University of California, Davis Medical Center

Report on Audits of Financial Statements
For the Years Ended June 30, 2005 and 2004

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PricewaterhouseCoopers LLP
400 Capitol Mall, Suite 600
Sacramento CA 95814
Telephone (916) 930 8100
Main Facsimile (916) 930 8450
Tax Facsimile (916) 930 8150

Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying financial statements, as shown on pages 9 through 30, 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, 2005 and 2004, and changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Medical Center's management. Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Medical Center are intended to present the financial position, and the changes in financial position and cash flows of only that portion of the University that is attributable to the transactions of the Medical Center. They do not purport to, and do not, present fairly the financial position of the University as of June 30, 2005 and 2004, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis on pages 2 through 8 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consist principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

PricewaterhouseCoopers LLP

September 21, 2005

Introduction

This Management Discussion and Analysis of the University of California, Davis Medical Center's (the "Medical Center") financial performance should be read in conjunction with the financial statements, starting on page 9, and the notes to the financial statements, starting on page 13. This section provides explanatory detail and perspective on the Medical Center finances for the fiscal year ended June 30, 2005. The term "Health System" is used to define the total of the "Medical Center" and the UC Davis School of Medicine. Unless otherwise indicated, years (2003, 2004, 2005, 2006, etc.) in this discussion refer to the fiscal year ended June 30.

Overview

The Medical Center has served as the principal clinical teaching site for the UC Davis School of Medicine since the school was founded in 1966. Initially the school used the Sacramento County hospital for clinical training, but in 1973 The University acquired the hospital outright and began operating it as the UC Davis Medical Center. The Medical Center is now licensed for 530 acute care beds, 25 operating rooms and a full complement of ancillary, support and ambulatory services in over 2.9 million gross square feet of facilities, mostly sited on the 140-acre Sacramento campus.

The Medical Center serves as a tertiary care referral hospital for a 33-county 65,000-square-mile service area with a population of approximately six million. It provides a comprehensive range of inpatient and outpatient services for adults and children; in fact it is the only provider of several tertiary/quaternary services between San Francisco and Portland, including Level 1 Adult & Pediatric Trauma Center, National Institute of Health designated Cancer Center, and burn unit.

Services are provided at the hospital facilities of the Medical Center, at outpatient hospital-based clinics (both primary care and specialty) located on or near the Medical Center campus, and at the UC Davis Primary Care Network (the "PCN"). The latter consists of 17 satellite clinics located in the surrounding communities, including Auburn, Carmichael, Colusa, Davis, Elk Grove, Folsom, Rancho Cordova, Rocklin, Roseville, and Sacramento.

The Medical Center participates in a variety of cooperative outreach activities with health care providers in the service area. For example, joint ventures have been established with two community-based providers in Marysville and Merced to offer cancer services such as radiation oncology and medical oncology. In addition, the Medical Center operates a nationally recognized clinical telemedicine, distance education and rural affiliation program. Through a variety of agreements and by using advanced telecommunications technology, the Medical Center is affiliated to 15 rural healthcare systems and approximately 80 sites across the state.

Inpatient and outpatient medical services are provided by the UC Davis Medical Group, which has clinical practices with approximately 650 faculty and contract physicians, 550 residents and fellows, and 100 PCN physicians.

For the year ended June 30, 2005, 32,886 patients were admitted to the Medical Center, of which approximately 46% were admitted through the emergency room, and overall occupancy was approximately 81%. During the same period, there were over 909,000 outpatient visits, of which approximately 810,000 were visits to the Clinics and the PCN Sites and approximately 46,000 were emergency room visits.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2005, 2004 and 2003 (dollars in thousands):

Statistics	2005	2004	2003
Admissions	32,886	32,235	31,340
Average daily census	425	415	416
Average length of stay	4.7	4.7	4.9
Case Mix Index	1.54	1.53	1.52
Patient days:			
Medicare (non-risk)	34,085	34,050	33,607
Medi-Cal (non-risk)	40,990	39,689	37,291
Commercial	299	168	120
County	14,488	14,106	14,469
Contracts (discount/per-diem)	41,908	41,343	42,356
Contracts (capitated)*	21,527	20,955	22,339
Non-sponsored/Self-pay	1,728	1,490	1,553
Total patient days	155,025	151,801	151,735
Outpatient visits:			
Hospital clinics	355,806	337,857	360,416
Primary care network	418,665	422,346	427,442
Home Health/Hosp	53,456	46,781	42,251
Emergency visits	46,196	49,341	53,710
PCN outreach	35,467	29,880	–
Total visits	909,590	886,205	883,819

* Includes Medicare (risk)
Medi-Cal (risk)

In 2005, Admissions increased by 651 or 2.0% over 2004. The average length of stay was constant at 4.7 days. Hospital clinic visits increased by 5.3%. PCN visits decreased by 0.9% in 2005 yet PCN outreach visits increased by 18.7%. Home Health visits increased by 14.3% based on program expansion. Emergency visits decreased by 6.4% in 2005 as was the trend from 2003. Changes in activity for visits in 2005 are consistent with the changes for 2004.

