FINANCIAL REPORT 2003

UC DAVIS

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A MESSAGE TO CHANCELLOR LARRY VANDERHOEF

This report sets forth the financial position and results of operations of the University of California, Davis for the fiscal year ended June 30, 2003.

UC Davis' financial position is strong and the campus is well positioned to meet any short-term obstacles. Major financial strengths of the campus include a diverse source of revenues, including those from student fees, the state of California, federally sponsored grants and contracts, the medical center, private support and self-supporting enterprises. Expenses for UC Davis' core activities were $1.96 billion in 2003 while revenues supporting those activities were over $2 billion. Capital assets increased by $277 million in 2003, a reflection of the campus' commitment to provide the facilities necessary to accommodate current and future enrollment growth. UC Davis' net assets totaled $2 billion at June 30, 2003, compared to $1.7 billion at June 30, 2002.

The financial statements of the University of California, which include the Davis campus, are audited on an annual basis by the firm of PricewaterhouseCoopers LLP, who have issued an unqualified opinion thereon dated October 2, 2003, that has been transmitted to the UC Board of Regents. The financial statements in this report have not been individually audited.

The records and accounts of the university from which this report is prepared are maintained in accordance with generally accepted accounting principles, including all applicable effective statements of the Governmental Accounting Standards Board (GASB) and the statements of the Financial Accounting Standards Board (FASB).

Stan Nosek
Vice Chancellor for Administration

J. Michael Allred
Associate Vice Chancellor for Finance

MANAGEMENT'S DISCUSSION AND ANALYSIS

Management has prepared the financial statements and the related footnote disclosures along with the discussion and analysis. The financial statements and discussion and analysis contain the financial activities of the University of California, Davis, campus. The objective of management's discussion and analysis is to help readers of the University of California, Davis, financial statements better understand the financial position and operating activities for the fiscal year ended June 30, 2003, with selected comparative information for the year ended June 30, 2002. This discussion should be read in conjunction with the financial statements and the notes to the financial statements. Unless otherwise indicated, years (2002, 2003, and 2004) in this discussion refer to the fiscal year ended June 30.

UNIVERSITY OF CALIFORNIA, DAVIS

UC Davis is one of 10 campuses of the University of California, which was chartered as a land grant college in 1868 and now constitutes the preeminent system of public higher education in the country. Together, the 10 campuses have an enrollment of 173,000 students, 90 percent of them California residents. Some 150 laboratories, extension centers, research and field stations strengthen teaching and research while providing public service to California and the nation.

In 1905, the California Legislature approved the establishment of a state agriculture school. Three years later, in 1908, the University Farm School opened at Davis. UC Davis offers a full range of undergraduate and graduate programs, along with five professional schools.

The Davis campus has undergraduate colleges of Agricultural and Environmental Sciences, Engineering, and Letters and Science. Graduate Studies administers graduate study and research in all schools and colleges. Professional studies are carried out in the schools of Education, Law, Management, Medicine and Veterinary Medicine.

Located off campus are numerous laboratories, extension centers and facilities, including the UC Davis Medical Center in Sacramento, the Lake Tahoe Center for Environmental Research, the Veterinary Medicine Teaching and Research Center in Tulare, Bodega Marine Laboratory at Bodega Bay, the College of Engineering's applied science department at Livermore and the UC Davis Washington Center in Washington, D.C.

ADOPTION OF NEW ACCOUNTING STANDARDS

UC Davis did not implement any new accounting pronouncements in 2003. However, beginning in 2004, UC Davis' legally separate, tax-exempt campus foundation will be presented discretely in UC Davis' financial statements. On June 30, 2003, the UC Davis Foundation's net assets exceeded $107 million.

UC DAVIS FINANCIAL POSITION

The statement of net assets presents the assets, liabilities and net assets of UC Davis as of the end of the fiscal year. The statement of net assets is a point-of-time financial statement and presents to the readers of the financial statements a fiscal snapshot of UC Davis.

From the data presented, readers of the statement of net assets are able to determine the assets available to continue the operations of the institution. They are also able to determine how much the institution owes vendors, investors and lending institutions. Finally, the statement of net assets provides a picture of the net assets (assets minus liabilities) and their availability for expenditure by the institution.

At June 30, 2003, UC Davis' assets were over $3 billion, liabilities were $1.3 billion and net assets exceeded $1.8 billion, an increase of $137 million from 2002.

The major components of the statement of net assets, compared to the prior year are as follows (in millions of dollars):

	JUNE 30 2003	JUNE 30 2002	CHANGE
ASSETS			
Cash	$1,015	$1,026	$(11)
Accounts receivable, net	254	208	46
Capital assets, net	1,790	1,586	204
Other assets	120	118	2
TOTAL ASSETS	**3,179**	**2,938**	**241**
LIABILITIES			
Debt	827	733	94
Other liabilities	487	477	10
TOTAL LIABILITIES	**1,314**	**1,210**	**104**
NET ASSETS			
Investment in capital assets, net of related debt	952	895	57
Restricted-expendable	147	117	30
Unrestricted	766	716	50
TOTAL NET ASSETS	**$1,865**	**$1,728**	**$137**

UC DAVIS ASSETS

Accounts receivable increased by $46 million from $208 million in 2002 to $254 million in 2003. Accounts receivable include those from the state and federal government, local and private grants and contracts, those associated with the Medical Center that are related to patient care and from others. Receivables from the federal and state government increased by $19 million, consistent with the increase in federal grant and contract activity. Over half of the increase is specifically attributable to construction-related receivables from the State Public Works Board that is financing capital improvements at the UC Davis Medical Center.

As has been the case in recent years, the required spending for capital assets continues at an accelerated pace in order to provide the facilities necessary to accommodate the current and future enrollment growth. Capital assets include land, infrastructure, buildings and improvements, equipment, libraries, collections and construction in progress. The original cost of capital assets increased by $277 million in 2003, consisting of capital expenditures of $342 million offset by $65 million of capital assets disposed of during the year in the normal course of doing business. Capital expenditures in 2002 were $229 million and disposals were $40 million. During 2003, capitalized costs for completed projects included $220 million for new buildings and improvements to existing buildings, $90 million for new equipment, and $12 million for libraries and collections. Projects under construction, net of the cost of those projects completed and reclassified during 2003 to buildings and improvements or equipment, totaled $19 million. Additions to projects under construction include the UC Medical Center M.I.N.D. Institute ($35 million), the Genome and Biomedical Science Facility ($61 million) and the Robert and Margrit Mondavi Center for the Performing Arts ($35 million).

Accumulated depreciation increased from $1.25 billion in 2002 to $1.32 billion in 2003. Depreciation expense for the year was $132 million and the accumulated depreciation on assets sold or disposed of during the year was $59 million. Substantially all of the disposals were for equipment that was fully depreciated or had reached the end of its useful life.

Other assets of $120 million in 2003, including investments held by trustees, pledges receivable, notes and mortgages receivable and inventories did not significantly change from 2002.

UC DAVIS LIABILITIES

Capital expenditures are financed from a variety of sources including equity contributions, federal and state support, revenue bonds, certificates of participation and leases. UC Davis' debt to finance capital assets grew from $733 million in 2002 to $827 million in 2003, an increase of $94 million.

During 2003, new UC Davis debt obligations totaled $412 million, net of $35 million of deferred financing costs. In July 2003, the University of California issued $364 million of Multiple Purpose Projects Revenue bonds of which UC Davis' participation totaled $53 million. Proceeds are available to pay for project construction and issuance costs and to repay interim financing incurred prior to the issuance of the bonds. In March 2003, the university refinanced $301 million of UC Davis Refunding Hospital Revenue Bonds with a variable interest rate. The university also entered into interest rate swap agreements in connection with this issuance that effectively changed the variable interest rate on the bonds to a fixed rate. New capital lease obligations this year totaled $46 million, $43 million in connection with lease-purchase agreements with the state of California for medical facilities and $3 million for equipment.

In September 2003, the university issued $914 million of General Revenue Bonds collateralized by certain operating and nonoperating revenues of the university. UC Davis' portion of the obligation included $34 million in new debt used to finance the construction and improvement of the Activities and Recreation Center and Segundo Commons and $36 million to refinance existing debt. The bonds are collateralized solely by general revenues that exceeded $501 million in 2003. General revenues include gross student tuition and fees, facilities and administrative cost recovery from contracts and grants, sales and service revenues from educational, auxiliary and other activities, and other sources of revenues, including unrestricted investment income.

In October 2003, an offering statement was issued for the sale of $386 million of General Revenue Bonds by the university to refinance certain facilities. Proceeds will be used to refund outstanding Multiple Purpose Project Bonds including $58 million of UC Davis' outstanding debt.

Debt service in 2003 was $354 million, consisting of $301 million for a one-time payment for the advance refunding and defeasance of the UC Davis Medical Center Revenue bonds, $13 million for principal payments associated with scheduled debt service on revenue bonds, certificates of participation and capital lease obligations and $41 million for interest, including accrued interest. Debt service in 2002 was $54 million consisting of $17 million for scheduled debt service on revenue bonds, certificates of participation and capital lease obligations and $37 million for interest, including accrued interest. In 2003 and 2002, respectively, the state of California provided $11 million and $13 million of UC Davis' debt service requirements under the terms of lease-purchase agreements that are recorded as capital lease obligations.

During 2003, the university's bond ratings were affirmed at the Aa2/AA level by Moody's Investors Service (Moody's) and Standard and Poor's (S&P). In July 2003, the university was placed on CreditWatch

Negative by S&P and on Watchlist by Moody's due to uncertainty surrounding the State of California's budget. In connection with the sale of the university's General Revenue Bonds in August 2003, the university's bond ratings were affirmed at Aa2 with a negative outlook by Moody's and AA- by S&P and the outlook was changed to stable.

Other liabilities, including accounts payable, accrued salaries and benefits, deferred revenue, and federal refundable loans did not significantly change from 2002.

UC DAVIS NET ASSETS

Net assets represent the residual interest in UC Davis' assets after all liabilities are deducted. UC Davis' net assets at the end of 2003 totaled $1.86 billion, an increase of $137 million from 2002. Net assets are reported in four major categories: invested in capital assets, net of related debt; restricted nonexpendable; restricted expendable; and unrestricted.

