KPMG

UNIVERSITY OF SOUTH ALABAMA

(A Component Unit of the State of Alabama)

Basic Financial Statements and Supplementary Information on Federal Awards Programs

September 30, 2010

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

September 30, 2010 and 2009

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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, 2010 and 2009 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, 2010, 2009, and 2008, the University had total assets of $917,157,000, $856,249,000, and $862,666,000, respectively; total liabilities of $497,886,000, $455,937,000, and $454,339,000, respectively; and net assets of $419,271,000, $400,312,000, and $408,327,000, respectively. University net assets increased by $18,959,000 during the year ended September 30, 2010 compared to a decrease of $5,806,000 for the year ended September 30, 2009 and an increase of $23,811,000 for the year ended September 30, 2008.

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.

During fiscal 2010, the University implemented Governmental Accounting Standards Board Statement Number 53 (Statement 53), *Accounting and Financial Reporting for Derivative Instruments*. Statement 53 requires restatement of all previously presented financial statements. As such, the University's 2009 basic financial statements have been restated to recognize the effect of the implementation of this statement and a cumulative effect of a change in accounting principle was recorded to reduce net assets as of October 1, 2008. Management's discussion and analysis has not been restated for 2008 financial information.

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, 2010 and 2009. 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

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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 63%, 7%, and 11%, respectively, of current assets at September 30, 2010. Noncurrent assets at September 30, 2010 consist primarily of capital assets, restricted cash and cash equivalents, and restricted investments.

The Condensed Schedule of Net Assets at September 30, 2010, 2009, and 2008 follows (in thousands):

		2010	2009	2008
Assets:				
Current	$	275,417	268,814	287,430
Capital assets		444,718	413,513	353,829
Other noncurrent		197,022	173,922	221,407
Total assets	$	917,157	856,249	862,666
Liabilities:				
Current	$	97,154	91,555	90,773
Noncurrent		400,732	364,382	363,566
Total liabilities	$	497,886	455,937	454,339
Net assets:				
Invested in capital assets, net of related debt	$	202,355	187,489	186,986
Restricted, nonexpendable		29,558	28,622	24,165
Restricted, expendable		42,053	28,685	23,071
Unrestricted		145,305	155,516	174,105
Total net assets	$	419,271	400,312	408,327

University cash, cash equivalents, and investments (current and noncurrent) increased between September 30, 2009 and 2010 by $20,243,000 to $370,465,000. This increase is due primarily to cash and investments associated with the issuance of the Series 2010 University bond and the growth in the professional liability trust fund. This follows a decrease of $73,526,000 in cash, cash equivalents, and investments between 2008 and 2009, which was the result of the use of existing funds for construction and a $31,286,000 decrease in state appropriations in 2009.

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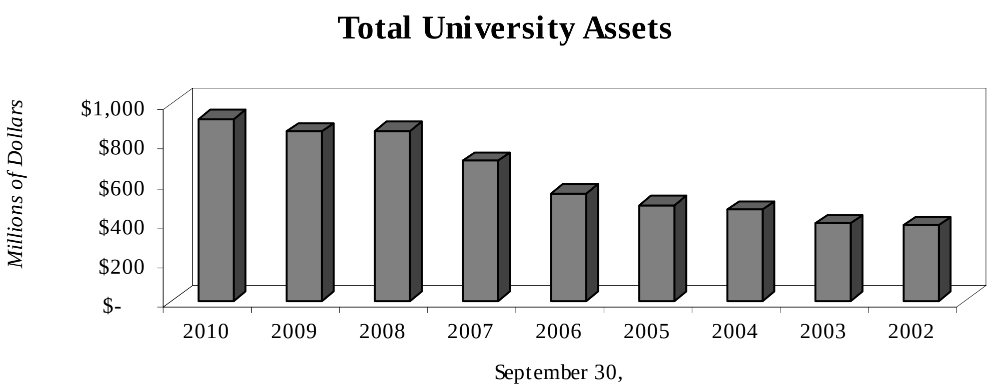
Total assets of the University as of September 30 are as follows:



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

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

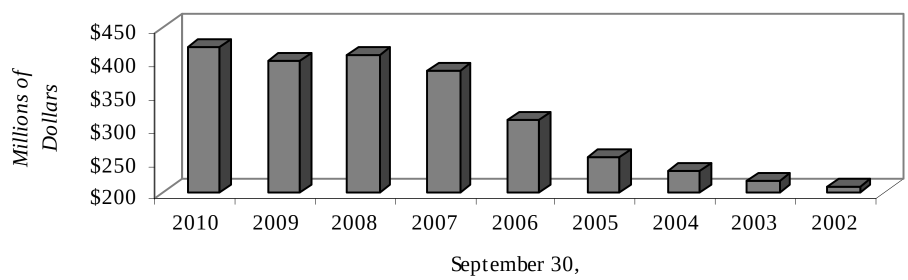
Restricted nonexpendable net assets consist primarily of the University's permanent endowment funds. While earnings from these funds may be expended, the corpus may not be expended for any reason and must remain intact with the University in perpetuity.

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

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

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

Net University Assets



All categories of restricted net assets increased by approximately 25% between September 30, 2009 and 2010, primarily due to improvement in financial market conditions and the addition of capital appropriations, gifts and grants to the University. Unrestricted net assets decreased from $155,516,000 to $145,305,000 between September 30, 2009 and 2010 reflecting the results of University financial operations during fiscal year 2010.

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.

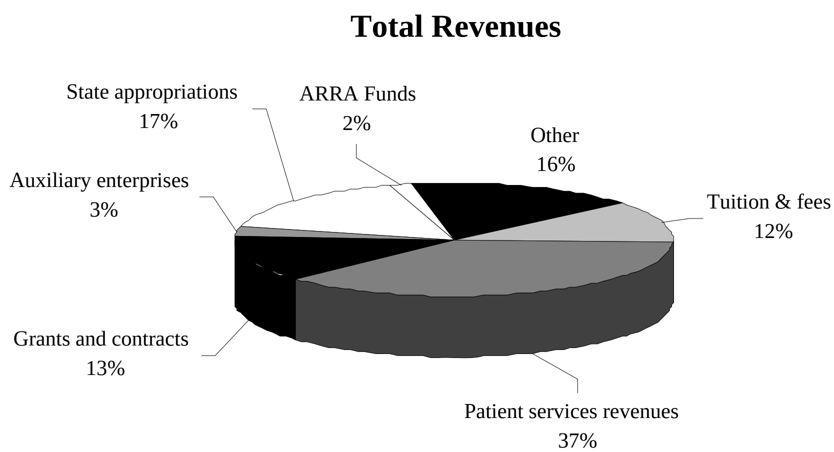
The Condensed Schedule of Revenues, Expenses, and Changes in Net Assets for the years ended September 30, 2010, 2009, and 2008 follows (in thousands):

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

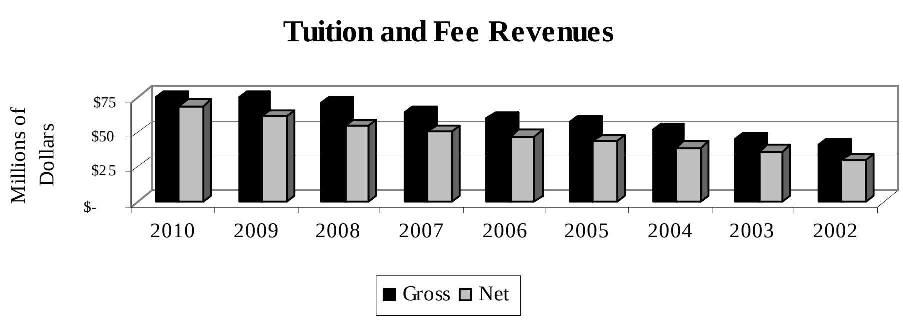
		2010	2009	2008
Operating revenues:				
Tuition and fees	$	69,212	61,076	54,823
Net patient service revenue		219,923	206,532	201,603
Federal, state and private grants and contracts		76,983	78,274	77,245
Other		55,722	49,753	47,660
		421,840	395,635	381,331
Operating expenses:				
Salaries and benefits		378,188	379,360	370,749
Supplies and other services		128,973	122,672	123,782
Other		49,197	46,540	39,565
		556,358	548,572	534,096
Operating loss		(134,518)	(152,937)	(152,765)
Nonoperating revenues (expenses):				
State appropriations		97,860	108,451	139,737
State appropriated – ARRA funds		10,769	—	—
Investment income (loss)		9,278	7,469	(4,257)
Other, net		10,369	10,266	12,332
Net nonoperating revenues		128,276	126,186	147,812
Loss before capital appropriations, capital contributions and additions to endowment		(6,242)	(26,751)	(4,953)
Capital appropriations, capital contributions and additions to endowment		25,201	20,945	28,764
Change in net assets		18,959	(5,806)	23,811
Beginning net assets, before cumulative effect of change in accounting principle		400,312	408,327	384,516
Cumulative effect of change in accounting principle		—	(2,209)	—
Beginning net assets - as adjusted		400,312	406,118	384,516
Ending net assets	$	419,271	400,312	408,327

In 2010, 2009, and 2008, approximately 37%, 37%, and 35%, 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 17% of total revenues in fiscal 2010. Also in 2010 tuition and fees charged to students and grants and contracts (federal, state and private) represented approximately 12% and 13% of total revenues, respectively.

A summary of University revenues for the year ended September 30, 2010 is presented below:



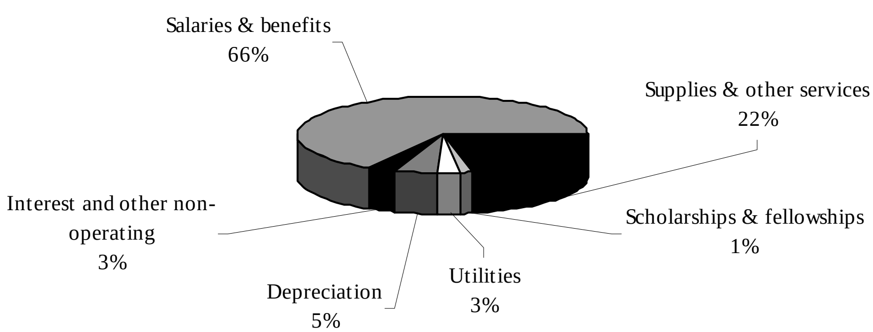
Tuition and fees have increased in each of the last eight years. These increases are due primarily to increases in tuition and fee rates charged to students as well as to an increase in the number of students enrolled. Additionally, tuition and fees as a percent of total operating revenues continue to increase, from 9.5% of operating revenues in 2002 to 16.4% in 2010. Tuition and fees, gross and net of scholarship allowances, for the past nine fiscal years are as follows:



Capital contributions and grants increased from $5,325,000 in 2009 to $14,099,000 in 2010 due to grant funds received for construction of the Shelby Building in 2010. The University recognized $6,193,000 in capital appropriations in 2010, compared to $10,171,000 in 2009. Those appropriations were utilized in the construction of the Student Recreation Center. Additionally, the University received revenue in the amount of $10,769,000 in 2010 appropriated by the State of Alabama pursuant to the American Recovery and Reinvestment Act (ARRA) of 2009.

