

**\*Revised\***

**Additions shown by underscoring; deletions shown by strikethrough**

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**Office of the President**

**TO MEMBERS OF THE COMMITTEE ON FINANCE:**

**ACTION ITEM**

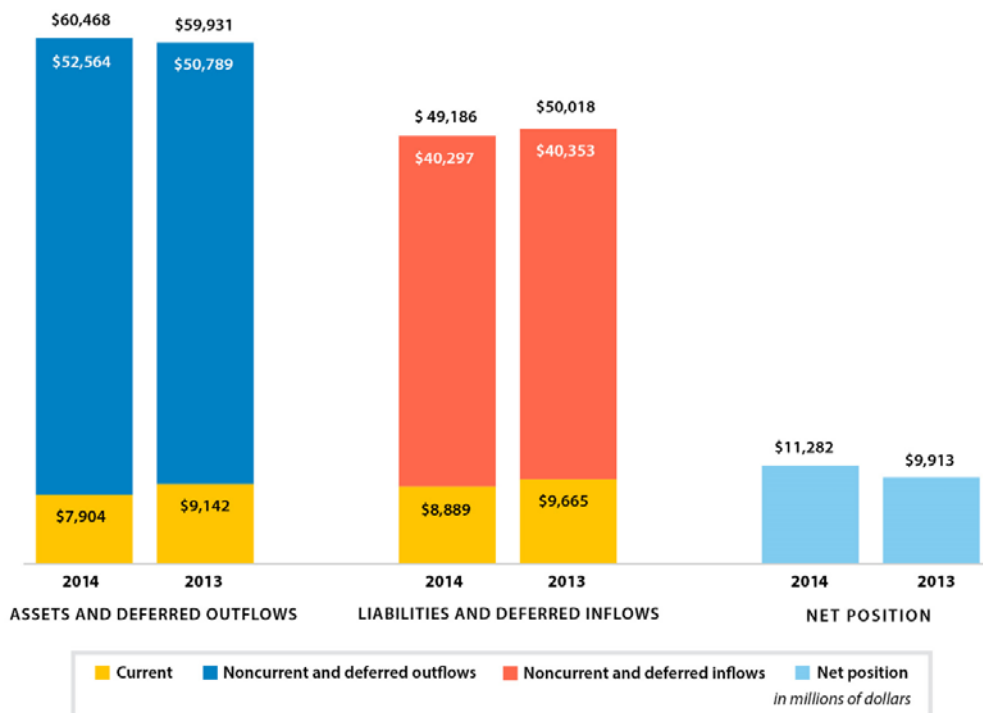
***For Meeting of November 19, 2014***

**UNIVERSITY OF CALIFORNIA FINANCIAL REPORTS, 2014**

**EXECUTIVE SUMMARY**

The University changed its accounting policies with the implementation of new accounting standards. Changes in accounting policies for pensions are designed to improve transparency regarding pension obligations by requiring recognition of a liability equal to the net pension liability for the University's defined benefit plans. This standard requires recognition of pension expense using a systematic method, designed to match the cost of pension benefits with service periods for eligible employees. These accounting policy changes do not affect the University's funding requirements for the pension plans. The University also adopted accounting changes for reporting deferred inflows and outflows, which required the write-off of unamortized bond issuance costs. Financial information for 2013 has been restated to retroactively apply these new accounting policies.

On January 1, 2014, the Regents became the sole corporate and voting member of the Children's Hospital and Research Center Oakland (CHRCO), an existing, legally separate 501(c)(3) corporation. The Board of Directors, comprised primarily of independent directors, serves as the governing body of CHRCO. Certain corporate powers are reserved to the Regents, including the power to appoint and remove directors and to approve CHRCO's strategic plan and budget. Children's Hospital & Research Center Foundation, a nonprofit public benefit corporation, is organized and operated for the purpose of supporting CHRCO. San Francisco provides certain management services for CHRCO. Since the University has the ability to impose its will on CHRCO, under Governmental Accounting Standards Board (GASB) requirements, CHRCO, combined with its foundation, is a discretely presented component unit of the University. Financial information for CHRCO is presented to retroactively apply this change in accounting entity. The ten campus foundations and CHRCO combined are reported as discretely presented component units in financial statements.



The University’s financial position improved in 2014 as compared to 2013, restated for the changes above. Net position increased due to positive investment returns and net capital investments, offset by increases in long-term debt and accounting for the unfunded liability for retiree health benefits. The University’s operating revenues continue to grow from operations. Expenses increased from operational growth, however, pension expense declined under the new accounting requirements due to strong investment returns for the retirement investment portfolio.

