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

Basic Financial Statements and Supplementary Information
on Federal Awards Programs

September 30, 2009

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

Basic Financial Statements

September 30, 2009 and 2008

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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, 2009 and 2008 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 number 1 to the basic financial statements, the University of South Alabama Professional Liability Trust Fund and the University of South Alabama General Liability Trust Fund 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, 2009, 2008, and 2007, the University had total assets of $856,249,000, $862,666,000, and $707,687,000, respectively; total liabilities of $449,570,000, $454,339,000, and $323,171,000, respectively; and net assets of $406,679,000, $408,327,000, and $384,516,000, respectively. University net assets decreased $1,648,000 during the year ended September 30, 2009 compared to increases of $23,811,000 and $73,158,000 in the years ended September 30, 2008 and 2007, respectively.

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, 2009 and 2008. 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 29%, 44%, and 12%, respectively, of current assets at September 30, 2009. Noncurrent assets at September 30, 2009 consist primarily of capital assets and restricted investments and noncurrent investments.

The Condensed Schedule of Net Assets at September 30, 2009, 2008, and 2007 follows (in thousands):

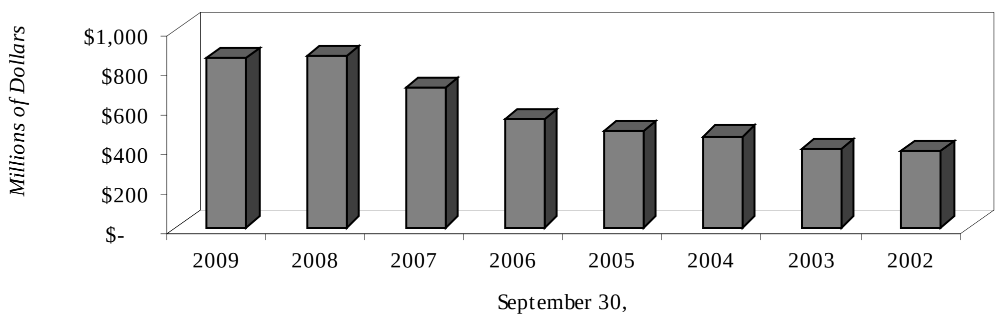
Condensed Schedule of Net Assets

		2009	2008	2007
Assets:				
Current	$	268,814	287,430	271,983
Capital assets		413,513	353,829	286,890
Other noncurrent		173,922	221,407	148,814
Total assets	$	856,249	862,666	707,687
Liabilities:				
Current	$	91,851	90,773	80,389
Noncurrent		357,719	363,566	242,782
Total liabilities	$	449,570	454,339	323,171
Net assets:				
Invested in capital assets, net of related debt	$	187,489	186,986	163,688
Restricted, nonexpendable		28,622	24,165	16,828
Restricted, expendable		28,685	23,071	35,955
Unrestricted		161,883	174,105	168,045
Total net assets	$	406,679	408,327	384,516

University cash, cash equivalents, and investments (current and noncurrent) decreased between September 30, 2008 and 2009 by $73,526,000 to $350,222,000. This decrease is due primarily to the use of existing funds for construction and to a $31,286,000 decrease in 2009 state appropriations. This follows an increase of $88,101,000 in cash, cash equivalents, and investments between 2007 and 2008, which resulted from cash generated by the issuance of additional bonded indebtedness totaling $120,085,000 and a $19,349,000 increase in state appropriations in 2008.

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

Total University Assets



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

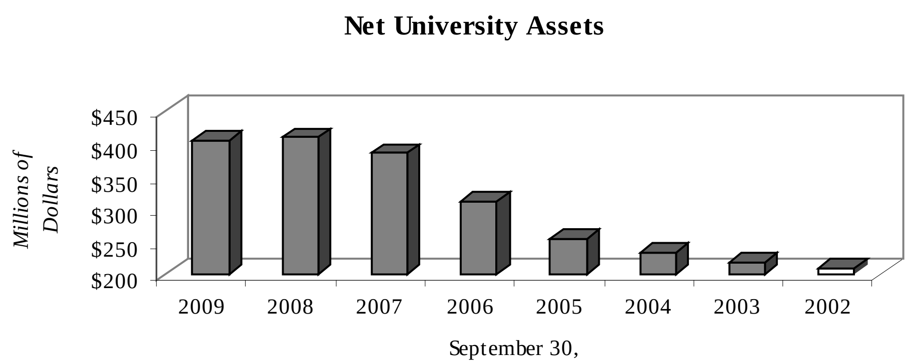
Net assets invested in capital assets, net of related debt, represent the University's capital assets less accumulated depreciation and outstanding principal balances of the debt attributable to the acquisition, construction, or improvement of those assets.

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:



All categories of restricted net assets increased by approximately 21% between September 30, 2008 and 2009 primarily due to the improvement in financial market conditions and due to the addition of restricted gifts to the University. Unrestricted net assets decreased from $174,105,000 to $161,883,000 between September 30, 2008 and 2009 reflecting the results of University financial operations during fiscal year 2009.

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, 2009, 2008, and 2007 follows (in thousands):

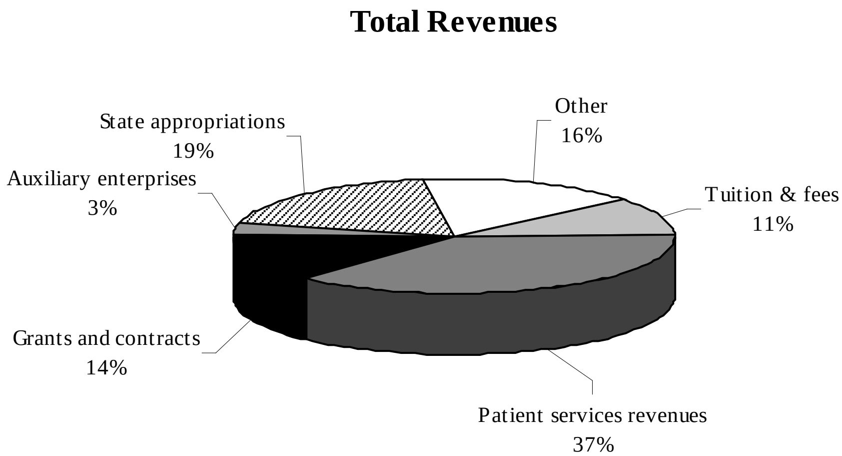
Condensed Schedule of Revenues, Expenses, and Changes in Net Assets

		2009	2008	2007
Operating revenues:				
Tuition and fees	$	61,076	54,823	49,579
Net patient service revenue		206,532	201,603	205,337
Federal, state and private grants and contracts		78,274	77,245	74,874
Other		49,753	47,660	45,803
		395,635	381,331	375,593
Operating expenses:				
Salaries and benefits		379,360	370,749	333,688
Supplies and other services		122,672	123,782	111,297
Other		46,540	39,565	35,977
		548,572	534,096	480,962
Operating loss		(152,937)	(152,765)	(105,369)
Nonoperating revenues (expenses):				
State appropriations		108,451	139,737	120,388
Investment income (loss)		11,744	(4,257)	19,534
Other, net		10,149	12,332	14,855
Net nonoperating revenues		130,344	147,812	154,777
(Loss) income before capital contributions and additions to endowment		(22,593)	(4,953)	49,408
Capital appropriations, capital contributions and additions to endowment		20,945	28,764	23,750
Change in net assets		(1,648)	23,811	73,158
Beginning net assets		408,327	384,516	311,358
Ending net assets	$	406,679	408,327	384,516

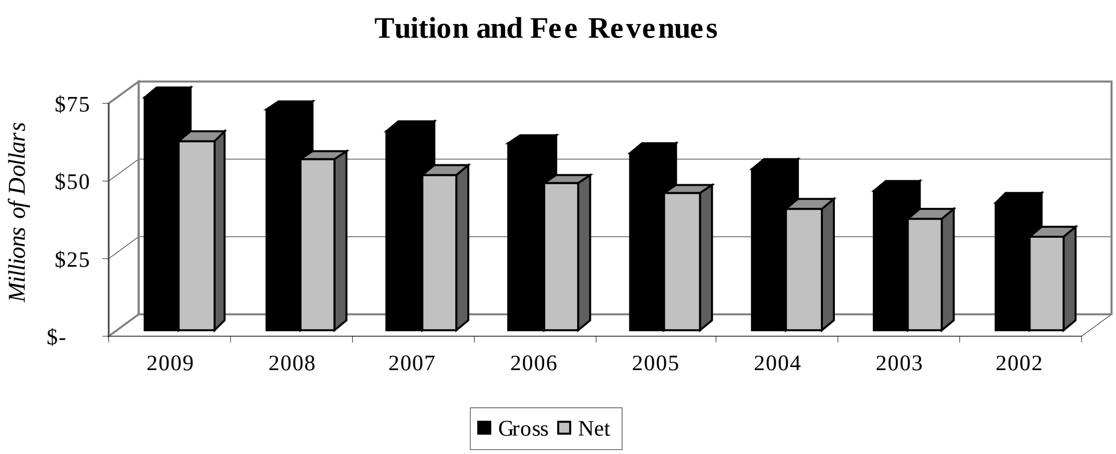
(Continued)

In 2009, 2008, and 2007, approximately 37%, 35%, and 38%, 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 19% of total revenues in fiscal 2009. Also in 2009 tuition and fees charged to students and grants and contracts (federal, state and private) represented approximately 11% and 14% of total revenues, respectively.

A summary of University revenues for the year ended September 30, 2009 is presented below:



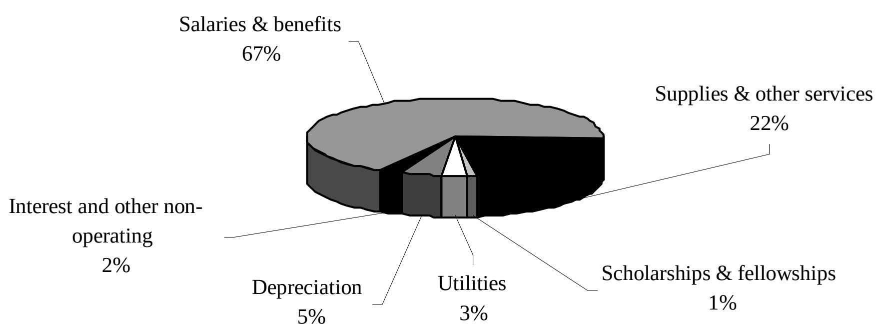
Tuition and fees have increased in each of the last six years. These increases are due to increases in tuition and fee rates charged to students as well as to an increase in the number of students enrolled. Additionally, tuition and fees as a percent of total operating revenues continue to increase, from 9.5% of operating revenues in 2002 to 15.4% in 2009. Tuition and fees, gross and net of scholarship allowances, for the past eight fiscal years are as follows:



Further, capital contributions and grants decreased from $19,268,000 in 2008 to $5,325,000 in 2009 due to the substantial completion in 2008 of grant funded construction of the Mitchell Cancer Institute. Additionally, the University recognized $10,171,000 in capital appropriations in 2009, compared to $0 in 2008. Those appropriations were utilized in the construction of the Student Recreation Center. As a result of significant fluctuations in financial market conditions, net investment income (loss) increased from a loss of $4,257,000 in 2008 to income of $11,744,000 in 2009. Included in 2009 income are unrealized market gains of $4,716,000.

