
University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

The objective of Management's Discussion and Analysis (MDA) is to help readers of the University of California, Berkeley's financial statements better understand the financial position and operating activities for the fiscal year ended June 30, 2008, with selected comparative information for the year ended June 30, 2007. This discussion has been prepared by management and should be read in conjunction with the financial statements and notes to the financial statements. Unless otherwise indicated, years (2007, 2008) in this discussion refer to the fiscal year ended June 30.

The University of California, Berkeley's financial report communicates financial information for the University of California Berkeley campus (Berkeley) through three primary financial statements and notes to the financial statements. The three financial statements present the financial position, changes in the financial position and cash flows for Berkeley. The notes provide additional information that is essential to a full understanding of the financial statements.

The financial statements for the University of California, Berkeley Foundation are presented separately from Berkeley's and are not covered in this discussion and analysis.

THE UNIVERSITY OF CALIFORNIA-BERKELEY

Berkeley is the oldest of the ten campuses of the University of California (UC), a public, state-supported institution. It is dedicated to excellence in teaching, research, and public service. Berkeley offers undergraduate, graduate and professional education and is one of the world's leading research universities.

Berkeley's financial statements are prepared from the official UC records and accounts for the campus. These records and accounts are maintained in accordance with UC policies and relevant accounting principles generally accepted in the United States of America established by the Governmental Accounting Standards Board (GASB). Berkeley's financial statements have not been individually audited, but rather are audited as part of the UC financial statement audit. The audited, consolidated financial statements of UC are available at: <http://www.universityofcalifornia.edu/finreports/>.

During 2008, Berkeley adopted GASB Statement No. 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions. Statement No. 45 requires accrual-based measurement, recognition and disclosure of other postemployment benefits (OPEB) expense, such as retiree medical and dental costs, over the employees' years of service, along with the related liability, net of any plan assets. Berkeley recognized \$20.4 million of OPEB cost in 2008 and \$18.0 million in 2007. The related unfunded liabilities are recorded in UC's annual financial reports.

During 2007, Berkeley adopted GASB Statement No. 48, Sales and Pledges of Receivables and Intra-Entity Transfers of Assets. Statement No. 48 establishes criteria to ascertain whether certain transactions should be recorded as sales or collateralized borrowings. The implementation of this Statement had no effect on Berkeley's net assets or changes in net assets in 2008, and there was no effect in 2007.

BERKELEY'S FINANCIAL POSITION

The statement of net assets presents the financial position at the end of each year. The difference between assets and liabilities is net assets, representing a measure of the current financial condition. Berkeley's statement of net assets displays all of the assets, liabilities, and net assets reflected in Berkeley's accounts. However, certain significant assets, liabilities, and net assets, such as system-wide investments, self-insurance liabilities, revenue bond debt, and endowment funds, are not reflected in Berkeley's campus-level accounts. Therefore, Berkeley's statement of net assets does not reflect a picture of the campus' financial position on a stand-alone basis but rather as a campus within the UC system. At June 30, 2008, Berkeley's assets were \$3.7 billion, liabilities were \$0.5 billion and net assets were nearly \$3.2 billion.

University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

The major components of Berkeley's assets, liabilities, and net assets, as of 2008 and 2007, are as follows (in thousands of dollars):

	2008	2007	\$ CHANGE	% CHANGE
Assets				
Cash and cash equivalents	\$977,279	\$846,564	130,715	15%
Investment held by trustees	30,770	78,246	(47,476)	(61%)
Accounts receivable, net	130,582	123,897	6,685	5%
Capital assets, net	2,491,439	2,294,248	197,191	9%
Other assets	94,550	97,023	(2,473)	(3%)
Total assets	3,724,620	3,439,978	284,642	8%
Liabilities				
Accounts payable	84,694	92,106	(7,412)	(8%)
Accrued salaries and benefits	101,727	39,649	62,078	157%
Deferred revenue	164,960	117,656	47,304	40%
Debt	96,793	118,564	(21,771)	(18%)
Other liabilities	95,141	85,860	9,281	11%
Total liabilities	543,315	453,835	89,480	20%
Net Assets				
Invested in capital assets, net of related debt	2,423,462	2,235,668	187,794	8%
Restricted expendable	332,269	349,735	(17,466)	(5%)
Unrestricted	425,574	400,740	24,834	6%
Total net assets	\$3,181,305	\$2,986,143	195,162	7%