Statements of Revenues, Expenses and Changes in Net Assets

Table of operating results for 2005, 2004 and 2003 (dollars in thousands):

	2005	2004	2003
Net patient service revenue	$ 844,758	$ 767,302	$ 753,862
Other operating revenue	14,349	14,678	14,226
Total operating revenue	859,107	781,980	768,088
Total operating expenses	802,509	736,690	712,878
Income from operations	56,598	45,290	55,210
Total nonoperating expenses	(13,211)	(12,282)	(11,946)
Income before other changes in net assets	$ 43,387	$ 33,008	$ 43,264
Margin	5.1%	4.2%	5.6%

Revenues

Table of Net Patient Revenue by Funding Source for 2005, 2004 and 2003 (dollars in thousands):

Payor	2005	2004	2003
Medicare (non-risk)	$ 148,841	$ 129,994	$ 147,934
Medi-Cal (non-risk)	139,782	110,216	101,122
Commercial	2,911	1,877	2,510
County	31,502	27,958	24,887
Contracts (discount/per-diem)	389,671	381,644	365,374
Contracts (capitated)*	126,721	111,722	108,280
Non-sponsored/Self-pay	5,330	3,891	3,755
Total	$ 844,758	$ 767,302	$ 753,862

* Includes Medicare (risk)
Medi-Cal (risk)

Total Net Patient Revenue increased by $77.5 million or 10.1% from 2004 to 2005. This increase resulted from volume and retroactive supplemental funding of $34.1 million from the SB 1255 program. In addition, at June 30, 2004, certain reserves were maintained based on management's estimates for reductions in reimbursement from the Medicare program. However, due to favorable developments in 2005, reserves in the amount of $6.1 million were released to income and $19.4 million in favorable settlements were received and are reflected in Net Patient Revenue. In 2004, total Net Patient Revenue increased by $13.4 million or 1.8% from 2003 and resulted from improved payor mix and supplemental funding of $7.3 million from the AB915 program.

Operating Expenses and Non-Operating Expenses
During 2005, total operating expenses of $802.5 million increased by $65.8 million or 8.9% over 2004 primarily due to rising labor costs and inflationary increases in prosthetics and medical supplies. In 2004, total operating expenses of $736.7 million increased by $23.8 million or 3.3% primarily due to rising labor costs and inflationary increases in pharmaceuticals and medical supplies.

Salary and employee benefit expense includes wages paid to hospital employees, vacation, holiday and sick pay, payroll taxes, workers' compensation insurance premiums, health insurance and other employee benefits. Amounts paid for other contracted labor are included in purchased services. The total paid for salaries and employee benefits in 2005 increased by $33.9 million or 8.3% over 2004. This is due to wage increases and the associated increases in employee benefits. In 2004, the increase was $25.9 million or 6.8% over 2003 due to wage increases and associated increases in employee benefit expense. In 2005, workers' compensation increased by only $0.2 million. In 2004, workers' compensation expense increased $2.5 million over 2003 due to increased premiums and increased employee staffing, yet was a significant improvement over the increasing trend from prior years.

In 2005, professional services increased by $5.6 million or 9.6% over 2004 due to increases in services and support provided by the UC Davis School of Medicine. In 2004, professional services decreased by $3.0 million or 4.8% over 2003 due to changes in contractual obligations.

Medical supply expense for 2005 increased by $14.9 million or 14.0% over 2004. The cost of prosthetics and other implants increased by $5.5 million while the cost of pharmaceuticals increased by $5.0 million due to volume, inflation and increased usage of high cost drugs. The cost of blood and plasma increased by $1.4 million, also due to volume and inflation. In 2004, Medical supply expense increased by $9.9 million or 10.3% over 2003. The cost of prosthetics and other implants increased by $3.3 million while the cost of pharmaceuticals increased $4.0 million due to inflation and increased usage.

Non-operating revenues and expenses, which include interest earned on invested cash, interest expense on debt, and losses from disposal or retirement of capital assets, increased by $0.9 million or 7.6% over 2004. Interest income decreased by $0.7 million or 11.9% due to a lower average cash balance during 2005. In 2004, this increase was $0.3 million or 2.8% over 2003. Interest expense decreased by $2.8 million or 14.2% from 2003 due to the 2003 bond refinancing. However, this savings was offset by a decrease in interest income of $2.0 million due to lower cash balances and yields.

Statements of Net Assets

Table showing abbreviated statements of net assets at June 30, 2005, 2004 and 2003 (dollars in thousands):

	2005	2004	2003
Current assets:			
Cash	$ 153,105	$ 162,815	$ 208,069
Restricted assets, held by trustee	8,551	7,569	7,326
Patient accounts receivable (net)	134,640	113,834	113,667
Other current assets	31,183	37,224	23,695
Total current assets	327,479	321,442	352,757
Capital assets (net)	709,223	660,544	632,633
Other assets	10,145	10,729	10,673
Total assets	1,046,847	992,715	996,063
Current liabilities	129,696	113,979	140,023
Long-term debt	349,707	348,793	343,796
Total liabilities	479,403	462,772	483,819
Net assets:			
Invested in capital assets (net)	342,183	307,145	278,964
Restricted – expendable for debt service	8,551	7,569	7,326
Unrestricted	216,710	215,229	225,954
Total net assets	$ 567,444	$ 529,943	$ 512,244

Total current assets increased by $6.0 million from 2004 to 2005. Patient accounts receivable increased by $20.8 million while other current assets decreased by $6 million. Patient accounts receivable increased primarily due to higher volume. Total current assets for 2004 decreased by $31.3 million over 2003 mainly due to cash decrease for capital expenditures and the pay down of third party settlements.