University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2009 is presented below.

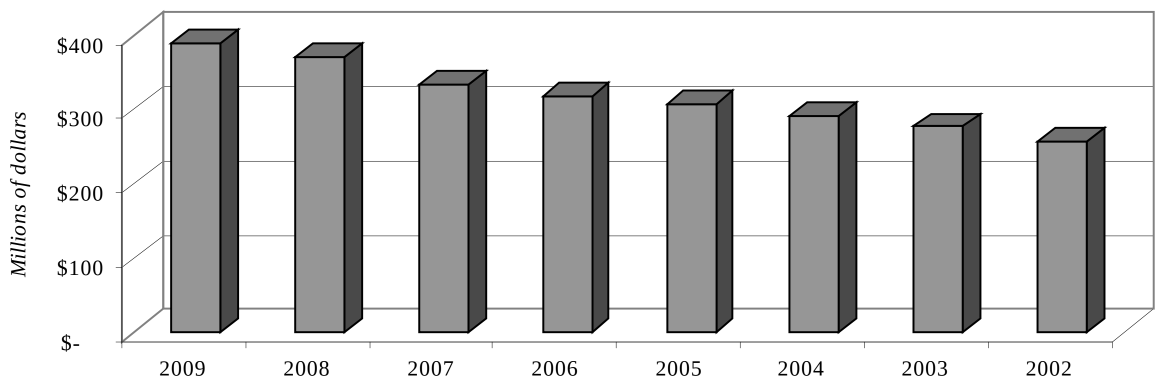
Total Expenses



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 16 to the basic financial statements.

In 2009, 2008, and 2007, approximately 69% of the University's total operating expenses were salaries and benefits. Salaries and benefits have steadily increased over the last eight years, resulting primarily from increases in salary rates to faculty and staff, as shown as follows:

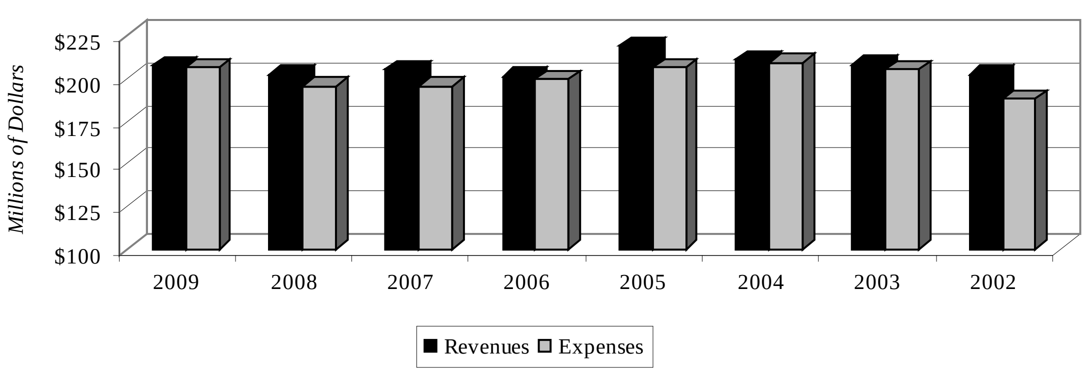
Total Salaries and Benefits Expense



For the years ended September 30, 2009, 2008, and 2007, the University reported an operating loss of approximately $152,937,000, $152,765,000, and $105,369,000, 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 $(1,648,000), $23,811,000, and $73,158,000, for the years ended September 30, 2009, 2008, and 2007, respectively.

The Hospitals represent a significant portion of total University revenues and expenses and have remained relatively constant over the past three years. Operating hospital revenues and expenses for the last eight 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 $84,904,000 in 2009. During 2009, the Mitchell Cancer Institute, the Nursing and Allied Health Building, and a major addition to the University's central utility plant system were placed into service and the Football Field House was substantially completed. Significant construction projects that remain in progress at September 30, 2009 include the Student Recreation Center, Bell Tower, and the Engineering and Science Building. Significant projects in fiscal 2007 and 2008 included Building II in the USA Technology and Research Park, JagTran (the campus shuttle system), Meisler Hall, and various ongoing projects. At September 30, 2009, the University has outstanding commitments of approximately $56,218,000 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 2009, $10,171,000 was recognized by the University and is reported as a capital appropriation and $11,161,000 remains unspent at September 30, 2009.

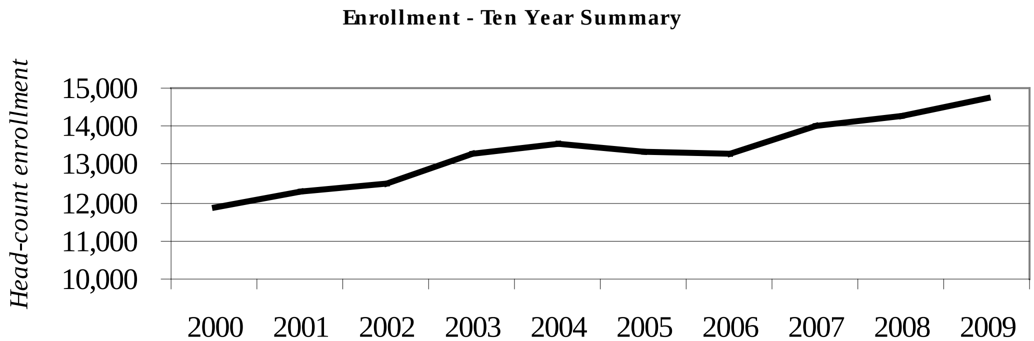
In September 2008, the University issued the University Facilities Revenue and Capital Improvement Bonds, Series 2008, with a face value of $112,885,000. The net proceeds of these bonds are being used to fund various construction and capital improvements at the University.

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.

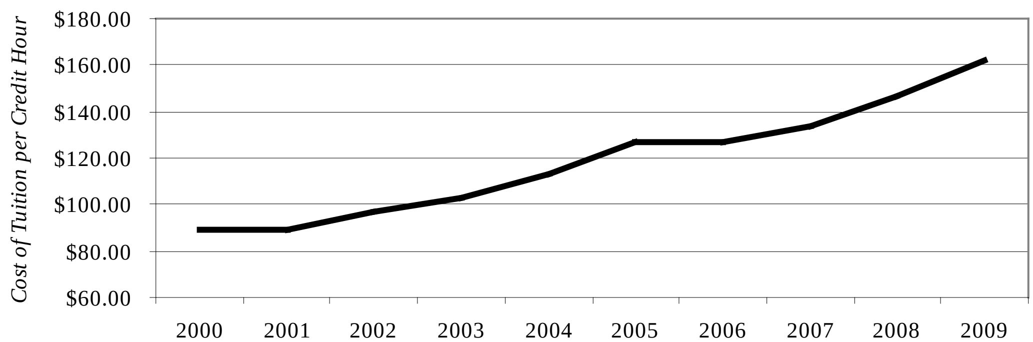
During the year ended September 30, 2008, the University's bond credit rating was upgraded by Moody's Investors Services from A2 to A1. This represents the first upgrade of the University's bond credit rating since 2004. The University also received a rating of A+ from Standard and Poor's Rating Services. There is no change in the University's rating at September 30, 2009.

Economic Outlook

Student enrollment and tuition have both increased over the past ten years. The University has experienced an increase in enrollment of approximately 24%, or 2,900 students, between 2000 and 2009, from 11,870 in 2000 to 14,755 for the 2009 fall semester. The enrollment trend for the University between 2000 and 2009 is as follows:



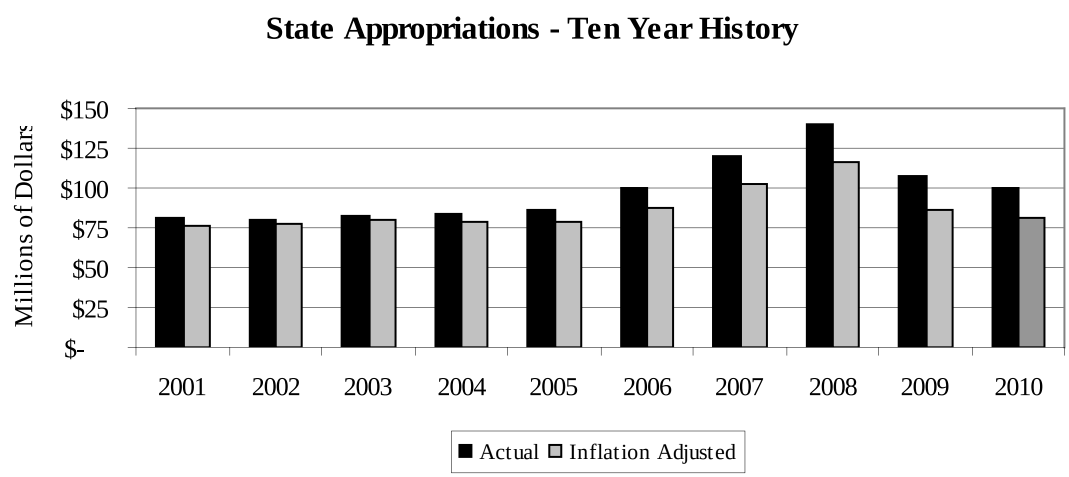
In that same time period, in-state tuition per credit hour has increased by approximately 96%. Similar increases have been experienced in out-of-state tuition, College of Medicine tuition, fees and housing fees. The trend of in-state tuition per credit hour between 2000 and 2009 is as follows:



While enrollment and tuition have both increased in recent years, state appropriations have historically been 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 has been authorized for the year ending September 30, 2010; however, in September 2009, the Governor announced proration of 7.5% for the year ending September 30, 2010. Following the announcement of proration, the state appropriation for the year ending September 30, 2010 is currently $100,022,000.

