



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

Basic Financial Statements and Supplementary Information
on Federal Awards Programs

September 30, 2008

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

Management's Discussion and Analysis (Unaudited)

September 30, 2008 and 2007

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, 2008 and 2007 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

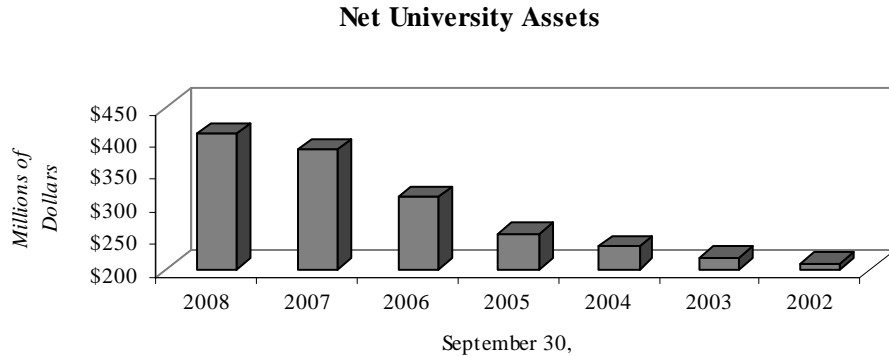
At September 30, 2008, 2007, and 2006, the University had total assets of \$862,666,000, \$707,687,000, and \$545,649,000, respectively; total liabilities of \$454,339,000, \$323,171,000, and \$234,291,000, respectively; and net assets of \$408,327,000, \$384,516,000, and \$311,358,000, respectively. University net assets increased 0

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



Net assets invested in capital assets, net of related debt, increased approximately \$23,298,000 from September 30, 2007 to 2008. This increase was due primarily to increases in construction activity (net of bond funds used for construction) and other capital asset additions. Restricted expendable net assets decreased to \$23,071,000 at September 30, 2008 primarily due to the expenditure of funds restricted for use by the Mitchell Cancer Institute. Unrestricted net assets increased from \$168,045,000 to \$174,105,000 between 2007 and 2008.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total University net assets as of September 30, 2008 compared to 2007 are as follows:

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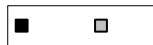
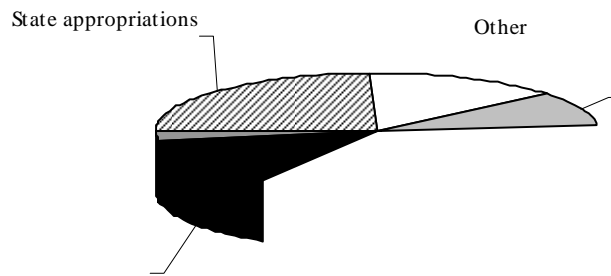
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In 2008, 2007, and 2006, approximately 36%, 38%, and 38%, respectively, of total revenues of the University were net patient service revenue. Excluding net patient service revenue, state appropriations represent the largest component of total university revenues, approximately 24% of total revenues in fiscal 2008. Also in 2008 tuition and fees charged to students and grants and contracts (federal, state and private) represented approximately 10% and 13% of total revenues, respectively.

A summary of University revenues for the year ended September 30, 2008 is presented below:

Total Revenues



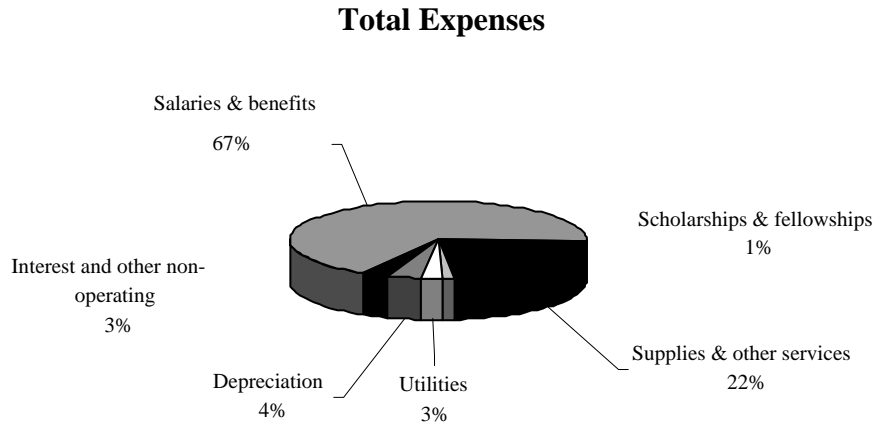
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September 30, 2008 and 2007

