University of California, Davis Medical Center

Financial Statements

For the Years Ended June 30, 2012 and 2011

University of California, Davis Medical Center
Index
June 30, 2012 and 2011

Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net position and the related statements of revenues, expenses and changes in net position, and cash flows, as shown on pages 19 through 22, 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, 2012 and 2011, 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, 2012 and 2011, 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 accompanying management's discussion and analysis on pages 3 through 18 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 11, 2012

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, 2012, with selected comparative information for the years ended June 30, 2011 and 2010. 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 (2010, 2011, 2012, 2013, 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 and the Betty Irene Moore School of Nursing at UC Davis, established in 2009.

Licensed as a 619-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 144-acre campus in the City of Sacramento. Ambulatory care is provided at the hospital-based clinics and at the 15 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. It is also home to the region's only nationally ranked comprehensive children's hospital and National Cancer Institute designated comprehensive Cancer Center.

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 880 faculty and contract physicians and 750 residents and fellows.

For the year ended June 30, 2012, 31,450 patients were admitted to the Medical Center, of which approximately 57.4 percent were admitted through the emergency room, and overall occupancy was approximately 79.9 percent. During the same period, there were 949,669 outpatient visits, of which 90.4 percent were visits to the clinics and the PCN sites and 6.4 percent were emergency room visits.

Significant events during the year are highlighted below:

Continuing expansion and renewal to meet mission, community needs
Several different construction projects were completed in fiscal 2011/12 or were 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**: Located on the 10^{th} floor of the Davis Tower, the new Pediatric Intensive Care/Pediatric Cardiac Intensive Care unit opened in November 2011. The unit has twice as much floor space as previous space and increases the number of beds from 16 to 24.
- **Cancer Center expansion**: This 46,000-square-foot expansion makes room for the pediatric cancer program, formerly located in other buildings on campus. The adult hematology and oncology clinic, adult infusion pharmacy, and other clinical services also have been relocated into the new 46,000-square-foot wing that is connected to the existing cancer center building via a bridge above a common courtyard. Patients and staff are scheduled to be fully utilizing the new wing by the end of October 2012.
- **Primary Care Network Expansion:** A new 18,000 square-foot UC Davis Medical Group clinic in Rancho Cordova opened in May 2012, replacing an existing outpatient building in that community. A new Primary Care Network facility in Sacramento's Campus Commons area opened in September 2012 and planning for the expansion of medical offices in Folsom, Elk Grove and Sacramento is under way.
- **Second Floor ICU Renovation:** An existing 18-bed Intensive Care Unit in the University Tower, requiring extensive renovation and upgrade, is set to reopen in December 2012.
- **Parking Structure 3:** In July 2012, a new 1,100-car garage opened adjacent to the Medical Center to provide convenient parking for patients, visitors, faculty and staff.

Enhancement of national reputation
The Medical Center continues to enhance its standing as one of the leading academic health centers in the U.S.

- UC Davis Comprehensive Cancer Center earned National Cancer Institute (NCI) designation in March 2012. The center, part of the Medical Center, is one of only 41 cancer centers in the U.S. to have earned the NCI's "comprehensive" status, which signifies that the center meets stringent criteria in the areas of laboratory, clinical and population-based research, professional and public education, and in the dissemination of clinical and public advances to the communities it serves. The designation is reserved for less than 1 percent of cancer centers nationwide.
- The UC Davis Children's Hospital at the Medical Center received the Excellence in Life Support Award from the international Extracorporeal Life Support Organization for its Extracorporeal Life Support Program.
- Professional Research Consultants presented three Medical Center units with 5-Star Excellence in Healthcare awards for meeting or exceeding the 90th percentile in patient satisfaction scores. The Same Day Surgery Center received its third 5-Star award and the

Department of Emergency Medicine and the Home Health Program received their second 5-Star awards.

- For the second year in a row, the nation's largest lesbian, gay, bisexual and transgender civil rights organization, the Human Rights Campaign, has recognized the medical center as a Leader in Healthcare Equality for creating a safe, inclusive and welcoming environment for LGBT patients and employees.
- The Medical Center received a Kidney Transplant Excellence Award from HealthGrades, a program that rates clinical outcomes. The Medical Center was one of only eight programs, out of 221 nationally, recognized as a top facility for kidney transplantation and just one of two to receive the award three years in a row.
- The adult and pediatric trauma centers at UC Davis Medical Center have been reverified as Level I trauma centers by the American College of Surgeons . The achievement recognizes the Medical Center's dedication to providing optimal care for injured patients.
- The Medical Center was among the top 50 hospitals in America in the 2012 annual U.S. News and World Report ranking, placing 46th for cancer care. In U.S. News Best Hospitals metro-area rankings, the Medical Center was the top hospital in Sacramento for cardiology and heart surgery; diabetes and endocrinology; ear, nose and throat; gastroenterology; geriatrics; gynecology; nephrology; neurology and neurosurgery; orthopedics; pulmonology; and urology.
- U.S. News and World Report ranked UC Davis Children's Hospital among the nation's top in four pediatric specialties in 2012, ranking 30th in urology and 40th in orthopedics, 48th in diabetes/endocrinology and 46th in nephrology.

Recognition for advanced use of Information Technology

The Medical Center has been a leader in the deployment of modern clinical information technology, implementing an electronic health record system to supports all types of care provided: inpatient, emergency, ambulatory, home health, and telehealth encounters. The Medical Center's successful use of information technology to improve patient safety and quality of care continued to earn national recognition.

- The Medical Center is currently at Stage 6 in the Healthcare Information and Management Systems Society Analytics Electronic Medical Records Adoption model, a level that only 396 hospitals in the world have attained. The Medical Center is close to achieving Stage 7 – the highest possible level – and has a site visit scheduled in November 2012 to evaluate its readiness for Stage 7, a level that only 98 hospitals in the world have attained.
- In only the second year of the award, the Medical Center was named one of the 'Most Connected Hospitals' in America by *U.S. News and World Report*, only 156 of the more than 5,300 hospitals in nation qualified for this award.
- The Medical Center was named again in 2012 as a 'Most Wired' healthcare organization by *Hospitals & Health Networks* magazine. For the 2012 award, only about 200 hospitals in America and 16 California hospitals qualified.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2012, 2011 and 2010:

	2012	2011	2010
Licensed beds	619	645	613
Admissions	31,450	31,025	33,169
Average daily census	464	460	462
Discharges	31,615	31,184	33,111
Average length of stay	5.4	5.4	5.1
Patient days	169,453	167,738	168,735
Case mix index	1.72	1.70	1.67
Outpatient visits:			
Clinic visits	410,719	408,142	418,695
Primary care network	448,048	455,367	461,363
Home health and hospice	29,865	30,279	35,394
Emergency visits	61,037	58,023	54,938
Total outpatient visits	949,669	951,811	970,390

In 2012, admissions increased by 425 or 1.4 percent, as compared to 2011. The average length of stay remained at 5.4 days even though there was a slight increase in case mix index in 2012. The increase in admissions is related to an increase in emergency visits and general increases in patient volumes and transfers. Licensed beds decreased by 26 in 2012 due to a decrease of 50 acute care beds offset by an increase of 24 intensive care beds as a result of recent renovations.

Significant changes in payor mix include a 6.8 percent increase in patient days for Medicare, a 5.8 percent increase in patient days for contracted commercial payors, and a 16.0 percent decrease in patient days for Medi-Cal.

Total outpatient visits decreased by 0.2 percent due to a decrease in primary care network visits, offset by an increase in emergency room visits. Primary care network clinics that had the largest decreases included Carmichael, Folsom, OB/GYN and Sports Medicine. This was primarily due to physician turnover.

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the operating results for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Net patient service revenue	$1,319,423	$1,247,655	$1,098,565
Other operating revenue	17,806	12,342	13,649
Total operating revenue	1,337,229	1,259,997	1,112,214
Total operating expenses	1,292,420	1,170,279	1,040,479
Income from operations	44,809	89,718	71,735
Total net non-operating revenues (expenses)	(9,936)	27,911	(2,765)
Income before other changes in net position	$ 34,873	$ 117,629	$ 68,970
Margin	2.6%	9.3%	6.2%
Other changes in net position	$ 41,326	$ (23,497)	$ (10,900)
Increase in net position	76,199	94,132	58,070
Net position – beginning of year	946,147	852,015	793,945
Net position – end of year	$1,022,346	$ 946,147	$ 852,015

Overall the financial results of the Medical Center declined in 2012 as compared to 2011 and increased in 2011 from 2010, principally due to two factors:

- The Medical Center received $5.5 million, $53.2 million and $0 from the Hospital Fee Program, reported as operating and non-operating revenues, in 2012, 2011 and 2010, respectively. Additionally, the Medical Center received enhanced reimbursements related to provisions contained in the American Reinvestment and Recovery Act ("ARRA") for supplemental Medicaid payments to hospitals, which expired in June 2011.

- The Medical Center's contributions to the University's defined benefit pension plan increased to $36.5 million in 2012 from $18.9 million in 2011 and $4.1 million in 2010.

Revenues

Total operating revenue for the year ended June 30, 2012 were $1.34 billion, an increase of $77.2 million, or 6.1 percent, over 2011. Total operating revenue for the year ended June 30, 2011 was $1.26 billion, an increase of $147.8 million, or 13.3 percent, over 2010.

Net patient service revenue for 2012 increased by $71.8 million, or 5.8 percent, over 2011. 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. The revenue increase in 2012 was due to increased contracted commercial payor mix. Net patient service revenue for 2011 increased by $149.1 million, or 13.6 percent, over 2010. The increase in 2011 was primarily due to increases in contracted commercial 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 DSRIP.

Other operating revenue consisted primarily of Meaningful Use of Electronic Health Records act revenues and other non-patient services such as cafeteria revenues.

The following table summarizes net patient service revenue by payor for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Medicare (non-risk)	$ 275,101	$ 249,200	$ 240,193
Medicare (risk)	-	62	22,235
Medi-Cal (non-risk)	156,887	187,852	153,624
Medi-Cal (risk)	-	-	14,034
Contract (discounted or per diem)	758,632	668,136	526,825
Contract (capitated)	112,408	123,015	125,981
Commercial	599	1,673	2,005
County	10,443	12,739	11,240
Non-sponsored/self-pay	5,353	4,978	2,428
Total	$ 1,319,423	$ 1,247,655	$ 1,098,565

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. Net patient revenue for Medicare increased by $25.9 million, or 10.4 percent, over the prior fiscal year primarily due to an increase in admissions of 10.2 percent. In 2011, net patient revenue for Medicare increased by $9.0 million over 2010 primarily due to increased admissions of 5.7 percent offset by a decrease in case mix from 1.95 in 2010 to 1.94 in 2011.

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"). In 2012 net patient revenue for Medi-Cal decreased by $31.0 million, or 16.5 percent from 2011, due to a decline in Medi-Cal patient activity. Whereas in 2011 net patient revenue for Medi-Cal had increased by $34.2 million, or 22.3 percent from 2010, 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 2012, County net patient revenue decreased by $2.3 million, or 18.0 percent. In 2011, 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 were 437 days higher, or 15 percent in 2011, compared to 2010. 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 2012, net patient revenue for contracts increased by $90.5 million, or 13.5 percent. 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 and higher negotiated contract rates. Patient days in the category increased by 3,774 days, or 7 percent, over 2010.
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 2012, the net patient service revenue for contracts that are full-risk capitation decreased by $10.6 million, or 8.6 percent, primarily due to a shift from full risk to shared risk wherein only the professional fees are capitated. In 2011, the decrease was $3.0 million, or 2.5 percent, due primarily to higher contract rates offset by a 10.1 percent decline in enrollment.

The non-sponsored/self-pay net revenue increased by $.4 million, or 7.5 percent, in 2012, and increased by $2.6 million, or 105 percent, in 2011. 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 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Salaries and wages	$ 594,712	$ 538,809	$ 498,063
Employee benefits	189,315	149,563	121,352
Professional services	101,010	87,460	79,326
Medical supplies	192,902	182,762	170,393
Other supplies and purchased services	98,615	104,840	86,066
Depreciation and amortization	84,821	77,760	59,575
Insurance	9,875	9,323	8,258
Other	21,170	19,762	17,446
Total	$ 1,292,420	$ 1,170,279	$ 1,040,479

Total operating expenses increased by $122.1 million and $129.8 million, or 10.4 percent and 12.5 percent, in 2012 and 2011, 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 2012, salaries and wages grew by $55.9 million, or 10.4 percent, over the prior year. This increase includes $40.0 million, or 7.5 percent in salary increases and an increase of 200 full time equivalent employees, or 3.0 percent, from the prior year, primarily in nursing, facilities, and information technology services. 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 264 full time equivalent employees, or 4.0 percent from the prior year.

Amounts paid for nurse registry and other contract labor are included in professional services. Temporary labor costs for 2012 increased $3.6 million, or 39.3 percent, over 2011 due to an increase in information technology contract staffing. Temporary labor costs for 2011 increased $2.5 million, or 46.3 percent, over 2010 due to increased utilization of information technology contract staffing.

In 2012, employee benefit costs increased by $39.8 million, or 26.6 percent, over 2011. Pension contributions were $39.7 million in 2012 as compared to $18.9 million in 2011 and $4.1 million in 2010. The Medical Center's health insurance and other employee benefit costs increased in 2012 as compared to 2011 by $18.9 million, or 14.5 percent, due to an increase in insurance premiums of $8.0 million, and increases in other benefit costs of $10.9 million. 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.

As a percentage of total operating revenue, salaries and employee benefits were 58.6 percent in 2012, 54.6 percent in 2011 and 55.7 percent in 2010. Overall labor costs increased as a percent of operating revenues due to a $20.8 million, or 110.3 percent, increase in pension contributions.

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 2012, professional services increased by $13.5 million, or 15.5 percent, over 2011 due to a combination of increased SOM support payments, organ acquisition fees for the kidney transplant program and temporary employment. The Medical Center purchased professional services from the UC Davis School of Medicine for the sum of $54.4 million in 2012, and $50.5 million in 2011.

Medical supply expense for 2012, including pharmaceuticals, increased by $10.1 million, or 5.6 percent, over 2011. Medical supply expense for 2011, including pharmaceuticals, increased by $12.4 million, or 7.3 percent, over 2010. The most significant increases occurred in the cost of pharmaceuticals, implants and surgical supplies. Supply costs as a percentage of net patient service revenue remained constant at 14.6 percent from 2011 to 2012.

Other supplies and purchased services include non-medical supplies and general purchased services. Other supplies and purchased services decreased by $6.2 million, or 5.9 percent, over

2011 due to decreases in consulting and utilities expense of $2.5 million and $0.7 million respectively, and reimbursements for shared clinic costs increased by $6.0 million, offsetting expense increases in telecommunications costs and non-medical supplies. Other supplies and purchased services increased by $18.8 million, or 21.8 percent, in 2011 over 2010.

In 2012, depreciation and amortization expense increased by $7.1 million, or 9.1 percent, as compared to the prior year. In 2011, depreciation and amortization expense increased by $18.2 million, or 30.5 percent, as compared to the prior year resulting from the completion of the hospital expansion.

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 $9.9 million was paid in 2012, $9.3 million in 2011, and $8.3 million in 2010, 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 $2.3 million, $4.9 million, and $6.2 million in 2012, 2011, and 2010, respectively.

Other expenses increased in both 2012 and 2011 by $1.4 million and $2.3 million, or 7.1 percent and 13.2 percent, respectively.

Income from Operations
The Medical Center reported income from operations of $44.8 million and operating revenue of $1.3 billion. Income from operations decreased in the current year to $44.8 million from $89.7 million in the prior year.

Non-operating Revenues (Expenses)
Non-operating revenues (expenses) include interest income and expenses, the gain or loss on disposal of capital assets and hospital fee program funds. In 2012, total non-operating expenses were $9.9 million compared to $27.9 million in non-operating revenues in 2011. The change was primarily due to hospital fee program funds received of $2.5 million in 2012 and $36.3 million in 2011. Total non-operating expenses were at $2.8 million for 2010 consisting of interest expense offset by interest income and joint venture income.

Income before Other Changes in Net Position
The Medical Center's income before other changes in net position was $34.9 million in 2012 compared to $117.6 million and $69.0 million in 2011 and 2010, a decrease of $82.7 million, or 70.3 percent, and an increase of $48.6 million, or 70.4 percent, respectively. The resulting margin for 2012 was 2.6 percent as compared to 9.3 percent and 6.2 percent in 2011 and 2010, respectively.

Other Changes in Net Position

The other changes in net position for 2012, 2011 and 2010 include:

	2012	2011	2010
Contributions from University for building program	$ 37,005	$ 13,603	$ 16,289
Health system support	(1,077)	(41,066)	(29,719)
Transfers from university, net	5,398	3,966	2,530
Total other changes in net position	$ 41,326	$ (23,497)	$ (10,900)

The lower section of the statements of revenues, expenses and changes in net position shows the other changes to net position in addition to the income or loss. Net position is the difference between the total assets and total liabilities. The other changes in net position 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 position for 2012 and 2011 are the following:

- "Contributions from the University" for the building program of $37.0 million are related primarily to the new Parking Structure 3 project and the Surgery and Emergency Pavilion project. In 2011, the contributions for the building program were $13.6 million and were related to the Parking Structure 3 project.

- The Medical Center transferred $31.6 million and $41.1 million respectively in 2012 and 2011 to support academic, research and administrative services of the health system. In 2012, $30.5 million was returned from prior years due to the deferral of capital expenditures.

- Transfers from the University totaled $5.4 million and $4.0 million for 2012 and 2011, respectively.

In total, the Medical Center's net position increased for the year ended June 30, 2012 and 2011 by $76.2 million and $94.1 million, respectively.

Statements of Net Position

The following table is an abbreviated statement of net position at June 30, 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Current assets:			
Cash	$ 158,203	$ 105,584	$ 91,819
Patient accounts receivable (net)	195,299	183,863	171,777
Other current assets	68,565	78,011	80,732
Total current assets	422,067	367,458	344,328
Capital assets (net)	1,122,623	1,111,322	1,073,344
Other assets	26,162	27,077	23,507
Total assets	1,570,852	1,505,857	1,441,179
Current liabilities	192,730	193,782	203,714
Long-term debt	355,776	365,928	385,450
Total liabilities	548,506	559,710	589,164
Net position:			
Invested in capital assets (net)	727,648	693,467	645,225
Restricted	-	-	108
Unrestricted	294,698	252,680	206,682
Total net position	$ 1,022,346	$ 946,147	$ 852,015

Total current assets increased in 2012 by $54.6 million, or 14.9 percent, and increased in 2011 by $23.1 million, or 6.7 percent.

Cash increased in 2012 by $52.6 million or 49.8 percent primarily due to $37.0 million from equity transfers for the building program and $36.0 in new financing obligations. In 2011, cash increased by $13.8 million, or 15.0 percent.

Net patient accounts receivable, net of estimated uncollectible accounts, increased by $11.4 million, or 6.2 percent, in 2012 due to increased contracted payor rates and delayed payments from Medi-Cal. In 2011, net patient accounts receivable increased by $12.1 million, or 7.0 percent, due to an increase in Contract payor activity.

In 2012, other current assets, including non-patient receivables, inventory and prepaid expenses, decreased by $9.4 million, or 12.1 percent, over the prior fiscal year primarily due to payments from the state related to Medi-Cal programs. In 2011, other current assets decreased by $2.7 million, or 3.4 percent, over 2010 primarily due to those same payments from the state related to Medi-Cal programs.

Net capital assets increased by $11.3 million, or 1.0 percent, from 2011 to 2012 and $38.0 million, or 3.5 percent, from 2010 to 2011 primarily due to construction for the Cancer Center expansion, a new parking structure and purchased equipment.

Other non-current assets decreased by $0.9 million in 2012 from 2011 due to income earned on joint venture investments offset by a $4.9 million equity distribution. In 2011, other non-current assets increased by $3.6 from 2010 due to income earned on joint venture investments.

Current liabilities decreased by $1.1 million, or 0.5 percent, from 2011 to 2012 primarily due to plant payables. Current liabilities decreased by $9.9 million, or 4.9 percent, from 2010 to 2011 primarily due to decreases in third-party payor settlements.

Long-term debt decreased by $10.2 million, or 2.8 percent, from 2011 to 2012 and $19.5 million, or 5.1 percent, from 2010 to 2011. The decreases are primarily due to debt service payments.

The net position invested in capital assets increased by $34.2 million and $48.2 million, or 4.9 percent and 7.5 percent, in 2012 and 2011, respectively. The increases are primarily due to increases in capital assets, net and decreases to long-term debt as payments are made.

The Medical Center's unrestricted net position changed primarily as a result of the changes above and the changes in net position in 2012 and 2011.

Liquidity and Capital Resources

The Medical Center generated $141.7 million and $138.8 million from operating activities in 2012 and 2011, respectively.

Cash flows from non-capital financing activities show the Medical Center's cash was increased by $4.5 million in 2012 and decreased by $0.8 million in 2011. In 2012, $31.6 million was transferred to the University for health system support and was offset by $30.5 million of returned support from prior years due to the deferral of capital expenditures. In 2011, transfers were made to the University for health system support, offset by grants received for the hospital fee program in 2011.

In 2012, cash flows from capital and related financing activities included the contributions from the University for funding the building program of $37.0 million, proceeds from financing loans of $36.0 million, purchases of capital assets of $109.8 million, principal payments on long-term debt and financing obligations of $46.3 million, and interest paid of $18.2 million. 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 financing obligations of $33.7 million, and interest paid of $19.0 million.

In 2012, cash flows from investing activities include interest income of $2.6 million and distributions from joint ventures of $5.1 million. In 2011 the Medical Center received $2.2 million from interest income and $0.3 million from distributions from joint ventures. Overall cash increased to $158.2 million in 2012 from $105.6 million in 2011.

The following table shows key liquidity and capital ratios for 2012, 2011 and 2010:

	2012	2011	2010
Days cash on hand	48	35	34
Days of revenue in accounts receivable	54	54	57
Purchases of capital assets	$ 109.8	$ 106.1	$ 112.0
Debt service coverage ratio	2.5	4.1	3.0

Days cash on hand increased to 48 days in 2012 from 35 days in 2011, for a 37 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 2012, days in accounts receivable remained at 54 days from 2011.

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 2012, 2011, and 2010 are 2.5, 4.1, and 3.0, respectively. The decrease of 1.6 in debt service coverage in 2012 is due to decreased net income and increased debt service. The ratio is higher than the 1.0 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2012, 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 $335.8 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 2012 and 2011, $5.7 million and $21.1 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, 2012, the Medical Center received $7.6 million in 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, 2012, the Medical Center has received $15.3 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, 2012, 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, 2011 actuarial valuation was $7.7 billion or 82.1 percent funded. As of July 1, 2012, the funded ratio is expected to decrease to approximately 78 percent. The total funding policy contributions in the July 1, 2011 actuarial valuations represent 26.35 percent of covered compensation. Member and employer contributions increased to 5 percent and 10 percent, respectively, of covered compensation in July 2012. The Regents approved increasing employee member and employer contributions to 6.5 percent and 12 percent, respectively, in July 2013. These contribution rates are below UCRP's total funding 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 cash outs, 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, 2011 actuarial valuation was $14.7 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 Position
June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Assets		
Current assets		
Cash	$ 158,203	$ 105,584
Patient accounts receivable, net of estimated uncollectibles of $47,403 and $41,864, respectively	195,299	183,863
Other receivables	6,956	4,440
Third-party payor settlements, net	25,445	46,814
Inventory	18,711	15,613
Prepaid expenses and other assets	17,453	11,144
Total current assets	422,067	367,458
Capital assets, net	1,122,623	1,111,322
Investments in joint ventures	23,806	24,593
Deferred costs of issuance	2,356	2,484
Total assets	1,570,852	1,505,857
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	29,246	39,843
Accrued salaries and benefits	88,409	85,053
Third-party payor settlements, net	30,022	24,682
Current portion of long-term debt and financing obligations	35,660	34,191
Other liabilities	9,393	10,013
Total current liabilities	192,730	193,782
Long-term debt and financing obligations, net of current portion	355,776	365,928
Total liabilities	548,506	559,710
Net Position		
Invested in capital assets, net of related debt	727,648	693,467
Unrestricted	294,698	252,680
Total net position	$1,022,346	$ 946,147

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 Position
For the Years Ended June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Net patient service revenue, net of provision for doubtful accounts of $82,569 and $78,723, respectively	$ 1,319,423	$ 1,247,655
Other operating revenue:		
Clinical teaching support	-	3,299
Other	17,806	9,043
Total other operating revenue	17,806	12,342
Total operating revenue	1,337,229	1,259,997
Operating expenses:		
Salaries and wages	594,712	538,809
UCRP, retiree health and other employee benefits	189,315	149,563
Medical supplies	192,902	182,762
Professional services	101,010	87,460
Other supplies and purchased services	98,615	104,840
Depreciation and amortization	84,821	77,760
Insurance	9,875	9,323
Other	21,170	19,762
Total operating expenses	1,292,420	1,170,279
Income from operations	44,809	89,718
Non-operating revenues (expenses):		
Hospital fee program grants	2,483	36,336
Interest income	2,623	2,185
Interest expense	(18,996)	(15,832)
Loss on disposal of capital assets	(220)	(40)
Other	4,174	5,262
Total net non-operating revenues (expenses)	(9,936)	27,911
Income before other changes in net position	34,873	117,629
Other changes in net position:		
Contributions from University for building program	37,005	13,603
Health system support	(1,077)	(41,066)
Transfers from University, net	5,398	3,966
Total other changes in net position	41,326	(23,497)
Increase in net position	76,199	94,132
Net position – beginning of year	946,147	852,015
Net position – end of year	$ 1,022,346	$ 946,147

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,334,696	$ 1,212,154
Payments to employees	(595,970)	(532,298)
Payments to suppliers	(420,047)	(409,685)
Payments for benefits	(189,034)	(149,563)
Other receipts, net	12,076	18,147
Net cash provided by operating activities	141,721	138,755
Cash flows from noncapital financing activities:		
Health system support	(1,077)	(41,066)
Grants from the hospital fee program	155	36,336
Transfers from University	5,398	3,966
Net cash used by noncapital financing activities	4,476	(764)
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	37,005	13,603
Proceeds from financing obligations	36,043	17,278
Proceeds from sale of capital assets	20	81
Purchases of capital assets	(109,765)	(106,135)
Principal paid on long-term debt and financing obligations	(46,276)	(33,695)
Interest paid on long-term debt and financing obligations	(18,189)	(18,964)
Net cash used by capital and related financing activities	(101,162)	(127,832)
Cash flows from investing activities:		
Interest income received	2,623	2,185
Distributions from investments in joint ventures, net	5,110	250
Change in restricted assets		108
Non-operating revenues (expenses)	(149)	1,063
Net cash provided by investing activities	7,584	3,606
Net increase in cash	52,619	13,765
Cash – beginning of year	105,584	91,819
Cash – end of year	$ 158,203	$ 105,584

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 44,809	$ 89,719
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	84,821	77,760
Provision for doubtful accounts	82,569	78,723
Changes in operating assets and liabilities:		
Patient accounts receivable	(94,005)	(90,809)
Other receivables	(188)	(28,541)
Inventory	(3,098)	(1,425)
Prepaid expenses and other assets	(6,309)	(700)
Accounts payable and accrued expenses	3,600	-
Accrued salaries and benefits	3,356	10,859
Third-party payor settlements	26,709	6,582
Other liabilities	(543)	(3,413)
Net cash provided by operating activities	$ 141,721	$ 138,755
Supplemental noncash activities information:		
Payables for property and equipment	$ 3,539	$ 17,736
Amortization of deferred financing costs	2,411	2,524
Bond retirements		941
Amortization of bond premium	862	913
Property and equipment transfers from the University	(10)	179
Amortization of deferred costs of issuance	128	139

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 619 licensed beds, hospital-based clinics located on the Sacramento campus, and fifteen 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.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Re-sources, 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. Implementation of Statement No. 63 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the Medical Center's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for the termination of hedge accounting. Implementation of Statement No. 64 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011.