The portion of net assets invested in capital assets, net of accumulated depreciation and the related outstanding debt used to finance the acquisition, construction or improvement of these capital assets, grew from $895 million in 2002 to $952 million in 2003. The $57 million increase represents UC Davis' continuing investment in its physical facilities.

Restricted nonexpendable net assets would normally include the corpus of a university's permanent endowments and the estimated value of charitable remainder trusts. At the University of California, endowments, funds functioning as endowments and trusts are managed and invested centrally by the University of California, and as such are not reported in UC Davis' financial statements. At June, 30, 2003, the total value, at cost, of UC Davis' endowments and other restricted nonexpendable net assets was $165 million. The total market value of UC Davis' endowments and other restricted nonexpendable net assets as of June 30, 2003, was $340 million.

Restricted expendable net assets of $147 million are subject to externally imposed restrictions governing their use. These net assets may be spent only in accordance with the restrictions placed upon them and may include endowment income and gains, subject to UC Davis' spending policy; support received from gifts, appropriations, grants or contracts for specific programs or capital projects; trustee held investments; or other third party receipts.

Under generally accepted accounting principles, net assets that are not subject to externally imposed restrictions governing their use must be classified as unrestricted for financial reporting purposes. Although unrestricted net assets are not subject to externally imposed restrictions, substantially all of these net assets are designated for academic and research initiatives or programs, or for capital purposes.

UC DAVIS RESULTS OF OPERATIONS

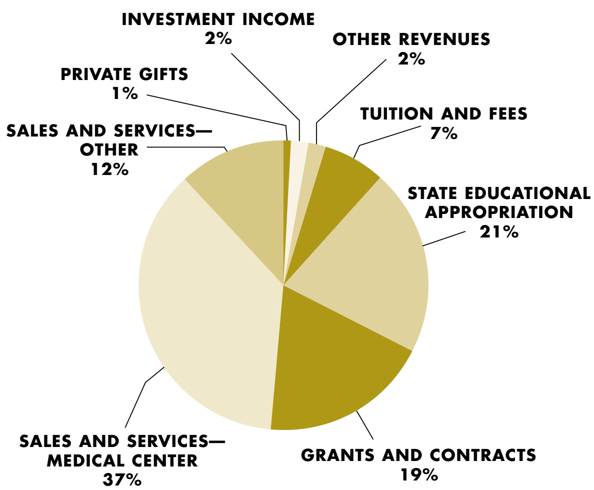
Changes in total net assets as presented on the statement of net assets are based on the activity presented in the statement of revenues, expenses, and changes in net assets. The purpose of the statement is to present UC Davis' operating results for the year and the increase or decrease in the financial condition of the university.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the institution. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the institution. Nonoperating revenues are revenues received for which goods and services are not provided. In accordance with Governmental Accounting Standards Board (GASB) requirements, certain significant revenues relied upon and budgeted for fundamental operational support of the core instructional mission of the university are mandated to be recorded as nonoperating revenues, including state educational appropriations, private gifts and investment income. A summarized comparison of the operating results for 2003 and 2002, arranged in an informative format that matches the revenues supporting the core activities of UC Davis with the expenses associated with core activities is as follows (in millions of dollars):

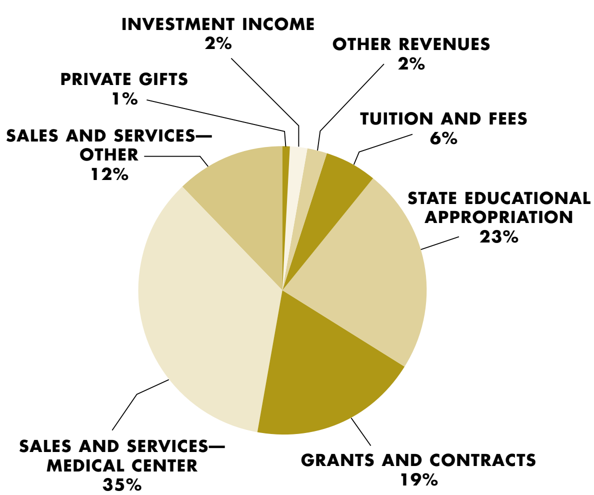
	YEAR ENDED JUNE 30, 2003			YEAR ENDED JUNE 30, 2002			
	OPERATING	NONOPERATING	TOTAL	OPERATING	NONOPERATING	TOTAL	CHANGE
REVENUES							
Student tuition and fees, net	$137		$137	$124		$124	$13
State educational appropriations		$444	444		$464	464	(20)
Grants and contracts	391		391	370		370	21
Sales and services:							
Medical center	784		784	698		698	86
Other	249		249	230		230	19
Private gifts		27	27		22	22	5
Investment income		46	46		46	46	-
Other revenues	22	11	33	18	13	31	2
Revenues supporting core activities	**1,583**	**528**	**2,111**	**1,440**	**545**	**1,985**	**126**
EXPENSES							
Salaries and benefits	1,235		1,235	1,139		1,139	96
Scholarships and fellowships	32		32	30		30	2
Utilities	22		22	24		24	(2)
Supplies and materials	238		238	202		202	36
Depreciation	132		132	110		110	22
Interest expense		41	41		37	37	4
Other expenses	301		301	283		283	18
Expenses associated with core activities	**1,960**	**41**	**2,001**	**1,788**	**37**	**1,825**	**176**
INCOME (LOSS) FROM CORE ACTIVITIES	**$(377)**	**$487**	**110**	**$(348)**	**$508**	**160**	**(50)**
OTHER NONOPERATING ACTIVITIES							
Loss on disposal of capital assets, net of proceeds			(3)			(9)	(6)
Income before other changes in net assets			**107**			**151**	**44**
OTHER CHANGES IN NET ASSETS							
State capital appropriations			24			26	(2)
Capital gifts and grants			17			11	6
Intercampus transfers			(11)			(37)	25
Increase in net assets			**137**			**151**	**(14)**
NET ASSETS							
Net assets beginning of year			1,728			1,577	151
NET ASSETS END OF YEAR			**$1,865**			**$1,728**	**$137**

REVENUES SUPPORTING CORE ACTIVITIES

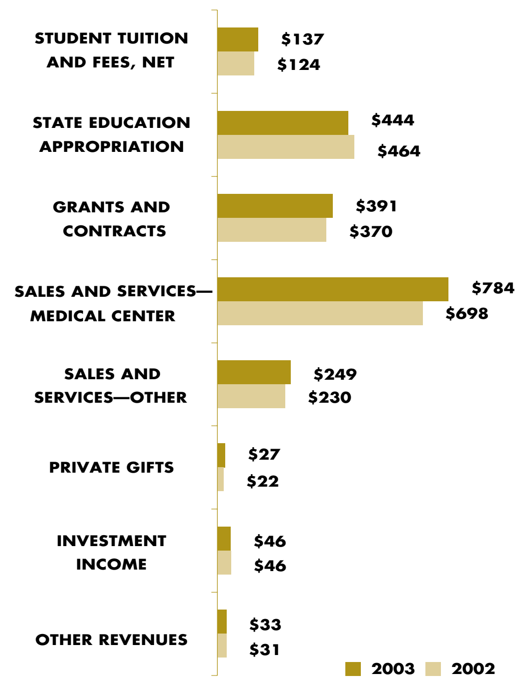
The following chart provides a breakdown of revenues supporting core activities for the fiscal year ended June 30, 2003.



The following chart provides a breakdown of revenues supporting core activities for the fiscal year ended June 30, 2002.



REVENUES SUPPORTING CORE ACTIVITIES (DOLLARS IN MILLIONS)



Revenues to support UC Davis' core activities of over $2 billion, including those classified as nonoperating revenues, increased by $126 million from 2002 to 2003. UC Davis has very diversified sources of revenue. State of California educational appropriations, in conjunction with student tuition and fees, are the core components that support the instructional mission of the University. Grants and contracts provide opportunities for undergraduate and graduate students to participate in basic research alongside some of the most prominent researchers in the country. Gifts to UC Davis allow crucial flexibility to faculty for support of their fundamental activities or new academic initiatives. Sales and service revenue includes the Medical Center, educational activities and auxiliary enterprises such as student housing, the bookstore, food service operations and parking.

Student tuition and fees revenue grew by $13 million in 2003 to $137 million from $124 million in

2002. These fees are net of scholarship allowances of $36 million in both 2003 and 2002. UC Davis enrollment grew by 6.8 percent in 2003 and fees for all students were increased by an annualized rate of $405 beginning in the spring of 2003. This represents a 3.7 percent increase in 2003 and an annualized increase of 11 percent. Before this increase, mandatory systemwide resident student fees at UC Davis had not been raised for seven consecutive years. The last increase was in 1995, and fees fell 10 percent for resident undergraduates and 5 percent for resident graduate academic students between 1998 and 2000. Tuition for nonresident students has been steadily growing over the past seven years by about 4 percent each year. However, in 2003, undergraduate nonresident student tuition was increased by 12 percent, in addition to the fee increase for resident students. Professional school fees were also raised. Consistent with past practices, one-third of the revenue generated from these fee increases will be used for financial aid to mitigate the impact on needy students. University Extension revenue has declined by 16 percent from 2002 to 2003 due to a reduction in enrollment.

State of California educational appropriations declined by $20 million, from $464 in 2002 to $444 million in 2003. This is the second year of budget reductions from the state that began in 2002 and included mid-year reductions in 2003. A wide variety of areas and programs have been affected including administration, maintenance, libraries, equipment, outreach, public service and student services. In order to maintain the quality of instruction, student fees were increased to offset a portion of the reduction in educational appropriations.

Revenue from federal, state, private and local grants and contracts of $391 million increased by $21 million or 6 percent. Federal grant and contract revenue, including facilities and administration cost recovery of $45 million and direct expenditures of $194 million, grew by $37 million (18 percent) to $239 million due to an increase in both award levels and number of awards granted. This revenue represents support from a variety of agencies: Department of Health and Human Services, $108 million: National Science Foundation, $35 million; Department of Education, $25 million; Department of Agriculture, $20 million and Department of Energy, $17 million. State grants (including special research appropriations) and contracts decreased by $19 million (20 percent) primarily due to decreases in financial aid and special research appropriations. Private contracts and grants increased by $3 million (4 percent), highlighting the continued competitive and effective nature of UC Davis' research enterprise.

