University of California,
Irvine Medical Center

Report on Audits of Financial Statements
For the Years Ended June 30, 2009 and 2008

University of California, Irvine Medical Center
Index
June 30, 2009 and 2008

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Report of Independent Auditors

The Regents of the University of California
Oakland, California

In our opinion, the accompanying financial statements, as shown on pages 15 through 37 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, 2009 and 2008, 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, 2009 and 2008, and its changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

PricewaterhouseCoopers LLP

October 12, 2009

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, 2009, with selected comparative information for the years ended June 30, 2008 and 2007. 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 (2007, 2008, 2009, 2010, 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 392 beds in year 2009. 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 construction of the new UC Irvine Douglas Hospital began in February 2005 and will be completed in two phases. Phase I was completed and opened for patient care in March 2009. Phase II will be complete at the end of 2011. The new 480,000-square-foot hospital will contain 424 licensed beds, including 236 beds in the new main hospital building, 107 beds in the existing medical center's tower, 67 neuropsychiatric beds, and 14 rehabilitation beds. The new replacement hospital will meet the State of California's SB 1953, The Hospital Facilities Seismic Safety Act.

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

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

The Medical Center was selected as one of the best hospitals in the United States by *U.S. News & World Report* for the ninth consecutive year. The Medical Center ranks among the best in two specialty areas: urology and gynecology.

During 2009, the Medical Center remained financially sound with a stable cash position and profitable operations.

For the year ended June 30, 2009, the Medical Center reported net income of $52.3 million and generated a margin of 9.0 percent. Total operating revenue increased by 11.0 percent. Total operating expenses increased by 10.0 percent. The year ended with a cash position of $73.4 million.

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

- *Opening of UC Irvine Douglas Hospital*
  The new UC Irvine Douglas Hospital was completed on budget and four months ahead of schedule. Currently, the seven-story, state-of-the-art hospital has 191 mostly private patient rooms and 15 high-tech operating rooms. The completion of Phase II in November 2011 will add 45 more patient rooms and four more operating rooms.

- *Medical Center Renovation Projects*
  In January 2008, the Regents approved five projects, including three separate projects on the Medical Center campus and two Phase II projects in the new UC Irvine Douglas Hospital. The Phase II projects will complete development of the UC Irvine Douglas Hospital. The other three projects will upgrade two existing clinical facilities which include renovation in Obstetrics for clinical and education programs, construction of the Clinical Laboratory Replacement building, and renovation in the Chao Comprehensive Cancer Center. The renovation costs of the three projects totaling $69.4 million will be funded from external financing and capital leases.

- *Increase in labor costs*
  Labor costs continue to be adversely affected by the nationwide nursing shortage, compliance with legislation covering nurse staffing ratios, and increased premiums for employee healthcare. These combined factors had a significant impact on both the salary costs of hospital-employed nurses as well as the rates charged for nurses employed from nurse registry agencies. Overall, labor costs, including employee benefits for hospital-paid employees increased by 4.8 percent over 2008.

- *Favorable settlement*
  During the year ended June 30, 2009, the medical center received a favorable settlement with Kaiser Foundation Health Plan in the amount of $10.8 million.

Operating Statistics

The following table presents utilization statistics for the Medical Center for 2009, 2008 and 2007:

Statistics	2009	2008	2007
Admissions	16,683	16,628	16,682
Average daily census	279	278	282
Discharges	16,793	16,719	16,793
Average length of stay	6.1	6.1	6.1
Patient days:			
Medicare (non-risk)	27,950	26,624	26,137
Medi-Cal (non-risk)	37,066	37,483	35,141
CalOptima	–	–	1,888
Commercial	1,406	1,078	892
Contracts (discounted/per diem)	26,282	25,631	27,312
County/uninsured	9,059	10,865	11,543
Total patient days	101,763	101,681	102,913
Ambulatory/emergency room visits	528,042	524,422	527,358

Total discharges and patient days remained stable compared to the prior year. Discharges increased slightly by 0.4 percent and patient days (excluding newborns) remained constant in 2009. In 2008, discharges and patient days decreased slightly by 0.4 percent and 1.2 percent, respectively, due to the termination of all full-risk capitated contracts.

In 2009, total ambulatory and emergency visits increased slightly by 3,620, or 1.0 percent, over the prior year, primarily in clinic visits.

Statements of Revenues, Expenses and Changes in Net Assets

This statement shows the revenues, expenses and changes in net assets for the Medical Center for 2009 compared to the prior two years.

The following table summarizes the operating results for the Medical Center for fiscal years 2009, 2008 and 2007 (dollars in thousands):

	2009	2008	2007
Net patient service revenue	$ 559,059	$ 502,829	$ 467,882
Other operating revenue	25,278	23,614	20,922
Total operating revenue	584,337	526,443	488,804
Total operating expenses	530,099	481,906	447,693
Income from operations	54,238	44,537	41,111
Total non-operating revenue	(1,937)	2,537	4,085
Income before other changes in net assets	$ 52,301	$ 47,074	$ 45,196
Margin	9.0 percent	9.0 percent	9.2 percent
Other changes in net assets	38,986	50,665	41,763
Net assets – beginning of year	539,661	441,922	354,963
Net assets – end of year	$ 630,948	$ 539,661	$ 441,922

Revenues

Total operating revenues for the year ended June 30, 2009 were $584.3 million, an increase of $57.9 million, or 11.0 percent, over 2008. Operating revenues for 2008 were $526.4 million, an increase of $37.6 million, or 7.7 percent, over 2007.

Net patient service revenue for 2009 increased by $56.2 million, or 11.2 percent, over the prior year. The increase in 2009 was due to changes in a more favorable patient mix and contract rate increases. Net patient service revenue in 2008 increased by $34.9 million, or 7.5 percent, over 2007. 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 2009, other operating revenue increased by $1.7 million, or 7.1 percent, over 2008 due primarily to the increase in various county funding and non-patient revenues. In 2008, other operating revenue increased by $2.7 million, or 12.9 percent, over 2007.

