capital assets	1,817	17,922
Transfer of capital assets from (to) the University	-	(185)

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 417 licensed beds for the year ended June 30, 2011.

The financial statements of the Medical Center 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.

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). 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, was adopted by the Medical Center during the year ended June 30, 2011. This Statement incorporates into GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedures that were issued on or before November 30, 1989. Implementation of Statement No. 62 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2011 and 2010.

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, 2011 and 2010 was $175,692 and $102,648, 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 2010-2011 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, Cash Restricted for 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 are deposited in STIP.

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 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. 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 on borrowings to finance facilities is capitalized during construction, net of any investment income earned on tax-exempt borrowings during the temporary investment of project-related borrowings.

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.

Operating revenue includes net patient service revenue reported at the estimated net realizable amounts due 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 University. 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 University. 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.

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

New Accounting Pronouncements
In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, effective for the University's fiscal year beginning July 1, 2011. This Statement requires the Medical Center to report the activities for certain public-private partnerships as service concession arrangements in the financial statements. Service concession arrangements are recorded when the arrangements meet certain criteria which include building and operating a facility, obtaining the right to collect fees from third parties, and transferring ownership of the facility to the Medical Center at the end of the arrangement. The Medical Center is evaluating the effect that Statement No. 60 will have on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the University's fiscal year beginning July 1, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements. The University is evaluating the effect that Statement No. 63 will have on its financial statements.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the University's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for termination hedge accounting. The University is evaluating the effect that Statement No. 64 will have on its financial statements.

3. Net Patient Service Revenue

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

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

  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 legislation enacted by the State of California. Medi-Cal outpatient FFS services are reimbursed based on a fee schedule. The total payments made to the Medical Center will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP") payments. Effective November 2010, the Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. For the years ended June 30, 2011 and 2010, the Medical Center recorded total Medi-Cal waiver revenue of $91,300 and $91,273, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 on September 8, 2010, established a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Program Fee", which are imposed on certain California hospitals. The effective date of the Hospital Feed Program was April 1, 2009 through December 31, 2010 and was predicated, in part, on the enhanced Federal Medicaid Assistance Percentage ("FMAP") contained in the American Reinvestment and Recovery Act ("ARRA"). The Hospital Fee program makes supplemental payments to hospitals for various health care services and supports the state's effort to maintain health care coverage for children. The Medical Center, designated as a public hospital, is exempt from paying the "Quality Assurance Fee"; however, the Medical Center received supplemental payments under the Hospital Fee Program. For the year ended June 30, 2011, the Medical Center received $27.4 million, which has been reported as net patient revenue and $13.9 million as a state grant which has been reported as non-operating revenue.

- ***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, 2011 and 2010, the Medical Center recorded revenue of $3,363 and $2,595, 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 represent 15.4 percent and 17.5 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively. Amounts due from Medi-Cal represent 15.1 percent and 20.9 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, net patient service revenue included unfavorable cost report settlements of $1,444 and $1,872, respectively, primarily from Medicare and Medi-Cal Programs.

(Dollars in thousands)

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

	2011	2010
Contract (discounted or per diem)	$ 315,886	$ 263,234
Medicare (non-risk)	146,485	152,524
Medi-Cal (non-risk)	179,148	141,540
County	21,779	22,346
Commercial	6,908	5,052
Non-sponsored (uninsured)	5,005	4,935
Total	$ 675,211	$ 589,631

4. Charity Care

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

	2011	2010
Charity care at established rates	$ 75,807	$ 71,703
Estimated cost of charity care	15,986	17,721

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $22,635 and $14,209 for the years ended June 30, 2011 and 2010, respectively.

5. Capital Assets

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

	2010	Additions	Disposals	2011
Original Cost				
Land	$ 7,394	$ 5,000	$ -	$ 12,394
Buildings and improvements	743,160	24,195	(51,164)	716,191
Equipment	202,052	39,766	(7,726)	234,092
Construction in progress	29,642	(2,298)	-	27,344
Capital assets, at cost	$ 982,248	$ 66,663	$ (58,890)	$ 990,021

	2010	Depreciation	Disposals	2011
Accumulated Depreciation				
Buildings and improvements	$ 181,615	$ 28,141	$ (51,164)	$ 158,592
Equipment	101,818	24,709	(7,123)	119,404
Accumulated depreciation	283,433	$ 52,850	$ (58,287)	277,996
Capital assets, net	$ 698,815			$ 712,025

(Dollars in thousands)

	2009	Additions	Disposals	2010
Original Cost				
Land	$ 7,394	$ -	$ -	$ 7,394
Buildings and improvements	596,870	146,535	(245)	743,160
Equipment	167,011	37,632	(2,591)	202,052
Construction in progress	101,658	(72,016)	-	29,642
Capital assets, at cost	$ 872,933	$ 112,151	$ (2,836)	$ 982,248

	2009	Depreciation	Disposals	2010
Accumulated Depreciation				
Buildings and improvements	$ 158,728	$ 22,887	$ -	$ 181,615
Equipment	83,576	20,700	(2,458)	101,818
Accumulated depreciation	242,304	$ 43,587	$ (2,458)	283,433
Capital assets, net	$ 630,629			$ 698,815

Equipment under capital lease obligations and related accumulated amortization was $76,011 and $36,806 in 2011, respectively, and $73,695 and $32,206 in 2010, 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 for the year ended June 30, 2010, are included in Transfers from University for building program on the statements of revenues, expenses, and changes in net assets. There was no such expenditure for the year ended June 30, 2011.

(Dollars in thousands)

6. Long-term Debt and Capital Leases

	2011	2010
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 through 2038	$ 77,035	$ 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 2012 through 2049	155,855	155,855
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	62,010	62,920
University of California General Revenue Bonds, interest rates from 4.0 percent to 5.125 percent, payable semi-annually, with annual principal payments through 2017	2,493	2,846
Orangewood Land Loan - 5.0 percent over 15 years	5,000	-
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 1.6 percent to 4.1 percent, payable through 2015	39,205	41,490
	341,598	340,146
Unamortized bond premium	3,330	3,462
Total debt and capital leases	344,928	343,608
Less: Amounts due within one year	(14,303)	(13,053)
Noncurrent portion of debt and capital leases	$ 330,625	$ 330,555

Total interest expense during the years ended June 30, 2011 and 2010 was $18,589 and $10,692, respectively. Interest expense totaling $5,144 and $4,722 was capitalized in each of the years ended June 30, 2011 and 2010. The remaining $13,445 in 2011 and $5,971 in 2010 are reported as interest expense in the statements of revenues, expenses, and changes in net assets. Net investment income totaling $2,003 and $1,844 was capitalized during the years ended June 30, 2011 and 2010, respectively.

(Dollars in thousands)

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

	Revenue Bonds	Debt Obligations	Total
Year ended June 30, 2011			
Long-term debt and capital leases at June 30, 2010	$ 302,119	$ 41,489	$ 343,608
New obligations	-	16,354	16,354
Principal payments	(1,263)	(13,639)	(14,902)
Amortization of bond premium	(132)	-	(132)
Long-term debt and capital leases at June 30, 2011	300,724	44,204	344,928
Less: Current portion of long-term debt and capital leases	(370)	(13,933)	(14,303)
Noncurrent portion of long-term debt and capital leases as June 30, 2011	$ 300,354	$ 30,271	$ 330,625
Year ended June 30, 2010			
Long-term debt and capital leases at June 30, 2009	$ 66,584	$ 33,646	$ 100,230
New obligations	232,890	19,011	251,901
Bond premium	3,107	-	3,107
Principal payments	(338)	(11,168)	(11,506)
Amortization of bond premium	(124)	-	(124)
Long-term debt and capital leases at June 30, 2010	302,119	41,489	343,608
Less: Current portion of long-term debt and capital leases	(351)	(12,702)	(13,053)
Noncurrent portion of long-term debt and capital leases as June 30, 2010	$ 301,768	$ 28,787	$ 330,555

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, 2011 are $2.26 billion of which $294,900 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, 2011 and 2010 were $6.4 billion and $5.94 billion, respectively.

In February 2011, the Medical Center retired $910 of Medical Center Pooled Revenue Bonds recognizing a gain of $205 on the statement of revenues, expenses and changes in net assets. The Medical Center has a payable to the University of $711, reported in other current liabilities. The retirements were financed through the University's commercial paper program. The Medical Center has a payable to the University for the cost of the retirements. The payable bears interest at the commercial paper rate and is due on demand when the University refinances these commercial paper proceeds into long-term bonds.

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 is being 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 is being 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 is being 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.

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)

Future Debt Service

Future debt service payments for each of the five fiscal years subsequent to June 30, 2011 and thereafter are as follows:

Year Ending June 30	Revenue Bonds	Other Debt	Total Payments	Principal	Interest
2012	23,565	14,855	38,420	20,708	17,712
2013	23,561	16,513	40,074	23,002	17,072
2014	23,568	7,877	31,445	14,962	16,483
2015	23,565	5,405	28,970	12,966	16,004
2016	23,552	1,385	24,937	9,369	15,569
2017 – 2021	87,552	-	87,552	12,080	75,472
2022 – 2026	96,732	-	96,732	26,025	70,707
2027 – 2031	96,130	-	96,130	32,930	63,200
2032 – 2036	94,193	-	94,193	41,205	52,988
2037 – 2041	90,437	-	90,437	50,680	39,757
2042 – 2046	85,125	-	85,125	62,040	23,085
2047 – 2048	40,164	-	40,164	35,631	4,532
Total future debt service	708,144	46,035	754,179	341,598	412,581
Less: Interest component of future payments	(410,750)	(1,831)	(412,581)		
Principal portion of future payments	297,394	44,204	341,598		
Adjusted by:					
Unamortized bond premium	3,330	-	3,330		
Unamortized deferred financing costs	-	-	-		
Total debt	300,724	44,204	344,928		

Additional information on the revenue bonds can be obtained from the 2010-2011 annual report of the University.

(Dollars in thousands)

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, 2011 and 2010 was $2,751 and $3,364, respectively. The terms of the operating leases extend through the year of 2019.

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
2012	$ 1,726
2013	1,195
2014	848
2015	706
2016	706
2017 – 2019	2,267
Total	$ 7,448

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 University. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.31 and $3.12 per $100 of UCRP-covered payroll resulting in Medical Center contributions of $8.0 million and $7.2 million for the years ended June 30, 2011 and 2010, 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, 2010, the date of the latest actuarial valuation, were $74.3 million and $15.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $71.3 million at June 30, 2011. For the years ended June 30, 2011 and 2010, combined contributions from the University's campuses and medical centers were $313.8 million and $283.5 million, respectively, including an implicit subsidy of $54.8 million and $49.5 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.7 billion and $1.6 billion for the years ended June 30, 2011 and 2010. 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 $5.1 billion at June 30, 2011 increased by $1.4 billion and $1.4 billion for the years ended June 30, 2011 and 2010.

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 2010–2011 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 and employee contributions were $9.3 million and $3.8 million, respectively, during the year ended June 30, 2011. Medical Center and employee contributions were $2.0 million and $0.7 million respectively, during the year ended June 30, 2010.

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, 2010, the date of the latest actuarial valuation, were $33.7 billion and $39.1 billion, respectively, resulting in a funded ratio of 86.2 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $41.9 billion and $34.6 billion at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, the University's campuses and medical centers contributed a combined $1.4 billion and $64.8 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.7 billion for the year ended June 30, 2011. 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 $239.2 million for the year ended June 30, 2011.

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 2010–2011 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 $5,646 and $5,107 for the years ended June 30, 2011 and 2010, respectively. During 2011 and 2010, as a result of actuarial analysis, the Medical Center received a refund of premiums of $430 and $1,613, respectively, from the University that reduced the overall workers' compensation cost for the year.

(Dollars in thousands)

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $4,914 and $2,536 for the years ended June 30, 2011 and 2010, 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:

	2011	2010
Professional services	$ 2,252	$ 2,195
Other supplies and purchased services	25,357	25,122
Interest income (net)	(1,989)	(1,648)
Insurance	4,914	2,536
Administrative costs	(4,406)	(4,406)
Total	$ 26,128	$ 23,799

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 $74,275 and $89,569 in 2011 and 2010, respectively. Of these amounts, $26,128 and $23,798 are reported as operating expenses for the years ended June 30, 2011 and 2010, respectively, and $48,147 and $65,771 are reported as health system support for the years ended June 30, 2011 and 2010, 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.

The state of California authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations for the medical centers, of which $235,000 was allocated to the Medical Center. 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 estimated to be $242,200. The phase II projects will be funded from external financing.

At June 30, 2011, the Medical Center had outstanding commitments for capital expenditures in connection with the phase II projects of approximately $59,428. The Medical Center expects to fund these costs principally through external financing sources.

Gift funds used for construction total $131 and $18,609 for the years ended June 30, 2011 and 2010, respectively, 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, 2011 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.

University of California,
Los Angeles Medical Center
Financial Statements
For the Years Ended June 30, 2011 and 2010

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets, and cash flows, as shown on pages 18 through 21 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, 2011 and 2010, and the 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, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management’s Discussion and Analysis on pages 2 through 17 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 12, 2011

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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, 2011, with selected comparative information for the years ended June 30, 2010 and 2009. 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 (2009, 2010, 2011, 2012, 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 466-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 leading edge 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' 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 2011 and occupancy beginning in calender year 2012.

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, 2011, the Medical Center reported income before other changes in net assets of $289.5 million, generating a margin of 16.8 percent. The year ended with a cash position of $598.1 million. For 2010, income before other changes in net assets was $212.1 million, generating a margin of 13.4 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 2011-2012 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 22nd 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 (7); ear, nose and throat (11); gastroenterology (6); geriatrics (2); gynecology (13); heart and heart surgery (9); 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 (7); pulmonology (13); rheumatology (6); and urology (4).

- *The Medical Center was an integral component of UCLA Health Science's Strategic Plan*
  The UCLA Health System and the David Geffen School of Medicine at UCLA recently completed a robust, comprehensive strategic planning process to provide a roadmap for its academic, research, clinical and community engagement activities during the next five years (2011 – 2015). With respect to the clinical mission and vision, the UCLA Health System will be focused on supporting the following five clinical goal areas: 1) outstanding faculty and staff recruitment/retention; 2) provide outstanding patient-centered care in all practice venues; 3) enhance access to care; 4) develop an integrated delivery system while maintaining tertiary and quaternary care delivery; and 5) develop a national reputation in health care innovations. In order to achieve these 5 goals, the following strategies will be pursued: a) provide high quality, patient-centered, efficient, cost-effective care; b) function as a full-service, integrated group practice providing the full continuum of care to all patients; c) foster innovation to radically improve health care quality delivery locally and globally; d) ensure sufficient capacity for clinical services; e) grow clinical volume; f) establish and align institutional service standards across all patient care settings; and g) strengthen communication and relationships with referring physicians, affiliated with UCLA or from the community.

- *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 2011 with occupancy beginning calendar 2012. Patient services continue to move from Westwood to Santa Monica, part of the ongoing process of reallocating services appropriately across the health system.

- *The Medical Center received significant new funding from State Medicaid Program*
  State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 on September 8, 2010, established 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 makes supplemental payments to hospitals for various health care services and supports the state's effort to maintain health care coverage for children. The Medical Center, designated as a public hospital, is exempt from paying the "Quality Assurance Fee"; however, the Medical Center received supplemental payments under the Hospital Fee Program. For the year ended June 30, 2011, the Medical Center received $16.6 million, which has been reported as net patient revenue and $31.4 million as a state grant which has been reported as non-operating revenue. Also, effective November 2011, the Medical Center is eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. These incentive payments are referred to as the Delivery System Reform Incentive Pool (DSRIP). The Medical Center received $ 22 million in 2011 of DSRIP funding.

- *The Medical Center started implementing an Electronic Health Record (EHR)*
  The EHR is a longitudinal electronic record of patient health information generated by one or more encounters in any care delivery setting. The EHR automates and streamlines the clinician's workflow. The EHR will have the ability to generate complete records of patient encounters including evidence-based decision support, quality management and outcomes reporting. There are many benefits but overall this will provide our clinicians and patients with a seamless and integrated set of systems that allow easy access to information to facilitate and improve the overall patient care process. The implementation is a multi-year process and is expected to be completed by the end of calendar 2013.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2011, 2010 and 2009:

	2011	2010	2009
Licensed beds	855	845	845
Admissions	40,336	40,220	40,342
Average daily census	723	718	715
Discharges	40,318	40,211	40,258
Average length of stay	6.5	6.5	6.5
Patient days	263,717	261,895	261,021
Case mix index	1.92	1.90	1.92
Outpatient visits:			
Hospital clinics	845,508	788,287	773,078
Home health and hospice	-	-	44,850
Emergency visits	83,082	81,383	76,739
Total visits	928,590	869,670	894,667

Total admissions increased by 0.3 percent in 2011 compared to 2010, due to an increase in medicine and psychiatric cases. Total admissions decreased by 0.3 percent in 2010 compared to 2009, due to a decrease in surgery and orthopedic cases.

Total patient days in 2011 increased by 1,822, or 0.7 percent, over 2010 due to an increase in Medicare and Medi-Cal payors. Total patient days in 2010 increased by 874, or 0.3 percent, over 2009 due to an increase in Medicare days.

In 2011, total outpatient visits increased by 58,920, or by 6.8 percent, compared to 2010, due primarily to an acquisition of new physician practice group, expansion of primary care clinics, and increase in blood draw stations. 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 2010.