Revenue from the UCD Medical Center, educational activities and auxiliary enterprises of $1.0 billion increased by $104 million, or 11 percent, from 2002. UCD Medical Center revenue grew by $86 million over the prior year to $784 million. The revenue growth is primarily due to a combination of renegotiated contracts, rate adjustments and an increase in patient activity (a 2 percent increase in patient days and an 8.5 percent increase in hospital clinic visits). Sales from educational activities, primarily physicians' professional fees, grew by $11 million, or 7 percent. Sales from auxiliary enterprises, net of scholarship allowances, grew by $7 million, or 9 percent, as a result of the demand associated with enrollment growth and fee increases to support new and remodeled facilities.

Private gifts for operating purposes increased by $5 million in 2003 to $27 million. Gifts are also received for capital purposes and recorded as capital gifts and grants in other changes in net assets. UC Davis continues to be aggressive in developing private revenue sources, although the nation's economy and decline in the equity markets are having a substantial effect on charitable giving.

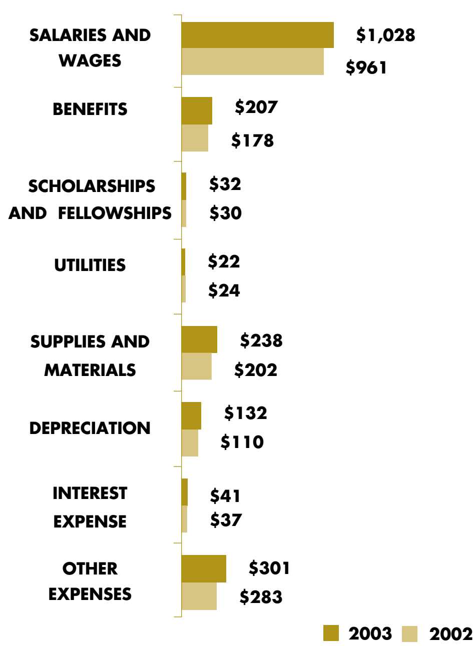
Investment income for the year of $46 million, consisting of $27 million from the University of California's Short Term Investment Pool (STIP) and $19 million from endowments, remained level from 2002 to 2003. The 2003 investment returns were 3.9 percent for STIP (5.0 in 2002) as short-term interest rates declined throughout the year. Declines in investment returns were offset by increases in cash balances and endowment principal.

Other revenues for 2003 of $33 million, including $11 million of state financing appropriations reported as nonoperating revenue and $22 million of other revenue reported as operating revenue, increased by $2 million from 2002. The state of California financing appropriation is directly related to the required rental payments under lease-purchase agreements with the state of California.

EXPENSES ASSOCIATED WITH CORE ACTIVITIES

The following chart provides a breakdown of expenses associated with core activities for the fiscal years ended June 30, 2003 and 2002.

EXPENSES ASSOCIATED WITH CORE ACTIVITIES (DOLLARS IN MILLIONS)



UC Davis' expenses associated with core activities for 2003, including those classified as nonoperating expenses, were over $2 billion, an increase of $176 million, or 10 percent, from 2002. More than half of UC Davis' expenses are related to salaries and benefits.

Salaries of $1,028 million in 2003 grew by $67 million from 2002, an increase of 7 percent. There are over 19,000 full time equivalent employees at UC Davis. More than half of the increase was related to new academic and administrative employees necessary to support the increase in enrollment and other academic, research and public service programs. Benefits increased by $29 million, or 16 percent, from 2002 to $207 million in 2003 primarily due to increases in health insurance costs, workers' compensation costs, and fee remissions for graduate student teaching assistants. The university experienced double-digit increases in health insurance rates that resulted in over $15 million in additional expense. Workers' compensation costs increased by $7 million and fee remissions for graduate student teaching and research assistants grew by $2 million. There were also substantial increases in UC Davis' share of payroll taxes.

Scholarships and fellowships, payments of financial aid made directly to students and reported as operating expense, were $32 million in 2003, an increase of $2 million, or 7 percent, from 2002. Scholarship allowances, financial aid and fee waivers by UC Davis are also a form of scholarship and fellowship cost that remained level in 2003 at $36 million. However, scholarship allowances are reported as an offset to revenue, not as an operating expense. On a combined basis, financial aid to students in all forms grew from $66 million in 2002 to $68 million in 2003, an increase of $2 million or 3 percent.

Utility costs dropped by 8 percent to $22 million in 2003. Supplies and materials costs increased by $36 million, or 18 percent, to $238 million primarily due to inflationary pressures on medical supplies and laboratory instruments and higher costs for general supplies necessary to support expanded research activity and student enrollment. Higher capital spending over the past several years, necessary to upgrade facilities and support the enrollment growth, resulted in depreciation expense increasing to $132 million in 2003 from $110 million in 2002. Interest expense, reported as a nonoperating expense, increased from $37 million in 2002 to $41 million in 2003. Other expenses grew by $18 million, or 6 percent, to $301 million in 2003 from $283 million in 2002.

In 2003, the operating loss of $377 million was more than offset by $487 million of net revenues classified as nonoperating. Revenue to support core activities exceeded the associated expenses by $110 million in 2003 and $160 million in 2002. This income is restricted by either legal or fiduciary obligations, allocated for academic and research initiatives or programs, necessary for debt service or required for capital purposes.

OTHER NONOPERATING ACTIVITIES

UC Davis' nonoperating activities are generally noncash transactions and therefore are not available to be used to support operating expenses and include the gain or loss on the disposal of capital assets. Disposals and write-offs of capital assets resulted in a loss of $3 million in 2003 compared to $9 million in 2002.

OTHER CHANGES IN NET ASSETS

Other changes in net assets are generally not available to be used to support UC Davis' operating expenses in the current year. State capital appropriations and capital gifts and grants may be used only for the purchase or construction of the specified capital asset.

UC Davis' enrollment growth requires new facilities, in addition to continuing needs for renewal, modernization and seismic correction of existing facilities. Capital appropriations from the state of California decreased by $2 million from $26 million in 2002 to $24 million in 2003. The 2002 capital appropriation was the final appropriation from the state of California's general obligation bond measure passed in 1998. The 2003 capital appropriation is the first from the 2002 bond measure.

TRANSFERS TO OTHER CAMPUSES

As one of 10 campuses of the University of California, UC Davis transfers funds to and receives funds from the University of California Office of the President, including the transfer of facilities and administration cost recoveries, University of California Housing System net revenues and intermediate funding for UC Davis capital projects. In addition, funds are transferred to and from the other campuses of the University of California as part of multi-campus agreements and intercampus charges.

UC DAVIS STATEMENT OF CASH FLOWS

The final statement presented by the University of California, Davis, is the statement of cash flows. The statement of cash flows presents detailed information about the cash activity of the institution during the year. The statement is divided into five parts. The first part deals with operating cash flows and shows the net cash used by the operating activities. The second section reflects cash flows from noncapital financing activities. This section includes the cash received and spent for state educational appropriations, gifts received for noncapital purposes, intercampus transfers and for activities other than those for operating, investing and capital financing purposes. The third section reflects the cash flows from capital and related financing activities. This section deals with the cash used for the acquisition and construction of capital and related items. The fourth section deals with cash flows from investing activities and shows the purchases, proceeds and interest received from investing activities. The fifth section reconciles the net cash used to the operating income or loss reflected on the statement of revenues, expenses and changes in net assets.

A summary comparison of cash flows for 2003 and 2002 is as follows (in millions of dollars):

	JUNE 30 2003	JUNE 30 2002	CHANGE
CASH PROVIDED (USED) BY:			
Operating activities	$(284)	$(130)	$(154)
Noncapital financing activities	459	449	10
Capital and related financing activities	(232)	(159)	(73)
Investing activities	46	46	-
Net increase (decrease) in cash	**(11)**	**206**	**(217)**
Cash, beginning of the year	**1,026**	**820**	**206**
Cash, end of the year	**$1,015**	**$1,026**	**$(11)**

UC Davis' cash remained level at over $1 billion for both 2002 and 2003. Substantially all of UC Davis' cash is invested in a short-term investment pool ("STIP") managed by the treasurer of the regents and is considered as demand deposits.

Cash of $284 million was used for operating activities, offset by $459 million of cash provided by noncapital financing activities. Noncapital financing activities, as defined by GASB, include state educational appropriations and gifts received for other than capital purposes that are used to support operating activities.

Cash used by capital and related financing activities was $232 million in 2003, primarily the result of capital assets acquired during the year and principal and interest paid on debt and capital leases, partially offset by state capital and financing appropriations and gifts for capital purposes.

Cash provided by investing activities, primarily the interest earned on endowments and UC Davis cash invested in the short-term investment pool, totaled $46 million in 2003 and 2002.

ECONOMIC OUTLOOK

As part of the University of California, UC Davis' quality is a hallmark for the state of California and the nation. The excellence of its programs attracts the best students, leverages millions of dollars in state, federal and private funding and promotes the discovery of new knowledge that fuels economic growth.

Major financial strengths of UC Davis include a diverse source of revenues, including those from student fees, the state of California, federally sponsored grants and contracts, the medical center, private support and self-supporting enterprises. The different sources of revenue are especially important at this time as the state-funded portion of the operating budget faces considerable volatility leading to non-instructional program cuts, student fee increases and possible enrollment caps.

While long-term prospects for the state of California look strong, there are major short-term financial problems. The state budget for 2004 adopted by the California legislature reduced the University of California's budget by approximately $484 million, with UC Davis' share estimated at $35 million, $17 million in state-targeted reductions in research, outreach and student services and $18 million in campuswide reductions in administration, libraries and core instructional needs plus an unallocated cut proposed by the governor. In addition, the campus faces a 30 percent reduction in its Cooperative Extension budget and continued shortfalls in such critical areas as purchased utilities and deferred maintenance. Although funding was provided for additional students in 2004, non-instructional programs will be affected, student fees will be increased and there will not be state funding provided for salary increases for faculty and staff.