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, 2012 and 2011 was $158,203 and $105,584, 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 position.

Additional information on cash and investments can be obtained from the 2011–2012 annual report of the University.

Inventory

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

Prepaid Expenses and Other Assets

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

Capital Assets

The Medical Center's capital assets are reported at cost. Depreciation is recorded on a straight-line basis over the estimated useful lives of the assets. 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 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 position. These costs are being amortized as interest expense over the remaining life of the defeased or refinanced bonds, whichever is shorter.

Net Position

Net position is 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 the net position resulting from transactions with purpose restrictions as restricted net position until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.

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

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

Expenses are charged to either restricted or unrestricted net position based upon a variety of factors, including consideration of prior and future revenue sources, the type of expense incurred, the Medical Center's budgetary policies surrounding the various revenue sources or whether the expense is a recurring cost.

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.

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 position.

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 position.

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 position.

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 position.

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 position 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.

Comparative Information

In connection with the preparation of the June 30, 2012 financial statements, the Medical Center determined that certain third-party payor settlements receivables were being reported separately from the related liabilities with the same counterparty. Management has revised current assets and current liabilities to present on a net basis decreasing both by $33.5 million. This revision had no effect on the net position of the Medical Center, statement of revenues, expenses and changes in net position and cash used by the Medical Center.

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, 2012. 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 March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Medical Center is evaluating the effect that Statement No. 65 will have on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement resolves conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Medical Center is evaluating the effect that Statement No. 66 will have on its financial statements.

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for the University's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the University to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This statement requires that most changes in the net pension liability be included in pension expense in the period of the change. As of June 30, 2012, the University reported an obligation to UCRP of $1.9 billion, representing unfunded contributions to UCRP based upon the University's funding policy. Under GASB No. 68, The University's obligation to UCRP is expected to increase. The Medical Center is evaluating the effect that Statement No. 68 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 is as 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 position 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, 2012 and 2011, the Medical Center recorded total Medi-Cal revenue of $156,887 and $187,852, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 in September 2010, SB 90 in April 2011, and SB 335 in September 2011, 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, 2013 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 years ended June 30, 2012 and 2011, the Medical Center received $3,061 and $16,850 respectively, which has been reported as net patient service revenue. For the years ended June 30, 2012 and 2011, the Medical Center received $2,483 and $36,336 respectively, 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, 2012 and 2011, the Medical Center recorded revenue of $12,886 and $14,556, 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, 2012 and 2011, the Medical Center applied for and received additional revenue of $8,240 and $8,178, 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 16.7 percent and 13.8 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively. Amounts due from Medi-Cal represent 6.3 percent and 9.1 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, net patient service revenue included $19.0 million and $0.9 million, respectively, due to cost report settlements and changes in estimates related to prior year settlements with Medicare, Medi-Cal, and Champus.

(Dollars in thousands)

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

	2012	2011
Contract (discounted or per diem)	$ 758,632	$ 668,136
Medicare (non-risk)	275,101	249,200
Medi-Cal (non-risk)	156,887	187,852
Contract (capitated)	112,408	123,015
Medicare (risk)	-	62
County	10,443	12,739
Non-sponsored/self-pay	5,353	4,978
Commercial	599	1,673
Total	$ 1,319,423	$ 1,247,655

4. Charity Care

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

	2012	2011
Charity care at established rates	$ 253,708	$ 232,742
Estimated cost of charity care	52,094	49,233

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $137,053 and $101,147 for the years ended June 30, 2012 and 2011, respectively.

(Dollars in thousands)

5. Capital Assets

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

	2011	Additions	Disposals	2012
Original Cost				
Land	$ 36,675	$ -	$ -	$ 36,675
Buildings and improvements	1,226,489	50,608	(263)	1,276,834
Equipment	394,903	46,683	(31,832)	409,754
Construction in progress	58,368	(919)		57,449
Capital assets, at cost	$1,716,435	$ 96,372	$ (32,095)	$1,780,712

	2011	Depreciation	Disposals	2012
Accumulated Depreciation				
Buildings and improvements	$ 362,855	$ 39,090	$ (197)	$ 401,748
Equipment	242,258	45,731	(31,648)	256,341
Accumulated depreciation	605,113	$ 84,821	$ (31,845)	658,089
Capital assets, net	$1,111,322			$1,122,623

	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	2010
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

Equipment under financing obligations and related accumulated amortization is $103.5 million and $42.2 million in 2012, respectively, and $97.5 million and $41.4 million in 2011, 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)

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 2012 and 2011, $5,693, and $21,115, respectively were spent on these requirements.

6. Long-term Debt and Financing Obligations

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

	2012	2011
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	$ 266,530	$ 281,205
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	63,344	64,059
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	10,089	10,777
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.4 percent to 4.0 percent, payable through 2015	64,011	58,165
	403,974	414,206
Unamortized bond premium	7,276	8,137
Unamortized deferred financing costs	(19,814)	(22,224)
Total debt and financing obligations	391,436	400,119
Less: Amounts due within one year	(35,660)	(34,191)
Noncurrent portion of debt and financing obligations	$ 355,776	$ 365,928

Total interest expense during the years ended June 30, 2012 and 2011 was $19,790 and $21,026 respectively. Interest expense totaling $794 and $5,194 was capitalized during the years ended June 30, 2012 and 2011, respectively. The remaining $18,996 in 2012 and $15,832 in 2011 are reported as interest expense in the statements of revenues, expenses and changes in net position.

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 position. 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	Financing Obligations	Total
Year ended June 30, 2012			
Long-term debt and financing obligations at June 30, 2011	$ 341,954	$ 58,165	$ 400,119
New obligations	-	36,043	36,043
Principal payments	(16,078)	(30,198)	(46,276)
Amortization of bond premium	(862)		(862)
Amortization of deferred financing costs	2,412		2,412
Long-term debt and financing obligations at June 30, 2012	327,426	64,010	391,436
Less: Current portion of long-term debt and financing obligations	(14,770)	(20,890)	(35,660)
Noncurrent portion of long-term debt and financing obligations as June 30, 2012	$ 312,656	$ 43,120	$ 355,776
Year ended June 30, 2011			
Long-term debt and financing obligations 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 financing obligations at June 30, 2011	341,954	58,165	400,119
Less: Current portion of long-term debt and financing obligations	(14,528)	(19,663)	(34,191)
Noncurrent portion of long-term debt and financing obligations as June 30, 2011	$ 327,426	$ 38,502	$ 365,928

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, 2012 are $2.2 billion of which $329,874 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, 2012 and 2011 were $6.9 billion and $6.5 billion, respectively.

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

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

The University has an internal working capital program which allows the Medical Center to receive internal advances 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, 2012 and thereafter are as follows:

Year Ending June 30	Revenue Bonds	Financing Obligations	Total Payments	Principal	Interest
2013	$ 32,764	$ 21,912	$ 54,676	$ 37,139	$ 17,537
2014	32,452	16,553	49,005	32,686	16,318
2015	32,110	13,131	45,241	29,974	15,266
2016	31,765	9,277	41,042	26,745	14,297
2017	31,414	5,288	36,702	23,345	13,357
2018 – 2022	151,197		151,197	98,575	52,623
2023 – 2027	135,291		135,291	108,266	27,024
2028 – 2032	18,328		18,328	8,370	9,958
2033 – 2037	18,321		18,321	10,475	7,846
2038 – 2042	18,326		18,326	13,060	5,266
2043 – 2047	17,388		17,388	15,339	2,051
2048 – 2049			-		
Total future debt service	519,356	66,161	585,517	$ 403,974	$ 181,543
Less: Interest component of future payments	(179,393)	(2,150)	(181,543)		
Principal portion of future payments	339,963	64,011	403,974		
Adjusted by:					
Unamortized bond premium	7,276		7,276		
Unamortized deferred financing costs	(19,814)		(19,814)		
Total debt	$ 327,425	$ 64,011	$ 391,436		

Additional information on the revenue bonds can be obtained from the 2011–2012 annual report of the University.

7. Operating Leases

The Medical Center leases certain buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2012 and 2011 was $14,510 and $13,307, respectively. The terms of the operating leases extend through the year 2034.

(Dollars in thousands)

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
2013	$ 11,959
2014	9,665
2015	6,818
2016	4,023
2017	2,603
2018 – 2034	11,847
Total	$ 46,915

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 $3.51 and $3.31 per $100 of UCRP covered payroll resulting in Medical Center contributions of $18,217 and $15,644 for the years ended June 30, 2012 and 2011, 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, 2011, the date of the latest actuarial valuation, were $77.7 million and $14.7 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net Position were $89.5 million at June 30, 2012. For the years ended June 30, 2012 and 2011, combined contributions from the University's campuses and medical centers were $346.4 million and $313.9 million, respectively, including an implicit subsidy of $54.1 million and $54.9 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.5 billion and $1.8 billion for the years ended June 30, 2012 and 2011. 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 $6.3 billion at June 30, 2012 increased by $1.2 billion for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California.

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 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 $36,481 and $18,165, respectively, during the year ended June 30, 2012. Medical Center and employee contributions were $18,900 and $7,664, respectively, during the year ended June 30, 2011.

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, 2011, the date of the latest actuarial valuation, were $35.3 billion and $43.0 billion, respectively, resulting in a funded ratio of 82.1 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net Position were $41.8 billion and $41.9 billion at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, the University's campuses and medical centers contributed a combined $1.5 billion and $1.4 billion, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was

$1.9 billion for the year ended June 30, 2012. 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 $361.8 million for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California Retirement System.

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 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 position, were $2,747 and $(285) for the years ended June 30, 2012 and 2011, respectively. During 2012 and 2011, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $2,319 and $4,916, 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 position, were $9,875 and $9,323 for the years ended June 30, 2012 and 2011, respectively.

(Dollars in thousands)

11. 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 position for the years ended June 30 as follows:

	2012	2011
Professional services	$ 54,393	$ 50,514
Insurance	9,875	9,323
Salaries and employee benefits	2,768	-
Interest income (net)	(16,373)	(13,647)
Other supplies and purchased services	2,103	1,305
Total	$ 52,766	$ 47,495

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 position. 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 $53,843 and $88,561 in 2012 and 2011, respectively. Of these amounts, $52,766 and $47,495 are reported as operating expenses for the years ended June 30, 2012 and 2011, respectively, and $1,077 and $41,066 are reported as health system support for the years ended June 30, 2012 and 2011, 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 $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 $9,262, excluding interest, as of June 30, 2012.

University of California, Irvine Medical Center

Financial Statements
For the Years Ended June 30, 2012 and 2011

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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 position and the related statements of revenues, expenses and changes in net position, and cash flows, as shown on pages 16 through 19 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, 2012 and 2011, 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, 2012 and 2011, 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 accompanying management's discussion and analysis on pages 3 through 15 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 11, 2012

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, 2012, with selected comparative information for the years ended June 30, 2011 and 2010. 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 (2010, 2011, 2012, 2013, etc.) in this discussion refer to the fiscal years ended June 30.

Overview

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

The Medical Center is licensed to provide acute care hospital services in Orange, California, and is licensed to operate 412 beds in year 2012. 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 and phase II construction of the new UC Irvine Douglas Hospital were completed and opened for patient care. 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.

Significant events during the year are highlighted below:

- *National recognition*
  The Medical Center was listed among the best hospitals in the United States by *U.S. News & World Report* for the 12th consecutive year. Since 2001, the magazine has bestowed national recognition on its programs in urology, geriatrics, gynecology, cancer, digestive disorders, kidney disorders, and ear, nose and throat.

- *QUEST (Quality, Excellence and Safety through Technology)*
  QUEST is a multi-year project began in 2009 that will integrate nearly all of UC Irvine Healthcare's clinical information systems. It will help the Medical Center and its clinics

move towards an electronic medical record (EMR) system. In 2012, the project successfully executed on its strategy plan to add the Enterprise registration and scheduling, physician order Entry, integrated pharmacy, eMar, Decisions Support, bed management, and clinical and research data warehouse capabilities. These activities position the Medical Center for complete ACO and PCMH models that are being driven by Health Reform. Participating in the OC RHIO (Regional Health Information Exchange (HIE)) pilot and building our own private HIE allow primary care physicians to connect to our model enables the EMR work outside our environment.

- *Major hospital projects*
  Phase II of the New University Replacement Hospital (Douglas Hospital) was completed in 2012. Other phase II projects are currently underway. The remodeling of the Chao Cancer Center is scheduled to be completed in early 2013. This $16 million project remodels over 15,000 square footage to consolidate, expand and improve patient treatment. The project includes new portico, waiting and reception area, hematology clinic, 31 chemotherapy infusion stations and upgrades the mechanical systems of the building. The Labor and Delivery remodel in the University Hospital Tower has started and is scheduled for completion at the end of 2012. The Regents approved the Chao Digestive Disease Center expansion project that is scheduled to start construction in early 2013.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2012, 2011 and 2010:

	2012	2011	2010
Licensed beds	412	417	412
Admissions	17,787	16,365	16,327
Average daily census	294	281	283
Discharges	17,900	16,424	16,389
Average length of stay	6.0	6.2	6.3
Patient days	107,732	102,400	103,465
Case mix index	1.63	1.59	1.57
Outpatient visits:			
Clinic vists	479,856	474,448	476,372
Emergency visits	39,289	35,622	34,788
Total visits	519,145	510,070	511,160

In 2012, total discharges increased by 9.0 percent, while patient days increased by 5.2 percent due to increase in medicine and obstetrics days. Total ambulatory visits increased slightly by 1.1 percent and emergency visits increased by 10.3 percent, over the prior year.

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.

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the operating results for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Net patient service revenue	$ 709,486	$ 675,211	$ 589,631
Other operating revenue	25,083	23,926	24,011
Total operating revenue	734,569	699,137	613,642
Total operating expenses	676,911	620,864	577,542
Income from operations	57,658	78,273	36,100
Total net non-operating revenues (expenses)	(10,513)	6,881	(2,470)
Income before other changes in net position	$ 47,145	$ 85,154	$ 33,630
Margin	6.4%	12.2%	5.5%
Other changes in net assets	$ (61,921)	$ (47,125)	$ (82,418)
Increase (decrease) in net position	(14,776)	38,029	(48,788)
Net position – beginning of year	620,189	582,160	630,948
Net position – end of year	$ 605,413	$ 620,189	$ 582,160

Overall the financial results of the Medical Center declined in 2012 as compared to 2011 and increased in 2011 from 2010, principally due to two factors:

- The Medical Center received $3.6 million, $41.4 million and $0 from the Hospital Fee Program, reported as operating and non-operating revenues, in 2012, 2011 and 2010, respectively. Additionally, the Medical Center received enhanced reimbursements related to provisions contained in the American Reinvestment and Recovery Act ("ARRA") for supplemental Medicaid payments to hospitals, which expired in June 2011.

- The Medical Center's contributions to the University's defined benefit pension plan increased to $19.6 million in 2012 from $9.3 million in 2011 and $2.0 million in 2010.

Revenues

Total operating revenues for the year ended June 30, 2012 were $734.6 million, an increase of $35.4 million, or 5.1 percent, over 2011. Operating revenues for 2011 were $699.1 million, an increase of $85.5 million, or 13.9 percent, over 2010.

For the years ended June 30, 2012, 2011 and 2010, 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 2012 increased by $34.3 million, or 5.1 percent, over the prior year due to volume increases and improved contract rates. 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. 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 2012, other operating revenue increased by $1.2 million, or 4.8 percent, over 2011 due primarily to increase in non-patient revenues. In 2011, other operating revenue decreased slightly by $0.1 million, or 0.4 percent, over 2010 due primarily to decrease in non-patient revenues.

The following table summarizes net patient service revenue for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Contracts (discounted/per diem)	$ 353,883	$ 315,886	$ 263,234
Medicare (non-risk)	156,520	146,485	152,524
Medi-Cal (non-risk)	165,639	179,148	141,540
County	20,476	21,779	22,346
Commercial	7,640	6,908	5,052
Non-sponsored (uninsured)	5,328	5,005	4,935
Total	$ 709,486	$ 675,211	$ 589,631

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments from Medicare for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Managed Medicare payments are paid on a per-diem or per-discharge basis. Net revenue for Medicare patients, including managed care patients, increased by $10.0 million, or 6.9 percent, from 2011 due primarily to increase in patient days. 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.

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 2012, net Medi-Cal revenue decreased by $13.5 million, or 7.5 percent, over 2011 due primarily to decrease in supplemental funding. In 2011, net Medi-Cal revenue increased by $37.6 million, or 26.6 percent, over 2010. For the year ended June 30, 2012, the Medical Center recorded revenue of $106.0 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 $118.7 million for year 2011.

Net revenue for contracts increased $38.0 million, or 12.0 percent, from 2011 due to the Medical Center's continued efforts in contract negotiations and improved pricing strategies. In 2011, net revenue for contracts grew by $52.7 million, or 20.0 percent, from 2010.

Commercial net patient revenue increased by $0.7 million, or 10.6 percent, compared to 2011. The change in revenue is the result of improved reimbursement rates. In 2011, commercial net patient revenue increased by $1.9 million, or 36.7 percent, compared to 2010.

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 $1.3 million, or 6.0 percent, in 2012 and decreased by $0.6 million, or 2.5 percent, in 2011. This category fluctuates from year to year depending on the patient volume and type of patients. The uninsured net revenue increased slightly by $0.3 million, or 6.5 percent, in 2012 and by $0.1 million, or 1.4 percent, in 2011.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Salaries and wages	$ 297,077	$ 270,018	$ 256,865
Employee benefits	100,998	83,052	68,608
Professional services	3,386	2,252	2,195
Medical supplies	95,012	88,522	81,498
Other supplies and purchased services	127,583	119,256	122,275
Depreciation and amortization	48,414	52,850	43,565
Insurance	4,441	4,914	2,536
Total	$ 676,911	$ 620,864	$ 577,542

During 2012, total operating expenses of $676.9 million increased by $56.0 million, or 9.0 percent, over the prior year. The change was due primarily from increases in salaries, benefits, medical and non-medical supplies, and purchased services. 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.

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 2012, salaries and wages grew by $27.1 million, or 10.0 percent, over the prior year. This increase includes $7.8 million, or 2.9 percent in salary increases and an increase of 272 full time equivalent employees, or 6.9 percent from the prior year. 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.

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2012 decreased $0.2 million, or 20.1 percent, over 2011. Temporary labor costs for 2011 decreased $0.2 million, or 12.3 percent, over 2010.

In 2012, employee benefit costs increased by $17.9 million, or 21.6 percent, over 2011. Pension contributions were $19.4 million in 2012 as compared to $9.4 million in 2011 and $2.2 million in 2010. The Medical Center's health insurance and other employee benefit costs increased in 2012 as compared to 2011 by $8.0 million, or 10.8 percent, due to an increase in insurance premiums of $5.5 million and increases in other benefit costs of $2.5 million. 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.

As a percentage of total operating revenue, salaries and employee benefits were 54.1 percent in 2012, 50.5 percent in 2011 and 53.0 percent in 2010. 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 by $1.1 million, or 50.4 percent, over 2011 due to increase in contracted medical director expenses. In 2011, payments for professional services increased slightly by $0.1 million, or 2.6 percent, over 2010 due to increase in contracted medical director expenses.

Medical supply expense for 2012 increased by $6.5 million, or 7.3 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 increased by $7.0 million, or 8.6 percent, in 2011 due to similar reasons.

Other supplies and purchased services expenses include nursing registry, residents, and the cost of medical and non-medical purchased services. These expenses increased by $8.3 million, or 7.0 percent, over 2011 due primarily to $0.2 million increase in registry, $0.7 million increase in residents recharge, $1.3 million increase in non-medical supplies, $4.7 million increase in purchased services, and $1.4 million increase in facility costs. In 2011, other supplies and purchased services 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.

Depreciation and amortization expense decreased by $4.4 million, or 8.4 percent in 2012. The decrease in depreciation is related to high-value equipment that was fully depreciated in the prior year. Depreciation and amortization expense increased by $9.3 million, or 21.3 percent, in 2011 as compared to 2010. The increase is primarily due to depreciation of the new Clinical Lab Building and related equipment.

Insurance expense of $4.4 million in 2012 and $4.9 million in 2011 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense decreased by $0.5 million, or 9.6 percent, in 2012 and increased by $2.4 million, or 93.8 percent, in 2011. Malpractice expenses fluctuated based upon claims experienced.

Income from Operations
The Medical Center reported income from operations of $57.7 million and operating revenue of $734.6 million. Income from operations decreased in the current year to $57.7 million from $78.3 million in the prior year. The $20.6 million or 26.3 percent decrease was the result of increase in operating expenses.

Non-operating Revenues (Expenses)
Non-operating revenues (expenses) include interest earned on invested cash balances, interest expenses on debt, and losses from disposal or retirement of capital assets. Total non-operating expenses were $10.5 million for 2012 compared to the total non-operating revenues of $6.9 million in 2011. The change was primarily due to decrease in hospital fee program funding and increased interest expenses.

Total non-operating revenues were $6.9 million for 2011 compared to $(2.5) million in 2010. The majority of this increase was due to the additional Medi-Cal Provider Fee funding received.

Income before Other Changes in Net Position
The Medical Center reported income before other changes in net position of $47.1 million in 2012 as compared to $85.2 million in 2011 and $33.6 million in 2010, a decrease of $38.1 million, or 44.6 percent, and an increase of $51.6 million, or 153.6 percent, respectively. The Medical Center's net income increased by $51.6 million in 2011 compared to 2010 mainly due to the additional Medi-Cal supplemental funding. The resulting margin for 2012 was 6.4 for 2012 compared to 12.2 percent and 5.5 percent in 2011 and 2010, respectively.

Other Changes in Net Position
The other changes in net position for 2012, 2011 and 2010 include:

	2012	2011	2010
Health system support	$ (53,182)	$ (48,147)	$ (65,771)
Transfers from (to) university, net	(8,739)	1,022	(16,647)
Total other changes in net position	$ (61,921)	$ (47,125)	$ (82,418)

The lower section of the statements of revenues, expenses and changes in net position shows the other changes to net position in addition to the income or loss. Net position is the difference between the total assets and total liabilities. The other changes in net position 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 position 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 $53.2 million in 2012 and $48.1 million in 2011.

- Transfers from University included donated assets of $0.4 million and other expended funds of $8.3 million in 2012. Transfers from University included donated assets of $1.8 million and other expended funds of $0.8 million in 2011.

In total, the net position decreased by $14.8 million in 2012. In 2011, the net position increased by $38.0 million in 2011. The majority of the increase is due to an increase in overall cash balance.

Statements of Net Position

The following table is an abbreviated statement of net position at June 30, 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Current assets:			
Cash	$ 141,335	$ 175,692	$ 102,648
Patient accounts receivable (net)	108,905	96,868	74,140
Other current assets	65,135	34,922	53,734
Total current assets	315,375	307,482	230,522
Capital assets (net)	726,428	712,025	698,815
Other assets	39,542	64,342	105,780
Total assets	1,081,345	1,083,849	1,035,117
Current liabilities	154,785	133,035	122,402
Long-term debt	321,147	330,625	330,555
Total liabilities	475,932	463,660	452,957
Net position:			
Invested in capital assets (net)	420,363	429,052	455,365
Unrestricted	185,050	191,137	126,795
Total net position	$ 605,413	$ 620,189	$ 582,160

In 2012, total current assets increased by $7.9 million, or 2.6 percent, compared to 2011 due to the increase in other receivables related to Medi-Cal waiver income. In 2011, total current assets increased by $77.0 million, or 33.4 percent, compared to the prior year. Total assets at June 30, 2012 were $2.5 million lower than 2011. Total assets at June 30, 2011 were $48.7 million higher than 2010.

Cash decreased by $34.4 million, or 19.6 percent, in 2012 due to decrease in cash from operations and investing activities. Cash increased by $73.0 million, or 71.2 percent, in 2011 due to the additional Medi-Cal supplemental payments under Assembly Bill 1383.

Net patient accounts receivable increased by $12.0 million, or 12.4 percent, in 2012. Net patient accounts receivable increased by $22.7 million, or 30.7 percent, in 2011. Net patient accounts receivable is increasing consistent with increases in revenues and days receivable. The methodology deployed in calculating the allowance for doubtful accounts is based on historical collection experience and current economic factors.