The following table summarizes net patient service revenue for 2009, 2008 and 2007 (dollars in thousands):

Payor	2009	2008	2007
Medicare (non-risk)	$ 142,815	$ 129,580	$ 108,006
Medi-Cal (non-risk)	126,888	118,695	123,765
CalOptima	–	–	3,780
Commercial	38,872	24,378	16,308
Contracts (discounted/per diem)	225,736	199,688	178,722
County/Uninsured	24,748	30,488	37,301
Total	$ 559,059	$ 502,829	$ 467,882

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 $13.2 million from 2008 due primarily to increased managed Medicare utilization and favorable Medicare settlements. In 2008, net revenue for Medicare patients increased by $21.6 million from 2007.

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 2009, net Medi-Cal revenue increased by $8.2 million over 2008 due to the Medi-Cal per-diem rate increase. In 2008, net Medi-Cal revenue decreased by $5.1 million over 2007 due to the decrease in supplemental funding primarily Medi-Cal hospital waiver Disproportionate Share ("DSH") payments. For the years ended June 30, 2009 and 2008, the Medical Center recorded additional revenue of $74.2 million and $74.6 million, respectively, from the Medi-Cal hospital waiver DSH payments under Senate Bill 1100.

Net revenue for contracts maintained a stable growth by increasing $26.0 million from 2008 due to the Medical Center's continued efforts in contract negotiations and improved pricing strategies. In 2008, net revenue for contracts grew by $21.0 million from 2007.

Commercial net patient revenue increased by $14.5 million, or 59.5 percent, compared to 2008, due to contract rate increases.

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 $3.1 million, or 16.4 percent, in 2009 and increased by $4.4 million, or 30.5 percent, in 2008. This category fluctuates from year to year depending on the patient volume and type of patients. The uninsured net revenue decreased by 2.6 million, or 22.8 percent, in 2009 and by 11.3 million, or 49.5 percent, in 2008.

Operating Expenses

The following table summarizes the operating expenses for the Medical Center for fiscal years 2009, 2008 and 2007 (dollars in thousands):

	2009	2008	2007
Salaries and wages	$ 232,235	$ 224,212	$ 201,778
Employee benefits	58,605	53,424	51,053
Professional services	1,975	1,462	893
Medical supplies	82,154	74,698	73,348
Other supplies and purchased services	118,738	105,347	100,941
Depreciation and amortization	33,941	20,877	17,884
Insurance	2,451	1,886	1,796
Total operating expenses	$ 530,099	$ 481,906	$ 447,693

During 2009, total operating expenses of $530.1 million increased by $48.2 million, or 10.0 percent, over the prior year. The change was due to several factors, but primarily an increase in labor costs, increased depreciation in facilities and equipment, and inflationary increases in purchased services and facility costs. Total operating expenses for 2008 increased by $34.2 million, or 7.7 percent, over the prior year due to similar reasons.

Salary and wage expenses include wages paid to hospital employees, holiday and sick pay, payroll taxes, and workers' compensation insurance premiums. Amounts paid for nurse registry and other contract labor are included in other expenses. The total expenses paid for employee salaries and wages in 2009 increased by $8.0 million, or 3.6 percent, over the prior year due to union negotiated and inflationary increases in wages. Salary and wages costs for 2008 increased by $22.4 million, or 11.1 percent, over 2007.

In 2009, increases in total benefits costs were $5.2 million, with health insurance benefits higher by $4.3 million, workers' compensation insurance premiums down $68 thousand, and all other benefit costs higher by $0.9 million over 2008. Increases in total benefit costs in 2008 were $2.4 million, with health insurance benefits higher by $3.6 million, workers' compensation insurance premiums down $1.6 million, and all other benefit costs higher by $0.4 million over 2007.

Payments for professional services increased by $513 thousand, or 35.1 percent, over 2008 due to increase in contracted medical director expenses. In 2008, professional services increased by $0.6 million, or 63.7 percent, over 2007.

Medical supply expense for 2009 increased by $7.5 million, or 10 percent, over the prior year due to a combination of inflationary increases and higher drug costs. Medical supply expense increased by $1.4 million, or 1.8 percent, in 2008 over 2007.

Other supplies and purchased services expenses include nursing registry, residents, and the cost of medical and non-medical purchased services. These expenses increased by $13.4 million, or 12.7 percent, over 2008 due primarily to $1.4 million increase in minor equipment and $5.3 million increase in facility costs as a result of the opening and moving to the UC Irvine Douglas Medical Center. In 2008, other supplies and purchased services increased by $4.3 million, or 4.2 percent, over 2007 due primarily to a $3.6 million increase in facility costs.

Depreciation and amortization expense increased by $13.1 million over the prior year. The increase is primarily due to the capitalization and depreciation of the UC Irvine Douglas Medical Center and the related new equipment. In 2008, depreciation and amortization increased by $3.0 million over 2007.

Insurance expense of $2.5 million in 2009 and $1.9 million in 2008 was primarily the Medical Center's contribution to the University of California self-insured malpractice fund. This expense increased by $0.6 million, or 30.0 percent, in 2009 and increased by $90 thousand, or 5.0 percent, in 2008.

Non-operating Revenues (Expenses)

Non-operating revenues, which include interest earned on invested cash balances and losses from disposal or retirement of capital assets, decreased by $4.5 million over 2008 due primarily to a decrease in the Short Term Investment Pool ("STIP") income and the increased losses from disposal of capital assets after the completion of the replacement hospital. Non-operating revenues decreased by $1.5 million in 2008 over 2007, due to a decrease in STIP income.