Further, additions to endowment increased from \$3,843,000 in 2007 to \$9,496,000 in 2008 primarily due to increased gifts as a result of the University's comprehensive fund raising campaign. As a result of significant fluctuations in financial markets conditions, net investment income (loss) increased from \$9,418,000 in 2006 to \$19,534,000 in 2007. In 2008, net investment income (loss) decreased by approximately \$23,791,000 to a net 2008 loss of \$4,257,000. Included in this amount are unrealized market losses of \$13,771,000 in 2008.

University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2008 is presented below.



While the University reports its expenses on a natural expense classification basis, functional classifications represent expenses categorized based on the function within the University. Such University functions include instruction, research, public service, academic support, student services, institutional support, scholarships, and operation and maintenance of plant. Expenses related to auxiliary enterprise activities and the hospitals are presented separately. Functional expense information is presented in note 16 to the basic financial statements.

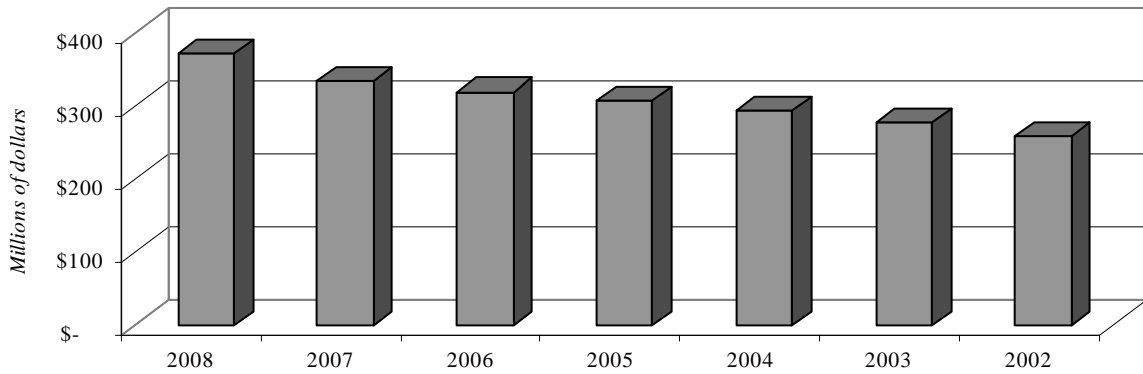
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September 30, 2008 and 2007

In 2008, 2007, and 2006, approximately 69% of the University's total operating expenses were salaries and benefits. Salaries and benefits have steadily increased over the last five 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, 2008, 2007, and 2006, the University reported an operating loss of approximately \$152,765,000, \$105,369,000, and \$88,256,000, respectively. Net operating losses are offset by state appropriations, which are reported as nonoperating revenue. For the year ended September 30, 2008, state appropriations were approximately \$23,811,000.



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September 30, 2008 and 2007

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 \$87,000,000 in 2008. Significant capital asset additions in fiscal 2008 include the Nursing and Allied Health Building, the Mitchell Cancer Institute and numerous ongoing construction projects at the University and Hospitals. Significant projects in fiscal 2006 and 2007 included Building II in the USA Technology and Research Park, JagTran (the campus shuttle system), Meisler Hall and ongoing projects. In 2007, Buildings II and III in the USA Technology and Research Park were sold to the USA Research and Technology Corporation. The proceeds from this sale were approximately \$11,986,000. At September 30, 2008, the University has outstanding commitments of approximately \$68,372,000 for various capital projects.