The effect on student instructional programs will be minimized, due in large part to student fee increases, partially offsetting the effects of the state's unallocated budget reduction. Resident undergraduate and graduate student fees and most professional school fees will increase 30 percent. In addition, nonresident students pay tuition that will increase by 10 percent. A portion of the fee increase will be used for financial aid.

For 2005, the Legislature has indicated that the state will not provide funding for any student enrollment growth, employee salary increases or other inflationary cost increases. As a result, the University of California will consider various proposals for limiting enrollments.

UC Davis remains highly competitive in terms of attracting federal grant and contract revenue. Over two-thirds of UC Davis' federal research revenue comes from two agencies, the Department of Health and Human Services, primarily through the National Institutes of Health (NIH), and the National Science Foundation. Other agencies that figure prominently in UC Davis' awards are the Department of Education, the Department of Agriculture and the Department of Energy. Between 1999 and 2003, federal research revenue has increased on an annual basis from 6 percent to 16 percent. With the 2003 appropriation, congress and the president will have finished their five-year commitment to double the NIH budget, making large increases in federal and university research less likely. In addition, the federal budget outlook has deteriorated due to reductions in federal income taxes, the economic slowdown, expenses for homeland security and the war in Iraq. This may lead to future congressional efforts to limit discretionary spending increases in such areas as research, which would have important ramifications for UC Davis' research budget.

The UC Davis Medical Center faces financial challenges in a price-sensitive managed-care environment, along with the added costs and responsibilities related to its function as an academic institution. The demand for health care services and the cost of providing them are increasing significantly while the revenues on a per patient basis to support these services are increasing at a slower rate.
In addition to cost increases faced by hospitals across the state, such as rising salary and benefit costs, UC Davis' and the other University of California medical centers also face additional costs associated with new technologies, biomedical research, the education and training of health care professionals and the care for a disproportionate share of the medically underserved in California. In recent years, federal legislation has been enacted to slow future rate increases in Medicare and Medicaid and reduce medical education and disproportionate-share funding. Also, as a result of state legislation, the UC Davis Medical Center faces capital requirements to ensure that its facilities can maintain uninterrupted operations following a major earthquake.

The continuing financial success of the UC Davis Medical Center is dependent upon dedicated and sustained financial support for medical education and care for the poor. Payment strategies must recognize the need to maintain an operating margin sufficient to cover debt, provide working capital, purchase state-of-the-art equipment and invest in infrastructure and program expansion.

The UC Davis Medical Center remains competitive by reducing costs through restructuring and improved efficiencies and by expanding its presence in the market through stronger links with other providers, especially community hospitals and physicians in larger networks. Short-term and long-range solutions to address financial challenges continue to be pursued at both the state and federal levels.

UC Davis' achievement in recent years in obtaining private support is a testament to the high regard in which the university is held. The level of private support underscores the continued confidence among donors in the quality of UC Davis' programs and the importance of its mission. At the same time, private support is beginning to reflect the changes in the economy and financial markets, the effect of which is likely to be more pronounced in 2004.

Affordable, accessible student housing will be required in order to satisfy the demand associated with increased enrollment growth. UC Davis residence halls continue to be occupied at 100 percent of design capacity. UC Davis is responding to the demand by building student housing in the traditional manner, with housing fees set to generate sufficient revenue to cover direct and indirect operating costs and debt service, and by seeking development opportunities for privately owned housing on campus.

UC Davis must have a balanced array of many categories of facilities to meet its education, research and public service goals and continues to assess its long-term capital requirements. The support for UC Davis' capital program will be provided from a combination of sources, including the state of California, external financing, gifts and other sources.

In the spring of 2002, the State Legislature and the Governor agreed on a new general obligation bond package for education, including both K-12 schools and higher education. This package proposes two Public Education Facilities Bond Acts, one for 2002 and one for 2004, authorizing a total of $27 billion in general education bond funding over four years to support K-12 and higher education facility needs. The first bond measure was on the November 2002 ballot and was approved by California voters. The amount of general obligation bond funding available to the University of California system from the 2002 bond measure will be approximately $408 million over 2003 and 2004. At UC Davis, the bond will help fund a new home for the departments of Viticulture and Enology and Food Science and Technology, and $66 million for the construction of the Veterinary Medicine 3A facility.

Because the second bond measure was approved by the California voters in March 2004, the University of California will receive another $690 million for its capital program for the two-year period 2005 and 2006.

There are also plans for additional capital projects that are traditionally not considered to be state supportable. This is a continuing process that is amended as required to include projects when gifts or other supplemental resources are obtained or financing plans are developed.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

Certain information provided by UC Davis, including written as outlined above or oral statements made by its representatives, may contain foward-looking statements as defined in the Private Securities Litigation Reform Act of 1995. All statements other than statements of historical facts that address activities, events or developments that UC Davis 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. UC Davis does not undertake to update forward-looking information contained in this report or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.

UNIVERSITY OF CALIFORNIA, DAVIS

STATEMENT OF NET ASSETS

JUNE 30, 2003 AND 2002 (IN THOUSANDS OF DOLLARS)

	2003	2002
ASSETS		
Current Assets		
Cash	$1,014,983	$1,025,800
Investments held by trustees	8,166	16,360
Accounts receivable, net:		
State and federal government	76,715	57,377
Medical center	128,447	106,886
Other	49,291	44,071
Pledges receivable, net	585	1,709
Current portion of notes and mortgages receivable, net	9,076	10,817
Inventories	12,932	11,184
Deferred charges	8,024	8,867
Other current assets	1,771	7,782
Total current assets	**1,309,990**	**1,290,853**
Noncurrent Assets		
Investments held by trustees	4,907	424
Pledges receivable	1,744	1,404
Notes and mortgages receivable	55,413	48,934
Land, buildings, equipment, libraries and collections	3,110,332	2,833,551
Less: Accumulated depreciation	(1,320,243)	(1,247,434)
Other noncurrent assets	16,765	9,998
Total noncurrent assets	**1,868,918**	**1,646,877**
Total assets	**3,178,908**	**2,937,730**
LIABILITIES		
Current Liabilities		
Accounts payable	100,964	98,326
Accrued salaries and benefits	111,150	106,699
Deferred revenue	82,203	77,016
Current portion of long-term debt	18,636	17,457
Other current liabilities	110,982	109,913
Total current liabilities	**423,935**	**409,411**
Noncurrent Liabilities		
Refundable federal loans	45,840	44,480
Long term debt:		
Revenue bonds	640,938	586,282
Certificates of participation	3,440	3,831
Capital lease obligations	163,816	125,197
Other noncurrent liabilities	36,367	40,554
Total noncurrent liabilities	**890,401**	**800,344**
Total liabilities	**1,314,336**	**1,209,755**
NET ASSETS		
Invested in capital assets, net of related debt	951,501	894,545
Restricted:		
Expendable:		
Gifts	51,820	50,220
Loans	6,510	6,188
Capital projects	6,737	11,549
Debt service	40,581	13,199
Appropriations	13,727	11,675
Other	27,729	24,262
Unrestricted	765,967	716,337
Total net assets	**$1,864,572**	**$1,727,975**

See accompanying Notes to Financial Statements

UNIVERSITY OF CALIFORNIA, DAVIS

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEARS ENDED JUNE 30, 2003 AND 2002 (IN THOUSANDS OF DOLLARS)

	2003	2002
OPERATING REVENUES		
Student tuition and fees, net	$137,519	$123,907
Grants and contracts:		
Federal	239,015	201,541
State	77,360	96,644
Private	68,386	65,577
Local	6,393	6,067
Sales and services:		
Medical center	783,784	697,822
Educational activities	168,982	157,808
Auxiliary enterprises, net	79,547	72,769
Other operating revenues, net	22,455	17,692
Total operating revenues	**1,583,441**	**1,439,827**
OPERATING EXPENSES		
Salaries and wages	1,028,520	961,296
Benefits	206,707	177,953
Scholarships and fellowships	31,560	29,996
Utilities	22,494	24,047
Supplies and materials	238,119	201,668
Depreciation	131,813	109,736
Other operating expenses	301,348	283,227
Total operating expenses	**1,960,561**	**1,787,923**
Operating loss	**(377,120)**	**(348,096)**
NONOPERATING REVENUES (EXPENSES)		
State educational appropriations	443,933	464,204
State financing appropriations	11,380	13,443
Private gifts	27,343	22,434
Investment income:		
Endowment fund income	18,993	17,931
Other	27,096	28,245
Interest expense	(40,637)	(36,663)
Gain (loss) on disposal of capital assets, net of proceeds	(3,553)	(9,213)
Other nonoperating revenues (expenses)	(70)	(251)
Net nonoperating revenues (expenses)	**484,485**	**500,130**
Income before other changes in net assets	**107,365**	**152,034**
OTHER CHANGES IN NET ASSETS		
State capital appropriations	24,333	25,883
Capital gifts and grants	17,384	10,753
Transfers to Office of the President and other campuses	(12,485)	(37,845)
Other changes in net assets	**29,232**	**(1,209)**
Increase in net assets	**136,597**	**150,825**
NET ASSETS		
Net assets, beginning of year	1,727,975	1,577,150
Net assets, end of year	**$1,864,572**	**$1,727,975**

See accompanying Notes to Financial Statements.