Income before Other Changes in Net Assets

The Medical Center reported income before other changes in net assets of $52.3 million in 2009 as compared to $47.1 million in 2008 and $45.2 million in 2007. The Medical Center's net income increased by $5.2 million in 2009 compared to the prior year, and a continuous improvement over the past years.

Other Changes in Net Assets

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

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

- Health system support represents transfers primarily to the School of Medicine for academic and clinical support including the Primary Care Network. The Medical Center transferred $53.4 million in 2009 and $35.3 million in 2008.

- Transfers in 2009 and 2008 from the University included $84.8 million and $77.7 million, from the state and federal appropriations, respectively, and $7.6 million and $8.2 million from donated assets, respectively.

In total, the net assets increased for 2009 by $91.3 million to $630.9 million. The majority of this increase is due to the excess of revenues over expenses of $52.3 million, the receipts of the transfers from University of $92.4 million, offset by the health system support of $53.4 million transferred to the University. Net assets increased by $97.7 million to $539.7 million for 2008.

Statements of Net Assets

The following table is an abbreviated statement of net assets at June 30, 2009, 2008 and 2007 (dollars in thousands):

	2009	2008	2007
Current assets:			
Cash	$ 73,353	$ 95,954	$ 100,823
Patient accounts receivable (net)	74,785	63,924	61,818
Other current assets	30,882	31,131	29,218
Total current assets	179,020	191,009	191,859
Capital assets	630,629	513,933	381,163
Other assets	6,875	14,495	29,703
Total assets	816,524	719,437	602,725
Current liabilities	95,940	91,554	76,680
Long-term debt	89,636	88,222	84,123
Total liabilities	185,576	179,776	160,803
Net assets:			
Invested in capital assets (net)	534,468	409,689	286,892
Restricted:			
Expendable:			
Capital projects	6,046	13,643	28,677
Unrestricted	90,434	116,329	126,353
Total net assets	$ 630,948	$ 539,661	$ 441,922

Total current assets decreased by $12.0 million, or 6.3 percent, compared to 2008 due to the decrease in cash and cash equivalents. In 2008, total current assets decreased by $0.9 million, or 0.5 percent, compared to the prior year. Total assets at June 30, 2009 were $97.1 million higher than 2008. Total assets at June 30, 2008 were $116.7 million higher than 2007.

Cash decreased by $22.6 million, or 23.6 percent, in 2009 due primarily to increased investment in capital assets. Cash decreased by $4.9 million, or 4.8 percent, in 2008.

In 2009, net patient accounts receivable, net of estimated uncollectibles, increased by 17 percent from the prior year due to higher patient service revenue. In 2008, net patient accounts receivable increased by 3.4 percent from 2007. The methodology deployed in calculating the allowance for doubtful accounts is based on historical collection experience, and current economic factors.

Other current assets, which include non-patient receivables, inventory, prepaid expenses and advances, decreased slightly by $249 thousand, or 0.8 percent, in 2009. The decrease was primarily due to a combined increase of $3.2 million increase in advances and prepaid expenses, offset by a 3.4 million decrease in other receivables and inventory. In 2008, other current assets increased slightly by $1.9 million, or 6.6 percent, due to a combination of $1.2 million increase in pharmaceutical and supply inventories and a $2.0 million increase in other receivables, offset by a $1.5 million decrease in advances.

Capital assets increased by $116.7 million, or 22.7 percent, in 2009 from the prior year primarily due to the increase in equipment and building costs of the new replacement hospital. In 2008, capital assets grew by $132.8 million, or 34.8 percent, from 2007 due to similar reasons.

Other assets, including restricted funds for the replacement hospital and the bond issuance costs, decreased by $7.6 million, or 52.6 percent, in 2009 over the prior year. The decrease is due to the use of restricted cash for the construction of the replacement hospital. Other assets decreased by $15.2 million, or 51.2 percent, in 2008 over 2007 due to similar reasons.

In 2009, current liabilities increased by $4.4 million from the prior year mainly in the following areas: a $1.7 million increase in vacation accrual and $2.9 million increase in third party payor settlement, reduced by $0.2 million in other liabilities. In 2008, current liabilities increased by $14.8 million from the prior year mainly in the following areas: a $4.0 million increase in accounts payable, a $9.4 million increase in accrued salaries and benefits due to the timing of bi-weekly payroll payments, a $1.0 million increase in third party payor settlements due to pending open cost report settlements, and a $0.6 million increase in the current portion of long-term debt due to the increase in capital leases, offset by $0.1 million decrease in other liabilities.

Long-term debt includes the 2007 Series A Pooled Revenue Bonds and long-term capital leases. In 2009, long-term debt increased by $1.4 million from the prior year, due to increase in long-term capital leases. In 2008, long-term debt increased by $4.1 million from the prior year, mainly due to the increase in capital lease obligations.

Net assets increased by $91.3 million in 2009. The change in net assets includes the excess of revenues over expenses of $52.3 million, contributed capital assets of $92.4 million, and the transfer of $53.4 million of funds to the School of Medicine as health system support. Net assets increased by $97.7 million in 2008.

Liquidity and Capital Resources

The Medical Center generated $84.2 million and $69.0 million from operating activities in 2009 and 2008, respectively.

In 2009, cash flows from non-capital financing activities show the Medical Center's cash were reduced by $53.4 million for transfers to the University as health system support. In 2008, cash flows from non-capital financing activities were reduced by $35.3 million for transfers to the University as health system support.

In 2009 and 2008, cash flows from capital and related financing activities included state capital appropriations of $84.8 million and $77.6 million, purchases of capital assets of $133.7 million and $123.3 million, principal payments on long-term debt and capital leases were $10.7 million and $9.7 million, and interest paid was $4.2 million and $2.8 million, respectively.