Berkeley's Assets

Berkeley's total assets grew \$284.6 million to \$3.7 billion at the end of 2008. \$197.2 million of the increase was attributable to capital assets, and another \$130.7 million of the increase was from cash and cash equivalents. Partially offsetting the increases was a decrease of \$47.5 million from investments held by trustees. Changes in other asset categories were relatively insignificant.

Capital assets include land, infrastructure, buildings and improvements, equipment, libraries, collections and construction in progress. The required spending for capital assets continued to provide the facilities necessary to accommodate current and future academic, research, and student support needs. The original cost of all capital assets increased by \$294.3 million to \$4.3 billion in 2008. The increase consisted of capital additions of \$334.0 million, partially offset by \$39.7 million of the original cost of equipment and buildings disposed of during the year. During 2008, capitalized costs included \$236.1 million for construction projects for new buildings or improvements to existing buildings, such as the University Village apartments, the Doe Library seismic improvements, the East Asian Library, the Underhill parking facility, and the 3300 Regatta Avenue property acquisition; \$36.5 million for new equipment; \$37.9 million for libraries and collections; \$20.2 million for land; and \$3.3 million for infrastructure. About \$32.6 million of the disposed assets was for equipment that was fully depreciated or had reached the end of its useful life or was traded in for new equipment, while disposed buildings attributable to the demolition of the old Warren Hall building during the year totaled \$7.1 million.

Accumulated depreciation increased \$97.1 million to \$1.8 billion in 2008. Depreciation expense for the year was \$132.4 million, and the accumulated depreciation on assets sold or disposed of during the year was \$35.3 million. Disposals were for equipment that was fully depreciated or had reached the end of its useful life or for buildings that were demolished.

Berkeley's cash and cash equivalents are managed at the UC system-wide level. The change in the balances between 2008 and 2007 of \$130.7 million is discussed in the section "Berkeley's Cash Flows" of this MDA.

Investments held by trustees for future capital projects decreased from \$78.2 million at 2007 to \$30.8 million at 2008. The state of California retained on deposit certain proceeds from the sale of lease-revenue bonds to be used for capital projects. During 2007, the State Public Works Board (SPWB) sold \$79.9 million in State of California Lease Revenue Bonds 2006 Series E to finance construction of Berkeley's Davis Hall North Replacement Building. The fair value of the amount held

University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

decreased \$31.0 million during 2008 to \$29.8 million due to funding withdrawals for the project. Another \$16.4 million reduction was associated with a deposit held by an escrow company at 2007 for the purchase of the 3300 Regatta Avenue property; the transaction was completed in 2008.

Berkeley's Liabilities

Berkeley's total liabilities increased \$89.5 million, or 20%, to \$543.3 million at 2008.

Accrued salaries and benefits increased from \$39.6 million at 2007 to \$101.7 million at 2008, an increase of \$62.1 million. The increase was primarily caused by different processing dates for the monthly June payroll for the two years. In 2008, employees were paid on July 1. In 2007, employees were paid on June 29 as July 1 fell on a weekend.

Deferred revenue includes student tuition and fees and housing and dining fees billed in advance of an academic term and amounts received from grant and contract sponsors that have not been earned under the terms of the agreements. Deferred revenue increased \$47.3 million to \$164.9 million in 2008. \$37.8 million of the increase was from conditional gifts or grants for a new biomedical and health sciences facility. Another \$6.9 million was from advance payments on other restricted contracts or grants. The remaining \$2.6 million increase was from student fees for summer sessions and the fall 2008 semester.