University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2010 is presented below.

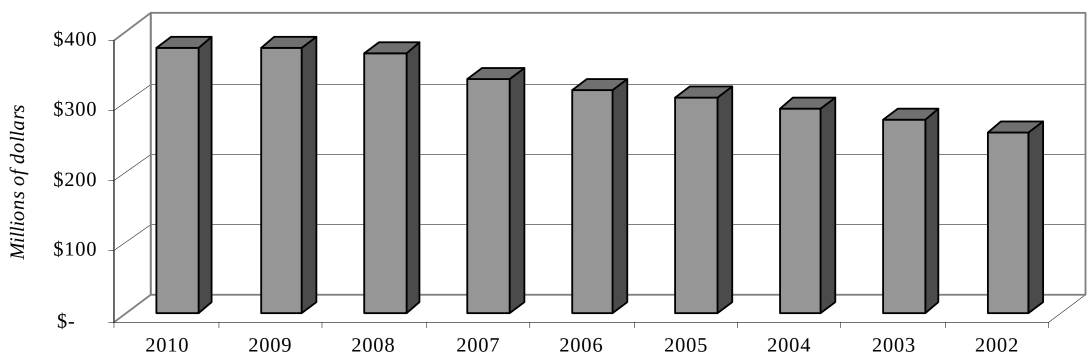
Total Expenses



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

In 2010, 2009, and 2008, approximately 68%, 69% and 69%, respectively, of the University's total operating expenses were salaries and benefits. Salaries and benefits have steadily increased over the last nine years, resulting primarily from increases in salary rates to faculty and staff, as shown as follows:

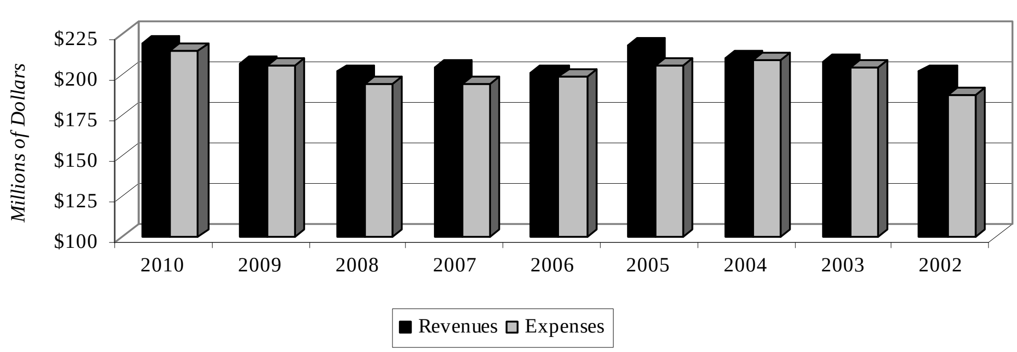
Total Salaries and Benefits Expense



For the years ended September 30, 2010, 2009, and 2008, the University reported an operating loss of approximately $134,518,000, $152,937,000, and $152,765,000, 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 $18,959,000, $(5,806,000), and $23,811,000, for the years ended September 30, 2010, 2009, and 2008, respectively.

The Hospitals represent a significant portion of total University revenues and expenses and have remained relatively constant over the past four years. Operating hospital revenues and expenses for the last nine 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 $59,050,000 in 2010. During 2010, the Football Field House and a major addition to the University’s central utility plant system were placed into service. Additionally, the Student Recreation Center and Moulton Bell Tower were substantially completed. Significant construction projects that remain in progress at September 30, 2010 include the Shelby Building, the expansion of Children’s and Women’s Hospital, Campus Entrance Portals, Student Dining Hall, a major renovation of the University Bookstore and a new Student Housing Facility. Major projects completed and placed into service in fiscal 2008 and 2009 included the Mitchell Cancer Institute, the Nursing and Allied Health Building and various other projects. At September 30, 2010, the University has outstanding commitments of approximately $53,690,000 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 2010, $6,193,000 was recognized by the University and is reported as a capital appropriation and $4,968,000 remains unspent at September 30, 2010.

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.

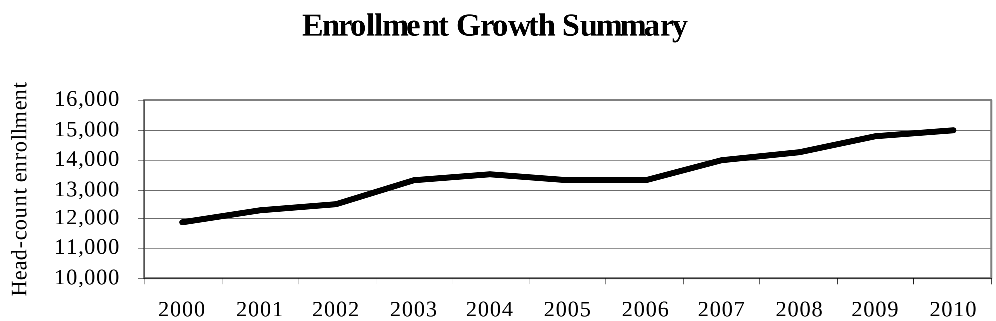
In June 2010, the University issued the University Facilities Revenue Capital Improvement Bond, Series 2010, with a face value of $29,750,000. The net proceeds of this bond will be used to fund the construction of new student housing as well as other construction and capital improvement projects at the 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. The fair value component of the refunding associated with the swaps is considered an investment derivative and, as such, the change in fair value component is reflected as a component of investment income in 2010 and 2009.

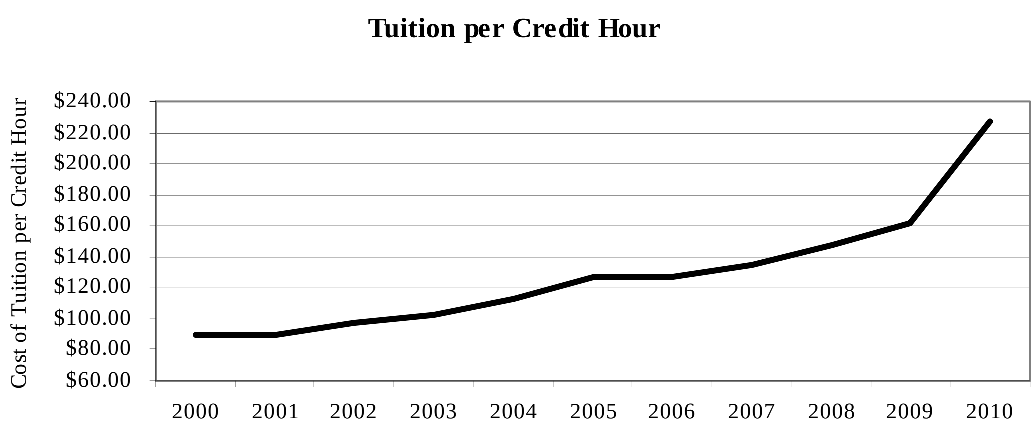
During the year ended September 30, 2010, the University’s bond credit rating was upgraded by Moody’s Investors Services from A1 to Aa3. This represents the first upgrade of the University’s bond credit rating since 2008. The University also has a rating of A+ from Standard and Poor’s Rating Services, which did not change in the 2010.

Economic Outlook

Student enrollment and tuition have both increased over the past ten years. The University has experienced an increase in enrollment of approximately 26%, or 3,137 students, between 2000 and 2010, from 11,870 in 2000 to 15,007 for the 2010 fall semester. The enrollment trend for the University between 2000 and 2010 is as follows:



In that same time period, in-state tuition per credit hour has increased by approximately 155%. The large increase in 2010 is the result of the University's bundling of tuition and required fees into a single per-hour charge. Similar increases have been experienced in out-of-state tuition, and College of Medicine tuition. The trend of in-state tuition per credit hour between 2000 and 2010 is as follows:

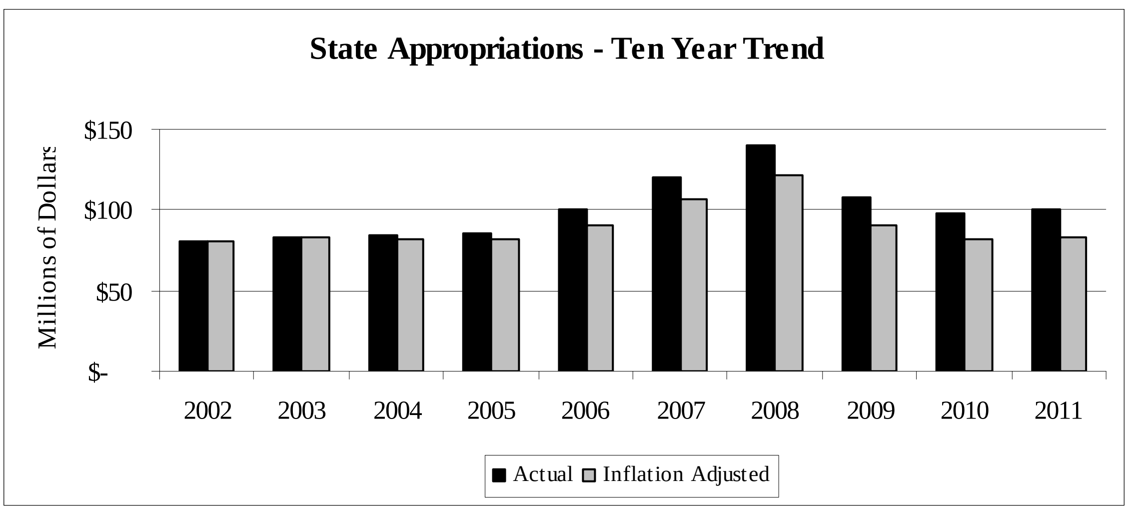


While enrollment and tuition have both increased in recent years, state appropriations prior to 2006 were relatively flat. However, in the 2008, 2007 and 2006 fiscal years, the University experienced increases of 16%, 19% and 17%, respectively, or approximately $19,349,000, $19,185,000 and $14,581,000,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

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

A state appropriation in the amount of $99,947,000 has been authorized for the year ending September 30, 2011. This represents a $2,087,000 increase from the fiscal 2010 appropriation received. While no announcement has been made, the University is aware that reductions in its 2011 appropriation are possible.

The ten year trend 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 over the past few years have had a significant impact on the value of the University's endowment. While financial markets showed signs of recovery in 2010, further weakening of the economy could have a potential further negative impact on the University's enrollment, extramural funding, endowment performance, and health care operations.