The ten year history of State Appropriations for the University is as follows:



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 have had a significant impact on the value of the University's endowment. 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, the American Recovery and Reinvestment Act (ARRA) was passed by Congress and signed into law by the President. As a result of this legislation, the University has been awarded approximately $10,769,000 in 2010 and 2011 through the U. S. Department of Education's State Fiscal Stabilization Fund Program. As of the current date, the total award is 90% of $21,538,000, or $19,384,000. The remaining 10% will not be awarded until the State has made application to the federal government. Additional funding is available through the competitive grant process from various federal agencies. As of September 30 2009, the University had been awarded ARRA grants totaling approximately $1,919,000. Additional proposals remain outstanding at September 30, 2009.

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 2010 beyond those unknown variables having a global effect on virtually all types of business operations.

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Independent Auditors' Report on Basic Financial Statements and Schedule of Expenditures of Federal Awards

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, 2009 and 2008, 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 2009 and 2008 consolidated financial statements of the University of South Alabama Foundation, which represents 80%, 101% and (50)%, respectively, of the 2009 assets, net assets, and revenues, gains and other support of the discretely presented component units and 82%, 100% and (14)%, respectively, of the 2008 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 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, 2009 and 2008, 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.

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, 2009 and 2008, 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 13, 2009, 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.

The management's discussion and analysis on pages 1 through 11 is not a required part of the basic financial statements but is supplementary information required by U. S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were performed 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, 2009 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. The Schedule of Expenditures of Federal Awards has been subjected to the auditing procedures applied in the audit of the 2009 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the 2009 basic financial statements taken as a whole.

KPMG LLP

November 13, 2009

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

Statements of Net Assets

September 30, 2009 and 2008

(In thousands)

		2009	2008
Assets:			
Current assets:			
Cash and cash equivalents	$	79,297	34,914
Investments		117,816	187,947
Net patient accounts receivable, (net of allowance for doubtful accounts of $48,690 and $45,650)		30,929	26,018
Accounts receivable, affiliates		18,284	15,329
Accounts receivable, other		15,162	14,485
Notes receivable, net		306	837
Prepaid expenses, inventories, and other		7,020	7,900
Total current assets		268,814	287,430
Noncurrent assets:			
Restricted cash and cash equivalents		56,615	95,893
Restricted investments		95,506	103,889
Investments		988	1,105
Accounts receivable		7,447	7,237
Notes receivable, net		5,058	4,887
Other noncurrent assets		8,308	8,396
Capital assets, net		413,513	353,829
Total noncurrent assets		587,435	575,236
Total assets		856,249	862,666
Liabilities:			
Current liabilities:			
Accounts payable and accrued liabilities		55,598	58,588
Deferred revenue		29,468	26,228
Deposits		904	990
Current portion of long-term debt		5,881	4,967
Total current liabilities		91,851	90,773
Noncurrent liabilities:			
Long-term debt, less current portion		307,471	311,359
Other long-term liabilities		50,248	52,207
Total noncurrent liabilities		357,719	363,566
Total liabilities		449,570	454,339
Net assets:			
Invested in capital assets, net of related debt		187,489	186,986
Restricted, nonexpendable:			
Scholarships		11,702	10,741
Other		16,920	13,424
Restricted, expendable:			
Scholarships		4,865	4,698
Other		23,820	18,373
Unrestricted		161,883	174,105
Total net assets	$	406,679	408,327

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2009 and 2008

(In thousands)

Assets		**2009**	**2008**
Cash and cash equivalents	$	2,298	1,337
Investments:			
Securities, at fair value		83,884	120,133
Timber and mineral properties		150,211	154,462
Real estate		8,573	9,792
Other		5,519	5,500
Accounts receivable		7	—
Other assets		520	452
Total assets	$	251,012	291,676
Liabilities and Net Assets			
Liabilities:			
Accounts payable	$	169	82
Other liabilities		672	646
Total liabilities		841	728
Net assets:			
Unrestricted		55,053	87,273
Temporarily restricted		26,295	34,739
Permanently restricted		168,823	168,936
Total net assets		250,171	290,948
Total liabilities and net assets	$	251,012	291,676

See accompanying notes to basic financial statements.

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

Statements of Financial Position

September 30, 2009 and 2008

(In thousands)

Assets		**2009**	**2008**
Current assets:			
Cash and cash equivalents	$	1,397	846
Patient accounts receivable (net of allowance for uncollectible accounts of approximately $4,827 and $5,281)		10,395	10,747
Other current assets		1,039	1,269
Total current assets		12,831	12,862
Interest in assets of University of South Alabama Professional Liability Trust Fund		20,685	20,928
Property and equipment, net		2,475	2,604
Total assets	$	35,991	36,394
Liabilities and Net Assets (Deficit)			
Current liabilities:			
Accounts payable	$	2,179	1,978
Current portion of notes payable		—	570
Due to affiliates		18,149	15,069
Total current liabilities		20,328	17,617
Estimated professional liability costs		20,685	20,928
Total liabilities		41,013	38,545
Unrestricted net deficit		(5,022)	(2,151)
Total liabilities and net assets	$	35,991	36,394

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Net Assets

September 30, 2009 and 2008

(In thousands)

		2009	2008
Assets:			
Current assets:			
Cash and cash equivalents	$	863	1,505
Investments		499	3,265
Rent receivable		167	147
Tenant expense reimbursements and other		32	14
Total current assets		1,561	4,931
Noncurrent assets:			
Intangible assets, net		261	245
Capital assets, net		26,492	24,052
Total noncurrent assets		26,753	24,297
Total assets		28,314	29,228
Liabilities:			
Current liabilities:			
Deposits, other current liabilities, and accrued expenses		554	557
Payable to University of South Alabama		11	11
Deferred rent income		115	137
Current portion of notes payable		909	858
Total current liabilities		1,589	1,563
Noncurrent liabilities:			
Notes payable, excluding current portion		25,278	26,173
Total noncurrent liabilities		25,278	26,173
Total liabilities		26,867	27,736
Net assets (deficit):			
Invested in capital assets, net of related debt		247	(259)
Unrestricted		1,200	1,751
Total net assets	$	1,447	1,492

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, 2009 and 2008

(In thousands)

		2009	2008
Operating revenues:			
Tuition and fees (net of scholarship allowances of $20,516 and $16,483)	$	61,076	54,823
Net patient service revenue		206,532	201,603
Federal grants and contracts		23,017	22,378
State grants and contracts		7,146	8,238
Private grants and contracts		48,111	46,629
Auxiliary enterprises (net of scholarship allowances of $635 and $510)		16,806	16,866
Other operating revenues		32,947	30,794
Total operating revenues		395,635	381,331
Operating expenses:			
Salaries and benefits		379,360	370,749
Supplies and other services		122,672	123,782
Scholarships and fellowships		5,615	4,997
Utilities		15,742	14,400
Depreciation and amortization		25,183	20,168
Total operating expenses		548,572	534,096
Operating loss		(152,937)	(152,765)
Nonoperating revenues (expenses):			
State appropriations		108,451	139,737
Investment income (loss)		11,744	(4,257)
Interest expense		(12,290)	(8,089)
Other nonoperating revenues		24,070	27,018
Other nonoperating expenses		(1,631)	(6,597)
Net nonoperating revenues		130,344	147,812
Loss before capital appropriations, contributions, and additions to endowment		(22,593)	(4,953)
Capital appropriations		10,171	—
Capital contributions and grants		5,325	19,268
Additions to endowment		5,449	9,496
Change in net assets		(1,648)	23,811
Net assets:			
Beginning of year		408,327	384,516
End of year	$	406,679	408,327

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, 2009

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Net realized and unrealized losses on investments	$ (24,589)	(10,367)	(114)	(35,070)
Rents, royalties and timber sales	5,852	—	71	5,923
Interest and dividends	816	1,225	10	2,051
Gifts	5	6	2	13
Required match of donor contributions	(13)	13	—	—
Interfund interest	(118)	118	—	—
Transfers	125	(43)	(82)	—
Reclassification of net assets based on change in law	(1,931)	1,931	—	—
Net assets released from program restrictions	1,327	(1,327)	—	—
Total revenues, gains, and other support	(18,526)	(8,444)	(113)	(27,083)
Expenditures:				
Program services:				
Faculty support	2,299	—	—	2,299
Scholarships	1,065	—	—	1,065
Other	1,506	—	—	1,506
Total program service expenditures	4,870	—	—	4,870
Management and general	1,536	—	—	1,536
Other investment expense	1,675	—	—	1,675
Depreciation expense	5,564	—	—	5,564
Depletion expense	49	—	—	49
Total expenditures	13,694	—	—	13,694
Decrease in net assets	(32,220)	(8,444)	(113)	(40,777)
Net assets – beginning of year	87,273	34,739	168,936	290,948
Net assets – end of year	$ 55,053	26,295	168,823	250,171

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, 2008

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Net realized and unrealized gains (losses) on investments	$ 3,011	(18,258)	(2,528)	(17,775)
Rents, royalties and timber sales	4,536	—	70	4,606
Interest and dividends	1,663	1,586	7	3,256
Gifts	—	7	170	177
Other income	5	24	—	29
Required match of donor contributions	(167)	—	167	—
Interfund interest	(513)	513	—	—
Net assets released from program restrictions	8,840	(8,840)	—	—
Total revenues, gains, and other support	17,375	(24,968)	(2,114)	(9,707)
Expenditures:				
Program services:				
Faculty support	2,521	—	—	2,521
Scholarships	1,016	—	—	1,016
Other	6,262	—	—	6,262
Total program service expenditures	9,799	—	—	9,799
Management and general	2,007	—	—	2,007
Other investment expense	2,900	—	—	2,900
Depreciation and depletion expense	3,408	—	—	3,408
Total expenditures	18,114	—	—	18,114
Decrease in net assets	(739)	(24,968)	(2,114)	(27,821)
Net assets – beginning of year	88,012	59,707	171,050	318,769
Net assets – end of year	$ 87,273	34,739	168,936	290,948

See accompanying notes to basic financial statements.