Campus specific debt decreased by \$21.8 million to \$96.8 million in 2008. A bank loan for the Stanley Hall project with a \$30.0 million balance at 2007 was paid off in 2008. On the other hand, a new mortgage of \$11.0 million was acquired for purchasing the property at 3300 Regatta Avenue in 2008. Other debt obligations, such as capital leases, changed slightly.

Changes in accounts payable and other liabilities were relatively insignificant.

Berkeley's Net Assets

Net assets represent the residual interest in Berkeley's assets after all liabilities are deducted. Berkeley's net assets at the end of 2008, totaling nearly \$3.2 billion, increased \$195 million, or 7%, during the year. Berkeley's net assets are reported in three major categories: invested in capital assets, restricted expendable, and unrestricted.

The portion of net assets invested in capital assets, net of accumulated depreciation, grew slightly from over \$2.2 billion in 2007 to over \$2.4 billion in 2008. The increase of \$187.8 million, mostly in buildings and improvements, represents Berkeley's continuing investment in its physical facilities and accounted for the majority of Berkeley's overall increase in its net assets.

Restricted expendable net assets of \$332.3 million at 2008 decreased \$17.5 million or 5% from 2007. These net assets are subject to externally imposed restrictions governing their use. They may be spent only in accordance with the external restrictions placed upon them and may include support received from gifts, appropriations, grants or contracts for specific programs or capital projects, or other third party receipts. There was a decrease of \$25.4 million in the restricted funds for capital projects due primarily to transfers of completed capital projects to buildings and other assets in invested in capital assets. Restricted gift funds for operational purposes grew \$7.9 million in 2008, while changes in other fund groups were insignificant.

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 Berkeley's unrestricted net assets of \$425.6 million are not subject to externally imposed restrictions, these net assets are typically allocated for academic and research initiatives or programs, for capital purposes, or other purposes.

University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

BERKELEY'S RESULTS OF OPERATIONS

The statement of revenues, expenses and changes in net assets is a presentation of Berkeley's operating results for the year. It indicates whether the financial condition has improved or deteriorated. In accordance with GASB requirements, certain significant revenues relied upon and budgeted for fundamental operational support of the core instructional mission of Berkeley are mandated to be recorded as nonoperating revenues, including state educational appropriations and private gifts. Berkeley's statement of revenues, expenses, and changes in net assets includes interest and insurance costs associated with the systemwide liabilities omitted from Berkeley's statement of net assets.

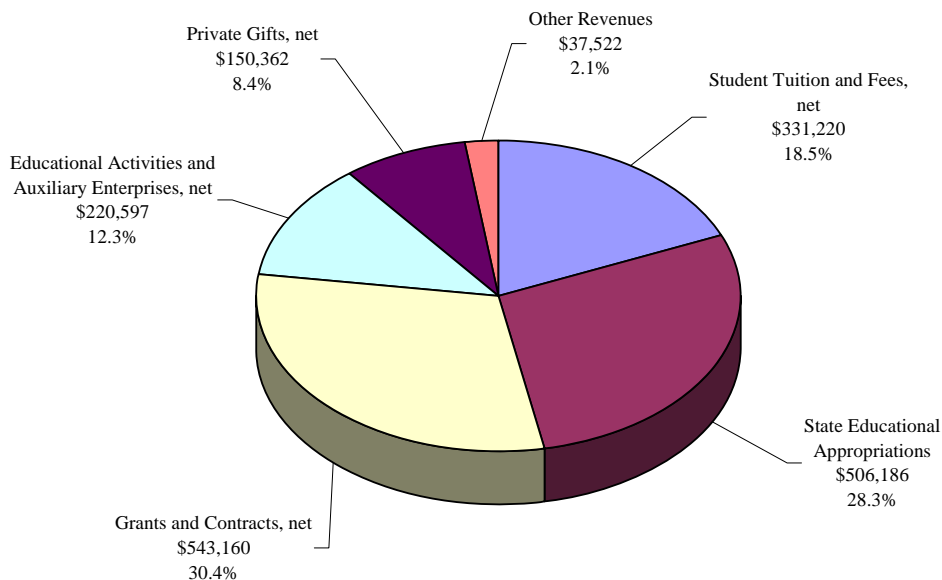
A summarized comparison of the operating results for 2008 and 2007, arranged in a format that matches the revenue supporting the core activities of Berkeley with the expenses associated with core activities, is as follows (in thousands of dollars):