Cash flows from investment activities in 2009 and 2008 show that $2.8 million and $4.0 million was provided by interest income, respectively. Change in restricted assets was reduced to $7.6 million in 2009 from $15.0 million in 2008 due to expenditures in construction projects.

Overall, cash flow decreased to $73.4 million in 2009 from $96.0 million in 2008 due mainly to increased capital expenditures in the new hospital. Cash flows decreased to $96.0 million in 2008 from $100.8 million in 2007 due to similar reasons.

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

	2009	2008	2007
Days cash on hand	53.8	76.0	85.4
Days of revenue in accounts receivable	54.0	53.3	56.3
Capital investment ($ in millions)	$155.5	$154.5	$161.7
Debt service coverage ratio	7.2	6.3	7.0

Days cash on hand decreased to 53.8 days in 2009 from 76.0 days in 2008, and decreased to 76 days in 2008 from 85.4 days in 2007. Days cash on hand measures the average number of days' expenses the Medical Center maintains in cash. The goal set by the University of California Office of the President is 60 days.

The days of revenue in accounts receivable measures the average number of days it takes to collect patient accounts receivable. In 2009, net days in receivables increased by 0.7 days compared to 54.0 due to the increase in commercial and contract billing activity. In 2008, net days in receivables decreased to 53.3 days from 56.3 days in 2007 as a result of improvement in billing and cash collection.

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 2009 is 7.2 versus 6.3 in 2008. The increase in debt service coverage ratio was due to increased operating income. In 2008, the Medical Center's ratio was 6.3 versus 7.0 in 2007 due to the increase in long-term debt, including the issuance of capital leases and the related principal and interest repayments in 2008.

Looking Forward

The Hospital Facilities Seismic Safety Act ("SB 1953")
During 2009, the UC Irvine Douglas Medical Center's capital program continued to address the requirements in the State of California Senate Bill 1953 ("SB 1953"). The project cost for the phase I construction of the Medical Center and the phase II improvement projects, which is now compliant with the requirements, is $626.5 million. The capital cost of compliance was financed through the use of state lease revenue bond funds, hospital reserves, gift funds and debt. In 2009 and 2008, $124.3 million and $99.5 million, respectively were spent on these requirements.

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

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

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

Medicaid Reform
In 2005, California implemented a new Medicaid fee-for-service ("FFS") inpatient hospital payment system. The new payment system is the result of a new federal Medicaid hospital financing waiver ("waiver") that will govern Medicaid FFS inpatient hospital payments through fiscal year 2010. The California state legislature enacted Senate Bill 1100 ("SB 1100") to implement the new waiver. SB 1100 is designed to protect baseline Medicaid funding for the University's medical centers from 2006 through 2010 – at a minimum medical centers will receive the Medicaid inpatient hospital payments they received in 2005 adjusted for yearly changes in costs. SB 1100 also allows the University's medical centers to receive additional waiver growth funding subject to the availability of funds. Payments to the University's medical centers under SB 1100 include a combination of Medi-Cal inpatient FFS payments, Medi-Cal DSH payments and Safety Net Care Pool ("SNCP") payments. The recently enacted federal economic stimulus package, which increases California's federal DSH allotment and the federal matching rate for FFS payments, will increase the net payment amounts under the waiver to the Medical Centers for the period October 2008 through December 2010. Although the federal inpatient hospital financing waiver and SB 1100 are designed to ensure a predictable Medicaid supplemental payment funding level and provide growth funding, the full financial impact of these changes in the future cannot be determined.

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. Each of the University 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.

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, there have not been any Medical Center contributions to the UCRP. In addition, since 1990, the required employee member contributions to the UCRP have been suspended. However, employee member contributions are required to be made to the separate defined contribution plan maintained by the University.

Effective with the July 1, 2008 actuarial valuation, a new funding policy, including a three-year amortization period for any initial surplus, was adopted for the Plan. The new funding policy determines recommended total contributions based upon the Plan's Normal Cost adjusted for any surplus or underfunding, starting with the Plan Year beginning July 1, 2009. University and member contributions to the plan have generally not been required since November 1, 1990 for most membership classifications. Member pretax contributions made to the Plan are redirected to the University of California Defined Contribution plan on a mandatory basis.

The Regents has authorized the initial resumption of shared employer and employee contributions to the Plan beginning in the last quarter of 2010. The University will implement a multi-year contribution strategy under which shared employer and employee contribution rates will increase gradually over time, shared between the Medical Center and employees, based upon UCRP's current normal cost.

Cautionary Note Regarding Forward-Looking Statements

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

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

University of California, Irvine Medical Center
Statements of Net Assets
June 30, 2009 and 2008
(Dollars in thousands)

	2009	2008
Assets		
Current assets:		
Cash	$ 73,353	$ 95,954
Patient accounts receivable, net of estimated uncollectibles of $6,165 and $4,456, respectively	74,785	63,924
Other receivables	10,277	13,596
Inventory	13,061	13,147
Prepaid expenses and other assets	7,544	4,388
Total current assets	179,020	191,009
Restricted assets:		
Cash restricted for replacement hospital	6,046	13,643
Capital assets, net	630,629	513,933
Deferred costs of issuance	829	852
Total assets	816,524	719,437
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	18,677	19,936
Accrued salaries and benefits	37,553	36,099
Third-party payor settlements	28,726	25,860
Current portion of long-term debt and capital leases	10,594	9,375
Other liabilities	390	284
Total current liabilities	95,940	91,554
Long-term debt and capital leases, net of current portion	89,636	88,222
Total liabilities	185,576	179,776
Net Assets		
Invested in capital assets, net of related debt	534,468	409,689
Restricted:		
Expendable:		
Capital projects	6,046	13,643
Unrestricted	90,434	116,329
Total net assets	$ 630,948	$ 539,661