Net capital assets increased by $48.7 million from 2004 to 2005 primarily due to construction of the Surgery and Emergency Services Pavillion, the Davis Tower II, and other planned projects and equipment. The increase of $27.9 million from 2003 to 2004 was due to planned expenditures for projects and equipment.

Current liabilities increased by $15.7 million from 2004 to 2005 primarily due to accrued payroll and third party settlements. A decrease of $26.0 million occurred between 2003 and 2004 primarily due to third party settlements.

Long term debt increased by $0.9 million from 2004 to 2005. Increases of $15.4 million in new financing loans were offset by scheduled debt service payments. Long-term debt increased by $5.0 million from 2003 to 2004 due to favorable escrow restructuring of deferred financing costs on the 2003 Revenue Refunding Bonds.

Net assets increased by $37.5 million from 2004 to 2005. This increase reflects $43.4 million from income before other changes in net assets, $2.8 million from transfers for capital by the University, less $17.0 million of Health System capital and operational support for the research and the teaching missions of the Health System.

Liquidity and Capital Resources

The following table shows key liquidity and capital ratios for 2005, 2004 and 2003:

	2005	2004	2003
Days of revenue in accounts receivable	58	54	58
Debt service coverage	3.9	3.9	4.3
Days cash on hand	81	90	114

Days of revenue in accounts receivable increased from 54 at 2004 to 58 at 2005. The increase is the result of higher volume. Days were also 58 at 2003.

Debt service coverage remained at 3.9 at 2005 from 2004 due to the $15.4 million increase in financing loans. At 2003, debt service coverage was 4.3.

Days cash on hand decreased from 90 at 2004 to 81 at 2005. This decrease in days is detailed in the accompanying Statement of Cash Flows on page 11.

Looking Forward

The Hospital Facilities Seismic Safety Act (SB 1953)
During 2005, the UC Davis Medical Center's capital program continued to address the requirements in the Hospital Facilities Seismic Safety Act. The projected cost for the UC Davis Medical Center, which will be compliant with the statutory requirements by January 1, 2008, is $117 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 2005, $17.3 million was spent on these requirements.

Regulatory Risk
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 hard to anticipate and quantify. Revenues are subject to adjustment as a result of examination by government agencies or contractors. The audit process and the resolution of significant related matters (including disputes based on differing interpretations of the regulations) often are not finalized until several years after the services were rendered.

Medicaid Reform
There are efforts to reform components of the Medicaid (Medi-Cal in California) program. Items that have been proposed include additional co-pays and deductibles for patients, expanded use of managed care and other coordinated systems of care for the chronically ill, and changes to hospital supplemental payment systems. Although these changes have been advanced in California to improve the quality of care to Medicaid beneficiaries and help maintain Medicaid supplemental payments to teaching hospitals and other hospitals that serve a large volume of Medicaid patients, the full financial impact of these changes can not be fully assessed at this time. The Medical Center currently incurs significant unreimbursed expenses related to serving Medi-Cal and uninsured patients.

Children's Hospital Bond Act of 2004
California voters passed Proposition 61 that enables the State of California to issue $750 million in General Obligation bonds to fund capital improvement projects for children's hospitals. Each of the University medical centers is eligible for $30 million of grant funding from this pool of funds. Grant funds must be used for capital projects associated with the care of children and must be used prior to June 30, 2014. Request for Proposition 61 funds will be made in future years as specific projects are identified.

University of California Retirement Plan
The University of California Retirement Plan ("UCRP") costs are funded by a combination of investment earnings, employee member and employer contributions. Since 1990, the Medical Center's contribution rate to the UCRP has been zero. In addition, since 1990, most of the required employee member contributions to the UCRP are being redirected to the separate defined contribution plan maintained by the University. Actuarial reviews of the UCRP have determined that, given its financial position and its ability to meet its benefit obligations, employer and employee member contributions are not currently needed and will not be needed in 2006. However, it is not reasonable to expect the Plan to maintain its high level of surplus and The Regents may require contributions at a future date. The zero rate for UCRP contributions and the redirection of employee member UCRP contributions will be reviewed annually by The Regents with the consulting actuaries and continue only until such time as a resumption of employer and employee member contributions to the UCRP are again required to maintain actuarially sound funding levels.

Cautionary Note Regarding Forward-Looking Statements

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

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

University of California, Davis Medical Center
Statements of Net Assets
June 30, 2005 and 2004
(Dollars in thousands)

	2005	2004
Assets		
Current assets:		
Cash	$ 153,105	$ 162,815
Restricted assets, held by trustee	8,551	7,569
Patient accounts receivable, net of estimated uncollectibles of $21,894 and $27,209, respectively	134,640	113,834
Other receivables, net of estimated uncollectibles of $10 and $2,773, respectively	17,829	22,384
Inventory	5,774	6,871
Prepaid expenses and other assets	7,580	7,969
Total current assets	327,479	321,442
Capital assets, net	709,223	660,544
Investments in joint ventures	10,145	10,729
Total assets	1,046,847	992,715
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	20,629	21,494
Accrued salaries and benefits	49,932	42,383
Third-party payor settlements	27,726	19,859
Current portion of long-term debt and capital leases	13,133	9,503
Other liabilities	18,276	20,740
Total current liabilities	129,696	113,979
Long-term debt and capital leases, net of current portion	349,707	348,793
Total liabilities	479,403	462,772
Net Assets		
Invested in capital assets, net of related debt	342,183	307,145
Restricted:		
Expendable:		
Debt service	8,551	7,569
Unrestricted	216,710	215,229
Total net assets	$ 567,444	$ 529,943