During 2007, the University sold the Health Services Building to the USA Research and Technology Corporation and also sold 100 lots in the Hillsdale area of campus to a third party. The University recognized a gain on the disposal of these assets of approximately \$3,739,000.

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, issued at a premium of approximately \$132,000, will be used to fund an expansion of the USA Children's and Women's Hospital as well as other construction and capital improvements at the University.

In January 2007, the University issued the University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2006, with a face value of \$100,000,000. The proceeds of these bonds, issued at a premium of approximately \$6,780,000, were used to refund the University Tuition Revenue Refunding Bonds, Series 1996 and will be used to fund construction and other capital improvements at the University.

In order to realize debt service savings currently from future debt refunding, in January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to a counterparty and resulted in an up-front payment to the University totaling \$9,328,000 in exchange for selling the counterparty the option to enter into an interest rate swap with respect to the Series 2004 and 2006 bonds. A portion of this payment is considered a borrowing and is included in the long-term debt of the University.

During the year ended September 30, 2008, the University's bond credit rating was upgraded by Moody's Investors Services from A2 to A1. This represents the first upgrade of the University's bond credit rating since 2004. The University also received a rating of A+ from Standard and Poor's Rating Services.

UNIVERSITY OF SOUTH ALABAMA
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Management's Discussion and Analysis (Unaudited)
September 30, 2008 and 2007

Economic Outlook

Student enrollment and tuition have both increased signi





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, 2008 and 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2008, on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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

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

Statements of Net Assets

September 30, 2008 and 2007

(In thousands)

	2008	2007
Assets:		
Current assets:		
Cash and cash equivalents	\$ 34,914	51,864
Investments	187,947	153,292
Net patient accounts receivable, (net of allowance for doubtful accounts of \$45,650 and \$42,447)	26,018	30,950
Accounts receivable, affiliates	15,329	11,521
Accounts receivable, other	14,485	17,577
Notes receivable, net	837	787
Prepaid expenses, inventories, and other	7,900	5,992
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UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2008 and 2007

(In thousands)

Assets	2008	2007
Cash and cash equivalents	\$ 1,337	1,713
Investments:		
Securities, at fair value	120,133	142,709
Timber and mineral properties	154,462	150,364
Real estate	9,792	18,794
Other	5,500	5,500
Other assets	452	488
Total assets	\$ 291,676	319,568
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 82	20
Other liabilities	646	779
Total liabilities	728	799
Net assets:		
Unrestricted	87,273	88,012
Temporarily restricted	34,739	59,707
Permanently restricted	168,936	171,050
Total net assets	290,948	318,769
Total liabilities and net assets	\$ 291,676	319,568

See accompanying notes to basic financial statements.

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

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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, 2008 and 2007

(In thousands)

	2008	2007
Operating revenues:		
Tuition and fees (net of scholarship allowances of \$16,483 and \$14,401)	\$ 54,823	49,579
Net patient service revenue	201,603	205,337
Federal grants and contracts	22,378	23,088
State grants and contracts	8,238	6,822
Private grants and contracts	46,629	44,964
Auxiliary enterprises (net of scholarship allowances of \$510 and \$432)	16,866	16,633
Other operating revenues	30,794	29,170
Total operating revenues	381,331	375,593
Operating expenses:		
Salaries and benefits	370,749	333,688
Supplies and other services	123,782	111,297
Scholarships and fellowships	4,997	4,295
Utilities	14,400	12,623
Depreciation and amortization	20,168	19,059
Total operating expenses	534,096	480,962
Operating loss	(152,765)	(105,369)
Nonoperating revenues (expenses):		
State appropriations	139,737	120,388
Investment income (loss)	(4,257)	19,534
Interest expense	(8,089)	(7,654)
Other nonoperating revenues	27,018	27,401
Other nonoperating expenses	(6,597)	(4,892)
Net nonoperating revenues	147,812	154,777
Income (loss) before capital contributions and additions to endowment	(4,953)	49,408
Capital contributions and grants	19,268	19,907
Additions to endowment	9,496	3,843
Increase in net assets	23,811	73,158
Net assets:		
Beginning of year	384,516	311,358
End of year	\$ 408,327	384,516

See accompanying notes to basic financial statements.