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

University of California, Irvine Medical Center
Statements of Revenues, Expenses and Changes in Net Assets
For the Years Ended June 30, 2009 and 2008
(Dollars in thousands)

	2009	2008
Net patient service revenue, net of provision for doubtful accounts of $4,621 and $7,666, respectively	$ 559,059	$ 502,829
Other operating revenue:		
Clinical teaching support	8,323	8,308
Other	16,955	15,306
Total other operating revenue	25,278	23,614
Total operating revenue	584,337	526,443
Operating expenses:		
Salaries and wages	232,235	224,212
UCRP, retiree health and other employee benefits	58,605	53,424
Professional services	1,975	1,462
Medical supplies	82,154	74,698
Other supplies and purchased services	118,738	105,347
Depreciation and amortization	33,941	20,877
Insurance	2,451	1,886
Total operating expenses	530,099	481,906
Income from operations	54,238	44,537
Non-operating revenues (expenses):		
Interest income	2,789	4,030
Interest expense	(1,274)	(1,086)
Loss on disposal of capital assets	(3,452)	(407)
Total non-operating (expenses) revenues	(1,937)	2,537
Income before other changes in net assets	52,301	47,074
Other changes in net assets:		
Health system support	(53,413)	(35,292)
Transfers from University, net	92,399	85,957
Total other changes in net assets	38,986	50,665
Increase in net assets	91,287	97,739
Net assets – beginning of year	539,661	441,922
Net assets – end of year	$ 630,948	$ 539,661

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, 2009 and 2008
(Dollars in thousands)

	2009	2008
Cash flows from operating activities:		
Receipts from patients and third-party payors	$ 551,065	$ 501,760
Payments to employees	(232,526)	(216,196)
Payments to suppliers	(203,724)	(184,140)
Payments for benefits	(56,860)	(52,060)
Other receipts, net	26,251	19,615
Net cash provided by operating activities	84,206	68,979
Cash flows from noncapital financing activities:		
Health system support	(53,413)	(35,292)
Net cash used by noncapital financing activities	(53,413)	(35,292)
Cash flows from capital and related financing activities:		
State capital appropriations	84,764	77,604
Transfers from University	–	505
Proceeds from sale of capital assets	–	32
Purchases of capital assets	(133,726)	(123,317)
Principal paid on long-term debt and capital leases	(10,658)	(9,655)
Interest paid on long-term debt and capital leases	(4,160)	(2,789)
Net cash used by capital and related financing activities	(63,780)	(57,620)
Cash flows from investing activities:		
Interest income received	2,789	4,030
Change in restricted assets	7,597	15,034
Net cash provided by investing activities	10,386	19,064
Net decrease in cash	(22,601)	(4,869)
Cash – beginning of year	95,954	100,823
Cash – end of year	$ 73,353	$ 95,954

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, 2009 and 2008
(Dollars in thousands)

	2009	2008
Reconciliation of income from operations to net cash provided by operating activities:		
Income from operations	$ 54,238	$ 44,537
Adjustments to reconcile income from operations to net cash provided by operating activities:		
Depreciation and amortization expense	33,941	20,877
Provision for doubtful accounts	4,621	7,666
Changes in operating assets and liabilities:		
Patient accounts receivable	(15,482)	(9,772)
Other receivables	3,319	(1,997)
Inventory	86	(1,169)
Prepaid expenses and other assets	(3,156)	1,253
Accounts payable and accrued expenses	2,213	(2,717)
Accrued salaries and benefits	1,454	9,380
Third-party payor settlements	2,866	1,037
Other liabilities	106	(116)
Net cash provided by operating activities	$ 84,206	$ 68,979
Supplemental noncash activities information:		
Capitalized interest	$ 2,898	$ 2,894
Capital assets acquired through capital lease obligations	13,304	14,410
Amortization of bond premium	13	13
Amortization of deferred costs of issuance	17	17
Payables for property and equipment	3,472	6,647
Gifts of capital assets	7,635	8,207
Transfer of capital assets from (to) the University	(1,550)	359
Capitalized interest	2,898	2,894

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 392 licensed beds for the year ended June 30, 2009.

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 standards.

GASB Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*, was adopted by the Medical Center during the fiscal year ended June 30, 2009. This Statement establishes criteria to ascertain whether certain events result in a requirement for the Medical Center to estimate the components of any expected pollution remediation costs and determine whether these costs should be accrued as a liability or, if appropriate, capitalized. The implementation of Statement No. 49 had no effect on the Medical Center's net assets or changes in net assets for the years ended June 30, 2009 and 2008.

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.

2. Summary of Significant Accounting Policies (Continued)

Cash (Continued)
The Medical Center's cash at June 30, 2009 and 2008 was $73,353 and $95,954, 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 2008-2009 annual report of the University.

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

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

Restricted Assets, Replacement Hospitals
Proceeds from the Medical Center Pooled Revenue Bonds are held by the Treasurer of The Regents. Bond proceeds remain on deposit with the Treasurer until the project is constructed.

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

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

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

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.

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

2. Summary of Significant Accounting Policies (Continued)

Retiree Health Benefits Expense

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

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

UCRP Benefits Expense

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

Charity Care

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

Transactions with the University and University Affiliates

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

2. Summary of Significant Accounting Policies (Continued)

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

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

Tax Exemption
The Regents of the University of California is a California public corporation qualified as a tax-exempt organization under the provisions of Section 501(c)(3)of the Internal Revenue Code and is exempt form federal and state income taxes on related income.

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

New Accounting Pronouncements
In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective for the Medical Center's fiscal year beginning July 1, 2009. This statement requires capitalization of identifiable intangible assets in the statement of net assets and provides guidance for amortization of intangible assets unless they are considered to have an indefinite useful life.