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

Statements of Operations and Changes in Unrestricted Net Assets (Deficit)

Years ended September 30, 2009 and 2008

(In thousands)

		2009	2008
Unrestricted revenues, gains and other support:			
Net patient service revenue	$	68,257	67,484
Other revenue		8,046	7,857
Total unrestricted revenues, gains, and other support		76,303	75,341
Expenses:			
Salaries and benefits		47,936	46,212
General and administrative		12,746	17,748
Provision for uncollectible accounts		13,582	13,459
Depreciation and amortization		976	993
Interest		7	65
Total expenses		75,247	78,477
Operating income (loss)		1,056	(3,136)
Nonoperating gains		301	180
Total nonoperating gains		301	180
Revenues over (under) expenses		1,357	(2,956)
Contributions restricted for debt service, received and expended within the same year		577	1,000
Transfer of capital to University of South Alabama College of Medicine		(4,805)	(1,517)
Change in unrestricted net assets (deficit)		(2,871)	(3,473)
Unrestricted net (deficit) assets at beginning of year		(2,151)	1,322
Unrestricted net deficit at end of year	$	(5,022)	(2,151)

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

Year ended September 30, 2009

(In thousands)

		2009	2008
Operating revenues:			
Rental income	$	3,475	2,878
Tenant reimbursements		39	29
Total operating revenues		3,514	2,907
Operating expenses:			
Building management and operating expenses		804	533
Depreciation and amortization		810	681
Legal and administrative fees		34	32
Insurance		48	57
Total operating expenses		1,696	1,303
Operating income		1,818	1,604
Nonoperating revenues (expenses):			
Investment income		31	83
Interest expense		(1,635)	(1,426)
Donation revenue		159	140
Other		5	3
Net nonoperating expenses		(1,440)	(1,200)
Transfer of building to University of South Alabama		(423)	—
Change in net assets		(45)	404
Net assets:			
Beginning of year		1,492	1,088
End of year	$	1,447	1,492

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, 2009 and 2008

(In thousands)

		2009	2008
Cash flows from operating activities:			
Receipts related to tuition and fees	$	63,151	57,061
Receipts from and on behalf of patients and third-party payers		201,850	206,743
Receipts from grants and contracts		74,695	79,517
Receipts related to auxiliary enterprises		16,832	16,823
Payments to suppliers and vendors		(142,998)	(141,907)
Payments to employees and related benefits		(378,752)	(366,379)
Payments for scholarships and fellowships		(5,615)	(5,451)
Other operating receipts		34,084	31,856
Net cash used in operating activities		(136,753)	(121,737)
Cash flows from noncapital financing activities:			
State appropriations		108,451	139,737
Endowment gifts		5,099	9,361
Agency funds received		515	625
Agency funds disbursed		(687)	(280)
Stafford and PLUS loans received		83,809	76,739
Stafford and PLUS loans disbursed		(83,768)	(76,857)
New loans issued to students		(26)	(113)
Student loan repayments		300	299
Other nonoperating revenues		23,852	26,476
Other nonoperating expenses		(2,133)	(5,173)
Net cash provided by noncapital financing activities		135,412	170,814
Cash flows from capital and related financing activities:			
Capital contributions and grants		5,062	19,268
Purchases of capital assets		(72,108)	(89,417)
Proceeds from sale of capital assets		105	68
Proceeds from issuance of capital debt		—	120,085
Principal payments on capital debt		(4,877)	(5,281)
Interest payments on capital debt		(12,131)	(7,860)
Net cash (used in) provided by capital and related financing activities		(83,949)	36,863
Cash flows from investing activities:			
Interest and dividends on investments		6,455	11,590
Purchases of investments		(86,749)	(392,507)
Proceeds from sales of investments		170,689	368,100
Net cash provided by (used in) investing activities		90,395	(12,817)
Net increase in cash and cash equivalents		5,105	73,123
Cash and cash equivalents (unrestricted and restricted):			
Beginning of year		130,807	57,684
End of year	$	135,912	130,807

(Continued)

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

Statements of Cash Flows

Years ended September 30, 2009 and 2008

(In thousands)

		2009	2008
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(152,937)	(152,765)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation and amortization expense		25,183	20,168
Changes in assets and liabilities, net:			
Student receivables		(1,186)	(598)
Net patient accounts receivable		(4,911)	3,628
Grants and contracts receivables		(3,542)	1,742
Other receivables		1,512	8,345
Prepaid expenses, inventories, and other		(2,351)	1,035
Accounts payable and accrued liabilities		(1,703)	(8,445)
Deferred revenue		3,182	5,153
Net cash used in operating activities	$	(136,753)	(121,737)
Noncash investing, noncapital financing, and capital and related financing transactions:			
Increase (decrease) in fair value of investments recognized as a component of investment income	$	4,716	(13,771)
Additional maturity on capital appreciation bonds payable recorded as interest expense		1,998	1,813
Payments on behalf of the University by the Alabama Public School and College Authority reducing purchases of capital assets		9,786	—
Gifts of capital and other assets		613	60
Pledges of operating and capital gifts		559	412
Capitalization of construction period interest		2,483	1,537
Increase (decrease) in accounts payable related to capital assets		179	(2,226)

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, 2009 and 2008, 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 14 for further discussion of this entity).

(b) Professional Liability and General Liability Trust Funds

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. The medical malpractice liability of the University is maintained and managed in a separate professional liability trust fund (the PLTF) in which the University and USAHSF 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 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.

(c) 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, 2009 and 2008 were $4,772,000 and $9,627,000, 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, 2009 and 2008 are discretely presented following the statements of net assets and statements of revenues, expenses, and changes in net assets of the University.

(d) 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 $43,535,000 and $40,745,000 for the years ended September 30, 2009 and 2008, 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, 2009 and 2008 are discretely presented following the statements of net assets and statements of revenues, expenses, and changes in net assets of the University.

(e) 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.

(f) 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.

(g) 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.

(h) 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.

(i) Investments and Investment Income

Investments are recorded at fair value. The fair value of alternative investments (limited partnerships, private equity securities, etc.) 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).

The liquidity crisis that originally was linked principally to the sub-prime lending markets has spread to other corners of the credit markets in the U.S. and internationally. It is not possible at this time to predict the full impact or duration of the existing illiquid credit market conditions. The unstable market conditions and the resulting uncertainties contribute to additional risks associated with certain significant investment valuation estimates. Management continues to monitor the composition of its portfolio to assess the potential impact of these market conditions on the valuation of its investments.

(j) 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.

(k) 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.

(l) 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, 2009 and 2008, no impairments were recorded.

(m) 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 11) are deferred and recognized as revenue over the term of the lease using the straight-line method.

The time value component of the payment to the University resulting from the sale of two swaptions by the University with respect to the outstanding Series 2004 and 2006 bonds is deferred and recognized as investment income over the term of the swaption (see note 5).

(n) 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.

(o) 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.

(p) 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.

(q) 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.

(r) 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.

(s) 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.

(t) Net Patient Service Revenue

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.

(u) 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.

(v) Compensated Absences

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

(w) Reclassifications

Certain amounts in the 2008 basic financial statements have been reclassified in order to conform to the 2009 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, 2009, the net public deposits subject to collateral requirements for all institutions participating in the pool totaled approximately $6,589,000,000. The University had cash and cash equivalents totaling $135,912,000 and $130,807,000 at September 30, 2009 and 2008, respectively.

(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, 2009 and 2008 (in thousands).

		2009	2008
U.S. Treasury notes	$	9,177	14,977
U.S. federal agency notes		119,836	188,810
Commercial paper		—	14,231
Pooled equity mutual funds		53,461	44,229
Pooled debt mutual funds		16,748	15,328
Managed income alternative investments (limited partnerships, private equity securities, and other)		9,979	12,858
State agency obligations		468	—
Other		4,641	2,508
	$	214,310	292,941

At September 30, 2009 and 2008, $3,501,000 and $3,849,000, 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.

The University's exposure to credit risk and concentration of credit risk at September 30, 2009 is as follows:

	Credit rating	Percentage of total investments
Federal Home Loan Mortgage Corporation	AAA	10.9%
Federal Home Loan Bank Corporation	AAA	9.4
Federal National Mortgage Association	AAA	13.5
Common Fund Bond Fund	AA	4.8
Federal Farm Credit Banks Funding Corporation	AAA	0.4
Government National Mortgage Association	AAA	—
Various State Housing Authorities	AAA	0.1

The University's exposure to credit risk and concentration of credit risk at September 30, 2008 is as follows:

	Credit rating	Percentage of total investments
Federal Home Loan Mortgage Corporation	AAA	27.3%
Federal Home Loan Bank Corporation	AAA	15.0
G. E. Capital Corporation	Aaa	3.4
Federal National Mortgage Association	AAA	1.5
Common – Bond Fund	AA	3.6
Federal Farm Credit Banks Funding Corporation	AAA	1.0
Government National Mortgage Association	AAA	0.1

Interest Rate Risk

At September 30, 2009, 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	$	9,177	1,786	7,391	—	—
U.S. federal agency notes		119,836	95,847	23,468	—	521
State agency obligations		468	—	—	—	468
Pooled debt mutual funds		16,748	—	16,748	—	—
	$	146,229	97,633	47,607	—	989

At September 30, 2008, 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	$	14,977	4,810	10,167	—	—
U.S. federal agency notes		188,810	169,011	18,012	324	1,463
Commercial paper		14,231	14,231	—	—	—
Pooled debt mutual funds		15,328	—	15,328	—	—
	$	233,346	188,052	43,507	324	1,463

Because the debt mutual funds had a weighted average maturity of 3.9 and 4.8 years, the investments were presented in the 1-5 year category at September 30, 2009 and 2008.

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 are no CMOs in the University's investment portfolio at September 30, 2009 or 2008.

At September 30, 2009, restricted investments consist of $24,967,000 related to unspent bond proceeds, $18,934,000 related to swaption collateral obligations and $51,605,000 related to investments included in the PLTF and GLTF to pay insurance liability claims. At September 30, 2008, restricted investments consist of $50,079,000 related to unspent bond proceeds and $53,810,000 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 marketable equity securities totaling $83,884,000 and $120,133,000, at June 30, 2009 and 2008, respectively.

Investment loss was comprised of the following for the years ended June 30, 2009 and 2008 (in thousands):

		2009	2008
Unrealized losses	$	(32,468)	(19,142)
Realized (losses) gains		(2,602)	1,367
Timber sales		5,135	3,813
Interest and dividends		2,051	3,256
Rents		589	520
Royalties		199	273
	$	(27,096)	(9,913)

Investment related expenses in the amount of $214,000 and $350,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2009 and 2008 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2009 and 2008 consisted of the following property held (in thousands):

		2009	2008
Land and land improvements – held for investment	$	7,443	8,658
Building and building improvements – held for investment, net of depreciation		1,130	1,134
	$	8,573	9,792

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.