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

University of California, Davis Medical Center

Statements of Revenues, Expenses and Changes in Net Assets

For the Years Ended June 30, 2005 and 2004

(Dollars in thousands)

	2005	2004
Net patient service revenue	$ 844,758	$ 767,302
Other operating revenue:		
Clinical teaching support	7,789	8,430
Other	6,560	6,248
Total other operating revenue	14,349	14,678
Total operating revenue	859,107	781,980
Operating expenses:		
Salaries and employee benefits	442,595	408,694
Professional services	64,480	58,854
Medical supplies	121,156	106,298
Other supplies and purchased services	74,100	64,739
Depreciation and amortization	49,389	47,331
Provision for doubtful accounts	39,315	42,104
Insurance	5,979	5,794
Other	5,495	2,876
Total operating expenses	802,509	736,690
Income from operations	56,598	45,290
Nonoperating revenue (expenses):		
Interest income	5,001	5,676
Interest expense	(17,023)	(16,987)
Loss on disposal of capital assets	(1,340)	(1,428)
Other	151	457
Total nonoperating expenses	(13,211)	(12,282)
Income before other changes in net assets	43,387	33,008
Other changes in net assets:		
Contributions from University for building program	8,228	–
Health system support	(16,984)	(17,320)
Transfers from University	2,870	2,011
Total other changes in net assets	(5,886)	(15,309)
Increase in net assets	37,501	17,699
Net assets – beginning of year	529,943	512,244
Net assets – end of year	$ 567,444	$ 529,943

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, 2005 and 2004
(Dollars in thousands)

	2005	2004
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 797,059	$ 701,099
Payments to employees	(351,909)	(337,528)
Payments to suppliers	(271,274)	(244,899)
Payments for benefits	(86,454)	(81,898)
Other receipts, net	11,687	12,490
Net cash provided by operating activities	99,109	49,264
Cash flows from noncapital financing activities:		
Health system support	(16,984)	(17,320)
Transfers from University	2,870	2,011
Net cash used by noncapital financing activities	(14,114)	(15,309)
Cash flows from capital and related financing activities:		
Proceeds from contributions by University for building program	8,228	–
Proceeds from sale of capital assets	807	10
Purchases of capital assets	(95,204)	(77,626)
Principal paid on long-term debt and capital leases	(12,891)	(8,068)
Proceeds from financing loan	14,560	8,082
Proceeds from 2003 General Revenue Bonds	–	(15,252)
Refinance of 1989 Multiple Purpose Project Bonds	–	15,820
Interest paid on long-term debt and capital leases	(14,959)	(7,819)
Net cash used by capital and related financing activities	(99,459)	(84,853)
Cash flows from investing activities:		
Interest income received	5,001	5,676
Distributions from investments in joint ventures, net	735	206
Change in restricted assets, held by trustee	(982)	(243)
Other non-operating income	–	5
Net cash provided by investing activities	4,754	5,644
Net decrease in cash	(9,710)	(45,254)
Cash – beginning of year	162,815	208,069
Cash – end of year	$ 153,105	$ 162,815

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, 2005 and 2004
(Dollars in thousands)

	2005	2004
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 56,598	$ 45,290
Adjustments to reconcile income from operations to net cash provided by operating activities		
Depreciation and amortization expense	49,389	47,331
Provision for doubtful accounts	39,315	42,104
Changes in operating assets and liabilities		
Patient accounts receivable	(60,121)	(42,271)
Other receivables	4,555	(7,243)
Inventory	1,097	(2,299)
Prepaid expenses and other assets	389	(3,987)
Accounts payable and accrued expenses	(5,065)	2,191
Accrued salaries and benefits	7,549	(7,126)
Third-party payor settlements	7,867	(16,689)
Other liabilities	(2,464)	(8,037)
Net cash provided by operating activities	$ 99,109	$ 49,264
Supplemental noncash activities information:		
Capital assets acquired through capital lease obligations	$ 811	$ –
Amortization of deferred financing costs	$ 2,064	$ 9,168

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

1. Organization

The University of California, Davis Medical Center (the "Medical Center") is a part of the University of California (the "University"), a California public corporation established under Article IX, Section 9 of the California Constitution. The University is administered by The Regents of the University of California ("The Regents"), an independent board composed of 26 members. The Medical Center's activities are monitored by The Regents' Committee on Health Services, with direct management authority being delegated to the Medical Center Director by the Chancellor of the Davis campus. The Medical Center has 530 licensed beds.

2. Summary of Significant Accounting Policies

Basis of Presentation

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

GASB Statement No. 40, *Deposit and Investment Risk Disclosures*, was adopted during the year ended June 30, 2005 and retroactively applied as of July 1, 2003. Statement No. 40 establishes additional disclosure requirements addressing common risks of deposits and investments. The implementation of Statement No. 40 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2005 and 2004.

GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*, was also adopted during the year ended June 30, 2005. Statement No. 42 requires an evaluation of prominent events or changes in circumstances to determine whether an impairment loss should be recorded and whether any insurance recoveries should be offset against the impairment loss. The implementation of Statement No. 42 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2005 and 2004.

Cash

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

2. Summary of Significant Accounting Policies (Continued)

Cash (Continued)

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

The Medical Center's cash at June 30, 2005 and 2004 was $164,586 and $162,815, respectively. None of these amounts are insured by the Federal Deposit Insurance Corporation.

Interest income is reported as non-operating revenue in the statements of revenues, expenses and changes in net assets.

Additional information on cash and investments can be obtained from the 2004-2005 annual report of the University.

Restricted Assets, Held by Trustee

Indenture requirements of bond financing (see Note 8, "Long-term Debt") provide for the establishment and maintenance of various accounts with a trustee. The indenture terms require that the trustee control the expenditure of bond proceeds as well as the payment of principal and interest to the bondholders. Assets held by trustee consist of short-term investments, recorded at cost, which approximates fair value.

Inventory

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

Prepaid Expenses and Other Assets

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

Capital Assets

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

2. Summary of Significant Accounting Policies (Continued)

Net Assets

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

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

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

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

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

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

Revenues and Expenses

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

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

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

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

2. Summary of Significant Accounting Policies (Continued)

Revenues and Expenses (Continued)

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

Charity Care

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

Transactions with the University and University Affiliates

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

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

Compensated Absences

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

Interest Rate Swap Agreement

The Medical Center has entered into interest rate swap agreements to limit the exposure of its variable rate debt to changes in market interest rates. Interest rate swap agreements involve the exchange with a counterparty of fixed and variable rate interest payments periodically over the life of the agreement without exchange of the underlying notional principal amounts. The difference to be paid or received is recognized over the life of the agreements as an adjustment to interest expense. The Medical Center's counterparties are major financial institutions.

2. Summary of Significant Accounting Policies (Continued)

Interest Rate Swap Agreement (Continued)
In accordance with GASB standards, the fair value of the interest rate swap agreements is not recognized in the Medical Center's statements of net assets and changes in fair value are not recognized in the statements of revenues, expenses and changes in net assets.

Tax Exemption
The Regents of the University of California is a California public corporation and is a tax-exempt organization under the provisions of the Internal Revenue Code.

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles 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. Actual amounts could differ from those estimates.

Reclassifications
Certain amounts for 2004 have been reclassified to conform to the current year presentation.

New Accounting Pronouncements
In August 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*, effective for the Medical Center's fiscal year beginning July 1, 2007. Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefit ("OPEB") expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. The Medical Center is currently evaluating the effect that Statement No. 45 will have on its financial statements.

In June 2005, the GASB issued Statement No. 47, *Accounting for Termination Benefits*, effective for the Medical Center's fiscal year beginning July 1, 2005. Statement No. 47 requires benefits such as early retirement incentives or severance to employees who are involuntarily terminated to be recognized in the period the Medical Center becomes obligated to provide the benefits. Benefits provided to employees who voluntarily terminate must be recognized when the termination offer is accepted. The Medical Center is currently evaluating the effect that Statement No. 47 will have on its financial statements.

3. Net Patient Service Revenue

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

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

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

  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.

- ***Medi-Cal*** –The federal Medicaid program is referred to as Medi-Cal in California. Inpatient services rendered to Medi-Cal program beneficiaries are reimbursed under a contract at a prospectively determined negotiated per-diem rate. Outpatient services are reimbursed based upon prospectively determined fee schedules. Medi-Cal patient revenues include traditional reimbursement under the California State Department of Health Services for patients covered under Title XIX of the Social Security Act (non-risk) or Medi-Cal capitated contract revenue (risk).

- ***Senate Bill 855 and 1255 Funds*** – State of California Senate Bills 855 ("SB 855") and 1255 ("SB 1255") provide supplemental payments to hospitals that provide a disproportionate share of their services to Medi-Cal and low income patients.

  In December 2004, the Centers for Medicare and Medicaid Services approved the University's request to recalculate the Medi-Cal Upper Payment Limit for fiscal years 2002-03 through 2004-05. The revised calculation resulted in an increased Medi-Cal inpatient supplemental payment for qualified Medi-Cal disproportionate share hospitals. These additional payments under SB 1255 have been recorded as revenue in the current year.

3. Net Patient Service Revenue (Continued)

For the year ended June 30, 2005, the Medical Center recorded additional revenue of $20,480 under SB-855, and $51,567 under SB-1255, including $34,100 associated with 2002-03 and 2003-04. For the year ended June 30, 2004, the Medical Center recorded additional revenue of $14,999 under SB-855 and $21,000 under SB-1255.

- ***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, 2005 and 2004, the Medical Center applied for and received additional revenue of $5,519 and $7,210, 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.

- ***Medical Education Fund*** – The Medical Education Fund provides for a supplemental payment in recognition of both direct and indirect medical education costs associated with inpatient health care services rendered to Medi-Cal beneficiaries. For the years ended June 30, 2005 and 2004, the Medical Center recorded additional revenue of $3,490 and $5,827, respectively.

- ***Assembly Bill 915*** – State of California Assembly Bill 915 ("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, which was approved for implementation on September 12, 2003, covers only Medi-Cal fee-for-service outpatient services, beginning July 1, 2002. 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, 2005 and 2004, the Medical Center recorded additional revenue of $6,828 and $7,280, respectively. The $7,280 recorded by the Medical Center during the year ended June 30, 2004 was for the two years of patient services rendered between July 1, 2002 and June 30, 2004.

