UNIVERSITY OF SOUTH ALABAMA

(A Component Unit of the State of Alabama)

Basic Financial Statements and Supplementary Information
on Federal Awards Programs

September 30, 2012

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

September 30, 2012 and 2011

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Introduction

The following discussion presents an overview of the financial position and financial activities of the University of South Alabama (the University), including the University of South Alabama Hospitals (the Hospitals), a division of the University, at September 30, 2012 and 2011 and for the years then ended. This discussion was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

The basic financial statements of the University consist of the University and its component units. The financial position and results of operations of the component units are either blended with the University's financial position and results of operations or are discretely presented. The treatment of each component unit is governed by pronouncements issued by the Governmental Accounting Standards Board. As more fully described in note 1 to the basic financial statements, the University of South Alabama Professional Liability Trust Fund, University of South Alabama General Liability Trust Fund and USA HealthCare Management, LLC are reported as blended component units. The University of South Alabama Foundation, the University of South Alabama Health Services Foundation, and the USA Research and Technology Corporation are discretely presented.

Financial Highlights

At September 30, 2012, 2011, and 2010, the University had total assets of $985,574,000, $920,197,000, and $917,157,000, respectively; total liabilities of $530,289,000, $503,301,000, and $497,886,000, respectively; and net assets of $455,285,000, $416,896,000, and $419,271,000, respectively. University net assets increased by $38,389,000 during the year ended September 30, 2012 compared to a decrease of $2,375,000 for the year ended September 30, 2011 and an increase of $18,959,000 for the year ended September 30, 2010.

An overview of each statement is presented herein along with a financial analysis of the transactions impacting each statement. Where appropriate, comparative financial information is presented to assist in the understanding of this analysis.

Analysis of Financial Position and Results of Operations

Statement of Net Assets

The statement of net assets presents the assets, liabilities, and net assets of the University at September 30, 2012 and 2011. The net assets are displayed in three parts: invested in capital assets, net of related debt, restricted and unrestricted. Restricted net assets may either be expendable or nonexpendable and are those assets that are restricted by law or external donor. Unrestricted net assets are generally designated for specific purposes, and are available for use by the University to meet current expenses for any purpose. The statement of net assets, along with all of the University's basic financial statements, is prepared under the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred by the University, regardless of when cash is exchanged.

Assets included in the statement of net assets are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, investments, and net patient accounts receivable. Of these amounts, cash and cash equivalents, investments, and patient accounts receivable comprise approximately 41%, 31%, and 9%, respectively, of current assets at September 30, 2012. Noncurrent assets at September 30, 2012 consist primarily of capital assets, restricted cash and cash equivalents, and restricted investments.

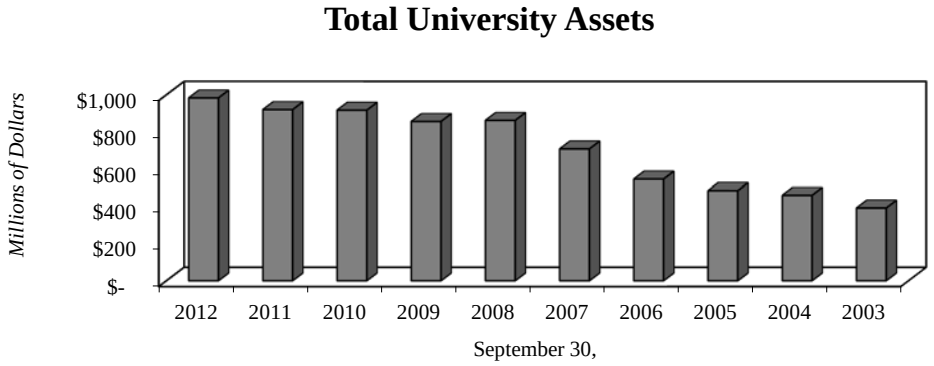
The Condensed Schedule of Net Assets at September 30, 2012, 2011, and 2010 follows (in thousands):

Condensed Schedule of Net Assets

		2012	2011	2010
Assets:				
Current	$	292,041	263,608	275,417
Capital assets		533,199	489,031	444,718
Other noncurrent		160,334	167,558	197,022
Total assets	$	985,574	920,197	917,157
Liabilities:				
Current	$	115,088	96,895	97,154
Noncurrent		415,201	406,406	400,732
Total liabilities	$	530,289	503,301	497,886
Net assets:				
Invested in capital assets, net of related debt	$	227,029	208,442	202,355
Restricted, nonexpendable		33,825	31,146	29,558
Restricted, expendable		48,201	43,227	42,053
Unrestricted		146,230	134,081	145,305
Total net assets	$	455,285	416,896	419,271

University cash, cash equivalents, and investments (current and noncurrent) increased between September 30, 2011 and 2012 by $28,418,000 to $347,648,000. This increase is due primarily to the issuance of the 2012-A and 2012-B bonds, net of the utilization of cash from the bond issue for various construction projects. This follows a decrease of $51,235,000 in cash, cash equivalents, and investments between 2010 and 2011, which was due primarily to the utilization of cash from the 2008 and 2010 bond issues for various construction projects.

Total assets of the University as of September 30 are as follows:



Net assets represent the residual interest in the University's assets after liabilities are deducted. Net assets are classified into one of four categories:

Net assets invested in capital assets, net of related debt, represent the University's capital assets less accumulated depreciation and outstanding principal balances of the debt attributable to the acquisition, construction, or improvement of those assets.

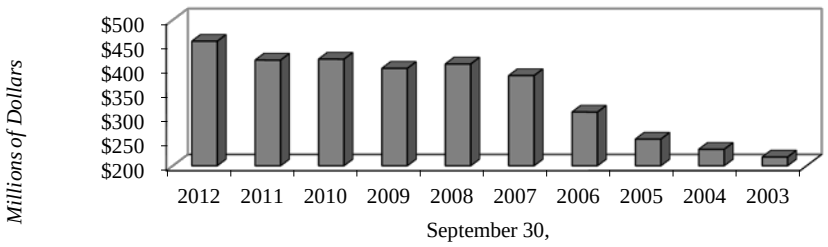
Restricted nonexpendable net assets consist primarily of the University's permanent endowment funds. While earnings from these funds may be expended, the corpus may not be expended for any reason and must remain intact with the University in perpetuity.

Restricted expendable net assets are subject to externally imposed restrictions governing their use. The funds are restricted primarily for debt service, capital projects, student loans, and scholarship purposes.

Unrestricted net assets represent those net assets not subject to externally imposed stipulations. Even though these funds are not legally restricted, the majority of the University's unrestricted net assets have been internally designated for various projects, all supporting the missions of the University. These unrestricted net assets include funds for various academic and research programs, auxiliary operations (including the bookstore, student housing and dining services), student programs, capital projects and general operations.

Net assets of the University as of September 30 are as follows:

University Net Assets



All categories of restricted net assets increased by approximately 10% between September 30, 2011 and 2012, primarily due to the addition of restricted gifts and grants to the University. Unrestricted net assets increased from $134,081,000 to $146,230,000 between September 30, 2011 and 2012 reflecting the results of University financial operations during fiscal year 2012.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total University net assets as reported in 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 this statement is to present the change in net assets resulting from revenues earned by the University, both operating and nonoperating, and the expenses incurred by the University, both operating and nonoperating, as well as any other revenues, expenses, gains, and losses earned or incurred by the University.

Generally, operating revenues have the characteristics of exchange transactions and are received or accrued for providing goods and services to the various customers and constituencies of the University. These include hospital patient care services, tuition and fees (net of scholarship discounts and allowances), most noncapital grants and contracts and revenues from auxiliary activities and sales and services of educational activities (primarily athletic activities). Operating expenses are those expenses paid or incurred to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University.

Nonoperating revenues have the characteristics of nonexchange transactions and are revenues generally earned for which goods and services are not provided, such as investment income, capital appropriations, gifts and other contributions. State appropriations are required by the Governmental Accounting Standards Board to be classified as nonoperating revenues. Nonoperating expenses are those expenses required in the operation and administration of the University, but not directly incurred to acquire or produce the goods and services provided in return for operating revenues. Such nonoperating expenses include interest on the University's indebtedness and losses related to the disposition of capital assets.

The Condensed Schedule of Revenues, Expenses, and Changes in Net Assets for the years ended September 30, 2012, 2011, and 2010 follows (in thousands):

Condensed Schedule of Revenues, Expenses, and Changes in Net Assets

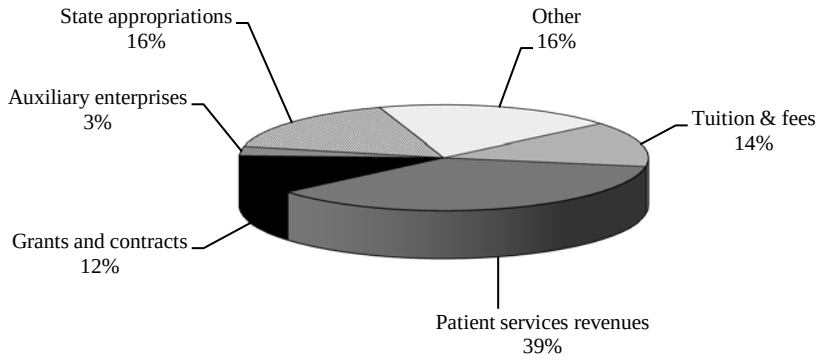
	2012	2011	2010
Operating revenues:			
Tuition and fees	$ 88,299	81,557	69,212
Net patient service revenue	247,802	227,039	228,524
Federal, state and private grants and contracts	76,448	79,780	76,983
Other	56,579	47,790	47,121
	469,128	436,166	421,840
Operating expenses:			
Salaries and benefits	396,170	390,002	378,188
Supplies and other services	134,841	136,749	128,973
Other	51,222	53,224	49,197
	582,233	579,975	556,358
Operating loss	(113,105)	(143,809)	(134,518)
Nonoperating revenues (expenses):			
State appropriations	105,639	96,948	97,860
State appropriated – ARRA funds	—	10,769	10,769
Investment income (loss)	14,561	(6,335)	9,278
Other, net	12,197	13,375	10,369
Net nonoperating revenues	132,397	114,757	128,276
Income (loss) before capital appropriations, capital contributions and additions to endowment	19,292	(29,052)	(6,242)
Capital appropriations, capital contributions and additions to endowment	19,097	26,677	25,201
Change in net assets	38,389	(2,375)	18,959
Beginning net assets	416,896	419,271	400,312
Ending net assets	$ 455,285	416,896	419,271

In 2012, 2011, and 2010, approximately 39%, 38%, and 39%, respectively, of total revenues of the University were net patient service revenue. Excluding net patient service revenue, state appropriations represent the largest component of total university revenues, approximately 16% of total revenues in fiscal 2012. Also in 2012, net

tuition and fees charged to students and grants and contracts (federal, state and private) represented approximately 14% and 12% of total revenues, respectively.

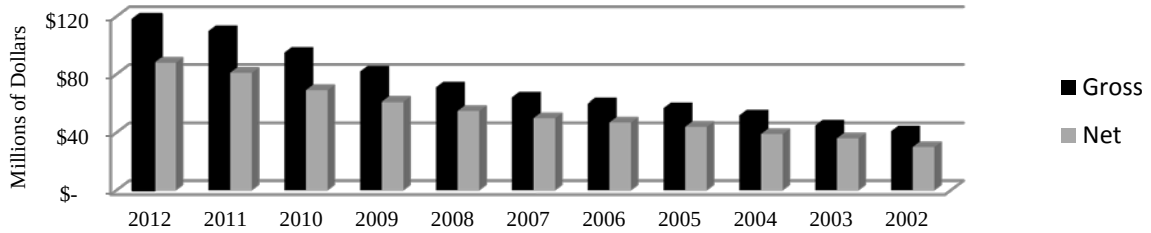
A summary of University revenues for the year ended September 30, 2012 is presented below:

Total Revenues



Tuition and fees have increased in each of the last ten years. These increases are due primarily to increases in tuition and fee rates charged to students as well as to an increase in the number of students enrolled and credit hours taken by those students. Additionally, net tuition and fees as a percent of total operating revenues continue to increase, from 9.5% of operating revenues in 2002 to 18.8% in 2012. Tuition and fees, gross and net of scholarship allowances, for the past eleven fiscal years are as follows:

Tuition and Fee Revenue

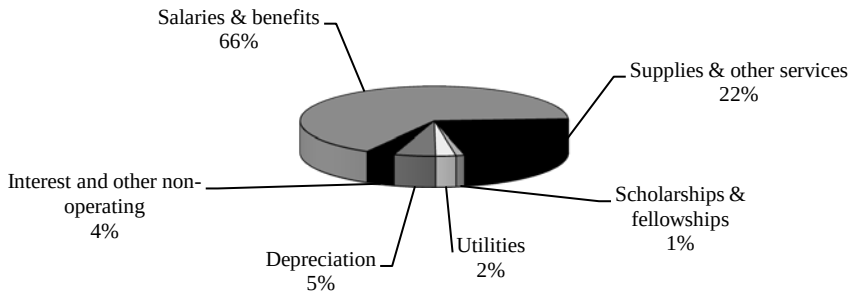


Other operating revenues increased by $6,778,0000 to $38,701,000 for the year ended September 30, 2012 primarily due to an increase in revenues from the Electronic Health Records Incentive Program.

Capital contributions and grants decreased from $23,247,000 in 2011 to $15,103,000 in 2012 due to a decrease in grant funds received for construction of Shelby Hall. The University recognized $239,000 in capital appropriations in 2012, compared to $20,000 in 2011. The 2012 appropriations were utilized in the renovation of the Student Center. Additionally, the University received revenue in the amount of $10,769,000 in 2011 appropriated by the State of Alabama pursuant to the American Recovery and Reinvestment Act (ARRA) of 2009. No state appropriated ARRA funds were received during the year ended September 30, 2012.

University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2012 is presented below:

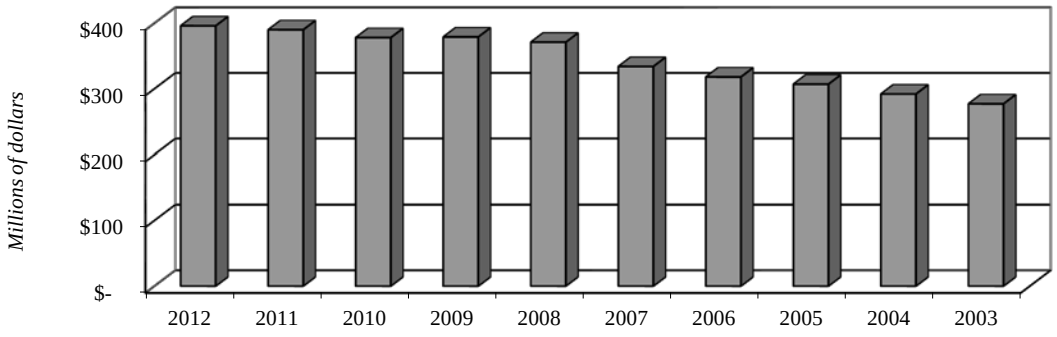
Total Expenses



While the University reports its expenses on a natural expense classification basis, functional classifications represent expenses categorized based on the function within the University. Such University functions include instruction, research, public service, academic support, student services, institutional support, scholarships, and operation and maintenance of plant. Expenses related to auxiliary enterprise activities and the hospitals are presented separately. Functional expense information is presented in note 15 to the basic financial statements.

In 2012, 2011, and 2010, approximately 68%, 67% and 68%, respectively, of the University's total operating expenses were salaries and benefits. After steady increases from 2003 to 2008, salaries and benefits have been consistent since 2008, as follows:

Total Salaries and Benefits Expense

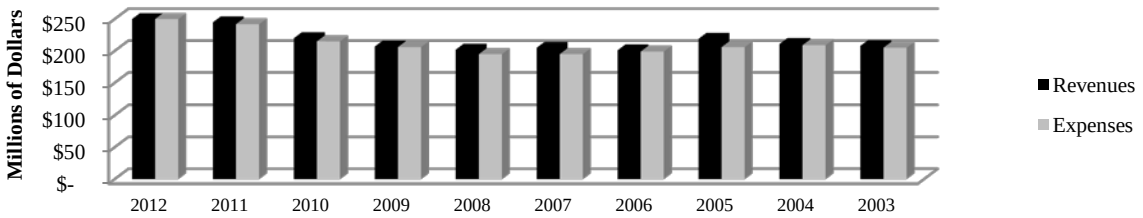


For the years ended September 30, 2012, 2011, and 2010, the University reported an operating loss of approximately $113,105,000, $143,809,000, and $134,518,000, respectively. Operating losses are offset partially by state appropriations, which are reported as nonoperating revenue. After adding state appropriations and other nonoperating revenues and expenses, (primarily capital appropriations, capital contributions, and additions to

endowment) the total change in net assets was approximately $38,389,000, $(2,375,000), and $18,959,000, for the years ended September 30, 2012, 2011, and 2010, respectively.

The Hospitals represent a significant portion of total University revenues and expenses and have remained relatively constant over the past four years. Operating hospital revenues and expenses for the last ten fiscal years are presented below:

Hospital Operating Revenues and Expenses



Statement of Cash Flows

The statement of cash flows presents information related to cash flows of the University. This statement presents cash flows by category: operating activities, noncapital financing activities, capital and related financing activities and investing activities. The net cash provided to, or used by, the University is presented by category.

Capital Assets and Debt Administration

Total capital asset additions for the University were approximately $74,972,000 in 2012. During 2012, the Campus Entrance Portals, Stokes Hall, and the renovation of the University Bookstore were placed into service. Significant construction projects that remain in progress at September 30, 2012 include the expansion of Children's and Women's Hospital, Shelby Hall, a major renovation of the Student Center and a new Student Housing Facility. Major projects completed and placed into service in fiscal 2010 and 2011 included the Student Recreation Center, Moulton Tower, the Glass Blowing Studio, a Student Dining Facility and various other smaller projects. At September 30, 2012, the University has outstanding commitments of approximately $42,236,000 for various capital projects.