UNIVERSITY OF CALIFORNIA, DAVIS

STATEMENT OF CASH FLOWS

YEARS ENDED JUNE 30, 2003 AND 2002 (IN THOUSANDS OF DOLLARS)

	2003	2002
CASH FLOWS FROM OPERATIONAL ACTIVITIES		
Student tuition and fees	$136,682	$122,879
Grants and contracts	376,217	390,906
Receipts from sales and services of:		
Medical centers	763,269	707,209
Educational activities	177,014	169,000
Auxiliary enterprises	78,992	71,246
Payments to employees	(1,019,024)	(909,706)
Payments to suppliers and utilities	(511,795)	(433,404)
Payments for benefits	(209,083)	(170,775)
Payments for scholarships and fellowships	(31,560)	(29,996)
Loans issued to students and employees	(18,075)	(17,632)
Collections of loans to students and employees	13,712	20,704
Other receipts (payments)	(40,484)	(50,369)
Net cash provided (used) by operating activities	**(284,135)**	**(129,938)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State educational appropriations	443,933	464,204
Gifts received for other than capital purposes	27,458	23,308
Other receipts (payments)	(37)	(249)
Intercampus transfers	(12,484)	(37,845)
Net cash flows provided by noncapital financing activities	**458,870**	**449,418**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
State capital appropriations	30,019	32,982
State financing appropriations	11,123	13,424
Capital gifts and grants	4,808	5,921
Proceeds from debt issuance	429,260	61,255
Proceeds from the sale of capital assets	314	741
Purchases of capital assets	(307,979)	(220,498)
Principal paid on debt and capital leases	(318,811)	(16,621)
Interest paid on debt and capital leases	(80,332)	(36,587)
Net cash provided (used) by capital and related financing activities	**(231,598)**	**(159,383)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income, net of investment expense	46,046	46,233
Net cash provided (used) by investing activities	**46,046**	**46,233**
Net increase in cash	**(10,817)**	**206,330**
Cash—beginning of year	1,025,800	819,470
Cash—end of year	**$1,014,983**	**$1,025,800**
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating income (loss)	$(377,120)	$(348,097)
Depreciation and amortization expense	131,813	109,736
Allowance for doubtful accounts	(7,057)	2,017
Change in assets and liabilities:		
Receivables, net	(32,705)	13,079
Investments held by trustees	(6)	(659)
Inventories	(1,748)	(192)
Deferred charges	1,117	(2,264)
Other assets	83	458
Accounts payable	(7,206)	15,957
Accrued salaries and benefits	4,451	57,626
Deferred revenue	(1,018)	18,757
Other liabilities	5,261	3,644
Net cash used by operating activities	**$(284,135)**	**$(129,938)**

See accompanying Notes to Financial Statements.

NOTES TO FINANCIAL STATEMENTS

FOR THE FISCAL YEAR ENDED JUNE 30, 2003

ORGANIZATION

The University of California (the university) was founded in 1868 as a public, state-supported institution. The California state constitution provides that the university shall be a public trust administered by the corporation, "The Regents of the University of California," which is vested with full powers of organization and government, subject only to such legislative control necessary to ensure the security of its funds and compliance with certain statutory and administrative requirements. The majority of the 26-member independent governing board (the regents) are appointed by the governor and approved by the state Senate. Various university programs and capital outlay projects are funded through appropriations from the state's annual Budget Act. The university's financial statements are discretely presented in the state's general purpose financial statements as a component unit. UC Davis is one of the 10 campuses and three national laboratories that constitute the University of California. Founded in 1908 as the University Farm, UC Davis has emerged as an acknowledged international leader in agriculture, veterinary medicine, biological, biotechnological and environmental sciences and is gaining similar recognition for excellence in the arts, humanities, social sciences, engineering, health sciences, law and management.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The financial statements of UC Davis have been prepared in accordance with generally accepted accounting principles, including all applicable effective statements of the Governmental Accounting Standards Board (GASB), using the economic resources measurement focus and the accrual basis of accounting.

The significant accounting policies of UC Davis are summarized below.

FINANCIAL REPORTING ENTITY

The University of California, Davis,' financial statements include the accounts of the campus and the medical center. The operations of the associated students organization are included in the reporting entity because the regents have certain fiduciary responsibilities for these organizations. Organizations that are not financially accountable to UC Davis, such as campus foundations and booster and alumni organizations, are not included in the reporting entity.

OTHER ACCOUNTING POLICIES

CASH. UC Davis considers all balances in demand deposit accounts to be cash. All other highly liquid cash equivalents are considered to be short-term investments.

INVESTMENTS. Investments are generally stated at fair value. Generally, securities are valued at the last sale price on the last business day of the fiscal year, as quoted on a recognized exchange or an industry standard pricing service. Securities for which no sale was reported as of the close of the last business day of the fiscal year are valued at the quoted market price of a dealer who regularly trades in the security being valued. Interests in venture capital partnerships are valued based upon the latest available valuations determined by the general partners of the respective partnerships. Investments in registered investment companies are valued based upon the net asset value of those companies. Mortgage loans, held as investments, are valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar instruments. Insurance contracts are valued at contract value, plus reinvested interest, which approximates fair value.

ACCOUNTS RECEIVABLE. Accounts receivable include reimbursements due from sponsors of externally funded research, patient billings, accrued income on investments, amounts due from students, employees and faculty for services and other miscellaneous receivables.

PLEDGES. Unconditional pledges of private gifts to UC Davis in the future are recorded as pledges receivable and revenue in the year promised at the present value of expected cash flows. Conditional pledges, including pledges of endowments to be received in future periods and intentions to pledge, are recognized as receivables and revenues when the specified conditions are met or when the promise is made.

NOTES AND MORTGAGES RECEIVABLE. Loans to students are provided from federal student loan programs and from other university sources. Home mortgage loans, primarily to faculty, are provided from other university sources.

INVENTORIES. Inventories are valued at cost, typically determined under the weighted average method, which is not in excess of net realizable value.

CAPITAL ASSETS. Land, infrastructure, buildings and improvements, equipment, libraries and collections and special collections are stated at cost at the date of acquisition or fair value at the date of donation in the case of gifts. Capital leases are stated at the lower of the fair market value of the asset or the present value of future minimum lease payments. Significant additions, replacements, major repairs and renovations are capitalized if the cost exceeds $1,500 and if they have a useful life of more than one year. Minor renovations are charged to operations.

Depreciation is calculated using the straight-line method over the estimated economic life of the asset. Leasehold improvements are amortized using the straight-line method over the shorter of the life of the applicable lease or the economic life of the asset.

Estimated economic lives are generally as follows:

Infrastructure	25 years
Buildings and improvements	15–33 years
Equipment	2–20 years
Library books and materials	15 years

Capital assets acquired through federal grants and contracts where the federal government retains a reversionary interest are capitalized and depreciated.

Inexhaustible capital assets, such as land and special collections, including art, museum, scientific and rare book collections, are not depreciated.

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

DEFERRED REVENUE. Deferred revenue primarily includes amounts received from grant and contract sponsors that have not been earned under the terms of the agreement and other revenue billed in advance of the event, such as student tuition and fees and fees for housing and dining services.

FEDERAL REFUNDABLE LOANS. Certain loans to students are administered by UC Davis with funding primarily supported by the federal government. UC Davis' statement of net assets includes both the notes receivable and the related federal refundable loan liability representing federal capital contributions owed upon termination of the program.

NET ASSETS. Net assets are required to be classified for accounting and reporting purposes into the following categories:

Invested in capital assets, net of related debt. This category includes all of UC Davis' capital assets, net of accumulated depreciation, reduced by outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

Restricted. UC Davis 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 UC Davis are classified as nonexpendable net assets. Such assets include UC Davis' permanent endowment funds that are held by the University of California and are not included in the UC Davis financial statements.

Expendable. Net assets whose use by UC Davis is subject to externally imposed restrictions that can be fulfilled by actions of UC Davis pursuant to those restrictions or that expire by the passage of time are classified as expendable net assets.

Unrestricted. Net assets that are neither restricted nor invested in capital assets, net of related debt, are classified as unrestricted net assets. Unrestricted net assets may be designated for specific purposes by management or the regents. Substantially all unrestricted net assets are allocated for academic and research initiatives or programs or for capital programs.

REVENUES AND EXPENSES. Operating revenue includes receipts from student tuition and fees, grants and contracts for specific operating activities, and sales and services from medical centers, educational activities and auxiliary enterprises. Operating expenses incurred in conducting the programs and services of UC Davis are presented in the financial statements as operating activities.

Nonoperating revenue and expense includes state educational appropriations (for the support of UC Davis operating expenses), state financing appropriations, private gifts for other than capital purposes, investment income, net unrealized appreciation or depreciation in the fair value of investments, interest expense, and gain or loss on the disposal of capital assets.

In accordance with GASB Statement No. 34, certain significant revenues relied upon for fundamental operational support of the core instructional mission of UC Davis are mandated to be recorded as nonoperating revenues, including state educational appropriations, private gifts and investment income.

State capital appropriations, capital gifts and grants and gifts for endowment purposes are classified as other changes in net assets.

STUDENT TUITION AND FEES. Substantially all of the student tuition and fees provide for current operations of the university. A portion of the student fees is required for debt service associated with the UC Davis Memorial Union. Certain waivers of student tuition and fees considered to be scholarship allowances are recorded as an offset to revenue.

STATE APPROPRIATIONS. The state of California provides appropriations to UC Davis on an annual basis. State educational appropriations are recognized as nonoperating revenue as the related expenses are incurred to support either educational operations or specific purposes. State appropriations for capital projects are recorded as revenue when the related expenditures are incurred.

GRANT AND CONTRACT REVENUE. UC Davis receives grant and contract revenue from governmental and private sources. Revenue associated with the direct costs of sponsored programs is recognized as the related expenditures are incurred.

Recovery of facilities and administrative costs of federally sponsored programs is at cost reimbursement rates negotiated with UC Davis' federal cognizant agency, the Department of Health and Human Services. For the fiscal year ended June 30, 2003, the facilities and administrative cost recovery totaled $58 million, $45 million from federally sponsored programs and $13 million from other sponsors. For the year ended June 30, 2002, the facilities and administrative cost recovery totaled $48 million, $36 million from federally sponsored programs and $12 million from other sponsors. The campus is required to transfer all facilities and administration cost recoveries, except clinical trials, received from performance under contracts and grants to the Office of the President. Subject to cost-sharing agreements with the state of California, a portion of the recoveries is returned to the campus in the annual budgetary allocation from the Office of the President.

MEDICAL CENTER REVENUE. Medical center revenue is reported at the estimated net realizable amounts from patients, third-party payors including Medicare and Medi-Cal, and others for services rendered, as well as estimated retroactive adjustments under reimbursement agreements with third-party payors. Laws and regulations governing Medicare and Medi-Cal are complex and subject to interpretation. 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. It is reasonably possible that estimated amounts accrued could change significantly based upon settlement or as additional information becomes available.