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

Statements of Operations and Changes in Net Assets

Years ended September 30, 2008 and 2007

(In thousands)

	2008	2007
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 67,484	66,917
Other revenue	7,857	8,281
Total unrestricted revenues, gains and other support	75,341	75,198
Expenses:		
Salaries and benefits	46,212	43,479
General and administrative	17,748	15,945
Provision for uncollectible accounts	13,459	12,631
Depreciation and amortization	993	945
Interest	65	138
Total expenses	78,477	73,138
Operating income (loss)	(3,136)	2,060
Nonoperating gains	180	215
Revenues over (under) expenses	(2,956)	2,275
Contributions restricted for debt service, received and expended within the same year	1,000	1,000
Transfer of capital to University of South Alabama College of Medicine	(1,517)	(3,041)
Change in unrestricted net assets	(3,473)	234
Unrestricted net assets at beginning of year	1,322	1,088
Unrestricted net assets (deficit) at end of year	\$ (2,151)	1,322

See accompanying notes to basic financial statements.

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UNIVERSITY OF SOUTH ALABAMA
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Statements of Cash Flows

Years ended September 30, 2008 and 2007

(In thousands)

	2008	2007
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (152,765)	(105,369)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation expense	20,168	19,059
Changes in assets and liabilities, net:		
Student receivables	(1,042)	96
Net patient accounts receivable	3,628	(2,917)
Grants and contracts receivables	1,742	(268)
Student loan program receivables	444	(190)
Other receivables	8,345	2,403
Prepaid expenses, inventories, and other	1,035	(1,529)
Accounts payable and accrued liabilities	(8,445)	9,024
Deferred revenue	5,153	2,764
Net cash used in operating activities	\$ (121,737)	(76,927)
Noncash investing, noncapital financing, and capital and related financing transactions:		
Increase (decrease) in fair value of investments recognized as a component of investment income	\$ (13,771)	2,404
Additional maturity on capital appreciation bonds payable recorded as interest expense	1,813	1,468
Gifts of capital and other assets	60	—
Pledges of operating and capital gifts	412	2,414
Capitalization of construction period interest	1,537	848
Increase (decrease) in accounts payable related to capital assets	(2,226)	522

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA
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Notes to Basic Financial Statements

September 30, 2008 and 2007

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*

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Notes to Basic Financial Statements

September 30, 2008 and 2007

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.

(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 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 partnership or companies.

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

(j) Accounts Receivable

Accounts receivable primarily result from net patient service revenue. Accounts receivable from affiliates primarily represent amounts due from USAHSF for salaries, and certain administrative and other support services. Accounts receivable – other includes amounts due from students, the federal government, state and local governments, or private sources in connection with reimbursement of allowable expenditures made pursuant to the University’s grants and contracts. Accounts receivable are recorded net of estimated uncollectible amounts.

(k) Inventories

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

(l) Capital Assets

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

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

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

Certain buildings are componentized for depreciation purposes.

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

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Notes to Basic Financial Statements

September 30, 2008 and 2007

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, 2008 and 2007, no impairments were recorded.

(m) *Deferred Revenue*

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

Operating lease rental payments related to the University's lease of USA Knollwood Hospital to the Infirmary Health System, Inc. (see note 11) are deferred and recognized as revenue over the term of the lease using the straight-line method.

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

(n) *Classification of Net Assets*

The University's net assets are classified as follows:

Invested in capital assets, net of related debt represents 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.

UNIVERSITY OF SOUTH ALABAMA

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Notes to Basic Financial Statements

September 30, 2008 and 2007

(s) ***Grants and Contracts***

The University has been awarded grants and contracts for which funds have not been received or expenditures made for the purpose specified in the

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Notes to Basic Financial Statements

September 30, 2008 and 2007

(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

UNIVERSITY OF SOUTH ALABAMA
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Notes to Basic Financial Statements

September 30, 2008 and 2007

Investments of the University, by type, at fair value, are as follows at September 30, 2008 and 2007 (in thousands).