Other current assets, which include non-patient receivables, inventory, prepaid expenses and advances, increased by $30.2 million, or 86.5 percent, in 2012. The increase was primarily due to increase in Medi-Cal waiver funding receivables. Other current assets 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.

Capital assets increased by $14.4 million, or 2.0 percent, in 2012 from the prior year primarily due to the continued Phase II construction. Capital assets increased by $13.2 million, or 1.9 percent, in 2011 from the prior year.

Other assets, including restricted funds for the replacement hospital and bond issuance costs decreased by $24.8 million, or 38.5 percent in 2012, due primarily to the bond construction expenditures and debt re-payments. In 2011, other assets decreased by $41.4 million, or 39.2 percent, over the prior year.

In 2012, current liabilities increased by $21.0 million from the prior year due mainly to the increase in salaries and benefits payable and increase in current portion of long term debts. 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.

Long-term debt includes the 2007 Series A Pooled Revenue bonds, the 2009 Series E and Series F Pooled Revenue Bonds, and long-term financing obligations. In 2012, long-term debt decreased by $2.0 million from the prior year. In 2011, long-term debt increased slightly by $0.1 million, from the prior year.

Net position decreased by $14.8 million, or 2.4 percent, in 2012. The change in net position includes the excess of revenues over expenses of $47.1 million, contributions to the University of $8.7 million, and the health system support of $53.2 million transferred to the School of Medicine. Net position increased by $38.0 million, or 6.5 percent, in 2011.

Liquidity and Capital Resources

The Medical Center generated $76.9 million and $144.4 million from operating activities in 2012 and 2011, respectively.

Cash flows from non-capital financing activities show the Medical Center's cash were reduced to $53.2 million and $34.2 million in 2012 and 2011, respectively, for $53.2 million transfers to the University as health system support.

In 2012 and 2011, cash flows from capital and related financing activities included proceeds by University for building program was $8.7 million, purchases of capital assets of $63.0 million and $68.6 million, Build America bonds federal interest subsidies was $3.6 million and $3.4 million, principal payments on long-term debt and financing obligations were $21.9 million and $14.0 million, interest paid was $17.4 million and $18.6 million, and other cash inflow was $1.3 million, respectively.

Cash flows from investment activities in 2012 and 2011 show that $3.4 million and $3.0 million was provided by interest income, respectively. Change in restricted assets was a decrease of $24.8 million and $41.4 million in 2012 and 2011, respectively.

Overall, cash on hand decreased to $141.3 million in 2012 from $175.7 million in 2011. Cash on hand increased to $175.7 million in 2011 from $102.6 million in 2010.

The following table shows key liquidity and capital ratios for 2012, 2011 and 2010:

	2012	2011	2010
Days cash on hand	80	110	70
Days of revenue in accounts receivable	63	60	50
Purchases of capital assets ($ in millions)	$ 63.0	$ 68.6	$ 64.5
Debt service coverage ratio	2.9	5.0	4.4

Days cash on hand decreased 27.4 percent to 80 days in 2012 from 110 days in 2011. In 2011, days cash on hand increased to by 59.4 percent to 110 days in 2011 from 70 days in 2010. The increase in 2011 was from additional Medi-Cal supplemental payments under Assembly Bill 1383. 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 2012, net days in receivables increased to 63 days. In 2011, net days in receivables increased to 60 days.

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 2012, 2011, and 2010 are 2.9, 5.0 and 4.4, respectively. The decrease of 2.1 in debt service coverage in 2012 is the result of the decrease in net income and an increase in long-term payments. The increase in debt service coverage ratio of 0.6 in 2011 was due to an increase of income from operations. 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 projected cost for the Medical Center, which will be compliant with the requirements by the first quarter of 2013, is $35.1 million. The capital cost of compliance was financed through the use of state lease revenue bond funds, hospital reserves, gift funds and debt. In 2012 and 2011, $18.0 million and $11.9 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"). On June 29, 2012, the Supreme Court upheld the constitutionality of much of 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 are being phased in through 2014. The medical centers will likely be affected by the coverage expansion provisions that go into effect in 2014, the effect of which is 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, 2012, the Medical Center received payments of $1.4 million for the meaningful use of EHR technology. No amounts were received for the year ended June 30, 2011.

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, 2012, 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, 2011 actuarial valuation was $7.7 billion or 82.1 percent funded. As of July 1, 2012, the funded ratio is expected to decrease to approximately 78 percent. The total funding policy contributions in the July 1, 2011 actuarial valuations represent 26.4 percent of covered compensation. Member and employer contributions increased to 5 percent and 10 percent, respectively, of covered compensation in July 2012. The Regents approved increasing the employer and employee contributions to 6.5 percent and 12 percent, respectively, in July 2013. 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, 2011 actuarial valuation was $14.7 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 Position
June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Assets		
Current assets		
Cash	$ 141,335	$ 175,692
Patient accounts receivable, net of estimated uncollectibles of $5,081 and $3,309, respectively	108,905	96,868
Other receivables	41,652	12,193
Inventory	14,826	13,565
Prepaid expenses and other assets	8,657	9,164
Total current assets	315,375	307,482
Restricted assets:		
Cash restricted for replacement hospital	37,230	61,995
Capital assets, net	726,428	712,025
Deferred costs of issuance	2,312	2,347
Total assets	1,081,345	1,083,849
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	23,714	21,193
Accrued salaries and benefits	52,340	46,605
Third-party payor settlements, net	53,137	49,462
Current portion of long-term debt and financing obligations	21,783	14,303
Other liabilities	3,811	1,472
Total current liabilities	154,785	133,035
Long-term debt and financing obligations, net of current portion	316,147	325,625
Notes payable to campus	5,000	5,000
Total liabilities	475,932	463,660
Net Position		
Invested in capital assets, net of related debt	420,363	429,052
Unrestricted	185,050	191,137
Total net position	$ 605,413	$ 620,189

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 Position
For the Years Ended June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Net patient service revenue, net of provision for doubtful accounts of $11,632 and $9,742, respectively	$ 709,486	$ 675,211
Other operating revenue:		
Clinical teaching support	8,648	8,474
Other	16,435	15,452
Total other operating revenue	25,083	23,926
Total operating revenue	734,569	699,137
Operating expenses:		
Salaries and wages	297,077	270,018
UCRP, retiree health and other employee benefits	100,998	83,052
Professional services	3,386	2,252
Medical supplies	95,012	88,522
Other supplies and purchased services	127,583	119,256
Depreciation and amortization	48,414	52,850
Insurance	4,441	4,914
Total operating expenses	676,911	620,864
Income from operations	57,658	78,273
Non-operating revenues (expenses):		
Hospital fee program grants	10	13,901
Build America bonds federal interest subsidies	3,587	3,438
Interest income	3,442	3,038
Interest expense	(17,486)	(13,445)
Other	(66)	(51)
Total net non-operating revenues (expenses)	(10,513)	6,881
Income before other changes in net position	47,145	85,154
Other changes in net position:		
Health system support	(53,182)	(48,147)
Contributions from (to) University for building program	(8,739)	1,022
Total other changes in net position	(61,921)	(47,125)
Increase (decrease) in net position	(14,776)	38,029
Net position – beginning of year	620,189	582,160
Net position – end of year	$ 605,413	$ 620,189

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 701,124	$ 663,398
Payments to employees	(294,543)	(266,660)
Payments to suppliers	(224,585)	(212,430)
Payments for benefits	(97,798)	(81,439)
Other (disbursements) receipts, net	(7,293)	41,509
Net cash provided by operating activities	76,905	144,378
Cash flows from noncapital financing activities:		
Health system support	(53,182)	(48,147)
Grants from the hospital fee program	10	13,901
Net cash used by noncapital financing activities	(53,172)	(34,246)
Cash flows from capital and related financing activities:		
Proceeds by University for building program	(8,739)	-
Proceeds from financing obligations	19,950	11,354
Proceeds from note payable from campus	-	5,000
Bond issuance costs	(32)	(51)
Build America bonds federal interest subsidies	3,587	3,438
Purchases of capital assets	(63,044)	(68,644)
Principal paid on long-term debt and financing obligations	(21,886)	(13,992)
Interest paid on long-term debt and financing obligations	(17,443)	(18,588)
Other	1,310	-
Net cash used by capital and related financing activities	(86,297)	(81,483)
Cash flows from investing activities:		
Interest income received	3,442	3,037
Change in restricted assets	24,765	41,358
Net cash provided by investing activities	28,207	44,395
Net increase (decrease) in cash	(34,357)	73,044
Cash – beginning of year	175,692	102,648
Cash – end of year	$ 141,335	$ 175,692

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 57,658	$ 78,273
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	48,414	52,850
Provision for doubtful accounts	11,632	9,742
Changes in operating assets and liabilities:		
Patient accounts receivable	(23,669)	(32,470)
Other receivables	(29,459)	22,580
Inventory	(1,261)	(700)
Prepaid expenses and other assets	507	(3,068)
Accounts payable and accrued expenses	2,148	1,368
Accrued salaries and benefits	5,735	4,970
Third-party payor settlements	3,675	10,915
Other liabilities	1,525	(82)
Net cash provided by operating activities	$ 76,905	$ 144,378
Supplemental noncash activities information:		
Payables for property and equipment	$ 2,047	$ 1,551
Gifts of capital assets	-	1,817
Bond retirements	-	910
Amortization of bond premium	(62)	124
Amortization of deferred costs of issuance	70	81

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

1. Organization

The University of California, Irvine Medical Center (the “Medical Center”) is a part of the University of California (the “University”), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California (“The Regents”), an independent board composed of 26 members. The Medical Center’s activities are monitored by The Regents’ Committee on Health Services, with direct management authority being delegated to the Medical Center Director by the Chancellor of the Irvine campus. The Medical Center has 412 licensed beds for the year ended June 30, 2012.

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.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Re-sources, 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. Implementation of Statement No. 63 had no effect on the Medical Center’s net position or changes in net position for the years ended June 30, 2012 and 2011.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the Medical Center’s fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for the termination of hedge accounting. Implementation of Statement No. 64 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011.

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, 2012 and 2011 was $141.3 million and $175.7 million, 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 position.

Additional information on cash and investments can be obtained from the 2011-2012 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. 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 Position
Net position is 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 position resulting from transactions with purpose restrictions as restricted net position until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.

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

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

Expenses are charged to either restricted or unrestricted net position based upon a variety of factors, including consideration of prior and future revenue sources, the type of expense incurred, the Medical Center's budgetary policies surrounding the various revenue sources or whether the expense is a recurring cost.

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. 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.

Health system support and contributions from the University for building program are classified as other changes in net position.

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 position.

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 position.

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 position.

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 position 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.

Comparative Information

In connection with the preparation of the June 30, 2012 financial statements, the Medical Center determined that restricted net position was being accounted for on a gross basis separately from restricted liabilities. Management has revised the restricted expendable net position for capital projects by $62.0 million to report restricted net position on a net basis with the related restricted liabilities. This revision had no effect on the total net position of the Medical Center.

The Medical Center noted that $5.0 million in notes payables to the Campus were being reported with long-term debt. Management revised the amount to present separately on the Statement of Net Position. The revision had no effect on the total net position of the Medical Center.

The Medical Center determined that certain cash flows for notes payables and financing obligations were being reported on a net basis with purchases of capital assets. Management has revised the cash flows reported for purchases of capital assets by $16.4 million to report cash flows on a gross basis. This revision had no effect on the statement of net position, statement of revenues, expenses and changes in net position and cash used by capital and related financing activities.

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, 2012. 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 March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Medical Center is evaluating the effect that Statement No. 65 will have on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement resolves conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Medical Center is evaluating the effect that Statement No. 66 will have on its financial statements.

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for the University's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the University to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This statement requires that most changes in the net pension liability be included in pension expense in the period of the change. As of June 30, 2012, the University reported an obligation to UCRP of $1.9 billion, representing unfunded contributions to UCRP based upon the University's funding policy. Under GASB No. 68, The University's obligation to UCRP is expected to increase. The Medical Center is evaluating the effect that Statement No. 68 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 position 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, 2012 and 2011, the Medical Center recorded total Medi-Cal waiver revenue of $102.4 million and $91.3 million, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 in September 2010, SB 90 in April 2011, and SB 335 in September 2011, 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 was April 1, 2009 through December 31, 2013 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 years ended June 30, 2012 and 2011, the Medical Center received $3.6 million and $27.4 million respectively, which has been reported as net patient service revenue. For the years ended June 30, 2012 and 2011, the Medical Center received $10.1 thousand and $13.9 million respectively, 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, 2012 and 2011, the Medical Center recorded revenue of $2.7 million and $3.4 million, respectively.

(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 11.8 percent and 15.4 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively. Amounts due from Medi-Cal represent 21.0 percent and 15.1 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, net patient service revenue included favorable cost report settlements of $7.4 million and unfavorable cost report settlements of $1.4 million, respectively, primarily from Medicare and Medi-Cal Programs.

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

	2012	2011
Contract (discounted or per diem)	$ 353,883	$ 315,886
Medicare (non-risk)	156,520	146,485
Medi-Cal (non-risk)	165,639	179,148
County	20,476	21,779
Commercial	7,640	6,908
Non-sponsored (uninsured)	5,328	5,005
Total	$ 709,486	$ 675,211

(Dollars in thousands)

4. Charity Care

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

	2012	2011
Charity care at established rates	$ 77,250	$ 75,807
Estimated cost of charity care	17,178	15,986
Total	$ 94,428	$ 91,793

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $31.7 million and $22.6 million for the years ended June 30, 2012 and 2011, respectively.

5. Capital Assets

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

	2011	Additions	Disposals	2012
Original Cost				
Land	$ 12,394	$ 24		$ 12,418
Buildings and improvements	716,191	26,158	(598)	741,751
Equipment	234,092	35,338	(7,044)	262,386
Construction in progress	27,344	835		28,179
Capital assets, at cost	$ 990,021	$ 62,355	$ (7,642)	$ 1,044,734
	2011	**Depreciation**	**Disposals**	**2012**
Accumulated Depreciation				
Buildings and improvements	$ 158,592	$ 27,846	$ (598)	$ 185,840
Equipment	119,404	20,568	(5,595)	134,377
Accumulated depreciation	277,996	$ 48,414	$ (6,193)	320,217
Capital assets, net	$ 712,025			$ 724,517

(Dollars in thousands)

	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

Equipment under financing obligations and related accumulated amortization was $93.4 million and $49.6 million in 2012, respectively, and $76.0 million and $36.8 million in 2011, 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 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 $5.9 million 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 position. There was no such expenditure for the year ended June 30, 2011.

6. Note Payable to Campus

The Medical Center has a note payable to campus to be repaid over a 15 year period by June 2025.

(Dollars in thousands)

7. Long-term Debt and Financing Obligations

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

	2012	2011
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	$ 71,320	$ 77,035
University of California Medical Center Pooled Revenue Bonds 2009 Series F, "Build America Bonds", net interest rates after the 35 percent federal subsidy ranging from 4.2 percent to 4.28 percent, payable semi-annually, with annual principal payments beginning in 2021 through 2049	155,854	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	61,320	62,010
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	2,123	2,493
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 1.34 percent to 4.1 percent, payable through 2022	43,802	39,205
Other borrowing	242	-
	334,661	336,598
Unamortized bond premium	3,269	3,330
Total debt and financing obligations	337,930	339,928
Less: Amounts due within one year	(21,783)	(14,303)
Noncurrent portion of debt and financing obligations	$ 316,147	$ 325,625

Total interest expense during the years ended June 30, 2012 and 2011 was $17.9 million and $18.6 million, respectively. Interest expense totaling $0.4 million and $5.1 million was capitalized in each of the years ended June 30, 2012 and 2011. The remaining $17.5 million in 2012 and $13.4 million in 2011 are reported as interest expense in the statements of revenues, expenses, and changes in net position. Net investment income totaling $1.1 million and $2.0 million was capitalized during the years ended June 30, 2012 and 2011, respectively.

(Dollars in thousands)

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

	Revenue Bonds	Financing Obligations	Total
Year ended June 30, 2012			
Long-term debt and financing obligations at June 30, 2011	$ 300,724	$ 39,204	$ 339,928
New obligations	-	19,950	19,950
Principal payments	(6,774)	(15,112)	(21,886)
Amortization of bond premium	(62)	-	(62)
Long-term debt and financing obligations at June 30, 2012	293,888	44,042	337,930
Less: Current portion of long-term debt and financing obligations	(6,645)	(15,138)	(21,783)
Noncurrent portion of long-term debt and financing obligations as June 30, 2012	$ 287,243	$ 28,904	$ 316,147
Year ended June 30, 2011			
Long-term debt and financing obligations at June 30, 2010	$ 302,119	$ 41,489	$ 343,608
New obligations	-	11,354	11,354
Principal payments	(1,263)	(13,639)	(14,902)
Amortization of bond premium	(132)	-	(132)
Long-term debt and financing obligations at June 30, 2011	300,724	39,204	339,928
Less: Current portion of long-term debt and financing obligations	(370)	(13,933)	(14,303)
Noncurrent portion of long-term debt and financing obligations as June 30, 2011	$ 300,354	$ 25,271	$ 325,625

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, 2012 are $2.2 billion of which $35.1 million are specifically for capital projects at the Medical Center. Combined operating revenues of the University's five medical centers for the years ended June 30, 2012 and 2011 were $6.9 billion and $6.5 billion, respectively.

In February 2011, the Medical Center retired \$0.9 million of Medical Center Pooled Revenue Bonds recognizing a gain of \$0.2 million on the statement of revenues, expenses and changes in net position. The Medical Center has a payable to the University of \$0.7 million, 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.

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, 2012 and thereafter are as follows:

Year Ending June 30	Revenue Bonds	Financing Obligations	Total Payments	Principal	Interest
2013	$ 23,562	$ 15,595	$ 39,157	$ 21,784	$ 17,373
2014	23,568	11,958	35,526	18,806	16,720
2015	23,564	9,464	33,028	16,854	16,174
2016	23,551	5,379	28,930	13,258	15,672
2017	16,583	2,780	19,363	4,090	15,273
2018 – 2022	90,346	649	90,995	16,080	74,915
2023 – 2027	96,635	-	96,635	27,285	69,350
2028 – 2032	95,907	-	95,907	34,490	61,417
2033 – 2037	93,625	-	93,625	43,040	50,585
2038 – 2042	89,416	-	89,416	52,710	36,706
2043 – 2047	83,064	-	83,064	63,750	19,314
2048	24,752	-	24,752	22,514	2,238
Total future debt service	684,573	45,825	730,398	334,661	395,737
Less: Interest component of future payments	$ (393,956)	$ (1,781)	$ (395,737)		
Principal portion of future payments	290,617	44,044	334,661		
Adjusted by:					
Unamortized bond premium	3,269	-	3,269		
Total debt	$ 293,886	$ 44,044	$ 337,930		

Additional information on the revenue bonds can be obtained from the 2011-2012 annual report of the University.

(Dollars in thousands)

8. Operating Leases

The Medical Center leases certain buildings and equipment under agreements recorded as operating leases. Operating lease expense for the years ended June 30, 2012 and 2011 was $2.2 million and $2.8 million, 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
2013	$ 1,753
2014	1,123
2015	967
2016	967
2017	1,008
2018 – 2019	1,955
Total	$ 7,773

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 $3.51 and $3.31 per $100 of UCRP-covered payroll resulting in Medical Center contributions of $9.5 million and $8.0 million for the years ended June 30, 2012 and 2011, 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, 2011, the date of the latest actuarial valuation, were $77.7 million and $14.7 billion, respectively. The net position held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net position were $89.5 million at June 30, 2012. For the years ended June 30, 2012 and 2011, combined contributions from the University's campuses and medical centers were $346.4 million and $313.9 million, respectively, including an implicit subsidy of $54.1 million and $54.9 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.5 billion and $1.8 billion for the years ended June 30, 2012 and 2011. 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 $6.3 billion at June 30, 2012 increased by $1.2 billion for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California.

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 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 $19.6 million and $8.0 million, respectively, during the year ended June 30, 2012. Medical Center and employee contributions were $9.3 million and $3.8 million respectively, during the year ended June 30, 2011.

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, 2011, the date of the latest actuarial valuation, were $35.3 billion and $43.0 billion, respectively, resulting in a funded ratio of 82.1 percent. The net position held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net position were $41.8 billion and $41.9 billion at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, the University's campuses and medical centers contributed a combined $1.5 billion and $1.4 billion, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.9 billion for the year ended June 30, 2012. 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 $361.8 million for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California Retirement System.

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 position, were $6.4 million and $5.6 million for the years ended June 30, 2012 and 2011, respectively. During 2012 and 2011, as a result of actuarial analysis, the Medical Center received a refund of premiums of $2.0 million and $0.4 million, 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 position, were $4.4 million and $4.9 million for the years ended June 30, 2012 and 2011, 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 position for the years ended June 30 as follows:

	2012	2011
Professional services	$ 3,386	$ 2,252
Other supplies and purchased services	28,053	25,357
Interest income (net)	(3,413)	(1,989)
Insurance	4,441	4,914
Administrative costs	(4,406)	(4,406)
Total	$ 28,061	$ 26,128

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 position. 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 $81.2 million and $74.3 million in 2012 and 2011, respectively. Of these amounts, $28.1 million and $26.1 million are reported as operating expenses for the years ended June 30, 2012 and 2011, respectively, and $53.2 million and $48.1 million are reported as health system support for the years ended June 30, 2012 and 2011, 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 $600.0 million in lease-revenue bond funds for earthquake safety renovations for the medical centers, of which $235.0 million 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 $242.2 million. The phase II projects will be funded from external financing.

At June 30, 2012, the Medical Center had outstanding commitments for capital expenditures in connection with the phase II projects of approximately $35.7 million. The Medical Center expects to fund these costs principally through external financing sources.

Gift funds used for construction total $0.1 million for the year ended June 30, 2011, are reflected in the statements of revenues, expenses and changes in net position. 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, 2012 and 2011

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pwc

Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net position and the related statements of revenues, expenses and changes in net position, and cash flows, as shown on pages 19 through 22 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, 2012 and 2011, 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, 2012 and 2011, 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 accompanying management's discussion and analysis on pages 3 through 18 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 11, 2012

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, 2012, with selected comparative information for the years ended June 30, 2011 and 2010. 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 (2010, 2011, 2012, 2013, 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 266-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 466-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. The final construction phase of the Santa Monica-UCLA Medical Center and Orthopaedic Hospital was completed and occupancy occurred on January 8th 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.

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 2012-2013 survey ranks Ronald Reagan UCLA Medical Center as one of the top five hospitals nationally, and the best hospital in the western United States for the 23rd consecutive year. According to this latest survey, UCLA ranked in the top 20 in 13 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 (9) diabetes and endocrine disorders (13); ear, nose and throat (12); gastroenterology (8); geriatrics (3); gynecology (12); heart and heart surgery (8); kidney disorders (5); neurology and neurosurgery (12); ophthalmology at UCLA's Jules Stein Eye Institute (5); psychiatry at the Resnick Neuropsychiatric Hospital at UCLA (7); rheumatology (7); and urology (4).

- *The Medical Center continues to work on quality and efficiencies*

  One of the underlying strategies to meet the UCLA Health Science's clinical goals is to provide high quality, patient-centered, efficient, cost-effective care. Toward this end, the Medical Center has implemented measures to enhance patient throughput by formalizing post-acute care relationships and improving coordination of care. To enhance the Medical Center's cost-effectiveness, a number performance excellence projects were initiated to improve and streamline work processes and Santa Monica –UCLA Medical Center and Orthopaedic Hospital opened its new eight-suite ambulatory surgery center to ensure future outpatient surgeries are performed in an appropriate operating room setting, in lieu of the inpatient surgery arena. Finally, the Medical Center's customer service program (CICARE) continues to maintain the Medical Center as one of the leading Academic Medical Center's with the highest patient satisfaction.

- *The Medical Center continues to work on strategic initiatives*

  During this fiscal year, the Medical Center continued to support UCLA Health Sciences Strategic Plan's tertiary and quaternary care delivery goal, by providing the tertiary/quaternary inpatient venue for high quality patient centered care of complex, high acuity patients. The Westwood campus's tertiary/quaternary focus will remain one of the requisite strategies to maintain UCLA Medical Center's viability and prominence in the future. The new Santa Monica replacement hospital provides patients of UCLA's primary care physicians located on the West Side, access to a convenient acute care user-friendly site. Furthermore, additional clinical programs, including certain pediatric subspecialties are relocating from Ronald Reagan UCLA Medical Center to the new Santa Monica replacement facility, which will rationalize appropriate services across the Medical Center venues.

- *Completion of Santa Monica-UCLA Medical Center and Orthopaedic Hospital Replacement Project*

  The final construction phase, i.e. north -central and orthopedic wing, of the Santa Monica-UCLA Medical Center and Orthopaedic Hospital was completed in late spring 2011. Fit-up with equipment and furniture, and testing of various facility systems occurred during the last half of 2011. Patient move-in and the resultant opening of the new replacement hospital occurred on January 8th 2012. Appropriate patient services continue to move from Westwood to Santa Monica, part of the ongoing process of reallocating services across the health system. This new Santa Monica replacement hospital and Ronald Reagan UCLA Medical Center continue to experience high patient occupancy while achieving high patient satisfaction at both hospitals.

- *The Medical Center continued with an Electronic Health Record (EHR) implementation*

  The UCLA EHR system, called CareConnect, includes a collection of technologies and revised clinical and operational processes that will result in improved efficiencies in patient care and lean operations. In addition to improved efficiencies, CareConnect offers patients and caregivers new secure ways to communicate that results in an improved patient experience, whether inpatient or outpatient. In addition to streamlining process around clinical care and operations, the integrated health information system enables implementation of delivery systems required by federal healthcare reform including but not limited to accountable care, populations management, telemedicine, and participation in health information exchanges. The implementation was kicked off in February 2010 and will be completed near the end of 2013.

<u>Service Area and Market Share</u>

The following table presents certain historical utilization statistics for the primary and secondary service area for the twelve-month period ended December 31, 2010. Data for the twelve-month period ended December 31, 2010 is the most current data available from the State of California Office of Statewide Health Planning and Development.