Statements of Revenues, Expenses and Changes in Net Assets

The following table summarizes the operating results for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Net patient service revenue	$ 1,656,724	$ 1,527,157	$ 1,401,847
Other operating revenue	63,666	60,326	64,068
Total operating revenue	1,720,390	1,587,483	1,465,915
Total operating expenses	1,446,726	1,363,893	1,331,930
Income from operations	273,664	223,590	133,985
Total net non-operating revenues (expenses)	15,879	(11,508)	(18,213)
Income before other changes in net assets	$ 289,543	$ 212,082	$ 115,772
Operating margin	16.8%	13.4%	7.9%
Other changes in net assets	$ (57,213)	$ (78,833)	$ 43,160
Increase in net assets	232,330	133,249	158,932
Net assets - Beginning of year	1,482,792	1,349,543	1,190,611
Net assets- End of year	$ 1,715,122	$ 1,482,792	$ 1,349,543

Revenues

Total operating revenues for the year ended June 30, 2011 were $ 1,720.4 million, an increase of $132.9 million, or 8.4 percent, over 2010. Operating revenues for 2010 were $1,587.5 million, an increase of $121.6 million, or 8.3 percent, over 2009.

Net patient service revenue for 2011 increased by $129.6 million, or 8.5 percent, over 2010. The increase in 2011 was due to increased contract rates, Medi-Cal funding for Delivery System Reform Incentive Pool and Medi-Cal Provider Fee. 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 for contracts currently in effect.

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.

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 increase in 2011 in other operating revenue was mainly due to investment gain and refund of sales and use tax and property tax. The decrease in 2010 in other operating revenue was mainly in Clinical Teaching Support Funds due to the state's budget reductions.

The following table summarizes net patient service revenue for 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Medicare (non-risk)	$ 348,592	$ 358,954	$ 327,054
Medi-Cal (non-risk/County)	191,238	151,669	139,954
Commercial	5,611	11,247	13,130
Contracts (discounted/per diem)	1,046,503	955,050	865,966
Contracts (capitated)*	38,114	33,283	35,146
Non-sponsored/self-pay (Uninsured)	26,666	16,954	20,597
Total	$ 1,656,724	$ 1,527,157	$ 1,401,847

*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 decreased by $10.4 million, or 2.9 percent, below the prior fiscal year. This decrease is primarily due to lower outlier cases and reductions in payment factors. In 2010, net patient revenue for Medicare increased by $31.9 million, or 9.7 percent, over 2009. This increase is primarily due to increase in utilization and adjustment to reserves for favorable cost report 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 2011, the Medical Center recorded additional Medi-Cal funding for the Delivery System Reform Incentive Pool of $22 million and Medi-Cal Provider Fee funding of $16.6 million. In 2010, the Medical Center recorded additional Medi-Cal net funding of $10.3 million. The Medi-Cal revenue includes funding for covered outpatient services pursuant to California Assembly Bill 915. Also included in net patient service revenue are Medi-Cal patients referred by county facilities and reimbursed to the Medical Center at Medi-Cal rates.

In 2011, contract net patient revenue (discounted/per-diem) increased by $91.5 million, or 9.6 percent, due to rate increases and outpatient volume. 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.

The net patient service revenue for contracts that are full-risk capitation increased by $4.8 million, or 14.5 percent in 2011, and decreased by $1.9 million, or 5.3 percent, in 2010.

In 2011, commercial net patient revenue decreased by $ 5.6 million, or 50.1 percent, due to a decrease in volume. In 2010, commercial net patient revenue decreased by $1.9 million, or 14.3 percent, due to a decrease in volume.

The non-sponsored/self-pay net revenue increased from the prior year by $9.7 million, or 57.3 percent in 2011 and decreased by $3.6 million, or 17.7 percent, in 2010. 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 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Salaries and wages	$ 648,152	$ 606,069	$ 597,706
Employee benefits	181,312	152,195	137,402
Professional services	33,530	51,717	43,847
Medical supplies	208,027	203,004	204,800
Other supplies and purchased services	275,568	255,917	256,741
Depreciation and amortization	89,277	85,873	81,921
Insurance	10,860	9,118	9,513
Total	$ 1,446,726	$ 1,363,893	$ 1,331,930

Total operating expenses for 2011 were $1,446.7 million, an increase of $82.8 million, or 6.1 percent, over 2010. This change was primarily due to increased salary and employee benefits, medical supplies, purchased services and an increase in depreciation costs for the replacement hospital. 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.

Salary and employee benefits expenses include wages paid to Medical Center employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance, pension contributions and other employee benefits. About one-half of the Medical Center's work force, including nurses and employees providing ancillary services, expand and contract with patient volumes.

In 2011, salaries and wages grew by $42.1 million, or 6.9 percent, over the prior year. This increase includes $23.5 million, or 3.9 percent in salary increases and an increase of 230 full time equivalent employees, or 3.0 percent from the prior year, due to a 0.7 percent increase in inpatient volume, a 7.0 percent increase in outpatient volume and various initiatives. In 2010, salaries and wages grew by $8.4 million, or 1.4 percent, over the prior year. This increase includes $20.9 million, or 3.5 percent in salary rate increases offset by a decrease of 157 full time equivalent employees, which represents a 2.0 percent decrease from the prior year.

Amounts paid for nurse registry and other contract labor are included in salaries and wages. Temporary labor costs for 2011 increased $4.2 million, or 56.7 percent, over 2010, due to a shortage of critical care nurses for higher acuity patients and an increase in outpatient rehabilitation volume. Temporary labor costs for 2010 decreased $14.4 million, or 66.2 percent, over 2009 due to full time equivalent reduction initiatives by senior management.

In 2011, employee benefit costs increased by $29.1 million, or 19.1 percent, over 2010. Pension contributions were $20.9 million in 2011 as compared to $4.6 million in 2010 and zero in 2009. The Medical Center's health insurance and other employee benefit costs increased in 2011 as compared to 2010 by $12.8 million, or 8.7 percent, due to an increase in insurance premiums of $7.5 million and increases in other benefit costs of $5.3 million. The Medical Center's health insurance and other employee benefit costs increased in 2010 as compared to 2009 by $10.2 million, or 7.4 percent, due to an increase in insurance premiums of $8.9 million and increases in other benefit costs of $1.3 million.

As a percentage of total operating revenue, salaries and employee benefits were 48.2 percent in 2011, 47.8 percent in 2010 and 50.2 percent in 2009. Overall labor costs increased as a percent of operating revenues due to salary increase, pension & health insurance increase, and full-time equivalent increase.

Payments for professional services decreased by $18.2 million, or 35.2 percent, in 2011 from 2010. The decrease was due to the completion of the revenue cycle engagement and a decrease in legal fees for the Replacement Hospital. In 2010, payments for professional services increased by $7.9 million, or 17.9 percent 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.

Medical supply expense increased by $5.0 million, or 2.5 percent, in 2011 from 2010 due to an increase in pharmaceutical expenses due to inflation and volume. In 2010, medical supply 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.

Other supplies and purchased services increased by $19.7 million, or 7.7 percent, over the prior year. The increase was primarily due to increased cost of transplant organs, an increase in Clinical and Pathology lab procedures, an increase in repair and maintenance expense, an increase in utility expense and an increase in building leases expense. Other supplies and purchased services decreased by $0.9 million, or 0.3 percent, in 2010 over 2009 primarily due to the decrease in utility expense because of reduced consumption and the decommissioning of spaces in the old hospital.

Depreciation and amortization expense increased by $3.5 million, or 4.0 percent, over 2010 due to new additions and capitalization of completed projects. In 2010, depreciation and amortization expense increased by $4.0 million, or 4.8 percent, over 2009 due an increase in equipment depreciation.

Insurance expense of $10.9 million in 2011 and $9.1 million in 2010 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $1.7 million, or 19.1 percent, in 2011 and decreased by $0.4 million, or 4.2 percent, in 2010.

Income from Operations
The Medical Center reported income from operations of $273.7 million and operating revenue of $1,720.4 million, resulting in an operating margin of 16.8 percent in 2011 as compared to 13.4 percent and 7.9 percent in 2010 and 2009, respectively. Income from operations increased in 2011 to $273.7 million from $223.6 million in the prior year. The $50.1 million increase was the result of increase in net patient service revenue.

Non-operating Revenues (Expenses)
Total non-operating revenues were $15.9 million for 2011 compared to $(11.5) million in the prior year. The majority of this increase was primarily due the funding from Hospital Fee Program and gain for defeasance of long term debt.

In 2010, total non-operating revenues (expenses) were $(11.5) million compared to $(18.2) million in 2009. The majority of this decrease was primarily due to an increase in interest income.

Income before Other Changes in Net Assets
The Medical Center's income before other changes in net assets was $289.5 million for 2011 compared to $212.1 million for 2010 and $115.8 million in 2009, an increase of $77.4 million, or 36.5 percent, and $96.3 million, or 83.2 percent, respectively. The Medical Center's net income increased in 2011 and 2010 mainly due to increases in net patient service revenues.

Other Changes in Net Assets
The other changes in net assets for 2011, 2010 and 2009 include:

	2011	2010	2009
Proceeds received or receivable from FEMA	$ -	$ 626	$ 110
Contributions from University for building program	24,854	21,483	40,819
Donated assets	3,481	14,299	40,203
Health system support	(85,548)	(56,217)	(37,932)
Transfers to University for building program	-	(59,024)	(40)
Total other changes in net assets	$ (57,213)	$ (78,833)	$ 43,160

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 2011 are the following:

- Proceeds received and receivable from the Federal Emergency Management Agency ("FEMA") for the hospitals' replacement projects were $0 thousand in 2011 and $0.6 million in 2010. 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 2011, contributions from the University for the building program of $24.9 million are related to Santa Monica hospital's replacement project and represent funding from the Children's Hospital Bond Act of 2008. 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.

- 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 $3.5 million and $14.3 million of gift funds in 2011 and 2010, 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 $85.5 million in 2011 and $56.2 million in 2010.

In total, the net assets increased in 2011 by $ 232.3 million to $1,715.1 million. The majority of this increase was due to cash balance and capital assets for the Santa Monica replacement hospital. In 2010, net assets increased by $133.2 million to $1,482.8 million. The majority of this increase was due an increase in cash balance.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Current assets:			
Cash	$ 598,063	$ 406,034	$ 219,604
Patient accounts receivable (net)	260,936	246,961	247,723
Other current assets	55,492	81,652	64,147
Total current assets	914,491	734,647	531,474
Capital assets (net)	1,728,111	1,692,645	1,625,852
Other assets	138,051	144,446	68,940
Total assets	2,780,653	2,571,738	2,226,266
Current liabilities	253,828	249,216	193,061
Long-term debt	773,744	787,066	643,731
Other liabilities	37,959	52,664	39,931
Total liabilities	1,065,531	1,088,946	876,723
Net assets:			
Invested in capital assets (net)	965,329	916,942	1,046,892
Restricted	88,970	81,247	19,427
Unrestricted	660,823	484,603	283,224
Total net assets	$ 1,715,122	$ 1,482,792	$ 1,349,543

Total current assets increased in 2011 by $179.8 million, or 24.5 percent, compared to 2010 due to an increase in cash and net patient accounts receivable. In 2010, total current assets increased by $203.2 million, or 38.2 percent, compared to 2009 due to an increase in cash and other current assets.

Cash increased by $192.0 million, or 47.3 percent, in 2011. This increase was mainly due an increase in operating income and the Medi-Cal funding for Califonia Hospital Fee Program and Delivery System Reform Incentive Pool. Cash increased by $186.4 million, or 84.9 percent, in 2010 due to an increase in operating income as well as improved cash collections due to the efforts from the revenue cycle engagement.

Net patient accounts receivable increased by $14.0 million, or 5.7 percent, from 2010 due to volume increases and increases in valuation rates. In 2010, net patient accounts receivable decreased by $0.8 million, or 0.3 percent, from 2009 due to cash collection efforts. Cash collections increased by $75.5 million, or 5.3 percent, in 2011 and by $186.2 million, or 15.0 percent, in 2010.

In 2011, other current assets, including non-patient receivables, inventory and prepaid expenses, decreased by $26.2 million, or 32.0 percent, over the prior fiscal year. The decrease was primarily related to payments received from the state for Medi-Cal Waiver and AB915. In 2010, other current assets increased by $17.5 million, or 27.3 percent, over 2009 due primarily to a receivable from the state for Medi-Cal Waiver funding and outpatient funding under AB915.

Capital assets increased by $35.5 million, or 2.1 percent, over 2010 due to the construction of the Santa Monica replacement hospital. In 2010, capital assets increased by $66.8 million, or 4.1 percent, over 2009 due to the construction of the Santa Monica replacement hospital.

Other assets includes 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. In 2011, other assets decreased by $ 6.4 million, or 4.4 percent, due primarily to the decrease in the bond interest swap fair value and increase in the restricted cash for the building program. In 2010, other assets increased by $75.5 million, or 109.5 percent, primarily due to the increase in restricted cash for the building program and the bond interest swap fair value.

Current liabilities increased by $4.6 million, or 1.9 percent in 2011 due to a decrease in accounts payable of $44.1 million, an increase in accrued salaries and benefits of $14.9 million, an increase in third party payor settlements of $17.3 million, an increase in current portion of long term debt of $3.6 million, an increase of $11.5 million of commercial paper with the University, and an increase of $1.4 million in other liabilities. In 2010, current liabilities increased by $56.2 million, or 29.1 percent, 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.

Long-term debt includes the 2004 Series A and Series B Hospital Revenue Bonds, 2003 General Revenue Bonds, 2007 Hospital Revenue Bonds , 2009 Series E and Series F "Build America Bonds", Hospital Revenue Bonds, 2010 Series G and Series I Hospital Revenue Bonds, and long-term capital leases. The Medical Center also financed $0 million and $8.8 million of capital equipment through leases during 2011 and 2010, respectively. The notes payable to campus is for long-term operating capital needs.

Liquidity and Capital Resources

The Medical Center generated operating cash flows of $363.3 million and $293.8 million from operating activities in 2011 and 2010, respectively.

In 2011, cash flows from non-capital financing activities show the Medical Center's cash was reduced by $1.2 million over 2010 due to the transfers to the University for health system support and general support and the funding received for the Hospital Fee Program. 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 2011 and 2010, cash flows from capital and related financing activities included the proceeds from state funds of $(2) thousand and $378 thousand, contributions from the University for funding from the State Public Works Board Bonds $24.9 million and $21.5 million, purchase of capital assets (including construction in process for replacement hospitals) $114.5 million and $90.3 million, proceeds from new debt of $19.8 million and $146 million, bond costs of $0 million and $1.2 million, principal payments on long-term debt and capital leases of $12.2 million and $11.1 million, interest payments of $34.2 million and $18.8 million, and replenishment of campus gift funds of $3.5 million and $14.3 million, respectively.

Cash flows from investing activities in 2011 and 2010 show that $14.9 million and $10.2 million was provided by interest income, $(8.9) million and $(57.0) million from a change in restricted assets primarily due to proceeds from debt for the building project and $1.1 million and $(4.9) million from the change in the Santa Monica Foundation investments, respectively.

Overall cash increased to $598.1 million, or 47.3 percent, in 2011 from $406.0 million in 2010.

The following table shows key liquidity and capital ratios for 2011, 2010 and 2009:

	2011	2010	2009
Days cash on hand	161	116	64
Days of revenue in accounts receivable	53	55	58
Purchases of capital assets ($ in millions)	$ 114.5	$ 90.3	$ 132.7
Debt service coverage ratio	6.6	5.9	5.7

Days cash on hand increased to 161 days in 2011 from 116 days in 2010 for a 38.8 percent increase. 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 2011, days in accounts receivable decreased to 53. The main reason for this decrease was due to the cash collection efforts. In 2010, days in accounts receivable decreased to 55 due to the efforts of the revenue cycle engagement and cash collection efforts.

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 2011 is 6.6 versus 5.9 in 2010. The increase was due to the increase in net income. In 2010, the Medical Center's ratio is 5.9 versus 5.7 in 2009. 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 2011, 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 Medical Center, which will be compliant with the statutory requirements by the first quarter of 2012, is $565 million. The capital cost of compliance will be financed through the use of state lease revenue bond funds, FEMA funds, Medical Center reserves, gift funds and debt. In 2011 and 2010, $34.4 million and $61.5 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.

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 were 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.

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. In November 2010, California received federal approval for a new five year waiver. State of California Assembly Bill 1066, signed in July 2011, contains the statutes to enact the terms of the new waiver program. Payments to the Medical Centers include a combination of Medi-Cal inpatient fee for service payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP") payments based upon costs. The Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. Although the waiver is designed to ensure predictable reimbursements for the care of poor and indigent patients, the full financial impact of these changes in the future cannot be determined.

Meaningful Use of Electronic Health Records
The American Recovery and Reinvestment Act of 2009 established one-time incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. A hospital may receive an incentive payment for up to four years, from 2011 through 2015, by meeting a series of objectives that make use of EHR's potential related to the improvement of quality, efficiency and patient safety. Meaningful use is assessed on a year-by-year basis and requires attestation by the facility that the criteria have been satisfied. For the year ended June 30, 2011, the Medical Center did not receive any payments for the meaningful use of EHR technology.

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. As of June 30, 2011, the Medical Center received $24.9 million of grant funding.

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, 2010 actuarial valuation was $5.4 billion or 86.2 percent funded. The total funding policy contributions in the July 1, 2010 actuarial valuations represent 23.25% of covered compensation. As of July 1, 2011, the funded ratio is expected to decrease to approximately 82.0 percent. At its September 2010 meeting, The Regents approved increasing the employer and employee contribution rates to UCRP. Contributions by members will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University will be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These contribution rates are below UCRP's total funding policy contributions. The Regents also approved a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55, but retain many of the current features of UCRP. The new tier would not offer lump sum cashouts, inactive member Cost of Living Adjustments (COLAs), or subsidized survivor annuities for spouses and domestic partners. These changes are subject to collective bargaining for union-represented employees.

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, 2010 actuarial valuation was $15.4 billion. The Regents approved a new eligibility formula for the Retiree Health Plan for all employees hired on or after July 1, 2013, and non-grandfathered members, that is based on a graduated formula using both a member's age and years of Retirement Plan service credit upon retirement, subject to collective bargaining for represented members.

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.