In the fiscal year ended June 30, 2008, the Foundation sold three parcels of real estate totaling approximately 53 acres, including the former Wright Campus consisting of approximately 32 acres, for $9,367,000. The Foundation recognized a gain on the sale of real estate in the amount of $396,000.

Investments at June 30, 2009 and 2008, 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 adopted FASB Statement No. 157, *Fair Value Measurements*, for the fiscal year beginning July 1, 2008. FASB Statement No. 157 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. 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. Investments that are not traded on an active exchange and do not have a quoted market price are classified as unobservable. 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 are summarized based on the criteria of FASB Statement No. 157 as follows (in thousands):

		Fair value measurements at June 30, 2009			
Description		**Observable values based on quoted prices**	**Other observable values**	**Unobservable values**	**Total**
Marketable equity securities	$	35,358	48,526	—	83,884
Timber and mineral properties		—	—	150,211	150,211
Real estate		—	—	8,573	8,573
Other investments		—	—	5,519	5,519
	$	35,358	48,526	164,303	248,187

For the year ended June 30, 2009, 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	$	154,462	9,792	5,500	169,754
Total gains or losses (realized/ unrealized)		809	(1,198)	19	(370)
Additions		190	6	—	196
Reforestation		314	—	—	314
Depreciation/depletion		(5,564)	(27)	—	(5,591)
Ending balance	$	150,211	8,573	5,519	164,303

(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 option is 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 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 contract, 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 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 option, the swaption would be canceled and the University would have no further obligation under this agreement.

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 time value component and an intrinsic value component, and each component treated separately. The intrinsic value of the swaption represents the value resulting from the fact that the fixed rate stated in the swaption is greater than the at-the-market rate. The time value of the swaption is the difference between the up front payment and the swaption's intrinsic value 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 time and intrinsic values at the date of execution of this transaction are as follows:

		2004 Bonds	2006 Bonds
Time value	$	520,000	1,741,000
Intrinsic value		1,468,000	5,599,000
	$	1,988,000	7,340,000

The time value of the payment to the University is considered an embedded derivative, is recorded as deferred investment income and is being amortized to investment income through the expiration date of the option. For the years ended September 30, 2009 and 2008, $307,000 and $237,000, respectively, was amortized and that amortization is included as investment income in the statement of revenues, expenses, and changes in net assets.

The intrinsic value of the payment to the University is considered a borrowing, and as such is included in long-term debt on the University's 2009 statement of net assets. Interest is being accreted on, and added to, the borrowing through the expiration date of the option. For the years ended September 30, 2009 and 2008, $375,000 and $269,000, respectively, was accreted and is included in interest expense in the statements of revenues, expenses, and changes in net assets.

Fair Value

At September 30, 2009 and 2008, the derivative transactions had a fair value of $(17,986,000) and $(12,290,000), respectively.

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, 2009 and 2008, the swap counterparty was rated Aa3 by Moody's investors Services and AA- by Fitch Ratings.

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, 2009 and 2008, 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, 2009 follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land	$ 29,287	25	—	—	29,312
Construction-in-progress	118,251	75,849	(134,149)	(12)	59,939
	147,538	75,874	(134,149)	(12)	89,251
Capital assets being depreciated:					
Land improvements	21,860	—	316	—	22,176
Buildings, fixed equipment, and infrastructure	311,101	1,920	132,742	(47)	445,716
Other equipment	116,146	4,188	1,091	(3,525)	117,900
Library materials	43,170	2,922	—	—	46,092
	492,277	9,030	134,149	(3,572)	631,884
Less accumulated depreciation for:					
Land improvements	(11,822)	(905)	—	—	(12,727)
Buildings, fixed equipment, and infrastructure	(167,522)	(11,072)	—	32	(178,562)
Other equipment	(74,927)	(10,849)	—	3,309	(82,467)
Library materials	(31,715)	(2,151)	—	—	(33,866)
	(285,986)	(24,977)	—	3,341	(307,622)
Capital assets being depreciated, net	206,291	(15,947)	134,149	(231)	324,262
Capital assets, net	$ 353,829	59,927	—	(243)	413,513

At September 30, 2009, the University had commitments of approximately $56,218,000 related to various construction projects.

A summary of the University's capital asset activity for the year ended September 30, 2008 follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land	$ 29,271	55	—	(39)	29,287
Construction-in-progress	64,828	65,291	(11,868)	—	118,251
	94,099	65,346	(11,868)	(39)	147,538
Capital assets being depreciated:					
Land improvements	21,888	—	(28)	—	21,860
Buildings, fixed equipment, and infrastructure	298,751	1,432	10,918	—	311,101
Other equipment	99,147	18,116	978	(2,095)	116,146
Library materials	40,519	2,651	—	—	43,170
	460,305	22,199	11,868	(2,095)	492,277
Less accumulated depreciation for:					
Land improvements	(10,747)	(1,075)	—	—	(11,822)
Buildings, fixed equipment, and infrastructure	(159,404)	(8,118)	—	—	(167,522)
Other equipment	(68,165)	(8,705)	—	1,943	(74,927)
Library materials	(29,198)	(2,517)	—	—	(31,715)
	(267,514)	(20,415)	—	1,943	(285,986)
Capital assets being depreciated, net	192,791	1,784	11,868	(152)	206,291
Capital assets, net	$ 286,890	67,130	—	(191)	353,829

At September 30, 2008, the University had commitments of approximately $68,372,000 related to various construction projects.

(b) USA Research and Technology Corporation

Changes in capital assets for the years ended September 30, 2009 and 2008 are as follows (in thousands):

	2009				
	Beginning balance	Additions	Transfers	Reductions	Ending balance
Land improvements	$ 1,950	181	—	(107)	2,024
Buildings	24,102	2,061	—	(316)	25,847
Tenant improvements	—	603	—	—	603
Construction in progress	—	795	—	—	795
Other equipment	173	5	—	—	178
	26,225	3,645	—	(423)	29,447
Less accumulated depreciation for:					
Land improvements	(381)	(89)	—	—	(470)
Buildings	(1,783)	(629)	—	—	(2,412)
Tenant improvements	—	(46)	—	—	(46)
Other equipment	(9)	(18)	—	—	(27)
	(2,173)	(782)	—	—	(2,955)
Capital assets, net	$ 24,052	2,863	—	(423)	26,492

	2008				
	Beginning balance	Additions	Transfers	Reductions	Ending balance
Land improvements	$ 1,828	122	—	—	1,950
Buildings	22,228	1,874	—	—	24,102
Other equipment	—	173	—	—	173
	24,056	2,169	—	—	26,225
Less accumulated depreciation for:					
Land improvements	(292)	(89)	—	—	(381)
Buildings	(1,217)	(566)	—	—	(1,783)
Other equipment	—	(9)	—	—	(9)
	(1,509)	(664)	—	—	(2,173)
Capital assets, net	$ 22,547	1,505	—	—	24,052

(7) Noncurrent Liabilities

A summary of the University's noncurrent liability activity for the years ended September 30, 2009 and 2008 follows (in thousands):

	2009					
	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Bonds payable	$ 316,234	1,998	(4,880)	313,352	5,881	307,471
Capital lease payable	92	—	(92)	—	—	—
Total long-term debt	316,326	1,998	(4,972)	313,352	5,881	307,471
Other long-term liabilities	65,470	17,599	(21,280)	61,789	11,541	50,248
Total noncurrent liabilities	$ 381,796	19,597	(26,252)	375,141	17,422	357,719

	2008					
	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Note payable	$ 1,456	—	(1,456)	—	—	—
Bonds payable	198,155	121,898	(3,819)	316,234	4,875	311,359
Capital lease payable	188	—	(96)	92	92	—
Total long-term debt	199,799	121,898	(5,371)	316,326	4,967	311,359
Other long-term liabilities	58,562	29,280	(22,372)	65,470	13,263	52,207
Total noncurrent liabilities	$ 258,361	151,178	(27,743)	381,796	18,230	363,566

Other long-term liabilities primarily consist of self-insurance liabilities and liabilities related to compensated absences. Amounts due within one year are included in accounts payable and accrued liabilities.

(8) Bonds Payable

Bonds payable consisted of the following at September 30, 2009 and 2008 (in thousands):

		2009	2008
University Tuition Revenue Bonds, Series 1999 Current Interest, 3.70% to 4.35%, payable through November 2010	$	7,565	10,625
University Tuition Revenue Bonds, Series 1999 Capital Appreciation, 4.70% to 5.25%, payable November 2011 through November 2018		33,443	31,821
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2004, 2.00% to 5.00%, payable through March 2024		44,895	46,245
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		112,510	112,885
Borrowing arising from swaption, Series 2004 Bonds		1,602	1,524
Borrowing arising from swaption, Series 2006 Bonds		6,110	5,813
		306,125	308,913
Plus unamortized premium		8,005	8,354
Less unamortized discount		(62)	(69)
Less unamortized debt extinguishment costs		(716)	(964)
	$	313,352	316,234

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 mature beginning 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.

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 time value and an intrinsic value. The intrinsic value of the payment is considered a borrowing and is included in long-term debt. As a result of this transaction, 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, 2009 and 2008, the maturity value of the Capital Appreciation Bonds increased $1,622,000 and $1,544,000, respectively, over the original principal amount of $19,810,000, reflecting accretion of interest.

Approximately $79,615,000 of proceeds from the issuance of the Series 2008 Bonds remained unspent at September 30, 2009 ($54,648,000 is included in restricted cash and cash equivalents and $24,967,000 is included in restricted investments in the 2009 statement of net assets) and are restricted for capital purposes as outlined in the indenture.