SCHOLARSHIP ALLOWANCES. UC Davis recognizes certain scholarship allowances, including both financial aid and fee waivers, as the difference between the stated charge for tuition and fees, housing and dining charges, recreational center fees, etc., and the amount that is paid by the student, as well as third parties making payments on behalf of the student. Payments of financial aid made directly to students are classified as scholarship and fellowship expenses.

Scholarship allowances are recorded as an offset to revenues in the following amounts (in thousands of dollars):

	2003	2002
Student tuition and fees	$29,012	$29,585
Sales and service of auxiliary enterprises	6,397	5,890
Other operating revenues	333	342
Scholarship allowance	**$35,742**	**$35,817**

COMPENSATED ABSENCES. UC Davis 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.

ENDOWMENT SPENDING. Under provisions of California law, the regents have adopted the Uniform Management of Institutional Funds Act (UMIFA). Investment income, as well as a portion of realized and unrealized gains, may be expended for the operational requirements of UC Davis programs.

TAX EXEMPTION. UC Davis is qualified as a tax-exempt organization under the provisions of Section 501(c) (3) of the Internal Revenue Code and is exempt from federal and state income taxes on related income.

USE OF ESTIMATES. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual amounts could differ from those estimates.

COMPARATIVE INFORMATION. Certain reclassifications have been made to the 2002 summarized financial information in order to conform to the 2003 presentation.

NEW ACCOUNTING PRONOUNCEMENTS. The GASB has issued Statement No. 39, "Determining Whether Certain Organizations are Component Units", effective for the year beginning July 1, 2003. Statement No. 39 will require UC Davis' legally separate, tax-exempt foundation to be presented discretely in UC Davis' financial statements. At June 30, 2003, the date of the most recently available financial statements, UC Davis Foundation's net assets exceeded $107 million.

The GASB has also issued Statement No. 40, "Deposit and Investment Risk Disclosures", effective for years beginning July 1, 2005. Statement No. 40 establishes additional disclosure requirements addressing common risks of investments. The Statement will have no effect on UC Davis' net assets or changes in net assets.

1. CASH

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

UC Davis 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. At June 30, 2003 and 2002, the carrying value of UC Davis' demand deposits was $1.015 billion and $1.026 billion, respectively.

2. INVESTMENTS HELD BY TRUSTEES

UC Davis has entered into agreements with trustees to maintain trusts for UC Davis' long-term debt and landfill closure requirements. All investments held by trustees are insured, registered or held by the University of California's trustee or custodial bank, as fiduciary for the bondholder or as agent for the university.

The trust agreements permit trustees to invest in U.S. and state government or agency obligations, commercial paper or other corporate obligations meeting certain credit rating requirements.

Investments held by trustees for the future payment of principal and interest are in accordance with various indenture and other long-term debt requirements. The fair value of these investments associated with UC Davis indenture and other long-term debt requirements was over $7 million at June 30, 2003.

Investments held by trustees for future landfill closure expenditures are in accordance with requirements of the California Integrated Waste Management Board. The fair value of these investments was less than $1 million at June 30, 2003.

UC Davis deposits into the trusts, or receipts from the trusts, are classified as a capital and related financing activity in the statement of cash flows, if related to long-term debt requirements, or an operating activity. Investment transactions initiated by trustees in conjunction with the management of the trust assets and payments from the trust to third parties are not included in UC Davis' statement of cash flows.

3. ACCOUNTS RECEIVABLE

Accounts receivable and the allowances for uncollectible amounts are as follows (in thousands of dollars):

	STATE AND FEDERAL GOVERNMENT	MEDICAL CENTER	OTHER	TOTAL
At June 30, 2003:				
Accounts receivable	$76,715	$162,001	$59,972	$298,688
Allowance for uncollectible amounts		(33,554)	(10,681)	(44,235)
Accounts receivable, net	**$76,715**	**$128,447**	**$49,291**	**$254,453**
At June 30, 2002:				
Accounts receivable	$57,377	$139,946	$61,855	$259,178
Allowance for uncollectible amounts		(33,060)	(17,784)	(50,844)
Accounts receivable, net	**$57,377**	**$106,886**	**$44,071**	**$208,334**

Other accounts receivable are primarily related to private grants and contracts, physicians' professional fees, pledges, tuition and fees and auxiliary enterprises.

4. NOTES AND MORTGAGES RECEIVABLE

Notes and mortgages receivable, along with estimated uncollectible amounts, are as follows (in thousands of dollars):

		NONCURRENT PORTION		
	CURRENT PORTION	NOTES	MORTGAGES	TOTAL
At June 30, 2003:				
Notes and mortgages receivable	$9,922	$58,925	$179	$69,02
Allowance for uncollectible amounts	(846)	(3,691)		(4,537)
Notes and mortgages receivable, net	**$9,076**	**$55,234**	**$179**	**$64,489**
At June 30, 2002:				
Notes and mortgages receivable	$11,807	$52,840	$89	$64,736
Allowance for uncollectible amounts	(990)	(3,995)		(4,985)
Notes and mortgages receivable, net	**$10,817**	**$48,845**	**$89**	**$59,751**

5. LAND, INFRASTRUCTURE, BUILDINGS, EQUIPMENT, LIBRARIES AND COLLECTIONS

UC Davis' capital asset activity for the years ended June 30, 2003, and June 30, 2002, is as follows (in thousands of dollars):

ORIGINAL COST	2001	ADDITIONS	DISPOSALS	2002	ADDITIONS	DISPOSALS	2003
Land	$50,066	$593	($630)	$50,029	$505		$50,534
Infrastructure	74,568	637	(18)	75,187	16,263		91,450
Buildings and improvements	1,450,329	75,970	(832)	1,525,467	203,770	(547)	1,728,690
Equipment	660,660	60,424	(39,144)	681,940	89,723	(64,451)	707,212
Libraries and collections	249,379	13,212		262,591	10,949		273,540
Special collections	19,282	1,307		20,589	1,223	(3)	21,809
Construction in progress	140,168	77,580		217,748	19,350	(1)	237,097
Capital assets, at original cost	**$2,644,452**	**$229,723**	**($40,624)**	**$2,833,551**	**$341,783**	**($65,002)**	**$3,110,332**

ACCUMULATED DEPRECIATION	2001	DEPRECIATION & AMORTIZATION	DISPOSALS	2002	DEPRECIATION & AMORTIZATION	DISPOSALS	2003
Infrastructure	$32,093	$2,350	($20)	$34,423	$2,314		$36,737
Buildings & improvements	540,024	49,128	(763)	588,389	52,916	(435)	640,870
Equipment	435,771	47,472	(29,635)	453,608	65,688	(58,570)	460,726
Libraries & collections	160,227	10,787		171,014	10,896		181,910
Accumulated depreciation	**$1,168,115**	**$109,737**	**($30,418)**	**$1,247,434**	**$131,814**	**($59,005)**	**$1,320,243**
Capital assets, net	**$1,476,337**			**$1,586,117**			**$1,790,089**

6. DEBT

The regents of the University of California may finance the construction, renovation and acquisition of certain facilities and equipment for UC Davis and other UC campuses through the issuance of debt obligations. Long-term financing includes revenue bonds, certificates of participation, mortgages and other borrowings and capital lease obligations.

UC Davis' portion of the University of California's outstanding debt at June 30, 2003 and 2002 is as follows (in thousands of dollars):

	INTEREST RATES	MATURITY YEARS	2003	2002
The Regents of the University of California:				
Multi-purpose projects revenue bonds	3.0-9.25%	2003-2034	$214,715	$165,662
Housing system revenue bonds	5.0-8.0%	2003-2018	24,418	25,378
Hospital revenue bonds	3.6-10.0%	2007-2027	340,096	332,805
Research facilities revenue bonds	4.1-10.0%	2002-2031	72,369	72,564
Bond for Memorial Union	5.7-5.8%	2007	620	730
Revenue bonds			652,218	597,139
Certificates of participation	3.3-10.0%	2002-2011	3,831	4,220
Capital leases	2.7-8.5%	2003-2023	170,781	131,407
Total outstanding debt			**826,830**	**732,766**
Current portion of long-term debt			(18,636)	(17,457)
Total long-term debt			**$808,194**	**$715,309**

Total interest expense during the years ended June 30, 2003, and 2002 was $41 million and $37 million, respectively. Interest expense of $2 million and $9 thousand associated with financing projects during the construction phase was capitalized during the year ended June 30, 2003, and 2002.

OUTSTANDING DEBT ACTIVITY

The activity with respect to UC Davis' outstanding debt for the years ended June 30, 2003 and 2002, is as follows (in thousands of dollars):

	REVENUE BONDS	CERTIFICATES OF PARTICIPATION	CAPITAL LEASE OBLIGATIONS	TOTAL
YEAR ENDED JUNE 30, 2003				
Current portion at June 30, 2002	$10,857	$390	$6,210	$17,457
Reclassification from noncurrent	311,249	390	7,582	319,221
Principal payments	(311,576)	(390)	(6,827)	(318,793)
Amortization of deferred financing costs	751			751
Current portion at June 30, 2003	**$11,281**	**$390**	**$6,965**	**$18,636**
Noncurrent portion at June 30, 2002	$586,282	$3,830	$125,197	$715,309
New obligations	365,905		46,201	412,106
Reclassification to current	(311,249)	(390)	(7,582)	(319,221)
Noncurrent portion at June 30, 2003	**$640,938**	**$3,440**	**$163,816**	**$808,194**
YEAR ENDED JUNE 30, 2002				
Current portion at June 30, 2001	$9,662	$366	$6,339	$16,367
Reclassification from noncurrent	10,857	390	6,433	17,680
Principal payments	(9,662)	(366)	(6,562)	(16,590)
Current portion at June 30, 2002	**$10,857**	**$390**	**$6,210**	**$17,457**
Noncurrent portion at June 30, 2001	$535,884	$4,220	$130,336	$670,440
New obligations	61,255		1,294	62,549
Reclassification to current	(10,857)	(390)	(6,433)	(17,680)
Noncurrent portion at June 30, 2002	**$586,282**	**$3,830**	**$125,197**	**$715,309**

REVENUE BONDS

Revenue bonds have financed various auxiliary, administrative, academic and research facilities of UC Davis. They have annual principal and semiannual interest payments, serial and term maturities, contain sinking fund requirements and may have optional redemption provisions.