In a prior year, the State of Alabama made allocations from state bond issues to the University in the amount of $21,332,000. During 2012, $239,000 was recognized by the University and is reported as a capital appropriation. $4,830,000 remains unspent at September 30, 2012.

In January 2012, the University issued the University Facilities Revenue Capital Improvement Bonds, Series 2012-A and 2012-B, with a face value of $32,740,000. The net proceeds of these bonds will be used to fund the construction of new student housing as well as other construction and capital projects on the main campus of the University, the Hospitals and the Mitchell Cancer Institute.

In order to realize debt service savings currently from future debt refunding, in January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to a counterparty and resulted in an up-front

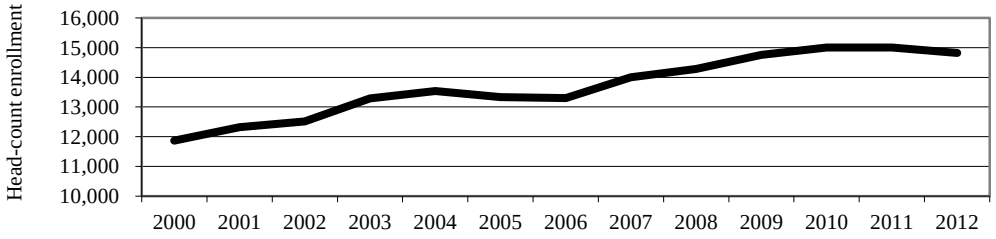
payment to the University totaling $9,328,000 in exchange for selling the counterparty the option to enter into an interest rate swap with respect to the Series 2004 and 2006 bonds. A portion of this payment is considered a borrowing and is included in the long-term debt of the University. The fair value component of the refunding associated with the swaps is considered an investment derivative and, as such, the change in the fair value component is reflected as a component of investment income in 2012, 2011 and 2010.

In March 2012, the University's bond credit rating was downgraded by Moody's Investors Services from Aa3 to A1. This represents the first change in the University's bond credit rating since it was upgraded from A1 to Aa3 in 2010. The University also has a rating of A+ from Standard and Poor's Ratings Services, which did not change in 2012.

Economic Outlook

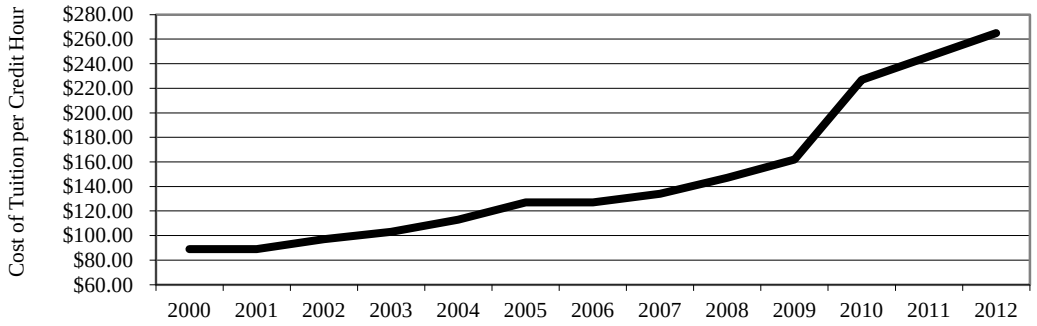
Student enrollment and tuition and fee rates have both increased over the past twelve years. The University has experienced an increase in enrollment between 2000 and 2012, from 11,870 in 2000 to 14,883 for the 2012 fall semester. The enrollment trend for the University between 2000 and 2012 is as follows:

Enrollment Growth Summary



In that same time period, in-state tuition per credit hour has increased by approximately 198%. The large increase in 2010 is the result of the University's bundling of tuition and required fees into a single per-hour charge. Similar increases have been experienced in out-of-state tuition and College of Medicine tuition. The trend of in-state tuition per credit hour between 2000 and 2012 is as follows:

Tuition per Credit Hour



While enrollment and tuition have both increased in recent years, state appropriations prior to 2006 were relatively flat. However, in the 2008, 2007 and 2006 fiscal years, the University experienced increases of 16%, 19% and 17%, respectively, or approximately $19,349,000, $19,185,000 and $14,581,000, respectively, in its state appropriation. These increases were unusually high. For the 2009 fiscal year, the University's original state appropriation decreased 12.8% or approximately $17,882,000. Additionally, in December 2008 the Governor of Alabama announced proration of 9%, or approximately $10,967,000; and in July 2009, the Governor announced additional proration of 2%, or approximately $2,437,000. Therefore, the total decrease in the 2009 state appropriation was approximately $31,286,000 to $108,451,000, or 22.4% lower than in 2008.

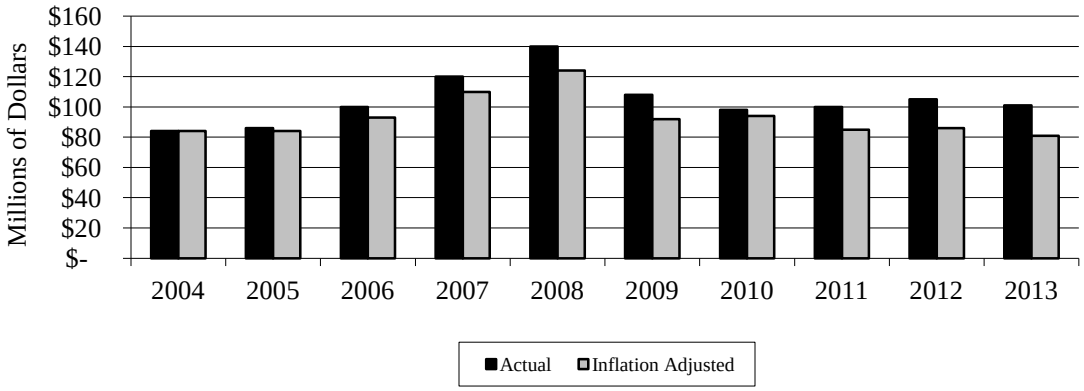
A state appropriation in the amount of approximately $108,286,000 was authorized for the year ended September 30, 2010. In September 2009, the Governor announced proration of 7.5%, or approximately $8,264,000; and in September 2010, the Governor announced additional proration of 2%, or approximately $2,162,000. Therefore, the total decrease from the original authorized 2010 state appropriation was approximately $10,426,000 to $97,860,000, or 9.6% lower than the original appropriation and 9.8% lower than actual 2009 amounts received.

A state appropriation in the amount of approximately $105,639,000 was authorized and received for the year ended September 30, 2012.

A state appropriation in the amount of approximately $101,295,000 has been authorized for the year ending September 30, 2013. This represents a $4,096,000 decrease from the fiscal 2012 appropriation received. While no announcement has been made, the University is aware that reductions in its 2013 appropriation are possible.

The ten-year trend of state appropriations for the University is as follows:

State Appropriations - Ten-year Trend



In addition to state appropriations, the University is subject to declines in general economic conditions in the United States and, specifically, the State of Alabama. Declines in financial markets over the past few years have had a significant impact on the value of the University's endowment. While financial markets were relatively flat over the past two years, further weakening of the economy could have a potential further negative impact on the University's enrollment, extramural funding, endowment performance, and health care operations.

In early 2009, ARRA was passed by Congress and signed into law by the President. As a result of this legislation, the University was awarded and received approximately $10,769,000 in both 2010 and 2011 through the U.S. Department of Education's State Fiscal Stabilization Fund Program. No additional ARRA State Fiscal Stabilization funds were received in 2012, nor are anticipated in 2013. Additional funding was available through the competitive grant process from various federal agencies. As of September 30, 2012, the University had been awarded ARRA grants totaling approximately $51,097,000.

Other than the issues presented above, University administration is not aware of any other currently known facts, decisions, or conditions that are expected to have a significant effect on the University's financial position or results of operations during fiscal year 2013 beyond those unknown variables having a global effect on virtually all types of business operations.

Requests for Information

These basic financial statements are designed to provide a general overview of the University of South Alabama and its component units' financial activities and to demonstrate the University's accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Mr. M. Wayne Davis; Vice-President for Financial Affairs; University of South Alabama – Room 170; Mobile, Alabama 36688. These basic financial statements can be obtained from our website at http:www.southalabama.edu/financialaffairs/businessoffice/statements.html.

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Independent Auditors' Report

The Board of Trustees
University of South Alabama:

We have audited the accompanying basic financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units as of and for the years ended September 30, 2012 and 2011, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the 2012 and 2011 consolidated financial statements of the University of South Alabama Foundation, which represents 80%, 101% and 14%, respectively, of the 2012 assets, net assets, and revenues, gains and other support of the discretely presented component units and 81%, 102% and 29%, respectively, of the 2011 assets, net assets, and revenues, gains and other support of the discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the University of South Alabama Foundation, is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The financial statements of the University of South Alabama Foundation, the University of South Alabama Health Services Foundation, the USA Research and Technology Corporation, and the Professional and General Liability Trust Funds were not audited in accordance with *Government Auditing Standards*. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinions.

As discussed in note 1, the financial statements of the University are intended to present the financial position, changes in financial position and, where applicable, cash flows of only that portion of the basic financial statements and the aggregate discretely presented component units of the State of Alabama that is attributable to the transactions of the University. They do not purport to, and do not, present fairly the financial position of the State of Alabama as of September 30, 2012 and 2011, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

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In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University and of its aggregate discretely presented component units as of September 30, 2012 and 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2012, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 2 through 12 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audits were conducted for the purpose of forming opinions on the financial statements that collectively comprise the University's basic financial statements. The accompanying Schedule of Expenditures of Federal Awards for the year ended September 30, 2012 is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule of Expenditures of Federal Awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

November 15, 2012

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Statements of Net Assets

September 30, 2012 and 2011

(In thousands)

	2012	2011
Assets:		
Current assets:		
Cash and cash equivalents	$ 120,227	100,967
Investments	91,193	79,620
Net patient accounts receivable, (net of allowance for doubtful accounts of $54,220 and $55,269)	26,838	33,707
Accounts receivable, affiliates	22,218	21,350
Accounts receivable, other	17,635	15,367
Notes receivable, net	4,630	4,896
Prepaid expenses, inventories, and other	9,300	7,701
Total current assets	292,041	263,608
Noncurrent assets:		
Restricted cash and cash equivalents	95,374	77,918
Restricted investments	39,969	60,003
Investments	885	722
Accounts receivable	5,239	7,012
Notes receivable, net	10,782	14,016
Other noncurrent assets	8,085	7,887
Capital assets, net	533,199	489,031
Total noncurrent assets	693,533	656,589
Total assets	985,574	920,197
Liabilities:		
Current liabilities:		
Accounts payable and accrued liabilities	57,513	47,072
Deferred revenue	44,306	39,394
Deposits	2,479	2,158
Current portion of long-term debt	10,790	8,271
Total current liabilities	115,088	96,895
Noncurrent liabilities:		
Long-term debt, less current portion	348,909	324,873
Other long-term liabilities	66,292	81,533
Total noncurrent liabilities	415,201	406,406
Total liabilities	530,289	503,301
Net assets:		
Invested in capital assets, net of related debt	227,029	208,442
Restricted, nonexpendable:		
Scholarships	14,685	13,892
Other	19,140	17,254
Restricted, expendable:		
Scholarships	10,323	8,917
Other	37,878	34,310
Unrestricted	146,230	134,081
Total net assets	$ 455,285	416,896

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2012 and 2011

(In thousands)

Assets		**2012**	**2011**
Cash and cash equivalents	$	671	775
Investments:			
Equity securities		104,498	110,579
Timber and mineral properties		153,574	153,432
Real estate		31,040	27,973
Other		5,522	5,531
Other assets		768	1,009
Total assets	$	296,073	299,299
Liabilities and Net Assets			
Liabilities:			
Accounts payable	$	182	76
Note payable - University of South Alabama		11,493	15,085
Other liabilities		637	642
Total liabilities		12,312	15,803
Net assets:			
Unrestricted		61,628	63,177
Temporarily restricted		52,887	51,393
Permanently restricted		169,246	168,926
Total net assets		283,761	283,496
Total liabilities and net assets	$	296,073	299,299

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA
HEALTH SERVICES FOUNDATION
(Discretely Presented Component Unit)

Statements of Financial Position

September 30, 2012 and 2011

(In thousands)

Assets		2012	2011
Current assets:			
Cash and cash equivalents	$	234	859
Patient accounts receivable (net of allowance for uncollectible accounts of approximately $5,873 and $5,307)		13,969	9,120
Other current assets		1,196	1,121
Total current assets		15,399	11,100
Interest in assets of University of South Alabama Professional Liability Trust Fund		20,218	21,016
Property and equipment, net		4,388	2,961
Total assets	$	40,005	35,077
Liabilities and Net Deficit			
Current liabilities:			
Accounts payable	$	1,914	1,190
Due to affiliates		21,715	20,790
Total current liabilities		23,629	21,980
Estimated professional liability costs		20,218	21,016
Total liabilities		43,847	42,996
Net deficit		(3,842)	(7,919)
Total liabilities and deficit	$	40,005	35,077

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Net Assets

September 30, 2012 and 2011

(In thousands)

	2012	2011
Assets:		
Current assets:		
Unrestricted cash and cash equivalents	$ 1,487	1,072
Restricted cash and cash equivalents	253	594
Investments	—	225
Rent receivable	268	237
Grant receivable	—	277
Prepaid expenses and other current assets	4	7
Total current assets	2,012	2,412
Noncurrent assets:		
Intangible assets, net	145	177
Capital assets, net	25,242	26,055
Total noncurrent assets	25,387	26,232
Deferred outflows	4,889	4,629
Total assets and deferred outflows	32,288	33,273
Liabilities:		
Current liabilities:		
Deposits, other current liabilities, and accrued expenses	195	314
Payable to University of South Alabama	12	—
Deferred rent income	400	395
Current portion of notes payable	946	881
Total current liabilities	1,553	1,590
Noncurrent liabilities:		
Notes payable, excluding current portion	24,287	25,233
Interest rate swap	4,889	4,629
Total noncurrent liabilities	29,176	29,862
Total liabilities	30,729	31,452
Net assets:		
Invested in capital assets, net of related debt	311	447
Unrestricted	1,248	1,374
Total net assets	$ 1,559	1,821

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2012 and 2011

(In thousands)

	2012	2011
Operating revenues:		
Tuition and fees (net of scholarship allowances of $29,770 and $29,025)	$ 88,299	81,557
Net patient service revenue	247,802	227,039
Federal grants and contracts	20,573	22,851
State grants and contracts	6,292	5,955
Private grants and contracts	49,583	50,974
Auxiliary enterprises (net of scholarship allowances of $873 and $871)	17,878	15,867
Other operating revenues	38,701	31,923
Total operating revenues	469,128	436,166
Operating expenses:		
Salaries and benefits	396,170	390,002
Supplies and other services	134,841	136,749
Scholarships and fellowships	6,272	6,690
Utilities	14,554	14,480
Depreciation and amortization	30,396	32,054
Total operating expenses	582,233	579,975
Operating loss	(113,105)	(143,809)
Nonoperating revenues (expenses):		
State appropriations	105,639	96,948
State appropriated – ARRA funds	—	10,769
Investment income (loss)	14,561	(6,335)
Interest expense	(13,775)	(14,128)
Other nonoperating revenues	32,996	31,927
Other nonoperating expenses	(7,024)	(4,424)
Net nonoperating revenues	132,397	114,757
Income (loss) before capital appropriations, capital contributions and grants, and additions to endowment	19,292	(29,052)
Capital appropriations	239	20
Capital contributions and grants	15,103	23,247
Additions to endowment	3,755	3,410
Change in net assets	38,389	(2,375)
Net assets:		
Beginning of year	416,896	419,271
End of year	$ 455,285	416,896

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statement of Activities and Changes in Net Assets

Year ended June 30, 2012

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Net realized and unrealized gains on investments	$ 5,513	768	—	6,281
Rents, royalties and timber sales	4,255	—	18	4,273
Interest and dividends	611	1,230	7	1,848
Gifts	—	—	195	195
Other income	5	—	—	5
Required match of donor contributions	(100)	—	100	—
Interfund interest	(88)	88	—	—
Transfer	(864)	864	—	—
Net assets released from program restrictions	1,456	(1,456)	—	—
Total revenues, gains, and other support	10,788	1,494	320	12,602
Expenditures:				
Program services:				
Faculty support	2,307	—	—	2,307
Scholarships	1,023	—	—	1,023
Other	1,096	—	—	1,096
Total program service expenditures	4,426	—	—	4,426
Management and general	1,653	—	—	1,653
Other investment expense	1,638	—	—	1,638
Depletion expense	4,135	—	—	4,135
Depreciation expense	77	—	—	77
Interest expense	408	—	—	408
Total expenditures	12,337	—	—	12,337
Increase (decrease) in net assets	(1,549)	1,494	320	265
Net assets – beginning of year	63,177	51,393	168,926	283,496
Net assets – end of year	$ 61,628	52,887	169,246	283,761

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statement of Activities and Changes in Net Assets