In early 2009, ARRA was passed by Congress and signed into law by the President. As a result of this legislation, the University has been awarded approximately $10,769,000 in 2010 and 2011 through the U.S. Department of Education's State Fiscal Stabilization Fund Program. Additional funding is available through the competitive grant process from various federal agencies. As of September 30, 2010, the University had been awarded ARRA grants totaling approximately $49,254,000. Additional proposals remain outstanding at September 30, 2010.

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 2011 beyond those unknown variables having a global effect on virtually all types of business operations.

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Independent Auditors' Report

The Board of Trustees
University of South Alabama:

We have audited the accompanying basic financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units as of and for the years ended September 30, 2010 and 2009, 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 2010 and 2009 consolidated financial statements of the University of South Alabama Foundation, which represents 80%, 101% and 23%, respectively, of the 2010 assets, net assets, and revenues, gains and other support of the discretely presented component units and 80%, 101% and (50)%, respectively, of the 2009 assets, net assets, and revenues, gains and other support of the discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the University of South Alabama Foundation, is based on the report of the other auditors.

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

As discussed in note 1, the financial statements of the University are intended to present the financial position, changes in financial position and, where applicable, cash flows of only that portion of the basic financial statements and the aggregate discretely presented component units of the State of Alabama that is attributable to the transactions of the University. They do not purport to, and do not, present fairly the financial position of the State of Alabama as of September 30, 2010 and 2009, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

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In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University and of its aggregate discretely presented component units as of September 30, 2010 and 2009, 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.

As discussed in note 1(j) to the basic financial statements, the University changed its method of accounting for derivative instruments in 2010 and 2009 due to the adoption of Governmental Accounting Standards Board Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2010, 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 12 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, 2010 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 2010 basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the 2010 basic financial statements taken as a whole.

KPMG LLP

November 15, 2010

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

Statements of Net Assets

September 30, 2010 and 2009

(In thousands)

		2010	2009
Assets:			
Current assets:			
Cash and cash equivalents	$	174,303	79,297
Investments		18,035	117,816
Net patient accounts receivable, (net of allowance for doubtful accounts of $51,108 and $48,690)		30,854	30,929
Accounts receivable, affiliates		21,659	18,284
Accounts receivable, other		21,796	15,162
Notes receivable, net		731	306
Prepaid expenses, inventories, and other		8,039	7,020
Total current assets		275,417	268,814
Noncurrent assets:			
Restricted cash and cash equivalents		26,860	56,615
Restricted investments		150,396	95,506
Investments		871	988
Accounts receivable		6,870	7,447
Notes receivable, net		3,970	5,058
Other noncurrent assets		8,055	8,308
Capital assets, net		444,718	413,513
Total noncurrent assets		641,740	587,435
Total assets		917,157	856,249
Liabilities:			
Current liabilities:			
Accounts payable and accrued liabilities		54,338	55,598
Deferred revenue		34,436	29,172
Deposits		1,738	904
Current portion of long-term debt		6,642	5,881
Total current liabilities		97,154	91,555
Noncurrent liabilities:			
Long-term debt, less current portion		330,993	305,571
Other long-term liabilities		69,739	58,811
Total noncurrent liabilities		400,732	364,382
Total liabilities		497,886	455,937
Net assets:			
Invested in capital assets, net of related debt		202,355	187,489
Restricted, nonexpendable:			
Scholarships		13,296	11,702
Other		16,262	16,920
Restricted, expendable:			
Scholarships		7,071	4,865
Other		34,982	23,820
Unrestricted		145,305	155,516
Total net assets	$	419,271	400,312

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2010 and 2009

(In thousands)

Assets		**2010**	**2009**
Cash and cash equivalents	$	868	2,298
Investments:			
Equity securities		92,053	83,884
Timber and mineral properties		156,465	150,211
Real estate		8,727	8,573
Other		5,535	5,519
Other assets		806	527
Total assets	$	264,454	251,012
Liabilities and Net Assets			
Liabilities:			
Accounts payable	$	204	169
Other liabilities		616	672
Total liabilities		820	841
Net assets:			
Unrestricted		55,627	55,053
Temporarily restricted		39,120	26,295
Permanently restricted		168,887	168,823
Total net assets		263,634	250,171
Total liabilities and net assets	$	264,454	251,012

See accompanying notes to basic financial statements.

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

Statements of Financial Position

September 30, 2010 and 2009

(In thousands)

Assets		**2010**	**2009**
Current assets:			
Cash and cash equivalents	$	778	1,397
Patient accounts receivable (net of allowance for uncollectible accounts of approximately $4,709 and $4,827)		11,299	10,395
Other current assets		3,915	1,039
Total current assets		15,992	12,831
Interest in assets of University of South Alabama Professional Liability Trust Fund		20,893	20,685
Property and equipment, net		2,367	2,475
Total assets	$	39,252	35,991
Liabilities and Deficit			
Current liabilities:			
Accounts payable	$	2,005	2,179
Due to affiliates		21,249	18,149
Total current liabilities		23,254	20,328
Estimated professional liability costs		20,893	20,685
Total liabilities		44,147	41,013
Deficit		(4,895)	(5,022)
Total liabilities and deficit	$	39,252	35,991

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Net Assets

September 30, 2010 and 2009

(In thousands)

		2010	2009
Assets:			
Current assets:			
Cash and cash equivalents	$	1,602	863
Investments		—	499
Rent receivable		150	195
Prepaid expenses and other current assets		13	4
Total current assets		1,765	1,561
Noncurrent assets:			
Intangible assets, net		238	261
Capital assets, net		26,060	26,492
Total noncurrent assets		26,298	26,753
Deferred outflows		4,171	2,916
Total assets and deferred outflows		32,234	31,230
Liabilities:			
Current liabilities:			
Deposits, other current liabilities, and accrued expenses		176	554
Payable to University of South Alabama		23	11
Deferred rent income		64	115
Current portion of notes payable		995	909
Total current liabilities		1,258	1,589
Noncurrent liabilities:			
Notes payable, excluding current portion		25,346	25,278
Interest rate swap		4,171	2,916
Total noncurrent liabilities		29,517	28,194
Total liabilities		30,775	29,783
Net assets (deficit):			
Invested in capital assets, net of related debt		(114)	247
Unrestricted		1,573	1,200
Total net assets	$	1,459	1,447

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, 2010 and 2009

(In thousands)

		2010	2009
Operating revenues:			
Tuition and fees (net of scholarship allowances of $25,343 and $20,516)	$	69,212	61,076
Net patient service revenue		219,923	206,532
Federal grants and contracts		21,563	23,017
State grants and contracts		7,452	7,146
Private grants and contracts		47,968	48,111
Auxiliary enterprises (net of scholarship allowances of $784 and $635)		16,129	16,806
Other operating revenues		39,593	32,947
Total operating revenues		421,840	395,635
Operating expenses:			
Salaries and benefits		378,188	379,360
Supplies and other services		128,973	122,672
Scholarships and fellowships		6,467	5,615
Utilities		15,071	15,742
Depreciation and amortization		27,659	25,183
Total operating expenses		556,358	548,572
Operating loss		(134,518)	(152,937)
Nonoperating revenues (expenses):			
State appropriations		97,860	108,451
State appropriated – ARRA funds		10,769	—
Investment income		9,278	7,469
Interest expense		(13,748)	(12,173)
Other nonoperating revenues		27,558	24,070
Other nonoperating expenses		(3,441)	(1,631)
Net nonoperating revenues		128,276	126,186
Loss before capital appropriations, capital contributions and grants, and additions to endowment		(6,242)	(26,751)
Capital appropriations		6,193	10,171
Capital contributions and grants		14,099	5,325
Additions to endowment		4,909	5,449
Change in net assets		18,959	(5,806)
Net assets:			
Beginning of year, before cumulative effect of change in accounting principle		400,312	408,327
Cumulative effect of change in accounting principle		—	(2,209)
Beginning of year – as adjusted		400,312	406,118
End of year	$	419,271	400,312

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, 2010

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Net realized and unrealized gains on investments	$ 6,110	12,385	7	18,502
Rents, royalties and timber sales	4,368	—	28	4,396
Interest and dividends	389	1,322	6	1,717
Gifts	—	1	13	14
Other income	23	—	—	23
Required match of donor contributions	(11)	1	10	—
Interfund interest	(187)	187	—	—
Net assets released from program restrictions	1,071	(1,071)	—	—
Total revenues, gains, and other support	11,763	12,825	64	24,652
Expenditures:				
Program services:				
Faculty support	2,149	—	—	2,149
Scholarships	1,009	—	—	1,009
Other	1,237	—	—	1,237
Total program service expenditures	4,395	—	—	4,395
Management and general	1,606	—	—	1,606
Other investment expense	1,440	—	—	1,440
Depletion expense	3,695	—	—	3,695
Depreciation expense	53	—	—	53
Total expenditures	11,189	—	—	11,189
Increase in net assets	574	12,825	64	13,463
Net assets – beginning of year	55,053	26,295	168,823	250,171
Net assets – end of year	$ 55,627	39,120	168,887	263,634

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
Depletion expense	5,564	—	—	5,564
Depreciation 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
HEALTH SERVICES FOUNDATION
(Discretely Presented Component Unit)

Statements of Operations and Changes in Deficit

Years ended September 30, 2010 and 2009

(In thousands)

		2010	2009
Unrestricted revenues, gains and other support:			
Net patient service revenue	$	68,977	68,257
Other revenue		7,953	8,046
Total unrestricted revenues, gains, and other support		76,930	76,303
Expenses:			
Salaries and benefits		48,703	47,936
General and administrative		12,744	12,746
Provision for uncollectible accounts		13,933	13,582
Depreciation and amortization		987	976
Interest		—	7
Total expenses		76,367	75,247
Operating income		563	1,056
Nonoperating gains		1,740	301
Revenues over expenses		2,303	1,357
Contributions restricted for debt service, received and expended within the same year		—	577
Transfer of capital to University of South Alabama, College of Medicine		(2,176)	(4,805)
Change in deficit		127	(2,871)
Unrestricted net deficit at beginning of year		(5,022)	(2,151)
Unrestricted net deficit at end of year	$	(4,895)	(5,022)

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2010 and 2009

(In thousands)

		2010	2009
Operating revenues:			
Rental income	$	3,766	3,514
Operating expenses:			
Building management and operating expenses		948	804
Depreciation and amortization		933	810
Legal and administrative fees		177	34
Insurance		78	48
Total operating expenses		2,136	1,696
Operating income		1,630	1,818
Nonoperating revenues (expenses):			
Investment income		8	31
Interest expense		(1,633)	(1,635)
Donation revenue		19	159
Other		(12)	5
Net nonoperating expenses		(1,618)	(1,440)
Transfer of building to University of South Alabama		—	(423)
Change in net assets		12	(45)
Net assets:			
Beginning of year		1,447	1,492
End of year	$	1,459	1,447

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, 2010 and 2009

(In thousands)