2. Summary of Significant Accounting Policies (Continued)

New Accounting Pronouncements (Continued)

In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, also effective for the Medical Center's fiscal year beginning July 1, 2009. This Statement requires the Medical Center to report its derivative instruments at fair value. Changes in fair value for effective hedges that are achieved with derivative instruments are to be reported as deferrals in the statements of net assets. Derivative instruments that either do not meet the criteria for an effective hedge or are associated with investments that are already reported at fair value are to be classified as investment derivative instruments. Changes in fair value of those derivative instruments are to be reported as investment revenue.

The Medical Center has determined that implementation of Statements No. 51 and 53 will not have a significant effect on its financial statements.

3. Net Patient Service Revenue

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

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

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

  The Medical Center is reimbursed for cost reimbursable items at a tentative rate with final settlement of such items determined after submission of annual cost reports and audits thereof by the Medicare fiscal intermediary. The Medical Center's classification of patients under the Medicare program and the appropriateness of their admission are subject to an independent review by a peer review organization. The Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through June 30, 2002. The fiscal intermediary is in the process of conducting their audits of the 2003 and subsequent cost reports. The results of these audits have yet to be finalized and any amounts due to or from Medicare have not been determined. Estimated receivables and payables related to all open cost reporting periods are included on the statements of net assets as third-party payor settlements.

3. Net Patient Service Revenue (Continued)

- ***Medi-Cal*** – The Medicaid program is referred to as Medi-Cal in California. Medi-Cal fee-for-service ("FFS") inpatient hospital payments are made in accordance with the federal Medicaid hospital financing waiver and State of California Senate Bill 1100 ("SB 1100"). Medi-Cal outpatient FFS services are reimbursed based on a fee schedule. SB 1100 allows the Medical Center to receive additional waiver growth funding subject to the availability of funds. The total payments made to the Medical Center under SB 1100 will include a combination of Medi-Cal inpatient FFS payments, Medi-Cal Disproportionate Share ("DSH") payments, and Safety Net Care Pool ("SNCP"). For the years ended June 30, 2009 and 2008, the Medical Center recorded total Medi-Cal waiver revenue of $74,200 and $74,599, respectively.

- ***Assembly Bill 915*** – State of California Assembly Bill ("AB") 915, *Public Hospital Outpatient Services Supplemental Reimbursement Program*, provides for supplemental reimbursement equal to the federal share of unreimbursed facility costs incurred by public hospital outpatient departments. This supplemental payment covers only Medi-Cal fee-for-service outpatient services. The supplemental payment is based on each eligible hospital's certified public expenditures ("CPE"), which are matched with federal Medicaid funds. For the years ended June 30, 2009 and 2008, the Medical Center recorded revenue of $1,583 and $1,883, respectively.

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

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

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

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

Amounts due from Medicare and Medi-Cal represent 13.6 percent and 19.4 percent of net patient accounts receivable for fiscal year at June 30, 2009. In 2008, the amount due from Medicare and Medi-Cal were 15.9 percent and 21.6 percent respectively.

For the years ended June 30, 2009 and 2008, net patient service revenue included favorable cost report settlements of $4,632 and $6,328, respectively, primarily from Medicare and Medi-Cal Programs.

(Dollars in thousands)

3. Net Patient Service Revenue (Continued)

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

	2009	2008
Medicare (non-risk)	$ 142,815	$ 129,580
Medi-Cal (non-risk)	126,888	118,695
Commercial	38,872	24,378
Contracts (discount/per diem)	225,736	199,688
County	15,873	18,994
Non-sponsored (uninsured)	8,875	11,494
Total	$ 559,059	$ 502,829

4. Charity Care

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

	2009	2008
Charity care at established rates	$ 81,022	$ 96,831
Estimated cost of charity care	$ 17,956	$ 21,363

Estimated cost in excess of reimbursement for indigent patients under publicly sponsored programs was $15,681 and $10,694 for the years ended June 30, 2009 and 2008, respectively.

(Dollars in thousands)

5. Capital Assets

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

	2007	Additions	Disposals	2008	Additions	Disposals	2009
Original Cost							
Land	$ 7,394	$ –	$ –	$ 7,394	$ –	$ –	$ 7,394
Buildings and improvements	199,650	11,015	(997)	209,668	389,054	(1,852)	596,870
Equipment	120,021	27,907	(4,842)	143,086	39,736	(15,811)	167,011
Construction in progress	259,425	115,523	–	374,948	(273,290)	–	101,658
Capital assets, at cost	$ 586,490	$ 154,445	$ (5,839)	$ 735,096	$ 155,500	$ (17,663)	$ 872,933

	2007	Depreciation	Disposals	2008	Depreciation	Disposals	2009
Accumulated Depreciation and Amortization							
Buildings and improvements	$ 133,144	$ 7,805	$ (706)	$ 140,243	$ 18,485	$ –	$ 158,728
Equipment	72,183	13,431	(4,694)	80,920	15,456	(12,800)	83,576
Accumulated depreciation and amortization	$ 205,327	$ 21,236	$ (5,400)	$ 221,163	$ 33,941	$ (12,800)	$ 242,304
Capital assets, net	$ 381,163			$ 513,933			$ 630,629

Equipment under capital lease obligations and related accumulated amortization was $62,123 and $28,477 in 2009, respectively, and $48,819 and $18,137 in 2008, respectively.

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

The Medical Center is currently making seismic improvements in order to be in compliance with Senate Bill 1953, the *Hospital Seismic Safety Act*. A portion of the improvements are financed under a lease-revenue bond with the State of California Public Works Board. These amounts totaling $19,929 and $71,825 for the years ending June 30, 2009 and 2008, respectively, are included in Transfers from University for building program on the statements of revenues, expenses, and changes in net assets.