Market Area	**Counties**	**# of Zip Codes**	**Population**	**Market Share of Discharges**
Primary	Los Angeles, Ventura, and Kern	403	7,376,583	4%
Secondary	Los Angeles, Kern, Orange, Riverside, San Bernardino, San Luis Obispo, Santa Barbara and Ventura	1,239	19,862,878	2%

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2012, 2011 and 2010:

	2012	2011	2010
Licensed beds	806	855	845
Admissions	39,982	40,336	40,220
Average daily census	719	723	718
Discharges	40,030	40,318	40,211
Average length of stay	6.6	6.5	6.5
Patient days	263,261	263,717	261,895
Case mix index	1.93	1.92	1.90
Outpatient visits:			
Clinic visits	885,107	845,508	788,287
Emergency visits	86,100	83,082	81,383
Total outpatient visits	971,207	928,590	869,670

Total admissions decreased by 0.9 percent in 2012 compared to 2011, primarily due to a decrease in surgery, orthopedic, and obstetrical inpatient cases. Total admissions increased by 0.3 percent in 2011 compared to 2010, due to an increase in medicine and psychiatric cases.

Total patient days in 2012 decreased by 456, or 0.2 percent, over 2011 due to a decrease in Medi-Cal and Non-sponsored/self-pay days. Total patient days in 2011 increased by 1,822, or 0.7 percent, over 2010 due to an increase in Medicare days.

In 2012, total outpatient visits increased by 42,617, or by 4.6 percent, compared to 2011, due primarily to an increase in emergency room visits, outpatient operating room procedures, medical procedures and imaging services. Total outpatient visits increased by 58,920 in 2011, or by 6.8 percent, compared to 2010. This increase was primarily due to an acquisition of new physician practice group, expansion of primary care clinics, and increase in blood draw stations.

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the operating results for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Net patient service revenue	$ 1,753,609	$ 1,656,724	$ 1,527,157
Other operating revenue	66,712	63,666	60,326
Total operating revenue	1,820,321	1,720,390	1,587,483
Total operating expenses	1,589,833	1,446,726	1,363,893
Income from operations	230,488	273,664	223,590
Total net non-operating revenues (expenses)	(38,722)	15,879	(11,508)
Income before other changes in net position	$ 191,766	$ 289,543	$ 212,082
Margin	10.5%	16.8%	13.4%
Other changes in net position	$ (80,586)	$ (57,213)	$ (78,833)
Increase in net position	111,180	232,330	133,249
Net position - Beginning of year	1,715,122	1,482,792	1,349,543
Net position - End of year	$ 1,826,302	$ 1,715,122	$ 1,482,792

Overall the financial results of the Medical Center declined in 2012 as compared to 2011 and increased in 2011 from 2010, principally due to two factors:

- The Medical Center received $2.4 million, $48.0 million and $0 from the Hospital Fee Program, reported as operating and non-operating revenues, in 2012, 2011 and 2010, respectively. Additionally, the Medical Center received enhanced reimbursements related to provisions contained in the American Reinvestment and Recovery Act ("ARRA") for supplemental Medicaid payments to hospitals, which expired in June 2011.

- The Medical Center's contributions to the University's defined benefit pension plan increased to $43.9 million in 2012 from $21.0 million in 2011 and $4.6 million in 2010.

Revenues

Total operating revenues for the year ended June 30, 2012 were $1,820.3 million, an increase of $99.9 million, or 5.8 percent, over 2011. Operating revenues for 2011 were $1,720.4 million, an increase of $132.9 million, or 8.4 percent, over 2010.

For the years ended June 30, 2012, 2011 and 2010, 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 2012 increased by $96.9 million, or 5.8 percent, over 2011. The increase in 2012 was due to increase in contract rates, outpatient volume, Medicare volume and rates. 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.

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 2012 in other operating revenue was mainly due to incentive funding from the State's Medi-Cal program for the Electronic Health Record (EHR). 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 following table summarizes net patient service revenue for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Medicare (non-risk)	$ 385,038	$ 348,592	$ 358,954
Medicare (risk)	44,980	38,114	33,283
Medi-Cal (non-risk)	149,815	191,238	151,669
Contract (discounted or per diem)	1,145,645	1,052,114	966,297
Non-sponsored/self-pay (uninsured)	28,131	26,666	16,954
Total	$ 1,753,609	$ 1,656,724	$ 1,527,157

Net revenues for Medicare represent payments for services provided to patients under Title XVIII of the Social Security Act. Payments for inpatient services provided to Medicare beneficiaries are paid on a per-discharge basis at rates set at the national level with adjustments for prevailing area labor costs. The Medical Center also receives additional payments for direct and indirect costs for graduate medical education, disproportionate share of indigent patients, capital reimbursement, and outlier payments on cases with unusually high costs of care. Hospital outpatient care is reimbursed under a prospective payment system. Medicare reimburses the Medical Center for allowable costs at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. Settlements with the Medicare program for prior years' cost reports are recognized in the year the settlement is resolved. Net patient revenue for Medicare increased by $36.5 million, or 10.5 percent, above the prior fiscal year. The increase is primarily due to the increases in inpatient discharges and payment factors. In 2011, net patient revenue for Medicare decreased by $10.4 million, or 2.9 percent, below the prior fiscal year. This decrease was primarily due to lower outlier cases and reductions in payment factors.

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 2012, the Medical Center recorded additional Medi-Cal funding for the Delivery System Reform Incentive Pool of $24.2 million and Medi-Cal Provider Fee funding of $2.4 million. 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 2012, contract net patient revenue (discounted/per-diem) increased by $93.5 million, or 8.9 percent, due to rate increases and growth in outpatient volume. In 2011, contract net patient revenue (discounted/per-diem) increased by $85.8 million, or 8.9 percent, due to rate increases and outpatient volume.

The net patient service revenue for contracts that are full-risk capitation increased by $6.9 million, or 18.0 percent in 2012, and increased by $4.8 million, or 14.5 percent in 2011. These increases were primarily due to increase in membership and rate increases.

The non-sponsored/self-pay net revenue increased from the prior year by $1.5 million, or 5.5 percent in 2012 and increased from the prior year by $9.7 million, or 57.3 percent in 2011. This category fluctuates from year to year depending on the volume and the acuity of the patients.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Salaries and wages	$ 713,574	$ 648,152	$ 606,069
Employee benefits	216,879	181,312	152,195
Professional services	35,966	33,530	51,717
Medical supplies	213,779	208,027	203,004
Other supplies and purchased services	294,123	275,568	255,917
Depreciation and amortization	104,124	89,277	85,873
Insurance	11,388	10,860	9,118
Total	$ 1,589,833	$ 1,446,726	$ 1,363,893

Total operating expenses for 2012 were $1,589.8 million, an increase of $143.1 million, or 9.9 percent, over 2011. This change was primarily due to increased salary and employee benefits, medical supplies, other supplies and purchased services and an increase in depreciation costs for the replacement hospital and the new ambulatory medical office building. 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 Santa Monica replacement hospital.

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 2012, salaries and wages grew by $65.4 million, or 10.1 percent, over the prior year. This increase includes $36.0 million, or 5.6 percent in salary increases and an increase in staffing, or 4.3 percent from the prior year, due to 0.4 percent decrease in inpatient volume, a 4.6 percent increase in outpatient volume and various initiatives. In 2011, salaries and wages grew by $42.1 million, or 6.9 percent, over the prior year. This increase includes $23.0 million, or 3.8 percent in salary increases and an increase in staffing, 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.

Amounts paid for nurse registry and other contract labor are included in salaries and wages. Temporary labor costs for 2012 increased $0.2 million, or 2.1 percent, over 2011 due to a shortage of critical care nurses for higher acuity patients and an increase in outpatient volume. Temporary labor costs for 2011 increased $4.2 million, or 57.1 percent, over 2010 due to a shortage of critical care nurses for higher acuity patients and an increase in outpatient rehabilitation volume.

In 2012, employee benefit costs increased by $35.6 million, or 19.6 percent, over 2011. Pension contributions were $43.7 million in 2012 as compared to $20.9 million in 2011 and $4.6 million in 2010. The Medical Center's health insurance and other employee benefit costs increased in 2012 as compared to 2011 by $12.7 million, or 7.9 percent, due to an increase in insurance premiums of $8.5 million and increases in other benefit costs of $4.2 million. 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.

As a percentage of total operating revenue, salaries and employee benefits were 51.1 percent in 2012, 48.2 percent in 2011 and 47.8 percent in 2010. Overall labor costs increased as a percent of operating revenues due to salary rate increases, pension & health insurance increases and an increase in staffing due to volume and various initiatives.

Payments for professional services increased by $2.4 million, or 7.3 percent, in 2012 from 2011. The increases were primarily due to an increase in consulting and management fees for a major expense reduction project. In 2011, 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.

Medical supply expense increased by $5.8 million, or 2.8 percent, in 2012 from 2011, primarily due to an increase in pharmaceutical expense, as a result of a 6.8 percent inflation and patients requiring more expensive cancer drugs. In 2011, 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.

Other supplies and purchased services increased by $18.6 million, or 6.7 percent, over the prior year. The increase was primarily due to an increase in organ acquisition costs for transplant cases, increase in operating room volume and an increase in outside provider costs for capitated insurance plans. Additionally, there were increases in supplies and purchased services due to the opening of the Santa Monica replacement hospital and the new Santa Monica ambulatory medical office building, increases in maintenance expenses and building lease expense. In 2011, other supplies and purchased services increased by $19.7 million, or 7.7 percent, over 2010. 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 lease expense.

Depreciation and amortization expense increased by $14.9 million, or 16.6 percent, over 2011 due to new additions, capitalization of completed projects, and the opening of Santa Monica replacement hospital and the new Santa Monica ambulatory medical office building. In 2011, depreciation and amortization expense increased by $3.4 million, or 4.0 percent, over 2010 due to new additions and capitalization of completed projects.

Insurance expense of $11.4 million in 2012 and $10.9 million in 2011 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $0.5 million, or 4.9 percent, in 2012 and increased by $1.7 million, or 19.1 percent, in 2011.

Income from Operations
The Medical Center reported income from operations of $230.5 million and operating revenue of $1,820.3 million. Income from operations decreased in 2012 to $230.5 million from $273.7 million in the prior year. The $43.2 million decrease was due to reduction in reimbursement for the hospital fee program and an increase in salaries, pension and other employee benefits costs.

Non-operating Revenues (Expenses)
Total non-operating expenses were $38.7 million for 2012 compared to $15.9 million in revenues in 2011. The majority of this decrease was primarily due to the recognition of losses on one of the Medical Center's interest rate swap agreements. The change in fair value of the interest rate swap agreement that no longer qualifies for hedge accounting was recognized as a non-operating expense in the current year. Additionally, there was a reduction of $29.2 million in grant funding from the Hospital Provider fee program. Total non-operating revenues were $15.9 million for 2011 compared to $(11.5) million in 2010. The majority of this increase was due to the funding from Hospital Fee Program and gain for defeasance of long term debt.

Income before Other Changes in Net Position
The Medical Center's income before other changes in net position was $191.8 million for 2012 compared to $289.5 million for 2011, a decrease of $97.7 million, or 33.8 percent. In 2011, the Medical Center's income before other changes in net position was $289.5 million, an increase of $77.4 million or 36.5 percent from 2010. The resulting margin for 2012 was 10.5 percent as compared to 16.8 percent and 13.4 percent in 2011 and 2010, respectively. The Medical Center's strong performance in 2011 was the result of the Hospital Fee Program, which is predicated on provisions contained the American Reinvestment and Recovery Act ("ARRA") for supplemental Medicaid payments to hospitals. The Medical Center received $2.4 million, $48.0 million and $0, reported as operating and non-operating revenues, in 2012, 2011 and 2010, respectively, related to the Hospital Fee Program. Additionally, the Medical Center's contributions to the University's defined benefit pension plan increased to $43.9 million in 2012 from $21.0 million in 2011 and $4.6 million in 2010.

Other Changes in Net Position

The other changes in net position for 2012, 2011 and 2010 include:

	2012	2011	2010
Proceeds received or receivable from FEMA	95	$ -	$ 626
Contributions from University for building program	-	24,854	21,483
Donated assets	8,087	3,481	14,299
Health system support	(88,768)	(85,548)	(56,217)
Transfers to University for building program	-	-	(59,024)
Total other changes in net position	$ (80,586)	$ (57,213)	$ (78,833)

The lower section of the statements of revenues, expenses and changes in net position shows the other changes to net position in addition to the income or loss. Net position is the difference between the total assets and total liabilities. The other changes in net position 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 position for 2012 are the following:

- Proceeds received and receivable from the Federal Emergency Management Agency ("FEMA") for the hospitals' replacement projects were $95 thousand in 2012 and $0 thousand in 2011. The total anticipated funding from FEMA for the replacement hospitals' project is $556 million. The total received to date from FEMA is $531 million.

- In 2012, the medical center did not receive any contributions from the university for the building program. 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.

- 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 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 $8.1 million and $3.5 million of gift funds in 2012 and 2011, 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 $88.8 million in 2012 and $85.5 million in 2011.

In total, the net position increased in 2012 by $111.2 million to $1,826.3 million. The majority of this increase was due to cash balance and capital assets for the Santa Monica replacement hospital. In total, the net position 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.

Statements of Net Position

The following table is an abbreviated statement of net position at June 30, 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Current assets:			
Cash	$ 745,094	$ 598,063	$ 406,034
Patient accounts receivable (net)	262,394	260,936	246,961
Other current assets	56,479	48,112	81,652
Total current assets	1,063,967	907,111	734,647
Capital assets (net)	1,862,415	1,728,111	1,692,645
Other assets	31,366	100,092	91,782
Total assets	2,957,748	2,735,314	2,519,074
Deferred outflows of resources	52,752	37,959	52,664
Current liabilities	307,700	246,448	249,216
Long-term debt	797,614	773,744	787,066
Other liabilities	78,884	37,959	52,664
Total liabilities	1,184,198	1,058,151	1,088,946
Net position:			
Invested in capital assets (net)	1,051,459	1,036,830	916,942
Restricted	17,553	17,469	81,247
Unrestricted	757,290	660,823	484,603
Total net position	$ 1,826,302	$ 1,715,122	$ 1,482,792

Total current assets increased in 2012 by $156.9 million, or 17.3 percent, compared to 2011 due to an increase in cash, net patient accounts receivable, third party payor settlements receivable, other receivables and prepaid expenses. In 2011, total current assets increased in 2011 by $172.5 million, or 23.5 percent, compared to 2010 due to an increase in cash and net patient accounts receivable.

Cash increased by $147.0 million, or 24.6 percent, in 2012. This increase was mainly due an increase in operating revenue and financing of capital items previously paid out of reserves. 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 California Hospital Fee Program and Delivery System Reform Incentive Pool.

Net patient accounts receivable was comparable to 2011. In 2011, net patient accounts receivable increased by $14.0 million, or 5.7 percent, from 2010 due to volume increases and increases in valuation rates. Cash collections increased by $64.3 million, or 4.3 percent, in 2012 and by $75.5 million, or 5.3 percent, in 2011.

In 2012, other current assets, including non-patient receivables, third party payor settlement receivable, inventory and prepaid expenses, increased by $8.4 million, or 17.4 percent, over the prior fiscal year. The increase was primarily due to the increases in Medi-Cal Waiver, the state grants received under the Hospital Fee Program and increases in prepaid expenses. In 2011, other current assets, decreased by $33.5 million, or 41.1 percent, over 2010. The decrease was primarily related to payments received from the state for supplemental Medi-Cal reimbursement under Assembly Bill 915.

Capital assets increased by $134.3 million, or 7.8 percent, over 2011 primarily due to the implementation costs for the electronic health record and the new Santa Monica ambulatory medical office building. In 2011, capital assets increased by $35.5 million, or 2.1 percent, over 2010 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 2012, other assets decreased by $68.7 million, or 68.7 percent, due primarily to the use of restricted cash for the building program. In 2011, other assets increased by $8.3 million, or 9.1 percent, due to the increase in the restricted cash for the building program.

Deferred outflows from interest rate swap agreements increased by $14.8 million, or 39.0% over 2011, due to the change in fair market value of the agreements.

Current liabilities increased by $61.3 million, or 24.9 percent in 2012 due to an increase in accounts payable of $3.3 million, an increase in accrued salaries and benefits of $19.9 million, a decrease in third party payor settlements of $22.7 million, a decrease in current portion of long term debt of $1.9 million, an increase of $58.8 million of commercial paper from borrowing from the University for capital assets, and an increase of $3.9 million in other liabilities. In 2011, current liabilities decreased by $2.8 million, or 1.1 percent, 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 $9.9 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.

Other liabilities increased by $40.9 million, or 107.8 percent, in 2012. This increase was due to the change in the value of the interest rate swap agreements. In 2011, other liabilities decreased by $14.7 million, or 27.9 percent, over 2010 due to the change in the value of the interest rate swap agreements.

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 financing obligations. In 2012, the Medical Center financed $62.1 million as a capital lease for the new Santa Monica ambulatory office building. The note payable to campus is for long-term operating capital needs.

Net Position increased by $111.2 million or 6.5 percent from 2011 primarily due to a gain from operations. Net position increased by $232.3 million or 15.7 percent from 2010 due to a gain from operations.

Liquidity and Capital Resources

The Medical Center generated operating cash flows of $334.6 million and $406.1 million from operating activities in 2012 and 2011, respectively, driven by income from operations.

The Medical Center used cash flows for noncapital financing activities totaling $92.4 million and $58.0 million in 2012 and 2011, respectively.

The Medical Center used cash flows from capital and related financing activities totaling $180.2 million and $163.3 million in 2012 and 2011, respectively. In 2012 and 2011, cash flows from capital and related financing activities included the proceeds from state funds of $95 thousand and $0 thousand, contributions from the University for funding from the State Public Works Board Bonds $0 million and $24.9 million, purchase of capital assets (including construction in process for replacement hospitals) $200.2 million and $168.8 million, proceeds from new debt of $62.1 million and $20.8 million, principal payments on long-term debt and financing obligations of $14.8 million and $12.2 million, interest payments of $38.8 million and $35.4 million, and replenishment of campus gift funds of $8.1 million and $3.5 million, respectively.

Cash flows from investing activities in 2012 and 2011 show that $16.8 million and $14.9 million was provided by interest income, $68.3 million and $(8.9) million from a change in restricted assets primarily due to proceeds from debt for the building project and $(85.0) thousand and $1.1 million from the change in the value of Santa Monica Foundation investments, respectively.

Overall cash increased to $745.1 million, or 24.6 percent, in 2012 from $598.1 million, or 47.3 percent in 2011.

The following table shows key liquidity and capital ratios for 2012, 2011 and 2010:

	2012	2011	2010
Days cash on hand	184	161	116
Days of revenue in accounts receivable	55	58	59
Purchases of capital assets ($ in millions)	$ 200.2	$ 168.8	$ 90.3
Debt service coverage ratio	6.2	8.7	10.6

Days cash on hand increased to184 days in 2012 from 161 days in 2011 for a 14.3 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 2012, days in accounts receivable decreased to 55. In 2011, days in accounts receivable decreased to 58. The main reason for this decrease was due to the 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 2012 is 6.2 versus 8.7 in 2011. The decrease was due to the decrease in income before other changes in net position. The Medical Center's ratio for 2011 is 8.7 versus 10.6 in 2010. The decrease was due to the increase of interest expense. This ratio is higher than the 1.1 required by the Bond Indenture.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
In 2012, the Medical Center completed the last phase of the replacement hospital building at Santa Monica Medical Center. With this completion, the two replacement hospitals are fully compliant with the hospital facilities seismic safety act ("SB 1953"). The medical center continues to operate an eleven bed neurological rehabilitation unit located in the old medical center building. This area is not seismically compliant. The medical center is in the process of assessing areas to locate this unit.

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, 2012, the Patient Protection and Affordable Care Act (PPACA) was signed into law. On March 30, 2012 the Health Care and Education Reconciliation Act of 2012 was signed, amending the PPACA (collectively the "Affordable Care Act"). On June 29, 2012, the Supreme Court upheld the constitutionality of much of 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 Affordability 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 are being phased in through 2014. The medical centers will likely be affected by the coverage expansion provisions that go into effect in 2014, the effect of which is 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, 2012, the Medical Center received $3.4 million in Medi-Cal funding for meeting certain criteria for EHR technology. No amounts were received for the year ended June 30, 2011.

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, 2012, 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, 2011 actuarial valuation was $7.7 billion or 82.1 percent funded. As of July 1, 2012, the funded ratio is expected to decrease to approximately 78 percent. The total funding policy contributions in the July 1, 2011 actuarial valuations represent 26.35 percent of covered compensation. Member and employer contributions increased to 5 percent and 10 percent, respectively, of covered compensation in July 2012. The Regents approved increasing employee member and employer contributions to 6.5 percent and 12 percent, respectively, in July 2013. These contribution rates are below UCRP's total funding 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 cash outs, 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, 2011 actuarial valuation was $14.7 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 Position
June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Assets		
Current assets		
Cash	$ 745,094	$ 598,063
Patient accounts receivable, net of estimated uncollectibles of $ 84,132 and $79,175, respectively	262,394	260,936
Other receivables	5,105	2,330
Third-party payor settlements, net	11,292	8,614
Inventory	21,972	21,406
Prepaid expenses and other assets	18,110	15,762
Total current assets	1,063,967	907,111
Restricted assets:		
Cash restricted for hospital construction	3,170	71,501
Donor funds	17,553	17,469
Capital assets, net	1,862,415	1,728,111
Deferred costs of issuance	5,501	5,949
Other assets	5,142	5,173
Total assets	2,957,748	2,735,314
Deferred Outflows of Resources		
Deferred outflows from interest rate swap agreements	52,752	37,959
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	83,240	79,938
Accrued salaries and benefits	130,642	110,781
Third-party payor settlements, net	293	22,975
Current portion of long-term debt and financing obligations	12,627	14,568
Other liabilities	80,898	18,186
Total current liabilities	307,700	246,448
Notes payable to campus	75,000	75,000
Long-term debt and financing obligations, net of current portion	722,614	698,744
Interest rate swap agreements	78,884	37,959
Total liabilities	1,184,198	1,058,151
Net Position		
Invested in capital assets, net of related debt	1,051,459	1,036,830
Restricted:		
Nonexpendable:		
Endowments	337	337
Expendable:		
Capital projects	3,325	4,036
Other	13,891	13,096
Unrestricted	757,290	660,823
Total net position	$ 1,826,302	$ 1,715,122

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 Position
For the Years Ended June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Net patient service revenue, net of provision for doubtful accounts of $ 39,757 and $36,919, respectively	$ 1,753,609	$ 1,656,724
Other operating revenue:		
Clinical teaching support	13,467	12,979
Other	53,245	50,687
Total other operating revenue	66,712	63,666
Total operating revenue	1,820,321	1,720,390
Operating expenses:		
Salaries and wages	713,574	648,152
UCRP, retiree health and other employee benefits	216,879	181,312
Professional services	35,966	33,530
Medical supplies	213,779	208,027
Other supplies and purchased services	294,123	275,568
Depreciation and amortization	104,124	89,277
Insurance	11,388	10,860
Total operating expenses	1,589,833	1,446,726
Income from operations	230,488	273,664
Non-operating revenues (expenses):		
Hospital fee program grants	2,249	31,399
Interest income	16,785	14,850
Interest expense	(33,777)	(35,876)
Replacement hospital transition expense/equipment transfer to University	(5,872)	(3,819)
Build America bonds federal interest subsidies	3,290	3,016
Loss on disposal of capital assets	(3,908)	(662)
Gain on bond retirement	8,643	6,971
Decrease upon hedge termination	(26,132)	-
Total net non-operating revenues (expenses)	(38,722)	15,879
Income before other changes in net position	191,766	289,543
Other changes in net position:		
Proceed received or receivable from FEMA	95	-
Contributions from University for building program	-	24,854
Donated assets	8,087	3,481
Health system support	(88,768)	(85,548)
Total other changes in net position	(80,586)	(57,213)
Increase in net position	111,180	232,330
Net position – beginning of year	1,715,122	1,482,792
Net position – end of year	$ 1,826,302	$ 1,715,122

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 1,728,479	$ 1,660,882
Payments to employees	(701,823)	(642,567)
Payments to suppliers	(535,808)	(518,305)
Payments for benefits	(208,769)	(172,031)
Other receipts, net	52,548	78,169
Net cash provided by operating activities	334,627	406,148
Cash flows from noncapital financing activities:		
Health system support	(88,768)	(85,548)
Replacement hospital transition costs	(5,872)	(3,820)
Grants from the hospital fee program	2,249	31,399
Net cash used by noncapital financing activities	(92,391)	(57,969)
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	-	24,854
Proceeds from debt issuance	62,140	20,834
Proceeds from FEMA	95	-
Build America bonds federal interest subsidies	3,290	3,016
Proceeds from sale of capital assets	-	935
Purchases of capital assets	(200,242)	(168,821)
Principal paid on long-term debt and financing obligations	(14,825)	(12,216)
Interest paid on long-term debt and financing obligations	(38,782)	(35,360)
Gifts and donated funds	8,087	3,481
Net cash used by capital and related financing activities	(180,237)	(163,277)
Cash flows from investing activities:		
Interest income received	16,785	14,850
Change in restricted assets	68,247	(7,723)
Net cash provided by investing activities	85,032	7,127
Net increase in cash	147,031	192,029
Cash – beginning of year	598,063	406,034
Cash – end of year	$ 745,094	$ 598,063

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 230,488	$ 273,664
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	104,124	89,277
Provision for doubtful accounts	39,757	36,919
Changes in operating assets and liabilities:		
Patient accounts receivable	(41,215)	(50,894)
Other receivables	(2,775)	25,362
Inventory	(566)	1,610
Prepaid expenses and other assets	(2,317)	(1,599)
Accounts payable and accrued expenses	8,710	(1,825)
Accrued salaries and benefits	19,861	14,866
Third-party payor settlements	(25,360)	17,334
Other liabilities	3,920	1,434
Net cash provided by operating activities	$ 334,627	$ 406,148
Supplemental noncash activities information:		
Bond retirements	$ 25,750	$ 18,615
Payables for property and equipment	9,897	12,056
Amortization of deferred costs of issuance	447	380
Amortization of deferred financing costs	331	346
Amortization of bond premium	207	75
Gain on bond retirement	8,643	6,971
Change in fair value of interest rate swaps classified as hedging derivatives	14,793	(14,705)
Purchase of capital assets under financing obligations	62,140	-
Decrease upon hedge termination	26,133	-

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 266-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.