	YEAR ENDED JUNE 30, 2008			YEAR ENDED JUNE 30, 2007			\$ Change	% Change
	Operating	Nonoperating	Total	Operating	Nonoperating	Total		
REVENUES								
Student tuition and fees, net	\$331,220		\$331,220	\$309,924		\$309,924	\$21,296	7%
State educational appropriations		\$506,186	506,186		\$475,242	475,242	30,944	7%
Grants and contracts, net	543,160		543,160	513,654		513,654	29,506	6%
Educational activities and auxiliary enterprises, net	220,597		220,597	200,788		200,788	19,809	10%
Private gifts, net		150,362	150,362		147,744	147,744	2,618	2%
Other revenues	18,463	19,059	37,522	15,522	18,264	33,786	3,736	11%
Revenues supporting core activities	1,113,440	675,607	1,789,047	1,039,888	641,250	1,681,138	107,909	6%
EXPENSES								
Salaries and benefits	1,136,462		1,136,462	1,038,325		1,038,325	98,137	9%
Scholarships and fellowships	75,736		75,736	76,757		76,757	(1,021)	(1%)
Utilities	35,927		35,927	34,238		34,238	1,689	5%
Supplies and materials	133,494		133,494	123,279		123,279	10,215	8%
Depreciation and amortization	132,408		132,408	130,868		130,868	1,540	1%
Other expenses	287,819	2,361	290,180	282,060		282,060	8,120	3%
Expenses associated with core activities	1,801,846	2,361	1,804,207	1,685,527	-	1,685,527	118,680	7%
Income (loss) from core activities	(\$688,406)	\$673,246	(15,160)	(\$645,639)	\$641,250	(4,389)	(10,771)	N/A
OTHER NONOPERATING ACTIVITIES								
Gain (loss) on disposal of capital assets, net of proceeds			(4,650)			35,460	(40,110)	N/A
Income (loss) before other changes in net assets			(19,810)			31,071	(50,881)	N/A
OTHER CHANGES IN NET ASSETS								
State capital appropriations			20,243			14,836	5,407	36%
Capital gifts and grants, net			68,887			26,037	42,850	N/A
Intercampus transfers			125,842			51,038	74,804	N/A
Increase in net assets			195,162			122,982	72,180	59%
NET ASSETS								
Beginning of year			2,986,143			2,863,161	122,982	4%
End of year			\$3,181,305			\$2,986,143	\$195,162	7%



University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

Categories of both operating and nonoperating revenues that support Berkeley's core activities in 2008 are as follows (in thousands of dollars):





Revenues to support Berkeley's core activities, including those classified as nonoperating revenues, were \$1.8 billion in 2008. These diversified sources of revenue increased in 2008 by \$107.9 million. State of California educational appropriations, in conjunction with student tuition and fees, are the core components that support the instructional mission of Berkeley. 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 Berkeley allow crucial flexibility to faculty for support of their fundamental activities or new academic initiatives. Other significant revenues are from educational activities and auxiliary enterprises such as student housing, food service operations and parking. The percentage of each revenue category of the total revenue of Berkeley's core activities remained approximately the same as in 2007.