Year ended June 30, 2011

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Net realized and unrealized gains (losses) on investments	$ 12,852	12,258	(22)	25,088
Rents, royalties and timber sales	4,149	—	22	4,171
Interest and dividends	712	1,094	7	1,813
Gifts	—	—	21	21
Other income	148	1	—	149
Required match of donor contributions	(12)	1	11	—
Interfund interest	(92)	92	—	—
Net assets released from program restrictions	1,173	(1,173)	—	—
Total revenues, gains, and other support	18,930	12,273	39	31,242
Expenditures:				
Program services:				
Faculty support	2,154	—	—	2,154
Scholarships	945	—	—	945
Other	1,071	—	—	1,071
Total program service expenditures	4,170	—	—	4,170
Management and general	1,622	—	—	1,622
Other investment expense	1,682	—	—	1,682
Depletion expense	3,534	—	—	3,534
Depreciation expense	67	—	—	67
Interest expense	305	—	—	305
Total expenditures	11,380	—	—	11,380
Increase in net assets	7,550	12,273	39	19,862
Net assets – beginning of year	55,627	39,120	168,887	263,634
Net assets – end of year	$ 63,177	51,393	168,926	283,496

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA
HEALTH SERVICES FOUNDATION
(Discretely Presented Component Unit)

Statements of Operations and Changes in Net Deficit

Years ended September 30, 2012 and 2011

(In thousands)

	2012	2011
Unrestricted revenues, gains and other support:		
Net patient service revenue	$ 66,026	65,152
Other revenue	8,410	7,857
Total unrestricted revenues, gains, and other support	74,436	73,009
Expenses:		
Salaries and benefits	48,328	47,667
General and administrative	7,064	13,363
Provision for uncollectible accounts	11,670	12,426
Depreciation and amortization	1,270	1,065
Total expenses	68,332	74,521
Operating income (loss)	6,104	(1,512)
Nonoperating gains	2,173	1,831
Revenues over expenses	8,277	319
Transfer of capital to University of South Alabama, College of Medicine	(4,200)	(3,343)
Change in deficit	4,077	(3,024)
Net deficit at beginning of year	(7,919)	(4,895)
Net deficit at end of year	$ (3,842)	(7,919)

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2012 and 2011

(In thousands)

	2012	2011
Operating revenues	$ 4,003	4,041
Operating expenses:		
Building management and operating expenses	1,367	1,119
Depreciation and amortization	1,137	941
Legal and administrative fees	222	177
Insurance	120	110
Lease termination expense	—	5
Total operating expenses	2,846	2,352
Operating income	1,157	1,689
Nonoperating revenues (expenses):		
Investment income	9	7
Interest expense	(1,458)	(1,550)
Abandoned development and tenant improvement costs	(158)	—
Loan refinancing expense	—	(49)
Donation revenue	—	2
Other	5	(14)
Net nonoperating expenses	(1,602)	(1,604)
Capital grant	183	277
Change in net assets	(262)	362
Net assets:		
Beginning of year	1,821	1,459
End of year	$ 1,559	1,821

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Statements of Cash Flows

Years ended September 30, 2012 and 2011

(In thousands)

	2012	2011
Cash flows from operating activities:		
Receipts related to tuition and fees	$ 89,347	83,753
Receipts from and on behalf of patients and third-party payers	253,766	225,158
Receipts from grants and contracts	73,694	79,165
Receipts related to auxiliary enterprises	17,995	17,041
Payments to suppliers and vendors	(161,308)	(127,826)
Payments to employees and related benefits	(383,158)	(408,644)
Payments for scholarships and fellowships	(6,272)	(6,690)
Other operating receipts	46,995	35,582
Net cash used in operating activities	(68,941)	(102,461)
Cash flows from noncapital financing activities:		
State appropriations	105,639	96,948
State appropriated – ARRA funds	—	11,548
Endowment gifts	3,755	3,410
Agency funds received	1,361	1,112
Agency funds disbursed	(1,007)	(679)
Student loan program receipts	115,253	91,984
Student loan program disbursements	(115,884)	(91,969)
Other nonoperating revenues	27,569	26,874
Other nonoperating expenses	(7,339)	(4,424)
Net cash provided by noncapital financing activities	129,347	134,804
Cash flows from capital and related financing activities:		
Capital contributions and grants	15,718	23,485
Purchases of capital assets	(71,804)	(79,219)
Proceeds from sale of capital assets	3,419	3,942
Proceeds from issuance of capital debt	32,740	—
Principal payments on capital debt	(8,033)	(6,404)
Interest payments on capital debt	(13,951)	(13,597)
Net cash used in capital and related financing activities	(41,911)	(71,793)
Cash flows from investing activities:		
Interest and dividends on investments	2,946	1,590
Purchases of investments	(22,330)	(29,581)
Proceeds from sales of investments	37,605	45,163
Net cash provided by investing activities	18,221	17,172
Net increase (decrease) in cash and cash equivalents	36,716	(22,278)
Cash and cash equivalents (unrestricted and restricted):		
Beginning of year	178,885	201,163
End of year	$ 215,601	178,885

(Continued)

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Statements of Cash Flows

Years ended September 30, 2012 and 2011

(In thousands)

		2012	2011
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(113,105)	(143,809)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation and amortization expense		30,396	32,054
Changes in assets and liabilities, net:			
Student receivables		(1,182)	(212)
Net patient accounts receivables		6,868	(2,852)
Grants and contracts receivables		(5,378)	290
Other receivables		3,201	8,033
Prepaid expenses, inventories, and other		(15,458)	1,667
Accounts payable and accrued liabilities		15,555	(302)
Deferred revenue		10,162	2,670
Net cash used in operating activities	$	(68,941)	(102,461)
Noncash investing, noncapital financing, and capital and related financing transactions:			
Net increase (decrease) in fair value of investments recognized as a component of investment income	$	11,490	(7,357)
Additional maturity on capital appreciation on bonds payable and other borrowings recorded as interest expense		2,086	2,151
Payments on behalf of the University by the Alabama Public School and College Authority reducing purchases of capital assets		239	20
Gifts of capital and other assets		513	3,805
Pledges of operating and capital gifts		1,064	1,666
Capitalization of construction period interest		2,466	1,243
Increase (decrease) in accounts payable related to capital assets		3,516	(513)

See accompanying notes to basic financial statements.

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

The accompanying basic financial statements present the financial position and activities of the University of South Alabama (the University), which is a component unit of the State of Alabama. The financial statements of the University are intended to present the financial position, changes in financial position and, where applicable, cash flows of only that portion of the basic financial statements and the aggregate discretely presented component units of the State of Alabama that is attributable to the transactions of the University.

The financial reporting entity, as defined by Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity*, and amended by GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units*, consists of the primary government and all of its component units. Component units are legally separate organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the financial statements to be misleading or incomplete. Accordingly, the basic financial statements include the accounts of the University, as the primary government, and the accounts of the following entities as component units.

The University has adopted GASB Statement No. 39, which provides criteria for determining whether certain organizations should be reported as component units based on the nature and significance of their relationship with the primary government. The statement also clarifies reporting requirements for those organizations. Based on these criteria as of September 30, 2012 and 2011, the University reports the University of South Alabama Foundation (USA Foundation), the University of South Alabama Health Services Foundation (USAHSF), and the USA Research and Technology Corporation (the Corporation) as discretely presented component units.

The University is also affiliated with the South Alabama Medical Science Foundation (SAMSF). This entity is not considered a component unit of the University under the provisions of GASB Statement Nos. 14 and 39 because the University does not consider SAMSF significant enough to warrant inclusion in the University's reporting entity (see note 13 for further discussion of this entity).

GASB Statement No. 14 requires the University, as the primary government, to include in its financial statements, as a component unit, organizations that, even though they are legally separate entities, meet certain requirements as defined by GASB Statement No. 14. Based on these criteria, the University reports the Professional Liability Trust Fund, the General Liability Trust Fund and the USA HealthCare Management, LLC as blended component units. All significant transactions among the University and its blended component units have been eliminated.

(b) USA HealthCare Management, LLC

In June 2010, the University's Board of Trustees approved the formation of the USA HealthCare Management, LLC (the LLC). The LLC was organized for the purpose of managing and operating on behalf of, and as agent for, substantially all of the health care clinical enterprise of the University.

The University is the sole member of the LLC. The LLC commenced operations in October 2010 and is reported as a blended component unit.

(c) Professional Liability and General Liability Trust Funds

The medical malpractice liability of the University is maintained and managed in a separate professional liability trust fund (the PLTF) in which the University, USAHSF, LLC and SAMSF are the only participants. In accordance with the bylaws of the trust fund, the president of the University is responsible for appointing members of the trust fund policy committee. Additionally, the general liability of the University, USAHSF, LLC, SAMSF and the Corporation is maintained and managed in a general liability trust fund (the GLTF) for which the University, as defined by GASB Statement No. 14, is responsible. The PLTF and GLTF are separate legal entities which are governed by the University Board of Trustees through the University president. As such, PLTF and GLTF are reported as blended component units.

(d) University of South Alabama Foundation

The USA Foundation is a not-for-profit foundation that was organized for the purpose of promoting education, scientific research, and charitable purposes, and to assist in developing and advancing the University in furthering, improving, and expanding its properties, services, facilities, and activities. Because of the significance of the relationship between the University and the USA Foundation, the USA Foundation is considered a component unit of the University. The Board of Directors of the USA Foundation is not appointed or controlled by the University. The University receives distributions from the USA Foundation primarily for scholarship, faculty and other support. Total distributions received or accrued by the University for the years ended September 30, 2012 and 2011 were $4,258,000 and $4,155,000, respectively, and are primarily included in other nonoperating revenues and capital contributions and grants in the University's statements of revenues, expenses, and changes in net assets. The USA Foundation presents its financial statements in accordance with standards issued by the Financial Accounting Standards Board (FASB). The USA Foundation is reported in separate financial statements because of the difference in the financial reporting format since the USA Foundation follows FASB rather than GASB pronouncements. The USA Foundation has a June 30 fiscal year end which differs from the University's September 30 fiscal year end. In accordance with GASB Statement No. 14, this discretely presented unit has been included with the most recent fiscal year. The consolidated statements of financial position and the consolidated statements of activities and changes in net assets for the USA Foundation as of and for the years ended June 30, 2012 and 2011 are discretely presented following the statements of net assets and statements of revenues, expenses, and changes in net assets of the University.

(e) University of South Alabama Health Services Foundation

The USAHSF is a not-for-profit corporation that exists to provide a group medical practice for physicians who are faculty members of the University and to further medical education and research at the University. Because of the significance of the relationship between the University and USAHSF, USAHSF is considered a component unit of the University. The USAHSF reimburses the University for salaries, certain administrative expenses, dean's clinical assessment and other support services. Total amounts received and accrued for such expenses were approximately $43,621,000 and $45,386,000 for the years ended September 30, 2012 and 2011, respectively, and are reflected as

private grants and contracts in the accompanying statements of revenues, expenses, and changes in net assets of the University. The USAHSF presents its financial statements in accordance with standards issued by the FASB. The statements of financial position and the statements of operations and changes in unrestricted net assets for the USAHSF for the years ended September 30, 2012 and 2011 are discretely presented following the statements of net assets and statements of revenues, expenses, and changes in net assets of the University.

(f) USA Research and Technology Corporation

The Corporation is a not-for-profit corporation that exists for the purpose of furthering the educational and scientific mission of the University by developing, attracting, and retaining technology and research industries in Alabama that will provide professional and career opportunities to the University's students and faculty. Because of the significance of the relationship between the University and the Corporation, the Corporation is considered a component unit of the University. The Corporation presents its financial statements in accordance with GASB. The statements of net assets and statements of revenues, expenses and changes in net assets for the Corporation are discretely presented following the statements of net assets and statements of revenues, expenses and changes in net assets of the University.

(g) Measurement Focus and Basis of Accounting

For financial reporting purposes, the University is considered a special purpose governmental agency engaged only in business type activities, as defined by GASB Statement No. 34. Accordingly, the University's basic financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

The University prepares its basic financial statements in accordance with U.S. generally accepted accounting principles, as prescribed by GASB, including all applicable effective statements of the GASB and all statements of the FASB issued through November 30, 1989 that do not conflict with GASB pronouncements. The University has elected not to apply the provisions of any pronouncements of the FASB issued after November 30, 1989.

(h) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions affecting the reported amounts of assets and liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs could change by a material amount in the near term.

(i) Cash and Cash Equivalents

Cash and cash equivalents are defined as petty cash, demand accounts, certificates of deposit, and any short-term investments that take on the character of cash. These investments have maturities of less than three months and include repurchase agreements and money market accounts.

(j) Investments and Investment Income

Investments are recorded at fair value. The fair value of alternative investments (low-volatility multi-strategy funds, private placement fund-of-funds, relative value arbitrage funds, and other) do not have readily ascertainable market values and the University values these investments in accordance with valuations provided by the general partners or fund managers of the underlying partnerships or companies. Because these investments are not marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investment existed. Investments received by gift are recorded at fair value at the date of receipt. Changes in the fair value of investments are reported in investment income (loss).

(k) Derivatives

The University has adopted the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 establishes a framework for accounting and financial reporting related to derivative instruments, requiring the fair value of derivatives to be recognized in the basic financial statements.

The University has two interest rate swaptions which were entered into in January 2008. As a result of entering into the swaptions, the University received up-front payments. Swaptions are considered hybrid instruments which are required to be bifurcated into the fair value of the derivative and a piece that reflects a borrowing for financial statement purposes, which will accrete interest over time. The University determined that as of September 30, 2012 and 2011, the swaptions were not hedging derivative instruments. Therefore, the swaptions are required to be recorded as investment derivatives, with the change in fair value flowing through the statements of revenues, expenses, and change in net assets.

The fair values of the derivatives were $(23,609,000) and $(20,661,000) at September 30, 2012 and 2011, respectively. At September 30, 2012 and 2011, the fair values of the derivatives were included in other long-term liabilities in the accompanying statements of net assets. The change in fair value for the years ended September 30, 2012 and 2011 was $(2,948,000) and $(7,334,000) and resulted in a reduction of investment income in the accompanying statements of revenues, expenses, and changes in net assets for the periods ended September 30, 2012 and 2011. See note 5 for further discussion.

(l) Accounts Receivable

Accounts receivable primarily result from net patient service revenue. Accounts receivable from affiliates primarily represent amounts due from USAHSF for salaries, and certain administrative and other support services. Accounts receivable – other includes amounts due from students, the federal government, state and local governments, or private sources in connection with reimbursement of

allowable expenditures made pursuant to the University's grants and contracts. Accounts receivable are recorded net of estimated uncollectible amounts.

(m) Inventories

The University's inventories primarily consist of bookstore inventories and medical supplies and pharmaceuticals. Bookstore inventories are valued at the lower of cost (moving average basis) or market. Medical supplies and pharmaceuticals are stated at the lower of cost (first-in, first-out method) or market.

(n) Capital Assets

Capital assets are recorded at cost, if purchased or at fair value at date of donation. Depreciation is provided over the estimated useful life of each class of depreciable asset using the straight-line method. Major renewals and renovations are capitalized. Costs for repairs and maintenance are expensed when incurred. When assets are retired or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and the gain or loss, if any, is included in nonoperating revenues (expenses) in the statements of revenues, expenses, and changes in net assets.

All capital assets other than land are depreciated using the following asset lives:

Buildings, infrastructure and certain building components	40 to 100 years
Fixed equipment	10 to 20 years
Land improvements	8 to 20 years
Library materials	10 years
Other equipment	4 to 15 years

Certain buildings are componentized for depreciation purposes.

Interest costs for certain assets constructed are capitalized as a component of the cost of acquiring those assets.

The University evaluates impairment in accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. For the years ended September 30, 2012 and 2011, no impairments were recorded.

(o) Deferred Revenue

Student tuition, fees, and dormitory rentals are deferred and recognized over the applicable portion of each school term.

Operating lease rental payments related to the University's lease of USA Knollwood Hospital to the Infirmary Health System, Inc. (see note 10) are deferred and recognized as revenue over the term of the lease using the straight-line method.

(p) Classification of Net Assets

The University's net assets are classified as follows:

Invested in capital assets, net of related debt reflect the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such debt is excluded from the calculation of *invested in capital assets, net of related debt*.

Restricted, nonexpendable net assets consist of endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted, expendable net assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, net patient service revenue, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff. While unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees, they are available for use at the discretion of the governing board, to meet current expenses for any purpose. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation.

(q) Scholarship Allowances and Student Financial Aid

Student tuition and fees, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statements of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants and other federal, state, or nongovernmental programs are recorded as either operating or nonoperating revenues in the University's basic financial statements based on their classification as either an exchange or nonexchange transaction. To the extent that revenues from such programs are used to satisfy tuition and fees and certain other student charges, the University has recorded a scholarship discount and allowance.

(r) Donor Restricted Endowments

The University is subject to the "Uniform Prudent Management of Institutional Funds Act (UPMIFA)" of the Code of Alabama. This law allows the University, unless otherwise restricted by the donor, to spend net appreciation, realized and unrealized, on the endowment. The law also allows the University to appropriate for expenditure or accumulate to an endowment fund such amounts as

the University determines to be prudent for the purposes for which the endowment fund was established. The University's endowment spending policy provides that 5% of the three-year invested net asset moving average value (inclusive of net realized and unrealized gains and losses), as measured at September 30, is available annually for spending. The University's policy is to retain the endowment net interest and dividend income and net realized and unrealized appreciation with the endowment after distributions allowed by the spending policy have been made. These amounts, unless otherwise directed by the donor, are included in restricted, expendable net assets.

(s) Classification of Revenues

The University has classified its revenues as either operating or nonoperating revenues.

Operating revenues include activities that have the characteristics of exchange transactions such as student tuition and fees, net of scholarship discounts and allowances; sales and services of auxiliary enterprises, net of scholarship allowances; most federal, state, and local grants and contracts; and, net patient service revenue.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources such as state appropriations and investment income.

(t) Gifts and Pledges

Pledges of financial support from organizations and individuals representing an unconditional promise to give are recognized in the basic financial statements once all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Endowment pledges generally do not meet eligibility requirements, as defined by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, and are not recorded as assets until the related gift has been received. Unconditional promises that are expected to be collected in future years are recorded at the present value of the estimated future cash flows.