University of California, Los Angeles Medical Center
Statements of Net Assets
June 30, 2011 and 2010
(Dollars in thousands)

	2011	2010
Assets		
Current assets		
Cash	$ 598,063	$ 406,034
Patient accounts receivable, net of estimated uncollectibles of $ 79,175 and $93,523, respectively	260,936	246,961
Other receivables, net of estimated uncollectibles of $93 and $93, respectively	18,324	43,506
Inventory	21,406	23,016
Prepaid expenses and other assets	15,762	15,130
Total current assets	914,491	734,647
Restricted assets:		
Cash restricted for replacement hospital	71,501	62,651
Donor funds	17,469	18,596
Capital assets, net	1,728,111	1,692,645
Deferred costs of issuance	5,949	6,329
Other assets	43,132	56,870
Total assets	2,780,653	2,571,738
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	79,938	124,065
Accrued salaries and benefits	110,781	95,915
Third-party payor settlements, net	30,355	13,021
Current portion of long-term debt and capital leases	14,568	10,972
Other liabilities	18,186	5,243
Total current liabilities	253,828	249,216
Notes payable to campus	75,000	75,000
Long-term debt and capital leases, net of current portion	698,744	712,066
Other liabilities	37,959	52,664
Total liabilities	1,065,531	1,088,946
Net Assets		
Invested in capital assets, net of related debt	965,329	916,943
Restricted:		
Nonexpendable:		
Endowments	337	337
Expendable:		
Capital projects	75,537	67,806
Other	13,096	13,104
Unrestricted	660,823	484,602
Total net assets	$ 1,715,122	$ 1,482,792

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Net patient service revenue, net of provision for doubtful accounts of $36,919 and $38,844, respectively	$ 1,656,724	$ 1,527,157
Other operating revenue:		
Clinical teaching support	12,979	12,981
Other	50,687	47,345
Total other operating revenue	63,666	60,326
Total operating revenue	1,720,390	1,587,483
Operating expenses:		
Salaries and wages	648,152	606,069
UCRP, retiree health and other employee benefits	181,312	152,195
Professional services	33,530	51,717
Medical supplies	208,027	203,004
Other supplies and purchased services	275,568	255,917
Depreciation and amortization	89,277	85,873
Insurance	10,860	9,118
Total operating expenses	1,446,726	1,363,893
Income from operations	273,664	223,590
Non-operating revenues (expenses):		
Hospital fee program grants	31,399	-
Interest income	14,850	10,178
Interest expense	(35,876)	(19,275)
Replacement hospital transition expense/equipment transfer to University	(3,819)	(2,923)
Build America bonds federal interest subsidies	3,016	1,627
Loss on disposal of capital assets	(662)	(1,115)
Gain on bond retirement	6,971	-
Total net non-operating revenues (expenses)	15,879	(11,508)
Income before other changes in net assets	289,543	212,082
Other changes in net assets:		
Proceeds received or receivable from FEMA	-	626
Contributions from University for building program	24,854	21,483
Donated assets	3,481	14,299
Health system support	(85,548)	(56,217)
Transfer to University for building program	-	(59,024)
Total other changes in net assets	(57,213)	(78,833)
Increase in net assets	232,330	133,249
Net assets – beginning of year	1,482,792	1,349,543
Net assets – end of year	$ 1,715,122	$ 1,482,792

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,660,882	$ 1,527,697
Payments to employees	(642,567)	(601,838)
Payments to suppliers	(561,153)	(520,329)
Payments for benefits	(172,031)	(146,865)
Other receipts, net	78,169	35,140
Net cash provided by operating activities	363,300	293,805
Cash flows from noncapital financing activities:		
Health system support	(85,548)	(56,217)
Replacement hospital transition costs	(3,820)	(2,923)
Grants from the hospital fee program	31,399	-
Net cash used by noncapital financing activities	(57,969)	(59,140)
Cash flows from capital and related financing activities:		
Proceeds from state funds	-	378
Proceeds from contributions by University for building program	24,854	21,483
Proceeds from sale of capital assets	935	-
Proceeds from debt issuance	20,834	146,000
Principal payments	(23,726)	(11,058)
Bond issuance cost	-	(1,164)
Build America bonds federal interest subsidies	3,016	1,627
Purchases of capital assets	(114,463)	(90,333)
Interest paid on long-term debt and capital leases	(35,360)	(18,801)
Transfer to University for building program	-	(59,024)
Gifts and donated funds	3,481	14,299
Net cash (used) provided by capital and related financing activities	(120,429)	3,407
Cash flows from investing activities:		
Interest income received	14,850	10,178
Change in restricted assets	(7,723)	(61,820)
Net cash provided (used) by investing activities	7,127	(51,642)
Net increase in cash	192,029	186,430
Cash – beginning of year	406,034	219,604
Cash – end of year	$ 598,063	$ 406,034

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 273,664	$ 223,590
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	89,277	85,873
Provision for doubtful accounts	36,919	38,844
Changes in operating assets and liabilities:		
Patient accounts receivable	(50,894)	(38,082)
Other receivables	25,362	(16,068)
Inventory	1,610	(434)
Prepaid expenses and other assets	(1,599)	(970)
Accounts payable and accrued expenses	(56,183)	(8,323)
Accrued salaries and benefits	14,866	9,561
Third-party payor settlements	17,334	(533)
Other liabilities	12,944	347
Net cash provided by operating activities	$ 363,300	$ 293,805
Supplemental noncash activities information:		
Capital assets acquired through capital lease obligations	$ -	$ 8,842
Reimbursement pending from FEMA	-	248
Change in fair value of interest rate swaps classified as hedging derivatives	(14,705)	(12,733)
Amortization of deferred financing costs	346	387
Amortization of bond premium	75	91
Amortization of deferred costs of issuance	380	178
Bond retirements	18,615	-
Payables for property and equipment	12,056	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 466-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.

The financial statements of the Medical Center 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.

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”). 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, was adopted by the Medical Center during the year ended June 30, 2011. This Statement incorporates into GASB’s authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants’ Committee on Accounting Procedures that were issued on or before November 30, 1989. Implementation of Statement No. 62 had no effect on the Medical Center’s net assets or changes in net assets as of and for the years ended June 30, 2011 and 2010.

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 the 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, 2011 and 2010 was $598,063 and $406,034, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation. To date, the Medical Center has not experienced any losses on these accounts.

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 2010-2011 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 are deposited in STIP.

Restricted Assets, Donor Funds
Donor restricted assets are invested in mutual funds which are recorded at net asset value. 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.

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 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 5 to 20 years for equipment. University guidelines mandate that land purchased with the 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 on borrowings to finance facilities is capitalized during construction, net of any investment income earned on tax-exempt borrowings during the temporary investment of project-related borrowings.

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 that 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.

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.

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. The Medical Center believes that it is in compliance with all applicable laws and regulations related to the Medicare and Medi-Cal programs.

The Medical Center estimates and recognizes a provision for doubtful accounts and the allowance for doubtful accounts based on historical experience.

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 University. 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 University. 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.

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

New Accounting Pronouncements
In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, effective for the University's fiscal year beginning July 1, 2011. This Statement requires the Medical Center to report the activities for certain public-private partnerships as service concession arrangements in the financial statements. Service concession arrangements are recorded when the arrangements meet certain criteria which include building and operating a facility, obtaining the right to collect fees from third parties, and transferring ownership of the facility to the Medical Center at the end of the arrangement. The Medical Center is evaluating the effect that Statement No. 60 will have on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the University's fiscal year beginning July 1, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements. The University is evaluating the effect that Statement No. 63 will have on its financial statements.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the University's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for termination hedge accounting. The University is evaluating the effect that Statement No. 64 will have on its financial statements.

3. Net Patient Service Revenue

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

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

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

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center 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 legislation enacted by the State of California. Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. The total payments made to the Medical Center will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP"). Effective November 2011, the Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. For the years ended June 30, 2011 and 2010, the Medical Center recorded total Medi-Cal revenue of $191,238 and $151,669, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 on September 8, 2010, established a series of Medicaid supplemental payments funded through a "Quality Assurance Fee" and a "Hospital Program Fee", 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 makes supplemental payments to hospitals for various health care services and supports the state's effort to maintain health care coverage for children. The Medical Center, designated as a public hospital, is exempt from paying the "Quality Assurance Fee"; however, the Medical Center received supplemental payments under the "Hospital Fee Program". For the year ended June 30, 2011, the Medical Center received $16.6 million, which has been reported as net patient revenue and $31.40 million as a state grant which has been reported as non-operating revenue.

- ***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, 2011 and 2010, the Medical Center recorded revenue of $8,752 and $13,535, 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.

(Dollars in thousands)

- 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 represent 14.3 percent and16.0 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively. Amounts due from Medi-Cal represent 8.6 percent and 8.0 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively.

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

	2011	2010
Medicare (non-risk)	$ 348,592	$ 358,954
Medicare (risk)	38,114	33,283
Medi-Cal (non-risk)	191,238	151,669
Commercial	5,611	11,247
Contract (discounted or per diem)	1,046,503	955,050
Non-sponsored/self-pay (uninsured)	26,666	16,954
Total	$ 1,656,724	$ 1,527,157

4. Charity Care

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

	2011	2010
Charity care at established rates	$ 21,857	$ 20,797
Estimated cost of charity care	$ 7,179	$ 6,517

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $ 40,282 and $50,216 for the years ended June 30, 2011 and 2010, 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.

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

	2011	2010
Mutual funds	$ 13,452	$ 13,247
Real property	-	2,100
Charitable remainder trusts	4,017	3,249
Total	$ 17,469	$ 18,596

Donor restricted funds are available for the following purposes:

	2011	2010
Capital purposes	$ 4,036	$ 5,155
Endowments	337	337
Operations	13,096	13,104
Total	$ 17,469	$ 18,596

6. Capital Assets

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

	2010	Additions	Disposals	2011
Original Cost				
Land	$ 13,943	$ 4,099	$ (600)	$ 17,442
Buildings and improvements	1,363,161	28,777	(240)	1,391,698
Equipment	365,086	40,987	(9,431)	396,642
Construction in progress	379,375	52,656	-	432,031
Capital assets, at cost	$ 2,121,565	$ 126,519	$ (10,271)	$ 2,237,813
	2010	**Depreciation**	**Disposals**	**2011**
Accumulated Depreciation				
Buildings and improvements	$ 212,379	$ 38,444	$ (445)	$ 250,378
Equipment	216,541	50,833	(8,050)	259,324
Accumulated depreciation	428,920	$ 89,277	$ (8,495)	509,702
Capital assets, net	$ 1,692,645			$ 1,728,111

(Dollars in thousands)

	2009	Additions	Disposals	2010
Original Cost				
Land	$ 12,098	$ 1,845	$ -	$ 13,943
Buildings and improvements	1,312,492	50,669	-	1,363,161
Equipment	361,937	31,982	(28,833)	365,086
Construction in progress	310,090	69,285	-	379,375
Capital assets, at cost	$ 1,996,617	$ 153,781	$ (28,833)	$ 2,121,565

	2009	Depreciation	Disposals	2010
Accumulated Depreciation				
Buildings and improvements	$ 175,701	$ 36,881	$ (203)	$ 212,379
Equipment	195,064	48,992	(27,515)	216,541
Accumulated depreciation	370,765	$ 85,873	$ (27,718)	428,920
Capital assets, net	$ 1,625,852			$ 1,692,645

Equipment under capital lease obligations and related accumulated amortization is $84,390 and $65,229 in 2011, respectively, and $87,434 and $61,206 in 2010, 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 from other donors 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.

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 June 2024 and accrued interest at the STIP rate of an annual average of 2.38 percent for the year ended June 30, 2011. As of June 30, 2011 and June 30, 2010, $75,000 was outstanding. Interest expense for the years ended June 30, 2011 and 2010 was $1,723 and $1,871, respectively. Effective July 1, 2011, the Campus has agreed to waive periodic interest payments for an undetermined time period.

(Dollars in thousands)

8. Long-term Debt and Capital Leases

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

	2011	2010
University of California Medical Center Pooled Revenue Bonds 2010 Series G & I, interest rates 4-6 percent, payable semi-annually, with annual principal payments beginning in 2011 through 2020	$ 18,840	$ -
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	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	246,385	250,000
University of California Medical Center Pooled Revenue Bonds 2007 Series C, variable interest rate with the interest rate being 4.7 percent as of June 30, 2011, with annual principal payments through 2047	182,030	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	83,720	86,500
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	8,809	9,346
Capital lease obligations, with fixed interest rates ranging from 2.9 percent to 9.4 percent, payable through 2014, collateralized by underlying equipment	16,931	24,833
The University Pool 2 Loan, interest rate of 5.7 percent payable annually, with annual principal payments through 2019	212	233
Other borrowing	30,079	30,573
	733,006	744,515
Unamortized bond premium	3,542	2,613
Unamortized deferred financing costs	(23,236)	(24,090)
Total debt and capital leases	713,312	723,038
Less: Amounts due within one year	(14,568)	(10,972)
Noncurrent portion of debt and capital leases	$ 698,744	$ 712,066

(Dollars in thousands)

Total interest expense during the years ended June 30, 2011 and 2010 was $35,224 and $30,048, respectively. Interest expense totaling $ 2,926 and $14,504 was capitalized during the years ended June 30, 2011 and 2010, respectively. The remaining $32,298 in 2011 and $15,544 in 2010 are reported as interest expense in the statements of revenues, expenses and changes in net assets. Investment income totaling $(254) and $(147) was capitalized during the years ended June 30, 2011 and 2010, 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, 2011				
Long-term debt and capital leases at June 30, 2010	$ 667,632	$ 24,833	$ 30,573	$ 723,038
New obligations	20,834			20,834
Principal payments and bond retirements	(22,929)	(7,902)		(30,831)
Amortization of bond premium	(75)	-	-	(75)
Amortization of deferred financing costs	840	-	(494)	346
Long-term debt and capital leases at June 30, 2011	666,302	16,931	30,079	713,312
Less: Current portion of long-term debt and capital leases	(7,045)	(7,001)	(522)	(14,568)
Noncurrent portion of long-term debt and capital leases as June 30, 2011	$ 659,257	$ 9,930	$ 29,557	$ 698,744
Year ended June 30, 2010				
Long-term debt and capital leases at June 30, 2009	$ 524,061	$ 23,857	$ 31,040	$ 578,958
New obligations	146,000	8,842	-	154,842
Principal payments	(3,192)	(7,866)	-	(11,058)
Amortization of bond premium	(91)	-	-	(91)
Amortization of deferred financing costs	854	-	(467)	387
Long-term debt and capital leases at June 30, 2010	667,632	24,833	30,573	723,038
Less: Current portion of long-term debt and capital leases	(2,576)	(7,902)	(494)	(10,972)
Noncurrent portion of long-term debt and capital leases as June 30, 2010	$ 665,056	$ 16,931	$ 30,079	$ 712,066

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, 2011 are $2.26 billion of which $593,255 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, 2011 and 2010 were $6.48 billion and $5.94 billion, respectively.

In June, 2011, the University purchased $25,800 of the Medical Center Pooled Revenue Bonds 2007 Series C currently outstanding. These bonds were purchased in the open market and are currently held in the University's investment portfolio.

In February 2011, the Medical Center retired $18,615 of Medical Center Pooled Revenue Bonds recognizing a gain of $6,971 on the statement of revenues, expenses and changes in net assets. The Medical Center has a payable to the University of $11,510, reported in other current liabilities. The retirements were financed through the University's commercial paper program. The Medical Center has a payable to the University for the cost of the retirements. The payable bears interest at the commercial paper rate and is due on demand when the University refinances these commercial paper proceeds into long-term bonds.

In November 2010, Medical Center Pooled Revenue Bonds Series G and I totaling $19,815, including $9,175 of taxable bonds and $10,640 of tax-exempt bonds, were issued to refinance certain improvements to the Medical Center. Proceeds, including a bond premium of $1,113, were used to pay for project construction and issuance costs. The bonds mature at various dates through 2025. The taxable bonds have a stated weighted average interest rate of 5.24 percent and the tax-exempt bonds have a stated weighted average interest rate of 4.4 percent. The deferred premium will be amortized as a reduction to interest expense over the term of the bonds. These costs 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.

In December 2009, Medical Center Pooled Revenue Bonds Series E and F totaling $146,000, including $143,320 of taxable Build America bonds and $2,680 of tax-exempt bonds, were issued for the Medical Center to finance certain improvements to the Medical Center. Proceeds, including a bond discount of $2 was 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.

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 $30,079 and $30,573 at June 30, 2011 and 2010, respectively.

(Dollars in thousands)

The notional amounts, fair value of the interest rate swap outstanding and the change in fair value for June 30, 2011 and 2010 are as follows:

Notional Amount		Fair Value – Positive (Negative)			Changes in Fair Value		
2011	**2010**	**Classification**	**2011**	**2010**	**Classification**	**2011**	**2010**
$ 174,775	$ 189,775	Other non-current assets (liabilities)	$ (37,959)	$ (52,664)	Deferred (inflows)/ outflows	$ 14,705	$ (12,733)

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, 2011 or 2010.

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, 2011, 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.

Depending on the fair value related to the swap with the $174,775 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 $75.0 million or the cash and investments held by all five of the University's medical centers fall below $250.0 million. As of June 30, 2011, there was no collateral required. As of June 30, 2010, the University was 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)

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, 2011 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 Revenue Bonds	Capital Lease Obligations	Total Total Payments	Principal	Interest
2012	$ 43,583	$ 7,594	$ 51,177	$ 14,692	$ 36,485
2013	43,944	5,559	49,503	13,631	35,872
2014	43,954	3,553	47,507	12,238	35,269
2015	43,954	1,306	45,260	10,532	34,728
2016	43,945	-	43,945	9,683	34,262
2017 – 2021	222,442	-	222,442	59,403	163,039
2022 – 2026	218,250	-	218,250	71,823	146,427
2027 – 2031	209,798	-	209,798	82,720	127,078
2032 – 2036	207,445	-	207,445	103,575	103,870
2037 – 2041	204,451	-	204,451	129,260	75,191
2042 – 2046	200,721	-	200,721	161,125	39,596
2047 – 2051	38,760	-	38,760	34,245	4,515
Total future debt service	1,521,247	18,012	1,539,259	$ 702,927	$ 836,332
Less: Interest component of future payments	(835,251)	(1,081)	(836,332)		
Principal portion of future payments	685,996	16,931	702,927		
Adjusted by:					
Unamortized bond premium	3,542	-	3,542		
Other borrowings	30,079	-	30,079		
Unamortized deferred financing costs	(23,236)	-	(23,236)		
Total debt	$ 696,381	$ 16,931	$ 713,312		

Additional information on the revenue bonds can be obtained from the 2010–2011 annual report of the University.