	2010	2009
Cash flows from operating activities:		
Receipts related to tuition and fees	$ 72,582	63,151
Receipts from and on behalf of patients and third-party payers	219,173	201,850
Receipts from grants and contracts	75,611	74,695
Receipts related to auxiliary enterprises	15,981	16,832
Payments to suppliers and vendors	(137,813)	(142,998)
Payments to employees and related benefits	(380,266)	(378,752)
Payments for scholarships and fellowships	(6,468)	(5,615)
Other operating receipts	38,967	34,084
Net cash used in operating activities	(102,233)	(136,753)
Cash flows from noncapital financing activities:		
State appropriations	97,860	108,451
State appropriated – ARRA funds	9,990	—
Endowment gifts	4,797	5,099
Agency funds received	1,162	515
Agency funds disbursed	(690)	(687)
Student loan program receipts	86,373	84,109
Student loan program disbursements	(85,847)	(83,794)
Other nonoperating revenues	27,632	23,852
Other nonoperating expenses	(3,445)	(2,133)
Net cash provided by noncapital financing activities	137,832	135,412
Cash flows from capital and related financing activities:		
Capital contributions and grants	11,755	5,062
Purchases of capital assets	(49,882)	(72,108)
Proceeds from sale of capital assets	488	105
Proceeds from issuance of capital debt	29,750	—
Principal payments on capital debt	(5,715)	(4,877)
Interest payments on capital debt	(12,843)	(12,131)
Net cash used in capital and related financing activities	(26,447)	(83,949)
Cash flows from investing activities:		
Interest and dividends on investments	6,451	6,455
Purchases of investments	(58,904)	(86,749)
Proceeds from sales of investments	108,552	170,689
Net cash provided by investing activities	56,099	90,395
Net increase in cash and cash equivalents	65,251	5,105
Cash and cash equivalents (unrestricted and restricted):		
Beginning of year	135,912	130,807
End of year	$ 201,163	135,912

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

Statements of Cash Flows

Years ended September 30, 2010 and 2009

(In thousands)

		2010	2009
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(134,518)	(152,937)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation and amortization expense		27,659	25,183
Changes in assets and liabilities, net:			
Student receivables		(1,768)	(1,186)
Net patient accounts receivables		212	(4,911)
Grants and contracts receivables		(4,013)	(3,542)
Other receivables		(2,018)	1,512
Prepaid expenses, inventories, and other		1,241	(2,351)
Accounts payable and accrued liabilities		5,911	(1,703)
Deferred revenue		5,061	3,182
Net cash used in operating activities	$	(102,233)	(136,753)
Noncash investing, noncapital financing, and capital and related financing transactions:			
Net increase in fair value of investments recognized as a component of investment income	$	4,873	4,268
Additional maturity on capital appreciation on bonds payable and other borrowings recorded as interest expense		2,100	1,998
Payments on behalf of the University by the Alabama Public School and College Authority reducing purchases of capital assets		6,431	9,786
Gifts of capital and other assets		122	613
Pledges of operating and capital gifts		453	559
Capitalization of construction period interest		1,820	2,483
Increase in accounts payable related to capital assets		102	179

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, 2010 and 2009, the University reports the University of South Alabama Foundation (USA Foundation), the University of South Alabama Health Services Foundation (USAHSF), and the USA Research and Technology Corporation (the Corporation) as discretely presented component units.

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

As further discussed in note 17, the operations of the USA HealthCare Management, LLC began on October 1, 2010. While there is no impact on fiscal year 2010 operations, it is anticipated that the USA HealthCare Management, LLC will be reported as a blended component unit in 2011.

(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, 2010 and 2009 were $4,340,000 and $4,772,000, 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, 2010 and 2009 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 $43,137,000 and $43,535,000 for the years ended September 30, 2010 and 2009, 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, 2010 and 2009 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

(Continued)

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).

(j) Derivatives

The University adopted the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*, during the year ended September 30, 2010. Retroactive application of the standard was required for all prior periods presented.

GASB 53 establishes a framework for accounting and financial reporting related to derivative instruments, requiring the fair value of derivatives to be recognized in the basic financial statements.

The University has two interest rate swaptions which were entered into in January 2008. As a result of entering into the swaptions, the University received up-front payments. Swaptions are considered hybrid instruments which are required to be bifurcated into the fair value of the derivative and a piece that reflects a borrowing for financial statement purposes, which will accrete interest over time. The University determined that as of September 30, 2009 and 2010, the swaptions were not hedging derivative instruments. Therefore, the swaptions are required to be recorded as investment derivatives, with the change in fair value flowing through the statements of revenues, expenses, and change in net assets.

The adoption of the provisions of GASB 53 reduced beginning net assets at October 1, 2008 by $2,209,000. The University's September 30, 2009 Statement of Net Assets has been restated to reflect a decrease in deferred revenue of $296,000, a decrease in long-term debt of $1,900,000, an increase in other long-term liabilities of $8,563,000 and a decrease in unrestricted net assets of $6,367,000 at September 30, 2009. The fair values of the derivatives were $(13,327,000), $(9,983,000), and $(6,015,000) at September 30, 2010, 2009, and 2008, respectively. At September 30, 2010 and 2009, the fair values of the derivatives were included in other long-term liabilities in the accompanying statements of net assets. The change in fair value for the years ended September 30, 2010 and 2009 was $(3,344,000) and $(3,968,000) and resulted in a reduction of investment income in the accompanying statements of revenues, expenses, and changes in net assets for the period ended September 30, 2010 and 2009. See note 5 for further discussion.

(k) 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.

(l) 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.

(m) 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, 2010 and 2009, no impairments were recorded.

(n) Deferred Revenue

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

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

(o) 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.

(p) 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.

(q) 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.

(r) 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.

(s) 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.

(t) 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.

(u) 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.

(v) State Appropriated – ARRA Funds

Pursuant to the American Recovery and Reinvestment Act (ARRA) of 2009, the University has been awarded approximately $10,769,000 annually in 2010 and 2011 through the U. S. Department of Education’s State Fiscal Stabilization Fund Program. These funds are billed and recorded as revenue as they are expended and reported in the statement of revenues, expenses and changes in net assets as State Appropriated – ARRA funds.

(w) 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.

(x) Compensated Absences

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

(y) Reclassifications

Certain amounts in the 2009 basic financial statements have been reclassified in order to conform to the 2010 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 June 30, 2010, the latest date at which such information is available, the net public deposits subject to collateral requirements for all institutions participating in the pool totaled approximately $8,053,000,000. The University had cash and cash equivalents totaling $201,163,000 and $135,912,000 at September 30, 2010 and 2009, 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, 2010 and 2009 (in thousands).

		2010	2009
U.S. Treasury notes	$	11,617	9,177
U.S. federal agency notes		60,677	119,836
Pooled equity mutual funds		57,584	53,461
Pooled debt mutual funds		19,230	16,748
Managed income alternative investments (limited partnerships, private equity securities, and other)		13,777	9,979
State agency obligations		777	468
Other		5,640	4,641
	$	169,302	214,310

At September 30, 2010 and 2009, $6,591,000 and $3,501,000, 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, 2010 is as follows:

	Credit rating	Percentage of total investments
Federal Home Loan Mortgage Corporation	AAA	4.5%
Federal Home Loan Bank Corporation	AAA	7.8
Federal National Mortgage Association	AAA	3.6
Common Fund Bond Fund	AA	5.2
Federal Farm Credit Banks Funding Corporation	AAA	0.5
Various State Housing Authorities	AAA	0.2

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
Various State Housing Authorities	AAA	0.1

Interest Rate Risk

At September 30, 2010, 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	$ 11,617	2,715	8,902	—	—
U.S. federal agency notes	60,677	37,970	22,702	—	5
State agency obligations	777	—	—	—	777
Pooled debt mutual funds	19,230	—	19,230	—	—
	$ 92,301	40,685	50,834	—	782

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

Because the debt mutual funds had a weighted average maturity of 3.5 and 3.9 years, the investments were presented in the 1-5 year category at September 30, 2010 and 2009.

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, 2010 or 2009.

At September 30, 2010, restricted investments consist of $64,581,000 related to unspent bond proceeds, $27,118,000 related to swaption collateral obligations and $58,697,000 related to investments included in the PLTF and GLTF to pay insurance liability claims. 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.

(b) University of South Alabama Foundation

Investments in securities consist primarily of equity securities totaling $92,053,000 and $83,884,000, at June 30, 2010 and 2009, respectively.

Investment gain (loss) was comprised of the following for the years ended June 30, 2010 and 2009 (in thousands):

		2010	2009
Unrealized gains (losses)	$	18,407	(32,468)
Realized gains (losses)		95	(2,602)
Timber sales		3,646	5,135
Interest and dividends		1,717	2,051
Rents		594	589
Royalties		156	199
	$	24,615	(27,096)

Investment related expenses in the amount of $224,000 and $214,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2010 and 2009 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2010 and 2009 consisted of the following property held (in thousands):

		2010	2009
Land and land improvements – held for investment	$	7,576	7,443
Building and building improvements – held for investment, net of depreciation		1,151	1,130
	$	8,727	8,573

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

Investments at June 30, 2010 and 2009, 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 ASC 820, *Fair Value Measurements and Disclosures*, (formally FASB Statement No. 157, *Fair Value Measurements*) for the fiscal year beginning July 1, 2008. ASC 820 provides a single definition of fair value and a hierarchical framework for measuring it, as well as establishing additional disclosure requirements about the use of fair value to measure assets and liabilities. Fair value measurements are classified as either observable or unobservable in nature. Observable fair values are derived from quoted market prices for investments traded on an active exchange or in dealer markets where there is sufficient activity and liquidity to allow price discovery by substantially all market participants. 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 at June 30, 2010 and 2009, respectively, are summarized based on the criteria of ASC 820 as follows (in thousands):

	Fair value measurements at June 30, 2010			
Description	**Observable values based on quoted prices**	**Other observable values**	**Unobservable values**	**Total**
Equity securities	$ 39,094	52,959	—	92,053
Timber and mineral properties	—	—	156,465	156,465
Real estate	—	—	8,727	8,727
Other investments	—	—	5,535	5,535
	$ 39,094	52,959	170,727	262,780

	Fair value measurements at June 30, 2009			
Description	**Observable values based on quoted prices**	**Other observable values**	**Unobservable values**	**Total**
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, 2010, 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	$ 150,211	8,573	5,519	164,303
Total gains (realized/unrealized)	9,250	136	16	9,402
Additions	518	46	—	564
Reforestation	181	—	—	181
Depreciation/depletion	(3,695)	(28)	—	(3,723)
Ending balance	$ 156,465	8,727	5,535	170,727

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

As of June 30, 2010, the Foundation has no outstanding commitments to purchase securities or other investments. Additionally, substantially all of the Foundation's equity securities at June 30, 2010 and 2009 are considered readily liquid. Timber and mineral properties, real estate, and other investments are generally considered illiquid.