(u) Grants and Contracts

The University has been awarded grants and contracts for which funds have not been received or expenditures made for the purpose specified in the award. These awards have not been reflected in the basic financial statements, but represent commitments of sponsors to provide funds for specific research or training projects. For grants that have allowable cost provisions, the revenue will be recognized as the related expenditures are made. For grants with work completion requirements, the revenue is recognized as the work is completed. For grants without either of the above requirements, the revenue is recognized as it is received.

(v) Net Patient Service Revenue and Electronic Health Records Incentive Program

Net patient service revenue is reported at estimated net realizable amounts due from patients, third-party payers and others for healthcare services rendered, including estimated retroactive revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are

rendered and such amounts are adjusted in future periods, as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

The Centers for Medicare and Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, eligible hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospitals utilize a grant accounting model to recognize EHR incentive revenues. The Hospitals record EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. The EHR reporting period for hospitals is based on the federal fiscal year, which runs from October 1 through September 30. The Hospitals believe that meaningful use objectives will be met for the federal fiscal year ended September 30, 2013. For the year ended September 30, 2012, the Hospitals recognized EHR incentive revenues of $4,673,000, comprised of Medicaid revenues as the Hospitals implemented certified EHR technology and therefore met the qualifications for year 1 of the Alabama Medicaid EHR incentive program. EHR incentive revenues are included in other operating revenues in the accompanying consolidated statements of revenues, expenses and changes in net assets.

(w) State Appropriated – ARRA Funds

Pursuant to the American Recovery and Reinvestment Act (ARRA) of 2009, the University was awarded approximately $10,769,000 in 2011 through the U.S. Department of Education's State Fiscal Stabilization Fund Program. These funds are billed and recorded as revenue as they are expended and reported in the statements of revenues, expenses and changes in net assets as State Appropriated – ARRA funds. No ARRA distributions were received in 2012.

(x) Costs of Borrowing

Debt financing costs and bond premium and discounts are deferred and amortized using the straight-line method, which approximates the effective interest rate method, over the term of the related bond issue.

(y) Compensated Absences

The University accrues annual leave for employees as incurred at rates based upon length of service and job classification.

(z) Reclassifications

Certain amounts in the 2011 basic financial statements have been reclassified in order to conform to 2012 classification.

(2) Income Taxes

The University is classified as both a governmental entity under the laws of the State of Alabama and as a tax-exempt entity under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). Consistent with that designation, no provision for income taxes has been made in the accompanying basic financial statements.

In addition, the University's discretely presented component units are tax-exempt entities under Section 501(a) of the Internal Revenue Code as organizations described in Section 501(c)(3). Consistent with that designation, no provision for income taxes has been made in the accompanying discretely presented financial statements.

(3) Cash

Pursuant to the Security for Alabama Funds Enhancement Act, funds on deposit may be placed in an institution designated as a qualified public depository (QPD) by the State of Alabama. QPD institutions pledge securities to a statewide collateral pool administered by the State Treasurer's office. Such financial institutions contribute to this collateral pool in amounts proportionate to the total amount of public fund deposits at their respective institutions. The securities are held at the Federal Reserve Bank and are designated for the State of Alabama. Additional collateral was not required for University funds on deposit with QPD institutions. At September 30, the net public deposits subject to collateral requirements for all institutions participating in the pool totaled approximately $8,080,000. The University had cash and cash equivalents totaling $215,601,000 and $178,885,000 at September 30, 2012 and 2011, respectively.

At September 30, 2012, restricted cash and cash equivalents consist of $36,753,000 related to swaption collateral obligations, $12,246,000 related to cash included in the PLTF and GLTF to pay insurance liability claims and $46,375,000 of unspent proceeds from the issuance of University bonds for capital purchases as outlined in the bond indenture. At September 30, 2011, restricted cash and cash equivalents consist of $30,911,000 related to swaption collateral obligations, $1,122,000 related to cash included in the PLTF and GLTF to pay insurance liability claims and $45,885,000 of unspent proceeds from the issuance of University bonds for capital purchases as outlined in the bond indenture.

(4) Investments

(a) University of South Alabama

The investments of the University are invested pursuant to the University of South Alabama "Nonendowment Cash Pool Investment Policies," the "Endowment Fund Investment Policy," and the "Derivatives Policy" (collectively referred to as the University Investment Policies) as adopted by the Board of Trustees. The purpose of the nonendowment cash pool investment policy is to provide guidelines by which pooled funds not otherwise needed to meet daily operational cash flows can be invested to earn a maximum return, yet still maintain sufficient liquidity to meet fluctuations in the inflows and outflows of University operational funds. Further, endowment fund investment policies exist to provide earnings to fund specific projects of the endowment fund, while preserving principal. The University Investment Policies require that management apply the "prudent person" standard in the context of managing its investment portfolio.

The investments of the blended component units of the University are invested pursuant to the separate investment policy of the PLTF and GLTF (the Trust Fund Investment Policy.) The objectives of the Trust Fund Investment Policy are to provide a source of funds to pay general and professional liability claims and to achieve long-term capital growth to help defray future funding requirements. Additionally, investments of the University's component units both blended and discretely presented are subject to UPMIFA as well as any requirements placed on them by contract or donor agreements.

Certain investments, primarily related to the University's endowment assets, are pooled. The University uses this pool to manage its investments and distribute investment income to individual endowment funds.

Investments of the University, by type, at fair value, are as follows at September 30, 2012 and 2011 (in thousands):

		2012	2011
U.S. Treasury notes	$	8,404	10,946
U.S. federal agency notes		14,981	32,782
Pooled equity mutual funds		57,464	51,812
Pooled debt mutual funds		24,619	21,213
Managed income alternative investments (low-volatility multi-strategy funds, private placement fund-of-funds, relative value arbitrage funds, and other)		17,777	16,741
State agency obligations		462	—
Other		8,340	6,851
	$	132,047	140,345

At September 30, 2012 and 2011, $6,938,000 and $6,060,000, respectively, of appreciation in fair value of investments of donor-restricted endowments was recognized and are included in restricted expendable net assets in the accompanying statements of net assets.

Credit Risk and Concentration of Credit Risk

The University Investment Policies limit investment in corporate bonds to securities with a minimum "A" rating, at the time of purchase, by both Moody's and Standard and Poor's. Investments in corporate paper are limited to issuers with a minimum quality rating of P-1 by Moody's, A-1 by Standard and Poor's or F-1 by Fitch.

Additionally, the University Investment Policies require that not more than 10% of the cash, cash equivalents and investments of the University be invested in the obligations of a single private corporation and not more than 35% of the cash, cash equivalents and investments of the University be invested in the obligations of a single government agency.

(Continued)

The University's exposure to credit risk and concentration of credit risk at September 30, 2012 is as follows:

	Credit rating	Percentage of total investments
Federal Home Loan Mortgage Corporation	Aaa	1.3%
Federal Home Loan Bank Corporation	Aaa	4.1
Federal National Mortgage Association	Aaa	4.3
Common Fund Bond Fund	AA	16.7
Various State Agency Obligations	Aaa/A2	0.4
PIMCO Pooled Bond Fund	AA+/NR	2.0
Federal Farm Credit Banks Funding Corporation	Aaa	1.7
Federal Agricultural Mortgage Corporation	Aaa	0.1

The University's exposure to credit risk and concentration of credit risk at September 30, 2011 is as follows:

	Credit rating	Percentage of total investments
Federal Home Loan Mortgage Corporation	AA+	8.0%
Federal Home Loan Bank Corporation	AA+	7.3
Federal National Mortgage Association	AA+	4.6
Common Fund Bond Fund	AA	15.1
Federal Farm Credit Banks Funding Corporation	AA+	2.2
Federal Agricultural Mortgage Corporation	AA+	0.8

Interest Rate Risk

At September 30, 2012, the maturity dates of the University's debt investments were as follows (in thousands):

		Years to maturity			
	Fair value	Less than 1	1 – 5	6 – 10	More than 10
U.S. Treasury notes	$ 8,404	4,497	3,907	—	—
U.S. federal agency notes	14,981	5,180	9,378	—	423
Pooled debt mutual funds	24,619	892	—	21,986	1,741
State agency obligations	462	—	42	—	420
	$ 48,466	10,569	13,327	21,986	2,584

(Continued)

At September 30, 2011, the maturity dates of the University's debt investments were as follows (in thousands):

	Fair value	Years to maturity: Less than 1	1 – 5	6 – 10	More than 10
U.S. Treasury notes	$ 10,946	4,464	6,482	—	—
U.S. federal agency notes	32,782	14,249	17,931	302	300
Pooled debt mutual funds	21,213	—	—	21,213	—
	$ 64,941	18,713	24,413	21,515	300

Pooled debt mutual funds are classified based on the weighted average maturity of the individual investment instruments within each fund.

The University's Investment Policies do not specifically address the length to maturity on investments which the University must follow; however, they do require that the maturity range of investments be consistent with the liquidity requirements of the University.

Mortgage-Backed Securities

The University, from time to time, invests in mortgage-backed securities issued by the Government National Mortgage Association (GNMA) and the Federal National Mortgage Association (FNMA), agencies of the United States government. The University invests in these securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The fair value of mortgage-backed securities is generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities include collateralized mortgage obligations (CMOs). In CMOs, the cash flow from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple security classes with different priority claims and payment streams (commonly referred to as tranches). A holder of the CMO security thus chooses the class of security that best meets its risk and return objectives. CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets. There were no CMOs in the University's investment portfolio at September 30, 2012 or 2011.

At September 30, 2012, restricted investments consist of $39,969,000 related to investments included in the PLTF and GLTF to pay insurance liability claims. At September 30, 2011, restricted investments consist of $6,996,000 related to swaption collateral obligations and $53,007,000 related to investments included in the PLTF and GLTF to pay insurance liability claims.

(b) University of South Alabama Foundation

Investments in securities consist primarily of equity securities totaling $104,498,000 and $110,579,000, at June 30, 2012 and 2011, respectively.

Investment income was comprised of the following for the years ended June 30, 2012 and 2011 (in thousands):

		2012	2011
Unrealized gains	$	5,840	24,043
Realized gains		441	1,045
Timber sales		3,473	3,351
Interest and dividends		1,848	1,813
Rents		602	614
Royalties		198	206
	$	12,402	31,072

Investment related expenses in the amount of $244,000 and $238,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2012 and 2011 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2012 and 2011 consisted of the following property held (in thousands):

		2012	2011
Land and land improvements – held for investment	$	29,913	26,816
Building and building improvements – held for investment, net of depreciation		1,127	1,157
	$	31,040	27,973

Timber and mineral properties are stated at fair market value. Depletion of mineral properties is recognized over the remaining producing lives of the properties based on total estimated production and current period production. Depletion of timber properties is recognized on a specific identification basis as timber rights are sold or on a unit basis for sales made on that basis. Reforestation costs consisting of site preparation and planting of seedlings are capitalized.

Investments at June 30, 2012 and 2011, include an equity interest in a timberland management company. The company's primary assets consist of timberland. The Foundation's proportionate share of the fair value of the company is based upon the valuation of the trustee responsible for the management of the company and the timber valuation.

The Foundation has adopted Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, (formally FASB Statement No. 157, *Fair Value Measurements*). ASC 820 provides a single definition of fair value and a hierarchical framework for measuring it, as well as establishing additional disclosure requirements about the use of fair value to measure assets and liabilities. Fair value measurements are classified as either observable or unobservable in nature. Observable fair values are derived from quoted market prices for investments traded on an active exchange or in dealer markets where there is sufficient activity and liquidity to allow price discovery by substantially all market participants (Level 1). The Foundation's observable values consist of

investments in exchange-traded equity securities with a readily determinable market price. Other observable values are fair value measurements derived either directly or indirectly from quoted market prices (Level 2). Investments that are not traded on an active exchange and do not have a quoted market price are classified as unobservable (Level 3). The Foundation's unobservable values consist of investments in timber and real estate with fair values based on independent third-party appraisals performed by qualified appraisers specializing in timber and real estate investments.

The Foundation's investment assets at June 30, 2012 and 2011, respectively, are summarized based on the criteria of ASC 820 as follows (in thousands):

	Fair value measurements at June 30, 2012			
Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities	$ 51,461	53,037	—	104,498
Timber and mineral properties	—	—	153,574	153,574
Real estate	—	—	31,040	31,040
Other investments	—	—	5,522	5,522
	$ 51,461	53,037	190,136	294,634

	Fair value measurements at June 30, 2011			
Description	**Level 1**	**Level 2**	**Level 3**	**Total**
Equity securities	$ 48,054	62,525	—	110,579
Timber and mineral properties	—	—	153,432	153,432
Real estate	—	—	27,973	27,973
Other investments	—	—	5,531	5,531
	$ 48,054	62,525	186,936	297,515

For the year ended June 30, 2012, activity in investment assets valued at fair value based on unobservable values is as follows (in thousands):

Description	**Timber and mineral properties**	**Real estate**	**Other investments**	**Total**
Beginning balance	$ 153,432	27,973	5,531	186,936
Total gains (losses) (realized/unrealized)	3,793	3,100	(9)	6,884
Reforestation	484	—	—	484
Depreciation/depletion	(4,135)	(33)	—	(4,168)
Ending balance	$ 153,574	31,040	5,522	190,136

(Continued)

For the year ended June 30, 2011, activity in investment assets valued at fair value based on unobservable values is as follows (in thousands):

Description	Timber and mineral properties	Real estate	Other investments	Total
Beginning balance	$ 156,465	8,727	5,535	170,727
Total gains (losses) (realized/unrealized)	(160)	457	(4)	293
Additions	—	18,820	—	18,820
Reforestation	661	—	—	661
Depreciation/depletion	(3,534)	(31)	—	(3,565)
Ending balance	$ 153,432	27,973	5,531	186,936

As of June 30, 2012, the Foundation has no outstanding commitments to purchase securities or other investments. Additionally, substantially all of the Foundation's equity securities at June 30, 2012 and 2011 are considered readily liquid. Timber and mineral properties, real estate, and other investments are generally considered illiquid.

(5) Derivative Transactions

In January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds with a counterparty. This transaction was effected through the sale of two swaptions by the University to the counterparty. The transactions resulted in an up-front payment to the University totaling $9,328,000, which was recorded as a liability, in exchange for selling the counterparty the option to enter into an interest rate swap with respect to the Series 2004 and 2006 bonds in 2014 and 2016, respectively.

Objective of the Derivative Transaction

The objective of this transaction is to realize debt service savings currently from future debt refunding and create an economic benefit to the University.

Terms

A summary of the transactions is as follows:

Issue	Date of issue	Option expiration date	Effective date of swap	Termination date	Payment amount
Series 2004 bonds	2-Jan-08	16-Dec-13	15-Mar-14	15-Mar-24	$ 1,988,000
Series 2006 bonds	2-Jan-08	1-Sep-16	1-Dec-16	1-Dec-36	7,340,000

If the counterparty exercises its options in 2014 and 2016, the University would, at the counterparty's option, be forced into an underlying swap. If the options are exercised, the University would begin to make payments on the notional amount, currently $41,125,000 and $100,000,000 for the 2004 bonds and 2006

(Continued)

bonds, respectively, of the underlying swap contract. Simultaneously, the University would call outstanding 2004 and 2006 bonds and issue variable rate demand notes (VRDNs) in their place. Under the swap contracts, the University would pay a fixed rate of 4.9753% on the 2004 bonds and 5.0% on the 2006 bonds to the counterparty and would receive payments based on 68% of the one-month LIBOR index. Alternatively, although it is not anticipated that this option would be to the University's advantage, the University could, at its option, cash settle the swap and retain its right to refund the 2004 and 2006 bonds.

If the interest rate environment is such that the counterparty chooses to not exercise its options, the swaptions would be canceled and the University would have no further obligation under these agreements.

Financial Statement Presentation

A swaption is considered a hybrid instrument and as such the payment by the counterparty to the University must be bifurcated into two components, a borrowing component and an embedded derivative component, and each component treated separately. The embedded derivative value of the swaption represents the fair value resulting from the fact that the fixed rate stated in the swaption is greater than the at-the-market rate. The initial value of the borrowing is the difference between the upfront payment and the fair value of the embedded derivative and represents the time value to the counterparty for holding the option, or the probability-weighted, discounted values of a range of future possible outcomes. The values of the derivatives and borrowings at the date of execution of this transaction are as follows:

		2004 Bonds	2006 Bonds
Embedded derivatives	$	918,000	3,343,000
Borrowings		1,070,000	3,997,000
	$	1,988,000	7,340,000

The values of the borrowings are included in long-term debt on the University's 2012 and 2011 statements of net assets. Interest is being accreted on, and added to, the borrowings through the expiration date of the option. For the years ended September 30, 2012 and 2011, $378,000 and $358,000, respectively, was accreted and is included in interest expense in the statements of revenues, expenses, and changes in net assets.

The fair values of the embedded investment derivatives are reported as investment assets if the derivatives are assets or other noncurrent liabilities, depending on the fair values of the derivatives. The change in the fair market values of the derivatives is reported as a component of investment income (loss) in the statements of revenues, expenses and changes in net assets. At September 30, 2012 and 2011, the negative fair values of the derivatives are approximately $(23,609,000) and $(20,661,000) and are included in other long-term liabilities in the accompanying statements of net assets. For the years ended September 30, 2012 and 2011, the changes in the fair value of the derivatives were $(2,948,000) and $(7,334,000), respectively.

Fair Value

At September 30, 2012 and 2011, the embedded derivatives had negative fair values of $(23,609,000) and $(20,661,000), respectively. The fair values of the embedded derivatives were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the

instruments, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement.