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. Implementation of Statement No. 63 resulted in the reclassification of the 2011 financial statements for purposes of presenting comparative information for the year ended June 30, 2012. The effect of the change from the adoption of Statement No. 63 on the Medical Center's statement of net position resulted in a reclassification of deferred outflows totaling $37,959 from other noncurrent assets to deferred outflows of resources for the year ended June 30, 2011.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the Medical Center's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for the termination of hedge accounting. Implementation of Statement No. 64 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011 net position.

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, 2012 and 2011 was $745,094 and $598,063, 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 position.

Additional information on cash and investments can be obtained from the 2011-2012 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 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 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. 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. 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.

Interest rate swaps are recorded at fair value as either assets or liabilities in the statements of net position. The Medical Center has determined that the certain market interest rate swaps are hedging derivatives that hedge future cash flows on variable rate Medical Center Pooled Revenue Bonds. 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 outflows are classified as deferred outflows of resources and deferred inflows classified as deferred inflows of resources in the statements of net position.

In 2012, the Medical Center retired certain issues of the variable rate Medical Center Pooled Revenue Bonds that were hedged with interest rate swaps, and discontinued hedge accounting for the related interest rate swaps. The related interest rate swaps were reclassified to investment derivatives. The changes in fair value for interest rate swaps classified as investment derivatives is recognized in the statements of revenue, expenses and changes in net position.

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

Net position

Net position is 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 position resulting from transactions with purpose restrictions as restricted net position until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.

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

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

Expenses are charged to either restricted or unrestricted net position based upon a variety of factors, including consideration of prior and future revenue sources, the type of expense incurred, the Medical Center's budgetary policies surrounding the various revenue sources or whether the expense is a recurring cost.

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 position.

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 position.

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 position.

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 position.

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 position 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.

Comparative Information

In connection with the preparation of the June 30, 2012 financial statements, the Medical Center determined that restricted net position was being accounted for on a gross basis separately from restricted liabilities. Management has revised the 2011 restricted expendable net position for capital projects by $71,501 to report restricted net position on a net basis with the related restricted liabilities. This revision had no effect on the total net position of the Medical Center.

The Medical Center determined that certain third-party payor settlements were being reported on a net basis. Management has revised current assets and current liabilities decreasing both by $7.4 million. This revision had no effect on the net position of the Medical Center, statement of revenues, expenses and changes in net position and cash used by the Medical Center.

The Medical Center concluded that cash flows from operating activities included capital expenditure and proceeds from note payables from the campus totaling $42,848. Management has revised the cash flows reported to report in cash flows from capital and related financing activities. This revision had no effect on the statement of net position, statement of revenues, expenses and changes in net position and total cash flows of the Medical Center.

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 March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Medical Center is evaluating the effect that Statement No. 65 will have on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement resolves conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Medical Center is evaluating the effect that Statement No. 66 will have on its financial statements

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for the University's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the University to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This statement requires that most changes in the net pension liability be included in pension expense in the period of the change. As of June 30, 2012, the University reported an obligation to UCRP of $1.9 billion, representing unfunded contributions to UCRP based upon the University's funding policy. Under GASB No. 68, The University's obligation to UCRP is expected to increase. The Medical Center is evaluating the effect that Statement No. 68 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 is as 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, 2010 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 position 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, 2012 and 2011, the Medical Center recorded total Medi-Cal revenue of $149,815 and $191,238, respectively.

- ***Assembly Bill 1383*** **–**State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 in September 2010, SB 90 in April 2011, and SB 335 in September 2011, 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, 2013 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 years ended June 30, 2012 and 2011, the Medical Center received $2,398 and $16,600 respectively, which has been reported as net patient service revenue. For the years ended June 30, 2012 and 2011, the Medical Center received $19 and $31,399, respectively 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, 2012 and 2011, the Medical Center recorded revenue of $9,200 and $8,752, 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.

(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. The most common payment arrangement for outpatient care is combination of a prospective payment system that uses ambulatory payment classifications and percentage of charge based reimbursement.

Amounts due from Medicare represent 16.5 percent and 14.3 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively. Amounts due from Medi-Cal represent 3.7 percent and 8.6 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively.

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

	2012	2011
Medicare (non-risk)	$ 385,038	$ 348,592
Medicare (risk)	44,980	38,114
Medi-Cal (non-risk)	149,815	191,238
Contract (discounted or per diem)	1,145,645	1,052,114
Non-sponsored/self-pay (uninsured)	28,131	26,666
Total	$ 1,753,609	$ 1,656,724

(Dollars in thousands)

4. Charity Care

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

	2012	2011
Charity care at established rates	$ 26,224	$ 21,857
Estimated cost of charity care	$ 9,286	$ 7,179

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $42,693 and $40,282 for the years ended June 30, 2012 and 2011, respectively.

5. Restricted Assets, Donor Funds

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

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

	2012	2011
Mutual funds	$ 12,976	$ 13,452
Charitable remainder trusts	4,577	4,017
Total	$ 17,553	$ 17,469

Donor restricted funds are available for the following purposes:

	2012	2011
Capital purposes	$ 3,325	$ 4,036
Endowments	337	337
Operations	13,891	13,096
Total	$ 17,553	$ 17,469

(Dollars in thousands)

6. Capital Assets

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

	2011	Additions	Disposals	2012
Original Cost				
Land	$ 17,442	$ 13,297	$ -	$ 30,739
Buildings and improvements	1,391,698	439,681	(8,593)	1,822,786
Equipment	396,642	81,772	(33,076)	445,338
Construction in progress	432,031	(292,414)	-	139,617
Capital assets, at cost	$ 2,237,813	$ 242,336	$ (41,669)	$ 2,438,480

	2011	Depreciation	Disposals	2012
Accumulated Depreciation				
Buildings and improvements	$ 250,378	$ 45,575	$ (380)	$ 295,573
Equipment	259,324	58,549	(37,381)	280,492
Accumulated depreciation	509,702	$ 104,124	$ (37,761)	576,065
Capital assets, net	$ 1,728,111			$ 1,862,415

	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

Equipment under financing obligations and related accumulated amortization is $141,027 and $65,392 in 2012, respectively, and $84,390 and $65,229 in 2011, 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.

(Dollars in thousands)

7. 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 agreements in connection with its variable-rate Medical Center Pooled Revenue Bonds. Under the swap agreements, the Medical Center pays the swap counterparty a fixed interest rate payment and receives a variable rate interest payment.

The Medical Center initially determined that its interest rate swap agreements were hedging derivatives that hedge future cash flows for its variable rate Medical Center Pooled Revenue Bonds. In 2012, a portion of the variable rate Medical Center Pooled Revenue Bonds were retired, and the Medical Center reclassified the related interest rate swap from a hedging derivative to an investment derivative. For the hedging derivatives, the notional amount of the swap matches the principal amount of the variable-rate Medical Center Pooled Revenue Bonds, and the swap agreement contains scheduled reductions to outstanding notional amounts that match scheduled reductions in the variable-rate 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 $29,556 and $30,079 at June 30, 2012 and 2011, respectively.

The notional amounts, fair value of the interest rate swaps outstanding and the change in fair value for June 30, 2012 and 2011 are as follows:

Notional Amount		Fair Value – Positive (Negative)			Changes in Fair Value		
2012	2011	Classification	2012	2011	Classification	2012	2011
124,775	174,775	Other non-current assets (liabilities)	$ (52,752)	$ (37,959)	Deferred (inflows)/ outflows	$ (14,793)	$ 14,705
50,000	-	Other non-current assets (liabilities)	$ (26,132)	$ -	Decrease upon hedge termination	$ (26,132)	$ -
174,775	174,775		$ (78,884)	$ (37,959)		$ (40,925)	$ 14,705

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, 2012 or 2011.

Additional terms with respect to the outstanding interest rate swaps, classified as both hedging and investment derivatives, along with the credit rating of the counterparty, are as follows:

(Dollars in thousands)

Terms	Notional Amount	Date	Date	at Inception	Credit Rating
Hedging Derivatives					
Pay fixed 4.550 percent; receive 67 percent of 3-Month LIBOR* + 0.61 percent**	31,610	2008	2030	None	A2/A+
Pay fixed 4.625 percent; receive 67 percent of 3-Month LIBOR* + 0.67 percent**	38,670	2008	2037	None	A2/A+
Pay fixed 4.6935 percent; receive 67 percent of 3-Month LIBOR* + 0.74 percent**	54,495	2008	2043	None	A2/A+
Investment Derivatives					
Pay fixed 4.741 percent; receive 67 percent of 3-Month LIBOR* + 0.79 percent**	50,000	2008	2047	None	A2/A+

* London Interbank Offered Rate (LIBOR)

** Weighted average spread

Concentration of Credit Risk. All of the interest rate swaps are with the same counterparty.

Credit Risk. The Medical Center could be exposed to credit risk if the counterparty to the swap contracts 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 of all of the swap contracts, 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, 2012 and 2011, there was no collateral required.

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

Custodial Credit Risk. Interest rate swaps do not exist in physical or book-entry form, as a result, custodial credit risk is remote.

Foreign Currency Risk. The interest rates swaps are denominated in U.S. dollars, therefore, there is no foreign currency risk.

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. Effective duration is the approximate change in price of a security resulting from 100 basis point (1 percentage point) change in the level of interest rates. It is not a measure of time. The effective duration for the interest rate swap classified as an investment derivative is 21.6.

Basis Risk. There is no basis or tax risk related to the swap classified as hedging derivatives 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 on the interest rate swaps classified as hedging derivatives 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.

8. 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 the entire balance is due upon expiration. The line accrues interest at the STIP rate of an annual average of 2.38 percent for the year ended June 30, 2012. As of June 30, 2012 and June 30, 2011, $75,000 was outstanding. Interest expense for the years ended June 30, 2012 and 2011 was $0 and $1,723, respectively. Effective July 1, 2011, the Campus has agreed to waive periodic interest payments for an undetermined time period.

(Dollars in thousands)

9. Long-term Debt and Financing Obligations

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

	2012	2011
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	$ 17,410	$ 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	243,635	246,385
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	156,280	182,030
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	80,795	83,720
University of California General Revenue Bonds 2003 Series B, interest rates from 2.0 percent to 5.3 percent, payable semi-annually, with annual principal payments through 2023	8,246	8,809
Financing obligations, with fixed interest rates ranging from 2.9 percent to 9.4 percent, payable through 2014, collateralized by underlying equipment	72,367	16,931
The University Pool 2 Loan, interest rate of 5.7 percent payable annually, with annual principal payments through 2019	-	212
Other borrowing	29,556	30,079
	754,289	733,006
Unamortized bond premium	3,334	3,542
Unamortized deferred financing costs	(22,382)	(23,236)
Total debt and financing obligations	735,241	713,312
Less: Amounts due within one year	(12,627)	(14,568)
Noncurrent portion of debt and financing obligations	$ 722,614	$ 698,744

Total interest expense during the years ended June 30, 2012 and 2011 was $36,648 and $35,224, respectively. Interest expense totaling $5,536 and $2,926 was capitalized during the years ended June 30, 2012 and 2011, respectively. The remaining $31,112 in 2012 and $32,298 in 2011 are reported as interest expense in the statements of revenues, expenses and changes in net position. Investment income totaling $(194) and $(254) was capitalized during the years ended June 30, 2012 and 2011, respectively.

(Dollars in thousands)

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

	Revenue Bonds	Financing Obligations	Other Borrowings	Total
Year ended June 30, 2012				
Long-term debt and financing obligations at June 30, 2011	$ 666,301	$ 16,931	$ 30,079	$ 713,311
New obligations	-	62,140	-	62,140
Principal payments and bond retirements	(33,629)	(6,706)	-	(40,335)
Amortization of bond premium	(207)	-	-	(207)
Amortization of deferred financing costs	854	-	(522)	332
Long-term debt and financing obligations at June 30, 2012	633,319	72,365	29,557	735,241
Less: Current portion of long-term debt and financing obligations	(7,737)	(4,337)	(553)	(12,627)
Noncurrent portion of long-term debt and financing obligations as June 30, 2012	$ 625,582	$ 68,028	$ 29,004	$ 722,614
Year ended June 30, 2011				
Long-term debt and financing obligations 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 financing obligations at June 30, 2011	666,302	16,931	30,079	713,312
Less: Current portion of long-term debt and financing obligations	(7,045)	(7,001)	(522)	(14,568)
Noncurrent portion of long-term debt and financing obligations as June 30, 2011	$ 659,257	$ 9,930	$ 29,557	$ 698,744

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, 2012 are $2.2 billion of which $563,325 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, 2012 and 2011 were $6.9 billion and $6.5 billion, respectively.

In August, 2011, the University retired $25,750 of the Medical Center Pooled Revenue Bonds 2007 Series C recognizing a gain of $8,643 on the statements of revenues, expenses and changes in net position. 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 position. During 2012, the campus provided interim financing of $41,925 for the purchase of certain capital assets. The

Medical Center has a payable to the University of $70,302 and $11,510, reported in other current liabilities, in 2012 and 2011, respectively. 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.

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 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 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, 2012 and thereafter are shown below. Although not a prediction by the Medical Center of the future interest rate cost of the variable rate bonds or the impact of the interest rate swaps, these amounts assume that current interest rates on variable rate bonds and the current reference rates of the interest rate swaps will remain the same. As these rates vary, variable-rate bond interest payments and net interest rate swap payments will vary.

Year Ending June 30	Revenue Bonds	Financing Obligations	Total Payments	Principal	Interest
2013	$ 42,748	$ 8,454	$ 51,202	$ 12,720	$ 38,482
2014	42,758	6,564	49,322	11,423	37,899
2015	42,759	4,437	47,196	9,789	37,407
2016	42,749	3,256	46,005	9,019	36,986
2017	42,749	3,387	46,136	9,605	36,531
2018 – 2022	209,029	19,077	228,106	61,914	166,192
2023 – 2027	206,842	23,210	230,052	72,657	157,395
2028 – 2032	203,571	28,238	231,809	95,755	136,054
2033 – 2037	201,133	34,356	235,489	127,551	107,938
2038 – 2042	193,968	38,711	232,679	161,831	70,848
2043 – 2047	165,340	-	165,340	136,330	29,010
2048 – 2052	17,762	-	17,762	16,140	1,622
Total future debt service	1,411,408	169,690	1,581,098	$ 724,734	$ 856,364
Less: Interest component of future payments	(759,042)	(97,322)	(856,364)		
Principal portion of future payments	652,366	72,368	724,734		
Adjusted by:					
Unamortized bond premium	3,334	-	3,334		
Other borrowings	29,556	-	29,556		
Unamortized deferred financing costs	(22,383)	-	(22,383)		
Total debt	$ 662,873	$ 72,368	$ 735,241		

Additional information on the revenue bonds can be obtained from the 2011–2012 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, 2012, 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**
2013	$ -	$ 1,513	$ 4,539	$ 6,052
2014	-	1,513	4,539	6,052
2015	-	1,513	4,539	6,052
2016	-	1,513	4,539	6,052
2017	-	1,513	4,539	6,052
2018 – 2022	-	7,564	22,695	30,259
2023 – 2027	18,415	7,240	21,418	47,073
2028 – 2032	23,025	6,306	17,759	47,090
2033 – 2037	28,840	5,082	13,166	47,088
2038 – 2042	48,755	3,350	6,961	59,066
2043 – 2047	29,990	557	209	30,756
Total future debt service	$ 149,025	$ 37,664	$ 104,903	$ 291,592

10. 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, 2012 and 2011 was $10,715 and $9,302, 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**
2013	$ 12,617
2014	11,676
2015	10,475
2016	9,199
2017	8,132
2018 – 2042	162,613
Total	$ 214,712

11. 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 $3.51 and $3.31 per $100 of UCRP covered payroll resulting in Medical Center contributions of $21,200 and $18,300 for the years ended June 30, 2012 and 2011, 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 $77.7 million and $14.7 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net Position were $89.5 million at June 30, 2012. For the years ended June 30, 2012 and 2011, combined contributions from the University's campuses and medical centers were $346.4 million and $313.9 million, respectively, including an implicit subsidy of $54.1million and $54.9 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.5 billion and $1.8 billion for the years ended June 30, 2012 and 2011. 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 $6.3 billion at June 30, 2012 increased by $1.2 billion for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California.

12. 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 $43,903 and $21,952, respectively, during the year ended June 30, 2012. Medical Center and employee contributions were $20,966 and $10,483, respectively, during the year ended June 30, 2011.

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, 2011, the date of the latest actuarial valuation, were $35.3 billion and $43.0 billion, respectively, resulting in a funded ratio of 82.1 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net Position were $41.8 billion and $41.9 billion at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, the University's campuses and medical centers contributed a combined $1.5 billion and $1.4 billion, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.9 billion for the year ended June 30, 2012. 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 $361.8 million for the year ended June 30, 2012.

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 System.

13. 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 position, were $10,751 and $14,295 for the years ended June 30, 2012 and 2011, respectively. During 2012, as a result of actuarial analysis, the Medical Center received a rebate from the University of $3,581, 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 position, were $11,388 and $10,860 for the years ended June 30, 2012 and 2011, respectively.

14. 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 position for the years ended June 30 as follows:

	2012	2011
Professional services	$ 9,000	$ 11,281
Medical supplies	(4,335)	(3,571)
Other supplies and purchased services	58,909	71,400
Interest income (net)	(16,098)	(11,658)
Insurance	11,389	10,860
Total	$ 58,865	$ 78,312

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 position. 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 \$147,633 and \$186,909 in 2012 and 2011, respectively. Of these amounts, \$58,865 and \$78,312 are reported as operating expenses for the years ended June 30, 2012 and 2011, respectively, and \$88,768 and \$85,548 are reported as health system support for the years ended June 30, 2012 and 2011, respectively.

15. Commitments and Contingencies

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

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

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 \$8,087 and \$3,481 for the years ended June 30, 2012 and 2011, respectively, and are reflected in the statements of revenues, expenses and changes in net position. 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.

The Medical Center has entered into various construction contracts. The remaining cost of these Medical Center projects is estimated to be approximately \$18.3 million, excluding interest, as of June 30, 2012.

University of California,
San Diego Medical Center

Financial Statements

For the Years Ended June 30, 2012 and 2011

University of California, San Diego Medical Center
Index
June 30, 2012 and 2011

Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net position and the related statements of revenues, expenses and changes in net position, and cash flows, as shown on pages 18 through 21, 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, 2012 and 2011, 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, 2012 and 2011, 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 accompanying management’s discussion and analysis on pages 3 through 17 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 11, 2012

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, 2012, with selected comparative information for the years ended June 30, 2011 and 2010. 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 (2010, 2011, 2012, 2013, 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 operate 600 beds and to provide acute care hospital services at two main sites in Hillcrest and La Jolla, as well as to provide psychiatric services for children and adolescents at a 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 and quaternary referral center for San Diego, Riverside and Imperial Counties. It is home to the only Regional Burn Center and one of only two Level I Trauma Centers in the county. A Level I ranking is the highest level given to a trauma center in the U.S. by the American College of Surgeons because of its comprehensive service. Also at this site is the only regional Level III neonatal intensive care unit (NICU) within a birthing facility in San Diego. A Level III NICU provides the highest level of care for the smallest and sickest of newborns.

The La Jolla site, located in north San Diego, includes UC San Diego Thornton Hospital ("Thornton Hospital"), UC San Diego Sulpizio Cardiovascular Center, UC San Diego Moores Cancer Center, and UC San Diego Shiley Eye Center. Thornton Hospital opened in July 1993 and contains 119 licensed beds. It is the principal location for inpatient cancer services and Moores Cancer Center serves as the primary site for outpatient clinical oncology care. Moores Cancer Center is one of only 41 National Cancer Institute-designated comprehensive cancer centers in the U.S. It has one of the first oncology practices in the nation to be recognized by the Quality Oncology Practice Initiative Certification Program, an affiliate of the American Society of Clinical Oncology, for meeting rigorous standards for high-quality cancer care. Sulpizio Cardiovascular Center contains 54 beds and is the principal location for cardiovascular services. In 2012 Shiley Eye Center celebrated its 20th year anniversary; it is retina and glaucoma center, and is home to the region's only eye facility dedicated to children.

Ambulatory care is provided at the Medical Center's hospital-based clinics located in Hillcrest and La Jolla, as well as the surrounding communities of Vista, Encinitas, Scripps Ranch, Kearny Mesa, and Chula Vista.

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 clinical care, research, and educational missions.

Significant events during the year are highlighted below:

- *The Medical Center continues to maintain an outstanding local and national reputation.*
  - The Medical Center was ranked first in San Diego in *U.S. News & World Report*'s first-ever "Best Hospitals" metro rankings in 2011. A hospital had to score in the top 25 percent among its peers in at least one of 16 medical specialties and represent a metropolitan area with 1 million or more residents to qualify.
  - In *U.S. News & World Report*'s "Best Hospitals" issue, six specialties at the Medical Center were nationally recognized – cancer, diabetes, nephrology, orthopedics, psychiatry and pulmonology.
  - The Medical Center was named one of the nation's 100 Top Hospitals by Thomson Reuters, and was one of only 12 hospitals in the nation to receive the Everest Award. This award honors hospitals that have achieved both the highest current performance and the fastest long-term improvement over a five-year period in Reuter's national benchmarking study
  - The Leapfrog Group, an independent national non-profit run by employers and other large purchasers of health benefits, designated the Medical Center as a "Top Hospital" based on the Leapfrog Hospital Survey which is the gold standard for comparing hospitals' performance in quality and patient safety. The Medical Center also received an "A" rating from The Leapfrog Group's Hospital Safety Score℠ in 2012 for its overall performance in keeping patients safe from preventable harm and medical errors.
  - The Medical Center was named a winner of the 2011 University HealthSystem Consortium (UHC) Quality Leadership Award for its quality, effectiveness, safety, equity, patient-centeredness and efficiency. It ranked 5th in the nation out of 101 institutions included; it previously ranked 13th. UHC is an alliance of academic medical centers whose mission is to create knowledge, foster collaboration, and promote change to help its members succeed.
  - The Medical Center was bestowed Magnet® status by the American Nurses Credentialing Center (ANCC). It is one of only 393 magnet hospitals worldwide to receive this status which recognizes organizations for quality patient care, nursing excellence and innovations in nursing.

- *The Medical Center completed the Thornton Expansion/Cardiovascular Center project.* The centerpiece of this project is the four-story Sulpizio Cardiovascular Center which opened on August 8, 2011, and includes four catheterization labs, four "smart" operating rooms, and 21 treatment bays in an expanded emergency department. This $227 million project also included some remodeling and construction work at Thornton Hospital and an expansion of the central plant. Sulpizio Cardiovascular Center is the first cardiovascular center in San Diego and the first hospital-based project in the region to receive Leadership in Energy and Environmental Design (LEED) Gold certification from the United States Green Building Council. LEED promotes a "whole-building" approach to sustainability, as well as good health by combining energy conservation techniques with the very best care available.

- *Construction began in January 2012 on UC San Diego Jacobs Medical Center.* This 245-bed, 10-story, 509,500-square-foot project will include four hospitals in one location: the existing Thornton Hospital, plus the Hospital for Cancer Care, Hospital for

Women and Infants, and Hospital for Advanced Surgery. The project also includes renovations to significant portions of Thornton Hospital to modernize and harmonize with Jacobs Medical Center. The projected completion date is 2016.

- *Recognition for Advanced Use of Information Technology*
  - Adopting new technologies to support operational, clinical and research excellence is a strategic priority for the Medical Center. The Medical Center was one of only 1.1 percent of U.S. hospitals in 2011 to achieve the highest ranking possible, "Stage 7" of electronic medical record (EMR) adoption — a ranking devised by the Healthcare Information and Management Systems Society (HIMSS) Analytics group. At Stage 7 paper charts are no longer used to deliver and manage patient care; the EMR is used in both in-and outpatient settings.
  - The Medical Center was named one of the nation's "Most Wired" for the sixth consecutive year in 2011 by *Hospitals and Health Networks, a publication of the American Hospital Association*. 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.

<u>Service Area and Market Share</u>

The following table presents certain historical utilization statistics for the primary and secondary service areas for the twelve-month period ended December 31, 2010, which is the most current data available from the State of California Office of Statewide Health Planning and Development.

	Counties	# of Zip Codes	Population	Market Share of Discharges
Primary service area	San Diego	78	1,342,000	13%
Secondary service area	San Diego	96	1,738,000	5%

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2012, 2011 and 2010:

	2012	2011	2010
Licensed beds	600	546	552
Admissions	27,411	26,722	24,216
Average daily census	420	384	369
Discharges	26,801	25,742	23,706
Average length of stay	5.8	5.5	5.8
Patient days	153,659	140,011	134,855
Case mix index	1.63	1.67	1.63
Outpatient visits:			
Clinic visits	572,142	554,013	536,188
Emergency visits	65,526	61,446	60,160
Total outpatient visits	637,668	615,459	596,348

Admissions increased by 2.6 percent in 2012 compared to 2011, while average length of stay increased to 5.8 days.

Discharges increased by 4.1 percent in 2012 compared to 2011 with increased cases from medicine, neuroscience, orthopaedic, pediatrics, psychiatry, and surgery. Discharges increased by approximately 8.6 percent in 2011 compared to 2010 with increased cases from medicine, orthopaedic, reproductive medicine, and surgery.

Patient days increased by 9.7 percent in 2012 compared to 2011 due to increased admissions and an increase in overall length of stay. 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.

In 2012, total outpatient clinic visits increased by 3.3 percent and emergency room visits increased by 6.6 percent from 2011. This change is due primarily to a 7.6 percent increase in visits to the UCSD Cancer Center and to increases in new clinics at the Sulpizio Cardiovascular Center, in Encinitas and in Vista. 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.