### RECOMMENDATION

The President of the University recommends that the Committee on Finance recommend that the Regents adopt the 2013-14 Annual Financial Reports for the University of California; and the University of California Retirement System. ~~and the five University of California Medical Centers.~~

### BACKGROUND

Attached are the June 30, 2014 audited financial statements for the University of California; the University of California Retirement System (UCRS) – University of California Retirement Plan (UCRP), University of California Voluntary Retirement Incentive Program (PERS Plus 5 Plan), the University of California Retirement Savings Program (UCRSP), including the Defined Contribution, 403(b) and 457(b) Plans. ~~and the five University of California Medical Centers: Davis, Irvine, Los Angeles, San Diego and San Francisco.~~ Following is a discussion of the highlights of these reports.

Statement of Net Position

*(in millions of dollars)*

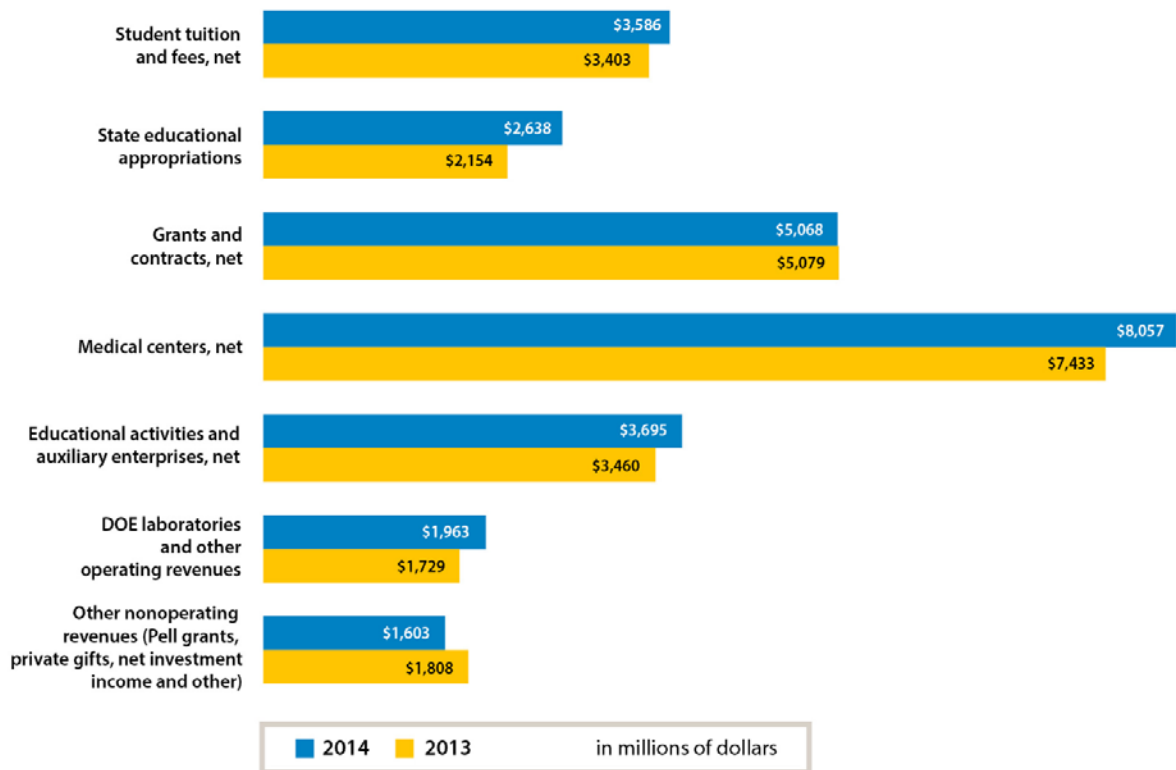
	2014	2013
<b>ASSETS</b>		
Investments	\$21,541	\$ 18,942
Investment of cash collateral	1,218	1,403
Accounts receivable, net	3,001	3,744
Capital assets, net	27,362	26,180
Other assets	3,646	4,895
<b>Total assets</b>	<b>56,768</b>	<b>55,164</b>
<b>DEFERRED OUTFLOWS OF RESOURCES</b>	<b>3,700</b>	<b>4,767</b>
<b>LIABILITIES</b>		
Debt, including commercial paper	18,031	17,236
Securities lending collateral	1,218	1,403
Pension obligations	7,714	12,338
Obligations for retiree health benefits	8,440	7,577
Other liabilities	6,705	7,246
<b>Total liabilities</b>	<b>42,108</b>	<b>45,800</b>
<b>DEFERRED INFLOWS OF RESOURCES</b>	<b>7,078</b>	<b>4,218</b>
<b>NET POSITION</b>		
Net investment in capital assets	11,884	11,856
Restricted:		
Nonexpendable	1,164	1,134
Expendable	6,837	5,729
Unrestricted	(8,603)	(8,806)
<b>Total net position</b>	<b>\$11,282</b>	<b>\$ 9,913</b>