Revenue bonds for the UCD medical center and auxiliary enterprises are collateralized by a pledge of the net revenues generated by the enterprises. Revenue bonds for research facilities and certain revenue bonds for administrative and academic facilities are collateralized by a pledge of UC Davis' share of facilities and administrative cost recoveries received on federal research grants and contracts performed by UC Davis. Revenue bonds are not collateralized by any encumbrance, mortgage or other pledge of property, except pledged revenues, and do not constitute general obligations of UC Davis or the regents.

The Multiple Purpose Projects Revenue Bond indentures require UC Davis to achieve net revenues after expenses and requirements for senior lien indentures equal to 1.25 times debt service and maintain certain other financial covenants. The Hospital Revenue Bonds require UC Davis to achieve debt service coverage of 1.1 times to 1.2 times (depending on the indenture), set limitations on encumbrances, indebtedness, disposition of assets and transfer services and maintain certain other financial covenants. The Multiple Purpose Projects Revenue Bond and Hospital Revenue Bond indentures require UC Davis to use the facilities in a way which will not cause the interest on the bonds to be included in the gross income of the holders of the bonds for federal tax purposes.

2003 ACTIVITY

In May 2003, Multiple Purpose Projects Revenue Bonds totaling $364.3 million were issued to finance and refinance the acquisition, construction, renovation, and improvement of certain facilities of the University, including student housing, faculty housing, parking facilities, student centers, recreation and events facilities, student health services facilities, telecommunications facilities, and certain academic and administrative facilities. UC Davis' obligation totaled $30 million to finance and refinance the acquisition, construction and improvement of student housing and the Aquatics Complex. Proceeds are available to pay for project construction and issuance costs and to repay interim financing incurred prior to the issuance of the bonds. The bonds mature at various dates through 2034 and have a weighted average interest rate of 4.9 percent.

In March 2003, UC Davis Medical Center Refunding Hospital Revenue Bonds totaling $347.8 million with a variable interest rate were issued to advance refund and defease $300.7 million of outstanding UC Davis Medical Center Revenue Bonds. The university also entered into interest rate swap agreements in connection with the UC Davis Medical Center Refunding Hospital Revenue Bonds with the intention that the variable interest rates it pays on the bonds will approximate the variable payments it receives from the interest rate swaps, resulting in a fixed interest rate of 3.1 percent. Proceeds were used to pay for issuance costs and to purchase $341 million of U.S. government securities sufficient to fund retirement of the specified obligations. The defeasance resulted in deferred financing costs of $35 million, included as an offset to the current and noncurrent portion of long-term debt, as appropriate, in UC Davis' statement of net assets, and is being amortized as interest expense over the remaining life of the defeased bonds. Aggregate debt service payments were reduced by $55 million over the next 23 years and UC Davis was able to obtain an economic gain of $42 million, based on the assumption that the variable rate bond payments will be offset by the variable receipts under the interest rate swaps.

In July 2002, Multiple Purpose Projects Revenue Bonds totaling $366 million were issued to finance and refinance the acquisition, construction, renovation and improvement of certain facilities of the University of California. UC Davis' obligation totaled $23 million to finance and refinance the acquisition, construction, renovation and improvement of the Center for Performing Arts and certain telecommunication facilities. The UCD obligation of the bonds maturing at various dates through 2034 totals $15 million and has a weighted average interest rate of 5.0 percent. The UCD obligation of the bonds maturing at various dates through 2019 totals $8 million and has a weighted average interest rate of 4.4 percent.

SUBSEQUENT EVENTS

In July 2003, the regents authorized the university to issue General Revenue Bonds collateralized solely by general revenues. The bonds do not constitute general obligations of the regents. General revenues are certain operating and nonoperating revenues of the university consisting of gross student tuition and fees, facilities and administrative cost recovery from contracts and grants, sales and service revenues from educational, auxiliary and other activities, and other sources of revenue, including unrestricted investment income.

In September 2003, General Revenue Bonds totaling $914.3 million were issued by the University of California to finance and refinance the acquisition, construction, renovation and improvement of certain facilities of the university. UC Davis' share of the obligation was $70 million to finance and refinance the acquisition, construction, renovation and improvement of UC Davis' facilities including the Activities and Recreation Center and Segundo Commons. Proceeds were also used to refund UC Davis' $12 million piece of outstanding Multiple Purpose Projects Revenue Bonds and UC Davis' $24 million piece of outstanding Housing System Revenue Bonds. The bonds mature at various dates through 2036 and have a weighted average interest rate of 5.0 percent.

In October 2003, an offering statement was issued for the sale of General Revenue Bonds totaling $385.8 million to refinance the acquisition, construction, renovation and improvement of certain facilities of the university. Proceeds will be used to refund outstanding Multiple Purpose Projects Revenue bonds including $58 million of UC Davis obligations. The bonds mature at various dates through 2028 and have a weighted average interest rate of 4.9 percent.

The General Bond indenture requires the university to set rates, charges and fees each year sufficient for general revenues to pay for the annual principal and interest on the bonds and certain other financial covenants. UC Davis general revenues for the years ended June 30, 2003, and 2002 were $501 million and $453 million, respectively.

2002 ACTIVITY

In December 2001, the University of California issued $122.8 million of Research Facility Revenue Bonds with a weighted average interest rate of 4.9 percent to finance and refinance the acquisition, construction and equipping of certain research facilities. UC Davis' obligation of this debt is $62 million. Proceeds are available to pay for project construction and issuance costs and to repay interim financing incurred prior to the issuance of the bonds.

INTEREST RATE SWAP AGREEMENTS

As a means to lower the university's borrowing costs, when compared against fixed-rate bonds at the time of issuance in March 2003, the university entered into interest rate swaps with three financial institutions in connection with the UC Davis Medical Center $347.8 million variable-rate Refunding Revenue Bonds (Series A-E). The intention of the swap transaction was to effectively change the variable interest rate on the bonds to a fixed rate of 3.1 percent.

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

Because interest rates have decreased since execution of the swaps, the swaps have an estimated negative fair value of $9.6 million as of June 30, 2003. The fair value is an indication of the difference in value of the fixed interest payments due on the swap and fixed rate payments due on a swap with identical terms executed on June 30, 2003. The fair value was estimated by the financial institutions using quoted market prices when available or a forecast of expected discounted future net cash flows.

The swap exposes UC Davis to basis risk whenever the interest rates on the bonds are reset. The interest rate on the bonds is a tax-exempt interest rate, while the basis of the variable receipt on the interest rate swaps is taxable (67 percent of 30 day LIBOR). Tax-exempt interest rates can change without a corresponding change in the 30 day LIBOR rate due to factors affecting the tax-exempt market which do not have a similar effect on the taxable market. For example, the swap exposes the campus to risk if reductions in the federal personal income tax cause the relationship between the variable interest rate on the bonds to be greater than 67 percent of 30 day LIBOR.

Although the university has entered into the interest rate swaps with credit worthy financial institutions, there is exposure to losses in the event of non-performance by counterparties or unfavorable interest rate movements. The swap may be terminated if the insurer's credit quality rating falls below "A –" as issued by Fitch Ratings or Standard & Poor's, thereby canceling the synthetic interest rate and returning the interest rate payments to the variable interest rates on the bonds. At termination, the university may also owe a termination payment if there is a realized loss based on the fair value of the swap.

Interest payments on the bonds are reset each 28 days for Series A, weekly for Series B-D, and daily for Series E. As rates vary, variable-rate bond interest payments and net swap payments will vary. Although not a prediction by UC Davis of the future interest cost of the variable rate bonds or the impact of the interest rate swaps, using rates as of June 30, 2003, debt service requirements of the variable-rate debt and net swap payments are as follows (in thousands of dollars):

	VARIABLE-RATE BOND		INTEREST RATE SWAP, NET	TOTAL PAYMENTS
	OPERATING	INTEREST		
FISCAL YEAR ENDING JUNE 30				
2004	$1,750	$2,454	$7,808	$12,012
2005	3,150	2,433	7,742	13,325
2006	3,275	2,410	7,669	13,354
2007	3,375	2,386	7,593	13,354
2008	11,950	2,312	7,356	21,618
2009-2013	66,250	10,190	32,422	108,862
2014-2018	78,475	7,604	24,193	110,272
2019-2023	92,975	4,540	14,443	111,958
2024-2027	86,575	1,048	3,336	90,959
Total	**$347,775**	**$35,377**	**$112,562**	**$495,714**

CERTIFICATES OF PARTICIPATION

Certificates of participation have been issued to finance buildings and equipment under lease agreements. The certificates are collateralized by buildings and equipment. A portion of the rental payments are provided to UC Davis by a state of California financing appropriation totaling $11 million for the year ended June 30, 2003 and $13 million for the year ended June 30, 2002. All rental payments have been pledged and assigned to a trustee by the lessor.

CAPITAL LEASES

UC Davis has entered into lease-purchase agreements with the state of California, recorded as capital leases. The state sells lease revenue bonds to finance construction and equipping of certain state-owned buildings to be used by UC Davis. During the construction phase, UC Davis acts as agent for the state. Upon completion, the buildings and equipment are leased to UC Davis under terms and amounts that are sufficient to satisfy the state's lease revenue bond requirements with the understanding that the state will provide financing appropriations to UC Davis to satisfy the annual lease requirements. At the conclusion of the lease term, ownership transfers to UC Davis.

In March 2003, UC Davis entered into a $32.8 million lease-purchase agreement with the state to finance the construction of the Medical Investigation of Neurodevelopmental Disorders (M.I.N.D.) Institute. At June 30, 2003, $4.5 million remains with the trustee, included in investments held by trustees in UC Davis' statement of net assets, pending completion of the facility.