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the operating results for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Net patient service revenue	$ 996,668	$ 899,949	$ 820,107
Other operating revenue	48,274	42,293	43,930
Total operating revenue	1,044,942	942,242	864,037
Total operating expenses	949,057	826,972	753,202
Income from operations	95,885	115,270	110,835
Total net non-operating revenues	220	27,950	2,037
Income before other changes in net position	$ 96,105	$ 143,220	$ 112,872
Margin	9.2%	15.2%	13.1%
Other changes in net position	$ 11,433	$ (38,030)	$ (35,742)
Increase in net position	107,538	105,190	77,130
Net position - Beginning of year	751,212	646,022	568,892
Net position - End of year	$ 858,750	$ 751,212	$ 646,022

Overall the financial results of the Medical Center declined in 2012 as compared to 2011 and increased in 2011 from 2010, principally due to several factors:

- The Medical Center received $3.3 million, $32.5 million and $0 from the Hospital Fee Program, reported as operating and non-operating revenues, in 2012, 2011 and 2010, respectively. Additionally, the Medical Center received enhanced reimbursements related to provisions contained in the American Reinvestment and Recovery Act ("ARRA") for supplemental Medicaid payments to hospitals, which expired in June 2011.

- The Medical Center's contributions to the University's defined benefit pension plan increased to $24.3 million in 2012 from $11.4 million in 2011 and $2.5 million in 2010.

- New capital assets including the opening of the Sulpizio Cardiovascular Center resulted in additional depreciation expense of $9.7 million in 2012.

Revenues

Total operating revenues for the year ended June 30, 2012 were $1,044.9 million, an increase of $102.7 million, or 10.9 percent, over 2011. Total operating revenues for the year ended June 30, 2011 were $942.2 million, an increase of $78.2 million, or 9.1 percent, over 2010.

For the years ended June 30, 2012, 2011 and 2010, 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 2012 increased by $96.7 million, or 10.7 percent, over 2011. The increase in 2012 over 2011 was due to increased patient volume, contract price increases, and improved collections. 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 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. An increase of $6.0 million, or 14.1 percent, in 2012 in other operating revenue was due to $5.5 million from Medicare and the State as an incentive payment for meeting Federal and State standards for "meaningful use" of electronic health record technology, and also from increased joint venture income. A decrease of $1.6 million, or 3.7 percent, in 2011 in other operating revenue was due primarily to decreased joint venture income.

The following table summarizes net patient service revenue for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Medicare (non-risk)	$ 208,555	$ 190,135	$ 179,436
Medi-Cal (non-risk)	192,516	192,592	169,218
Contract (discounted or per diem)	552,684	482,120	435,710
Commercial	10,326	9,364	8,562
County	28,171	21,309	19,627
Non-sponsored/self-pay	4,416	4,429	7,554
Total	$ 996,668	$ 899,949	$ 820,107

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 2012 by $18.4 million, or 9.7 percent, from 2011. Medicare inpatient net revenue for 2012 increased by $11.9 million, or 8.9 percent, over 2011 due primarily to increased patient volume and higher intensity patients as measured by the Medicare case mix index. Medicare outpatient net revenues for 2012 increased by $6.5 million, or 11.4 percent, over 2011, due to increased patient activity. Net revenues also includes reimbursement for prior year settlements and other adjustments of $5.5 million in 2012 compared to $2.6 million in 2011 and $8.5 million in 2010.

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.

In 2006, the State implemented a new five-year 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. A second five-year Medicaid hospital financing waiver in California was enacted in 2011 under Assembly Bill 1066. Under the second waiver, 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 in addition to fee-for-service, DSH, and SNCP payments.

Total Medi-Cal net revenues for 2012 decreased by $0.1 million, or 0.0 percent, over 2011 as a result of two offsetting issues. Beginning on July 1, 2011, the Medicaid Waiver's mandatory transition of Senior and Disabled Persons (SDP's) from traditional fee-for-service Medi-Cal to managed Medi-Cal plans reduced fee-for-service payments, but was offset by favorable adjustments in amounts due from the State for the first five-year waiver program. 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.

Inpatient Medi-Cal net revenues for 2012 increased by $12.6 million, or 8.3 percent, from 2011 primarily due to the favorable adjustment to the amount due from the State for the first five-year waiver program offset partially by the transition of SDP's to managed Medi-cal plans. Inpatient Medi-Cal net revenues for 2011 increased by $23.1 million, or 17.9 percent, from 2010 due to the Medicaid financing waiver and to $0.6 million from the hospital fee program.

In 2012, outpatient Medi-Cal net revenues decreased by $12.7 million, or 31.9 percent, from 2011 because of the impact of the SDP transition on fee-for-service payments as well as decreases of $7.5 million in payments under Assembly Bill 915, the Public Hospital Outpatient Services Supplemental Reimbursement Program. 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 2012, net revenues for contracts/commercial increased by $71.5 million, or 14.6 percent, over 2011 due primarily to increased patient volume, and the impact of the Medical Center's ongoing revenue cycle initiatives, contracting efforts and strategic pricing. 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.

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 increased by $6.9 million, or 32.2 percent from 2011 due primarily to the newly created Low Income Health Program (LIHP). The LIHP expanded coverage under the Medicaid Waiver effective July 1, 2011 to all legal residents up to 133% of the Federal poverty level. 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.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Salaries and wages	$ 379,668	$ 337,692	$ 314,490
Employee benefits	148,128	121,329	101,268
Professional services	38,607	35,447	32,211
Medical supplies	192,117	170,054	162,490
Other supplies and purchased services	139,853	120,596	105,721
Depreciation and amortization	45,110	35,437	32,181
Insurance	5,574	6,417	4,841
Total	$ 949,057	$ 826,972	$ 753,202

Total operating expenses for 2012 of $949.1 million increased by $122.1 million, or 14.8 percent, over 2011 primarily due to increased salaries, benefits, medical supplies, purchased services, and depreciation for the Sulpizio Cardiovascular Center. Total operating expenses for 2011 of $827.0 million increased by $73.8 million, or 9.8 percent, over 2010 primarily due to increased salaries, benefits, medical supplies, and purchased services.

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 2012, salaries and wages grew by $42.0 million, or 12.4 percent, over the prior year. This increase includes $15.6 million, or 4.6 percent in salary increases and an increase of 350 full time equivalent employees, or 7.8 percent from the prior year. This increase was due to a 4.0 percent increase in inpatient volume, a 3.6 percent increase in clinic and emergency room visits, and included staff required for the Sulpizio Cardiovascular Center that opened in August 2011. In 2011, salaries and wages grew by $23.2 million, or 7.4 percent, over the prior year. This increase includes $10.0 million, or 3.2 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.

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2012 increased $4.4 million, or 43.6 percent, over 2011 due to the need for nursing and other technical staff especially during periods of peak census. 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.

In 2012, employee benefit costs increased by $26.8 million, or 22.1 percent, over 2011. Pension contributions were $24.3 million in 2012 as compared to $11.4 million in 2011 and $2.5 million in 2010. The Medical Center's health insurance and other employee benefit costs increased in 2012 as compared to 2011 by $13.9 million, or 12.6 percent, due to an increase in health insurance premiums of $5.8 million and increases in other benefit costs of $8.1 million. 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.

As a percentage of total operating revenue, salaries and employee benefits were 50.5 percent in 2012, 48.7 percent in 2011 and 48.1 percent in 2010. Overall labor costs increased in 2012 as a percent of operating revenues primarily due to increased employer contributions to the pension plan.

Payments for professional services increased by $3.2 million, or 8.9 percent, in 2012 compared to 2011 primarily due to the provision of new services, and $3.2 million, or 10.0 percent, in 2011 compared to 2010 due to the provision of new services.

In 2012, medical supply expense increased by $22.1 million, or 13.0 percent, over 2011 due primarily to higher patient volume and inflation. 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.

Other supplies and purchased services expense increased in 2012 by $19.3 million, or 16.0 percent, over 2011 due to an increase in temporary labor primarily for nursing registry, rent for the building lease for the Center for Advanced Laboratory Medicine, purchased medical services, maintenance and repairs, and other purchased services. 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 labor expense of $2.8 million, or 38.8 percent and campus administrative charges of $5.3 million, or 1,098.8 percent.

Depreciation and amortization increased by $9.7 million, or 27.3 percent, in 2012 compared to 2011 primarily due to the opening of the Sulpizio Cardiovascular Center, and by $3.3 million, or 10.1 percent, in 2011 compared to 2010 due to increased capital expenditures.

Insurance expense of $5.6 million in 2012 and $6.4 million in 2011 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense decreased by $0.8 million, or 13.1 percent, in 2012 and increased by $1.6 million, or 32.6 percent, in 2011.

Income from Operations

The Medical Center reported income from operations of $95.9 million and operating revenue of $1,044.9 million. Income from operations decreased in the current year to $95.9 million from $115.3 million in the prior year. The $19.4 million or 16.8 percent decrease in 2012 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, decreased by $27.7 million, or 99.2 percent, from

2011. This decrease is primarily due to the direct grant portion of the hospital fee program which was $1.9 million in 2012. Interest expense was $4.3 million higher in 2012 because less interest expense was capitalized in 2012 for the Sulpizio Cardiovascular Center. Non-operating revenues in 2011 increased by $25.9 million, or 1,272.1 percent, from 2010 primarily due to due to the direct grant portion of the hospital fee program which was $24.5 million in 2011.

Income before Other Changes in Net Position

The Medical Center reported income before other changes in net position of $96.1 million in 2012 compared to $143.2 million in 2011 and $112.9 million in 2010, a decrease of $47.1 million, or 32.9 percent, and an increase of $30.3 million, or 26.8 percent, respectively. The resulting margin for 2012 was 9.2 percent as compared to 15.2 percent and 13.1 percent in 2011 and 2010.

Other Changes in Net position

The other changes in net position for 2012, 2011 and 2010 include:

	2012	2011	2010
Donated assets	$ 11,399	$ 15,851	$ 1,614
Transfers from University, net	46,746	2,024	1,958
Health system support	(46,712)	(55,905)	(39,314)
Total other changes in net position	$ 11,433	$ (38,030)	$ (35,742)

The lower section of the statements of revenues, expenses and changes in net position shows the other changes to net position in addition to the income or loss. Net position is the difference between the total assets and total liabilities. The other changes in net position 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 position in 2012 and 2011 are the following:

- Donated assets of $11.4 million and $15.9 million, respectively. Most of the 2012 amount was due to a gift of $10.1 million from the Jacobs family for the Jacobs Medical 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 $46.7 million and $55.9 million, respectively.

- Transfers from the University of $46.7 million and $2.0 million, respectively. The amount received in 2012 includes $29.8 million in proceeds from the Children's Hospital Bond Act of 2004, which was California ballot Proposition 61. It authorized the sale of $750 million in bonds to provide funding for children's hospitals as well as specified University of California hospitals. The Medical Center was eligible for $29.8 million from this pool of funds to be used for construction of the Jacobs Medical Center.

In total, the net position increased for the year ended June 30, 2012 by $107.5 million to $858.8 million. In total, the net position increased for the year ended June 30, 2011 by $105.2 million to $751.2 million.

Statements of Net Position

The following table is an abbreviated statement of net position at June 30, 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Current assets:			
Cash	$ 120,359	$ 189,906	$ 185,295
Patient accounts receivable (net)	183,812	144,509	139,756
Other current assets	102,174	54,641	50,448
Total current assets	406,345	389,056	375,499
Restricted assets	134	610	36,429
Capital assets (net)	796,358	687,612	550,675
Other assets	11,092	12,174	9,075
Total assets	1,213,929	1,089,452	971,678
Current liabilities	138,731	125,283	115,750
Other liabilities	2,077	-	-
Long-term debt	214,371	212,957	209,906
Total liabilities	355,179	338,240	325,656
Net position:			
Invested in capital assets (net)	557,388	452,293	358,128
Unrestricted	301,362	298,919	287,894
Total net position	$ 858,750	$ 751,212	$ 646,022

Total current assets increased by $17.3 million, or 4.4 percent, in 2012 over 2011. Total current assets increased by $13.6 million, or 3.6 percent, in 2011 over 2010.

Cash decreased by $69.5 million, or 36.6 percent, in 2012 over 2011. This was due to an increase in patient accounts receivable, delays in payments by the State related to the Medi-Cal program, and cash used for capital investments. 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.

Patient accounts receivable, net of estimated uncollectibles, increased by $39.3 million, or 27.2 percent, in 2012 over 2011 due primarily to increased patient activity and an increase in the days outstanding in accounts receivable. 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 2012, other current assets, which include third party payor settlements, non-patient receivables, inventory, and prepaid expenses increased by $47.5 million, or 87.0 percent, primarily due to increases in third party settlements receivable from the State for amounts due under the Medicaid Waiver program. In 2011, other current assets increased by $4.2 million, or 8.3 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.

Capital assets increased by $108.7 million, or 15.8 percent, in 2012 over 2011 due primarily to capital spending related to construction on the Jacobs Medical Center project. 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.

Restricted assets represent unspent proceeds of $0.1 million from the December 2010 and December 2011 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 2012, other assets decreased by $1.1 million, or 8.9 percent, from the prior year due primarily to cash distributions received from investments in joint ventures. 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.

Current liabilities increased by $13.4 million, or 10.7 percent, from 2011 due primarily to an increase in accounts payable, accrued salaries and benefits, and an increase in the current portion of long-term debt due to new financing obligations in 2012. In 2011, current liabilities increased by $9.5 million, or 8.2 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 financing obligations in 2011, offset by a decrease in accounts payable.

Other long term liabilities increased $2.1 million in 2012 as a result of unearned rent on new centralized locations for laboratory services and for patient billing services.

Long-term debt in 2012 increased by $1.4 million, or 0.7 percent, from the prior year due to two new financing arrangements for capital equipment, offset by debt service payments. In 2011 long-term debt increased by $3.1 million from the prior year due to two new financing arrangements for capital equipment, offset by debt service payments and the refunding of 2000 Series bonds by the 2010 Series G pooled revenue bonds.

Net position increased by $107.5 million, or 14.3 percent, in 2012 over the prior year. The change in net position includes excess of revenues over expenses of $96.1 million, receipt of $11.4 million of donated assets, $16.9 million of transfers from the University, and receipt of $29.8 million in State appropriations from proceeds of Proposition 61 bonds. These increases to net position were reduced by the transfer of approximately $46.7 million of funds to the University as health system support. During fiscal years 2011 and 2010, the Medical Center transferred $55.9 million and $39.3 million of funds to the University as health system support, respectively.

Liquidity and Capital Resources

The Medical Center generated $68.0 million and $146.2 million from operating activities in 2012 and 2011, respectively.

Cash flows from non-capital financing activities decreased by $44.8 million in 2012 due to transfers to the University for health system support and to funding received from the Hospital Fee Program. In 2011, cash flows from non-capital financing activities decreased by $31.4 million due to transfers to the University for health system support and to funding received from the Hospital Fee Program.

Cash flows from capital and related financing activities decreased by $97.1 million in 2012 primarily due to $46.7 million in contributions by the University for building programs (including proceeds from Proposition 61 bonds), $18.5 million from capital equipment financing obligations, purchase of $151.7 million in capital assets (including construction in progress on the Jacobs Medical Center), principal payments on debt of $13.2 million, interest payments of $11.4 million, and gifts and donated funds received of $11.4 million. In 2011, cash flows from capital and related financing activities decreased by $147.8 million mainly due to bond proceeds of $41.7 million from the refunding of debt, $15.7 million from capital equipment financing obligations, purchase of $161.6 million in capital assets (including completion of the Sulpizio Cardiovascular Center), principal payments on debt of $51.3 million including refunding payment of debt, interest payments of $12.7 million, and $15.9 million in gifts and donated funds.

Cash flows from investing activities increased by $4.4 million in 2012 due to interest income of $3.0 million, a change in restricted assets of $0.5 million resulting from bond proceeds used in the Sulpizio Cardiovascular Center construction, and $0.9 million from joint ventures. In 2011, cash flows from investing activities increased by $37.6 million due to interest income of $3.9 million, a change in restricted assets of $35.8 million from bond funds used in the Sulpizio Cardiovascular Center construction, and $2.2 million invested in joint ventures.

Overall cash decreased to $120.4 million or 36.6 percent in 2012 from $189.9 million in 2011.

The following table shows key liquidity and capital ratios for 2012, 2011 and 2010:

	2012	2011	2010
Days cash on hand	49	88	94
Days of revenue in accounts receivable	68	59	62
Purchases of capital assets ($ in millions)	$ 151.7	$ 161.6	$ 113.6
Debt service coverage ratio	6.3	3.0	8.2

Days cash on hand decreased to 49 days at June 30, 2012 from 88 days at June 30, 2011 for a 44.3 percent decrease. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash. A large portion of the decrease in days cash on hand in 2012 is due to delays in payment by the State related to the Medi-Cal program.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2012, net days in accounts receivable was 68 days as compared to 59 days in 2011. The increase is due to changes in billing standards, payor mix shifts, and continuing efforts to ensure compliant billing.

The debt service coverage ratio for 2012 was 6.3 times debt service compared to 3.0 times debt service in 2011. The increase is due to the refunding of medical center bonds in 2011. Total debt service payments were $13.2 million in 2012 and $12.7 million in 2011.

Looking Forward

Payments from Federal and State Health Care Programs

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

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

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

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"). On June 29, 2012, the Supreme Court upheld the constitutionality of much of 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 Affordability 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 are being phased in through 2014. The medical centers will likely be affected by the coverage expansion provisions that go into effect in 2014, the effect of which is 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, 2012, the Medical Center received $5.5 million in payments for the meaningful use of EHR technology. No amounts were received for the year ended June 30, 2011.

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, 2012, 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, 2011 actuarial valuation was $7.7 billion or 82.1 percent funded. As of July 1, 2012, the funded ratio is expected to decrease to approximately 78 percent. The total funding policy contributions in the July 1, 2011 actuarial valuations represent 26.4 percent of covered compensation. Member and employer contributions increased to 5 percent and 10 percent, respectively, of covered compensation in July 2012. The Regents approved increasing employee member and employer contributions to 6.5 percent and 12 percent, respectively, in July 2013. These contribution rates are below UCRP's total funding 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 cash outs, 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, 2011 actuarial valuation was $14.7 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 Position
June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Assets		
Current assets		
Cash	$ 120,359	$ 189,906
Patient accounts receivable, net of estimated uncollectibles of $64,616 and $95,486, respectively	183,812	144,509
Other receivables	9,975	7,989
Third-party payor settlements, net	64,248	20,534
Inventory	17,602	16,291
Prepaid expenses and other assets	10,349	9,827
Total current assets	406,345	389,056
Restricted assets:		
Cash restricted by trustee	134	610
Capital assets, net	796,358	687,612
Investments in joint ventures	7,404	8,293
Deferred costs of issuance	2,075	2,212
Other assets	1,613	1,669
Total assets	1,213,929	1,089,452
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	59,332	56,114
Accrued salaries and benefits	56,837	51,652
Third-party payor settlements, net	6,437	4,719
Current portion of long-term debt and financing obligations	15,907	12,580
Other liabilities	218	218
Total current liabilities	138,731	125,283
Unearned Rent	2,077	-
Long-term debt and financing obligations, net of current portion	214,371	212,957
Total liabilities	355,179	338,240
Net Position		
Invested in capital assets, net of related debt	557,388	452,293
Unrestricted	301,362	298,919
Total net position	$ 858,750	$ 751,212

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 Position
For the Years Ended June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Net patient service revenue, net of provision for doubtful accounts of $98,192 and $95,365, respectively	$ 996,668	$ 899,949
Other operating revenue:		
Clinical teaching support	6,277	6,182
Other	41,997	36,111
Total other operating revenue	48,274	42,293
Total operating revenue	1,044,942	942,242
Operating expenses:		
Salaries and wages	379,668	337,692
UCRP, retiree health and other employee benefits	148,128	121,329
Professional services	38,607	35,447
Medical supplies	192,117	170,054
Other supplies and purchased services	139,853	120,596
Depreciation and amortization	45,110	35,437
Insurance	5,574	6,417
Total operating expenses	949,057	826,972
Income from operations	95,885	115,270
Non-operating revenues (expenses):		
Hospital fee program grants	1,923	24,530
Interest income	3,003	3,945
Interest expense	(7,020)	(2,688)
Build America bonds federal interest subsidies	2,534	2,527
Loss on disposal of capital assets	(220)	(364)
Total net non-operating revenues	220	27,950
Income before other changes in net position	96,105	143,220
Other changes in net position:		
Donated assets	11,399	15,851
Contributions from University for building program	46,746	2,024
Health system support	(46,712)	(55,905)
Total other changes in net position	11,433	(38,030)
Increase in net position	107,538	105,190
Net position – beginning of year	751,212	646,022
Net position – end of year	$ 858,750	$ 751,212

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 915,369	$ 891,953
Payments to employees	(403,517)	(358,879)
Payments to suppliers	(376,002)	(334,255)
Payments for benefits	(124,602)	(99,411)
Other receipts, net	56,731	46,753
Net cash provided by operating activities	67,979	146,161
Cash flows from noncapital financing activities:		
Health system support	(46,712)	(55,905)
Grants from the hospital fee program	1,923	24,530
Net cash used by noncapital financing activities	(44,789)	(31,375)
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	46,747	2,024
Proceeds from debt issuance	-	41,651
Proceeds from financing obligations	18,535	15,666
Build America bonds federal interest subsidies	2,534	2,527
Proceeds from sale of capital assets	37	95
Purchases of capital assets	(151,702)	(161,581)
Principal paid on long-term debt and financing obligations	(13,233)	(51,288)
Interest paid on long-term debt and financing obligations	(11,422)	(12,708)
Gifts and donated funds	11,399	15,851
Net cash used by capital and related financing activities	(97,105)	(147,763)
Cash flows from investing activities:		
Change in restricted assets	476	35,819
Interest income received	3,003	3,945
Investments in joint ventures	889	(2,176)
Net cash provided by investing activities	4,368	37,588
Net increase (decrease) in cash	(69,547)	4,611
Cash – beginning of year	189,906	185,295
Cash – end of year	$ 120,359	$ 189,906

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 95,885	$ 115,270
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	45,110	35,437
Provision for doubtful accounts	98,192	95,365
Changes in operating assets and liabilities:		
Patient accounts receivable	(137,495)	(100,118)
Other receivables	(1,986)	5,039
Inventory	(1,311)	(1,700)
Prepaid expenses and other assets	(466)	(802)
Accounts payable and accrued expenses	4,784	(4,993)
Accrued salaries and benefits	5,185	5,688
Third-party payor settlements	(41,996)	(3,243)
Other liabilities	-	218
Unearned rent	2,077	-
Net cash provided by operating activities	$ 67,979	$ 146,161
Supplemental noncash activities information:		
Payables for capital assets	$ 7,585	$ 10,392
Amortization of bond premium	561	395
Bond retirements	-	278
Amortization of deferred costs of issuance	137	137

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 600 licensed beds which include the 392-bed UCSD Medical Center in Hillcrest, near downtown San Diego, the 119-bed John M. and Sally B. Thornton Hospital ("Thornton Hospital") and the 54-bed Sulpizio Cardiovascular Center both located in La Jolla on the UCSD campus, and the 35-bed child and adolescent program 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.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Re-sources, 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. Implementation of Statement No. 63 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the Medical Center's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for the termination of hedge accounting. Implementation of Statement No. 64 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011.

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, 2012 and 2011 was $120,359 and $189,906, 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 position.

Additional information on cash and investments can be obtained from the 2011–2012 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 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. 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.

Investments in Joint Ventures
The Medical Center has entered into joint venture arrangements with various third party entities that include bone marrow transplantation services and ambulatory surgery services. 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.

Unearned Rent
Operating lease payments are recognized as rent expense on a straight line basis over the life of the lease.

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 Position
Net position is 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 position resulting from transactions with purpose restrictions as restricted net position until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.

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

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

Expenses are charged to either restricted or unrestricted net position based upon a variety of factors, including consideration of prior and future revenue sources, the type of expense incurred, the Medical Center's budgetary policies surrounding the various revenue sources or whether the expense is a recurring cost.

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 position.

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 position.

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 position.

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 position.

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 position 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.

Comparative Information

In connection with the preparation of the June 30, 2012 financial statements, the Medical Center determined that restricted net position was being accounted for on a gross basis separate from restricted liabilities. Management has revised the restricted expendable net position for capital projects by $610 to report restricted net position on a net basis with the related restricted liabilities. This revision had no effect on the total net position of the Medical Center.

The Medical Center determined that certain third-party payor settlements were being reported on a net basis. Management has revised current assets and current liabilities increasing both by $4.7 million. This revision had no effect on the net position of the Medical Center, statement of revenues, expenses and changes in net position and cash used by the Medical Center.

The Medical Center noted that investments in joint ventures were being reported net with other noncurrent assets. Management has revised to present separately its investment in joint ventures on the statement of net position.

The Medical Center determined that revenues on services provided to third-party entities were being reported on a net basis with the related operating expenses on the statement of revenues, expenses and changes in net position. Management has revised operating expenses by $28,594 to report operating revenues on a gross basis. This revision had no effect on the statement of net position or income from operations of the Medical Center.

The Medical Center identified interest payments on long-term debt of $9.9 million, which were capitalized with capital projects that were being reported on a net basis with purchases of capital assets in the statement of cash flows. Additionally, proceeds from financing obligations of $15.7 million were being reported net with proceeds from debt issuances. Management has revised to present all interest payments on long-term debt together and proceeds from financing obligations separately within cash flows from capital and related financing activities. This revision had no effect on the statement of net position, statement of revenues, expenses and changes in net position and cash used by capital and related financing activities.

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, 2012. 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 March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Medical Center is evaluating the effect that Statement No. 65 will have on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement resolves conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Medical Center is evaluating the effect that Statement No. 66 will have on its financial statements.