(Dollars in thousands)

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, 2011, 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**
2012		$ 1,566	$ 6,576	$ 8,142
2013		1,538	6,617	8,155
2014		1,538	6,617	8,155
2015		1,538	6,617	8,155
2016		1,538	6,617	8,155
2017 – 2021		7,690	33,085	40,775
2022 – 2026	14,395	7,529	32,299	54,223
2027 – 2031	22,015	6,806	28,779	57,600
2032 – 2036	27,565	5,826	24,212	57,603
2037 – 2041	42,765	4,499	18,331	65,595
2042 – 2046	67,550	2,005	8,001	77,556
2047 – 2051	485	5	18	508
Total future debt service	$ 174,775	$ 42,078	$ 177,769	$ 394,622

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, 2011 and 2010 was $9,302 and $7,621, respectively. The terms of the operating leases extend through the year 2020.

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**
2012	$ 10,719
2013	8,004
2014	6,337
2015	4,963
2016	3,589
2017 – 2020	20,406
Total	$ 54,018

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 University. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.31, $3.12 and $3.09 per $100 of UCRP covered payroll resulting in Medical Center contributions of $18,300, $16,200, and $15,400 for the years ended June 30, 2011, 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, 2010, the date of the latest actuarial valuation, were $74.5 million and $15.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $71.3 million at June 30, 2011. For the years ended June 30, 2011 and 2010, combined contributions from the University's campuses and medical centers were $314.7 million and $283.5 million, respectively, including an implicit subsidy of $54.9 million and $49.5 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.8 billion and $1.6 billion for the years ended June 30, 2011 and 2010. 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 $5.1 billion at June 30, 2011 increased by $1.4 billion for the year ended June 30, 2011.

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 2010–2011 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 $20,966 and $10,483, respectively, during the year ended June 30, 2011. Medical Center and employee contributions were $4,581 and $2,291, respectively, during the year ended June 30, 2010.

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, 2010, the date of the latest actuarial valuation, were $33.7 billion and $39.1 billion, respectively, resulting in a funded ratio of 86.2 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $41.9 billion and $34.6 billion at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, the University's campuses and medical centers contributed a combined $1.4 billion and $64.8 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.7 billion for the year ended June 30, 2011. 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 $239.2 million for the year ended June 30, 2011.

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)

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 2010–2011 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 $14,295 and $13,970 for the years ended June 30, 2011 and 2010, respectively.

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $10,860 and $9,118 for the years ended June 30, 2011 and 2010, 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:

	2011	**2010**
Professional services	$ 11,281	$ 11,843
Medical supplies	(3,571)	(2,318)
Other supplies and purchased services	94,449	63,553
Interest income (net)	(11,658)	(7,077)
Insurance	10,860	8,982
Total	$ 101,361	$ 74,983

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 $186,909 and $131,200 in 2011 and 2010, respectively. Of these amounts, $101,361 and $74,983 are reported as operating expenses for the years ended June 30, 2011 and 2010, respectively, and $85,548 and $56,217 are reported as health system support for the years ended June 30, 2011 and 2010, respectively.

14. Commitments and Contingencies

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

The 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.

The state of California authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations for the medical centers, of which $180,000 was allocated to the Medical Center. 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.

Gift funds used for construction totaling $3,481 and $14,299 for the years ended June 30, 2011 and 2010, 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 million, excluding interest, as of June 30, 2011.

University of California,
San Diego Medical Center

Financial Statements

For the Years Ended June 30, 2011 and 2010

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets, and cash flows, as shown on pages 16 through 19, 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, 2011 and 2010, and the 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, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

PricewaterhouseCoopers LLP

October 12, 2011

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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, 2011, with selected comparative information for the years ended June 30, 2010 and 2009. 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 (2009, 2010, 2011, 2012, 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 392 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 350 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, 2011, the Medical Center reported income before changes in net assets of $143.2 million and generated a total margin of 15.7 percent. Total operating revenues increased by 9.5 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 10.4 percent due to wage increases, increases in the employer portion of employee benefits for retirement and for health insurance, and inflationary increases in pharmaceuticals and supplies.

The Medical Center's cash position remained strong despite using $171.5 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 2011. There were multiple initiatives that included piloting a centralized authorization unit for outpatient radiology services, utilizing commission-based vendors to recovery underpayments by third-party payors, and ongoing changes and education to refine business processes and technology used in all phases of the revenue cycle. The Medical Center also continued strategic pricing initiatives through 2011, working with the same outside consulting group as in the three prior years, to review and revise pricing to maintain and improve its competitive market position.

  During 2011, contract renewals with major payors were successfully completed. Provisions that address the trend toward shorter but more intensive lengths of stay for inpatient admissions, complex surgical techniques, and advancing pharmaceutical and implanted devices, represent key areas of focus for contracting efforts. These revenue cycle improvement efforts in 2011 led to a further reduction in the Medical Center's denial rate to 7.6 percent, as compared to 7.9 percent in 2010 and 8.3 percent in 2009 and an increased collection rate.

- *Managing resources and costs*
  During 2011, the Medical Center's efforts to manage labor costs included flexed staffing based on patient volumes, rigorous review of vacant positions, and efforts to reduce the use of premium labor. Overall labor costs increased 7.6 percent as compared to the prior year largely due to an increase in the average daily census of 4.1 percent, an increase in outpatient visits of 3.2 percent, a full year of increased contributions by the Medical Center to the University of California Retirement Plan, and additional staff that were hired in the last quarter of the fiscal year to work on preopening activities for the Sulpizio Cardiovascular Center.

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

  During the past year, renegotiation of contracts and other supply chain initiatives resulted in savings for the Medical Center estimated at $4.1 million. There were also process improvements to streamline and manage the purchasing process, including moving 61 vendors from manual purchase orders to electronic purchase orders, and completion of a tracking process for major projects on a shared computer site. A supply storage and replenishment program was developed and implemented for the new Sulpizio Cardiovascular Center and its four heart catheterization labs.

In 2012, the Medical Center will benefit from new contracts on pacemakers, implantable defibrillators, and other electrophysiology devices as a result of contracts that were negotiated in collaboration with the other four UC hospitals. The Medical Center will continue work with the other UC hospitals in the coming year to negotiate volume discounts on supplies and services, particularly in the areas of orthopedic trauma products, and hip, knee, and shoulder implants. Software improvements to better manage supply and service contracts and to improve sales and use tax compliance will be implemented as part of the existing supply chain information system.

- *Facilities planning*
  During 2011, work was completed on the $227 million Thornton Expansion/Cardiovascular Center project. The centerpiece of this project is the four-story Sulpizio Cardiovascular Center that is built next to Thornton Hospital in La Jolla. This facility includes 54 inpatient beds, four new cardiac catheterization laboratories, four new cardiovascular operating rooms, a new non-invasive cardiovascular laboratory, outpatient clinics and exam rooms, and an expanded emergency department that will replace the emergency room at Thornton Hospital. The project also includes some remodeling and construction work at Thornton Hospital and an expansion of the central plant. The facility opened on August 8, 2011.

  Also during 2011, preliminary work began on the East Campus Bed Tower, which consisted of preparing the site for construction ("make ready" work) and obtaining construction design documentation. This is a $663.8 million project that includes the Jacobs Medical Center, a ten-story building adjacent to Thornton Hospital in La Jolla. It includes the capacity for 245 inpatient beds, 11 operating rooms, and a new stand-alone central plant. The project also includes renovations to significant portions of Thornton Hospital to modernize and harmonize with the new Jacobs Medical Center tower. The University of California Board of Regents approved up to $356.8 million in external tax-exempt revenue bond financing for the project with the remainder of the funding coming from gifts, hospital reserves, and other sources. Construction is scheduled to begin in March 2012 with occupancy in 2015.

  During 2011, the Medical Center spent $119.8 million on facilities renovation and improvement projects, which included $69.0 million funded with hospital cash reserves, $2.5 million funded with State lease revenue bonds under The Hospital Facilities Seismic Safety Act ("SB1953"), $35.7 million of proceeds from bonds issued for the Thornton Expansion/Cardiovascular project, and $12.6 of donated and other funds. An additional $53.5 million was spent for equipment, information systems and new technology, which included $37.8 million funded with hospital cash reserves and $15.7 million acquired under capital lease obligations.

  At June 30, 2011, the Medical Center's financial statements include capital assets of $687.6 million.

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

  On February 26, 2011, the Medical Center went "live" on new Epic software that brought a sophisticated electronic medical record ("EMR") system to the inpatient setting. This complements the work done in 2009 to bring the EMR across our ambulatory clinics, enabling clinical providers to have on line access to clinical information for their patients. The Medical Center now has a totally integrated EMR across the inpatient and outpatient setting including the Moores Cancer Center. 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 July 2011, shortly after the fiscal year ended, the EMR adoption was certified at HIMSS Stage 7, the highest level possible. Management believes that our health information technology deployment is 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."

In addition, during 2011 the Medical Center was again named a winner of the nationally recognized "Most Wired" award by the Hospitals and Health Network publication. Most Wired hospitals are leaders in ordering medications electronically, implementing computerized standing orders based on treatment protocols that have been proven effective, and encrypting data on movable devices, such as laptops, to safeguard information.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2011, 2010 and 2009:

	2011	2010	2009
Licensed beds	546	552	552
Admissions	26,722	24,216	23,339
Average daily census	384	369	367
Discharges	25,742	23,706	23,219
Average length of stay	5.5	5.8	5.9
Patient days	140,011	134,855	133,871
Case mix index	1.67	1.63	1.69
Outpatient visits:			
Clinic visits	554,013	536,188	520,491
Emergency room visits	61,446	60,160	60,551
Total outpatient visits	615,459	596,348	581,042

Admissions increased by 10.3 percent in 2011 compared to 2010, while average length of stay decreased to 5.5 days.

Discharges increased by approximately 8.6 percent in 2011 compared to 2010 with increased cases from medicine, orthopaedic, reproductive medicine, and surgery. In 2010, discharges increased by approximately 2.1 percent 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.

Patient days increased by 3.8 percent in 2011 compared to 2010 due to increased admissions offset by a reduction in overall length of stay. Patient days increased in 2010 by 0.7 percent over 2009 due to increased admissions offset by a reduction in overall length of stay.

In 2011, total outpatient clinic visits increased by 3.3 percent and emergency room visits increased by 2.1 percent from 2010. This change is due primarily to a 7.6 percent increase in visits to the UCSD Cancer Center. In 2010, total outpatient clinic visits increased by 3.0 percent and emergency room visits decreased by 0.6 percent from 2009. The change was due primarily to a 19.9 percent increase in visits to the UCSD Cancer Center, partially offset by the transfer of a University staff midwife comprehensive health center to a community provider.

Statements of Revenues, Expenses and Changes in Net Assets

The following table summarizes the operating results for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Net patient service revenue	$ 899,949	$ 820,107	$ 770,679
Other operating revenue	13,699	14,182	13,778
Total operating revenue	913,648	834,289	784,457
Total operating expenses	798,378	723,454	690,121
Income from operations	115,270	110,835	94,336
Total net non-operating revenues	27,950	2,037	1,653
Income before other changes in net assets	$ 143,220	$ 112,872	$ 95,989
Operating margin	15.7%	13.5%	12.2%
Other changes in net assets	$ (38,030)	$ (35,742)	$ (13,037)
Increase in net assets	105,190	77,130	82,952
Net assets – beginning of year	646,022	568,892	485,940
Net assets – end of year	$ 751,212	$ 646,022	$ 568,892

Revenues

Total operating revenues for the year ended June 30, 2011 were $913.6 million, an increase of $79.4 million, or 9.5 percent, over 2010. 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.

Net patient service revenue for 2011 increased by $79.8 million, or 9.7 percent, over 2010. The increase in 2011 over 2010 was due to increased patient volume, contract price increases, higher intensity of patients as measured by the total case mix index, improved collections, and to $8.0 million in net patient revenue from the hospital fee program. Net patient service revenue in 2010 increased by $49.4 million, or 6.4 percent, over 2009 due to increased outpatient volumes, contract price increases, and improved collections. 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. A decrease of $0.5 million, or 3.4 percent, in 2011 in other operating revenue was due to decreased joint venture income. 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 following table summarizes net patient service revenue for 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Medicare (non-risk)	$ 190,135	$ 179,436	$ 159,861
Medi-Cal (non-risk)	192,592	169,218	185,605
Contracts – Commercial	491,484	444,272	395,361
County/Uninsured	25,738	27,181	29,852
Total	$ 899,949	$ 820,107	$ 770,679

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 2011 by $10.7 million, or 6.0 percent, from 2010. Medicare inpatient net revenue for 2011 increased by $5.4 million, or 4.3 percent, over 2010 due primarily to increased patient volume and higher intensity patients as measured by the Medicare case mix index. Medicare outpatient net revenues for 2011 increased by $5.3 million, or 10.1 percent, over 2010, due to increased patient activity. Net revenues also includes reimbursement for prior year settlements and other adjustments of $2.6 million in 2011 compared to $8.5 million in 2010 and $0.7 million in 2009.

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 increase 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.

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 Hospital ("DSH") payments and Safety Net Care Pool ("SNCP") payments.

Total Medi-Cal net revenues for 2011 increased by $23.4 million, or 13.8 percent, over 2010 due to the Medicaid hospital financing waiver and to $0.6 million from the hospital fee program. In 2010, total Medi-Cal net revenue decreased by $16.4 million, or 8.8 percent, over 2009 as a result of two factors related to the Medicaid hospital waiver: 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 prior year amounts decreased $7.5 million.

Inpatient Medi-Cal net revenues for 2011 increased by $23.1 million, or 17.9 percent, from 2010 due to the same two factors described in the preceding paragraph. Inpatient Medi-Cal net revenues for 2010 decreased by $16.1 million, or 11.0 percent from 2009 due primarily to the same two factors described in the preceding paragraph.

In 2011, outpatient Medi-Cal net revenues increased by $0.3 million, or 0.6 percent, from 2010 because of $1.4 million more in supplemental payments under Assembly bill 915, the Public Hospital Outpatient Services Supplemental Reimbursement Program, offset by lower patient volume. In 2010, outpatient Medi-Cal net revenues decreased by $0.3 million, or 0.8 percent, 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 2011, net revenues for contracts – commercial increased by $47.2 million, or 10.6 percent, over 2010 due primarily to increased patient volume, $7.4 million from the managed care portion of the hospital fee program, and the impact of the Medical Center's ongoing revenue cycle initiatives, contracting efforts and strategic pricing. In 2010, net revenues for contracts – commercial increased by $48.9 million, or 12.4 percent, 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.

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 $1.4 million, or 5.3 percent from 2010 due primarily to decreased collections from patients without insurance. In 2010, net revenues for county/uninsured patient service decreased by $2.7 million, or 8.9 percent, from 2009 due primarily to decreased patient volume.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Salaries and wages	$ 323,782	$ 300,890	$ 278,809
Employee benefits	118,874	98,868	86,204
Professional services	35,447	32,211	30,054
Medical supplies	170,054	162,490	164,592
Other supplies and purchased services	108,367	91,973	95,139
Depreciation and amortization	35,437	32,181	29,763
Insurance	6,417	4,841	5,560
Total	$ 798,378	$ 723,454	$ 690,121

Total operating expenses for 2011 of $798.4 million increased by $74.9 million, or 10.4 percent, over 2010 due to increased patient activity, the impact of inflation, higher employer contributions for pension plan, increased employee healthcare premiums, and preopening expenditures for the Sulpizio Cardiovascular Center. 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.

Salary and employee benefits expenses include wages paid to Medical Center employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance, pension contributions and other employee benefits. About one-half of the Medical Center's work force, including nurses and employees providing ancillary services, expand and contract with patient volumes.

In 2011, salaries and wages grew by $22.9 million, or 7.6 percent, over the prior year. This increase includes $10.2 million, or 3.4 percent in salary increases and an increase of 178 full time equivalent employees, or 4.2 percent from the prior year. The 2011 increase in employees was due to higher patient volume and for additional staff needed for preopening activities related to the Sulpizio Cardiovascular Center. In 2010, salaries and wages grew by $22.1 million, or 7.9 percent, over the prior year. This increase includes $13.9 million, or 5.0 percent in salary increases and an increase of 117 full time equivalent employees, or 2.9 percent from the prior year. The 2010 increase in employees was due to higher patient volume and for staff hired to replace nurse registry labor (offset by a reduction in contract labor expense).

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2011 increased $2.8 million, or 38.8 percent, over 2010 due to the need for nursing and other technical staff especially during periods of peak census. Temporary labor costs for 2010 decreased $8.4 million, or 53.7 percent, over 2009 due to hiring of permanent staff to replace contract labor.

In 2011, employee benefit costs increased by $20.0 million, or 20.2 percent, over 2010. Pension contributions were $11.4 million of in 2011 as compared to $2.5 million in 2010 and zero in 2009. The Medical Center's health insurance and other employee benefit costs increased in 2011 as compared to 2010 by $11.1 million, or 11.5 percent, due to an increase in health insurance premiums of $5.2 million and increases in other benefit costs of $5.9 million. The Medical Center's health insurance and other employee benefit costs increased in 2010 as compared to 2009 by $10.2 million, or 11.8 percent, due to an increase in insurance premiums of $5.0 million and increases in other benefit costs of $5.2 million.