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

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

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

- Capitated contracts with health plans, which reimburse the Medical Center on a per-member-per-month basis, whether or not services are actually rendered. The Medical Center takes on a certain amount of financial risk as the contract requires them to treat a patient for all covered services. Expected losses on capitated agreements are accrued when probable and can be reasonably estimated.

- Certain health plans established a shared-risk pool through which the Medical Center shares in any surplus of budget over actual health care utilization costs as defined in the related contracts. Additionally, the Medical Center bears risk of health care utilization cost above budgeted cost, 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, which reimburse the Medical Center for certain indigent patients covered under county contracts.

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

Amounts due from Medicare and Medi-Cal represent 31% and 33% of net patient accounts receivable at June 30, 2005 and 2004, respectively.

For the years ended June 30, 2005 and 2004, net patient service revenue included $10,662 and $2,013, respectively, due to favorable cost report settlements with Medicare, Medi-Cal and the County Medical Services Program. In addition, in 2005 and 2004, previously established liabilities in the amount of $9.0 million and $4.6 million, respectively, were released to income and are reflected in net patient service revenue.

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

	2005	2004
Medicare (Non-Risk)	$ 148,841	$ 129,994
Medicare (Risk)	16,256	18,298
Medi-Cal (Non-Risk)	139,782	110,216
Medi-Cal (Risk)	16,282	17,281
Commercial Insurance	2,911	1,877
Contract (Discounted or Per-Diem)	389,671	381,644
Contract (Capitated)	94,183	76,143
County	31,502	27,958
Non-sponsored/self-pay	5,330	3,891
Total	$ 844,758	$ 767,302

(Dollars in thousands)

4. Charity Care

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

	2005	2004
Charity care at established rates	$ 81,102	$ 70,724
Estimated cost of charity care	$ 20,969	$ 17,964

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $132,949 and $129,167 for the years ended June 30, 2005 and 2004, respectively.

5. Restricted Assets, Held by Trustee

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

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

	2005	2004
Short-term, highly liquid investments	$ 8,551	$ 7,569

6. Capital Assets

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

	2003	Additions	Disposals	2004	Additions	Disposals	2005
Original Cost							
Land	$ 29,356	$ 250	–	$ 29,606	–	–	$ 29,606
Buildings and improvements	653,837	10,807	$ (6,277)	658,367	$ 16,909	$ (1,721)	673,555
Equipment	235,951	40,195	(17,235)	258,911	37,603	(33,461)	263,053
Construction in progress	40,209	26,374	–	66,583	45,703	–	112,286
Capital assets, at cost	$ 959,353	$ 77,626	$ (23,512)	$1,013,467	$ 100,215	$ (35,182)	$1,078,500
	2003	**Depreciation**	**Disposals**	**2004**	**Depreciation**	**Disposals**	**2005**
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 174,329	$ 23,390	$ (5,586)	$ 192,133	$ 23,645	$ (853)	$ 214,925
Equipment	152,391	23,941	(15,542)	160,790	25,744	(32,182)	154,352
Accumulated depreciation and amortization	$ 326,720	$ 47,331	$ (21,128)	$ 352,923	$ 49,389	$ (33,035)	$ 369,277
Capital assets, net	$ 632,633			$ 660,544			$ 709,223

6. Capital Assets (Continued)

Equipment under capital lease obligations and related accumulated amortization is $811 and $0 in 2005, respectively. There was no equipment financed through capital leases in 2004.

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

During 2005, the University has been making seismic improvements in order to be in compliance with Senate Bill 1953, the Hospital Facilities Seismic Safety Act. A portion of the improvements is financed under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $8,228 during 2005 are shown as contributions from University for building program on the statements of revenues, expenses and changes in net assets.

7. Investments in Joint Ventures

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

(Dollars in thousands)

8. Long-term Debt and Capital Leases

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

	Outstanding Debt	
	2005	**2004**
The Regents of the University of California Hospital Revenue Bonds (University of California, Davis Medical Center, Series 1996), interest rates of 10% payable semi-annually, with annual principal payments through 2006	$ 14,690	$ 21,050
The Regents of the University of California Refunding Hospital Revenue Bonds (University of California, Davis Medical Center, Series 2003) Series A-E, variable rate bonds payable semi-annually, with annual principal payments through 2026	342,875	346,025
The Regents of the University of California General Revenue Bonds 2003, interest rates from 2.0% to 5.25%, payable semi-annually, with annual principal payments through 2023	14,359	14,886
Capital lease obligation, for computer software, with a fixed interest rate of 3.0%, payable through 2010, collateralized by underlying computer software	811	–
Financing obligations, primarily for computer and medical equipment, with fixed interest rates of 2.7% to 3.4%, payable through 2010	19,747	8,041
Unamortized cost of financing	(29,642)	(31,706)
Total debt and capital leases	362,840	358,296
Less: Current portion of debt and capital leases	(13,133)	(9,503)
Noncurrent portion of debt and capital leases	$ 349,707	$ 348,793

(Dollars in thousands)