(5) Derivative Transactions

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

Objective of the Derivative Transaction

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

Terms

A summary of the transactions is as follows:

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

If the counterparty exercises its options in 2014 and 2016, the University would, at the counterparty's option, be forced into an underlying swap. If the options are exercised, the University would begin to make payments on the notional amount, currently $41,125,000 and $100,000,000 for the 2004 bonds and 2006 bonds, respectively, of the underlying swap contract. Simultaneously, the University would call outstanding 2004 and 2006 bonds and issue variable rate demand notes (VRDNs) in their place. Under the swap contracts, the University would pay a fixed rate of 4.9753% on the 2004 bonds and 5.0% on the 2006 bonds to the counterparty and would receive payments based on 68% of the one-month LIBOR index. Alternatively, although it is not anticipated that this option would be to the University advantage, the University could, at its option, cash settle the swap and retain its right to refund the 2004 and 2006 bonds.

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

Financial Statement Presentation

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

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

The values of the borrowings are included in long-term debt on the University's 2010 and 2009 statements of net assets. Interest is being accreted on, and added to, the borrowings through the expiration date of the option. For the years ended September 30, 2010 and 2009, $609,000 and $493,000, respectively, was accreted and is included in interest expense in the statements of revenues, expenses, and changes in net assets.

The fair values of the embedded investment derivatives are reported as investment assets if the derivatives are assets or other noncurrent liabilities, depending on the fair values of the derivatives. The change in the fair market values of the derivatives is reported as a component of investment income in the statements of revenues, expenses and changes in net assets. At September 30, 2010 and 2009, the fair values of the derivatives are approximately $(13,327,000) and $(9,983,000) and are included in other long-term liabilities in the accompanying statements of net assets. For the years ended September 30, 2010 and 2009, the changes in the fair value of the derivatives were $(3,344,000) and $(3,968,000), respectively.

Fair Value

At September 30, 2010 and 2009, the embedded derivatives had fair values of $(13,327,000) and $(9,983,000), respectively. The fair values of the embedded derivatives were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the instruments, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement.

Risks Associated with this Transaction

Certain risks are inherent to derivative transactions.

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

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

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

Credit risk. Although the underlying swap exposes the University to credit risk should the swap be executed, the swaption itself does not expose the University to credit risk. If the option is exercised on one or both issues, the University would begin to make payments on the appropriate notional amount of the underlying swap contract. In that situation, if the fair value of the swap is positive, the University would be exposed to credit risk on the swap in the amount of its fair value. As of September 30, 2010 and 2009, the swap counterparty was rated Aa2 by Moody's Investors Services and AA by Standard and Poors Rating Services.

(Continued)

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, 2010 and 2009, 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, 2010 follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land	$ 29,312	359	—	—	29,671
Construction-in-progress	59,939	45,381	(20,586)	—	84,734
	89,251	45,740	(20,586)	—	114,405
Capital assets being depreciated:					
Land improvements	22,176	296	4,279	—	26,751
Buildings, fixed equipment, and infrastructure	445,716	2,232	12,046	(885)	459,109
Other equipment	117,900	8,134	4,261	(6,582)	123,713
Library materials	46,092	2,648	—	—	48,740
	631,884	13,310	20,586	(7,467)	658,313
Less accumulated depreciation for:					
Land improvements	(12,727)	(1,173)	—	—	(13,900)
Buildings, fixed equipment, and infrastructure	(178,562)	(12,667)	—	686	(190,543)
Other equipment	(82,467)	(11,343)	—	6,388	(87,422)
Library materials	(33,866)	(2,269)	—	—	(36,135)
	(307,622)	(27,452)	—	7,074	(328,000)
Capital assets being depreciated, net	324,262	(14,142)	20,586	(393)	330,313
Capital assets, net	$ 413,513	31,598	—	(393)	444,718

At September 30, 2010, the University had commitments of approximately $53,690,000 related to various construction projects.

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.

(b) USA Research and Technology Corporation

Changes in capital assets for the years ended September 30, 2010 and 2009 are as follows (in thousands):

		2010				
		Beginning balance	Additions	Transfers	Reductions	Ending balance
Land improvements	$	2,024	13	278	—	2,315
Buildings		25,847	161	771	—	26,779
Tenant improvements		603	20	—		623
Construction in progress		795	260	(1,055)	—	—
Other equipment		178	4	6	—	188
		29,447	458	—	—	29,905
Less accumulated depreciation for:						
Land improvements		(470)	(90)	—	—	(560)
Buildings		(2,412)	(663)	—	—	(3,075)
Tenant improvements		(46)	(118)	—	—	(164)
Other equipment		(27)	(19)	—	—	(46)
		(2,955)	(890)	—	—	(3,845)
Capital assets, net	$	26,492	(432)	—	—	26,060

		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

(7) Noncurrent Liabilities

A summary of the University's noncurrent liability activity for the years ended September 30, 2010 and 2009 follows (in thousands):

	2010					
	Beginning balance	**Additions**	**Reductions**	**Ending balance**	**Less amounts due within one year**	**Noncurrent liabilities**
Long-term debt:						
Bonds payable and other	$ 311,452	32,064	(5,881)	337,635	6,642	330,993
Total long-term debt	311,452	32,064	(5,881)	337,635	6,642	330,993
Other long-term liabilities	70,057	24,809	(13,124)	81,742	12,003	69,739
Total noncurrent liabilities	$ 381,509	56,873	(19,005)	419,377	18,645	400,732

	2009					
	Beginning balance	**Additions**	**Reductions**	**Ending balance**	**Less amounts due within one year**	**Noncurrent liabilities**
Long-term debt:						
Bonds payable and other	$ 314,334	1,998	(4,880)	311,452	5,881	305,571
Capital lease payable	92	—	(92)	—	—	—
Total long-term debt	314,426	1,998	(4,972)	311,452	5,881	305,571
Other long-term liabilities	65,470	25,867	(21,280)	70,057	11,246	58,811
Total noncurrent liabilities	$ 379,896	27,865	(26,252)	381,509	17,127	364,382

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

(Continued)

(8) Bonds Payable

Bonds payable consisted of the following at September 30, 2010 and 2009 (in thousands):

		2010	2009
University Tuition Revenue Bonds, Series 1999 Current Interest, 3.70% to 4.35%, payable through November 2010	$	3,965	7,565
University Tuition Revenue Bonds, Series 1999 Capital Appreciation, 4.70% to 5.25%, payable November 2011 through November 2018		35,148	33,443
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2004, 2.00% to 5.00%, payable through March 2024		43,470	44,895
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		111,820	112,510
University Facilities Revenue and Capital Improvement Bond, Series 2010, 3.81%, payable through August 2030		29,750	—
Borrowing arising from swaption, Series 2004 Bonds		1,419	1,278
Borrowing arising from swaption, Series 2006 Bonds		5,002	4,534
		330,574	304,225
Plus unamortized premium		7,656	8,005
Less unamortized discount		(55)	(62)
Less unamortized debt extinguishment costs		(540)	(716)
	$	337,635	311,452

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. The Series 2010 Bond begins maturing in August 2011 and is redeemable beginning in February 2020.

In January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to a counterparty. The proceeds from each sale, totaling $9,328,000, consist of two components, a borrowing and an embedded derivative. The borrowing is included in long-term debt. As a result of this transaction, 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, 2010 and 2009, the maturity value of the Capital Appreciation Bonds increased $1,705,000 and $1,622,000, respectively, over the original principal amount of $19,810,000, reflecting accretion of interest.

Approximately $62,276,000 of proceeds from the issuance of the Series 2008 Bonds remained unspent at September 30, 2010 ($12,717,000 is included in restricted cash and cash equivalents and $49,559,000 is included in restricted investments in the 2010 statement of net assets) and are restricted for capital purposes as outlined in the indenture.

Approximately $26,475,000 of proceeds from the issuance of the Series 2010 Bond remained unspent at September 30, 2010 ($11,453,000 is included in restricted cash and cash equivalents and $15,022,000 is included in restricted investments in the 2010 statement of net assets) and are restricted for capital purposes as outlined in the indenture.

The University is subject to arbitrage restrictions on its bonded indebtedness prescribed by the U. S. Internal Revenue Service. As such, amounts have been accrued in the University's basic financial statement for any expected arbitrage liabilities.

The University is subject to restrictive covenants related to its bonds payable. At September 30, 2010, 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, 2010 (in thousands):

		Debt service on bonds			
		Principal	Interest	Additional maturity	Total
2011	$	6,404	13,597	(2,506)	17,495
2012		8,033	13,420	(2,488)	18,965
2013		8,377	13,275	(2,440)	19,212
2014		8,654	13,233	(2,224)	19,663
2015		8,926	13,143	(1,986)	20,083
2016 – 2020		59,213	64,730	(3,134)	120,809
2021 – 2025		65,208	53,575	—	118,783
2026 – 2030		66,095	38,001	—	104,096
2031 – 2035		73,014	20,698	—	93,712
2036 – 2038		41,428	3,062	—	44,490
Subtotal		345,352	246,734	(14,778)	577,308
Plus (less):					
Additional maturity		(14,778)			
Unamortized bond premium		7,656			
Unamortized bond discount		(55)			
Unamortized debt extinguishment costs		(540)			
Total	$	337,635			

The principal amount of debt service due on bonds at September 30, 2010 includes $15,339,000 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, 2010, is $1,354,000 representing additional maturity value of the borrowing resulting from the Series 2004 and Series 2006 swaption. As described in note 5, additional maturity will continue to accrue until the swaption option period in 2014 and 2016. Although this additional maturity is presented as principal on the debt service schedule above, it is also recognized as interest expense on an annual basis in the University’s basic financial statements as it accretes.

(a) USA Research and Technology Corporation

Notes Payable

Notes payable consisted of the following at September 30, 2010 and 2009 (in thousands):

		2010	2009
Whitney National Bank commercial mortgage note, 6.0%, payable through 2014	$	8,406	8,803
Wachovia Bank, N.A. (now Wells Fargo, N.A.) promissory note, one-month LIBOR plus 0.85% (1.107% at September 30, 2010) payable through 2028		16,858	17,369
Hancock Bank of Alabama construction loan, converted into a commercial mortgage note on December 23, 2009		—	15
Hancock Bank of Alabama commercial mortgage note, converted from a construction loan on December 23, 2009, 6.5%, payable through 2030		1,077	—
	$	26,341	26,187

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

The note payable to Hancock Bank of Alabama was incurred by the Corporation to finance construction of the shell of a building that is leased to a company that provides dialysis services. The construction loan was an interest-only loan until December 23, 2009, at which time the loan was converted to a fully amortizing commercial mortgage note with a 20-year term and bearing a 6.5% interest rate. The construction loan was and the commercial mortgage note payable is 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, 2010, the Corporation's management believes the Corporation was in compliance with its debt covenants.