As a percentage of total operating revenue, salaries and employee benefits were 48.4 percent in 2011, 47.9 percent in 2010 and 46.5 percent in 2009. Overall labor costs increased in 2011 as a percent of operating revenues due to additional staff for preopening activities related to the Sulpizio Cardiovascular Center, increased employer contributions to the pension plan, and higher employee healthcare premiums.

Payments for professional services increased by $3.2 million, or 10.0 percent, in 2011 compared to 2010 primarily due to the provision of new services, and $2.2 million, or 7.2 percent, in 2010 compared to 2009 due to the provision of new services.

In 2011, medical supply expense increased by $7.6 million, or 4.7 percent, over 2010 due primarily to an increase in pharmaceuticals of $1.0 million, or 1.3 percent, an increase in surgical supply and implant costs of $1.7 million, or 3.8 percent, and an increase in other medical supplies of $4.1 million, or 11.8 percent. Medical supply expense for 2010 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, offset by a $2.0 million, or 7.9 percent increase in pharmaceuticals.

Other supplies and purchased services expense increased in 2011 by $16.4 million, or 17.8 percent, over 2010 due primarily to an increase in temporary help expense of $2.8 million, or 38.8 percent and campus administrative charges of $5.3 million, or 1,098.8 percent. 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.

Depreciation and amortization increased by $3.3 million, or 10.1 percent, in 2011 compared to 2010 and by $2.4 million, or 8.1 percent, in 2010 compared to 2009 due to increased capital expenditures.

Insurance expense of $6.4 million in 2011 and $4.8 million in 2010 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $1.6 million, or 32.6 percent, in 2011 and decreased by $0.7 million, or 12.9 percent, in 2010.

Income from Operations
The Medical Center reported income from operations of $115.3 million and operating revenue of $913.6 million, resulting in an operating margin of 15.7 percent in 2011 as compared to 13.5 percent and 12.2 percent in 2010 and 2009, respectively. Income from operations increased in the current year to $115.3 million from $110.8 million in the prior year. The $4.5 million or 4.1 percent increase in 2011 was the result of operating revenue and operating expense changes discussed in the previous sections.

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 $25.9 million, or 1,272.1 percent, from 2010. This increase is due to the direct grant portion of the hospital fee program which was $24.5 million in 2011. Non-operating revenue for 2010 increased by $0.4 million, or 23.2 percent, from 2009.

Income before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $143.2 million in 2011 compared to $112.9 million in 2010 and $96.0 million in 2009, an increase of $30.3 million, or 26.8 percent, and $16.9 million, or 17.6 percent, respectively. The Medical Center's net income increased in 2011 compared to the prior year mainly due to revenue from the hospital fee program.

Other Changes in Net Assets
The other changes in net assets for 2011, 2010 and 2009 include:

	2011	2010	2009
State capital appropriations	$ -	$ -	$ 1,918
Donated assets	15,851	1,614	1,849
Health system support	(55,905)	(39,314)	(32,907)
Transfers from University, net	2,024	1,958	16,627
Other	-	-	(524)
Total other changes in net assets	$ (38,030)	$ (35,742)	$ (13,037)

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 2011 and 2010 are the following:

- Donated assets of $15.9 million and $1.6 million, respectively. Most of the increase in 2011 was due to a gift of $10 million from the Sulpizio family for the Cardiovascular Center.

- 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 $55.9 million and $39.3 million, respectively.

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

In total, the net assets increased for the year ended June 30, 2011 by $105.2 million to $751.2 million. In 2010, net assets increased by $77.1 million to $646.0 million.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Current assets:			
Cash	$ 189,906	$ 185,295	$ 150,789
Patient accounts receivable (net)	144,509	139,756	123,060
Other current assets	49,922	50,448	49,635
Total current assets	384,337	375,499	323,484
Restricted assets	610	36,429	-
Capital assets (net)	687,612	550,675	450,805
Other assets	12,174	9,075	5,958
Total assets	1,084,733	971,678	780,247
Current liabilities	120,564	115,750	128,368
Long-term debt	212,957	209,906	82,987
Total liabilities	333,521	325,656	211,355
Net assets:			
Invested in capital assets (net)	451,683	321,699	320,904
Restricted	610	36,429	-
Unrestricted	298,919	287,894	247,988
Total net assets	$ 751,212	$ 646,022	$ 568,892

Total current assets increased by $8.8 million, or 2.4 percent, in 2011 over 2010. Total current assets at June 30, 2010 were $52.0 million, or 16.1 percent, higher than the previous year.

Cash increased by $4.6 million, or 2.5 percent, in 2011 over 2010. This was due to cash from operations and investing activities offset by cash used for capital investments and non-capital financing. In 2010, cash increased by $34.5 million, or 22.9 percent, over 2009. The increase was primarily due to cash from operations and investing activities exceeding the cash used for capital investments and non-capital financing.

Patient accounts receivable, net of estimated uncollectibles, increased by $4.8 million, or 3.4 percent, in 2011 over 2010 due primarily to increased patient activity and a small increase in the days outstanding in accounts receivable. In 2010, net patient accounts receivable increased by $16.7 million, or 13.6 percent, in 2010 over 2009 due primarily to increased patient activity and a small increase in days outstanding in accounts receivable.

In 2011, other current assets, which include third party payor settlements, non-patient receivables, inventory, and prepaid expenses decreased by $0.5 million, or 1.0 percent, due to collection of prior year amounts due from affiliated institutions for house staff rotations, offset by increases in third party settlements receivable and an increase in inventory due to inflation and for preopening inventory for the Sulpizio Cardiovascular Center. In 2010, other current assets were consistent with 2009 levels.

Capital assets increased by $136.9 million, or 24.9 percent, in 2011 over 2010 due primarily to capital spending to complete the Sulpizio Cardiovascular Center. Capital assets increased by $99.9 million, or 22.2 percent, in 2010 over 2009 due primarily to an increase in capital spending on the Sulpizio Cardiovascular Center (formerly known as the Thornton Expansion/Cardiovascular Center project).

Restricted assets represent unspent proceeds of $0.6 million from the December 2009 and December 2010 bond issues that are held by the trustee. This money is restricted for use to pay for annual fees and other administrative costs associated with those two bond issues.

In 2011, other assets increased by $3.1 million, or 34.1 percent, from the prior year due primarily to an increase in the investment in joint ventures. In 2010, other assets increased by $3.1 million, or 52.3 percent, from 2009 due primarily to an increase in the investment in joint ventures.

Current liabilities increased by $4.8 million, or 4.2 percent, from 2010 due primarily to an increase in accrued salaries and benefits and an increase in the current portion of long-term debt due to new capital leases in 2011, offset by a decrease in accounts payable. In 2010, current liabilities decreased by $12.6 million, or 9.8 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.

Long-term debt in 2011 increased by $3.1 million, or 1.5 percent, from the prior year due to two new capital leases, offset by payment of principal and the refunding of 2000 series bonds by the 2010 Series G pooled revenue bonds. In 2009 long-term debt 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.

Net assets increased by $105.2 million, or 16.3 percent, in 2011 over the prior year. The change in net assets includes excess of revenues over expenses of $143.2 million, receipt of $15.9 million of donated assets, and $2.0 million of transfers from the University. These increases to net assets were reduced by the transfer of approximately $55.9 million of funds to the University as health system support. During fiscal years 2010 and 2009, the Medical Center transferred $39.3 million and $32.9 million of funds to the University as health system support, respectively.

Liquidity and Capital Resources

During 2011, the Medical Center generated $146.2 million of cash from operations and $37.6 million from investing activities. Capital expenditures for equipment, facilities, and information systems totaled $171.5 million, of which $2.5 million was acquired with state lease revenue bond funds under the Hospital Facilities Seismic Safety Act ("SB1953"), $15.5 million was acquired with donated funds, and $15.7 million was acquired under capital lease obligations.

In 2011, cash used for debt repayments was $51.3 million. An additional $55.9 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 2011, 2010 and 2009:

	2011	2010	2009
Days cash on hand	91	97	83
Days of revenue in accounts receivable	64	63	61
Purchases of capital assets ($ in millions)	$ 171.5	$ 113.6	$ 117.9
Debt service coverage ratio	14.3	11.1	13.5

Days cash on hand decreased to 91 days at June 30, 2011 from 97 days at June 30, 2010 for a 6.2 percent decrease. 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 2011, net days in accounts receivable was 64 days as compared to 63 days in 2010.

The debt service coverage ratio for 2011 was 14.3 times debt service compared to 11.1 times debt service in 2010. Total debt service payments were $12.7 million in 2011 and $10.0 million in 2010.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2011, 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 $40 million. Only two relatively small projects remain to complete the program, and these will be finished during the next eighteen months. The capital cost of compliance will be financed through the use of state lease revenue bond funds and Medical Center reserves. In 2011 and 2010, $2.5 million and $1.9 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.

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 were 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.

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. In November 2010, California received federal approval for a new five year waiver. State of California Assembly Bill 1066, signed in July 2011, contains the statutes to enact the terms of the new waiver program. Payments to the Medical Centers include a combination of Medi-Cal inpatient fee for service payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP") payments based upon costs. The Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. Although the waiver is designed to ensure predictable reimbursement for the care of indigent patients, the full financial impact of these changes in the future cannot be determined.

Meaningful Use of Electronic Health Records

The American Recovery and Reinvestment Act of 2009 established one-time incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. A hospital may receive an incentive payment for up to four years, from 2011 through 2015, by meeting a series of objectives that make use of EHR's potential related to the improvement of quality, efficiency and patient safety. Meaningful use is assessed on a year-by-year basis and requires attestation by the facility that the criteria have been satisfied. For the year ended June 30, 2011, the Medical Center did not receive any payments for the meaningful use of EHR technology.

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. As of June 30, 2011, the Medical Center received $0 million of grant funding.

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, 2010 actuarial valuation was $5.4 billion or 86.2 percent funded. The total funding policy contributions in the July 1, 2010 actuarial valuations represent 23.25% of covered compensation. As of July 1, 2011, the funded ratio is expected to decrease to approximately 82.0 percent. At its September 2010 meeting, The Regents approved increasing the employer and employee contribution rates to UCRP. Contributions by members will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University will be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These contribution rates are below UCRP's total funding policy contributions. The Regents also approved a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55, but retain many of the current features of UCRP. The new tier would not offer lump sum cashouts, inactive member Cost of Living Adjustments (COLAs), or subsidized survivor annuities for spouses and domestic partners. These changes are subject to collective bargaining for union-represented employees.

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, 2010 actuarial valuation was $15.4 billion. The Regents approved a new eligibility formula for the Retiree Health Plan for all employees hired on or after July 1, 2013, and non-grandfathered members, that is based on a graduated formula using both a member's age and years of Retirement Plan service credit upon retirement, subject to collective bargaining for represented members.

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.

University of California, San Diego Medical Center
Statements of Net Assets
June 30, 2011 and 2010
(Dollars in thousands)

	2011	2010
Assets		
Current assets		
Cash	$ 189,906	$ 185,295
Patient accounts receivable, net of estimated uncollectibles of $95,486 and $48,799, respectively	144,509	139,756
Other receivables, net of estimated uncollectibles of $158 and $202, respectively	7,989	13,028
Third-party payor settlements, net	15,815	12,572
Inventory	16,291	14,591
Prepaid expenses and other assets	9,827	10,257
Total current assets	384,337	375,499
Restricted assets:		
Cash restricted by trustee	610	36,429
Capital assets, net	687,612	550,675
Deferred costs of issuance	2,212	2,521
Prepaid expenses and other assets, net of current portion	9,962	6,554
Total assets	1,084,733	971,678
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	56,114	59,789
Accrued salaries and benefits	51,652	45,964
Current portion of long-term debt and capital leases	12,580	9,997
Other liabilities	218	-
Total current liabilities	120,564	115,750
Long-term debt and capital leases, net of current portion	212,957	209,906
Total liabilities	333,521	325,656
Net Assets		
Invested in capital assets, net of related debt	451,683	321,699
Restricted:		
Expendable:		
Capital projects	610	36,429
Unrestricted	298,919	287,894
Total net assets	$ 751,212	$ 646,022

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Net patient service revenue, net of provision for doubtful accounts of $95,365 and $74,003, respectively	$ 899,949	$ 820,107
Other operating revenue:		
Clinical teaching support	6,182	6,146
Other	7,517	8,036
Total other operating revenue	13,699	14,182
Total operating revenue	913,648	834,289
Operating expenses:		
Salaries and wages	323,782	300,890
UCRP, retiree health and other employee benefits	118,874	98,868
Professional services	35,447	32,211
Medical supplies	170,054	162,490
Other supplies and purchased services	108,367	91,973
Depreciation and amortization	35,437	32,181
Insurance	6,417	4,841
Total operating expenses	798,378	723,454
Income from operations	115,270	110,835
Non-operating revenues (expenses):		
Hospital fee program grants	24,530	-
Interest income	3,945	4,463
Interest expense	(2,688)	(3,364)
Build America bonds federal interest subsidies	2,527	1,365
Loss on disposal of capital assets	(364)	(427)
Total net non-operating revenues	27,950	2,037
Income before other changes in net assets	143,220	112,872
Other changes in net assets:		
Donated assets	15,851	1,614
Health system support	(55,905)	(39,314)
Transfers from University, net	2,024	1,958
Total other changes in net assets	(38,030)	(35,742)
Increase in net assets	105,190	77,130
Net assets – beginning of year	646,022	568,892
Net assets – end of year	$ 751,212	$ 646,022

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 891,953	$ 807,846
Payments to employees	(358,879)	(333,043)
Payments to suppliers	(334,255)	(305,165)
Payments for benefits	(99,411)	(80,911)
Other receipts, net	46,753	52,043
Net cash provided by operating activities	146,161	140,770
Cash flows from noncapital financing activities:		
Health system support	(55,905)	(39,314)
Grants from the hospital fee program	24,530	-
Net cash used by noncapital financing activities	(31,375)	(39,314)
Cash flows from capital and related financing activities:		
Transfers from University	2,024	1,958
Proceeds from debt issuance	57,317	145,297
Proceeds from sale of capital assets	95	14
Bond issuance costs	-	(1,132)
Build America bonds federal interest subsidies	2,527	1,365
Purchases of capital assets	(171,515)	(113,580)
Principal paid on long-term debt and capital leases	(51,288)	(65,022)
Interest paid on long-term debt and capital leases	(2,774)	(3,349)
Gifts and donated funds	15,851	1,614
Net cash used by capital and related financing activities	(147,763)	(32,835)
Cash flows from investing activities:		
Change in restriced assets	35,819	(36,429)
Interest income received	3,945	4,463
Investments in joint venture	(2,176)	(2,149)
Net cash provided (used) by investing activities	37,588	(34,115)
Net increase in cash	4,611	34,506
Cash – beginning of year	185,295	150,789
Cash – end of year	$ 189,906	$ 185,295

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 115,270	$ 110,835
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	35,437	32,181
Provision for doubtful accounts	95,365	74,003
Changes in operating assets and liabilities:		
Patient accounts receivable	(100,118)	(90,699)
Other receivables	5,039	(4,180)
Inventory	(1,700)	(1,040)
Prepaid expenses and other assets	(802)	10
Accounts payable and accrued expenses	(4,993)	8,532
Accrued salaries and benefits	5,688	6,693
Third-party payor settlements	(3,243)	4,435
Other liabilities	218	-
Net cash provided by operating activities	$ 146,161	$ 140,770
Supplemental noncash activities information:		
Capital assets acquired through capital lease obligations	$ 15,666	$ 13,595
Amortization of bond premium	395	111
Amortization of deferred costs of issuance	137	126

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 division 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 392-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.

The financial statements of the Medical Center 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.

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"). 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, was adopted by the Medical Center during the year ended June 30, 2011. This Statement incorporates into GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedures that were issued on or before November 30, 1989. Implementation of Statement No. 62 had no effect on the Medical Center's net assets or changes in net assets as of and for the years ended June 30, 2011 and 2010.

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 the 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, 2011 and 2010 was $189,906 and $185,295, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation. To date, the Medical Center has not experienced any losses on these accounts.

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 2010–2011 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 their activities.

Restricted Assets, Cash Restricted by Trustee
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 are deposited in STIP.

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 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 3 to 20 years for equipment. 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 on borrowings to finance facilities is capitalized during construction, net of any investment income earned on tax-exempt borrowings during the temporary investment of project-related borrowings.

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.

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. The Medical Center believes that it is in compliance with all applicable laws and regulations related to the Medicare and Medi-Cal programs.

The Medical Center estimates and recognizes a provision for doubtful accounts and the allowance for doubtful accounts based on historical experience.

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 University. 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 University. 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.

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

New Accounting Pronouncements
In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, effective for the University's fiscal year beginning July 1, 2011. This Statement requires the Medical Center to report the activities for certain public-private partnerships as service concession arrangements in the financial statements. Service concession arrangements are recorded when the arrangements meet certain criteria which include building and operating a facility, obtaining the right to collect fees from third parties, and transferring ownership of the facility to the Medical Center at the end of the arrangement. The Medical Center is evaluating the effect that Statement No. 60 will have on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position,* effective for the University's fiscal year beginning July 1, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements. The University is evaluating the effect that Statement No. 63 will have on its financial statements.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions,* effective for the University's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for termination hedge accounting. The University is evaluating the effect that Statement No. 64 will have on its financial statements.

3. Net Patient Service Revenue

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

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

  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 legislation enacted by the state of California. Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. The total payments made to the Medical Center will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share Hospital (“DSH”) payments, and Safety Net Care Pool (“SNCP”) payments. Effective November 2010, the Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. For the year ended June 30, 2011 and 2010, the Medical Center recorded total Medi-Cal revenue of $192,592 and $169,218, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill (“AB”) 1383 of 2009, as amended by AB 1653 on September 8, 2010, established 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 makes supplemental payments to hospitals for various health care services and supports the state’s effort to maintain health care coverage for children. The Medical Center, designated as a public hospital, is exempt from paying the “Quality Assurance Fee;” however, the Medical Center received supplemental payments under the Hospital Fee Program. For the year ended June 30, 2011, the Medical Center received $8,006, which has been reported as net patient revenue and $24,530 as a state grant which has been reported as non-operating revenue.