Risks Associated with this Transaction

Certain risks are inherent to derivative transactions.

Interest rate risk. Interest rate risk, as a result of rising short-term interest rates causing higher interest rate payments, is effectively hedged by the University's fixed rate bonds. If the counterparty exercises its options, the underlying swaps are expected to effectively hedge the potentially higher payments on VRDNs as well. The University is also subject to interest rate risk, as a result of changes in long-term interest rates, which may cause the value of fixed rate bonds or interest rate derivatives to change. If long-term interest rates fall subsequent to the execution of this transaction, the value of the swaptions will change, with negative consequences for the University.

Market access risk. This transaction assumes that VRDNs will be issued as a replacement of the 2004 and 2006 bonds. If the University is unable to issue variable rate bonds after the counterparty exercises its right under the swaptions, the University would still be required to begin making periodic payments on the swaps, even though there are no related bonds. Alternatively, the University could choose to liquidate the swaps, which may create a substantial cash outlay.

Basis risk. If the counterparty exercises its option, there is a risk that the floating payments received under the swaps will not fully offset the variable rate payments due on the assumed VRDNs.

Credit risk. Although the underlying swap exposes the University to credit risk should the swap be executed, the swaption itself does not expose the University to credit risk. If the option is exercised on one or both issues, the University would begin to make payments on the appropriate notional amount of the underlying swap contract. In that situation, if the fair value of the swap is positive, the University would be exposed to credit risk on the swap in the amount of its fair value. As of September 30, 2012 and 2011, the swap counterparty was rated Aa3 by Moody's Investors Services and AA- by Standard and Poor's Rating Services.

Termination risk. The University may be required to terminate the swaptions or swaps under certain circumstances, such as credit downgrades or other events specified in the contracts. In the event that a position needs to be terminated, the University may owe a substantial amount of money to terminate the contracts. At September 30, 2012 and 2011, no events of termination have occurred.

(6) Capital Assets

(a) University of South Alabama

A summary of the University's capital asset activity for the year ended September 30, 2012 follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land and other	$ 25,341	188	—	(1)	25,528
Construction-in-progress	88,128	61,556	(29,921)	—	119,763
	113,469	61,744	(29,921)	(1)	145,291
Capital assets being depreciated:					
Land improvements	27,112	426	3,728	(10)	31,256
Buildings, fixed equipment, and infrastructure	512,428	3,375	25,313	(1,998)	539,118
Other equipment	129,741	6,458	880	(3,989)	133,090
Library materials	51,687	2,969	—	—	54,656
	720,968	13,228	29,921	(5,997)	758,120
Less accumulated depreciation for:					
Land improvements	(15,372)	(1,226)	—	10	(16,588)
Buildings, fixed equipment, and infrastructure	(194,925)	(15,082)	—	1,508	(208,499)
Other equipment	(96,577)	(11,366)	—	3,859	(104,084)
Library materials	(38,532)	(2,509)	—	—	(41,041)
	(345,406)	(30,183)	—	5,377	(370,212)
Capital assets being depreciated, net	375,562	(16,955)	29,921	(620)	387,908
Capital assets, net	$ 489,031	44,789	—	(621)	533,199

At September 30, 2012, the University had commitments of approximately $39,618,000 related to various construction projects.

(Continued)

A summary of the University's capital asset activity for the year ended September 30, 2011 follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land and other	$ 29,671	3,170	—	(7,500)	25,341
Construction-in-progress	84,734	67,355	(63,961)	—	88,128
	114,405	70,525	(63,961)	(7,500)	113,469
Capital assets being depreciated:					
Land improvements	26,751	93	332	(64)	27,112
Buildings, fixed equipment, and infrastructure	459,109	1,517	61,385	(9,583)	512,428
Other equipment	123,713	8,694	2,244	(4,910)	129,741
Library materials	48,740	2,947	—	—	51,687
	658,313	13,251	63,961	(14,557)	720,968
Less accumulated depreciation for:					
Land improvements	(13,900)	(1,558)	—	86	(15,372)
Buildings, fixed equipment, and infrastructure	(190,543)	(13,918)	—	9,536	(194,925)
Other equipment	(87,422)	(13,971)	—	4,816	(96,577)
Library materials	(36,135)	(2,397)	—	—	(38,532)
	(328,000)	(31,844)	—	14,438	(345,406)
Capital assets being depreciated, net	330,313	(18,593)	63,961	(119)	375,562
Capital assets, net	$ 444,718	51,932	—	(7,619)	489,031

At September 30, 2011, the University had commitments of approximately $60,958,000 related to various construction projects.

(Continued)

(b) USA Research and Technology Corporation

Changes in capital assets for the years ended September 30, 2012 and 2011 are as follows (in thousands):

	2012				
	Beginning balance	**Additions**	**Transfers**	**Reductions**	**Ending balance**
Land improvements	$ 2,326	14	7	(146)	2,201
Buildings	27,145	25	499	—	27,669
Tenant improvements	801	14	150	(223)	742
Construction in progress	277	379	(656)	—	—
Other equipment	250	6	—	—	256
	30,799	438	—	(369)	30,868
Less accumulated depreciation for:					—
Land improvements	(654)	(94)	—	—	(748)
Buildings	(3,746)	(727)	—	212	(4,261)
Tenant improvements	(280)	(248)	—	—	(528)
Other equipment	(64)	(25)	—	—	(89)
	(4,744)	(1,094)	—	212	(5,626)
Capital assets, net	$ 26,055	(656)	—	(157)	25,242

	2011				
	Beginning balance	**Additions**	**Transfers**	**Reductions**	**Ending balance**
Land improvements	$ 2,315	4	22	(15)	2,326
Buildings	26,779	388	(22)	—	27,145
Tenant improvements	623	178	—	—	801
Construction in progress	—	277	—	—	277
Other equipment	188	67	—	(5)	250
	29,905	914	—	(20)	30,799
Less accumulated depreciation for:					
Land improvements	(560)	(94)	—	—	(654)
Buildings	(3,075)	(671)	—	—	(3,746)
Tenant improvements	(164)	(116)	—	—	(280)
Other equipment	(46)	(20)	—	2	(64)
	(3,845)	(901)	—	2	(4,744)
Capital assets, net	$ 26,060	13	—	(18)	26,055

(Continued)

(7) Noncurrent Liabilities

A summary of the University's noncurrent liability activity for the years ended September 30, 2012 and 2011 follows (in thousands):

	2012					
	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Bonds payable and other	$ 333,144	34,826	(8,271)	359,699	10,790	348,909
Total long-term debt	333,144	34,826	(8,271)	359,699	10,790	348,909
Other long-term liabilities	96,379	34,179	(50,493)	80,065	13,773	66,292
Total noncurrent liabilities	$ 429,523	69,005	(58,764)	439,764	24,563	415,201

	2011					
	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Bonds payable and other	$ 337,635	2,151	(6,642)	333,144	8,271	324,873
Total long-term debt	337,635	2,151	(6,642)	333,144	8,271	324,873
Other long-term liabilities	81,742	43,001	(28,364)	96,379	14,846	81,533
Total noncurrent liabilities	$ 419,377	45,152	(35,006)	429,523	23,117	406,406

Other long-term liabilities primarily consist of self-insurance liabilities, liabilities related to compensated absences, and the fair value of derivatives. Amounts due within one year are included in accounts payable, accrued liabilities and deferred revenue.

(Continued)

(8) Bonds Payable

Bonds payable consisted of the following at September 30, 2012 and 2011 (in thousands):

	2012	2011
University Tuition Revenue Bonds, Series 1999 Capital Appreciation, 4.70% to 5.25%, payable November 2011 through November 2018	$ 34,398	36,941
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2004, 2.00% to 5.00%, payable through March 2024	42,250	42,785
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2006, 5.00%, payable through December 2036	100,000	100,000
University Facilities Revenue and Capital Improvement Bonds, Series 2008, 3.00% to 5.00%, payable through August 2038	108,850	111,060
University Facilities Revenue and Capital Improvement Bond, Series 2010, 3.81%, payable through August 2030	27,718	28,756
University Facilities Revenue Capital Improvement Bond, Series 2012-A, 2.92% payable through August 2032	25,000	—
University Facilities Revenue Capital Improvement Bond, Series 2012-B, 2.14% payable through August 2018	7,740	—
Borrowing arising from swaption, Series 2004 Bonds	1,571	1,494
Borrowing arising from swaption, Series 2006 Bonds	5,587	5,286
	353,114	326,322
Plus unamortized premium	6,958	7,307
Less unaccreted discount	(42)	(49)
Less unamortized debt extinguishment costs	(331)	(436)
	$ 359,699	333,144

Substantially all student tuition and fee revenues secure University bonds. Additionally, security for Series 2008 bonds includes Children's and Women's Hospital revenues in an amount not exceeding $10,000,000. Series 1999 Current Interest Bonds began maturing November 2002, and Capital Appreciation Bonds began maturing in November 2011. Series 1999 Bonds are not redeemable prior to maturity. Series 2004 Bonds began maturing in March 2005 and are redeemable beginning in March 2014. Series 2006 Bonds begin maturing in December 2024 and are redeemable beginning in December 2016. Series 2008 Bonds began maturing in August 2009 and are redeemable beginning in August 2018. The Series 2010 Bond began maturing in August 2011 and is redeemable beginning in February 2020. The 2012-A and 2012-B Bonds begin maturing in August 2013.

In January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to a counterparty. The proceeds from each sale, totaling $9,328,000, consist of two components, a borrowing and an embedded derivative. The borrowing is included in long-term debt. As a result of this transaction,

(Continued)

the counterparty has the option to force the University to redeem its Series 2004 and 2006 bonds at their respective redemption dates. See note 5 for a complete description of this transaction.

During the years ended September 30, 2012 and 2011, the maturity value of the Capital Appreciation Bonds increased $1,708,000 and $1,793,000, respectively, over the original principal amount of $19,810,000, reflecting accretion of interest.

Approximately $16,801,000 of proceeds from the issuance of the Series 2008 bonds remained unspent at September 30, 2012 and is included in restricted cash and cash equivalents in the 2012 statement of net assets. These funds are restricted for capital purposes as outlined in the indenture.

Approximately $29,574,000 of proceeds from the issuance of the Series 2012-A and 2012-B bonds remained unspent at September 30, 2012 and is included in restricted cash and cash equivalents in the 2012 statement of net assets. These funds are restricted for capital purposes as outlined in the indenture.

The University is subject to arbitrage restrictions on its bonded indebtedness prescribed by the U. S. Internal Revenue Service. As such, amounts are accrued as needed in the University's basic financial statement for any expected arbitrage liabilities. At September 30, 2012 and 2011, no amounts were due or recorded in the financial statements.

The University is subject to restrictive covenants related to its bonds payable. At September 30, 2012, management believes the University was in compliance with such financial covenants.

Debt Service on Long-Term Obligations

Total debt service by fiscal year is as follows as of September 30, 2012 (in thousands):

	Debt service on bonds			
	Principal	Interest	Additional maturity	Total
2013	$ 10,552	14,170	(1,981)	22,741
2014	10,854	14,073	(1,854)	23,073
2015	11,160	13,927	(1,627)	23,460
2016	11,428	13,665	(1,473)	23,620
2017	14,728	13,754	(782)	27,700
2018 – 2022	69,826	64,686	(476)	134,036
2023 – 2027	70,729	49,055	—	119,784
2028 – 2032	75,029	31,927	—	106,956
2033 – 2037	79,926	12,945	—	92,871
2038 – 2039	7,075	354	—	7,429
Subtotal	361,307	228,556	(8,193)	581,670
Plus (less):				
Additional maturity	(8,193)			
Unamortized bond premium	6,958			
Unaccreted bond discount	(42)			
Unamortized debt extinguishment costs	(331)			
Total	$ 359,699			

The principal amount of debt service due on bonds at September 30, 2012 includes $18,839,000 representing additional maturity value on Series 1999 Capital Appreciation Bonds. These bonds mature through 2019. Also included in the principal amount of debt service due on bonds at September 30, 2012, is $1,732,000 representing additional maturity value of the borrowing resulting from the Series 2004 and Series 2006 swaption. As described in note 5, additional maturity will continue to accrue until the swaption option period in 2014 and 2016. Although this additional maturity is presented as principal on the debt service schedule above, it is also recognized as interest expense on an annual basis in the University's basic financial statements as it accretes.

(Continued)

(a) USA Research and Technology Corporation

Notes Payable

Notes payable consisted of the following at September 30, 2012 and 2011 (in thousands):

	2012	2011
Wells Fargo, N.A. promissory note, one-month LIBOR plus 0.85% (1.0645% at September 30, 2012) payable through 2028	$ 15,746	16,314
PNC Bank promissory note, 4.88%, payable through 2021	9,487	9,800
	$ 25,233	26,114

The note payable to Wells Fargo Bank, N.A. was incurred by the Corporation to acquire Buildings II and III in the USA Technology & Research Park and to provide funds for renovations and tenant finishing costs. The loan is a fully amortizing promissory note with a 20-year term. As is more fully described below, the Corporation entered into a "receive-variable, pay-fixed" type of interest rate swap on the promissory note, which will yield a synthetic fixed interest rate of 6.1%. The promissory note payable is secured by an interest in the ground lease with respect to the parcels of land on which Buildings II and III stand, an interest in Buildings II and III, an interest in tenant leases for Buildings II and III, and an interest in income received from rental of Buildings II and III. The University also entered into an agreement with Wells Fargo Bank, N.A. providing that, for a year in which the Corporation's debt service coverage ratio is less than one to one, the University will pay the Corporation rent equal to the amount necessary to bring the ratio to one to one.

The promissory note payable to PNC Bank has a 10-year term and amortization is based on a 20-year term. PNC Bank acquired the promissory note as part of its acquisition of RBC Bank (USA) on March 20, 2012. The Corporation agreed to not transfer or encumber the buildings or its leasehold interest in the real estate on which the buildings stand. The promissory note payable is secured by an interest in tenant leases for Building I and the dialysis services building, and an interest in income received from rental of Building I and the dialysis services building. The University also entered into an agreement with PNC Bank providing that, for a year in which the Corporations' debt service coverage ratio is less than one to one, the University will pay the Corporation rent equal to the amount necessary to bring the ratio to one to one.

Proceeds of $253,000 and $594,000 from the issuance of notes payable remain unspent at September 30, 2012 and 2011, respectively, and are restricted for capital purposes. These amounts are included in restricted cash and cash equivalents.

At September 30, 2012, the Corporation's management believes the Corporation was in compliance with its debt covenants.

(Continued)

Debt Service on Long-Term Obligations

At September 30, 2012, total debt service by fiscal year is as follows (in thousands):

	Debt service on note and loan		
	Principal	**Interest**	**Total**
2013	$ 946	1,409	2,355
2014	1,002	1,354	2,356
2015	1,060	1,295	2,355
2016	1,118	1,238	2,356
2017	1,186	1,169	2,355
2018 – 2022	12,426	4,238	16,664
2023 – 2027	6,471	1,386	7,857
2028	1,024	24	1,048
Total	$ 25,233	12,113	37,346

Derivative Transaction

The Corporation is a party to a derivative with Wells Fargo Bank, N.A., the counterparty (successor to Wachovia Bank, N.A. the original counterparty). The derivative is a "receive-variable, pay-fixed" interest rate swap entered into in connection with the promissory note to Wells Fargo Bank, N.A.

Objective of the derivative transaction. The Corporation utilizes the interest rate swap to convert its variable rate on the promissory note to a synthetic fixed rate.

The swap will terminate on May 1, 2028, when the loan matures. The notional amount of the swap will at all times match the outstanding principal amount of the loan. Under the swap, the Corporation pays the counterparty a fixed payment of 6.10% and receives a variable payment of the one-month LIBOR rate plus 0.85%. Conversely, the loan bears interest at the one-month LIBOR rate plus 0.85%. The Corporation paid $802,711 and $847,261 under the interest rate swap agreement for the years ended September 30, 2012 and 2011, respectively, which is reflected as an increase in interest expense.

Fair value. The interest rate swap had a negative fair value of $(4,888,612) and $(4,629,253) at September 30, 2012 and 2011, respectively.

The changes in fair value are reported as a deferred outflows on the Statements of Net Assets since the interest rate swap is a hedging derivative instrument.

The fair value of the interest rate swap was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement.

Interest rate risk. On the Corporation's "receive-variable, pay-fixed" interest rate swap, as LIBOR decreases, the net payment on the swap increases.

Credit risk. As of September 30, 2012 and 2011, the Corporation was not exposed to credit risk on the interest rate swap because it had a negative fair value. However, if interest rates change and the fair value of the derivatives become positive, the Corporation would have a gross exposure to credit risk in the amount of the derivatives' fair value. The counterparty was rated Aa3 and Aa3 by Moody's Investors Services and AA- and AA by Standard & Poor's Ratings Services as of September 30, 2012 and 2011, respectively.

Termination risk. The interest rate swap contracts use the International Swaps and Derivatives Association, Inc. Master Agreement, which includes standard default and termination events, such as failure to make payments, breach of agreement, and bankruptcy. At September 30, 2012 and 2011, no events of default or termination had occurred. If the interest rate swap is terminated, interest rate risk associated with the variable rate debt would no longer be hedged. Also, if at the time of termination the interest rate swap had a negative fair value, the Corporation would be liable to the counterparty for a payment equal to the interest rate swap's fair value. To allow the Corporation the maximum flexibility to manage the utilization of Buildings II and III while at the same time providing protection for the counterparty, the Corporation granted the counterparty a $2,000,000 mortgage secured by an interest in the ground lease with respect to the parcel of land on which Building II stands, an interest in Building II, a security interest in Building II tenant leases, and a security interest in income received from rental of Building II.