2008		\$331,220
2007		\$309,924

Student tuition and fees revenue, net of scholarship allowances, grew \$21.3 million in 2008 to \$331.2 million. Gross student tuition and fees increased \$35.4 million, or 8.7%. The increase was primarily due to an 8% increase in the educational fee charged to most students, a 5% increase in non-resident tuition for undergraduate students, and rate increases for other fees, such as registration fees and summer sessions fees. The enrollment for undergraduate students and graduate students grew 3% and 2%, respectively, in 2008. Scholarship allowances increased \$14.1 million, or 14%, reflecting a greater proportion of aid used to pay tuition and fees. Consistent with past practices, a significant percentage of the revenue generated from tuition and fees was used for financial aid to mitigate the impact on students with financial need.

University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

2008		\$506,186
2007		\$475,242

Educational appropriations from the state of California that were allocated to Berkeley from the Office of the President of the University of California increased \$30.9 million, or 6.5%, to \$506.2 million in 2008. The increase reflected the state of California's increased fiscal year 2008 funding to the University of California, which was 6.4% above the fiscal year 2007 level. The increase was for basic budget support and student enrollment growth.

2008		\$543,160
2007		\$513,654

Grants and contracts revenue from federal, state, private and local government, including facilities and administration cost recovery, increased \$29.5 million, or 6%, to \$543.2 million in 2008. Federal grant and contract revenue represents support from a variety of agencies: Department of Health and Human Services, National Science Foundation, National Aeronautics and Space Administration (NASA) and Department of Education. In 2008, federal, state and local government contracts and grants remained approximately the same as in 2007. The bulk of the increase, \$28.9 million, was from private contracts and grants, including \$15.9 million from British Petroleum (BP) for the newly established Energy Biosciences Institute (EBI).

2008		\$220,597
2007		\$200,788

Revenue from *educational activities and auxiliary enterprises* increased \$19.8 million, or 10%, from 2007. The increase was from a wide variety of activities with rate increases, including workshop and conference fees, royalties and license fees, food sales and services and athletic ticket sales.

2008		\$150,362
2007		\$147,744

Private gifts, mainly restricted as to use, increased only \$2.6 million, or 2%, in 2008 as the economy tightened. Gifts may be made to Berkeley through UC or the Foundation. Berkeley continues to be aggressive in developing private gifts. It launched The Campaign for Berkeley, a landmark multi-year fundraising campaign to raise \$3 billion. In addition to private gifts for operating purposes, gifts are also received for capital purposes - recorded as capital gifts and grants - and for permanent endowments. The latter are recorded on UC's books.

2008		\$37,522
2007		\$33,786

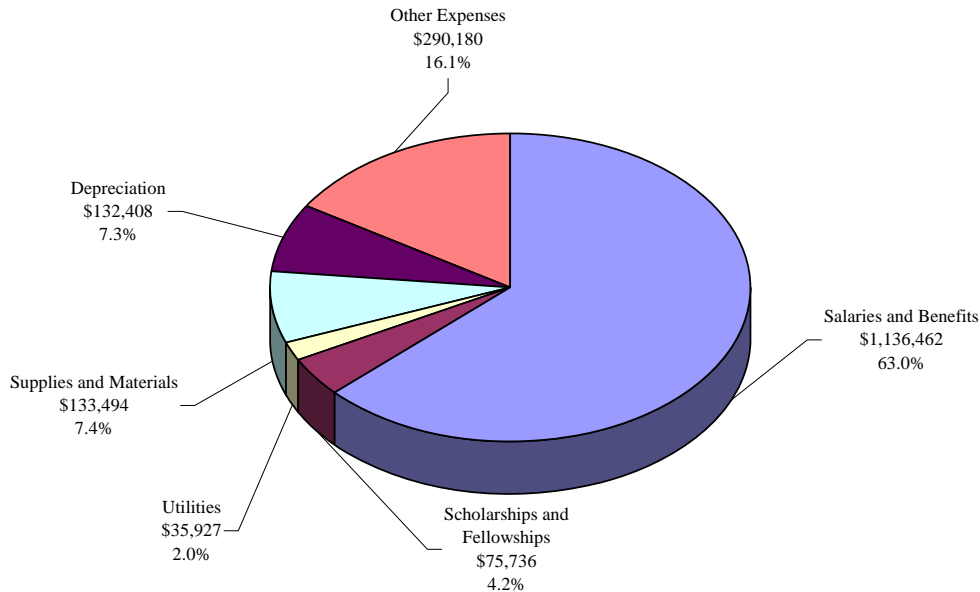
Other revenues for 2008 of \$37.5 million, including \$19.0 million of state financing appropriations reported as nonoperating revenue and \$18.5 million of other revenue, increased \$3.7 million from \$33.8 million in 2007. The state of California financing appropriation, which increased slightly in 2008, is directly related to the required rental payments under lease-