(Dollars in thousands)

6. Long-term Debt and Capital Leases

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

	2009	2008
University of California Medical Center Pooled Revenue Bonds Series 2007 A, interest rates ranging from 4.5 percent to 5.0 percent, payable semi-annually, with annual principle payments beginning in 2012 through 2047	$ 62,920	$ 62,920
University of California General Revenue Bonds, interest rates from 1.0 to 5.125 percent, payable semi-annually, with annual principal payments through 2017	3,183	3,507
Capital lease obligations, primarily for computer and medical equipment, with fixed interest rates of 2.5 percent to 4.1 percent payable through 2014	33,647	30,677
Unamortized bond premium	480	493
Total debt and capital leases	100,230	97,597
Less: Current portion of debt and capital leases	(10,594)	(9,375)
Noncurrent portion of debt and capital leases	$ 89,636	$ 88,222

Interest expense associated with financing projects during construction, along with any investment income earned on bond proceeds during construction, is capitalized. Total interest expense during the years ended June 30, 2009 and 2008 was $4,169 and $4,200, respectively. Interest expense totaling $2,898 and $2,894 was capitalized in each of the years ended June 30, 2009 and 2008. The remaining $1,274 in 2009 and $1,086 in 2008 are reported as interest expense in the statements of revenues, expenses, and changes in net assets. Investment income totaling $364 and $1,029 was capitalized during the years ended June 30, 2009 and 2008, respectively.

(Dollars in thousands)

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

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

	Revenue Bonds	Capital Lease Obligations	Total
Year Ended June 30, 2009			
Current portion at June 30, 2008	$ 321	$ 9,054	$ 9,375
Reclassification from noncurrent	351	11,539	11,890
Principal payments	(323)	(10,335)	(10,658)
Amortization of bond premium	(13)	–	(13)
Current portion at June 30, 2009	$ 336	$ 10,258	$ 10,594
Noncurrent portion at June 30, 2008	$ 66,599	$ 21,623	$ 88,222
New obligations	–	13,304	13,304
Reclassification to current	(351)	(11,539)	(11,890)
Noncurrent portion at June 30, 2009	$ 66,248	$ 23,388	$ 89,636
Year Ended June 30, 2008			
Current portion at June 30, 2007	$ 307	$ 8,425	$ 8,732
Reclassification from noncurrent	336	9,975	10,311
Principal payments	(309)	(9,346)	(9,655)
Amortization of bond premium	(13)	–	(13)
Current portion at June 30, 2008	$ 321	$ 9,054	$ 9,375
Noncurrent portion at June 30, 2007	$ 66,935	$ 17,188	$ 84,123
New obligations	–	14,410	14,410
Reclassification to current	(336)	(9,975)	(10,311)
Noncurrent portion at June 30, 2008	$ 66,599	$ 21,623	$ 88,222

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

Medical Center Pooled Revenue Bonds are issued to finance the University's medical centers and are collateralized by a joint and several pledge of the operating revenues, as defined in the indenture, of all five of the University's medical centers. The Medical Center Pooled Revenue Bond indenture requires the medical centers to set rates, charges and fees each year sufficient for the medical center operating revenues to pay for the annual principal and interest on the bonds and certain other financial covenants. Total Medical Center Pooled Revenue Bonds outstanding at June 30, 2009 are $1.04 billion of which $62,920 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, 2009 and 2008 were $5.56 billion and $5.0 billion, respectively.

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. The Medical Center's obligations under the terms of the General Revenue Bonds are subordinate to the Medical Center Pooled Revenue Bonds.

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

(Dollars in thousands)

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

Future Debt Service

Future debt service payments for each of the five fiscal years subsequent to June 30, 2009 and thereafter are as follows:

Year Ending June 30,	Revenue Bonds	Capital Lease Obligations	Total Payments	Principal	Interest
2010	$ 3,393	$ 11,248	$ 14,641	$ 10,594	$ 4,047
2011	3,392	9,741	13,133	9,432	3,701
2012	4,081	8,374	12,455	9,072	3,383
2013	4,081	5,059	9,140	6,033	3,107
2014	4,084	1,395	5,479	2,547	2,932
2015 – 2019	19,418	–	19,418	5,757	13,661
2020 – 2024	17,946	–	17,946	5,630	12,316
2025 – 2029	17,943	–	17,943	7,055	10,888
2030 – 2034	17,951	–	17,951	8,885	9,066
2035 – 2039	17,940	–	17,940	11,075	6,865
2040 – 2044	17,943	–	17,943	13,805	4,138
2045 – 2048	10,766	–	10,766	9,865	901
Total future debt service	138,938	35,817	174,755	$ 99,750	$ 75,005
Less: Interest component of future payments	(72,835)	(2,170)	(75,005)		
Principal portion of future payments	66,103	33,647	99,750		
Adjusted by: Unamortized bond premium	480	–	480		
Total debt	$ 66,583	$ 33,647	$100,230		

Additional information on the revenue bonds can be obtained from the 2008-2009 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, 2009 and 2008 was $4,930 and $4,454, respectively. The terms of the operating leases extend through the year of 2013.

(Dollars in thousands)

7. Operating Leases (Continued)

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

Year Ending June 30,	Minimum Annual Lease Payments
2010	$ 3,559
2011	2,826
2012	1,702
2013	872
Total	$ 8,959

8. Retiree Health Plans

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

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

Participating University locations, such as the Medical Center, are required to contribute at a rate assessed each year by the UCRHBT. The contribution requirements are based upon projected pay-as-you-go financing requirements. The assessment rates were $3.09, $2.86 and $2.75 per $100 of UCRP covered payroll resulting in Medical Center contributions of $6,500, $5,700 and $5,000 for the years ended June 30, 2009, 2008 and 2007, respectively.