Debt Service on Long-Term Obligations

At September 30, 2010, total debt service by fiscal year is as follows (in thousands):

		Debt service on note and loan		
		Principal	**Interest**	**Total**
2011	$	996	1,597	2,593
2012		1,046	1,547	2,593
2013		1,128	1,465	2,593
2014		7,752	1,120	8,872
2015		736	934	1,670
2016 – 2020		4,429	3,923	8,352
2021 – 2025		6,039	2,313	8,352
2026 – 2030		4,215	389	4,604
Total	$	26,341	13,288	39,629

Derivative Transaction

On February 27, 2007, the Corporation entered a derivative transaction with Wachovia Bank, N.A. (now Wells Fargo Bank, N.A.), the counterparty. The derivative 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.

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

The 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 $864,000 and $756,000 under the interest rate swap agreement for the years ended September 30, 2010 and 2009, respectively, which is reflected as an increase in interest expense.

Fair value. The interest rate swap had a fair value of $(4,171,030) and $(2,916,000) at September 30, 2010 and 2009, respectively.

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

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

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

Credit risk. As of September 30, 2010 and 2009, 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 Aa2 by Moody’s Investors Services and AA by Standard & Poor’s Ratings Services as of September 30, 2010 and 2009.

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, 2010 and 2009, no events of default or termination had occurred. If the interest rate swap is terminated, interest rate risk associated with the variable rate debt would no longer be hedged. Also, if at the time of termination the interest rate swap had a negative fair value, the Corporation would be liable to the counterparty for a payment equal to the interest rate swap’s fair value. To allow the Corporation the maximum flexibility to manage the utilization of Buildings II and III while at the same time providing protection for the counterparty, the Corporation granted the counterparty a $2,000,000 mortgage secured by an interest in the ground lease with respect to the parcel of land on which Building II stands, an interest in Building II, a security interest in Building II tenant leases, and a security interest in income received from rental of Building II.

Derivative payments and hedged debt. As interest rates fluctuate, variable rate debt interest and net derivative payments will fluctuate. Using interest rates as of September 30, 2010, 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:

		Variable rate loan		Interest rate	
		Principal	**Interest**	**swap, net**	**Total**
2011	$	544	186	841	1,571
2012		568	182	821	1,571
2013		618	173	780	1,571
2014		657	166	748	1,571
2015		698	158	715	1,571
2016 – 2020		4,199	664	2,994	7,857
2021 – 2025		5,719	388	1,750	7,857
2026 – 2030		3,855	61	275	4,191
Total	$	16,858	1,978	8,924	27,760

(9) Net Patient Service Revenue

The Hospitals have agreements with governmental and other third-party payers that provide for reimbursement at amounts different from their established rates. Contractual adjustments under third-party reimbursement programs represent the difference between the Hospitals' billings at established rates for services and amounts reimbursed by third-party payers.

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

Medicare – Substantially all acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Additionally, the Hospitals are reimbursed for both direct and indirect medical education costs (as defined), principally based on per-resident prospective payment amounts and certain adjustments to prospective rate-per-discharge operating reimbursement payments. The Hospitals generally are reimbursed for certain retroactively settled items at tentative rates, with final settlement determined after submission of annual cost reports by the Hospitals and audits by the Medicare fiscal intermediary. The cost report for the USA Medical Center has been audited and settled through 2006. The cost report for USA Children's and Women's Hospital has been audited through 2008 and settled through 2007. Revenue from the Medicare program accounted for approximately 13% and 15% of the Hospitals' net patient service revenue for the years ended September 30, 2010 and 2009, respectively.

Blue Cross – Inpatient services rendered to Blue Cross subscribers are paid at a prospectively determined per diem rate. Outpatient services are reimbursed under a cost reimbursement methodology. For outpatient services, the Hospitals are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospitals and audits thereof by Blue Cross. The Hospitals' Blue Cross cost reports have been audited through 2009 and settled for all fiscal years through 2008. Revenue from the Blue Cross program accounted for approximately 18% and 23% of the Hospitals' net patient service revenue for the years ended September 30, 2010 and 2009, respectively.

(Continued)

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 29% and 37% of the Hospitals' net patient service revenue for the years ended September 30, 2010 and 2009, 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, 2010 and 2009 follows (in thousands):

		2010	2009
Gross patient service revenue	$	442,540	416,428
Less provision for contractual and other adjustments		151,332	133,795
Less provision for bad debts		71,285	76,101
	$	219,923	206,532

Changes in estimates related to prior cost reporting periods resulted in an increase of approximately $344,000 and $123,000 in net patient service revenue for the years ended September 30, 2010 and 2009, respectively.

(10) Hospital Lease

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

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:		
2011	$	416,000
2012		555,000
2013		277,000
		1,248,000
Less amounts representing interest		(64,000)
Total capital lease receivable	$	1,184,000

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.

(11) Employee Benefits

(a) Retirement and Pension Plans

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

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

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 2010, 2009 and 2008, the University made total contributions of $32,259,000, $32,465,000, and $30,252,000 (100% of the required contributions), respectively, to TRS on behalf of participants, which represents 12.51%, 12.07%, and 11.06%, respectively, of each participant's gross earnings. The University’s payroll for all employees was approximately $292,299,000 and $295,647,000 in 2010 and 2009, respectively. Total payroll for University employees participating in the Teachers’ Retirement System of Alabama was approximately $257,864,000 and $268,969,000 in 2010 and 2009, 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 $1,074,000 and $982,000 in 2010 and 2009, respectively, representing 522 and 519 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 $17,020,000 and $16,398,000 at September 30, 2010 and 2009, 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, 2010 and 2009, the University’s expense related to PEEHIP was $5,937,000 and $5,482,000, respectively.

(12) 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, 2010 and 2009. 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 $1,596,000 and $1,573,000 in 2010 and 2009, 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, 2010 and 2009 for the PLTF, GLTF and health plan are summarized as follows (in thousands):

		2010	2009
Balance, beginning of year	$	34,755	37,283
Liabilities incurred and other additions		42,787	35,013
Claims, administrative fees paid and other reductions		(36,232)	(37,541)
Balance, end of year	$	41,310	34,755

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

(13) Other Related Party

SAMSF is a not-for-profit corporation that exists for the purpose of promoting education and research at the University. At September 30, 2010 and 2009, SAMSF had total assets of $10,510,000 and $9,317,000, net assets of $7,514,000 and $6,801,000, and total revenues of $4,195,000 and $4,717,000, respectively. SAMSF reimburses the University for certain administrative expenses and other related support services. Total amounts received for such expenses were approximately $1,128,000 and $1,538,000 in 2010 and 2009, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net assets.

(14) Commitments and Contingencies

(a) Grants and Contracts

At September 30, 2010 and 2009, the University had been awarded approximately $72,132,000 and $61,699,000, respectively, in grants and contracts for which resources had not been received and for which reimbursable expenditures had not been made for the purposes specified. These awards, which represent commitments of sponsors to provide funds for research or training projects, have not been reflected in the accompanying basic financial statements as the eligibility requirements of the award have not been met. Advances include amounts received from grant and contract sponsors which have not been earned under the terms of the agreements and, therefore, have not yet been included in revenues in the accompanying basic financial statements. Federal awards are subject to audit by Federal agencies. The University's management believes any adjustment from such audits will not be material.

(b) Letter of Credit

In connection with the Hospitals' participation in the State of Alabama Medicaid Program, the University has established a $77,000 irrevocable standby letter of credit with Wells Fargo, N.A. The Alabama Medicaid Agency is the beneficiary of this letter of credit. No funds were advanced under this letter during the years ended September 30, 2010 and 2009.

(c) Litigation

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

(d) Rent Supplement Agreements

The University has entered into two irrevocable rent supplement agreements with the Corporation and a financial institution. The agreements require that, in the event the Corporation fails to maintain a debt service coverage ratio of one to one with respect to all of its outstanding indebtedness, the University will pay to the Corporation any and all rent amounts necessary to cause the Corporation's net operating income to be equal to the Corporation's annual debt service obligations (see note 8). As of September 30, 2010 and 2009, 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, 2010, approximately $4,968,000 is unspent and remains available to the University for certain future construction costs. The allocations have not been reflected in the accompanying financial statements.

(f) FICA Refund

In March 2010, the Internal Revenue Service (the Service) ruled that for all tax periods ending before April 2005, the medical residents working at the USA hospitals could be treated under the student exception with respect to FICA taxes. Historically, the Service had held that residents were not exempt from FICA taxes. As a result of this ruling, the University has recorded a receivable of $5,144,000 representing the employer's portion of FICA contributions from March 1996 to April 2005 and any related interest.

(g) 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 such as common area maintenance, utilities, and general liability and property damage insurance. In 2009, the lease called 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. Under a lease amendment dated September 14, 2004, the tenant leased 5,958 square feet in the building previously occupied by another tenant. After occupying that space for twelve months the tenant had the right to terminate the lease of that square footage upon six months advance notice. Such advance notice under both options was received by letter dated May 13, 2010, in which the tenant chose to terminate a total of 13,440 square feet.

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 42,209 and 48,556 square feet at September 30, 2010 and 2009, respectively. Under these leases, the Corporation must pay all operating expenses of the buildings, including utilities, janitorial, maintenance, property taxes, and insurance. Tenants will reimburse the Corporation for such expenses only as the total expenses for a year increase over the total expenses for the base year of the lease (the Corporation's fiscal year beginning after the date the lease is signed). The leases have terms varying from one to ten years.

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

The Corporation had three ground leases in place at September 30, 2010 and 2009. One lease is for a 40-year initial term with 20-year, and 15-year renewal options. The second lease is for a 30-year initial term with four 5-year renewal options. The third lease has a 38.5-year initial term with 20-year and 15-year renewal options.

Minimum future rentals by fiscal year are as follows:

2011	$	3,132,000
2012		2,794,000
2013		2,088,000
2014		1,013,000
2015		639,000
2016 – 2046		7,890,000
Total	$	17,556,000

(15) Functional Information

Operating expenses by functional classification for the years ended September 30, 2010 and 2009 are listed below (in thousands). In preparing the basic financial statements, all significant transactions and balances among accounts have been eliminated.

		2010	2009
Instruction	$	112,973	113,323
Research		20,793	21,548
Public service		46,543	41,647
Academic support		14,617	15,816
Student services		26,990	24,619
Institutional support		30,966	31,769
Operation and maintenance of plant		23,889	25,161
Scholarships		1,591	458
Hospital		233,033	233,306
Auxiliary enterprises		17,304	15,742
Depreciation and amortization		27,659	25,183
	$	556,358	548,572

(16) Significant New Accounting Pronouncements

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 was effective for the year ended 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 was effective for the year ended September 30, 2010. The adoption of Statement No. 51 did not have a material impact on the University’s basic financial statements. The impact of the implementation of Statement No. 53 is addressed in detail in note 1(j).