Derivative payments and hedged debt. As interest rates fluctuate, variable rate debt interest and net derivative payments will fluctuate. Using interest rates as of September 30, 2012, debt service requirements by fiscal year of the variable rate debt and net derivative payments, assuming current interest rates remain the same in the future, are as follows (in thousands):

	Variable rate loan		Interest rate	
	Principal	Interest	swap, net	Total
2013	$ 618	166	787	1,571
2014	657	160	755	1,572
2015	698	152	721	1,571
2016	738	145	688	1,571
2017	787	137	647	1,571
2018 – 2022	4,753	542	2,562	7,857
2023 – 2027	6,471	242	1,144	7,857
2028	1,024	4	20	1,048
Total	$ 15,746	1,548	7,324	24,618

(9) Net Patient Service Revenue

The Hospitals have agreements with governmental and other third-party payers that provide for reimbursement at amounts different from their established rates. Contractual adjustments under third-party

reimbursement programs represent the difference between the Hospitals' billings at established rates for services and amounts reimbursed by third-party payers.

A summary of the basis of reimbursement with major-third party payers follows:

Medicare – Substantially all acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Additionally, the Hospitals are reimbursed for both direct and indirect medical education costs (as defined), principally based on per-resident prospective payment amounts and certain adjustments to prospective rate-per-discharge operating reimbursement payments. The Hospitals generally are reimbursed for certain retroactively settled items at tentative rates, with final settlement determined after submission of annual cost reports by the Hospitals and audits by the Medicare fiscal intermediary. The cost report for the USA Medical Center has been audited and settled through 2009. The cost report for USA Children's and Women's Hospital has been audited and settled through 2010. Revenue from the Medicare program accounted for approximately 13% and 14% of the Hospitals' net patient service revenue for the years ended September 30, 2012 and 2011, respectively.

Blue Cross – Inpatient services rendered to Blue Cross subscribers are paid at a prospectively determined per diem rate. Outpatient services are reimbursed under a cost reimbursement methodology. For outpatient services, the Hospitals are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospitals and audits thereof by Blue Cross. The Hospitals' Blue Cross cost reports have been audited through 2011 and settled for all fiscal years through 2010. Revenue from the Blue Cross program accounted for approximately 17% of the Hospitals' net patient service revenue for both years ended September 30, 2012 and 2011.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are reimbursed at all-inclusive prospectively determined per diem rates. Outpatient services are reimbursed based on an established fee schedule.

The Hospitals qualify as Medicaid essential providers and, therefore, also receive supplemental payments based on formulas established by the Alabama Medicaid Agency. There can be no assurance that the Hospitals will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified.

Revenue from the Medicaid program accounted for approximately 25% of the Hospitals' net patient service revenue for both years ended September 30, 2012 and 2011.

Other – The Hospitals have also entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The bases for payments to the Hospitals under these agreements include discounts from established charges and prospectively determined daily and case rates.

The composition of net patient service revenue for the years ended September 30, 2012 and 2011 follows (in thousands):

	2012	2011
Gross patient service revenue	$ 547,824	467,388
Less provision for contractual and other adjustments	(221,339)	(178,282)
Less provision for bad debts	(78,683)	(62,067)
	$ 247,802	227,039

Changes in estimates related to prior cost reporting periods resulted in an increase (decrease) of approximately $2,272,000 and $(14,000) in net patient service revenue for the years ended September 30, 2012 and 2011, respectively.

(10) Hospital Lease

In fiscal 2006, the University and Infirmary Health System, Inc. (the Infirmary) entered into a Lease Agreement (the Lease) in which the University agreed to lease certain land, buildings and equipment used in connection with the operation of its USA Knollwood Hospital campus to the Infirmary. The lease is effective through March 2056 with an automatic renewal, for an additional forty-nine years, through March 2105; and may be canceled by the Infirmary after the initial fifty-year term. Upon the expiration or termination of the lease, the assets, along with responsibility for the operation of such assets, will revert to the University and the University will pay the Infirmary, at fair market value, for any capital improvements to the assets. Additionally, the lease may be terminated at any time, at the option of the Infirmary, in the event that a change in any law, statute, rule, or a regulation of any governmental or other regulatory body or any third-party payment program is deemed by the Infirmary to be significant, as defined by the lease.

In January 2009, the Infirmary and the University entered into a "First Amendment to Lease Agreement" (the Amendment). The Amendment deferred the original payment terms of the lease for two years such that during the period from January 2009 to December 2010, annual lease payments are reduced to $1 annually. Beginning in January 2011, the original payment schedule resumed. The payment schedule and narrative presented below reflects these revised terms.

The total amount of lease payments due the University was based on the fair market value of the appraised assets, $32,418,000. The allocation of the appraised fair market value was $29,370,000 for the land and buildings and $3,048,000 for medical equipment, office furnishings and other equipment.

Upon execution of the lease, a partial lease prepayment in the amount of $7,418,000 was made by the Infirmary. In addition to the prepayment, required lease payments by the Infirmary to the University are as follows (payable monthly):

- Months one through thirty-three of the initial lease term – $1,000,000 annually ($83,333 monthly)
- Months thirty-four through fifty-seven of the initial lease term – $1 annually
- Months fifty-eight through eighty-four of the initial lease term – $1,000,000 annually ($83,333 monthly)

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- Years eight through twelve of the initial lease term – $1,250,000 annually
- Years thirteen through seventeen of the initial lease term – $1,500,000 annually
- Years eighteen through thirty-two of the initial lease term – The monthly payment will be the remaining unpaid balance of the lease payments amortized over years sixteen through thirty using an interest rate calculated from the immediately previous 15-year monthly average of the 20-year state and local tax exempt general obligation bond issues as determined by the United States Federal Reserve System. The remaining unpaid balance at the end of year fifteen, $17,401,000, is derived by taking the initial unpaid balance of rent due after the partial lease prepayment, $25,000,000 plus accrued interest at an annual rate of 3.75%, less monthly lease payments.
- Years thirty-three through fifty of the initial lease term – $1 annually
- Year fifty-one through ninety-nine of the extended lease term – $1 annually

For reporting purposes, management assumed that the interest rate utilized in years sixteen through thirty would remain at 3.75%. This assumption will be reviewed, and amortization schedules adjusted, if necessary, when the actual interest rate is determined.

In order to properly report this transaction, the University has bifurcated the lease into an equipment component and a real property component, as required by FASB Statement No. 13, based on the appraised fair value of each such component. The financial considerations of the lease are then applied to, and the accounting treatment is determined for, each component based on this bifurcation.

The equipment component of the lease is considered a capital lease (sales-type lease) and as such the current portion of the receivable has been recorded as a capital lease receivable in other current assets and the noncurrent portion has been recorded in other noncurrent assets in the accompanying basic financial statements of the University. The capital equipment lease is being amortized through fiscal 2013 at a fixed rate of 3.75%. Future receipts from this capital lease are expected as follows:

Year ending September 30:		
2013	$	298,000
		298,000
Less amounts representing interest		(3,000)
Total capital lease receivable	$	295,000

The component of the lease attributable to land and buildings is considered an operating lease. As such, lease revenue will be recorded as it is earned over the ninety-nine year lease term (the fifty-year initial term and the forty-nine year automatic renewal term). The expected total lease payments to be received over the next twenty-seven years are approximately $42,939,000. These total receipts will be recognized as revenue in the amount of approximately $485,000 annually. Payments received in excess of this amount, along with cash and other consideration already received in the amount of $5,602,000, will be deferred and amortized over the ninety-nine year lease term.

As more fully discussed in note 17, on October 15, 2012, the Infirmary publically announced the closing of Mobile Infirmary West (formerly USA Knollwood Hospital), effective October 31, 2012. Currently, the University has received no formal notice from the Infirmary as to its intent with respect to the lease and, as such, the ultimate impact on the financial statements of the University has not yet been determined.

(11) Employee Benefits

(a) Retirement and Pension Plans

Employees of the University are covered by two pension plans: a cost sharing multiple-employer defined benefit pension plan administered by the Teachers' Retirement System of the State of Alabama (TRS), and a defined contribution pension plan.

Permanent employees of the University participate in TRS, a public retirement system created by an act of the State Legislature, with benefit provisions established by the Code of Alabama. Responsibility for general administration and operation of the TRS is vested in the Board of Control (currently 14 members). Benefits fully vest after 10 years of full-time, permanent employment. Vested employees may retire with full benefits at age 60 or after 25 years of service. Participating retirees may elect the maximum benefit, or may choose among four other monthly benefit options. Under the maximum benefit, participants are allowed 2.0125% of their average final salary (average of three highest years of annual compensation during the last ten years of service) for each year of service. The TRS issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to the Retirement Systems of Alabama, P.O. Box 302150, Montgomery, Alabama 36130-2150, or by calling (334) 832-4140.

Prior to October 1, 2011, all employees covered by this retirement plan were required to contribute 5% of their eligible earnings to TRS. Effective October 1, 2011, the required employee contribution was increased to 7.25% of their eligible earnings. An actuary employed by the TRS Board of Control establishes the employer-matching amount annually. During 2012, 2011 and 2010, the University made total contributions of $23,381,000, $31,420,000, and $32,259,000 (100% of the required contributions), respectively, to TRS on behalf of participants, which represents 10%, 12.51%, and 12.51%, respectively, of each participant's gross earnings. The University's payroll for all employees was approximately $268,684,000 and $286,504,000 in 2012 and 2011, respectively. The LLC's payroll for all employees was approximately $43,479,000 and $14,817,000 in 2012 and 2011, respectively. Total payroll for University employees participating in the Teachers' Retirement System of Alabama was approximately $233,806,000 and $251,158,000 in 2012 and 2011, respectively.

The defined contribution pension plan covers certain academic and administrative employees, and participation by eligible employees is optional. Under this plan, administered by Teachers Insurance and Annuity Association – College Retirement Equities Fund (TIAA-CREF), contributions by eligible employees are matched equally by the University up to a maximum of 3% of current annual pay. The University and the employees each contributed $984,000 and $1,000,000 in 2012 and 2011, respectively, representing 469 and 522 employees participating in this Plan.

All employees of the LLC working at least half time are eligible to participate in a defined contribution pension plan. Under this plan, contributions by eligible employees are matched equally by the LLC up to a maximum of 5% of current annual pay. The LLC and the employees contributed $1,272,000 and $395,000, respectively in 2012 and 2011 representing 307 and 531, employees participating in this plan. University employees as of September 30, 2011 who later transfer to the LLC are immediately vested in the plan. All other employees do not vest until they have held employment with the LLC for thirty-six months; at which time they become 100% vested in the plan.

(b) Compensated Absences

Regular University employees accumulate vacation and sick leave and hospital and clinical employees accumulate paid time off. These are subject to maximum limitations, at varying rates depending upon their employee classification and length of service. Upon separation of employment, employees who were hired before January 1, 2012 are paid all unused accrued vacation at their regular rate of pay up to a maximum of two times their annual accumulation rate. Employees hired after January 1, 2012 are not eligible for payment of unused accrued vacation or PTO hours upon separation of employment. The accompanying statements of net assets include accruals for vacation pay and paid time off of approximately $15,990,000 and $17,949,000 at September 30, 2012 and 2011, respectively. The current portion of the accrual is included in accounts payable and accrued liabilities and the noncurrent portion is included in other long-term liabilities in the accompanying basic financial statements. No accrual is recognized for sick leave benefits since no terminal cash benefit is available to employees for accumulated sick leave.

(c) Other Postretirement Employee Benefits

As the provider of postretirement benefits to state retirees, the state is responsible for implementing GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. In September 2003, the State of Alabama Legislature passed legislation that requires all colleges and universities to fund the healthcare premiums of its participating retirees. In prior years, such costs have been paid by the State. Beginning in October 2003, the University was assessed a monthly premium by the Public Education Employees' Health Insurance Plan (PEEHIP) based on the number of retirees in the system and an actuarially determined premium. During the years ended September 30, 2012 and 2011, the University's expense related to PEEHIP was $7,318,000 and $7,361,000, respectively.

(12) Risk Management

The University, USAHSF, LLC and SAMSF participate in the professional liability trust fund and the University, USAHSF, LLC, SAMSF and the Corporation participate in the general liability trust fund. Both funds are administered by an independent trustee. These trust funds are revocable and use contributions by the University and USAHSF, together with earnings thereon, to pay liabilities arising from the performance of its employees, trustees and other individuals acting on behalf of the University. If the trust funds are ever terminated, appropriate provision for payment of related claims will be made and any remaining balance will be distributed to the University and USAHSF in proportion to contributions made.

(Continued)

As discussed in note 1, the PLTF and GLTF are blended component units of the University, as defined by GASB Statement No. 14, and as such are included in the basic financial statements of the University for the years ended September 30, 2012 and 2011. Claims and expenses are reported when it is probable that a loss has occurred and the amount of the loss can be reasonably estimated. Those losses include an estimate of claims that have been incurred but not reported and the future costs of handling claims. These liabilities are generally based on actuarial valuations and are reported at their present value.

The University and LLC participate in a self-insured health plan, administered by an unaffiliated entity. Administrative fees paid by the University for such services were approximately $1,712,000 and $1,700,000 in 2012 and 2011, respectively. Contributions by the University and its employees, together with earnings thereon, are used to pay liabilities arising from healthcare claims. It is the opinion of University administration that plan assets are sufficient to meet future plan obligations.

The changes in the total self-insurance liabilities for the years ended September 30, 2012 and 2011 for the PLTF, GLTF and health plan are summarized as follows (in thousands):

		2012	2011
Balance, beginning of year	$	38,568	41,310
Liabilities incurred and other additions		51,937	44,154
Claims, administrative fees paid and other reductions		(67,758)	(46,896)
Balance, end of year	$	22,747	38,568

Self-insurance liabilities due within one year are included in accounts payable and accrued liabilities. The noncurrent portion is included in other long-term liabilities in the accompanying basic financial statements.

(13) Other Related Party

SAMSF is a not-for-profit corporation that exists for the purpose of promoting education and research at the University. At September 30, 2012 and 2011, SAMSF had total assets of $11,506,000 and $11,609,000, net assets of $8,933,000 and $8,804,000, and total revenues of $3,175,000 and $5,075,000, respectively. SAMSF reimburses the University for certain administrative expenses and other related support services. Total amounts received for such expenses were approximately $521,000 and $1,008,000 in 2012 and 2011, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net assets.

(14) Commitments and Contingencies

(a) Grants and Contracts

At September 30, 2012 and 2011, the University had been awarded approximately $35,987,000 and $56,337,000, respectively, in grants and contracts for which resources had not been received and for which reimbursable expenditures had not been made for the purposes specified. These awards, which represent commitments of sponsors to provide funds for research or training projects, have not been reflected in the accompanying basic financial statements as the eligibility requirements of the award have not been met. Advances include amounts received from grant and contract sponsors which have not been earned under the terms of the agreements and, therefore, have not yet been included in

revenues in the accompanying basic financial statements. Federal awards are subject to audit by Federal agencies. The University's management believes any adjustment from such audits will not be material.

(b) Letter of Credit

In connection with the Hospitals' participation in the State of Alabama Medicaid Program, the University has established a $77,000 irrevocable standby letter of credit with Wells Fargo, N.A. The Alabama Medicaid Agency is the beneficiary of this letter of credit. No funds were advanced under this letter during the years ended September 30, 2012 and 2011.

(c) Litigation

Various claims have been filed against the University alleging discriminatory employment practices and other matters. University administration and legal counsel are of the opinion the resolution of these matters will not have a material effect on the financial position or the statements of revenues, expenses, and changes in net assets of the University.

(d) Rent Supplement Agreements

The University has entered into two irrevocable rent supplement agreements with the Corporation and a financial institution. The agreements require that, in the event the Corporation fails to maintain a debt service coverage ratio of one to one with respect to all of its outstanding indebtedness, the University will pay to the Corporation any and all rent amounts necessary to cause the Corporation's net operating income to be equal to the Corporation's annual debt service obligations (see note 8). As of September 30, 2012 and 2011, no amounts were payable pursuant to these agreements.

(e) State Bond Issues

The State of Alabama has made allocations to the University from bond issues in prior years. Pursuant to these allocations, at September 30, 2012, approximately $4,830,000 is unspent and remains available to the University for certain future construction costs. The allocations have not been reflected in the accompanying financial statements.

(f) FICA Refund

In March 2010, the Internal Revenue Service (the Service) ruled that for all tax periods ending before April 2005, the medical residents working at the USA hospitals could be treated under the student exception with respect to FICA taxes. Historically, the Service had held that residents were not exempt from FICA taxes. As a result of this ruling, the University has recorded a receivable of $5,297,000 representing the employer's portion of FICA contributions from March 1996 to April 2005 and any related interest.

(g) Sale of Brookley Campus

On September 29, 2010, the University and the USA Foundation executed purchase and sale agreement calling for the University to sell approximately 327 acres on Mobile Bay, known as the Brookley campus, to the Foundation. The terms of the agreement required the Foundation to pay the University $20,000,000; $4,000,000 at closing and $4,000,000 annually thereafter through the 2015

fiscal year. The sale closed on November 10, 2010 and the initial payment was received by the University at that point. The transaction is recorded as an installment sale. As such, during the years ended September 30, 2012 and 2011, the University reported a gain on the sale of $2,035,000 and $2,380,000, respectively, which is reported as other nonoperating revenues in the 2012 statement of revenues, expenses and changes in net assets. At September 30, 2012, the University is reporting a note receivable from the Foundation in the amount of $11,100,000 ($3,556,000 is reported as a current asset in notes receivable and $7,544,000 is reported as a noncurrent asset in noncurrent notes receivable) and deferred revenue in the amount of $6,605,000 ($2,116,000 is reported as current deferred revenue and $4,489,000 as other noncurrent liabilities). At September 30, 2011, the University is reporting a note receivable from the Foundation in the amount of $14,520,000 ($3,846,000 is reported as a current asset in notes receivable and $10,674,000 is reported as a noncurrent asset in noncurrent notes receivable) and deferred revenue in the amount of $8,639,000 ($2,289,000 is reported as current deferred revenue and $6,350,000 as other noncurrent liabilities.) The deferred revenue will be amortized as an installment gain as payments are received through 2015.