Highlights of the changes in the University's statement of net position as of June 30, 2014 are as follows:

- For 2014, the General Endowment Pool (GEP) portfolio had a positive return of 19.0 percent, the Total Return Investment Pool (TRIP) had a positive return of 14.7 percent and the Short Term Investment Pool (STIP) had positive returns of 1.6 percent.
- Total additions of capital assets for 2014 were \$2.9 billion, offset by depreciation of \$1.7 billion.
- In October 2013, the University issued General Revenue Bonds of \$2.5 billion to restructure Lease Revenue Bonds issued by the State Public Works Board of the state of California, reported as lease-purchase agreements by the University. General Revenue Bonds totaling \$970.4 million and Medical Center Pooled Revenue Bonds totaling \$650 million were issued to finance and refinance certain facilities and projects.
- The net pension liability decreased by \$4.6 billion due to position investment returns of 17.4 percent for UCRP. This decrease is offset by changes in deferred inflows and outflows and the pension receivable from the Department of Energy for the National Laboratories.
- The obligation for retiree health increased \$0.9 billion due to the impact of amortizing the University's unfunded obligation.

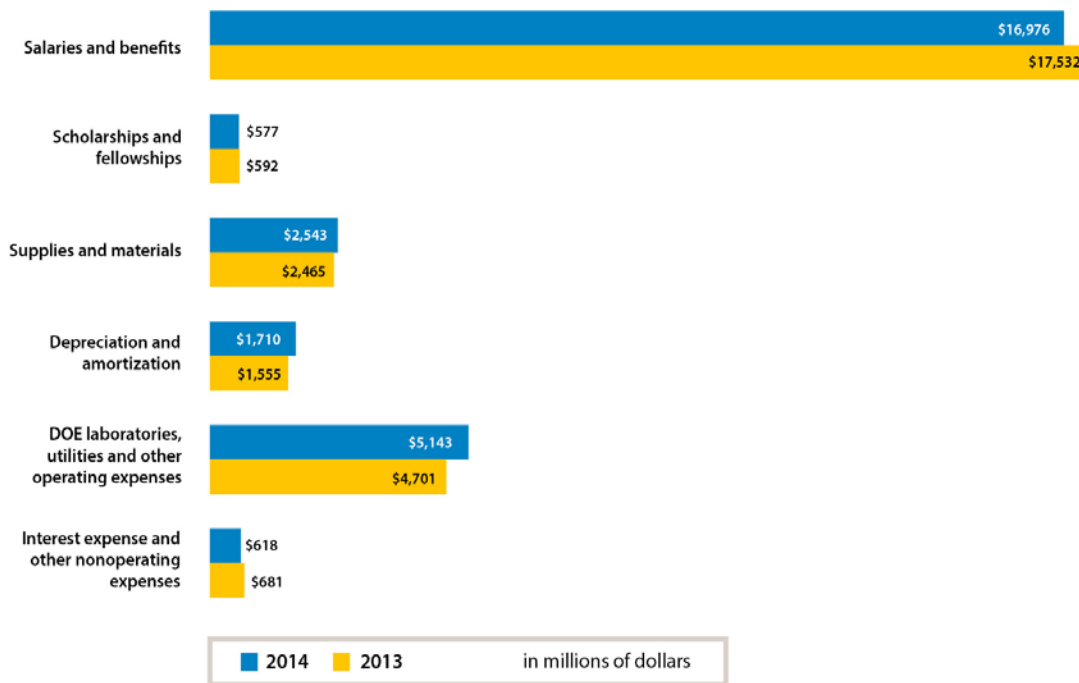
Statement of Revenues, Expenses and Changes in Net Position

Revenues in various categories have increased and decreased as follows:



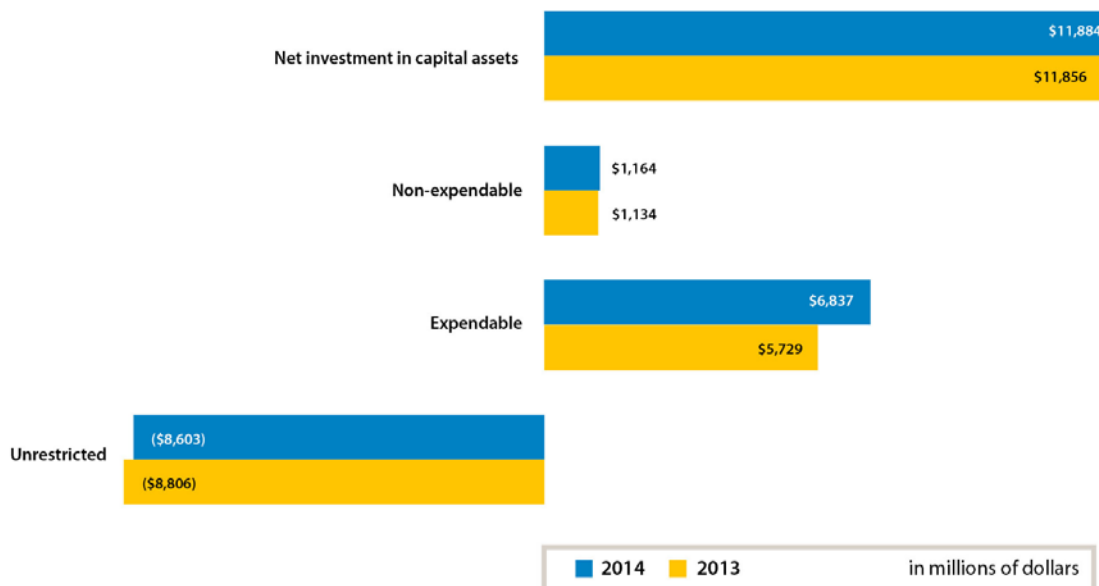
Revenues increased in most categories due to continued growth in the University's operations. Revenues from grants and contracts remained flat even though federal grants and contracts funded from federal economic stimulus funds expired. The reduction in other non-operating revenues is due to the redirection of State financing appropriations to State educational appropriations with the restructured Lease Revenue Bonds issued by the State Public Works Board of the State of California.

Expenses in various categories have increased and decreased as follows:



Total expenses decreased slightly overall due to declines in pension and retiree health benefits. Pension expense declined under the new accounting requirements due to strong investment returns for the retirement investment portfolio. Expenses for retiree health benefits decreased due to reductions in health insurance premiums. Salaries, the University's largest expense, continued to increase due to a higher number of full-time equivalent employees and higher average salaries per full-time equivalent employee.

Components of Net Position



The University’s total net position as of June 30, 2014 increased. Strong investment returns contributed to the increases in restricted net position. Unrestricted net position is negative due to obligations for pension and retiree health benefits exceeding University reserves. Although unrestricted net position is not subject to externally imposed restrictions, substantially all of the University’s reserves are allocated for academic and research initiatives or programs and for capital and other purposes.

Discretely Presented Component Units

The ten campus foundations and CHRCO combined are reported as discretely presented component units in financial statements. The discretely presented component units have \$7.5 billion of net position as of June 30, 2014. In addition to benefitting from strong market investment performance, the campus foundations continued to show increases in their fundraising results and gifts transferred to campuses in 2014 as compared to 2013.

In accordance with GASB reporting requirements, CHRCO results for the entire 2014 and 2013 fiscal years are reported in the financial statements. CHRCO’s revenues declined in 2014 due to the expiration in 2013 of supplemental state healthcare reimbursement programs and expenses increased in 2014 due to inflation, resulting in an operating margin loss of \$56 million. The operating loss is offset by gifts and investment returns.

Retirement Plans (UCRP, UCRSP and PERS-VERIP)

Investment returns for UCRP were 17.4 percent for 2014. As of June 30, 2014, there were over 64,000 retirees and beneficiaries receiving payments from UCRP as compared to 59,000 in 2013. Contributions to UCRP in 2014 were \$3.2 billion as compared to \$2.2 billion in 2013 due to increased employer and employee contribution rates and higher contributions from the Department of Energy for the National Laboratories.

University of California Medical Centers

The annual report for the five University of California Medical Centers: Davis, Irvine, Los Angeles, San Diego and San Francisco with CHRCO, its discretely presented component unit, along with a discussion of the highlights, will be mailed to the Regents by the end of November and approval of the report will be requested.

(Attachments: **Financial Report**; **UCRS**; Medical Centers)

Key to Acronyms

CHRCO	Children's Hospital and Research Center Oakland
GASB	Governmental Accounting Standards Board
GEP	General Endowment Pool
PERS Plus 5	University of California Voluntary Retirement Incentive Program
STIP	Short Term Investment Pool
TRIP	Total Return Investment Pool
UCRP	University of California Retirement Plan
UCRS	University of California Retirement System
UCRSP	University of California Retirement Savings Program