The University is subject to restrictive covenants related to its bonds payable. At September 30, 2009, 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, 2009 (in thousands):

	Debt service on bonds			
	Principal	**Interest**	**Additional maturity**	**Total**
2010	$ 5,715	12,700	(2,100)	16,315
2011	5,410	12,464	(2,207)	15,667
2012	6,995	12,324	(2,144)	17,175
2013	7,295	12,219	(2,039)	17,475
2014	7,599	12,213	(1,830)	17,982
2015 – 2019	50,014	60,084	(4,441)	105,657
2020 – 2024	57,658	52,401	—	110,059
2025 – 2029	53,933	38,888	—	92,821
2030 – 2034	68,939	23,879	—	92,818
2035 – 2038	57,328	5,795	—	63,123
Subtotal	320,886	242,967	(14,761)	549,092
Plus (less):				
Additional maturity	(14,761)			
Unamortized bond premium	8,005			
Unamortized bond discount	(62)			
Unamortized debt extinguishment cost	(716)			
Total	$ 313,352			

The principal amount of debt service due on bonds at September 30, 2009 includes $11,847,000 representing additional maturity value on Series 1999 Capital Appreciation Bonds. These bonds mature in years 2011 through 2019. Also included in the principal amount of debt service due on bonds at September 30, 2009, is $2,914,000 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 financial statements as it accretes.

(a) USA Research and Technology Corporation

Notes Payable

Notes payable consisted of the following at September 30, 2009 and 2008 (in thousands):

		2009	2008
Whitney National Bank commercial mortgage note, 6.0%, payable through 2014	$	8,803	9,178
Wachovia Bank, N.A. promissory note, one-month LIBOR plus 0.85% (4.989% at September 30, 2009), payable through 2028		17,369	17,853
Hancock Bank of Alabama construction loan, convertible into a promissory note on January 1, 2010, 6.5%, payable through 2030		15	—
	$	26,187	27,031

The note payable to Whitney National Bank is secured by all funds of the Corporation on deposit with Whitney National Bank, an interest in the ground lease with respect to the parcel of land on which Building I stands, an interest in Building I, an interest in the tenant lease for Building I, and an interest in income received from rental of Building I. The note has a 10-year term and amortization is based on a 20-year term.

The note payable to Wachovia 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. First structured as a construction loan, it was an interest-only loan until May 1, 2008. At that time the loan was converted to a fully amortizing promissory note with a 20-year term. The Corporation has entered into two derivative instruments in connection with the borrowing, an interest rate cap of 6.1% on the construction loan and 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 construction loan was and 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 Wachovia 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 note payable to Hancock Bank of Alabama was incurred by the Corporation to finance construction of the shell of a building that will be leased to a company that provides dialysis services. The maximum amount that might be borrowed under the construction loan is $1,250,000.

The construction loan is an interest-only loan until January 1, 2010, at which time the loan will be converted to a fully amortizing promissory note with a 20-year term and bearing a 6.5% interest rate. The construction loan is and the promissory note payable will be secured by an interest in the ground lease with respect to the parcel of land on which the dialysis building stands, an interest in the dialysis building, an interest in the tenant lease for the dialysis building, and an interest in income received from rental of the dialysis building. The University also entered into an agreement with Hancock Bank of Alabama 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.

At September 30, 2009, the Corporation's management believes the Corporation was in compliance with all debt covenants.

Debt Service on Long-Term Obligations

At September 30, 2009, total debt service by fiscal year is as follows (in thousands):

		Debt service on note and loan		
		Principal	**Interest**	**Total**
2010	$	909	1,574	2,483
2011		970	1,513	2,483
2012		1,030	1,453	2,483
2013		1,096	1,387	2,483
2014		7,717	1,046	8,763
2015 – 2019		3,963	3,843	7,806
2020 – 2024		5,372	2,435	7,807
2025 – 2029		5,130	607	5,737
Total	$	26,187	13,858	40,045

Derivative Transactions

On February 27, 2007, the Corporation entered into two derivative transactions with Wachovia, the counterparty. The first transaction was an interest rate cap entered into in connection with the construction loan. The second transaction is a "receive variable, pay fixed" interest rate swap entered into in connection with the promissory note that came into effect upon conversion of the construction loan into a permanent loan on May 1, 2008. On December 31, 2008, Wells Fargo & Company completed its merger with Wachovia Corporation (the holding company parent of Wachovia Bank, N.A.). As of September 30, 2009, Wachovia Bank, N.A. and other banking subsidiaries of the combined corporation remained as separate legal entities.

Objectives of the derivative transactions. The Corporation utilized the interest rate cap to limit its variable rate exposure on the construction loan and utilizes the interest rate swap to convert its variable rate on the promissory note to a synthetic fixed rate.

Terms. The construction loan and the associated interest rate cap were entered into on July 17, 2007 and February 27, 2007, respectively. The interest rate cap terminated on May 1, 2008 when the loan was converted into a promissory note. The interest rate cap's notional amount was equal to the construction loan balance and was limited to a maximum of $18,000,000. The construction loan bore variable rate interest equal to the one-month London Interbank Offered Rate (LIBOR) plus 0.85%. When the variable rate exceeded 6.10%, the cap operated to cause the counterparty to pay the Corporation the difference between the variable rate and 6.10%. For the year ended September 30, 2008, the Corporation received $6,345 under the interest rate cap agreement, which is reflected as a reduction of interest expense.

The promissory note came into effect on May 1, 2008 upon conversion of the construction loan. Also, on May 1, 2008, the interest rate swap associated with the loan became effective. 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 $755,523 and $206,104 under the interest rate swap agreement for the years ended September 30, 2009 and 2008, respectively, which is reflected as an increase in interest expense.

Fair value. The interest rate swap had a fair value of $(2,916,000) and $(1,315,000) at September 30, 2009 and 2008, respectively.

Credit risk. As of September 30, 2009 and 2008, 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 AA by Standard & Poor's Ratings Services as of September 30, 2009 and 2008.

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, 2009 and 2008, 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 net 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, 2009, 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**
2010	$ 512	193	855	1,560
2011	548	184	828	1,560
2012	582	178	800	1,560
2013	619	171	770	1,560
2014	657	165	738	1,560
2015 – 2019	3,960	699	3,141	7,800
2020 – 2024	5,368	442	1,990	7,800
2025 – 2029	5,123	110	496	5,729
Total	$ 17,369	2,142	9,618	29,129

(9) Capital Lease Obligation

In September 2006, the University signed a three-year purchase agreement as a method of financing the purchase of certain computer equipment for the USA Hospitals. All required payments pertaining to this agreement were paid in 2009 and there was no balance outstanding at September 30, 2009,

(10) 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 2006. A re-opening has been requested for USA Medical Center cost reports for the 2004 and 2005 fiscal years. The cost report for USA Children's and Women's Hospital has been audited through 2008 and settled through 2007. The cost report for USA Knollwood Hospital has been audited through March 2006 and settled through September 2004. Revenue from the Medicare program accounted for approximately 15% of the Hospitals' net patient service revenue for both years ended September 30, 2009 and 2008.

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 and settled for all fiscal years through 2008. Revenue from the Blue Cross program accounted for approximately 23% and 20% of the Hospitals’ net patient service revenue for the years ended September 30, 2009 and 2008, respectively.

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 37% and 30% of the Hospitals’ net patient service revenue for the years ended September 30, 2009 and 2008, respectively.

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, 2009 and 2008 follows (in thousands):

		2009	2008
Gross patient service revenue	$	416,428	399,945
Less provision for contractual and other adjustments		133,795	125,674
Less provision for bad debts		76,101	72,668
	$	206,532	201,603

Changes in estimates related to prior cost reporting periods resulted in an increase of approximately $123,000 and $2,082,000 in net patient service revenue for the years ended September 30, 2009 and 2008, respectively.

(11) 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. University management does not anticipate that this option will be exercised by the Infirmary.

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 resumes. 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)
- 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.

(Continued)

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 2011 at a fixed rate of 3.75%. Future receipts from this capital lease are expected as follows:

Year ending September 30:		
2010	$	—
2011		416,000
2012		555,000
2013		277,000
		1,248,000
Less amounts representing interest		(108,000)
Total capital lease receivable	$	1,140,000

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-eight years are approximately $43,788,000. 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 $6,327,000, will be deferred and amortized over the ninety-nine year lease term.

(12) 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.

All employees covered by this retirement plan must contribute 5% of their eligible earnings to TRS. An actuary employed by the TRS Board of Control establishes the employer-matching amount annually. During 2009, 2008 and 2007, the University made total contributions of $32,465,000, $30,252,000, and $22,023,000 (100% of the required contributions), respectively, to TRS on behalf of participants, which represents 12.07%, 11.06%, and 9.36%, respectively, of each participant's gross earnings. The University's payroll for all employees was approximately $295,647,000 and $288,477,000 in 2009 and 2008, respectively. Total payroll for University employees participating in the Teachers' Retirement System of Alabama was approximately $268,969,000 and $257,466,000 in 2009 and 2008, 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 $982,000 and $951,000 in 2009 and 2008, respectively, representing 519 and 457 employees participating in this Plan.

(b) Compensated Absences

Regular University employees accumulate vacation and sick leave, subject to maximum limitations, at varying rates depending upon their employee classification and length of service. Upon termination of employment, employees are paid all unused accrued vacation at their regular rate of pay up to a maximum of two times their annual accumulation rate. The accompanying statements of net assets include accruals for vacation pay of approximately $16,398,000 and $16,197,000 at September 30, 2009 and 2008, 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 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, 2009 and 2008, the University's expense related to PEEHIP was $5,482,000 and $4,842,000, respectively.

(13) Risk Management

The University and USAHSF participate in the professional liability trust fund and the University participates 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.

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, 2009 and 2008. 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 participates in a self-insured health plan, administered by an unaffiliated entity. Administrative fees paid by the University for such services were approximately $1,573,000 and $1,521,000 in 2009 and 2008, 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, 2009 and 2008 for the PLTF, GLTF and health plan are summarized as follows (in thousands):

		2009	2008
Balance, beginning of year	$	37,283	33,956
Liabilities incurred and other additions		35,013	43,382
Claims, administrative fees paid and other reductions		(37,541)	(40,055)
Balance, end of year	$	34,755	37,283

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.

(14) 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, 2009 and 2008, SAMSF had total assets of $9,317,000 and $9,354,000, net assets of $6,801,000 and $5,980,000, and total revenues of $4,717,000 and $14,816,000, respectively. SAMSF reimburses the University for certain administrative expenses and other related support services. Total amounts received for such expenses were approximately $1,538,000 and $1,556,000 in 2009 and 2008, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net assets.

(15) Commitments and Contingencies

(a) Grants and Contracts

At September 30, 2009 and 2008, the University had been awarded approximately $61,699,000 and $52,337,000, 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

(Continued)

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 $1,400,000 irrevocable standby letter of credit with Wachovia Bank. 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, 2009 and 2008.