(h) USA Research and Technology Corporations Leases

The Corporation leases space in Building I to two tenants under operating leases. One lease has a 10-year initial term expiring in November 2013 with two 5-year renewal options. During 2011, this tenant agreed to pay $250,000 in exchange for termination a portion of the leased space. The other lease has a 10-eyar initial term expiring in March 2021, an option to cancel at the end of 6 years, and two 5-year renewal options. Under the leases, the tenants must also pay as rent an amount to reimburse the Corporation for operating expenses such as common area maintenance, utilities, and general liability and property damage insurance.

Space in Buildings II and III is leased under operating leases to the University and various other tenants. Space under lease to the University was 53,000 and 52,636 square feet at September 30, 2012 and 2011, respectively. Under these leases, the Corporation must pay all operating expenses of the buildings, including utilities, janitorial, maintenance, property taxes, and insurance. Tenants will reimburse the Corporation for such expenses only as the total expenses for a year increase over the total expenses for the base year of the lease (the Corporation's fiscal year beginning after the date the lease is signed). The leases have terms varying from one to ten years.

The Corporation owns a building located on the premises of the USA Medical Center which is leased to a single tenant. The Corporation paid for construction of the building shell and land improvements while the tenant paid for the cost of finishing the building's interior. The lease has a ten-year initial term with three five-year renewal options. Under the lease, the tenant must also pay for utilities, taxes, insurance, and interior repairs and maintenance. The Corporation is responsible for repairs and maintenance to the exterior and HVAC system.

The Corporation, as lessor, had three ground leases in place at September 30, 2012 and 2011. One lease is for a 40-year initial term with 20-year, and 15-year renewal options. The second lease is for a 30-year initial term with four 5-year renewal options. The third lease has a 38.5-year initial term with 20-year and 15-year renewal options.

Minimum future rentals by fiscal year are as follows (in thousands):

2013	$	2,369
2014		1,436
2015		1,290
2016		1,145
2017		980
2018 – 2046		7,791
Total	$	15,011

(15) Functional Information

Operating expenses by functional classification for the years ended September 30, 2012 and 2011 are listed below (in thousands). In preparing the basic financial statements, all significant transactions and balances among accounts have been eliminated.

		2012	2011
Instruction	$	115,526	115,265
Research		20,860	22,019
Public service		48,110	52,112
Academic support		16,184	15,666
Student services		26,831	24,945
Institutional support		24,837	26,190
Operation and maintenance of plant		29,901	29,635
Scholarships		5,290	5,936
Hospital		251,196	242,372
Auxiliary enterprises		13,102	13,781
Depreciation and amortization		30,396	32,054
	$	582,233	579,975

(16) Significant New Accounting Pronouncements

In November 2010, the GASB issued Statement No. 60, *Accounting and Financial Reporting for Service Concession Arrangements*. GASB Statement No. 60 addresses accounting and reporting issues related to public-public and public-private service concession arrangements and will be effective for the year ended September 30, 2013. In November 2010, the GASB issued Statement No. 61, *The Financial Reporting Entity: Omnibus*. GASB Statement No. 61 modifies certain requirements for inclusion of component units in the financial reporting entity and will be effective for the year ending September 30, 2013. In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. GASB Statement No. 62 incorporates into the GASB's authoritative literature accounting and financial reporting guidance that is

(Continued)

included in certain FASB and AICPA authoritative literature, where such guidance does not conflict with or contradict GASB pronouncements. In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. Statement No. 63 renames the Statement of Net Assets as the Statement of Net Position and requires that deferred inflows and outflows of resources be reported as components of the Statement of Net Position and will be effective for the year ending September 30, 2013. In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. GASB Statement No. 65 establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities and will be effective for the year ending September 30, 2014. In March 2012, the GASB issued Statement No. 66, *Technical Corrections – 2012*. GASB Statement No. 66 resolves conflicting guidance that resulted from the issuance of GASB Statements No. 54 and 62 and will be effective for the year ending September 30, 2014. In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. GASB Statement No. 68 changes accounting and financial reporting for entities participating in certain pension plans and will be effective for the year ending September 30, 2015.

The effect of the implementation of GASB Statements Nos. 60, 61, 62, 63, 65, 66 and 68 on the University has not been determined.

(17) Subsequent Event

On October 15, 2012, officials of the Infirmary publically announced the closing of Mobile Infirmary West, formerly USA Knollwood Hospital. As more fully described in note 10, in 2006, the University and the Infirmary entered into a lease agreement in which the University agreed to lease the property and certain equipment to the Infirmary. The lease is effective through 2056, with an automatic renewal for an additional forty-nine years. There are provisions within the lease agreement that allow the Infirmary to terminate the lease in the event certain conditions exist. To date, no formal notice has been received by the University from the Infirmary and it is unknown as to whether or not the Infirmary intends to invoke the termination provisions of the lease. Assets and liabilities related to this transaction that are currently reported in the University's 2012 financial statements include a receivable in the amount of $295,000, which is included in current assets on the statement of net assets and deferred revenue in the amount of $5,602,000. Of the total deferred revenue, $525,000 is included in current assets and $5,077,000 is included in other noncurrent liabilities. As formal notice has not been received by the University, no adjustments have been made to the University's financial statements nor has the impact of the closing on the financial statements been determined.

UNIVERSITY OF SOUTH ALABAMA
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Schedule of Expenditures of Federal Awards

Year ended September 30, 2012

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Student Financial Aid Cluster*:						
U.S. Department of Education:						
Federal Pell Grant Program	84.063			$ 17,827,588	—	17,827,588
Federal Supplemental Educational Opportunity Grant Program	84.007			254,112	—	254,112
Federal Direct Student Loan Program	84.268			95,775,236	—	95,775,236
Federal Work Study Program	84.033			432,556	—	432,556
Teacher Education Assistance for College and Higher Education	84.379			48,500	—	48,500
Nurse Faculty Loan Program	93.264			108,116	—	108,116
Scholarships for Health Professions Students	93.925			37,987	—	37,987
Total Student Financial Aid Cluster				114,484,095	—	114,484,095
Research and Development Cluster*:						
U.S. Department of Commerce:						
Economic Impact Analysis of Major	11.307	EDPASG02	Economic Development Partnership of Alabama	—	95,210	95,210
Sea Grant Support	11.417	GR2375MC	Dauphin Island Sea Lab	—	107,093	107,093
Sea Grant Support	11.417	USM-GRO3925/CCD-23-PP	University of Southern Mississippi	—	46,168	46,168
Total CFDA				—	153,261	153,261
Coastal Zone Management Esturaine Research Reserves	11.420			148	—	148
Marine Fisheries Initiative	11.433			105,200	—	105,200
Economics Survey of the Alabama Sea	11.434	EDP-ESF-RB-2010-USA	Gulf States Marine Fisheries commission	—	2,813	2,813
Economics Survey of the Alabama Sea	11.454	Task Order D8	Dauphin Island Sea Lab (MESC)	—	16,127	16,127
Unallied Management Projects	11.454			865	—	865
Artificial Habitat Enhancement	11.454	80182	Alabama Department of Conservation and Natural Resources	—	(4,352)	(4,352)
Total CFDA				865	11,775	12,640
Habitat Conservation	11.463			208,401	—	208,401
Coastal Alabama Economic Recovery	11.463	GMT-USA-111711	The Nature Conservancy	—	10,227	10,227
ARRA - Coastal Alabama Economic Recovery	11.463	ALFO SA 3807-02	The Nature Conservancy	—	(967)	(967)
Total CFDA				208,401	9,260	217,661
Applied Meteorological Research	11.468			37,730	—	37,730
Congressionally Identified Award and Projects	11.469	TASK ORDER D-1	Dauphin Island Sea Lab (MESC)	—	(107)	(107)
Congressionally Identified Award and Projects	11.469	10-62-08-A1	Exxon Valdez Oil Spill Trustee	—	60,408	60,408
Total CFDA				—	60,301	60,301
Alabama Coastal Pelagic Fisheries	11.472	TASK ORDER D-4	Dauphin Island Sea Lab (MESC)	—	102,480	102,480
Center for Sponsored Coastal Ocean Research - Coastal Ocean	11.478			18,312	—	18,312
Total U.S. Department of Commerce				370,656	435,100	805,756
U.S. Department of Defense:						
Military Medical Research and Development	12.420			168,612	—	168,612
Air Force Defense Research Sciences Program	12.800			68,769	—	68,769
Total U.S. Department of Defense				237,381	—	237,381
U.S. Department of Housing and Urban Development:						
Community Development Block Grants	14.228	10-100112	Mississippi Department of Archives and History	—	(643)	(643)
U.S. Department of Interior:						
Red Snaper and Amberjack Habitat	15.605	110266/120071	Alabama Department of Conservation and Natural Resources	—	330,232	330,232
Cooperative Endangered Species Conservation Fund	15.615	110236/110235	Alabama Division of Wildlife and Fisheries	—	10,898	10,898
Endangered Species Conservation - Recovery Implementation Funds	15.657			19,152	—	19,152
National Cooperative Geologic Mapping Program	15.810			1,543	—	1,543
American Battlefield Protection	15.926			29,424	—	29,424
Total U.S. Department of Interior				50,119	341,130	391,249
U.S. Department of Transportation:						
Highway Planning and Construction	20.205			(765,334)	—	(765,334)

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Schedule of Expenditures of Federal Awards

Year ended September 30, 2012

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
National Aeronautics and Space Administration:						
Aerospace Education Services Program	43.001	SUB2010-2006	University of Alabama in Huntsville	$ —	207,309	207,309
Technology Transfer	43.002			(519)	—	(519)
Technology Transfer	43.002	SUB2010-176-A2-02	National Aeronautics and Space Administration	—	(83)	(83)
Technology Transfer	43.002	SUB2010.176	University of Alabama in Huntsville	—	40	40
Total CFDA				(519)	(43)	(562)
Total National Aeronautics and Space Administration				(519)	207,266	206,747
National Science Foundation:						
Engineering Grants	47.041			442,707	—	442,707
Mathematical and Physical Sciences	47.049			156,574	—	156,574
Geosciences	47.050			98,998	—	98,998
Geosciences	47.050	1021RR100513	University of Georgia	—	6,178	6,178
Total CFDA				98,998	6,178	105,176
Biological Sciences	47.074			9,008	—	9,008
Social Behavioral and Economic Sciences	47.075			46,611	—	46,611
Education and Human Resources	47.076			130,110	—	130,110
Education and Human Resources	47.076	11-110327/100390	Mobile Area Education Foundation Inc.	—	59,852	59,852
Total CFDA				130,110	59,852	189,962
Polar Programs	47.078			143,170	—	143,170
Office of Experimental Programs	47.081	34-21530-200-76190	Tuskegee University	—	44,178	44,178
Office of Experimental Programs	47.081	SUB2011-026	University of Alabama in Huntsville	—	59,113	59,113
Total CFDA				—	103,291	103,291
ARRA - NSF Recovery Act Research Support	47.082			256,423	—	256,423
ARRA - NSF Recovery Act Research Support	47.082	AA-5-31980	Oklahoma State University	—	51,125	51,125
ARRA - NSF Recovery Act Research Support	47.082	1328-206-2087448	Clemson University	—	28,521	28,521
Total CFDA				256,423	79,646	336,069
Total National Science Foundation				1,283,601	248,967	1,532,568
U.S. Environmental Protection Agency:						
Dendritic Polynmers as Biocompatible	66.509	1614-218-2008962	Clemson University	—	6,573	6,573
U.S. Department of Energy:						
Basic Energy Sciences University and Science	81.049			75,841	—	75,841
Basic Energy Sciences University and Science	81.049	10-ENG-246590-USA	Auburn University	—	45,365	45,365
Total CFDA				75,841	45,365	121,206
Total U. S. Department of Energy				75,841	45,365	121,206
U.S. Department of Education:						
Research in Special Education	84.324			331,806	—	331,806
Project C. A. R. E	84.377	110347	Information Transport Solutions, Inc.	—	43,449	43,449
Total U. S. Department of Education				331,806	43,449	375,255
U.S. Department of Health and Human Services:						
Public Health and Social Services	93.003	110019	Alabama Department of Mental Health	—	85,130	85,130
Birth Defects and Development Disabilities	93.073	NO1-A1-30025-01	University of Alabama in Birmingham	—	9,012	9,012
Molecular and Biochemical Character	93.103	TASK ORDER D5/D6	Dauphin Island Sea Lab	—	12,954	12,954
Environmental Health	93.113			480,566	—	480,566
Oral Diseases and Disorders Research	93.121	R 548086-03	State University of New York – Buffalo	—	54,378	54,378
Minority Health and Health Disparities Research	93.307			1,425,478	—	1,425,478
Minority Health and Health Disparities Research	93.307	30021805313	University of Michigan	—	15,233	15,233
Total CFDA				1,425,478	15,233	1,440,711

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Year ended September 30, 2012

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Trans-NIH Research Support	93.310			$ 34,917	—	34,917
National Center for Research Resources	93.389			385,386	—	385,386
Cancer Cause and Prevention Research	93.393			261,156	—	261,156
Cancer Cause and Prevention Research	93.393	S12001	Southern Research Institute	—	50,984	50,984
Total CFDA				261,156	50,984	312,140
Cancer Detection and Diagnosis Research	93.394			8,443	—	8,443
Cancer Treatment Research	93.395			8,721	—	8,721
Cancer Treatment Research	93.395	7U10CA76001-4	Duke University Medical Center	—	14,319	14,319
Cancer Treatment Research	93.395	98543-1234	National Childhood Cancer Foundation	—	70,267	70,267
Cancer Treatment Research	93.395	27469-02	University of Alabama	—	2,793	2,793
Total CFDA				8,721	87,379	96,100
Cancer Biology Research	93.396			522,972	—	522,972
ARRA - NIH Recovery Act Research Support	93.701			117,144	—	117,144
NIH Recovery Act Research Support	93.701	12-7921-2009-8.A	Children's Hospital of Oakland	—	2,065	2,065
Total CFDA				117,144	2,065	119,209
ARRA-National Center for Research Resources, Recovery Act Construction Support	93.702			5,233,174	—	5,233,174
Cardiovascular Diseases Research	93.837			2,310,127	—	2,310,127
Cardiovascular Diseases Research	93.837	SR00001589	University of Maryland	—	20,697	20,697
Total CFDA				2,310,127	20,697	2,330,824
Lung Diseases Research	93.838			2,618,342	—	2,618,342
Blood Diseases and Resources Research	93.839	101524623	Baylor College of Medicine	—	28,449	28,449
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847			101,807	—	101,807
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	VUMC37157	Vanderbilt University	—	8,688	8,688
Total CFDA				101,807	8,688	110,495
Allergy Immunology and Transplantation Research	93.853	A08580	Yale University	—	14,676	14,676
Allergy Immunology and Transplantation Research	93.853	126155-03	University of British Columbia		10,151	10,151
Allergy Immunology and Transplantation Research	93.853	A08082 (M01A10568)	Yale University	—	(686)	(686)
Allergy Immunology and Transplantation Research	93.853			157,963	—	157,963
Total CFDA				157,963	24,141	182,104
Allergy Immunology and Transplantation Research	93.855	2012-2764	University of California	—	9,602	9,602
Allergy Immunology and Transplantation Research	93.855			615,897	—	615,897
Total CFDA				615,897	9,602	625,499
Pharmacology Physiology and Biological Chemistry	93.859			302,523	—	302,523
Vision Research	93.867			507,208	—	507,208
Total U.S. Department of Health and Human Services				15,091,824	408,712	15,500,536
Total Research and Development Cluster				16,675,375	1,735,919	18,411,294
Other federal assistance:						
U. S. Department of Agriculture:						
Plant and Animal Disease Pest Control and Animal Care	10.025			9,191	—	9,191
U.S. Department of Commerce:						
Special Economic Development	11.307	EDPASG02	Economic Development Partnership of Alabama Foundation	—	(24,765)	(24,765)
Coastal Zone Management Estuarine Research	11.420			31,245	—	31,245
Cooperative Fishery Statistics	11.434	EDP-ESF-RB-2010-USA	Gulf States Marine Fisheries Commission	—	(974)	(974)
NIST Summer Undergrad Research Fellowship	11.609			8,704	—	8,704
Congressionally Identified Projects*	11.617			8,692,186	—	8,692,186
Total U.S. Department of Commerce				8,732,135	(25,739)	8,706,396

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Schedule of Expenditures of Federal Awards