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, effective for the University's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the University to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This statement requires that most changes in the net pension liability be included in pension expense in the period of the change. As of June 30, 2012, the University reported an obligation to UCRP of $1.9 billion, representing unfunded contributions to UCRP based upon the University's funding policy. Under GASB No. 68, The University's obligation to UCRP is expected to increase. The Medical Center is evaluating the effect that Statement No. 68 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 is as 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 concluding their audits of the 2005 and 2006 cost reports, and has begun the audit of the 2007 cost report. 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 position 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, 2012 and 2011, the Medical Center recorded total Medi-Cal revenue of $192,516 and $192,592, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 on September 8, 2010, SB 90 in April 2011, and SB 335 in September 2011, 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, 2013 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 years ended June 30, 2012 and 2011, the Medical Center received $1,330 and $8,006 respectively, which has been reported as net patient service revenue. For the years ended June 30, 2012 and 2011, the Medical Center received $1,923 and $24,530, respectively 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, 2012 and 2011, the Medical Center recorded patient services revenue of $11,750 and $19,227, 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, 2012 and 2011, the Medical Center applied for and received additional revenue of $3,100 and $1,902, respectively. The amounts received are related to the reimbursement of costs for certain debt financed construction projects based on the Medical Center's Medi-Cal utilization rate.

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

  - Commercial insurance companies that reimburse the Medical Center for reasonable and customary charges. Workers' compensation plans pay negotiated rates and are reported as contract (discounted or per-diem) revenue.
  - Managed care contracts such as those with HMO's and PPO's that reimburse the Medical Center at contracted or per-diem rates, which are usually less than full charges.
  - Counties in the state of California that reimburse the Medical Center for certain indigent patients covered under county contracts.

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

Amounts due from Medicare represent 13.5 percent and 10.3 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively. Amounts due from Medi-Cal represent 9.2 percent and 8.0 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, net patient service revenue included $5,561 and $2,600, respectively, due to cost report settlements of previous years with Medicare, Medi-Cal and the Champus Program.

(Dollars in thousands)

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

	2012	2011
Medicare (non-risk)	$ 208,555	$ 190,135
Medi-Cal (non-risk)	192,516	192,592
Contract (discounted or per diem)	552,684	482,120
Commercial	10,326	9,364
County	28,171	21,309
Non-sponsored/self-pay	4,416	4,429
Total	$ 996,668	$ 899,949

4. Charity Care

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

	2012	2011
Charity care at established rates	$ 108,265	$ 107,842
Estimated cost of charity care	$ 33,545	$ 30,696

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $28,386 and $17,949 for the years ended June 30, 2012 and 2011, respectively.

(Dollars in thousands)

5. Capital Assets

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

	2011	Additions	Disposals	2012
Original Cost				
Land	$ 4,550	$ 4,091	$ -	$ 8,641
Buildings and improvements	650,196	47,187	-	697,383
Equipment	217,792	33,121	(5,141)	245,772
Construction in progress	129,813	70,027	(312)	199,528
Capital assets, at cost	$ 1,002,351	$ 154,426	$ (5,453)	$ 1,151,324

	2011	Depreciation	Disposals	2012
Accumulated Depreciation				
Buildings and improvements	$ 211,693	$ 21,466	$ -	$ 233,159
Equipment	103,046	23,644	(4,883)	121,807
Accumulated depreciation	314,739	$ 45,110	$ (4,883)	354,966
Capital assets, net	$ 687,612			$ 796,358

	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

Equipment under financing obligations and related accumulated amortization is $47,445 and $12,200 in 2012, respectively, and $27,373 and $13,185 in 2011, 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

(Dollars in thousands)

California Public Works Board. These amounts totaling $1,936 and $2,538 for the years ended June 30, 2012 and 2011, respectively, are included in Transfers from University for building program on the statements of revenues, expenses and changes in net position.

6. Long-term Debt and Financing Obligations

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

	2012	2011
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	33,930	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	18,742	18,952
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	10,789	11,782
Financing 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	37,993	27,918
	225,169	219,867
Unamortized bond premium	5,109	5,670
Total debt and financing obligations	230,278	225,537
Less: Amounts due within one year	(15,907)	(12,580)
Noncurrent portion of debt and financing obligations	$ 214,371	$ 212,957

Total interest expense during the years ended June 30, 2012 and 2011 was $10,998 and $12,622, respectively. Interest expense totaling $3,978 and $9,934 was capitalized during the years ended June 30, 2012 and 2011, respectively. The remaining $7,020 in

(Dollars in thousands)

2012 and $2,688 in 2011 are reported as interest expense in the statements of revenues, expenses and changes in net position.

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

	Revenue Bonds	Financing Obligations	Total
Year ended June 30, 2012			
Long-term debt and financing obligations at June 30, 2011	$ 197,619	$ 27,918	$ 225,537
New obligations	-	18,535	18,535
Principal payments	(4,773)	(8,460)	(13,233)
Amortization of bond premium	(561)	-	(561)
Long-term debt and financing obligations at June 30, 2012	192,285	37,993	230,278
Less: Current portion of long-term debt and financing obligations	(5,490)	(10,417)	(15,907)
Noncurrent portion of long-term debt and financing obligations as June 30, 2012	$ 186,795	$ 27,576	$ 214,371
Year ended June 30, 2011			
Long-term debt and financing obligations at June 30, 2010	$ 202,128	$ 17,775	$ 219,903
New obligations	37,500	15,666	53,166
Principal payments	(45,765)	(5,523)	(51,288)
Amortization of bond premium	(395)	-	(395)
Bond Premium	4,151	-	4,151
Long-term debt and financing obligations at June 30, 2011	197,619	27,918	225,537
Less: Current portion of long-term debt and financing obligations	(5,168)	(7,412)	(12,580)
Noncurrent portion of long-term debt and financing obligations as June 30, 2011	$ 192,451	$ 20,506	$ 212,957

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, 2012 are $2.2 billion of which $176,387 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, 2012 and 2011 were $6.9 billion and $6.5 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 position. 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.

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. 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, 2012 and thereafter are as follows:

Years Ending June 30	Revenue Bonds	Financing Obligations	Total Payments	Principal	Interest
2013	$ 15,760	$ 11,030	$ 26,790	$ 15,346	$ 11,444
2014	15,452	10,065	25,517	14,490	11,027
2015	15,439	8,581	24,020	13,374	10,646
2016	15,438	6,947	22,385	12,070	10,315
2017	15,430	2,723	18,153	8,162	9,991
2018 – 2022	72,807	-	72,807	26,977	45,830
2023 – 2027	61,099	-	61,099	21,368	39,731
2028 – 2032	57,809	-	57,809	24,965	32,844
2033 – 2037	55,000	-	55,000	30,815	24,185
2038 – 2042	51,123	-	51,123	37,580	13,543
2043 – 2047	22,232	-	22,232	20,022	2,210
Total future debt service	397,589	39,346	436,935	$ 225,169	$ 211,766
Less: Interest component of future payments	$ (210,413)	$ (1,353)	$ (211,766)		
Principal portion of future payments	187,176	37,993	225,169		
Adjusted by:					
Unamortized bond premium	5,109	-	5,109		
Total debt	$ 192,285	$ 37,993	$ 230,278		

Additional information on the revenue bonds can be obtained from the 2011–2012 annual report of the University.

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, 2012 and 2011 was $7,475 and $5,318, respectively. The terms of the operating leases extend through the year 2016.

(Dollars in thousands)

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
2013	$ 8,690
2014	7,496
2015	6,646
2016	5,334
2017	3,741
2018 - 2022	14,683
Total	$ 46,590

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 $3.51 and $3.31 per $100 of UCRP-covered payroll resulting in Medical Center contributions of $11,202 and $9,560 for the years ended June 30, 2012 and 2011, 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, 2011, the date of the latest actuarial valuation, were $77.7 million and $14.7 billion respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net Position were $89.5 million at June 30, 2012. For the years ended June 30, 2012 and 2011, combined contributions from the University's campuses and medical centers were $346.4 million and $313.9 million, respectively, including an implicit subsidy of $54.1 million and $54.9 million respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.5 billion and $1.8 billion for the years ended June 30, 2012 and 2011. 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 $6.3 billion at June 30, 2012 increased by $1.2 billion for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California.

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 $24,320 and $9,678, respectively, during the year ended June 30, 2012. Medical Center and employee contributions were $11,389 and $5,501, respectively, during the year ended June 30, 2011.

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, 2011, the date of the latest actuarial valuation, were $35.3 billion and $43.0 billion, respectively, resulting in a funded ratio of 82.1 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net Position were $41.8 billion and $41.9 billion at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, the University's campuses and medical centers contributed a combined $1.5 billion and $1.4 billion respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.9 billion for the year ended June 30, 2012. 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 $361.8 million for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California Retirement System.

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 position, were $3,688 and $2,389 for the years ended June 30, 2012 and 2011, respectively. During 2012 and 2011, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $3,306 and $3,610, 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 position, were $5,574 and $6,417 for the years ended June 30, 2012 and 2011, 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 position for the years ended June 30 as follows:

	2012	2011
Salaries and employee benefits	$ 10,749	$ 9,197
Professional services	38,607	35,447
Medical supplies	(930)	(881)
Other supplies and purchased services	(7,820)	(6,609)
Interest income (net)	(2,380)	(3,215)
Insurance	5,574	6,417
Total	$ 43,800	$ 40,356

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 position. 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 $90,512 and $96,261 in 2012 and 2011, respectively. Of these amounts, $43,800 and $40,356 are reported as operating expenses for the years ended June 30, 2012 and 2011, respectively, and $46,712 and $55,905 are reported as health system support for the years ended June 30, 2012 and 2011, 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 $741 million, excluding interest, as of June 30, 2012.

University of California, San Francisco Medical Center

Financial Statements
For the Years Ended June 30, 2012 and 2011

University of California, San Francisco Medical Center
Index
June 30, 2012 and 2011

Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying statements of net position and the related statements of revenues, expenses and changes in net position, and cash flows, as shown on pages 18 through 21, 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, 2012 and 2011, 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, 2012 and 2011, 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 accompanying management’s discussion and analysis on pages 3 through 17 are required by accounting principles generally accepted in the United States of America to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in the appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements.

We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

PricewaterhouseCoopers LLP

October 11, 2012

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, 2012, with selected comparative information for the years ended June 30, 2011 and 2010. 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 (2010, 2011, 2012, 2013, 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 2012, U.S. News & World Report ranked the UCSF School of Medicine third 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 720 beds. At June 30, 2012, the Medical Center had 650 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 72 percent of the Medical Center's existing inpatient cases represent adults, while 28 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 thirteenth 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 20 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. The 2012-2013 children's hospital survey ranked UCSF Benioff Children's Hospital among the top hospitals nationally in cancer, diabetes and endocrinology, gastroenterology, heart and heart surgery, kidney care, neonatology, neurology and neurosurgery, urology, and pulmonology.

Significant events during the year are highlighted below:

- The Medical Center developed and implemented an enterprise-wide electronic medical records project. The electronic system, known as Advancing Patient-Centered Excellence, or APeX, creates a single electronic health record for every outpatient and inpatient at UCSF Medical Center. The project, begun in 2009, transforms how UCSF providers and staff exchange information across all care settings, enhancing safety and improving the overall patient experience.

- The Medical Center achieved a Magnet designation for excellence in nursing by the American Nurses Credentialing Center (ANCC). ANCC launched the Magnet program in 1994 to recognize health care organizations for high-quality patient care, professional excellence and innovations in nursing practice. Less than seven percent of the nation's 5,700 hospitals registered with the American Hospital Association had Magnet status as of 2011.

- 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. Construction is expected to be completed in 2015.

- 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 2012 included further reducing hospital-acquired pressure ulcers in adult patients, ensuring hand hygiene standards are met in all clinical settings, and other patient safety and quality goals. All organization-wide goals were met.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2012, 2011 and 2010:

	2012	2011	2010
Licensed beds	722	722	722
Admissions	27,788	28,268	29,087
Average daily census	491	500	500
Discharges	27,831	28,273	29,098
Average length of stay	6.5	6.5	6.3
Patient days	179,611	182,397	182,641
Case mix index	1.97	1.94	1.92
Outpatient visits:			
Clinic visits	775,337	778,525	752,635
Home health visits	17,850	16,704	18,468
Emergency visits	37,560	36,051	36,426
Total outpatient visits	830,747	831,280	807,529

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 2,786, or 1.5 percent, in 2012 and decreased by 244, or 0.1 percent, in 2011. The lower inpatient volume is reflective of an overall reduction of inpatient utilization rather than shifts of market share in the primary and secondary service areas of the Medical Center. 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 decreased by 533, or 0.1%, in 2012 and increased 23,751, or 2.9 percent, in 2011, from the previous year.

Statements of Revenues, Expenses and Changes in Net Position

The following table summarizes the operating results for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Net patient service revenue	$1,945,325	$1,864,052	$1,766,688
Other operating revenue	31,809	25,152	21,069
Total operating revenue	1,977,134	1,889,204	1,787,757
Total operating expenses	1,881,549	1,714,796	1,637,178
Income from operations	95,585	174,408	150,579
Total net non-operating revenues (expenses)	5,161	32,559	(1,474)
Income before other changes in net position	$ 100,746	$ 206,967	$ 149,105
Margin	5.1%	11.0%	8.3%
Other changes in net position	$ (55,090)	$ (15,392)	$ 22,066
Increase in net position	45,656	191,575	171,171
Net position - Beginning of year	1,123,504	931,929	760,758
Net position - End of year	$1,169,160	$1,123,504	$ 931,929

Overall the financial results of the Medical Center declined in 2012 as compared to 2011 and increased in 2011 from 2010, principally due to two factors:

- The Medical Center received $4.6 million, $50.9 million and $0 from the Hospital Fee Program, reported as operating and non-operating revenues, in 2012, 2011 and 2010, respectively. Additionally, the Medical Center received enhanced reimbursements related to provisions contained in the American Reinvestment and Recovery Act ("ARRA") for supplemental Medicaid payments to hospitals, which expired in June 2011.

- The Medical Center's contributions to the University's defined benefit pension plan increased to $46.6 million in 2012 from $23.4 million in 2011 and $5.4 million in 2010.

Revenues

Total operating revenues for 2012 were $1,977 million, an increase of $88 million, or 4.7 percent, over 2011. Operating revenues for 2011 were $1,889 million, an increase of $101 million, or 5.7 percent, over 2010.

For the years ended June 30, 2012, 2011 and 2010, 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 2012 increased by $81 million, or 4.4 percent, over 2011. The increase in 2012 was primarily due to an improvement in inpatient and outpatient reimbursement rates, an increase in the complexity of cases and a slight change in the mix of payors to those with better contracted rates. 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.

Other operating revenue consisted primarily of State Clinical Teaching Support Funds ("CTS") and other non-patient services, including contributions, cafeteria revenues, drug purchasing service agreements, and vendor rebates. The increases in both 2012 and 2011 in other operating revenue was mainly due to increased revenues from drug purchasing service agreements

The following table summarizes net patient service revenue for 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Medicare (non-risk)	$ 364,687	$ 367,279	$ 356,344
Medicare (risk)	6,646	7,596	9,126
Medi-Cal (non-risk)	183,681	215,821	202,936
Contract (discounted or per diem)	1,296,382	1,186,078	1,110,081
Contract (capitated)	2,208	3,103	2,255
Commercial	40,535	35,861	34,173
County	17,234	16,283	18,157
Non-sponsored/self-pay	33,952	32,031	33,616
Total	$ 1,945,325	$ 1,864,052	$ 1,766,688

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

Net revenue for Medicare beneficiaries decreased $2.6 million, or 0.7 percent, from 2011 to 2012 and increased $10.9 million, or 3.1 percent, from 2010 to 2011. The decrease in 2012 is partially due to a high level of favorable cost report settlements in 2011 compared to 2012. 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 2012, the Medical Center decreased its net liability related to prior year third party settlements and loss contingencies by $6.3 million with a corresponding increase to net patient service revenue in the statements of revenues, expenses and changes in net position. 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 position.

Net revenue for Medi-Cal patients decreased $32.1 million, or 14.9 percent, from 2011 to 2012 and increased $12.9 million, or 6.3 percent, from 2010 to 2011. 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 decrease in net revenue during 2012 for Medi-Cal was due to lower patient volumes as traditional Medi-Cal patients migrated to commercial managed care plans and lower supplemental payments received under State of California Assembly Bill AB 1383. 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. Medi-Cal net revenues in 2012, 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 contracts (discounted or per diem) and commercial increased $115.0 million, or 9.4 percent, from 2011 to 2012 and $77.7 million, or 6.8 percent, from 2010 to 2011. 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 contracts (discounted or per diem) and commercial represented about 68.7 percent of total net patient service revenue in 2012, up from 65.6 percent in 2011 and 64.8 percent in 2010. Contracts (discounted or per diem) and commercial inpatient days, outpatient visits, patient acuity as well as the average yield—net revenue per inpatient day—increased in both 2012 and 2011. Contracts (discounted or per diem) and commercial revenue for hospital clinic visits also increased in 2012 compared to 2011 and 2010.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Salaries and wages	$ 740,809	$ 672,756	$ 652,506
Employee benefits	202,215	168,754	141,248
Professional services	25,041	19,836	24,665
Medical supplies	271,048	257,472	245,015
Other supplies and purchased services	480,831	442,846	424,973
Depreciation and amortization	90,259	81,474	77,790
Insurance	6,482	6,820	7,288
Other	64,864	64,838	63,693
Total	$ 1,881,549	$ 1,714,796	$ 1,637,178

Total operating expenses were $1,882 million in 2012, up $166.8 million, or 9.7 percent, from 2011. Operating expenses increased in 2012 primarily due to higher labor and pension costs, medical supplies, general expense inflation, and incremental costs associated with the implementation of an electronic health records system. In 2011, operating expenses increased $77.6 million, or 4.7 percent, from 2010. Operating expenses increased in 2011 also primarily due to higher labor and pension costs, medical supplies, and general expense inflation. Depreciation expense increased as capital investments in equipment and infrastructure grew in 2012 and 2011.

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 2012, salaries and wages grew by $68.1 million, or 10.1 percent, over the prior year. This increase includes $39.4 million, or 5.4 percent in salary increases and an increase of 308 full time equivalent employees, or 4.5 percent from the prior year. Much of this increase was associated with additional training and implementation efforts for an electronic health records system that was placed in service during 2012. 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.

Amounts paid for nurse registry and other contract labor are included in other expenses. Temporary labor costs for 2012 increased $24.0 million, or 113.7 percent, over 2011 due to an increase in the use of temporary staffing as well as an increase in the average rate. Most of the increased use of temporary staffing in 2012 was related to the implementation of an electronic health records system during the year. 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.

In 2012, employee benefit costs increased by $33.5 million, or 19.8 percent, over 2011. Pension contributions were $46.6 million in 2012 as compared to $23.4 million in 2011 and $5.4 million in 2010. The Medical Center's health insurance and other employee benefit costs increased in 2012 as compared to 2011 by $9.8 million, or 6.7 percent, due to an increase in insurance premiums of $7.8 million and increases in other benefit costs of $2.0 million. 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.

As a percentage of total operating revenue, salaries and employee benefits were 47.7 percent in 2012, 44.5 percent in 2011 and 44.4 percent in 2010. Overall labor costs increased as a percent of operating revenues from 2011 as total labor costs grew from higher wage rates and higher staffing connected to the implementation of the electronic health records system at a faster rate than the increase of operating revenue.

In 2012, payments for professional services increased by $5.2 million, or 26.2 percent. The increase was due to the consultant costs associated with the implementation of the electronic health records system that was placed in service during 2012 and the beginning of a revenue cycle enhancement project. In 2011, payments for professional services decreased $4.8 million, or 19.6 percent as consultant costs were curtailed in anticipation of the ramp up needed for the electronic health records system implementation in 2012.

Medical supplies including pharmaceuticals, totaled $271.0 million in 2012, up $13.6 million, or 5.3 percent, from 2011, primarily due to price inflation. In 2011, medical supplies, including pharmaceuticals, totaled $257.5 million, up $12.5 million, or 5.1 percent, from 2010, primarily due to price inflation. Medical supplies are subject to significant inflationary pressures, due to escalating pharmaceutical costs and continued innovation in implants, prosthetics, and other medical supplies. As a percentage of total operating revenue, medical supplies were 13.7 percent in 2012, up from 13.6 percent of operating revenue in 2011 and equal to13.7 percent in 2010. The Medical Center has ongoing initiatives to control supply utilization and to negotiate competitive pricing.

Other supplies and purchased services totaled $480.8 million in 2012, up $38.0 million, or 8.6 percent, from 2011. Purchased services increased in 2012 primarily due to inflation, increased medical service costs and higher costs associated with technology improvements. In 2011, these costs 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. 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 $90.2 million in 2012, an increase of $8.8 million, or 10.8 percent, from 2011, due to capital investment in facilities, an electronic medical records system, and equipment. In 2011, depreciation and amortization increased $3.7 million, or 4.7 percent, from 2010, also due to capital investment in facilities, systems, and equipment.

Insurance expense totaled $6.5 million in 2012, down from $6.8 million and $7.3 million in 2011 and 2010, 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 $95.6 million and operating revenue of $1,977 million. Income from operations decreased in the current year to $95.6 million from $174.4 million in the prior year. The $78.8 million decrease was the result of a decrease of supplemental payments received under AB 1383, an increase in labor, pension and technology implementation costs, and a decrease of patient volume during the year.

Non-operating Revenues (Expenses)

Non-operating revenues, net of non-operating expenses, totaled $5.2 million in 2012, compared to non-operating revenues, net of non-operating expenses, totaled $32.6 million in 2011, and non-operating expenses, net of non-operating revenues of $1.5 million in 2010. 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 Position

The Medical Center reported income before other changes in net position of $100.7 million in 2012, compared to $207.0 million in 2011, and $149.1 million in 2010, a decrease of $106.2 million, or 51.3 percent, and an increase of $57.9 million, or 38.8 percent, respectively. The Medical Center's net income decreased in 2012 mainly due to a decrease of supplemental payments received under AB 1383, an increase in labor, pension and technology implementation costs, and a decrease of patient volume during the year. The Medical Center's net income increased in 2011 mainly due to improved reimbursement rates, operating efficiencies, and an increase of Medi-Cal incentive payments and supplemental payments received under AB 1383 in 2011.The resulting margin for 2012 was 5.1 as of 2012 compared to 11.0 percent and 8.3 percent in 2011 and 2010, respectively.

Other Changes in Net Position

The other changes in net position for 2012, 2011 and 2010 include (dollars in thousands):

	2012	2011	2010
Donated assets	$ 4,394	$ 27,003	$ 59,132
Health system support	(59,484)	(42,395)	(37,066)
Total other changes in net position	$ (55,090)	$ (15,392)	$ 22,066

The lower section of the statements of revenues, expenses and changes in net position shows the other changes to net position in addition to the income or loss. Net position are the difference between the total assets and total liabilities. The other changes in net position represent additional funds the Medical Center receives and cash outflow for support and transfers to other university entities. Funds donated to the UCSF Foundation are transferred to UCSF Medical Center and recognized as donated assets when used. During 2012, construction for the Mission Bay project has been funded with bond funds rather than donated funds resulting in a lower use of donor funds in 2012.

Included in the other changes in net position for 2012 and 2011 are the following:

- Donated assets of $4.4 million and $27.0 million, respectively.

- Health system support represents transfers primarily to the School of Medicine for academic and research support. The Medical Center transferred $59.5 million in 2012 and $42.4 million in 2011.

Statements of Net Position

The following table is an abbreviated statement of net position at June 30, 2012, 2011 and 2010 (dollars in thousands):

	2012	2011	2010
Current assets:			
Cash	$ 256,924	$ 349,008	$ 217,192
Patient accounts receivable (net)	329,744	322,786	302,481
Other current assets	90,856	85,130	71,188
Total current assets	677,524	756,924	590,861
Cash restricted for hospital construction	377,307	628,185	-
Capital assets (net)	1,297,071	957,406	824,471
Other assets	25,056	21,858	17,515
Total assets	2,376,958	2,364,373	1,432,847
Deferred outflows of resources	16,743	9,133	11,418
Current liabilities	263,972	243,937	198,794
Long-term debt	889,407	946,642	262,810
Other liabilities	71,162	59,423	50,732
Total liabilities	1,224,541	1,250,002	512,336
Net position:			
Invested in capital assets (net)	759,131	605,924	531,091
Restricted	16,970	13,491	12,759
Unrestricted	393,059	504,089	388,079
Total net position	$ 1,169,160	$ 1,123,504	$ 931,929

Total current assets decreased $79.4 million, or 10.5 percent, from 2011 to 2012 primarily due to a decrease of cash retained from hospital operations. In 2011, 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.

Cash decreased $92.1 million, or 26.4 percent, during 2012 and increased $131.8 million, or 60.7 percent, during 2011. The decrease in 2012 was primarily due to the investment in capital assets and payments of long-term debt obligations that were in excess of cash provided by operations. The Medical Center invested more than $100 million in an electronic health records system that was placed in service during the year. The increase in 2011 was primarily due to cash provided by operations.

In 2012, net patient account receivables increased by $7.0 million from the prior year. This increase was due to higher outpatient volumes and higher rates. In 2011, net patient account receivables increased by $20.3 million from the prior year also due to higher outpatient volumes and higher rates. Net patient accounts receivable represented 48.7 percent of current assets at June 30, 2012, up from 43.8 percent and down from 51.2 percent of current assets at June 30, 2011 and 2010, respectively.

Other current assets, including third party payor settlements, inventory and prepaid expenses, increased $5.7 million, or 6.7 percent, over 2011 primarily due to an increase in net current third party payor settlements. In 2011, other current assets increased by $13.9 million, or 19.6 percent due to an increase in third party payor settlements and in inventory related to the opening of a new pharmacy production facility in 2011.

Cash restricted for hospital construction consist of unspent bond proceeds issued for the construction of the UCSF Mission Bay Hospital. In 2012, this balance decreased by $250.9 million, or 39.9 percent, as funds were used for construction. In 2011, this balance increased by $628.2 million as bonds were issued and not yet spent in 2011.

Net capital assets increased by $339.7 million, or 35.5 percent, from 2011 to 2012 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 $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.