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. In December 2009, the GASB issued Statement No. 57, *OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans*. GASB Statement 57 addresses issues related to the use of the alternative measurement method and the frequency and timing of measurements by employers that participate in agent multi-employer other post-employment benefit plans and will be effective for the year ending September 30, 2011. In June 2010, the GASB issued Statement No. 59, *Financial Instruments Omnibus*. Statement No. 59 clarifies numerous issues related to the financial reporting for financial instruments.

The effect of the implementation of GASB Statements Nos. 54, 57 and 59 on the University has not been determined.

(17) Subsequent Events

(a) USA HealthCare Management, LLC

In June 2010, the University's Board of Trustees approved the formation of the USA HealthCare Management, LLC (the LLC). The University is the sole member of the LLC, which was organized for the purpose of managing and operating on behalf of and as agent for, substantially all of the health care enterprise of the University. The operations of the LLC commences on October 1, 2010.

(b) Sale of Brookley Campus

On September 29, 2010, the University and the USA Foundation executed a purchase and sale agreement calling for the University to sell approximately 327 acres on Mobile Bay, known as the Brookley campus, to the Foundation. The terms of the agreement require the Foundation to pay the University $20,000,000; $4,000,000 at closing and $4,000,000 annually thereafter for four years. At September 30, 2010, the property had a book value of $7,500,000. The sale closed on November 10, 2010, and the initial payment has been received by the University.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2010

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Student Financial Aid Cluster*:						
U.S. Department of Education:						
Federal Pell Grant Program	84.063			$ 17,136,928	—	17,136,928
Federal Supplemental Educational Opportunity Grant Program	84.007			315,938	—	315,938
Federal Family Educational Loans	84.032			84,911,229	—	84,911,229
Federal Work Study Program	84.033			677,555	—	677,555
Academic Competitiveness Grant	84.375			188,881	—	188,881
National Science and Mathematics Access to Retain Talent Grant	84.376			332,952	—	332,952
Teacher Education Assistance for College and Higher Education	84.379			28,000	—	28,000
Federal Perkins Loan Program	84.038			—	—	—
Loans for Disadvantaged Students	93.342			—	—	—
Health Professions Student Loans	93.342			—	—	—
Total Student Financial Aid Cluster				103,591,483	—	103,591,483
Research and Development Cluster*:						
U.S. Department of Commerce:						
Sea Grant Support	11.417	2375HM	Dauphin Island Sea Lab	—	5,034	5,034
Cooperative Fishery Statistics	11.434	EDP-ESF-RB-2010-USA	Gulf States Marine Fisheries Commission	—	20,409	20,409
Marine Fisheries Initiative	11.433			92,006	—	92,006
Unallied Management Projects	11.454	80182	Alabama Department of Conservation and Natural Resources	—	200,837	200,837
Unallied Management Projects	11.454	Task Order D-3	Dauphin Island Sea Lab (MESC)	—	16,489	16,489
Total CFDA				—	217,326	217,326
Habitat Conservation	11.463			698,140	—	698,140
Habitat Conservation	11.463	ALFO SA 3807-02	The Nature Conservancy	—	88,250	88,250
Total CFDA				698,140	88,250	786,390
Applied Meteorological Research	11.468			463,782	—	463,782
Congressionally Identified Award and Projects	11.469	TASK ORDER D-1	Dauphin Island Sea Lab (MESC)	—	24,761	24,761
Total U.S. Department of Commerce				1,253,928	355,780	1,609,708
U.S. Department of Defense:						
Military Medical Research and Development	12.420			162,379	—	162,379
Information Security Grant Program	12.902	360356-062900-01	Mississippi State University	—	101,059	101,059
Research and Technology Development	12.910			87,972	—	87,972
Cultural Resource Assessment	12.000	12.W912P9-09-D-0537	Brockington Associates, Inc.	—	27,272	27,272
Total U.S. Department of Defense				250,351	128,331	378,682
U.S. Department of Housing and Urban Development:						
Community Development Block Grants	14.228	CDBG/HUD	Washington County Commission	—	(133)	(133)
Community Development Block Grants	14.228	10-1001122	Mississippi Department of Archives and History	—	69,854	69,854
Total CFDA				—	69,721	69,721
Resident Opportunity and Supportive Services - Elderly and Persons with Disabilities	14.876	100279	Mobile Housing Board	—	6,895	6,895
Total U. S. Department of Housing and Urban Development				—	76,616	76,616
U.S. Department of Interior:						
Cooperative Endangered Species Conservation Fund	15.615	80240	Alabama Division of Wildlife and Fisheries	—	327	327
Cooperative Endangered Species Conservation Fund	15.615	90256	Alabama Department of Conservation and Natural Resources	—	17,524	17,524
Total CFDA				—	17,851	17,851
National Cooperative Geologic Mapping Program	15.810			5,593	—	5,593
Historic Preservation Fund Grants-In-Aid	15.904	AL-06-003	Alabama Historical Commission	—	19,503	19,503
American Battlefield Protection	15.926			21,006	—	21,006
Total U.S. Department of Interior				26,599	37,354	63,953
U.S. Department of Justice:						
Developing, Testing and Demonstrating Promising New Programs	16.541			345,996	—	345,996

(Continued)

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2010

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
U.S. Department of Transportation:						
ARRA Highway Planning and Construction	20.205	STMTE-TE09(925)	Alabama Department of Transportation	$ —	278,744	278,744
Highway Training and Education	20.215	DTFH61-01-R-00063	Kilgore Consulting & Management	—	3,794	3,794
Pipeline Safety Program Base Grants	20.700	8/10/2017	Prince William Sound Science Center	—	4,847	4,847
University Transportation Centers Program	20.701			180,721	—	180,721
University Transportation Centers Program	20.701	281348-002	University of Alabama at Birmingham	—	10,415	10,415
Total CFDA				180,721	10,415	191,136
Total U.S. Department of Transportation				180,721	297,800	478,521
National Aeronautics and Space Administration:						
Technology Transfer	43.002			197,902	—	197,902
Technology Transfer	43.002	SUB2005-152-18-01	University of Alabama in Huntsville	—	18,771	18,771
Total CFDA				197,902	18,771	216,673
National Science Foundation:						
Engineering Grants	47.041			28,424	—	28,424
Mathematical and Physical Sciences	47.049			337,630	—	337,630
Geosciences	47.050			147,627	—	147,627
Geosciences	47.050	1021RR100513	University of Georgia	—	148,395	148,395
Total CFDA				147,627	148,395	296,022
Computer and Information Science and Engineering	47.070			7,176	—	7,176
Biological Sciences	47.074			3,850	—	3,850
Social Behavioral and Economic Sciences	47.075			47,685	—	47,685
Education and Human Resources	47.076	10-090120	Mobile Area Education Foundation Inc.	—	48,879	48,879
Polar Programs	47.078			25,728	—	25,728
Office of Cyber infrastructure	47.080	39-21530-081	Tuskegee University	—	82,011	82,011
Office of Cyber infrastructure	47.080	09-013	University of Alabama	—	4,313	4,313
Total CFDA				—	86,324	86,324
ARRA - NSF Recovery Act Research Support	47.082			166,288	—	166,288
ARRA - NSF Recovery Act Research Support	47.082	AA-5-31980	Oklahoma State University	—	35,116	35,116
ARRA - NSF Recovery Act Research Support	47.082	1328-206-2087448	Clemson University	—	46,503	46,503
Total CFDA				166,288	81,619	247,907
Total National Science Foundation				764,408	365,217	1,129,625
Environmental Protection Agency:						
Office of Research and Development Consolidated Research/Training/Fellowships	66.511			(28,781)	—	(28,781)
U.S. Department of Energy:						
Basic Energy Sciences University and Science	81.049			120,952	—	120,952
Basic Energy Sciences University and Science	81.049	10-ENG-246590-USA	Alabama EPSCOR	—	30,424	30,424
Total CFDA				120,952	30,424	151,376
U.S. Department of Education:						
Research in Special Education	84.324			391,826	—	391,826
U.S. Election Assistance Commission:						
Help America Vote Act Requirement Payments	90.401			265,377	—	265,377
U.S. Department of Health and Human Services:						
Cooperative Agreements to Improve the Health Status of Minority Populations	93.004	6MPCMP0610110104	Morehouse School of Medicine	—	6,802	6,802
Environmental Health	93.113			518,585	—	518,585
Oral Diseases and Disorders Research	93.121	R 548086	State University of New York – Buffalo	—	44,770	44,770
Minority Health and Health Disparities Research	93.307			1,342,724	—	1,342,724
Trans-NIH Research Support	93.310			38,470	—	38,470
National Center for Research Resources	93.389			229,006	—	229,006
Cancer Cause and Prevention Research	93.393			94,767	—	94,767
Cancer Detection and Diagnosis Research	93.394			71,459	—	71,459
Cancer Treatment Research	93.395			12,770	—	12,770
Cancer Treatment Research	93.395	7U10CA76001-4	Duke University Medical Center	—	2,134	2,134
Cancer Treatment Research	93.395	98543-1234	National Childhood Cancer Foundation	—	30,253	30,253
Total CFDA				12,770	32,387	45,157

(Continued)