University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

purchase agreements with the state of California and deferred maintenance projects. An increase of \$2.7 million in other operating revenues was attributable to increased rental income from newly acquired properties.

Categories of expenses related to Berkeley's core activities in 2008 are as follows (in thousands of dollars):



Similar to its revenues to support core activities, Berkeley's expenses associated with core activities for 2008, including those classified as nonoperating expense, totaled \$1.8 billion. Berkeley's expenses associated with core activities increased \$118.7 million, or 7%, from 2007. About 63% of Berkeley's core expenses in 2008 were related to salaries and benefits, compared to 62% in 2007. The percentage of the other expense categories of Berkeley's total expenses related to core activities remained approximately the same as in 2007.



Salaries and benefits of \$1,136.4 million in 2008 (\$932.2 million of salaries and wages and \$204.2 million of benefits) grew by \$98.1 million, an increase of 9%. There were approximately 14,400 full time equivalent employees at Berkeley at 2008, an increase of 4% from 2007. Combined salaries and wages for both academic and administrative staff increased \$74.1 million, or 9%, from 2007. Total benefit costs increased \$24.0 million, or 13%. Health insurance costs continued to grow and increased \$7.5 million, or 12%, from 2007. All other benefit costs, including employer taxes, graduate student fee remission, and dental insurance, also increased.

University of California-Berkeley
MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

2008		\$75,736
2007		\$76,757

Scholarships and fellowships, representing payments of financial aid made directly to students and reported as an operating expense, totaled \$75.7 million in 2008, \$1.0 million less than 2007. However, scholarship allowances, also a form of scholarship and fellowship cost, increased in 2008 \$17.2 million to \$142.4 million. Scholarship allowances are reported as an offset to revenue, not as an operating expense. On a combined basis, as Berkeley continues its commitment to provide financial support for needy students, financial aid in all forms grew from \$202.0 million in 2007 to \$218.2 million in 2008, an increase of \$16.2 million, or more than 8%.

2008		\$35,927
2007		\$34,238

Utility costs increased by \$1.7 million, or 5%, to \$35.9 million in 2008, due primarily to increases in electrical rates.

2008		\$133,494
2007		\$123,279

Supplies and materials costs of \$133.5 million in 2008 increased \$10.2 million, or 8%, from 2007. Most of the increase was due to inflation on the costs for laboratory instruments and general supplies to support expanded research activity and student enrollment.

2008		\$132,408
2007		\$130,868

Depreciation expense increased \$1.5 million to \$132.4 million in 2008, reflecting the increase in capital assets.

2008		\$290,180
2007		\$282,060

Other expenses, including other nonoperating expenses, increased \$8.1 million, or 3%, to \$290.2 million in 2008. In 2008, there were increases across a variety of expense categories, including rent, computing, travel, and royalties. Also in 2008, interest expense increased as debt was incurred on facilities used in operations.

In accordance with the GASB's reporting standards, operating losses were \$688.4 million. However, these operating losses were substantially offset by \$673.2 million of net revenue and expenses that are required by the GASB to be classified as nonoperating, but clearly support operating activities. Therefore, revenue to support core activities was \$15.2 million less than the associated expenses in 2008. In 2007, there was a net loss of \$4.4 million from core activities. Net losses from core activities for a year are funded by net income carry forwards from previous years.