- ***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, 2011 and 2010, the Medical Center recorded patient services revenue of $19,227 and $16,055 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, 2011 and 2010, the Medical Center applied for and received additional revenue of $1,902 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.

(Dollars in thousands)

- ***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 represent 10.3 percent and 9.8 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively. Amounts due from Medi-Cal represent 8.0 percent and 8.0 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, net patient service revenue included $2,600 and $8,500, 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:

	2011	2010
Medicare (non-risk)	$ 190,135	$ 179,436
Medi-Cal (non-risk)	192,592	169,218
Commercial	9,364	8,562
Contract (discounted or per diem)	482,120	435,710
County	21,309	19,627
Non-sponsored/self-pay	4,429	7,554
Total	$ 899,949	$ 820,107

(Dollars in thousands)

4. Charity Care

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

	2011	2010
Charity care at established rates	$ 107,842	$ 100,429
Estimated cost of charity care	$ 30,696	$ 26,086

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $17,949 and $15,757 for the years ended June 30, 2011 and 2010, respectively.

5. Capital Assets

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

	2010	Additions	Disposals	2011
Original Cost				
Land	$ 4,550	$ -	$ -	$ 4,550
Buildings and improvements	474,448	175,748	-	650,196
Equipment	170,176	53,547	(5,931)	217,792
Construction in progress	186,272	(55,898)	(561)	129,813
Capital assets, at cost	$ 835,446	$ 173,397	$ (6,492)	$ 1,002,351
	2010	**Depreciation**	**Disposals**	**2011**
Accumulated Depreciation				
Buildings and improvements	$ 195,216	$ 16,477	$ -	$ 211,693
Equipment	89,555	18,960	(5,469)	103,046
Accumulated depreciation	284,771	$ 35,437	$ (5,469)	314,739
Capital assets, net	$ 550,675			$ 687,612

(Dollars in thousands)

	2009	Additions	Disposals	2010
Original Cost				
Land	$ 4,550	$ -	$ -	$ 4,550
Buildings and improvements	394,036	80,412	-	474,448
Equipment	142,234	33,135	(5,193)	170,176
Construction in progress	167,327	18,945	-	186,272
Capital assets, at cost	$ 708,147	$ 132,492	$ (5,193)	$ 835,446

	2009	Depreciation	Disposals	2010
Accumulated Depreciation				
Buildings and improvements	$ 179,478	$ 15,738	$ -	$ 195,216
Equipment	77,864	16,443	(4,752)	89,555
Accumulated depreciation	257,342	$ 32,181	$ (4,752)	284,771
Capital assets, net	$ 450,805			$ 550,675

Equipment under capital lease obligations and related accumulated amortization is $27,373 and $13,185 in 2011, respectively, and $29,362 and $12,813 in 2010, 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 $2,538 and $1,945 for the years ended June 30, 2011 and 2010, 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:

	2011	2010
University of California Medical Center Pooled Revenue Bonds 2009 Series F "Build America Bonds", 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	$ 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	13,360
University of California Medical Center Pooled Revenue Bonds 2010 Series G, interest rates ranging from 2.0 percent to 5.0 percent, payable semi-annually, with annual principal payments beginning in 2012 through 2020	37,500	-
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	18,952	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 originally through 2019, but was fully paid in 2011	-	44,535
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	11,782	12,731
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 3.28 percent to 7.79 percent, payable through 2016, collateralized by underlying equipment	27,918	17,775
	219,867	217,986
Unamortized bond premium	5,670	1,917
Total debt and capital leases	225,537	219,903
Less: Amounts due within one year	(12,580)	(9,997)
Noncurrent portion of debt and capital leases	$ 212,957	$ 209,906

Total interest expense during the years ended June 30, 2011 and 2010 was $12,622 and $8,811, respectively. Interest expense totaling $9,934 and $5,447 was capitalized during the years ended June 30, 2011 and 2010, respectively. The remaining $2,688 in 2011 and $3,364 in 2010 are reported as interest expense in the statements of revenues, expenses and changes in net assets.

(Dollars in thousands)

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, 2011				
Long-term debt and capital leases at June 30, 2010	$ 202,128	$ 17,775	$ -	$ 219,903
New obligations	37,500	15,666	-	53,166
Principal payments	(45,763)	(5,523)	-	(51,286)
Amortization of bond premium	(397)	-	-	(397)
Amortization of deferred financing costs	4,151	-	-	4,151
Long-term debt and capital leases at June 30, 2011	197,619	27,918	-	225,537
Less: Current portion of long-term debt and capital leases	(5,168)	(7,412)	-	(12,580)
Noncurrent portion of long-term debt and capital leases as June 30, 2011	$ 192,451	$ 20,506	$ -	$ 212,957
Year ended June 30, 2010				
Long-term debt and capital leases at June 30, 2009	$ 81,937	$ 9,893	$ 34,314	$ 126,144
New obligations	123,715	13,595	20,686	157,996
Principal payments	(4,309)	(5,713)	(55,000)	(65,022)
Amortization of bond premium	(111)	-	-	(111)
Bond premium	896	-	-	896
Long-term debt and capital leases at June 30, 2010	202,128	17,775	-	219,903
Less: Current portion of long-term debt and capital leases	(4,624)	(5,373)	-	(9,997)
Noncurrent portion of long-term debt and capital leases as June 30, 2010	$ 197,504	$ 12,402	$ -	$ 209,906

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, 2011 are $2.26 billion of which $180,167 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, 2011 and 2010 were $6.48 billion and $5.94 billion, respectively.

In February 2011, the Medical Center retired $278 of Medical Center Pooled Revenue Bonds recognizing a gain of $62 on the statement of revenues, expenses and changes in net assets. The Medical Center has a payable to the University of $218, reported in other current liabilities. The retirements were financed through the University's commercial paper program. The Medical Center has a payable to the University for the cost of the retirements. The payable bears interest at the commercial paper rate and is due on demand when the University refinances these commercial paper proceeds into long-term bonds.

In November 2010, Medical Center Pooled Revenue Bonds Series G totaling $37,500 of tax-exempt bonds were issued to refinance certain improvements to the Medical Center. Proceeds, including a bond premium of $4,151, were used to refund $40,985 of Medical Center bonds and to pay for issuance costs. The bonds mature at various dates through 2020. The bonds have a stated weighted average interest rate of 4.0 percent.

In December 2009, Medical Center Pooled Revenue Bonds Series E and F totaling $123,715, including $110,355 of taxable Build America bonds and $13,360 of tax-exempt bonds, were issued for the Medical Center to finance the Cardiovascular Center at the Thornton Hospital location in La Jolla. Proceeds including a bond premium of $895 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.

Medical Center Pooled Revenue Bonds Series A were issued specifically for the Medical Center to refinance a portion of the UCSD Cancer Center construction costs. 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.

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 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)

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, 2011 and thereafter are as follows:

Years Ending June 30	Revenue Bonds	Other Debt	Total Payments	Principal	Interest
2012	$ 15,769	$ 7,998	$ 23,767	$ 12,185	$ 11,582
2013	15,760	7,193	22,953	11,722	11,231
2014	15,452	6,228	21,680	10,818	10,862
2015	15,439	4,744	20,183	9,653	10,530
2016	15,438	3,113	18,551	8,303	10,248
2017 – 2021	74,963	-	74,963	27,825	47,138
2022 – 2026	62,517	-	62,517	21,574	40,943
2027 – 2031	58,306	-	58,306	23,945	34,361
2032 – 2036	55,610	-	55,610	29,545	26,065
2037 – 2041	51,994	-	51,994	36,150	15,844
2042 – 2046	31,290	-	31,290	27,375	3,915
2047 – 2048	819	-	819	772	47
Total future debt service	413,357	29,276	442,633	$ 219,867	$ 222,766
Less: Interest component of future payments	$ (221,408)	$ (1,358)	$ (222,766)		
Principal portion of future payments	191,949	27,918	219,867		
Adjusted by:					
Unamortized bond premium	5,670	-	5,670		
Total debt	$ 197,619	$ 27,918	$ 225,537		

Additional information on the revenue bonds can be obtained from the 2010–2011 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, 2011 and 2010 was $5,318 and $6,138, 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:

Years Ending June 30	Minimum Annual Lease Payments
2012	$ 5,033
2013	4,423
2014	3,317
2015	2,597
2016	1,298
Total	$ 16,668

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 University. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.31 and $3.12 per $100 of UCRP-covered payroll resulting in Medical Center contributions of $9,560 and $8,400 for the years ended June 30, 2011 and 2010, 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, 2010, the date of the latest actuarial valuation, were $74.5 million and $15.5 billion respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary

Net assets were $71.3 million at June 30, 2011. For the years ended June 30, 2011 and 2010, combined contributions from the University's campuses and medical centers were $314.7 million and $283.5 million, respectively, including an implicit subsidy of $54.9 million and $49.5 million respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.8 billion and $1.6 billion for the years ended June 30, 2011 and 2010. 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 $5.1 billion at June 30, 2011 increased by $1.4 billion for the years ended June 30, 2011 and 2010.

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 2010–2011 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 $11,389 and $5,501, respectively, during the year ended June 30, 2011. Medical Center and employee contributions were $2,497 and $775, respectively, during the year ended June 30, 2010.

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, 2010, the date of the latest actuarial valuation, were $33.7 billion and $39.1 billion, respectively, resulting in a funded ratio of 86.2 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $41.9 billion and $34.6 billion at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, the University's campuses and medical centers contributed a combined $1.4 billion and $64.8 million respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.7 billion for the year ended

June 30, 2011. 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 $239.2 million for the year ended June 30, 2011.

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 2010–2011 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 $2,389 and $949 for the years ended June 30, 2011 and 2010, respectively. During 2011 and 2010, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $3,610 and $4,601, 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 $6,417 and $4,841 for the years ended June 30, 2011 and 2010, respectively.

(Dollars in thousands)

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:

	2011	2010
Salaries and employee benefits	$ 9,197	$ 3,714
Professional services	35,447	32,211
Medical supplies	(881)	(1,087)
Other supplies and purchased services	(6,609)	(9,482)
Interest income (net)	(3,215)	(3,785)
Insurance	6,417	4,841
Total	$ 40,356	$ 26,412

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 $96,261 and $65,726 in 2011 and 2010, respectively. Of these amounts, $40,356 and $26,412 are reported as operating expenses for the years ended June 30, 2011 and 2010, respectively, and $55,905 and $39,314 are reported as health system support for the years ended June 30, 2011 and 2010, 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.

The state of California authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations for the medical centers, of which $40,000 was allocated to the Medical Center. 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 $219,000, excluding interest, as of June 30, 2011.

University of California,
San Francisco Medical Center

Financial Statements

For the Years Ended June 30, 2011 and 2010

University of California, San Francisco Medical Center
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June 30, 2011 and 2010

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net assets and the related statements of revenues, expenses and changes in net assets, and cash flows, as shown on pages 15 through 18, 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, 2011 and 2010, and the 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, 2011 and 2010, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 14 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

October 12, 2011

PricewaterhouseCoopers LLP, 350 South Grand Avenue, Los Angeles, CA 90071
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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, 2011, with selected comparative information for the years ended June 30, 2010 and 2009. 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 (2009, 2010, 2011, 2012, 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 Chief Executive Officer 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. In 2011, U.S. News & World Report ranked the UCSF School of Medicine fourth nationally for its primary care training and fifth for its research training – the only medical school in the country ranked in the top five in both categories.

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, 2011, 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 Butte 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.

The Medical Center continues to maintain an outstanding national reputation. The 2011-2012 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, 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 nine pediatric specialties, making it one of the top-ranked facilities in California. Rather than provide an overall ranking for the nation's best children's hospitals, the 2011-2012 children's hospital survey ranked UCSF Benioff Children's Hospital among the top 30 hospitals in 8 individual specialties – cancer, diabetes and endocrinology, gastroenterology, heart and heart surgery, kidney care, neonatology, neurology and neurosurgery, and urology.

For the fiscal year ended June 30, 2011, the Medical Center reported income before changes in net assets of $207 million, generating a margin of 11.0%. The year ended with a cash position of $349 million, up from $217 million at the end of 2010.

Significant events during the year are highlighted below:

- The Medical Center opened 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 previously outsourced. The pharmacy production facility also implemented bar-coded medication administration.

- The Medical Center continued to develop an enterprise-wide electronic medical records project. During 2011, the Medical Center implemented two phases of the project for Ambulatory Care. Implementation of additional phases are planned during 2012.

- Development of the UCSF Mission Bay Hospital continued. 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.

- New debt was issued. In November 2010, Medical Center pooled revenue bonds totaling $700 million were issued as taxable "Build American Bonds" to finance project construction on the Mission Bay Hospital.

- There was 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.

- There was continued emphasis on quality and patient safety. The organization-wide goals for 2011 included further reducing hospital-acquired pressure ulcers in adult patients, and other patient safety and quality goals. All organization goals were 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.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2011, 2010 and 2009:

	2011	2010	2009
Licensed beds	722	722	722
Admissions	28,268	29,087	28,190
Average daily census	500	500	523
Discharges	28,273	29,098	28,591
Average length of stay	6.5	6.3	6.6
Patient days	182,397	182,641	190,870
Case mix index	1.94	1.92	1.94
Outpatient visits:			
Hospital clinics	778,525	752,635	735,713
Home health visits	16,704	18,468	17,717
Emergency visits	36,051	36,426	37,759
Total outpatient visits	831,280	807,529	791,189

Patient service revenue depends on inpatient occupancy levels, the volume of outpatient visits, the complexity of the care provided, and the charges or negotiated payment rates for services provided. Patient days decreased by 244, or 0.1 percent, in 2011 and decreased by 8,229, or 4.3 percent, in 2010. 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. Total outpatient visits have also increased in each of the last two years: an increase of 23,751, or 2.9 percent, and 16,340, or 2.1 percent, in 2011 and 2010, respectively, from the previous year.

Statements of Revenues, Expenses and Changes in Net Assets

The following table summarizes the operating results for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Net patient service revenue	$ 1,864,052	$ 1,766,688	$ 1,629,106
Other operating revenue	25,152	21,069	24,044
Total operating revenue	1,889,204	1,787,757	1,653,150
Total operating expenses	1,714,796	1,637,178	1,552,113
Income from operations	174,408	150,579	101,037
Total net non-operating revenues (expenses)	32,559	(1,474)	(20,954)
Income before other changes in net assets	$ 206,967	$ 149,105	$ 80,083
Operating margin	11.0%	8.3%	4.8%
Other changes in net assets	$ (15,392)	$ 22,066	$ (28,110)
Increase in net assets	191,575	171,171	51,973
Net assets – beginning of year	931,929	760,758	708,785
Net assets – end of year	$ 1,123,504	$ 931,929	$ 760,758

Revenues
Total operating revenues for 2011 were $1,889 million, an increase of $101 million, or 5.7 percent, over 2010. Operating revenues for 2010 were $1,788 million, an increase of $135 million, or 8.1 percent, over 2009.

Net patient service revenue for 2011 increased by $97 million, or 5.5 percent, over 2010. The increase in 2011 was primarily due to an improvement in inpatient and outpatient reimbursement rates, increase of outpatient volumes, and a slight increase in the complexity of cases. Net patient service revenue in 2010 increased by $138 million, or 8.5 percent, over 2009 also primarily due to an increase of outpatient volumes and an improvement in inpatient and outpatient reimbursement rates.

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 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Medicare (non-risk)	$ 367,279	$ 356,344	$ 331,397
Medi-Cal (non-risk)	215,821	202,936	190,396
Contracts – commercial	1,221,939	1,144,254	1,051,007
Contracts (capitated)*	10,699	11,381	11,973
County/Uninsured	48,314	51,773	44,333
Total	$ 1,864,052	$ 1,766,688	$ 1,629,106

*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 $10.9 million, or 3.1 percent, from 2010 to 2011 and $24.9 million, or 7.5 percent, from 2009 to 2010. 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 2011, the Medical Center decreased its net liability related to prior year third party settlements and loss contingencies by $14.2 million with a corresponding increase to net patient service revenue in the statements of revenues, expenses and changes in net assets. 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.

Net revenue for Medi-Cal patients increased $12.9 million, or 6.3 percent, from 2010 to 2011 and $12.5 million, or 6.6 percent, from 2009 to 2010. Medi-Cal fee-for-service ("FFS") inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and legislation enacted by the State of California Senate. Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. The total payments made to the Medical Center will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP"). Effective November 2010, the Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform.

The increase in net revenue during 2011 for Medi-Cal was due to incentive payments received, supplemental payments received under State of California Assembly Bill AB 1383, higher patient volumes and improved reimbursement rates. The increase in 2010 was due to improved reimbursement rates, including stimulus amounts received under the American Recovery and Reinvestment Act of 2009. Medi-Cal net revenues in 2011 and 2010 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 $77.7 million, or 6.8 percent, from 2010 to 2011 and $93.2 million, or 8.9 percent, from 2009 to 2010. 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 65.6 percent of total net patient service revenue in 2011, up slightly from 64.8 percent in 2010 and 64.5 percent in 2009. Commercial inpatient days, outpatient visits, patient acuity as well as the average yield—net revenue per inpatient day—increased in both 2011 and 2010. Commercial contract revenue for hospital clinic visits also increased in 2011 compared to 2010 and 2009.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Salaries and wages	$ 672,756	$ 652,506	$ 642,416
Employee benefits	168,754	141,248	131,479
Professional services	19,836	24,665	25,196
Medical supplies	257,472	245,015	230,108
Other supplies and purchased services	442,846	424,973	388,187
Depreciation and amortization	81,474	77,790	67,707
Insurance	6,820	7,288	7,083
Other	64,838	63,693	59,937
Total	$ 1,714,796	$ 1,637,178	$ 1,552,113

Total operating expenses were $1,715 million in 2011, up $77.6 million, or 4.7 percent, from 2010. Operating expenses increased in 2011 primarily due higher labor and pension costs, medical supplies, and general expense inflation. In 2010, operating expenses increased $85 million, or 5.5 percent, from 2009 primarily due to higher labor and medical supply costs, along with higher medical services purchased from the University. Depreciation expense also increased as capital investments in equipment and infrastructure grew in 2010.