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Cancer Biology Research	93.396			$ 166,920	—	166,920
ARRA - NIH Recovery Act Research Support	93.701			1,699,110	—	1,699,110
Cardiovascular Diseases Research	93.837			2,476,857	—	2,476,857
Lung Diseases Research	93.838			3,112,870	—	3,112,870
Blood Diseases and Resources Research	93.839	111513010-7366495	St. Jude Children's Research Hospital	—	2,056	2,056
Arthritis Musculoskeletal and Skin Diseases Research	93.846			47,474	—	47,474
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847			395,834	—	395,834
Extramural Research Programs in Neurosciences and Neurological Disorders	93.853	70190	Columbia University	—	1,208	1,208
Extramural Research Programs in Neurosciences and Neurological Disorders	93.853	126155-03	University of Texas	—	83,155	83,155
Extramural Research Programs in Neurosciences and Neurological Disorders	93.853	AO7593	Yale University	—	31,045	31,045
Total CFDA				—	115,408	115,408
Allergy Immunology and Transplantation Research	93.855			404,548	—	404,548
Allergy Immunology and Transplantation Research	93.855	09-111	University of Texas Medical Branch (The)	—	105,015	105,015
Total CFDA				404,548	105,015	509,563
Microbiology and Infectious Diseases Research	93.856			391,013	—	391,013
Pharmacology Physiology and Biological Chemistry	93.859			122,357	—	122,357
Vision Research	93.867			56,687	—	56,687
Clinical Research	93.000189671-218	N01-A1-30025-01	University of Alabama at Birmingham	—	16,735	16,735
Total U.S. Department of Health and Human Services				11,181,451	323,173	11,504,624
Total Research and Development Cluster				14,950,730	1,633,466	16,584,196
Other federal assistance:						
U. S. Department of Agriculture:						
Plant and Animal Disease Pest Control and Animal Care	10.025			24,446	—	24,446
U.S. Department of Commerce:						
Coastal Zone Management Estuarine Research	11.420			20,123	—	20,123
Congressionally Identified Projects	11.617			11,171,961	—	11,171,961
Total U.S. Department of Commerce				11,192,084	—	11,192,084
U.S. Department of Defense:						
Procurement Technical Assistance for Business Firms	12.002	PTAC-USA-10-006	University of Alabama Birmingham	—	18,528	18,528
Procurement Technical Assistance for Business Firms	12.002	PTAC-USA-10-067	University of Alabama	—	4,146	4,146
Total U. S. Department of Defense:				—	22,674	22,674
U. S. Department of Housing and Urban Development:						
Resident Opportunity and Supportive Services - Service Coordinators	14.870	100,213	Mobile Housing Board	—	13,935	13,935
Resident Opportunity and Supportive Services - Elderly and Persons with Disabilities	14.876	AL002REL041A007	Mobile Housing Board	—	30,351	30,351
Total U. S Department of Housing and Urban Development				—	44,286	44,286
U.S. Department of Transportation:						
Highway Planning and Construction	20.205			894,603	—	894,603
National Aeronautics and Space Administration:						
Technology Transfer	43.002	SUB2005-152	University of Alabama in Huntsville	—	50,340	50,340
National Endowment for the Humanities:						
Promotion of the Humanities Division and Preservation	45.149			5,680	—	5,680
National Science Foundation:						
Biological Sciences	47.074			76,727	—	76,727
Social Behavioral and Economic Sciences	47.075			7,055	—	7,055
Education and Human Resources	47.076			67,791	—	67,791
Education and Human Resources	47.076	0602359-011-A1	University of Alabama at Birmingham	—	14,596	14,596
Education and Human Resources	47.076	SUB2005-291	University of Alabama in Huntsville	—	(250)	(250)
Education and Human Resources	47.076	100,390	Mobile Area Education Foundation Inc.	—	4,559	4,559
Total CFDA				67,791	18,905	86,696
Total National Science Foundation				151,573	18,905	170,478
U.S. Small Business Administration:						
Minority Business Development	59.006			2,168	—	2,168
Small Business Development Centers	59.037	SBA-USA-10-027	University of Alabama at Birmingham	—	129,499	129,499
Total U.S. Small Business Administration				2,168	129,499	131,667

(Continued)

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2010

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
U.S. Department of Energy:						
Basic Energy Sciences University and Science Education	81.049	DE-SC0002470	University of Alabama	$ —	12,638	12,638
U.S. Department of Education:						
Special Education Grants to States	84.027	100,041	Alabama State Department of Education	—	34,380	34,380
TRIO Cluster:						
TRIO Talent Search	84.044			323,309	—	323,309
TRIO Upward Bound	84.047			236,556	—	236,556
Total TRIO Cluster				559,865	—	559,865
Special Education - State Personnel Development	84.323	U900524	Alabama Department of Education	—	1,298	1,298
Transition to Teaching	84.350			173,471	—	173,471
Reading First State Grants	84.357	90420-170030-1	Alabama Department of Education	—	135,805	135,805
Mathematics and Science Partnerships	84.366	U900135	Alabama Department of Education	—	119,730	119,730
Improving Teacher Quality State Grants	84.367	80400	Alabama Commission of Higher Education	—	210,631	210,631
Improving Teacher Quality State Grants	84.367	100219 100409	Jacksonville State University	—	18,659	18,659
Total CFDA				—	229,290	229,290
College Access Challenge Grant Program	84.378	FY09-4018	Alabama Department of Education	—	3,016	3,016
ARRA State Fiscal Stabilization Fund (SFSF) - Education State Grants Recovery Act*	84.394	S394A090001	Alabama State Executive Budget Office	—	10,768,819	10,768,819
Total U.S. Department of Education				733,336	11,292,338	12,025,674
U.S. Department of Health and Human Services:						
Alzheimer's Disease Demonstration Grants to States	93.051	10-1000246	South Alabama Regional Planning Commission	—	11,161	11,161
Public Health Emergency Preparedness	93.069	90412	Alabama Department of Mental Health	—	(7,195)	(7,195)
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153			299,310	—	299,310
Advanced Education Nursing Grant Programs	93.247			3,078,014	—	3,078,014
Nursing Faculty Loan Program	93.264			1,518	—	1,518
Centers for Disease Control and Prevention	93.283	C00113157	State of Alabama Department of Public Health	—	95,205	95,205
Minority Health and Health Disparities Research	93.307			24,708	—	24,708
Professional Nurse Traineeships	93.358			333,746	—	333,746
Basic Nurse Education and Practice Grants	93.359			312,208	—	312,208
ARRA National Center for Research Resources, Recovery Act Construction Support	93.702			273,453	—	273,453
ARRA Health Information Technology Regional Extension Centers Program	93.718			75,465	—	75,465
Grants for Residency Training for General Pediatrics	93.884			93,890	—	93,890
Health Care and Other Facilities	93.887			956,165	—	956,165
National Bioterrorism Hospital Preparedness Program	93.889	C90118276 (CEP-13-QW0-10)	Alabama Department of Public Health	—	1,340,337	1,340,337
HIV Care Formula Grants	93.917	RW-USAF-1011	United Way of Central Alabama	—	79,369	79,369
Healthy Start Initiative	93.926	C00113118	State of Alabama Dept of Public Health	—	20,000	20,000
Block Grants for Community Mental Health Services	93.958	09-005	University of Alabama	—	(1,021)	(1,021)
Geriatric Education Centers	93.969	R01262	Florida State University	—	65,931	65,931
Maternal and Child Health Services Block Grant to the	93.994	C00113034	Alabama Department of Public Health	—	13,238	13,238
Total U.S. Department of Health and Human Services				5,448,477	1,617,025	7,065,502
Corporation for National and Community Service:						
AmeriCorps	94.006			25,865	—	25,865
Total other federal assistance				18,478,232	13,187,705	31,665,937
Total federal expenditures				$ 137,020,445	14,821,171	151,841,616

* Denotes a major program.

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

See accompanying independent auditors' report.

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

Notes to Schedule of Expenditures of Federal Awards

September 30, 2010

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of the University of South Alabama (the University) and is presented on the accrual basis of accounting. The information in 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.

There were no loans advanced for Federal Perkins Loans, Loans for Disadvantaged Students, and Health Professions Student Loans for the year ended September 30, 2010. Outstanding loans made by the University are included in notes receivable in the University's 2010 statement of net assets and consist of the following loan programs:

	CFDA #		Amount
Federal Perkins Loan Program	84.038	$	3,739,803
Loans for Disadvantaged Students	93.342		1,193
Health Professions Student Loans	93.342		47,056
Nursing Faculty Loans	93.264		9,614
			3,797,666
Less outstanding balance of loans granted in previous years			(3,796,148)
Nursing Faculty Loans advanced to eligible students of the University during 2010		$	1,518

The University's Federal Family Education Loans (FFEL) included in the Schedule represent loans received by students of the University during fiscal year 2010 which were not made by the University. Accordingly, FFEL amounts are not reflected in the University's basic financial statements. It is not practical to determine the balance of loans outstanding to students and former students of the University under these programs as of September 30, 2010.

(2) Contingencies

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

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

Notes to Schedule of Expenditures of Federal Awards

September 30, 2010

(3) Federal Family Education Loan Programs

During fiscal year ended September 30, 2010, 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	$	30,841,493
Unsubsidized Stafford loans	84.032		49,172,408
Parent Loans for Undergraduate Students	84.032		4,897,328
Total		$	84,911,229

(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	$	100,980
Technology Transfer	43.002		31,796
Mathematical and Physical Sciences	47.049		88,667
Geosciences	47.050		12,003
Office of Research and Development Consolidated Research/Training/Fellowships	66.511		20,572
Transition to Teaching	84.350		61,519
Help America Vote Act Requirements Payments	90.401		57,358
Environmental Health	93.113		60,533
Coordinated Services and Access to Research for Women, Infants, Children, and Youth	93.153		7,241
Minority Health and Health Disparities Research	93.307		219,027
Cancer Biology Research	93.396		(705)
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847		74,544
Cardiovascular Diseases Research	93.837		39,151
Health Resources Services Administration/State of Alabama Department of Public Health/Healthy Start Initiative	93.926		20,000
Health Resources Services Administration/United Way of Central Alabama/HIV Care Formula Grants	93.917		1,600
U.S. Department of Education/Alabama Department of Education/Mathematics and Science Partnerships	84.366		173,628

	Federal CFDA #	Amounts expended
U.S. Department of Education/Alabama Commission on Higher Education/Improving Teacher Quality State Grants	84.367	119,148
		$ 1,087,062

(5) Matching

Under the Federal Work Study Program and Federal Supplemental Education Opportunity Grant Program, the University matched $36,695 and $162,330, respectively, in funds awarded to students for the year ended September 30, 2010 in addition to the Federal share of expenditures included in the accompanying schedule of expenditures of federal awards.

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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, 2010, and have issued our report thereon dated November 15, 2010. We did not audit the 2010 consolidated financial statements of the University of South Alabama Foundation, which represents 80%, 101%, and 23%, 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. Our report states that the University changed its method of accounting for derivative instruments due to the adoption of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. The financial statements of the University of South Alabama Foundation, the University of South Alabama Health Services Foundation, the USA Research and Technology Corporation, and the Professional and General Liability Trust Funds were not audited in accordance with *Government Auditing Standards.*

Internal Control over Financial Reporting

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

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

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

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Compliance and Other Matters

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

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

KPMG LLP

November 15, 2010

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188 East Capitol Street
Jackson, MS 39201

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

The Board of Trustees
University of South Alabama:

Compliance

We have audited the University of South Alabama's (the University's) compliance with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* (Compliance Supplement) that could have a direct and material effect on each of the University's major federal programs for the year ended September 30, 2010, 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 (ACS). Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements. ACS's compliance with the requirements governing the functions that it performs for the University for the year ended June 30, 2010 was examined by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* Our report does not include the results of the other accountants' examination of ACS's compliance with such requirements.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States; and OMB Circular A-133. 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 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 compliance requirements referred to in the first paragraph above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2010.

KPMG

Internal Control Over Compliance

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

Requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan program in the Student Financial 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 June 30, 2010 was reported on by other accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* Our report does not include the results of the other accountants' testing of the University's internal control over compliance related to such functions.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be deficiencies, 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

November 15, 2010

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

Schedule of Findings and Questioned Costs

Year ended September 30, 2010

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, 84.038, 93.342	Student Financial Aid Cluster
Various	Research and Development Cluster
84.394	U.S. Department of Education/State Fiscal Stabilization Fund (SFSF) - Education State Grants Recovery Act

Dollar threshold used to distinguish between type A and type B programs:	$ 1,447,458
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, 2010

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, 2010.

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

Schedule of Findings and Questioned Costs

Year ended September 30, 2010

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, 2010.