University of California-Berkeley

MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

Other Nonoperating Activities

Berkeley recorded a \$4.7 million loss on disposals of capital assets in 2008, compared to a \$35.5 million gain in 2007. The loss in 2008 was from a building demolition and the disposal of equipment. The significant gain in 2007 was due to several real estate sales. Those proceeds will be used for funding future capital asset transactions.

Other Changes in Net Assets

Similar to other nonoperating activities discussed above, other changes in net assets are generally not available to be used to support Berkeley's operating expenses in the current year.

State capital appropriations and capital gifts and grants may only be used for the purchase or construction of the specified capital asset. State capital appropriations increased \$5.4 million in 2008. The increase was for several building seismic improvement projects, including Doe Library and Campbell Hall.

Capital gifts and grants totaled \$68.9 million in 2008, increasing \$42.9 million from 2007. Most of the increase was associated with the Health Sciences Initiative to provide faculty and students with two state-of-the-art facilities that encourage cross-disciplinary research in human health.

Transfers of funds, primarily between Berkeley and UC's Office of the President, were a \$125.8 million addition to Berkeley's net assets in 2008, compared to a \$51.0 million addition in 2007, an increase of \$74.8 million. \$48.4 million of the increase was from the discontinuance of transferring the net operating income from Berkeley's housing and dining operations to the Office of the President. Another \$21.8 million of the increase was from debt financing for various capital projects. The remaining \$4.6 million net increase resulted from transfers from the Office of the President of endowment and short-term investment pool earnings and other operating funding, offset by transfers from Berkeley of recovered indirect costs and debt service payments.

BERKELEY'S CASH FLOWS

The statement of cash flows presents the significant sources and uses of cash (composed of cash in demand deposit accounts and Berkeley's cash equivalents).

A summary comparison of cash flows for 2008 and 2007 is as follows (in thousands of dollars):

	2008	2007	Change
Cash received from operations	\$1,125,871	\$1,061,853	\$64,018
Cash payments for operations	(1,605,676)	(1,536,411)	(69,265)
Net cash used by operating activities	(479,805)	(474,558)	(5,247)
Net cash provided by noncapital financing activities	654,536	627,523	27,013
Net cash used by capital and related financing activities	(169,858)	(179,003)	9,145
Net cash provided by transfers, net	125,842	51,038	74,804
Net increase in cash	130,715	25,000	105,715
Cash and cash equivalents, beginning of the year	846,564	821,564	25,000
Cash and cash equivalents, end of the year	\$977,279	\$846,564	\$130,715

Berkeley's cash and cash equivalents increased \$130.7 million from \$846.6 million in 2007 to \$977.3 million in 2008. Nearly \$479.8 million of cash was used for operating activities in 2008, offset by \$654.5 million provided by noncapital financing activities, resulting in \$174.7 million of cash before capital financing or transfer activities. Noncapital financing activities, as defined by the GASB, include state educational appropriations and gifts received for other than capital purposes that are used to support operating activities.

Cash of \$169.9 million and \$179.0 million in 2008 and 2007, respectively, was used for capital and related financing activities, primarily for purchases of capital assets and principal and interest payments, partially offset by sources that include

University of California-Berkeley
MANAGEMENT'S DISCUSSION AND ANALYSIS (unaudited)

state and federal capital appropriations, gifts for capital purposes and new external financing. During 2008, purchases of capital assets and debt service payments were greater than those in 2007 by \$72.4 million, while appropriations, gifts and proceeds from debt and capital asset sales increased \$81.5 million.

Cash from transfers between Berkeley and UC's Office of the President or other campuses totaled a net \$125.8 million addition to Berkeley's net assets in 2008, compared to a \$51.0 million addition in 2007. Funds that were received at Berkeley, primarily transfers from the Office of the President, included net income reserves from Berkeley's housing and dining operations, capital project funding, endowment income, earnings from the short-term investment pool and other operating funding. Funds that were transferred from Berkeley to the Office of the President included recovered indirect costs and Berkeley's share of debt service payments.