Other assets includes donor funds and bond issuance costs. In 2012, other assets increased $3.2 million, or 14.6 percent, over 2011 as donor funds increased. In 2011, other assets increased by $4.3 million, or 24.8 percent as bond issuance costs increased due to $700 million in bonds that were issued during the year.

Current liabilities increased by $20.0 million, or 8.2 percent, from 2011 to 2012 primarily due to an increase of accounts payable balances. In 2011, current liabilities increased by $25.3 million, or 12.7 percent, from 2010 to 2011 primarily due to an increase of accounts payable balances. The increase of accounts payable balances in both years was due to increased year end liabilities for the Mission Bay and electronic health records projects.

Long-term liabilities of $960.6 million at June 30, 2012, decreased $45.5 million, or 4.5 percent, from June 30, 2011. Long-term debt decreased due to scheduled principal payments and the early payoff of three financing obligations. 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. Third party payor settlements and loss contingencies increased as the Medical Center reclassified certain amounts to current assets.

Net position increased $45.7 million, or 4.1 percent, during 2012 and $191.6 million, or 20.6 percent, during 2011. Income for 2012 and 2011 totaled $100.7 million and $207.0 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 and overall campus support, payments to support clinical research, and transfers to faculty practice plans, reduced net position by $59.5 million and $42.4 million in 2012 and 2011, respectively. Donations added $4.4 million and $27.0 million to net position during 2012 and 2011, respectively.

Liquidity and Capital Resources

During 2012, the Medical Center generated $203.2 million in cash from operating activities. This represented a decrease of $49.5 million, or 19.6 percent, from 2011 to 2012, and an increase of $56.9 million, or 26.1 percent, from 2010 to 2011. The increase in 2011 was due to cash from AB 1383 and from operations. The decrease in 2012 was due to a decrease in cash received under AB 1383, higher labor and pension costs, and increased technology implementation costs. Cash received from patients and third-party payors totaled $1.9 billion in 2012, up $84.9 million, or 4.6 percent, from 2011. This amount totaled $1.8 billion in 2011, up $65.2 million, or 3.8 percent, from 2010.

In 2012 and 2011, cash flows from non-capital financing activities reduced cash by $57.5 million and $5.8 million, respectively, for transfers to the University for health system support offset by grants received for the hospital fee program.

Cash used by capital and related financing activities totaled $509.7 million in 2012, compared to cash provided by capital and related financial activities of $493.6 million in 2011 and cash used of $97.2 million in 2010. The amount used in 2012 was mainly due to construction of the UCSF Mission Bay Hospital and investments in capital for the electronic health records system. The amount provided in 2011 was mainly due to $700 million of bond debt that was issued during the year.

Cash provided by or used for capital and related financing activities decreased by $1,002.2 million from 2011 to 2012 and increased by $567.0 million from 2010 to 2011. The Medical Center purchased capital assets of $408.9 million in 2012 and received donated funds of $4.4 million. Principal payments on long-term debt and financing obligations totaled $65.0 million in 2012 and interest paid was $56.9 million. The Medical Center issued debt of $718.7 million, purchased capital assets of $190.2 million in 2011 and received donated funds of $27.0 million. Principal payments on long-term debt and financing obligations totaled $32.6 million in 2011 and interest paid was $40.8 million.

Cash flows from investment activities included $24.5 million and $21.2 million provided by interest income in 2012 and 2011, respectively. Overall cash decreased to $256.9 million in 2012 from $349.0 million in 2011 and increased to $349.0 million in 2011 from $217.2 million in 2010.

Overall cash decreased to $256.9 million, or 26.4 percent, in 2012 from $349.0 million, or 60.7 percent in 2011.

The following table shows key liquidity and capital ratios for 2012, 2011 and 2010:

	2012	**2011**	**2010**
Days cash on hand	52	78	51
Days of revenue in accounts receivable	62	63	63
Purchases of capital assets ($ in millions)	$ 408.9	$ 190.2	$ 163.9
Debt service coverage ratio	2.0	4.9	6.2

Days cash on hand decreased to 52 days in 2012 from 78 days in 2011, for a 33.3 percent decrease. In 2011, days cash on hand increased to 78 days from 51 days in 2010, for a 52.9 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 2012, net days in receivables decreased by one day compared to the previous year. In 2011, net days in receivables stayed flat at 63 compared to the previous year.

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 2012 was 2.0 times versus 4.9 times in 2011. The decrease was primarily due to an increase in the level of a full year of debt service for new borrowings made in 2011 and additional payments made in 2012 to retire debt in advance of their scheduled maturities totaling $35.0 million. The Medical Center's ratio for 2011 was 4.9 times versus 6.2 times in 2010. The decrease was also primarily due to an increase in the level of debt service for new borrowings made in 2011. The ratios in 2012, 2011 and 2010 are higher than the 1.0 required by the Bond Indenture. Debt service coverage ratios for next year's debt service was 3.4, 3.9, and 5.5 for 2012, 2011 and 2010, respectively.

Looking Forward

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

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

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

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, 2012, the Medical Center received payments of $2.6 million for the meaningful use of EHR technology. No amounts were received for the year ended June 30, 2011.

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, 2012, 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, 2012, 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, 2011 actuarial valuation was $7.7 billion or 82.1 percent funded. As of July 1, 2012, the funded ratio is expected to decrease to approximately 78 percent. The total funding policy contributions in the July 1, 2011 actuarial valuations represent 26.4 percent of covered compensation. Member and employer contributions increased to 5 percent and 10 percent, respectively, of covered compensation in July 2012. The Regents approved increasing employee member and employer contributions to 6.5 percent and 12 percent, respectively, in July 2013. These contribution rates are below UCRP's total funding 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 cash outs, 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, 2011 actuarial valuation was $14.7 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 Position
June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Assets		
Current assets		
Cash	$ 256,924	$ 349,008
Patient accounts receivable, net of estimated uncollectibles of $22,088 and $18,135, respectively	329,744	322,786
Other receivables	277	1,424
Third-party payor settlements, net	33,142	28,357
Inventory	28,774	28,028
Prepaid expenses and other assets	28,663	27,321
Total current assets	677,524	756,924
Restricted assets:		
Cash restricted for hospital construction	377,307	628,185
Donor funds	16,970	13,491
Capital assets, net	1,297,071	957,406
Deferred costs of issuance	7,371	7,640
Other assets	715	727
Total assets	2,376,958	2,364,373
Deferred Outflows of Resources		
Deferred outflows from interest rate swap agreements	16,743	9,133
Liabilities		
Current liabilities		
Accounts payable and accrued expenses	154,204	115,475
Accrued salaries and benefits	73,386	66,754
Third-party payor settlements, net	3,261	19,825
Current portion of long-term debt and financing obligations	25,343	33,025
Other liabilities	7,778	8,858
Total current liabilities	263,972	243,937
Long-term debt and financing obligations, net of current portion	889,407	946,642
Third-party payor settlements, net	54,419	50,290
Interest rate swap agreements	16,743	9,133
Total liabilities	1,224,541	1,250,002
Net Position		
Invested in capital assets, net of related debt	759,131	605,924
Restricted:		
Expendable:		
Capital projects	10,840	7,850
Other	6,130	5,641
Unrestricted	393,059	504,089
Total net position	$ 1,169,160	$ 1,123,504

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 Position
For the Years Ended June 30, 2012 and 2011
(Dollars in thousands)

	2012	2011
Net patient service revenue, net of provision for doubtful accounts of $72,724 and $47,285, respectively	$ 1,945,325	$ 1,864,052
Other operating revenue:		
Clinical teaching support	4,287	4,292
Other	27,522	20,860
Total other operating revenue	31,809	25,152
Total operating revenue	1,977,134	1,889,204
Operating expenses:		
Salaries and wages	740,809	672,756
UCRP, retiree health and other employee benefits	202,215	168,754
Professional services	25,041	19,836
Medical supplies	271,048	257,472
Other supplies and purchased services	480,831	442,846
Depreciation and amortization	90,259	81,474
Insurance	6,482	6,820
Other	64,864	64,838
Total operating expenses	1,881,549	1,714,796
Income from operations	95,585	174,408
Non-operating revenues (expenses):		
Hospital fee program grants	1,973	36,594
Interest income	24,461	21,230
Interest expense	(37,290)	(34,039)
Build America bonds federal interest subsidies	16,149	10,131
Loss on disposal of capital assets	(132)	(1,357)
Total net non-operating revenues (expenses)	5,161	32,559
Income before other changes in net position	100,746	206,967
Other changes in net position:		
Donated assets	4,394	27,003
Health system support	(59,484)	(42,395)
Total other changes in net position	(55,090)	(15,392)
Increase in net position	45,656	191,575
Net position – beginning of year	1,123,504	931,929
Net position – end of year	$ 1,169,160	$ 1,123,504

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Cash flows from operating activities:		
Receipts from patients and third-party payors	$1,921,147	$1,836,205
Payments to employees	(739,391)	(671,816)
Payments to suppliers	(808,020)	(800,597)
Payments for benefits	(197,001)	(165,530)
Other receipts, net	26,486	54,477
Net cash provided by operating activities	203,221	252,739
Cash flows from noncapital financing activities:		
Health system support	(59,484)	(42,395)
Grants from the hospital fee program	1,973	36,594
Net cash used by noncapital financing activities	(57,511)	(5,801)
Cash flows from capital and related financing activities:		
Proceeds from debt issuance	-	700,000
Proceeds from financing obligations	-	18,656
Bond issuance costs	-	(4,022)
Build America bonds federal interest subsidies	16,149	10,131
Proceeds from sale of capital assets	550	746
Purchases of capital assets	(408,869)	(190,221)
Principal paid on long-term debt and financing obligations	(65,001)	(32,616)
Interest paid on long-term debt and financing obligations	(56,877)	(37,112)
Gifts and donated funds	4,394	27,003
Net cash provided (used) by capital and related financing activities	(509,654)	492,565
Cash flows from investing activities:		
Interest income received	24,461	21,230
Change in restricted assets	247,399	(628,917)
Net cash provided (used) by investing activities	271,860	(607,687)
Net increase (decrease) in cash	(92,084)	131,816
Cash – beginning of year	349,008	217,192
Cash – end of year	$ 256,924	$ 349,008

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, 2012 and 2011
(Dollars in thousands)

	2012	2011
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 95,585	$ 174,408
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	90,259	81,474
Provision for doubtful accounts	72,724	47,285
Changes in operating assets and liabilities:		
Patient accounts receivable	(79,682)	(67,590)
Other receivables	1,147	(1,270)
Inventory	(746)	(3,471)
Prepaid expenses and other assets	(1,330)	1,360
Accounts payable and accrued expenses	36,846	(5,728)
Accrued salaries and benefits	6,632	5,164
Third-party payor settlements	(17,220)	20,898
Other liabilities	(994)	209
Net cash provided by operating activities	$ 203,221	$ 252,739
Supplemental noncash activities information:		
Payables for property and equipment	$ 35,048	$ 33,165
Bond retirements	-	634
Amortization of deferred financing costs	105	108
Amortization of deferred costs of issuance	269	153
Amortization of bond premium	21	20
Change in fair value of interest rate swaps	7,610	(2,285)

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 (720 licensed beds and 650 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.

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. Implementation of Statement No. 63 resulted in the reclassification of the 2011 financial statements for purposes of presenting comparative information for the year ended June 30, 2012. The effect of the change from the adoption of Statement No. 63 on the Medical Center’s statement of net position resulted in a reclassification of deferred outflows totaling $9,133 from other noncurrent assets to deferred outflows of resources for the year ended June 30, 2011.

In June 2011, the GASB issued Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions*, effective for the Medical Center's fiscal year beginning July 1, 2012. This Statement clarifies the existing requirements for the termination of hedge accounting. Implementation of Statement No. 64 had no effect on the Medical Center's net position or changes in net position for the years ended June 30, 2012 and 2011.

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, 2012 and 2011 was $256,924 and $349,008, 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 position.

Additional information on cash and investments can be obtained from the 2011–2012 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, 2012 and 2011 by the Treasurer's Office were $16,970 and $13,491, 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. 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 position. 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 outflows are classified as deferred outflows of resources and deferred inflows classified as deferred inflow of resources in the statement of net position.

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 position. These costs are being

amortized as interest expense over the remaining life of the defeased or refinanced bonds, whichever is shorter.

Net Position

Net position 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 position resulting from transactions with purpose restrictions as restricted net position until the resources are used for the specific purpose or for as long as the provider requires the resources to remain intact.

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

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

Expenses are charged to either restricted or unrestricted net position based upon a variety of factors, including consideration of prior and future revenue sources, the type of expense incurred, the Medical Center's budgetary policies surrounding the various revenue sources or whether the expense is a recurring cost.

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 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.

Health system support, donated assets and other transactions with the University are classified as other changes in net position.

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 position.

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 position.

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 position.

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 position 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.

Comparative Information

In connection with the preparation of the June 30, 2012 financial statements, the Medical Center determined that certain third-party payor settlement receivables were being reported separately from the related liabilities with the same counterparty. Management has revised current assets and current liabilities to present on a net basis increasing both by $19.8 million. This revision had no effect on the net position of the Medical Center, statement of revenues, expenses and changes in net position and cash used by the Medical Center.

The Medical Center noted that deferred costs of issuance of $7.6 million were being reported net with other noncurrent assets. Management elected to present separately its deferred costs of issuance on the statement of net position. Further, proceeds from financing obligations of $18.7 million were being reported with proceeds of debt issuance on the statement of cash flows. Management elected to separately present proceeds from financing obligations separately. These revisions had no effect on the statement of net position, statement of revenues, expenses and changes in net position and cash used by capital and related financing activities.

The Medical Center concluded that cash flows from operating activities included capital expenditure and interest liabilities related to long-term debt totaling $23.2 million. Management has revised the cash flows reported to report in cash flows from capital and related financing activities. This revision had no effect on the statement of net position, statement of revenues, expenses and changes in net position and total cash flows of the Medical Center.

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, 2012. 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 March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement reclassifies, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The Medical Center is evaluating the effect that Statement No. 65 will have on its financial statements.

In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012 – An Amendment of GASB Statements No. 10 and No. 62*, effective for the Medical Center's fiscal year beginning July 1, 2013. This Statement resolves conflicting guidance that resulted from the issuance of two pronouncements, Statements No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*, and No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The Medical Center is evaluating the effect that Statement No. 66 will have on its financial statements.

In June 2012, the GASB issued Statement No. 68*, Accounting and Financial Reporting for Pensions*, effective for the University's fiscal year beginning July 1, 2014. This Statement revises existing standards for measuring and reporting pension liabilities for pension plans provided by the University to its employees. This Statement requires recognition of a liability equal to the net pension liability, which is measured as the total pension liability, less the amount of the pension plan's fiduciary net position. The total pension liability is determined based upon discounting projected benefit payments based on the benefit terms and legal agreements existing at the pension plan's fiscal year end. Projected benefit payments are required to be discounted using a single rate that reflects the expected rate of return on investments, to the extent that plan assets are available to pay benefits, and a tax-exempt, high-quality municipal bond rate when plan assets are not available. This statement requires that most changes in the net pension liability be included in pension expense in the period of the change. As of June 30, 2012, the University reported an obligation to UCRP of $1.9 billion, representing unfunded contributions to UCRP based upon the University's funding policy. Under GASB No. 68, The University's obligation to UCRP is expected to increase. The Medical Center is evaluating the effect that Statement No. 68 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 is as 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 position 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, 2012 and 2011, the Medical Center recorded total Medi-Cal revenue of $183,681 and $215,821, respectively.

- ***Assembly Bill 1383*** –State of California Assembly Bill ("AB") 1383 of 2009, as amended by AB 1653 on September 8, 2010, SB 90 in April 2011, and SB 335 in September 2011, 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, 2013 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 years ended June 30, 2012 and 2011, the Medical Center received $2,626 and $14,293 respectively which has been reported as net patient service revenue. For the years ended June 30, 2012 and 2011, the Medical Center received $1,973 and $36,594, respectively 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, 2012 and 2011, the Medical Center recorded revenue of $11,049 and $15,586, respectively.

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

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

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

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

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

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

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 10.9 percent and 11.0 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively. Amounts due from Medi-Cal represent 6.2 percent and 8.9 percent of net patient accounts receivable at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, net patient service revenue included $26,101 and $15,524, respectively, due to favorable cost report settlements with Medicare and changes in estimates for settlements related to SB 1100 for Medi-Cal.

(Dollars in thousands)

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

	2012	2011
Medicare (non-risk)	$ 364,687	$ 367,279
Medicare (risk)	6,646	7,596
Medi-Cal (non-risk)	183,681	215,821
Contract (discounted or per diem)	1,296,382	1,186,078
Contract (capitated)	2,208	3,103
Commercial	40,535	35,861
County	17,234	16,283
Non-sponsored/self-pay	33,952	32,031
Total	$ 1,945,325	$ 1,864,052

4. Charity Care

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

	2012	2011
Charity care at established rates	$ 25,697	$ 21,983
Estimated cost of charity care	$ 6,689	$ 5,612

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $80,632 and $87,529 for the years ended June 30, 2012 and 2011, 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:

	2012	2011
Capital projects	$ 10,840	$ 7,850
Other	6,130	5,641
Total	$ 16,970	$ 13,491

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, 2012 and 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.

(Dollars in thousands)

6. Capital Assets

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

	2011	Additions	Disposals	2012
Original Cost				
Land	$ 118,349	$ 173	$ -	$ 118,522
Buildings and improvements	909,935	29,470	-	939,405
Equipment	361,419	168,471	(22,745)	507,145
Construction in progress	288,774	232,492	(58)	521,208
Capital assets, at cost	$1,678,477	$ 430,606	$ (22,803)	$2,086,280

	2011	Depreciation	Disposals	2012
Accumulated Depreciation				
Buildings and improvements	$ 487,174	$ 44,731	$ -	$ 531,905
Equipment	233,897	45,528	(22,121)	257,304
Accumulated depreciation	721,071	$ 90,259	$ (22,121)	789,209
Capital assets, net	$ 957,406			$1,297,071

	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

Equipment under financing obligations and related accumulated amortization is $95,755 and $50,183 in 2012, respectively, and $124,019 and $57,158 in 2011, 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 Financing Obligations

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

	2012	2011
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	$ 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	1,600	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	42,899	43,384
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, 2012, with annual principal payments through 2032	83,115	85,915
Financing 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	68,007	129,643
	915,241	980,242
Unamortized bond premium	704	725
Unamortized deferred financing costs	(1,195)	(1,300)
Total debt and financing obligations	914,750	979,667
Less: Amounts due within one year	(25,343)	(33,025)
Noncurrent portion of debt and financing obligations	$ 889,407	$ 946,642

Total interest expense during the years ended June 30, 2012 and 2011 was $57,144 and $40,813, respectively. Interest expense totaling $19,854 and $6,774 was capitalized during the years ended June 30, 2012 and 2011. The remaining $37,290 in 2012 and $34,039 in 2011 are reported as interest expense in the statements of revenues, expense and changes in net position.

(Dollars in thousands)

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

	Revenue Bonds	Financing Obligations	Total
Year ended June 30, 2012			
Long-term debt and financing obligations at June 30, 2011	$ 850,024	$ 129,643	$ 979,667
Principal payments	(3,365)	(61,636)	(65,001)
Amortization of bond premium	(21)		(21)
Amortization of deferred financing costs	105		105
Long-term debt and financing obligations at June 30, 2012	846,743	68,007	914,750
Less: Current portion of long-term debt and financing obligations	(3,403)	(21,940)	(25,343)
Noncurrent portion of long-term debt and financing obligations as June 30, 2012	$ 843,340	$ 46,067	$ 889,407
Year ended June 30, 2011			
Long-term debt and financing obligations 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 financing obligations at June 30, 2011	850,024	129,643	979,667
Less: Current portion of long-term debt and financing obligations	(3,281)	(29,744)	(33,025)
Noncurrent portion of long-term debt and financing obligations as June 30, 2011	$ 846,743	$ 99,899	$ 946,642

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, 2012 are $2.2 billion of which $846,743 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, 2012 and 2011 were $6.9 billion and $6.5 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 position. 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.

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.

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)

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, 2012 and 2011 are as follows:

Notional Amount		Fair Value – Positive (Negative)			Changes in Fair Value		
2012	**2011**	**Classification**	**2012**	**2011**	**Classification**	**2012**	**2011**
83,115	85,915	Other noncurrent (liabilities)	$ (16,743)	$ (9,133)	Deferred (inflows)/ outflows	$ (7,610)	$ 2,285

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, 2012 or 2011.

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.

Additional terms with respect to the outstanding swap and the fair value at June 30, 2012, 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, 2012 and thereafter are shown below.

Year Ending June 30	Revenue Bonds	Financing Obligations	Total Payments	Principal	Interest
2013	$ 54,210	$ 24,192	$ 78,402	$ 25,425	$ 52,977
2014	54,409	44,050	98,459	46,533	51,926
2015	54,615	3,193	57,808	6,914	50,894
2016	54,843		54,843	3,915	50,928
2017	55,053		55,053	4,060	50,993
2018 – 2022	301,907		301,907	52,360	249,547
2023 – 2027	338,286		338,286	109,750	228,536
2028 – 2032	327,965		327,965	133,070	194,895
2033 – 2037	285,629		285,629	130,895	154,734
2038 – 2042	269,767		269,767	161,125	108,642
2043 – 2047	249,631		249,631	197,719	51,912
2048	46,041		46,041	43,475	2,566
Total future debt service	2,092,356	71,435	2,163,791	$ 915,241	$ 1,248,550
Less: Interest component of future payments	(1,245,122)	(3,428)	(1,248,550)		
Principal portion of future payments	847,234	68,007	915,241		
Adjusted by:					
Unamortized bond premium	(1,195)		(1,195)		
Unamortized deferred financing costs	704		704		
Total debt	$ 846,743	$ 68,007	$ 914,750		

Additional information on the revenue bonds can be obtained from the 2011–2012 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, 2012, 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**
2013	$ 2,895	$ 112	$ 2,465	$ 5,472
2014	3,000	108	2,376	5,484
2015	3,110	104	2,287	5,501
2016	3,230	100	2,195	5,525
2017	3,340	95	2,099	5,534
2018 – 2022	18,635	406	8,929	27,970
2023 – 2027	22,280	271	5,951	28,502
2028 – 2032	26,625	109	2,391	29,125
Total future debt service	$ 83,115	$ 1,305	$ 28,693	$ 113,113

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, 2012 and 2011 was $28,339 and $26,141, 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**
2013	$ 16,068
2014	12,169
2015	9,844
2016	8,548
2017	7,814
2018 – 2022	16,102
Total	$ 70,545

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 $3.51 and $3.31 per $100 of UCRP covered payroll resulting in Medical Center contributions of $23,200 and $20,400 for the years ended June 30, 2012 and 2011, 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, 2011, the date of the latest actuarial valuation, were $77.7 million and $14.7 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net Position were $89.5 million at June 30, 2012. For the years ended June 30, 2012 and 2011, combined contributions from the University's campuses and medical centers were $346.4 million and $313.9 million, respectively, including an implicit subsidy of $54.1 million and $54.9 million, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.5 billion and $1.8 billion for the years ended June 30, 2012 and 2011. 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 $6.3 billion at June 30, 2012 increased by $1.2 billion for the year ended June 30, 2012.

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 2011–2012 annual reports of the University of California.

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 $48,046 and $19,752, respectively, during the year ended June 30, 2012. Medical Center and employee contributions were $23,392 and $11,324, respectively, during the year ended June 30, 2011.

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, 2011, the date of the latest actuarial valuation, were $35.3 billion and $43.0 billion, respectively, resulting in a funded ratio of 82.1 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net Position were $41.8 billion and $41.9 billion at June 30, 2012 and 2011, respectively.

For the years ended June 30, 2012 and 2011, the University's campuses and medical centers contributed a combined $1.5 billion and $1.4 billion, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was $1.9 billion for the year ended June 30, 2012. 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 $361.8 million for the year ended June 30, 2012.

The UCRSP plans (DC Plan, Supplemental DC Plan, 403(b) Plan and 457(b) Plan) provide savings incentives and additional retirement security for all eligible employees. The DC Plan accepts both pre-tax and after-tax employee contributions. The Supplemental DC Plan accepts employer contributions on behalf of certain qualifying employees. The 403(b) and 457(b) plans accept pre-tax employee contributions and the Medical Center may also make contributions on behalf of certain members of management. Benefits from the plans are based on participants' mandatory and voluntary contributions, plus earnings, and are immediately vested.

Information related to plan assets and liabilities as they relate to individual campuses and medical centers is not readily available. Additional information on the retirement plans can be obtained from the 2011–2012 annual reports of the University of California Retirement Plan, the University of California Retirement System.

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.

(Dollars in thousands)

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net position, were $7,386 and $9,318 for the years ended June 30, 2012 and 2011, respectively. During 2012 and 2011, as a result of actuarial analysis, the Medical Center received a refund of premiums from the University of $8,522 and $7,679, 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 position, were $6,482 and $6,820 for the years ended June 30, 2012 and 2011, 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 position for the years ended June 30 are as follows:

	2012	2011
Salaries and employee benefits	$ 5,349	$ 3,204
Medical supplies	(5,550)	(5,749)
Other supplies and purchased services	367,038	332,345
Interest income, net	(24,461)	(21,230)
Insurance	6,482	6,820
Total	$ 348,858	$ 315,390

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 position. 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 $408,342 and $357,785 in 2012 and 2011, respectively. Of these amounts, $348,858 and

(Dollars in thousands)

$315,390 are reported as operating expenses for the years ended June 30, 2012 and 2011, respectively, and $59,484 and $42,395 are reported as health system support for the years ended June 30, 2012 and 2011, 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, 2012 and 2011 is as follows:

	Hospital Practice	UCSF Medical Group	Total
Year ended June 30, 2012			
Operating revenues	$ 1,581,630	$ 395,504	$ 1,977,134
Operating expenses	1,479,687	401,862	1,881,549
Net non-operating expenses	(5,161)	-	(5,161)
Income before other changes in net position	$ 107,104	$ (6,358)	$ 100,746
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 position	$ 202,864	$ 4,103	$ 206,967

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 $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 $550,057, excluding interest, as of June 30, 2012.

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.