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

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

	Revenue Bonds	Other Debt Obligations	Total
Year Ended June 30, 2005			
Current portion at June 30, 2004	$ 7,973	$ 1,530	$ 9,503
Reclassification from noncurrent	8,749	5,708	14,457
Principal payments	(10,037)	(2,854)	(12,891)
Amortization of cost of financing	2,064	–	2,064
Current portion at June 30, 2005	$ 8,749	$ 4,384	$ 13,133
Noncurrent portion at June 30, 2004	$ 342,282	$ 6,511	$ 348,793
New obligations	–	15,371	15,371
Reclassification to current	(8,749)	(5,708)	(14,457)
Noncurrent portion at June 30, 2005	$ 333,533	$ 16,174	$ 349,707
Year Ended June 30, 2004			
Current portion at June 30, 2003	$ 5,755	$ 131	$ 5,886
Reclassification from noncurrent	7,973	1,571	9,544
Principal payments	(7,896)	(172)	(8,068)
Amortization of cost of financing	2,141	–	2,141
Current portion at June 30, 2004	$ 7,973	$ 1,530	$ 9,503
Noncurrent portion at June 30, 2003	$ 343,796	$ –	$ 343,796
New obligations	15,252	8,082	23,334
Refinanced 1989 Multiple Purpose Project bonds	(15,820)	–	(15,820)
Reclassification to current	(7,973)	(1,571)	(9,544)
Amortization of cost of financing	7,027	–	7,027
Noncurrent portion at June 30, 2004	$ 342,282	$ 6,511	$ 348,793

Hospital Revenue Bonds Series 1996 were issued to finance the acquisition and construction of certain health care and related facilities. The Bonds have sinking fund requirements and optional redemption provisions. The Hospital Revenue Bonds are collateralized by gross revenues of the Medical Center. In addition, under the bond indentures, the Medical Center is required to maintain a debt service coverage ratio of 1.2 to 1.0 and has limitations as to additional borrowings and the purchase or sale of business assets.

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

Refunding Hospital Revenue Bonds Series 2003 with a variable interest rate were issued to advance refund and defease the majority of the previously outstanding bonds. The Medical Center also entered into interest rate swap agreements in connection with the Refunding Hospital Revenue Bonds Series 2003 with the intention that the variable interest rate it pays on the bonds will approximate the variable payments it receives from the interest rate swaps, resulting in a fixed interest of 3.1%. The defeasance resulted in deferred financing costs, included as an offset to the current and noncurrent portion of long-term debt, as appropriate, in the Medical Center's statements of net assets, and is being amortized as interest expense over the remaining life of the defeased bonds. The Refunding Hospital Revenue Bonds Series 2003 are collateralized by the gross revenues of the Medical Center and have sinking fund requirements and optional redemption provisions. In addition, under the bond indentures, the Medical Center is required to maintain a debt coverage ratio of 1.1 to 1.0 and has limitations as to additional borrowings and the purchase or sale of business assets.

The University issued General Revenue Bonds Series 2003, collateralized solely by general revenues of the University, to refinance 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.

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 in 2003, the Medical Center entered into interest rate swaps with three financial institutions in connection with its $347.8 million variable-rate Refunding Hospital Revenue Bonds (Series A–E). The intention of the swap transaction was to effectively change the variable interest rate on the bonds to a fixed rate of 3.1%.

The bonds and the related swap agreement mature on September 1, 2026 and the aggregate notional amount of swaps matches the outstanding amounts on the bonds throughout the entire term of the bonds. Under the swaps, the Medical Center pays the swap counterparties a fixed payment of 3.1385% and receives a variable payment computed as 67% of 30 day London Interbank Offered Rate (LIBOR). The Medical Center believes that over time the variable interest rates it pays on the bonds will approximate the variable payments it receives on the interest rate swaps, leaving the fixed interest rate payment on the swaps as the net payment obligation for the transaction.

Because swap interest rates have decreased since execution of the swaps, the swaps have an estimated negative fair value of $5.5 million as of June 30, 2005. The fair value is an indication of the difference in value of the swap fixed interest payments due on the swap and swap fixed rate payments due on a swap with identical terms executed on June 30, 2005. The fair value of the interest rate swap is the estimated amount the University would have paid if the swap agreement was terminated on June 30, 2005. The fair value was estimated by the financial institutions using quoted market prices when available or a forecast of expected discounted future net cash flows.

(Dollars in thousands)

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

These swaps expose 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 swaps is taxable (67% of 30 day LIBOR). Tax-exempt interest rates can change without a corresponding change in the 30 day LIBOR rate due to factors affecting the tax exempt market which do not have a similar effect on the taxable market. For example, the swap exposes 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 67% of 30 day LIBOR.

Although the Medical Center has the interest rate swaps with creditworthy financial institutions, there is exposure to losses in the event of non-performance by counterparties or unfavorable interest rate movements. The swap may be terminated if the insurer's credit quality rating falls below "A –" as issued by Fitch Ratings or Standard & Poor's, thereby canceling the synthetic interest rate and returning the interest rate payments to the variable interest rates on the bonds. 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.