(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 statement 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(b)). As of September 30, 2009 and 2008, 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, 2009, approximately $11,161,000 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) USA Research and Technology Corporations Leases

The Corporation leases space in Building I to a single tenant under an operating lease. The lease has a 10-year initial term with two 5-year renewal options. Under the lease, the tenant must also pay, or reimburse to the Corporation for expenses paid by the Corporation, property taxes on the building, common area maintenance, utilities, and general liability and property damage insurance. In 2009, the lease calls for a one-time increase in monthly rent of 4%. Beginning on November 1, 2008, after providing a one-year advance notice, the tenant has the annual noncumulative option to terminate up to 10% of the square footage covered under the lease. Such advance notice was not received by November 1, 2008 or 2009.

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 48,556 and 51,662 square feet at September 30, 2009 and 2008, 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 had four and three ground leases in place at September 30, 2009 and 2008, respectively. 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 first and second leases were in effect for the whole of each of the years ended September 30, 2009 and 2008. The third lease was entered into on March 14, 2008 and has a 38.5-year initial term with 20-year and 15-year renewal options. The fourth lease was entered into on June 26, 2009 and has a 29-year initial term with two 10-year renewal options.

Minimum future rentals by fiscal year are as follows:

2010	$	3,416,569
2011		3,211,788
2012		2,771,511
2013		2,197,768
2014		951,695
2015 – 2046		7,689,999
Total	$	20,239,330

(16) Functional Information

Operating expenses by functional classification for the years ended September 30, 2009 and 2008 are listed below (in thousands). In preparing the basic financial statements, all significant transactions and balances among accounts have been eliminated.

		2009	2008
Instruction	$	113,323	115,044
Research		21,548	21,275
Public service		41,647	39,202
Academic support		15,816	13,557
Student services		24,619	23,249
Institutional support		31,769	29,992
Operation and maintenance of plant		25,161	24,934
Scholarships		458	1,425
Hospital		233,306	229,162
Auxiliary enterprises		15,742	16,088
Depreciation and amortization		25,183	20,168
	$	548,572	534,096

(17) Significant New Accounting Pronouncements

In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations*. GASB Statement No. 49 addresses accounting and reporting standards for pollution remediation obligations, which are obligations with respect to current operations and were effective for the year ended September 30, 2009. In November 2007, the GASB issued Statement No. 52, *Land and Other Real Estate Held as Investments by Endowments*. GASB Statement No. 52 addressed accounting and reporting standards for real estate held by endowments. The adoption of these Statements did not have a material impact on the University's basic financial statements.

In June 2007, the GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 requires that certain intangible assets be classified and reported as capital assets and will be effective for the year ending September 30, 2010. In June 2008, the GASB issued Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 addresses the recognition, measurement, and disclosure of information regarding derivative instruments entered into by state and local governments and will be effective for the year ending September 30, 2010. In February 2009, the GASB issued Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definition*. GASB State No. 54 revised classification requirements related to fund balance reporting and will be effective for the year ending September 30, 2011.

The effect of the implementation of GASB Statements Nos. 51 and 53 on the University has not been determined. GASB Statement No. 54 is not applicable to the University.

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2009

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			$ 12,399,617	—	12,399,617
Federal Supplemental Educational Opportunity Grant Program	84.007			496,987	—	496,987
Federal Family Educational Loan Program	84.032			76,321,276	—	76,321,276
Federal Work Study Program	84.033			270,172	—	270,172
Academic Competitiveness Grant	84.375			109,838	—	109,838
National Science and Mathematics Access to Retain Talent Grant	84.376			229,706	—	229,706
Teacher Education Assistance for College and Higher Education	84.379			2,000	—	2,000
Total Student Financial Aid Cluster				89,829,596	—	89,829,596
Research and Development Cluster*:						
U.S. Department of Commerce:						
Sea Grant Support	11.417	USM-GRO2639/	University of Southern Mississippi	—	7,238	7,238
Undersea Research	11.430	08-04-068	University of Mississippi	—	9,365	9,365
Marine Fisheries Initiative	11.433			94,579	—	94,579
Unallied Management Projects	11.454	80182	Alabama Department of Conservation and Natural Resources	—	239,061	239,061
	11.454	2254KP-A-ADCNR	Dauphin Island Sea Lab (MESC)	—	82,435	82,435
Total CFDA				—	321,496	321,496
Habitat Conservation	11.463			804,795	—	804,795
Applied Meteorological Research	11.468			461,835	—	461,835
Congressionally Identified Award and Projects	11.469	TASK ORDER D-1	Dauphin Island Sea Lab (MESC)	—	22,646	22,646
Total U.S. Department of Commerce				1,361,209	360,745	1,721,954
U.S. Department of Defense:						
Military Medical Research and Development	12.420			142,806	—	142,806
Research and Technology Development	12.HUD001-09-1-TS01, N09-001			10,983	—	10,983
Total U.S. Department of Defense				153,789	—	153,789
U.S. Department of Housing and Urban Development:						
Community Development Block Grants	14.228	CDBG/HUD	Washington County Commission	—	9,490	9,490
U.S. Department of Interior:						
Cooperative Endangered Species Conservation Fund	15.615	80240	Alabama Division of Wildlife and Fisheries	—	18,674	18,674
National Cooperative Geologic Mapping Program	15.810			3,754	—	3,754
Historic Preservation Fund Grants-In-Aid	15.904	AL-06-003	Alabama Historical Commission	—	(476)	(476)
Total U.S. Department of Interior				3,754	18,198	21,952
U.S. Department of Justice:						
Developing, Testing and Demonstrating Promising New Programs	16.541			295,057	—	295,057
U.S. Department of Transportation:						
Highway Planning and Construction	20.205			262,704	—	262,704
Pipeline Safety Program Base Grants	20.700	8/10/2007	Prince William Sound Science Center	—	11,050	11,050
University Transportation Centers Program	20.701			143,187	—	143,187
Total U.S. Department of Transportation				405,891	11,050	416,941
National Aeronautics and Space Administration:						
Technology Transfer	43.002			338,557	—	338,557
	43.002	SUB2005-152-A5	University of Alabama in Huntsville	—	18,624	18,624
Total CFDA				338,557	18,624	357,181

(Continued)

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2009

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
National Science Foundation:						
Engineering Grants	47.041			$ 20,754	—	20,754
Mathematical and Physical Sciences	47.049			493,444	—	493,444
Geosciences	47.050			59,650	—	59,650
	47.050	1021RR100513 -3506498	University of Georgia	—	129,602	129,602
Total CFDA				59,650	129,602	189,252
Computer and Information Science and Engineering	47.070			95,363	—	95,363
Biological Sciences	47.074			57,332	—	57,332
	47.074	RR100-391/8920207	University of Georgia	—	(276)	(276)
Total CFDA				57,332	(276)	57,056
Education and Human Resources	47.076	34-21530-038-621	Tuskegee University	—	(3,091)	(3,091)
	47.076	06-006	University of Alabama	—	3,847	3,847
Total CFDA				—	756	756
Polar Programs	47.078			38,717	—	38,717
Office of Cyberinfrastructure	47.080	39-21530-081	Tuskegee University	—	29,820	29,820
	47.080	09-013	University of Alabama	—	35,194	35,194
Total CFDA				—	65,014	65,014
ARRA - NSF Recovery Act Research Support	47.082			7,986	—	7,986
Total National Science Foundation				773,246	195,096	968,342
Environmental Protection Agency:						
Office of Research and Development Consolidated Research/Training/Fellowships	66.511			660,796	—	660,796
U.S. Department of Energy:						
Basic Energy Sciences University and Science	81.049			1,397	—	1,397
U.S. Department of Education:						
Research in Special Education	84.324			42,404	—	42,404
U.S. Election Assistance Commission:						
Help America Vote Act Requirement Payments	90.401			676,450	—	676,450
U.S. Department of Health and Human Services:						
Cooperative Agreements to Improve the Health Status of Minority Populations	93.004	US2MP002001-03-4	Morehouse School of Medicine	—	77,885	77,885
Environmental Health	93.113			642,193	—	642,193
	93.113	UAB LINK NO -238575-04	University of Alabama Birmingham	—	10,591	10,591
Total CFDA				642,193	10,591	652,784
Oral Diseases and Disorders Research	93.121	R 548086	State University of New York – Buffalo	—	31,502	31,502
Research Related to Deafness and Communicative Disorders	93.173			81,642	—	81,642
Mental Health Research Grants	93.242	RO1 MH075026-02	Columbia University	—	(3,476)	(3,476)
Comparative Medicine	93.306			93,763	—	93,763
Minority Health and Health Disparities Research	93.307			1,259,537	—	1,259,537
Trans-NIH Research Support	93.310			3,780	—	3,780
National Center for Research Resources	93.389			260,576	—	260,576
Cancer Cause and Prevention Research	93.393			232,853	—	232,853
Cancer Detection and Diagnosis Research	93.394			207,178	—	207,178
Cancer Treatment Research	93.395			237,865	—	237,865
Cancer Biology Research	93.396			16,751	—	16,751
Developmental Disabilities Basic Support and Advocacy Grants	93.630	80040	Alabama Council for Developmental Disabilities	—	20,546	20,546
ARRA - NIH Recovery Act Research Support	93.701			90,252	—	90,252
Cardiovascular Diseases Research	93.837			2,496,937	—	2,496,937
Lung Diseases Research	93.838			3,283,831	—	3,283,831
	93.838	FY07.032.008	University of Colorado	—	34,642	34,642
Total CFDA				3,283,831	34,642	3,318,473

(Continued)