Salary and employee benefits expenses include wages paid to Medical Center employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance, pension contributions and other employee benefits. About one-half of the Medical Center's work force, including nurses and employees providing ancillary services, expand and contract with patient volumes.

In 2011, salaries and wages grew by $20.3 million, or 3.1 percent, over the prior year. This increase includes $11.6 million, or 1.8 percent in salary increases and an increase of 90 full time equivalent employees, or 1.3 percent from the prior year. In 2010, salaries and wages grew by $10.1 million, or

1.6 percent, over the prior year. This increase includes $13.3 million, or 2.1 percent in salary increases and a decrease of 32 full time equivalent employees, or 0.5 percent from the prior year.

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2011 increased $1.6 million, or 8.2 percent, over 2010 due to an increase in the use of temporary staffing as well as an increase in the average rate. Temporary labor costs for 2010 decreased $9.2 million, or 32.1 percent, over 2009 due to a reduction of temporary staffing that had been in place while an automated medication management system was being installed.

In 2011, employee benefit costs increased by $27.5 million, or 19.5 percent, over 2010. Pension contributions were $23.4 million in 2011 as compared to $5.4 million in 2010 and zero in 2009. The Medical Center's health insurance and other employee benefit costs increased in 2011 as compared to 2010 by $12.9 million, or 9.5 percent, due to an increase in insurance premiums of $9.4 million and increases in other benefit costs of $3.5 million. The Medical Center's health insurance and other employee benefit costs increased in 2010 as compared to 2009 by $4.5 million, or 3.4 percent, due to an increase in insurance premiums of $7.2 million and decreases in other benefit costs of $2.7 million.

As a percentage of total operating revenue, salaries and employee benefits were 44.5 percent in 2011, 44.4 percent in 2010 and 46.8 percent in 2009. Overall labor costs decreased as a percent of operating revenues from 2009 as total operating revenue grew at a faster rate the than the change in full time equivalent employees.

Medical supplies including pharmaceuticals, totaled $257.5 million in 2011, up $12.5 million, or 5.1 percent, from 2010, primarily due to price inflation. In 2010, medical supplies, including pharmaceuticals, totaled $245.0 million, up $14.9 million, or 6.5 percent, primarily due to 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 13.6 percent in 2011, down from 13.7 percent of operating revenue in 2010 and 13.9 percent in 2009. The Medical Center has ongoing initiatives to control supply utilization and to negotiate competitive pricing.

Other supplies and purchased services totaled $442.8 million in 2011, up $17.9 million, or 4.2 percent, from 2010. Purchased services increased in 2011 primarily due to inflation and higher costs associated with technology improvements. In 2010, these costs totaled $425.0 million, up $36.8 million, or 9.4 percent, from 2009 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 $81.5 million in 2011, an increase of $3.7 million, or 4.7 percent, from the prior year, due to capital investment in facilities, systems, and equipment. In 2010, depreciation and amortization increased $10.1 million, or 14.9 percent, from 2009 also due to capital investment in facilities, systems, and equipment.

Insurance expense totaled $6.8 million in 2011, down from $7.3 million and $7.1 million in 2010 and 2009, respectively. The Medical Center is insured through the University's malpractice and general liability programs.

Income from Operations
The Medical Center reported income from operations of $174.4 million and operating revenue of $1,889 million, resulting in an operating margin of 9.2 percent in 2011 as compared to 8.4 percent and 6.1 percent in 2010 and 2009, respectively. Income from operations increased in the current year to $174.4 million from $150.6 million in the prior year. The $23.8 million increase was the result of improved reimbursement rates, an increase of Medi-Cal incentive payments, supplemental payments received under AB 1383, and a slight increase in the complexity of cases during the year. In addition, expense controls helped to mitigate the national trend of higher healthcare costs.

Non-operating Revenues (Expenses)
Non-operating revenues, net of non-operating expenses, totaled $32.6 million in 2011, compared to non-operating expenses, net of non-operating revenues of $1.5 million in 2010, and $21.0 million in 2009. Non-operating revenues and expenses include hospital fee program revenue, interest income and expense, federal subsidies for bond interest and loss on disposals of capital assets. In 2011, hospital fee program income was received, interest income was higher due to higher invested cash balances, partially offset by higher interest expense due to the $700 million debt issuance for Mission Bay construction.

Income before Other Changes in Net Assets
The Medical Center reported income before other changes in net assets of $207.0 million in 2011, compared to $149.1 million in 2010, and $80.1 million in 2009, an increase of $57.9 million, or 38.8 percent, and $69.0 million, or 86.2 percent, respectively. The Medical Center's net income increased in 2011 and 2010 mainly due to improved reimbursement rates, operating efficiencies, and a slight increase in the complexity of cases during the year. Additionally, there was an increase of Medi-Cal incentive payments and supplemental payments received under AB 1383 in 2011.

Other Changes in Net Assets
The other changes in net assets for 2011, 2010 and 2009 include:

	2011	2010	2009
Donated assets	$ 27,003	$ 59,132	$ 2,174
Health system support	(42,395)	(37,066)	(30,284)
Total other changes in net assets	$ (15,392)	$ 22,066	$ (28,110)

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 2011 and 2010 are the following:

- Donated assets of $27.0 million and $59.1 million, respectively.

- Health system support represents transfers primarily to the School of Medicine for academic and research support. The Medical Center transferred $42.4 million in 2011 and $37.1 million in 2010.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2011, 2010 and 2009 (dollars in thousands):

	2011	2010	2009
Current assets:			
Cash	$ 349,008	$ 217,192	$ 127,526
Patient accounts receivable (net)	322,786	302,481	291,110
Other current assets	65,305	71,188	51,903
Total current assets	737,099	590,861	470,539
Cash restricted for hospital construction	628,185	-	-
Capital assets (net)	957,406	824,471	736,367
Other assets	30,991	28,933	22,641
Total assets	2,353,681	1,444,265	1,229,547
Current liabilities	224,112	198,794	188,801
Long-term debt	946,642	262,810	245,783
Other liabilities	59,423	50,732	34,205
Total liabilities	1,230,177	512,336	468,789
Net assets:			
Invested in capital assets (net)	605,924	531,091	462,741
Restricted	13,491	12,759	9,536
Unrestricted	504,089	388,079	288,481
Total net assets	$ 1,123,504	$ 931,929	$ 760,758

Total current assets increased $146.2 million, or 24.7 percent, from 2010 to 2011 primarily due to an increase of cash retained from hospital operations. In 2010, total current assets increased $120.3 million, or 25.6 percent, from 2009 primarily due to an increase of cash and an increase in patient accounts receivable and third party payor settlements.

Cash increased $131.8 million, or 60.7 percent, during 2011 and increased $89.7 million, or 70.3 percent, during 2010. The increase in both 2011 and 2010 was primarily due to cash provided by operations.

Net patient accounts receivable represented 43.8 percent of current assets at June 30, 2011, down from 51.2 and down from 61.9 percent of current assets at June 30, 2010 and 2009, respectively. In 2011, net patient account receivables increased by $20.3 million from the prior year. This increase was due to higher outpatient volumes and higher rates. In 2010, net patient account receivables increased by $11.4 million from the prior year also due to higher outpatient volumes and higher rates.
Net capital assets increased by $132.9 million, or 16.1 percent, from 2010 to 2011 due to the development of land at Mission Bay and an increased level of investment in an electronic health record system. Net capital assets increased by $88.1 million, or 12.0 percent, from 2009 to 2010 due to continued investment in equipment, systems, infrastructure and development of land at Mission Bay.

Current liabilities increased by $25.3 million, or 12.7 percent, from 2010 to 2011 primarily due to an increase of accounts payable balances. In 2010, current liabilities increased by $10.0 million, or 5.3 percent, from 2009 primarily due to higher accounts payable balances and an increase of long-term debt payments due in the coming fiscal year.

Long-term liabilities of $1,006.1 million at June 30, 2011, increased $692.5 million, or 221 percent, from June 30, 2010. Long-term debt increased due to $700 million of Build America bonds being issued during the year. Long-term liabilities of $313.5 million at June 30, 2010, increased $33.6 million, or 12.0 percent, from June 30, 2009, 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 $191.6 million, or 20.6 percent, during 2011 and $171.2 million, or 22.5 percent, during 2010. Income for 2011 and 2010 totaled $207.0 million and $149.1 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 $42.4 million and $37.1 million in 2011 and 2010, respectively. Donations added $27.0 million and $59.1 million to net assets during 2011 and 2010, respectively.

Liquidity and Capital Resources

During 2011, the Medical Center generated $275.5 million in cash from operating activities. This represented an increase of $56.9 million, or 26.1 percent, from 2010 to 2011, and an increase of $72.6 million, or 49.8 percent, from 2009 to 2010. Cash received from patients and third-party payors totaled $1.8 billion in 2011, up $65.2 million, or 3.8 percent, from 2010. This amount totaled $1.7 billion in fiscal year 2010, up $170.1 million, or 10.9 percent, from 2009.

In 2011 and 2010, cash flows from non-capital financing activities reduced cash by $5.8 million and $37.1 million, respectively, for transfers to the University for health system support offset in 2011 by grants received for the hospital fee program.

Cash provided by capital and related financing activities totaled $469.8 million in 2011, compared to cash used by capital and related financial activities of $97.2 million in 2010 and $120.7 million in 2009.

Cash provided by or used for capital and related financing activities increased by $567.0 million from 2010 to 2011 and decreased by $23.5 million, or 19.5 percent, from 2009 to 2010. The Medical Center issued debt of $719.2 million, purchased capital assets of $209.7 million in 2011 and received donated funds of $27.0 million. Principal payments on long-term debt and capital leases totaled $32.6 million in 2011 and interest paid was $40.8 million. In 2010, cash flows from capital and related financing activities included purchases of capital assets of $163.9 million, donated funds of $59.1 million, principal payments on long-term debt and capital leases of $30.1 million and interest paid of $7.7 million.

Cash flows from investment activities included $21.2 million and $8.6 million provided by interest income in 2011 and 2010, respectively. Overall cash increased to $349.0 million in 2011 from $217.2 million in 2010 and increased to $217.2 million in 2010 from $127.5 million in 2009.

The following table shows key liquidity and capital ratios for 2011, 2010 and 2009:

	2011	2010	2009
Days cash on hand	78	51	31
Days of revenue in accounts receivable	63	63	65
Purchases of capital assets ($ in millions)	$ 209.7	$ 163.9	$ 138.8
Debt service coverage ratio	4.9	6.2	5.3

Days cash on hand increased to 78 days in 2011 from 51 days in 2010, for a 52.9 percent increase. In 2010, days cash on hand increased to 51 days from 31 days in 2009, for a 64.5 percent increase. 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 2011, net days in receivables stayed flat at 63 compared to the previous year. In 2010, net days in receivables decreased 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 ratio for 2011 was 5.0 times versus 6.2 times in 2010. The decrease was primarily due an increase in the level of debt service for new borrowings made in 2011. 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 ratios in 2011 and 2010 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.

During 2011, a validation survey was conducted by the Center for Medicare and Medicaid Services (CMS). The Medical Center was cited for deficiencies and a statement of deficiencies was issued by CMS in September 2011. A corrective plan was submitted to CMS in September 2011, and the Medical Center is awaiting a response from CMS.

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.

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.

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. In November 2010, California received federal approval for a new five year waiver. State of California Assembly Bill 1066, signed in July 2011, contains the statutes to enact the terms of the new waiver program. Payments to the Medical Centers include a combination of Medi-Cal inpatient fee for service payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP") payments based upon costs. The Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. Although the waiver is designed to ensure predictable reimbursements for the care of poor and indigent patients, the full financial impact of these changes in the future cannot be determined.

Meaningful Use of Electronic Health Records

The American Recovery and Reinvestment Act of 2009 established incentive payments under the Medicare and Medicaid programs for certain professionals and hospitals that meaningfully use certified electronic health record ("EHR") technology. A hospital may receive an incentive payment for up to four years, from 2011 through 2015, by meeting a series of objectives that make use of EHR's potential related to the improvement of quality, efficiency and patient safety. Meaningful use is assessed on a year-by-year basis and requires attestation by the facility that the criteria have been satisfied. For the year ended June 30, 2011, the Medical Center did not receive any payments for the meaningful use of EHR technology.

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. As of June 30, 2011, the Medical Center had not received any of this grant funding.

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. As of June 30, 2011, the Medical Center had not received any of this grant funding.

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, 2010 actuarial valuation was $5.4 billion or 86.2 percent funded. The total funding policy contributions in the July 1, 2010 actuarial valuations represent 23.25% of covered compensation. As of July 1, 2011, the funded ratio is expected to decrease to approximately 82.0 percent. At its September 2010 meeting, The Regents approved increasing the employer and employee contribution rates to UCRP. Contributions by members will be increased to 3.5 percent of covered compensation in July 2011 and 5 percent in July 2012 and contributions by the University will be increased to 7 percent of covered compensation in July 2011 and 10 percent in July 2012. These contribution rates are below UCRP's total funding policy contributions. The Regents also approved a new tier of pension benefits applicable to employees hired on or after July 1, 2013, which would increase the early retirement age from 50 to 55, but retain many of the current features of UCRP. The new tier would not offer lump sum cashouts, inactive member Cost of Living Adjustments (COLAs), or subsidized survivor annuities for spouses and domestic partners. These changes are subject to collective bargaining for union-represented employees.

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, 2010 actuarial valuation was $15.4 billion. The Regents approved a new eligibility formula for the Retiree Health Plan for all employees hired on or after July 1, 2013, and non-grandfathered members, that is based on a graduated formula using both a member's age and years of Retirement Plan service credit upon retirement, subject to collective bargaining for represented members.

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.

University of California, San Francisco Medical Center
Statements of Net Assets
June 30, 2011 and 2010
(Dollars in thousands)

	2011	2010
Assets		
Current assets		
Cash	$ 349,008	$ 217,192
Patient accounts receivable, net of estimated uncollectibles of $18,135 and $20,350, respectively	322,786	302,481
Other receivables	1,424	154
Third-party payor settlements, net	8,532	18,454
Inventory	28,028	24,557
Prepaid expenses and other assets	27,321	28,023
Total current assets	737,099	590,861
Restricted assets:		
Cash restricted for hospital construction	628,185	-
Donor funds	13,491	12,759
Capital assets, net	957,406	824,471
Deferred costs of issuance and other	17,500	16,174
Total assets	2,353,681	1,444,265
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	115,475	101,686
Accrued salaries and benefits	66,754	61,590
Current portion of long-term debt and capital leases	33,025	30,570
Other liabilities	8,858	4,948
Total current liabilities	224,112	198,794
Long-term debt and capital leases, net of current portion	946,642	262,810
Third-party payor settlements, net	50,290	39,314
Other liabilities	9,133	11,418
Total liabilities	1,230,177	512,336
Net Assets		
Invested in capital assets, net of related debt	605,924	531,091
Restricted:		
Expendable:		
Capital projects	7,850	7,787
Other	5,641	4,972
Unrestricted	504,089	388,079
Total net assets	$ 1,123,504	$ 931,929

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Net patient service revenue, net of provision for doubtful accounts of $47,285 and $37,415, respectively	$ 1,864,052	$ 1,766,688
Other operating revenue:		
Clinical teaching support	4,292	3,796
Other	20,860	17,273
Total other operating revenue	25,152	21,069
Total operating revenue	1,889,204	1,787,757
Operating expenses:		
Salaries and wages	672,756	652,506
UCRP, retiree health and other employee benefits	168,754	141,248
Professional services	19,836	24,665
Medical supplies	257,472	245,015
Other supplies and purchased services	442,846	424,973
Depreciation and amortization	81,474	77,790
Insurance	6,820	7,288
Other	64,838	63,693
Total operating expenses	1,714,796	1,637,178
Income from operations	174,408	150,579
Non-operating revenues (expenses):		
Hospital fee program grants	36,594	-
Interest income	21,230	8,576
Interest expense	(34,039)	(7,720)
Build America bonds federal interest subsidies	10,131	241
Loss on disposal of capital assets	(1,357)	(2,571)
Total net non-operating revenues (expenses)	32,559	(1,474)
Income before other changes in net assets	206,967	149,105
Other changes in net assets:		
Donated assets	27,003	59,132
Health system support	(42,395)	(37,066)
Total other changes in net assets	(15,392)	22,066
Increase in net assets	191,575	171,171
Net assets – beginning of year	931,929	760,758
Net assets – end of year	$ 1,123,504	$ 931,929

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,836,205	$ 1,734,564
Payments to employees	(671,816)	(650,956)
Payments to suppliers	(781,494)	(764,994)
Payments for benefits	(165,530)	(139,435)
Other receipts, net	58,592	39,351
Net cash provided by operating activities	275,957	218,530
Cash flows from noncapital financing activities:		
Health system support	(42,395)	(37,066)
Grants from the hospital fee program	36,594	-
Net cash used by noncapital financing activities	(5,801)	(37,066)
Cash flows from capital and related financing activities:		
Proceeds from debt issuance	718,656	49,889
Bond issuance costs	(4,022)	(97)
Build America bonds federal interest subsidies	10,131	241
Proceeds from sale of capital assets	746	67
Purchases of capital assets	(209,738)	(163,877)
Principal paid on long-term debt and capital leases	(32,616)	(30,131)
Interest paid on long-term debt and capital leases	(40,813)	(12,375)
Gifts and donated funds	27,003	59,132
Net cash provided (used) by capital and related financing activities	469,347	(97,151)
Cash flows from investing activities:		
Interest income received	21,230	8,576
Change in restricted assets	(628,917)	(3,223)
Net cash provided (used) by investing activities	(607,687)	5,353
Net increase in cash	131,816	89,666
Cash – beginning of year	217,192	127,526
Cash – end of year	$ 349,008	$ 217,192

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, 2011 and 2010
(Dollars in thousands)

	2011	2010
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 174,408	$ 150,579
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	81,474	77,790
Provision for doubtful accounts	47,285	37,415
Changes in operating assets and liabilities:		
Patient accounts receivable	(67,590)	(48,786)
Other receivables	(1,270)	1,773
Inventory	(3,471)	(2,473)
Prepaid expenses and other assets	1,360	(1,277)
Accounts payable and accrued expenses	13,789	3,112
Accrued salaries and benefits	5,164	2,619
Third-party payor settlements	20,898	(3,757)
Other liabilities	3,910	1,535
Net cash provided by operating activities	$ 275,957	$ 218,530
Supplemental noncash activities information:		
Change in fair value of interest rate swaps	$ (2,285)	$ (3,245)
Amortization of deferred financing costs	108	113
Amortization of bond premium	26	20
Amortization of deferred costs of issuance	153	153
Payables for property and equipment	33,165	13,648

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.