Year ended September 30, 2012

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
U.S. Department of Defense:						
Procurement Technical Assistance for Business Firms	12.002	PTAC-USA-10-067/UA 11-062	University of Alabama	$ —	11,304	11,304
Psychometric Evaluation	12.910			18	—	18
Total U. S. Department of Defense				18	11,304	11,322
U. S. Department of Justice						
Bulletproof Vest Partnership	16.607	11BPBPV005	Alabama Department of Economic and Community Affairs	—	3,103	3,103
U.S. Department of Transportation:						
Highway Planning and Construction	20.205	DPI-0030 (005)	Volkert and Associates	—	2,673	2,673
National Aeronautics and Space Administration:						
Aerospace Education Services Program	43.001			3,174	—	3,174
Aerospace Education Services Program	43.001	SUB2010-176-A3	University of Alabama in Huntsville	—	57,910	57,910
Total CFDA				3,174	57,910	61,084
Technology Transfer	43.002	SUB2010-176	University of Alabama in Huntsville	—	3,689	3,689
Total National Aeronautics and Space Administration				3,174	61,599	64,773
National Endowment for the Humanities:						
Promotion of the Humanities Division and Preservation	45.129	0910-2005-TS	Alabama Humanities Foundation	—	(300)	(300)
National Science Foundation:						
Therophysical and Solvent Properties	47.041			2,286	—	2,286
Mathematical and Physical Sciences	47.049			416	—	416
Geosciences	47.050			46	—	46
Biological Sciences	47.074			84,380	—	84,380
Education and Human Resources	47.076			116,750	—	116,750
Education and Human Resources	47.076			78,271	—	78,271
Education and Human Resources	47.076	000398033-006	University of Alabama at Birmingham	—	10,142	10,142
Education and Human Resources	47.076	062900-362475	Mississippi State University	—	73,043	73,043
Education and Human Resources	47.076	100390	Mobile Area Education Foundation Inc.	—	19,925	19,925
Total CFDA				195,021	103,110	298,131
ARRA-Pathway to Science	47.082			215,045	—	215,045
Total National Science Foundation				497,194	103,110	600,304
U.S. Small Business Administration:						
Small Business Development Centers	59.037	SBA-USA-11-041	University of Alabama at Birmingham	—	(205)	(205)
Small Business Development Centers	59.037	SBAUA12-023	University of Alabama	—	126,071	126,071
Total CFDA				—	125,866	125,866
Total U.S. Small Business Administration				—	125,866	125,866
U. S. Environmental Protection Agency					—	
Science to Achieve Results	66.514			2,236	—	2,236
U.S. Department of Energy:						
Basic Energy Sciences University and Science Education	81.049	DE-SC0002470	University of Alabama	—	21,215	21,215
ARRA - USAMC Energy Retrofit Project	81.128	90402	City of Saraland	—	750,000	750,000
Total U. S. Department of Energy				—	771,215	771,215
U.S. Department of Education:						
Special Education Grants to States	84.027	100383/110373	Alabama State Department of Education	—	25,000	25,000
TRIO Cluster:						
TRIO Talent Search	84.044			270,424	—	270,424
TRIO Upward Bound	84.047			268,852	—	268,852
Total TRIO Cluster				539,276	—	539,276
Research in Sepcial Education	84.324			1,112	—	1,112
Teacher Quality Enhancement Grants	84.336	U00717-01	Alabama State Department of Education	—	31,431	31,431
Transition to Teaching	84.350			82,711	—	82,711
Mathematics and Science Partnerships	84.366	U100606	Alabama Department of Education	—	219,377	219,377
Improving Teacher Quality State Grants	84.367	100406/110312	Alabama Commission of Higher Education	—	133,940	133,940
Improving Teacher Quality State Grants	84.367	110328	Jacksonville State University	—	40,347	40,347
Total CFDA				—	174,287	174,287
Total U.S. Department of Education				623,099	450,095	1,073,194

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Schedule of Expenditures of Federal Awards

Year ended September 30, 2012

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
U.S. Department of Health and Human Services:				$		
Environmental Public Health	93.007	C20119164	State of Alabama Department of Public Health	—	17,225	17,225
Alzheimer's Disease Demonstration Grants to States	93.051	12-120267	South Alabama Regional Planning Commission	—	9,515	9,515
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153			348,728	—	348,728
Advanced Education Nursing Grant Programs*	93.247			3,432,927	—	3,432,927
Universal Newborn Hearing Study	93.251	C20119022	State of Alabama Department of Public Health	—	20,250	20,250
Centers for Disease Control	93.283	C10114277	State of Alabama Department of Public Health	—	85,812	85,812
Minority Health and Health Disparities Research	93.307			29,709	—	29,709
Professional Nurse Traineeships	93.358			222,008	—	222,008
Basic Nurse Education and Practice Grants	93.359			257,282	—	257,282
Patient Protection and Affordable Act	93.541	000305851-021	University of Alabama at Birmingham	—	34,258	34,258
ARRA-Health Information Technology Regional Extension Centers Program*	93.718			1,845,653	—	1,845,653
Lung Diseases Research	93.838			72,136	—	72,136
Grants for Residency Training for General Pediatrics	93.884			266,589	—	266,589
Health Care and Other Facilities*	93.887			1,647,751	—	1,647,751
Specially Selected Health Projects	93.888			31,162	—	31,162
National Bioterrorism Hospital Preparedness Program	93.889	C10114292(EEP-13-QW2-12)	Alabama Department of Public Health	—	1,182,324	1,182,324
HIV Care Formula Grants	93.917	RW-USAF-1112	United Way of Central Alabama	—	100,682	100,682
Human Immunodeficiency	93.944	C20119019	State of Alabama Department of Public Health	—	12,314	12,314
Cooperative Agreements to Support State-Based Infant	93.946	120025	Mobile County Health Department	—	131,947	131,947
Total U.S. Department of Health and Human Services				8,153,945	1,594,327	9,748,272
Corporation for National and Community Service:						
AmeriCorps	94.006			24,173	—	24,173
Total other federal assistance				18,045,165	3,097,253	21,142,418
Total federal expenditures				$ 149,204,635	4,833,172	154,037,807

* Denotes a major program.

See accompanying notes to the schedule of expenditures of federal awards.

See accompanying independent auditors' report.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Notes to Schedule of Expenditures of Federal Awards

September 30, 2012

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of the University of South Alabama (the University) and is presented on the accrual basis of accounting. The information in the Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Therefore, some amounts presented in the Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

There were no loans advanced related to Loans for Disadvantaged Students and Health Professions Student Loans for the year ended September 30, 2012. Outstanding loans made by the University are included in notes receivable in the University's 2012 statement of net assets and consist of the following loan programs:

	CFDA #		Amount
Federal Perkins Loan Program	84.038	$	3,866,450
Loans for Disadvantaged Students	93.342		623
Health Professions Student Loans	93.342		3,162
Nurse Faculty Loan Program	93.264		149,228
Nurse Faculty Loan Program ARRA	93.408		42,115
			4,061,578
Less outstanding balance of loans granted in previous years			(3,261,957)
Loans advanced to eligible students of the University during 2012		$	799,621

The University's Federal Direct Student Loan Program (Direct Loan) included in the Schedule represents loans received by students of the University during fiscal year 2012 which were not made by the University. Accordingly, Direct Loan amounts are not reflected in the University's basic financial statements. It is not practicable to determine the balance of loans outstanding to students and former students of the University under these programs as of September 30, 2012.

(2) Contingencies

The University's federal programs are subject to financial and compliance audits by grantor agencies which, if instances of material noncompliance are found, may result in disallowed expenditures and affect the University's continued participation in specific programs.

(3) Federal Direct Student Loans

During fiscal year ended September 30, 2012, the University advanced to students the following amount of new loans under Direct Loan:

	CFDA #		Amount expended
Stafford loans	84.268	$	28,831,814
Unsubsidized Stafford loans	84.268		58,358,045
Parent Loans for Undergraduate Students	84.268		8,585,377
Total		$	95,775,236

(4) Subrecipients

Of the federal expenditures presented in the Schedule, the University provided federal awards to subrecipients under the following programs:

	Federal CFDA #		Amounts expended
Habitat Conservation	11.463	$	44,904
Aeorspace Education Services Program	43.001		86,907
Biological Sciences	47.074		7,797
Geosciences	47.050		4,305
Education and Human Resources	47.076		7,594
Office of Science Financial Assistance Program Recovery	81.049		15
Transition to Teaching	84.350		49,173
Mathematics and Science Partnerships	84.366		156,185
Improving Teacher Quality State Grants on Higher Education	84.367		44,125
Environmental Health	93.113		34,604
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153		11,844
Minority Health and Health Disparities Research	93.307		193,170
National Center for Research Resources	93.389		82,954
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847		(1,092)
Cardiovascular Diseases Research	93.837		25,845
The Patient Protection and Affordable Care Act	93.541		15,770
Health Information Technology Regional Extension Centers Program	93.718		1,345,475
Vision Research	93.867		59,500

	Federal CFDA #	Amounts expended
Allergy, Immunology and Transplantation Research	93.855	10,529
Grants for Residency Training for General Pediatrics	93.884	10,000
Healthcare and Other Facilities	93.887	460,000
		$ 2,649,604

(5) Matching

Under the Federal Work Study Program and Federal Supplemental Education Opportunity Grant Program, the University matched $22,577 and $137,309, respectively, in funds awarded to students for the year ended September 30, 2012 in addition to the Federal share of expenditures included in the Schedule.

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Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
University of South Alabama:

We have audited the basic financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units as of and for the year ended September 30, 2012, and have issued our report thereon dated November 15, 2012. We did not audit the 2012 consolidated financial statements of the University of South Alabama Foundation, which represents 80%, 101%, and 14%, respectively, of the assets, net assets and revenues, gains and other support of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the University of South Alabama Foundation, is based on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. The financial statements of the University of South Alabama Foundation, the University of South Alabama Health Services Foundation, the USA Research and Technology Corporation, and the Professional and General Liability Trust Funds were not audited in accordance with *Government Auditing Standards.*

Internal Control over Financial Reporting

In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards.*

This report is intended solely for the information and use of the board of trustees, management, and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 15, 2012

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Independent Auditors' Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
University of South Alabama:

Compliance

We have audited the University of South Alabama's (the University's) compliance with the types of compliance requirements described in the OMB *Circular A-133 Compliance Supplement* (Compliance Supplement) that could have a direct and material effect on each of the University's major federal programs for the year ended September 30, 2012, except the requirements discussed in the second paragraph of this report. The University's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the University's management. Our responsibility is to express an opinion on the University's compliance based on our audit.

We did not audit the University's compliance with requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan program in accordance with the requirements of the Student Financial Assistance Cluster: Federal Perkins Loan program as described in the Compliance Supplement. Those requirements govern functions performed by XEROX Education Services dba ACS Education Services, Inc. (ACS). Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements. ACS's compliance with the requirements governing the functions that it performs for the University for the year ended June 30, 2012 was examined by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* Our report does not include the results of the other accountants' examination of ACS's compliance with such requirements.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the University's compliance with those requirements.

As described in item 2012-02 in the accompanying schedule of findings and questioned costs, the University did not comply with requirements regarding allowable costs applicable to the Congressionally

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Identified Projects Program. Compliance with such requirements is necessary, in our opinion, for the University to comply with the requirements applicable to that program.

In our opinion, except for the noncompliance described in the preceding paragraph, the University complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2012. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as item 2012-01.

Internal Control Over Compliance

Management of the University is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing our audit, we considered the University's internal control over compliance with the requirements that could have a direct and material effect on a major federal program to determine the auditing procedures for the purpose of expressing our opinion on compliance, and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over compliance.

Requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan program in the Student Financial Aid Cluster: Federal Perkins Loan program as described in the Compliance Supplement are performed by ACS. Internal control over compliance related to such functions for the year ended June 30, 2012 was reported on by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* Our report does not include the results of the other accountants' testing of the University's internal control over compliance related to such functions.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified a deficiency in internal control over compliance that we consider to be a material weakness.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. We consider the deficiency in internal control over compliance described in the accompanying schedule of findings and questioned costs as item 2012-02 to be a material weakness.

The University's responses to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the University's responses and, accordingly, we express no opinion on the responses.

This report is intended solely for the information and use of the board of trustees, management and federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

November 15, 2012

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Schedule of Findings and Questioned Costs

Year ended September 30, 2012

I – Summary of Auditor's Results

Financial Statements

Type of auditors' report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	____ yes __x__ no
Significant deficiency(ies) identified that are not considered to be material weaknesses?	____ yes __x__ none reported
Noncompliance material to financial statements noted?	____ yes __x__ no

Federal Awards

Internal control over major programs:	
Material weakness(es) identified?	__x__ yes ____ no
Significant deficiency(ies) identified that are not considered to be material weaknesses?	____ yes __x__ none reported
Type of auditors' report issued on compliance for major programs:	**Unqualified** Student Financial Aid Cluster (CFDA #s 84.063, 84.007, 84.268, 84.033, 84.379, 84.038, 93.342, 93.264, 93.408 and 93.925); Research and Development Cluster (various CFDA #'s); U.S. Department of Health and Human Services/ Advanced Education Nursing Grant Programs (CFDA # 93.247); U.S. Department of Health and Human Services/ARRA - Health Information Technology Regional Extension Centers Program (CFDA # 93.718); and U.S. Department of Health and Human Services/Healthcare and Other Facilities (CFDA # 93.887); **Qualified** U.S. Department of Commerce/Congressionally Identified Projects (CFDA # 11.617)
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	__x__ yes ____ no

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Schedule of Findings and Questioned Costs

Year ended September 30, 2012

Identification of major programs:

CFDA Numbers	Name of Federal Program/Cluster
84.063, 84.007, 84.268, 84.033, 84.379, 84.038, 93.342, 93.264, 93.408, 93.925	Student Financial Aid Cluster
Various	Research and Development Cluster
11.617	U.S. Department of Commerce/ Congressionally Identified Projects
93.247	U.S. Department of Health and Human Services/Advanced Education Nursing Grant Programs
93.718	U.S. Department of Health and Human Services/ARRA - Health Information Technology Regional Extension Centers Program
93.887	U.S. Department of Health and Human Services/Healthcare and Other Facilities
Dollar threshold used to distinguish between type A and type B programs:	$ 1,186,612
Auditee qualified as low-risk auditee?	x yes _____ no

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Schedule of Findings and Questioned Costs

Year ended September 30, 2012

Section II – Findings Related to Financial Statements Reported in Accordance with *Government Auditing Standards*

There were no findings related to the financial statements reported in accordance with *Government Auditing Standards* for the year ended September 30, 2012.

Section III – Federal Award Findings and Questioned Costs relating to Federal Awards

Finding No. 2012-01 Special Tests and Provisions – Verification

Federal Agency:

U.S. Department of Education

CFDA Numbers:

84.063, 84.007, 84.268, 84.033, 84.379, 84.038, 93.342, 93.264, 93.408, 93.925

Program:

Student Financial Aid Cluster

Award Year:

July 1, 2011 through June 30, 2012
July 1, 2012 through June 30, 2013

Criteria

Under the Student Financial Aid Cluster, schools must perform verification of information submitted by applicants in connection with the calculation of their expected family contribution in accordance with 34 CFR Section 668.51. Schools shall require applicants selected for verification to submit acceptable documentation that will be verified or updated to determine the applicant's expected family contribution in accordance with 34 CFR Section 668.56.

Condition

During our test work over the Student Financial Aid Cluster, we selected a sample of 60 students selected for verification. Within our sample, we noted 3 instances in which income was not properly verified by University personnel and subsequently updated on the students' ISIR.

Cause

Additional information was received by the student financial aid office subsequent to the initial verification. At that time, each student's ISIR was not properly updated to reflect the change.

Questioned Cost

Total overawards to students totaled $1,150.

Effect

Noncompliance could result in failure to properly perform verification procedures in accordance with federal guidelines.

Recommendation

We recommend that the University strengthen its processes and controls in place to help ensure that information subject to verification is properly supported and updated on each applicant's ISIR if necessary.

Management Response

Management concurs with the finding. These errors were caused by increasing workloads within the Office of Student Financial Aid resulting from recent enrollment increases and additional regulatory requirements of administering financial aid funds. Financial Aid Office staff are fully and appropriately trained in the verification process. Management will initiate a thorough review of its internal controls over the verification process to determine if certain controls should be revised or additional controls should be added. As part of that review, staffing levels will be analyzed to ensure that they are adequate to ensure compliance with verification requirements.

Finding No. 2012-02 Allowable Costs / Activities Allowed

Federal Agency:

U.S. Department of Health and Human Services

CFDA Number:

11.617

Program:

Congressionally Identified Projects

Project Title:

University of South Alabama Engineering and Science Center

Award Number:

60NANB8D8120

Award Years:

May 1, 2008 through April 30, 2013

Criteria

OMB Circular A-21 (A-21) establishes principles for determining the costs applicable to activities performed by educational institutions under grants, contracts, and other agreements with the Federal Government. In accordance with A-21, direct costs charged to Federal grants must be for allowable costs.

Condition

During our testwork related to the Congressionally Identified Projects Program, we noted that certain costs charged to these grants were unallowable. The amount of costs determined to be unallowable was $1,581,461, which related to moveable equipment that was not an allowable cost under the grant. The University reversed the charges to this grant before the fiscal year end and therefore, these amounts are not included on the Schedule of Federal Awards for the year ended September 30, 2012. Total program costs after the unallowable costs were reversed totaled $8,692,186 for the year ended September 30, 2012.

Questioned Costs

$1,581,461

Context

The grant documents did not allow moveable equipment to be charged to the Federal grant.

Cause and Effect

Management of the University was unaware that moveable equipment was being charged to the grant. The construction management company that manages the University's major construction projects processed these as allowable costs. Appropriate internal controls were not in place at the University that would identify such an oversight by the construction management company. As a result, Federal funds were originally charged to the grant for unallowable purposes.

Recommendation

We recommend that the University strengthen its processes and internal controls to ensure that costs charged to the grant are allowable under the related grant agreement.

Management Response

Management concurs with the finding. As noted earlier, the University contracts with a construction management company to manage its construction projects and process all related accounting documentation. University accounting management was of the understanding that all employees of this company that were involved in this process were adequately trained not only in University accounting procedures but also in federal regulations with respect to allowable and unallowable costs. As such, too much reliance was placed on the ability of the company to determine the ultimate treatment of certain construction charges.

Effective immediately upon learning of this situation, additional procedures were put into place whereby all charges to construction grants for projects managed by the contractor are also being reviewed by the office of grants and contracts accounting personnel. Additionally, periodic meetings are held between University compliance and company personnel to discuss potential unallowable charges on an ongoing basis. Management is of the opinion that these additional layers of control will ensure that unallowable charges will no longer be made to federally funded construction projects.