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Arthritis Musculoskeletal and Skin Diseases Research	93.846			$ 17,824	—	17,824
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847			198,693	—	198,693
Extramural Research Programs in Neurosciences and Neurological Disorders	93.853			10,349	—	10,349
	93.853	70190	Columbia University	—	1,570	1,570
	93.853	UO1 NS0404060	University of Miami	—	(3,801)	(3,801)
	93.853	116447/115709-02	University of Texas	—	63,083	63,083
	93.853	AO5648	Yale University	—	149,960	149,960
	93.853	SWISS	Mayo Foundation for Medical Research	—	(285)	(285)
Total CFDA				10,349	210,527	220,876
Biomedical Research and Research Training	93.859			355,417	—	355,417
Allergy Immunology and Transplantation Research	93.855			591,263	—	591,263
Microbiology and Infectious Diseases Research	93.856			995,540	—	995,540
	93.856	09-002/09-111	University of Texas Medical Branch	—	130,769	130,769
Total CFDA				995,540	130,769	1,126,309
Total U.S. Department of Health and Human Services				11,076,244	512,986	11,589,230
Total Research and Development Cluster				15,788,794	1,126,189	16,914,983
Other federal assistance:						
U.S. Department of Commerce:						
Coastal Zone Management Estuarine Research	11.420			19,408	—	19,408
Congressionally Identified Projects*	11.617			1,744,956	—	1,744,956
Total U.S. Department of Commerce				1,764,364	—	1,764,364
U.S. Department of Defense:						
Procurement Technical Assistance for Business Firms	12.002	DOD 07-70	University of Alabama Birmingham	—	22,000	22,000
U. S. Housing and Urban Development:						
Resident Opportunity and Supportive Services - Elderly and Persons with Disabilities	14.876	AL002REL041A007	Mobile Housing Board	—	17,350	17,350
U.S. Department of Transportation:						
Highway Planning and Construction	20.205			129,795	—	129,795
National Motor Carrier Safety	20.218			77,937	—	77,937
Total U.S. Department of Transportation				207,732	—	207,732
National Aeronautics and Space Administration:						
Technology Transfer	43.002			(134)	—	(134)
	43.002	SUB2005-152	University of Alabama in Huntsville	—	35,996	35,996
Total CFDA				(134)	35,996	35,862
National Endowment for the Humanities:						
Promotion of the Humanities Division and Preservation	45.149			5,267	—	5,267
National Science Foundation:						
Biological Sciences	47.074			64,511	—	64,511
Education and Human Resources	47.076			86,259	—	86,259
	47.076	0602359-011-A1	University of Alabama at Birmingham	—	11,517	11,517
Total CFDA				86,259	11,517	97,776
ARRA - NSF Recovery Act Research Support	47.082			6,223	—	6,223
Total National Science Foundation				92,482	11,517	103,999
U.S. Small Business Administration:						
Minority Business Development	59.006			238,078	—	238,078
Small Business Development Centers	59.037	SBA FY2007-2008	University of Alabama at Birmingham	—	115,116	115,116
Total U.S. Small Business Administration				238,078	115,116	353,194

(Continued)

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2009

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
U.S. Department of Education:						
TRIO Upward Bound	84.047			$ 598,880	—	598,880
Nursing Faculty Loan Program	84.264			8,096	—	8,096
Special Education - State Personnel Development	84.323	U900524, U800176	Alabama Department of Education	—	9,989	9,989
Transition to Teaching	84.350			201,825	—	201,825
Reading First State Grants	84.357	370684-005503 -170030-1	Alabama Department of Education	—	224,319	224,319
Mathematics and Science Partnerships	84.366	U900135	Alabama Department of Education	—	197,527	197,527
Improving Teacher Quality State Grants	84.367	50406	Alabama Commission of Higher Education	—	165,776	165,776
College Access Challenge Grant Program	84.378	FY09-4018	Alabama Department of Education	—	10,184	10,184
Total U.S. Department of Education				808,801	607,795	1,416,596
National Archives and Records Administration:						
National Historical Publications and Records Grants	89.003	09-090114	Alabama Department of Archives and History	—	2,497	2,497
U.S. Department of Health and Human Services:						
Alzheimer's Disease Demonstration Grants to States	93.051	80273	South Alabama Regional Planning Commission	—	9,714	9,714
Public Health Emergency Preparedness	93.069	90411/2	Alabama Department of Mental Health	—	22,932	22,932
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153			372,205	—	372,205
Advanced Education Nursing Grant Programs*	93.247			3,160,416	—	3,160,416
Centers for Disease Control and Prevention	93.283			3,239	—	3,239
President's Council on Physical Fitness and Sports	93.289	C70119129	Alabama Department of Public Safety	—	(18,187)	(18,187)
Minority Health and Health Disparities Research	93.307			14,993	—	14,993
Professional Nurse Traineeships	93.358			331,855	—	331,855
Basic Nurse Education and Practice Grants	93.359			25,425	—	25,425
Developmental Disabilities Basic Support and Advocacy Grants	93.630	G9-923638	Alabama Department of Mental Health	—	24,660	24,660
Foster Care_Title IV-E	93.658	80055	University of Alabama	—	(1,155)	(1,155)
Medical Library Assistance	93.879	CHECK #12461	Medical Library Association	—	90	90
	93.879	070106-MOA	University of Maryland Baltimore	—	701	701
Total CFDA				—	791	791
Grants for Residency Training for General Pediatrics	93.884			89,646	—	89,646
Health Care and Other Facilities*	93.887			2,600,223	—	2,600,223
National Bioterrorism Hospital Preparedness Program	93.889	C80117142	Alabama Department of Public Health	—	1,012,720	1,012,720
HIV Care Formula Grants	93.917	RW-USAF-0809	United Way of Central Alabama	—	95,039	95,039
Block Grants for Community Mental Health Services	93.958	09-005	University of Alabama	—	56,786	56,786
Geriatric Education Centers	93.969	R00891	Florida State University	—	77,592	77,592
Total U.S. Department of Health and Human Services				6,598,002	1,280,892	7,878,894
Corporation for National and Community Service:						
AmeriCorps	94.006			23,234	—	23,234
Total other federal assistance				9,802,337	2,093,163	11,895,500
Total federal expenditures				$ 115,420,727	3,219,352	118,640,079

* Denotes a major program.

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

See accompanying independent auditors' report on supplementary information.

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

Notes to Schedule of Expenditures of Federal Awards

September 30, 2009

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards 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 this 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 this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Expenditures listed on the accompanying schedule of expenditures of federal awards, except for Federal Perkins Loans, Federal Family Educational Loan (FFEL) Programs, Parent Loans-PLUS Loans, Loans to Disadvantaged Students and Health Education Assistance Loans (HEAL), represent actual expenditures incurred under the accrual basis of accounting for the year ended September 30, 2009. Outstanding loans made by the University are included in notes receivable in the University's 2009 statement of net assets and consist of the following loan programs:

Federal Perkins Loan Program	$	4,190,969
Loans to Disadvantaged Students		1,435
Health Professional Loans		59,968
		4,252,372
Less outstanding balance of loans granted in previous years		(4,252,372)
Loans advanced to eligible students of the University during 2009	$	—

The FFEL and HEAL federal awards represent loans received by students of the University during fiscal year 2009 which were not made by the University. Accordingly, FFEL and HEAL amounts are not reflected in the University's basic financial statements.

(2) Contingencies

These 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.

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

Notes to Schedule of Expenditures of Federal Awards

September 30, 2009

(3) Federal Family Education Loan Programs

During fiscal year ended September 30, 2009, the University advanced to students the following amount of new loans under the Federal Family Education Loan Program:

	CFDA #		Amount expended
Subsidized Stafford loans	84.032	$	27,653,280
Unsubsidized Stafford loans	84.032		45,490,314
Parents' Loans for Undergraduate Students	84.032		3,177,682
Total		$	76,321,276

(4) Subrecipients

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

	Federal CFDA #		Amounts expended
Habitat Conservation	11.463	$	149,266
Applied Meteorological Research	11.468		15,047
Technology Transfer	43.002		97,969
Mathematical and Physical Sciences	47.049		94,279
Biological Sciences	47.074		39,379
Office of Research and Development Consolidated Research/Training/Fellowships	66.511		293,339
Research in Special Education	84.324		6,000
Transition to Teaching	84.350		42,301
U.S. Department of Education/Alabama Department of Education	84.366		223,030
U.S. Department of Education/Alabama Department of Higher Education	84.367		73,436
Help America Vote Act Requirements Payments	90.401		94,044
Environmental Health	93.113		52,619
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153		8,168
Minority Health and Health Disparities Research	93.307		334,047
Cancer Biology Research	93.396		16,751
Health Resources Services Administration/Alabama Department of Public Health	93.889		20,000
Biomedical Research and Research Training	93.859		9,476
Cardiovascular Diseases Research	93.837		35,893
U.S. Department of Health and Human Services/ Alabama Department of Mental Health	93.630		833
Health Resources Services Administration/United Way of Central Alabama	93.917		1,400
		$	1,607,277

(5) Matching

Under the Federal Work Study Program and Federal Supplemental Education Opportunity Grant Program, the University matched $65,117 and $164,138, respectively, in funds awarded to students for the year ended September 30, 2009 in addition to the Federal share of expenditures included in the accompanying schedule of expenditures of federal awards.

KPMG LLP
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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, 2009, and have issued our report thereon dated November 13, 2009. We did not audit the 2009 consolidated financial statements of the University of South Alabama Foundation, which represents 80%, 101%, and (50)%, 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.

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.*

We noted certain matters that we reported to management of the University in a separate letter dated November 13, 2009.

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 13, 2009

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188 East Capitol Street
Jackson, MS 39201

Report on Compliance with Requirements Applicable to 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 compliance of the University of South Alabama (the University) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* (Compliance Supplement) that are applicable to each of its major federal programs for the year ended September 30, 2009, 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 Affiliated Computer 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 September 30, 2009 was examined by accountants for the servicer 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 accountants for the servicer's 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 described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* 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.

In our opinion, the University complied, in all material respects, with the requirements referred to in the first paragraph above that are applicable to each of its major federal programs for the year ended September 30, 2009.

Internal Control Over Compliance

The 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 in order to determine our auditing procedures for the purpose of expressing our opinion on compliance, 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 Assistance 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 September 30, 2009 was reported on by 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.

A control deficiency in an entity's internal control over compliance 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 noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material noncompliance with a type of compliance requirement of a federal program will not be prevented or detected by the entity's internal control.

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

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

February 24, 2010

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

Schedule of Findings and Questioned Costs

Year ended September 30, 2009

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?	___ yes _x_ 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
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	___ yes _x_ no

Identification of major programs:

CFDA Numbers	Name of Federal Program/Cluster
84.063, 84.007, 84.032, 84.033, 84.375, 84.376, 84.379	Student Financial Aid Cluster
Various	Research and Development Cluster
93.247	U.S. Department of Health and Human Services / Advanced Education Nursing Grant Programs
93.887	U.S. Department of Health and Human Services / Health Care and Other Facilities
11.617	U.S. Department of Commerce / Congressionally-Identified Projects

Dollar threshold used to distinguish between type A and type B programs:	$ 1,269,321
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, 2009

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, 2009.

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

Schedule of Findings and Questioned Costs

Year ended September 30, 2009

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

There were no findings or questioned costs relating to federal awards for the year ended September 30, 2009.