8. Retiree Health Plans (Continued)

The actuarial value of UCRHBT assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2008, the date of the latest actuarial valuation, were $51,221 and $13.30 billion, respectively. The net assets held in trust for pension benefits on the UCRHBT's Statement of Plan Fiduciary Net assets were $74,370 at June 30, 2009. For the years ended June 30, 2009 and 2008, combined contributions from the University's campuses and medical centers were $278,507 and $268,102, respectively, including an implicit subsidy of $44,079 and $43,036, respectively. The University's annual retiree health benefit expense for its campuses and medical centers was $1.50 billion and $1.36 billion for the years ended June 30, 2009 and 2008. 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 $2.31 billion at June 30, 2009 increased by $1.23 billion and $1.09 billion for the years ended June 30, 2009 and 2008, respectively.

Information related to plan assets and liabilities as they relate to individual campuses and medical centers is not readily available. Additional information on the retiree health plans can be obtained from the 2008–2009 annual reports of the University of California and the University of California Health and Welfare Program.

9. Retirement Plans

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

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

Contributions to the UCRP may be made by the Medical Center and the employees. The rates for contributions as a percentage of payroll are determined annually pursuant to The Regents' funding policy and based upon recommendations of the consulting actuary. The Regents determine the portion of the total contribution to be made by the Medical Center and by the employees. Employee contributions are subject to collective bargaining agreements. As a result of the funded status of the UCRP, during the years ended June 30, 2009 and 2008, there were no required Medical Center or employee contributions other than for service credit buybacks.

9. Retirement Plans (Continued)

The actuarial value of UCRP assets and the actuarial accrued liability associated with the University's campuses and medical centers using the entry age normal cost method as of July 1, 2008, the date of the latest actuarial valuation, were \$35.61 billion and \$34.45 billion, respectively, resulting in a funded ratio of 103.4 percent. The net assets held in trust for pension benefits on the UCRP Statement of Plan's Fiduciary Net assets were \$32.26 billion and \$42.02 billion at June 30, 2009 and 2008, respectively.

The University utilizes asset allocation strategies that are intended to optimize the UCRP's investment returns over time in accordance with investment objectives and at acceptable levels of risks. However, the financial markets, both domestically and internationally, deteriorated subsequent to July 1, 2008. As a result, the funded ratio as of July 1, 2009 actuarial valuation for the campuses and medical centers is approximately 94.8 percent.

For the years ended June 30, 2009 and 2008, the University's campuses and medical centers contributed a combined \$442 and \$2,657, respectively. The University's annual UCRP benefits expense for its campuses and medical centers was \$69,131 for the year ended June 30, 2009. 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 \$68,696 for the year ended June 30, 2009. For the year ended June 30, 2008, contributions from the University's campuses and medical centers was equivalent to the annual UCRP benefits expense. As a result, there was no obligation for UCRP benefits at June 30, 2008.

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 2008–2009 annual reports of the University of California Retirement Plan, the University of California Retirement Savings Plan and the University of California PERS–VERIP.

(Dollars in thousands)

10. University Self-insurance

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

Workers' compensation premiums, included as salaries and employee benefits expense in the statements of revenues, expenses and changes in net assets, were $5,041 and $4,847 for the years ended June 30, 2009 and 2008, respectively. During 2009 and 2008, as a result of actuarial analysis, the Medical Center received a refund of premiums of $2,572 and $2,318, respectively, from the University that reduced the overall workers' compensation cost for the year.

Combined malpractice and general liability premiums, recorded as insurance expense in the statements of revenues, expenses and changes in net assets, were $2,451 and $1,886 for the years ended June 30, 2009 and 2008, respectively.

11. Transactions with Other University Entities

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

	2009	2008
Professional services	$ 1,975	$ 1,462
Other supplies and purchased services	24,457	23,170
Interest income (net)	(2,616)	(3,843)
Insurance	2,451	1,886
Administrative costs	(4,406)	(4,406)
Total	$ 21,861	$ 18,269

11. Transactions with Other University Entities (Continued)

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

The total net amounts of payments made by the Medical Center to the School of Medicine were \$75,274 and \$53,561 in 2009 and 2008, respectively. Of these amounts, \$21,861 and \$18,269 are reported as operating expenses for the years ended June 30, 2009 and 2008, respectively, and \$53,413 and \$35,292 are reported as health system support for the years ended June 30, 2009 and 2008, 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 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.

State of California Senate Bill 1953, *Hospital Facilities Seismic Safety Act*, specifies certain requirements that must be met within a specified time in order to increase the probability that the hospital could maintain uninterrupted operations following major earthquakes. By January 1, 2030, all general acute care inpatient buildings must be operational after an earthquake. Previously, the state of California's budget authorized the University to use \$600,000 in lease-revenue bond funds for earthquake safety renovations. The Regents have approved the allocation of the \$600,000 among the University's medical centers, of which \$235,000 was allocated to the Medical Center. The Medical Center spent \$19,929 and \$71,825 of its allocation during the years ended June 30, 2009 and 2008, respectively, recorded in the statements of revenues, expenses and changes in net assets as a component of Transfers from the University. As of June 30, 2009, any repayment the Medical Center may be obligated for under these financing arrangements is still being determined.

12. Commitments and Contingencies (Continued)

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

At June 30, 2009, the Medical Center had outstanding commitments for capital expenditures in connection with the phase II projects of approximately $166,900. The Medical Center expects to fund these costs principally through external financing sources.

Gift funds used for construction total $1,700 and $7,300 for the years ended June 30, 2009 and 2008, respectively, and are reflected in the statements of revenues, expenses and changes in net assets. Additional gift funds and pledges received but not used as of June 30, 2009 are not included in the financial statements of the Medical Center. These gifts and pledges are included in the financial statements of the University and transferred to the Medical Center when used.