Interest payments on the bonds are reset weekly for Series B–D, and daily for Series A and E. 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, 2005, 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
2006	$ 3,275	$ 6,695	$ 3,917	$ 13,887
2007	3,375	6,629	3,879	13,883
2008	11,950	6,436	3,766	22,152
2009	12,375	6,195	3,625	22,195
2010	12,800	5,945	3,479	22,224
2011 – 2015	70,875	25,671	15,021	111,567
2016 – 2020	83,975	18,011	10,539	112,525
2021 – 2025	99,500	8,935	5,228	113,663
2026 – 2027	44,750	667	391	45,808
Total	$342,875	$ 85,184	$ 49,845	$477,904

Additional information on the General Revenue Bonds can be obtained from the 2004-2005 annual report of the University.

(Dollars in thousands)

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

Future debt service payments for each of the five fiscal years subsequent to June 30, 2005 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Other Debt	Total Payments	Principal	Interest
2006	$ 23,221	$ 4,979	$ 28,200	$ 15,197	$ 13,003
2007	23,183	5,115	28,298	16,294	12,004
2008	23,371	5,116	28,487	17,342	11,145
2009	23,414	5,066	28,480	17,892	10,588
2010	23,443	1,822	25,265	15,222	10,043
2010 – 2014	117,660	–	117,660	74,477	43,183
2015 – 2019	118,603	–	118,603	88,514	30,089
2020 – 2024	117,300	–	117,300	102,794	14,506
2025 – 2027	45,809	–	45,809	44,750	1,059
Total future debt service	516,004	22,098	538,102	$ 392,482	$ 145,620
Less: Interest component of future payments	(144,080)	(1,540)	(145,620)		
Principal portion of future payments	371,924	20,558	392,482		
Less: Unamortized cost of financing	(29,642)	–	(29,642)		
Total debt	$ 342,282	$ 20,558	$ 362,840		

9. Operating Leases

The Medical Center leases certain facilities under operating leases with terms of 1 to 15 years. Total rental expense on operating leases for the years ended June 30, 2005 and 2004 was $9,454 and $8,628, respectively. As of June 30, 2005, amounts payable under noncancelable operating leases are as follows:

Year Ending June 30,	
2006	$ 10,147
2007	9,918
2008	8,955
2009	6,537
2010	4,835
2011 – 2015	13,182
Total	$ 53,574

10. Retirement Plans

The University maintains retirement plans, which are administered by the University of California Retirement System. The plans consist of The University of California Retirement Plan ("UCRP"), a single employer defined benefit plan, and three defined contribution plans with several investment portfolios funded with employee non-elective and elective contributions (collectively the "Plans"). Substantially all full-time employees of the Medical Center participate in the Plans.

The UCRP is a defined benefit plan funded with University and employee contributions, and 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. The University's policy is to fund actuarially determined contributions.

The actuarial value of UCRP assets and the actuarial accrued liability as of June 30, 2005 were $41.1 billion and $37.3 billion, respectively. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were $41.9 billion at June 30, 2005. For the years ended June 30, 2005 and 2004, there was no employer contribution, annual pension cost or net pension obligation for the University. The annual pension cost was equal to the actuarially determined contributions.

The three defined contribution plans (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 contributions. The 403(b) and 457(b) plans accept pre-tax contributions. There are no employer contributions to any of these three plans. Benefits from the plans are based on participants' mandatory and voluntary contributions, plus earnings, and are immediately vested.

Information as to contributions made, plan assets and liabilities, as they relate to Medical Center employees, is not readily available. Additional information on the plans can be obtained from the 2004-2005 annual report of the University.

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. The Medical Center is contingently liable for the obligations under these self-insurance programs.

The Medical Center paid premiums of $23,025 and $23,057 for the years ended June 30, 2005 and 2004, respectively. These amounts are included in salaries and employee benefits, and insurance on the statements of revenues, expenses and changes in net assets.

(Dollars in thousands)

12. Transactions with Other University Entities

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

	2005	2004
Salaries and employee benefits	$ 17,203	$ 17,291
Professional services	38,162	30,711
Other supplies and purchased services	3,610	3,924
Interest income	(5,001)	(5,676)
Insurance	5,979	5,794
Total	$ 59,953	$ 52,044

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

The total net amount of payments made by the Medical Center to the School of Medicine were $58,952 and $52,048 in 2005 and 2004, respectively. Of these amounts, $41,968 and $34,728 are reported as operating expenses for the years ended June 30, 2005 and 2004, respectively, and $16,984 and $17,320 are reported as health system support for the years ended June 30, 2005 and 2004, 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 University is contingently liable in connection with certain claims and contracts, including those currently in litigation, arising out of the normal course of its activities. Management and General Counsel are of the opinion that the outcome of such matters will not have a material effect on the financial statements.

13. Commitments and Contingencies (Continued)

California Senate Bill 1953, Hospital Facilities Seismic Safety Act, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. By January 1, 2008, all general acute care inpatient buildings must be life safe. By January 1, 2030, all general acute care inpatient buildings must be operational after an earthquake. Previously, the State of California's budget authorized the University to use $600 million in lease-revenue bond funds for earthquake safety renovations. The Regents have approved the allocation of the $600 million among the University's medical centers, of which $120 million was allocated to the Medical Center. During 2005, the Medical Center expended $8,228 of its allocation and spent none of its allocation in 2004. As of June 30, 2005, any repayment the Medical Center may be obligated for under these financing arrangements is still being determined.

The Medical Center currently has a contractual obligation related to the construction of the Surgery and Emergency Services Pavillion in the amount of $42.5 million. As of June 30, 2005, $28.5 million of this obligation was outstanding.