The financial statements of the Medical Center 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.

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"). 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. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, was adopted by the Medical Center during the year ended June 30, 2011. This Statement incorporates into GASB's authoritative literature certain accounting and financial reporting guidance that is included in Financial Accounting Standards Board Statements and Interpretations, Accounting Principles Board Opinions and Accounting Research Bulletins of the American Institute of Certified Public Accountants' Committee on Accounting Procedures that were issued on or before November 30, 1989. Implementation of Statement No. 62 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2011 and 2010.

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, 2011 and 2010 was $349,008 and $217,192, 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 2010–2011 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, Cash Restricted for Hospital 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 project costs are incurred. Restricted assets are deposited in STIP.

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. Restricted assets are deposited in STIP. The amounts held at June 30, 2011 and 2010 by the Treasurer’s Office were $13,491 and $12,759, 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 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. 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 on borrowings to finance facilities is capitalized during construction, net of any investment income earned on tax-exempt borrowings during the temporary investment of project-related borrowings.

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.

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.

- 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.

The Medical Center estimates and recognizes a provision for doubtful accounts and the allowance for doubtful accounts based on historical experience.

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.

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 University. 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 University. 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.

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

New Accounting Pronouncements
In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*, effective for the University's fiscal year beginning July 1, 2011. This Statement requires the Medical Center to report the activities for certain public-private partnerships as service concession arrangements in the financial statements. Service concession arrangements are recorded when the arrangements meet certain criteria which include building and operating a facility, obtaining the right to collect fees from third parties, and transferring ownership of the facility to the Medical Center at the end of the arrangement. The Medical Center is evaluating the effect that Statement No. 60 will have on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, effective for the University's fiscal year beginning July 1, 2012. This Statement modifies the presentation of deferred inflows and deferred outflows in the financial statements. The University is evaluating the effect that Statement No. 63 will have on its financial statements.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the University's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for termination hedge accounting. The University is evaluating the effect that Statement No. 64 will have on its financial statements.

3. Net Patient Service Revenue

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

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

  Inpatient acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic and other factors. Inpatient non-acute services, certain outpatient services and medical education costs related to Medicare beneficiaries are paid based, in part, on a cost reimbursement methodology. Medicare reimburses hospitals for covered outpatient services rendered to its beneficiaries by way of an outpatient prospective payment system based on ambulatory payment classifications. 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.

- ***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 legislation enacted by the state of California. Medi-Cal Outpatient FFS services are reimbursed based on a fee schedule. The total payments made to the Medical Center will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share Hospital ("DSH") payments, and Safety Net Care Pool ("SNCP"). Effective November 2010, the Medical Center is also eligible to receive incentive payments designed to encourage delivery system innovation in preparation for the implementation of federal health care reform. For the years ended June 30, 2011 and 2010, the Medical Center recorded total Medi-Cal revenue of $215,821 and $202,936, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 on September 8, 2010, established 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 makes supplemental payments to hospitals for various health care services and supports the state's effort to maintain health care coverage for children. The Medical Center, designated as a public hospital, is exempt from paying the "Quality Assurance Fee"; however, the Medical Center received supplemental payments under the Hospital Fee Program. For the year ended June 30, 2011, the Medical Center received $14,293, which has been reported as net patient service revenue and $36,594 as a state grant which has been reported as non-operating revenue.

- ***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, 2011 and 2010, the Medical Center recorded revenue of $15,586 and $12,319, 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.

(Dollars in thousands)

- 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, 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 represent 11.0 percent and 10.3 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively. Amounts due from Medi-Cal represent 8.9 percent and 9.1 percent of net patient accounts receivable at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, net patient service revenue included $15,524 and $10,805, 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:

	2011	**2010**
Medicare (non-risk)	$ 367,279	$ 356,344
Medicare (risk)	7,596	9,126
Medi-Cal (non-risk)	215,821	202,936
Commercial	35,861	34,173
Contract (discounted or per diem)	1,186,078	1,110,081
Contract (capitated)	3,103	2,255
County	16,283	18,157
Non-sponsored/self-pay	32,031	33,616
Total	$ 1,864,052	$ 1,766,688

(Dollars in thousands)

4. Charity Care

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

	2011	2010
Charity care at established rates	$ 21,983	$ 41,044
Estimated cost of charity care	$ 5,612	$ 11,371

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $87,529 and $89,171 for the years ended June 30, 2011 and 2010, 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.

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

	2011	2010
Capital projects	$ 7,850	$ 7,787
Other	5,641	4,972
Total	$ 13,491	$ 12,759

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, 2011 and 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.

(Dollars in thousands)

6. Capital Assets

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

	2010	Additions	Disposals	2011
Original Cost				
Land	$ 102,577	$ 15,772	$ -	$ 118,349
Buildings and improvements	840,330	69,605	-	909,935
Equipment	335,325	38,833	(12,739)	361,419
Construction in progress	197,569	92,399	(1,194)	288,774
Capital assets, at cost	$ 1,475,801	$ 216,609	$ (13,933)	$ 1,678,477

	2010	Depreciation	Disposals	2011
Accumulated Depreciation				
Buildings and improvements	$ 448,376	$ 38,798	$ -	$ 487,174
Equipment	202,954	42,676	(11,733)	233,897
Accumulated depreciation	651,330	$ 81,474	$ (11,733)	721,071
Capital assets, net	$ 824,471			$ 957,406

	2009	Additions	Disposals	2010
Original Cost				
Land	$ 100,358	$ 2,219	$ -	$ 102,577
Buildings and improvements	784,325	56,005	-	840,330
Equipment	337,584	44,435	(46,694)	335,325
Construction in progress	133,520	66,039	(1,990)	197,569
Capital assets, at cost	$ 1,355,787	$ 168,698	$ (48,684)	$ 1,475,801

	2009	Depreciation	Disposals	2010
Accumulated Depreciation				
Buildings and improvements	$ 409,960	$ 38,416	$ -	$ 448,376
Equipment	209,460	39,374	(45,880)	202,954
Accumulated depreciation	619,420	$ 77,790	$ (45,880)	651,330
Capital assets, net	$ 736,367			$ 824,471

Equipment under capital lease obligations and related accumulated amortization is $124,019 and $57,158 in 2011, respectively, and $107,480 and $45,859 in 2010, 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.

(Dollars in thousands)

7. Long-term Debt and Capital Leases

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

	2011	2010
University of California Medical Center Pooled Revenue Bonds 2010 Series H "Build America Bonds", net interest rates after the 35 percent federal subsidy of 4.2 percent, payable semi-annually, with annual principal payments beginning in 2021 through 2048	$ 700,000	$ -
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	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 2047	1,680	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	43,384	44,020
University of California Medical Center Pooled Revenue Bonds 2007 Series B, variable rate bonds with the interest rate being 3.6 percent as of June 30, 2011, with annual principal payments through 2032	85,915	88,610
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	129,643	140,272
	980,242	294,202
Unamortized bond premium	725	751
Unamortized deferred financing costs	(1,300)	(1,573)
Total debt and capital leases	979,667	293,380
Less: Amounts due within one year	(33,025)	(30,570)
Noncurrent portion of debt and capital leases	$ 946,642	$ 262,810

Total interest expense during the years ended June 30, 2011 and 2010 was $40,813 and $12,375, respectively. Interest expense totaling $6,774 and $4,655 was capitalized during the years ended June 30, 2011 and 2010.

(Dollars in thousands)

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, 2011				
Long-term debt and capital leases at June 30, 2010	$ 153,108	$ 140,272	$ -	$ 293,380
New obligations	700,000	18,656	-	718,656
Principal payments	(3,331)	(29,285)	-	(32,616)
Amortization of bond premium	(26)	-	-	(26)
Amortization of deferred financing costs	273	-	-	273
Long-term debt and capital leases at June 30, 2011	850,024	129,643	-	979,667
Less: Current portion of long-term debt and capital leases	(3,281)	(29,744)	-	(33,025)
Noncurrent portion of long-term debt and capital leases as June 30, 2011	$ 846,743	$ 99,899	$ -	$ 946,642
Year ended June 30, 2010				
Long-term debt and capital leases at June 30, 2009	$ 134,416	$ 135,737	$ 3,473	$ 273,626
New obligations	21,300	28,589		49,889
Principal payments	(2,605)	(24,054)	(3,473)	(30,132)
Amortization of bond premium	(20)	-	-	(20)
Amortization of deferred financing costs	113	-	-	113
Bond premium	70	-	-	70
Deferred financing costs	(166)	-	-	(166)
Long-term debt and capital leases at June 30, 2010	153,108	140,272	-	293,380
Less: Current portion of long-term debt and capital leases	(2,603)	(27,967)		(30,570)
Noncurrent portion of long-term debt and capital leases as June 30, 2010	$ 150,505	$ 112,305	$ -	$ 262,810

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, 2011 are $2.26 billion of which $850,024 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, 2011 and 2010 were $6.48 billion and $5.94 billion, respectively.

In February 2011, the Medical Center retired $636 of Medical Center Pooled Revenue Bonds recognizing a gain of $143 on the statement of revenues, expenses and changes in net assets. The Medical Center has a payable to the University of $497, reported in other current liabilities. The retirements were financed through the University's commercial paper program. The Medical Center has a payable to the University for the cost of the retirements. The payable bears interest at the commercial paper rate and is due on demand when the University refinances these commercial paper proceeds into long-term bonds.

In November 2010, Medical Center Pooled Revenue Bonds Series H totaling $700,000 were issued as taxable "Build America Bonds" to finance certain improvements to the Medical Center. Proceeds were used to pay for project construction and issuance costs. The bonds require interest only payments through November 2020 and mature at various dates through 2048. The taxable bonds have a stated weighted average interest rate of 6.48 percent and a net weighted average interest rate of 4.21 percent after the expected cash subsidy payment from the United States Treasury equal to 35 percent of the interest payable on the taxable bonds.

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 Medical Center Pooled Revenue Bonds 2007 Series B totaling $88,610 are variable rate demand obligations subject to daily remarketing. The University has entered into a standby bond purchase agreement if a failed remarketing were to occur and the redemption of any of the bonds is required. In addition, the Medical Center has access to the hospital working capital program from the University described below for any amounts that would be obligated for repayment to the University.

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)

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 2007 Series B.

The notional amounts, fair value of the interest rate swap outstanding and the change in fair value for June 30, 2011 and 2010 are as follows:

Notional Amount		Fair Value – Positive (Negative)			Changes in Fair Value		
2011	2010	Classification	2011	2010	Classification	2011	2010
$ 85,915	$ 88,610	Other noncurrent (liabilities)	$ (9,133)	$ (11,418)	Deferred (inflows)/ outflows	$ 2,285	$ (3,245)

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, 2011 or 2010.

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 market interest rate swap is a hedging derivative that hedges 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)

Additional terms with respect to the outstanding swap and the fair value at June 30, 2011, 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)

Future Debt Service and Interest Rate Swaps

Future debt service payments for each of the five fiscal years subsequent to June 30, 2011 and thereafter are shown below.

Year Ending June 30	**Revenue Bonds**	**Capital Lease Obligations**	**Total Payments**	**Principal**	**Interest**
2012	$ 54,641	$ 34,771	$ 89,412	$ 33,109	$ 56,303
2013	54,225	28,759	82,984	27,997	54,987
2014	54,423	65,230	119,653	66,636	53,017
2015	54,629	6,340	60,969	9,643	51,326
2016	54,857	2,856	57,713	6,506	51,207
2017 – 2021	287,882	4,204	292,086	40,557	251,529
2022 – 2026	340,065	-	340,065	105,925	234,140
2027 – 2031	330,194	-	330,194	127,875	202,319
2032 – 2036	294,757	-	294,757	131,280	163,477
2037 – 2041	273,201	-	273,201	154,560	118,641
2042 – 2046	254,505	-	254,505	190,285	64,220
2047 – 2048	93,690	-	93,690	85,869	7,821
Total future debt service	2,147,069	142,160	2,289,229	$ 980,242	$ 1,308,987
Less: Interest component of future payments	(1,296,470)	(12,517)	(1,308,987)		
Principal portion of future payments	850,599	129,643	980,242		
Adjusted by:					
Unamortized bond premium	725	-	725		
Unamortized deferred financing costs	(1,300)	-	(1,300)		
Total debt	$ 850,024	$ 129,643	$ 979,667		

Additional information on the revenue bonds can be obtained from the 2010–2011 annual report of the University.

(Dollars in thousands)

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, 2011, 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**
2012	$ 2,800	$ 36	$ 2,569	$ 5,405
2013	2,895	29	2,491	5,415
2014	3,000	28	2,404	5,432
2015	3,110	27	2,314	5,451
2016	3,230	26	2,220	5,476
2017 – 2021	17,980	111	9,575	27,666
2022 – 2026	21,495	78	6,668	28,241
2027 – 2031	25,695	37	3,192	28,924
2032 - 2036	5,710	2	164	5,876
Total future debt service	$ 85,915	$ 374	$ 31,597	$ 117,886

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, 2011 and 2010 was $26,141 and $23,288, 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**
2012	$ 15,173
2013	12,772
2014	9,359
2015	7,974
2016	7,305
2017 – 2021	21,090
2022	1,079
Total	$ 74,752

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 University. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.31 and $3.12 per $100 of UCRP covered payroll resulting in Medical Center contributions of $20,400 and $18,200 for the years ended June 30, 2011 and 2010, 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, 2010, the date of the latest actuarial valuation, were $74.5 million and $15.5 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net Assets were $71.3 million at June 30, 2011. For the years ended June 30, 2011 and 2010, combined contributions from the University's campuses and medical centers were $314.7 million and $283.5 million, respectively, including an implicit subsidy of $54.9 million and $49.5 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.8 billion and $1.6 billion for the years ended June 30, 2011 and 2010. 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 $5.1 billion at June 30, 2011 increased by $1.4 billion for the years ended June 30, 2011 and 2010.

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 2010–2011 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 $23,392 and $11,324, respectively, during the year ended June 30, 2011. Medical Center and employee contributions were $5,372 and $1,618, respectively, during the year ended June 30, 2010.

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, 2010, the date of the latest actuarial valuation, were $33.7 billion and $39.1 billion, respectively, resulting in a funded ratio of 86.2 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $41.9 billion and $34.6 billion at June 30, 2011 and 2010, respectively.

For the years ended June 30, 2011 and 2010, the University's campuses and medical centers contributed a combined $1.4 billion and $64.8 million, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.7 billion for the year ended June 30, 2011. 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 $239.2 million for the year ended June 30, 2011.

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)

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 2010–2011 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 $9,318 and $9,732 for the years ended June 30, 2011 and 2010, respectively. During 2011 and 2010, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $7,679 and $6,374, 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 $6,820 and $7,288 for the years ended June 30, 2011 and 2010, 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:

	2011	2010
Salaries and employee benefits	$ 3,204	$ 4,530
Medical supplies	(5,749)	(4,570)
Other supplies and purchased services	332,345	333,790
Interest income (net)	(21,230)	(8,576)
Insurance	6,820	7,288
Total	$ 315,390	$ 332,462

(Dollars in thousands)

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 was $357,785 and $369,528 in 2011 and 2010, respectively. Of these amounts, $315,390 and $332,462 are reported as operating expenses for the years ended June 30, 2011 and 2010, respectively, and $42,395 and $37,066 are reported as health system support for the years ended June 30, 2011 and 2010, respectively.

13. Faculty Practices

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, 2011 and 2010 is as follows:

	Hospital Practice	UCSF Medical Group	Total
Year ended June 30, 2011			
Operating revenues	$ 1,520,385	$ 368,819	$ 1,889,204
Operating expenses	1,350,080	364,716	1,714,796
Net non-operating expenses	(32,559)	-	32,559
Income before other changes in net assets	$ 202,864	$ 4,103	$ 206,967
Year ended June 30, 2010			
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

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.

During 2011, a validation survey was conducted by the Center for Medicare and Medicaid Services (CMS). The Medical Center was cited for deficiencies and statement of deficiencies was issued by CMS in September 2011. A corrective plan was submitted to CMS in September 2011, and the Medical Center is awaiting a response from CMS.

The state of California authorized the University to use $600,000 in lease-revenue bond funds for earthquake safety renovations for the medical centers, of which $25,000 was allocated to the Medical Center. 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 $760,185, excluding interest, as of June 30, 2011.

Concurrent with execution of the land lease described in Note 7, The Regents on behalf of the Medical Center entered into a Disposition and Development Agreement with the Redevelopment Agency of the City and County of San Francisco (Agency) under which the Agency agreed to sell and convey an additional acre of land at Mission Bay to The Regents for $1,155 for affordable housing. The Regents on behalf of the Medical Center entered into a Disposition and Development Agreement with the Agency under which The Regents agreed 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 specifies that a default under the agreement allows the Agency to terminate the grant deed, keep the site, and to receive liquidated damages of an additional $2,400.