The state of California financing appropriation to UC Davis under the terms of the lease-purchase agreements, recorded as nonoperating revenue in the statement of revenues, expenses and changes in net assets, for the years ended June 30, 2003, and 2002 was $11 million and $13 million, respectively. The principal and interest, including accrued interest, reported in UC Davis' financial statements for the years ended June 30, 2003, and 2002 contain amounts related to these lease-purchase agreements with the state of California as follows (in thousands of dollars):

	2003	2002
Capital lease principal	$ 4,148	$ 4,137
Capital lease interest	8,187	8,194
	$12,335	**$12,331**

Capital leases entered into with other lessors, primarily for equipment, totaled $3 million and $1 million for the years ended June 30, 2003, and 2002, respectively.

FUTURE DEBT SERVICE

Future debt service payments for each of the five fiscal years subsequent to June 30, 2003, and thereafter are as follows (in thousands of dollars):

YEAR ENDED JUNE 30	REVENUE BONDS	CERTIFICATES OF PARTICIPATION	CAPITAL LEASES STATE	CAPITAL LEASES OTHER	TOTAL PAYMENTS	PRINCIPAL	INTEREST
2004	$30,927	$591	$25,353	$2,406	$59,277	$29,346	$29,931
2005	31,565	594	14,615	1,435	48,209	20,163	28,046
2006	35,440	595	14,263	1,162	51,460	23,332	28,128
2007	35,462	594	14,493	1,037	51,586	24,613	26,973
2008	35,931	592	14,466	622	51,611	25,736	25,875
2009–2013	185,034	1,774	73,482	2,440	262,730	162,136	100,594
2014–2018	192,198		55,123	1,313	248,634	179,637	68,997
2019–2023	185,328		37,479		222,807	181,833	40,974
2024–2028	148,986		11,439		160,425	142,160	18,265
2029–2035	42,982				42,982	37,873	5,109
Total future debt service	**923,853**	**4,740**	**260,713**	**10,415**	**$1,199,721**	**$826,829**	**$372,892**
Less: Interest component of future payments	271,635	909	97,797	2,551			
Principal portion of future payments	**$652,218**	**$3,831**	**$162,916**	**$7,864**			

7. OTHER NONCURRENT LIABILITIES

The activity with respect to other noncurrent liabilities for the years ended June 30, 2003 and 2002, is as follows (in thousands of dollars):

	2003		2002	
	CURRENT	NONCURRENT	CURRENT	NONCURRENT
Compensated absences	$56,106	$16,424	$49,185	$20,672
3rd Party payor settlement liability	$34,473		$44,064	
UCDMC contingent liability	$10,700			
Accrued Interest	9,139		16,175	
McClellan closure		17,593		17,593
Landfill closure		2,007		1,930
Other noncurrent liabilites	563	343	488	360
Total other liabilites	**$110,981**	**$36,367**	**$109,912**	**$40,555**

Payments are generally made from a variety of revenue sources, including state educational appropriations, grants and contracts, auxiliary enterprises, endowment income, or other revenue sources that support the employee's salary.

MCCLELLAN CLOSURE LIABILITY

In September 1999, the regents of the University of California authorized UC Davis to acquire the McClellan Nuclear Radiation Center (MNRC) from the Department of Defense. The Nuclear Regulatory Commission license for this reactor requires that the majority (51%) of the workload be for the purposes of education and research. Legislation authorized the allocation of $17.6 million to UC Davis to cover the cost of the eventual decommissioning of the MNRC in approximately 27 years. A fund functioning as an endowment has been established for these funds and the approximate decommission costs recorded as a liability.

LANDFILL CLOSURE

UC Davis has two landfill units. Unit I had a total capacity of close to 420 thousand cubic yards and was closed in June 2001. Unit II is made up of 8 cells with a combined capacity of 477 thousand cubic yards and will be opened one cell at a time.

State laws and regulations require UC Davis to perform certain maintenance and monitoring functions at each landfill site for 30 years after closure. Although closure and postclosure care costs will be paid only near or after the date that the landfill stops accepting waste, UC Davis reports a portion of these closure and postclosure care costs as an operating expense in each period based on the landfill capacity used as of each balance sheet date. The $1.9 million reported as landfill closure liability at June 30, 2003, represents the cumulative amount reported to date based on the use of 52% of the estimated capacity of the landfill. UC Davis will recognize the remaining estimated cost of closure and postclosure care of $1.6 million as the remaining estimated capacity is filled.

UC Davis is required by state laws and regulations to make contributions to a trust to finance closure care. UC Davis is in compliance with these requirements and, at June 30, 2003, investments of $424,000 are held for these purposes. UC Davis expects that future inflation costs will be paid from the interest earnings on these annual contributions. However, if interest earnings are inadequate or additional postclosure care requirements are determined (due to changes in technology or applicable laws or regulations, for example), these costs may need to be covered by charges to future landfill users.

8. ENDOWMENT FUNDS

Endowment funds consist of monies gifted to the university for which the donor has specified that only the earnings from investment of the principal may be expended. Expenditures of these funds are typically restricted to a specific purpose. Funds donated to UC Davis, like those donated to the nine other University of California campuses, are managed by the treasurer of the regents of the University of California. All endowment funds participate in the General Endowment Pool (GEP), unless payout needs by the donors require otherwise. Investments are made to generate growth of principal and a growing payout stream to ensure that future funding for endowment-supported activities can be maintained, while assuming appropriate levels of risk. Income from the investment of endowment funds is periodically transferred to the campus.

At June, 30, 2003, the total value, at cost, of UC Davis' endowments, funds functioning as endowments and other restricted nonexpendable net assets was $159 million. The total market value of UC Davis' endowments and other restricted nonexpendable net assets as of June 30, 2003, was $331 million.

The portion of investment returns earned on endowments held by the regents and distributed each year to support current operations is based upon a rate (stated in dollars per share) that is approved by the regents. The total distribution from endowments held by the regents to UC Davis was $18 million for the year ended June 30, 2003.

9. OPERATING EXPENSES BY FUNCTION

Operating expenses, by functional classification, for the years ended June 30, 2003, and June 30, 2002 are as follows (in thousands of dollars):

	2003	2002
Instruction	$367,332	$348,090
Research	324,344	308,106
Public service	55,470	51,545
Academic support	118,478	105,674
Student services	43,402	42,157
Institutional support	71,036	69,487
Operations and maintenance of plant	61,194	71,079
Student financial aid	35,973	29,289
Medical center	680,346	590,782
Auxiliary enterprises	69,733	66,622
Depreciation	131,813	109,736
Other	1,440	(4,644)
Total operating expenses	**$1,960,561**	**$1,787,923**

10. SEGMENT INFORMATION

UC Davis' significant identifiable activities for which revenue bonds are outstanding are related to the University of California, Davis Medical Center. The medical center operating revenue and expenses consist primarily of revenues associated with patient care and the related costs of providing that care.

Condensed financial statement information related to UC Davis Medical Center for the years ended June 30, 2003 and 2002 appears at left (in thousands of dollars):

	2003	2002
Bonds outstanding	$349,551	$349,070
Bonds due serially through	2026	2027
CONDENSED STATEMENT OF NET ASSETS		
Assets		
Current assets	$352,757	$329,733
Capital assets, net	632,633	610,753
Other assets	10,673	10,001
Total assets	**996,063**	**950,487**
Liabilities		
Current liabilities	140,023	132,670
Long-term debt	343,796	343,501
Total liabilities	**483,819**	**476,171**
Net assets		
Invested in capital assets, net of debt	278,964	259,006
Restricted	7,326	15,523
Unrestricted	225,954	199,787
Total net assets	**$512,244**	**$474,316**
CONDENSED STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS		
Operating revenues	$782,065	$695,307
Operating expenses	(678,908)	(604,949)
Depreciation expense	(47,947)	(43,799)
Operating income	**55,210**	**46,559**
Nonoperating revenues (expenses)	(11,946)	(11,238)
Income before changes in other assets	**43,264**	**35,321**
Health systems support	(23,834)	(24,684)
Transfers to/from the University of California	18,498	(202)
Increase in net assets	**37,928**	**10,435**
Net assets—Beginning of the year	474,316	463,881
Net assets—End of the year	**$512,244**	**$474,316**
CONDENSED STATEMENT OF CASH FLOWS		
Net cash provided (used) by:		
Operating activities	89,771	131,931
Noncapital financing activities	(19,481)	(24,886)
Capital and related financing activities	(76,370)	(70,682)
Investing activities	16,358	10,213
Net increase in cash	**10,278**	**46,576**
Cash-beginning balance	197,791	151,215
Cash—ending balance	**$208,069**	**$197,791**

Additional information on UC Davis Medical Center can be obtained from its separate June 30, 2003, audited financial statements.

11. UNIVERSITY OF CALIFORNIA RETIREMENT SYSTEM (UCRS)

Most UC Davis employees participate in the University of California Retirement System (UCRS). UCRS includes a defined benefits plan (the Retirement Plan), in which eligible employees are required to participate; defined contribution plans, which include the Defined Contribution Plan–Pretax Account and the Defined Contribution Plan–After Tax Account; and a Tax-Deferred 403(b) plan. The Board of Regents is the trustee for all UCRS funds and Public Employees Retirement System-Voluntary Early Retirement Incentive Program (PERS-VERIP) plan funds. Accordingly, these funds are separately identified in the University of California's Annual Financial Report.

12. COMMITMENTS AND CONTINGENCIES

UC Davis leases land, buildings and equipment under agreements recorded as operating leases. Operating lease expenditures for the years ended June 30, 2003 and 2002, were $11 million each year. The terms of operating leases extend through the year ending 2012.

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

YEAR ENDING JUNE 30	Minimum Annual Lease Payments
2004	$10,742
2005	9,775
2006	8,202
2007	6,519
2008	5,563
2009–2012	8,370
Total	**$49,171**

Substantial amounts are received and expended by UC Davis under other federal and state grants and contracts and are subject to audit by cognizant governmental agencies. This funding relates to research, student aid, medical center operations and other programs. UC Davis management believes that any liabilities arising from such audits will not have a material effect on UC Davis' financial statements.

UC Davis is contingently liable in connection with certain other claims and contracts, including those currently in litigation, arising in the normal course of its activities. Although there are inherent uncertainties in any litigation, UC Davis management and general counsel are of the opinion that the outcome of such matters will not have a material effect on UC Davis' financial position.

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