	2008	2007
U.S. Treasury notes	\$ 14,977	14,402
U.S. federal agency notes	188,810	103,572
Commercial paper	14,231	100,554
Pooled equity mutual funds	44,229	35,938
Pooled debt mutual funds	15,328	12,710
Managed income alternative investments (limited partnerships, private equity securities, and other)	12,858	10,532
Other	2,508	255
	\$ 292,941	277,963

At September 30, 2008 and 2007, \$3,849,000 and \$5,182,000, 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, 2008 is as follows:

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

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Notes to Basic Financial Statements

September 30, 2008 and 2007

The University's exposure to credit risk and concentration of credit risk at September 30, 2007 is as follows:

	<u>Credit rating</u>	<u>Percentage of total investments</u>
Federal Home Loan Mortgage Corporation	AAA	16.4%
Federal Home Loan Bank Corporation	AAA	14.2
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UNIVERSITY OF SOUTH ALABAMA
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Notes to Basic Financial Statements

September 30, 2008 and 2007

Because the debt mutual funds had a weighted average maturity of 4.8 and 6.5 years, the investments were presented in the 1-5 year and the 6-10 year maturity category at September 30, 2008 and 2007, respectively.

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

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Notes to Basic Financial Statements

September 30, 2008 and 2007

Investment related expenses in the amount of \$350,000 and \$339,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2008 and 2007 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2008 and 2007 consisted of the following property held (in thousands):

	<u>2008</u>	<u>2007</u>
Land and land improvements – held for investment	\$ 8,658	16,525
Building and building improvements –		
	<u> </u>	<u> </u>
	<u> </u>	<u> </u>

UNIVERSITY OF SOUTH ALABAMA
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Notes to Basic Financial Statements

September 30, 2008 and 2007

Terms

A summary of the transactions is as follows:

Issue	Date of					
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UNIVERSITY OF SOUTH ALABAMA
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Notes to Basic Financial Statements

September 30, 2008 and 2007

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

Fair Value

At September 30, 2008, the derivative transactions had a fair value of \$(12,290,000).

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

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

Notes to Basic Financial Statements

September 30, 2008 and 2007

A summary of the University's capital asset activity for the year ended September 30, 2007 follows (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets not being depreciated:					
Land	\$ 28,490	994	—	(213)	29,271
Construction-in-progress	45,671	47,118	(27,961)	—	64,828
	<u>74,161</u>	<u>48,112</u>	<u>(27,961)</u>	<u>(213)</u>	<u>94,099</u>
Capital assets being depreciated:					
Land improvements	17,470	45	4,373	—	21,888
Buildings, fixed equipment, and infrastructure	287,227	3,051	22,916	(14,443)	298,751
Other equipment	88,341	14,234	672	(4,100)	99,147
Library materials	38,039	2,480	—	—	40,519
	<u>431,077</u>	<u>19,810</u>	<u>27,961</u>	<u>(18,543)</u>	<u>460,305</u>
Less accumulated depreciation for:					
Land improvements	(9,910)	(837)	—	—	(10,747)
Buildings, fixed equipment, and infrastructure	(156,819)	(7,671)	—	5,086	(159,404)
Other equipment	(62,966)	(9,021)	—	3,822	(68,165)
Library materials	(27,668)	(1,530)	—	—	(29,198)
	<u>(257,363)</u>	<u>(19,059)</u>	<u>—</u>	<u>8,908</u>	<u>(267,514)</u>
Capital assets being depreciated, net	<u>173,714</u>	<u>751</u>	<u>27,961</u>	<u>(9,635)</u>	<u>192,791</u>
Capital assets, net	<u>\$ 247,875</u>	<u>48,863</u>	<u>—</u>	<u>(9,848)</u>	<u>286,890</u>

At September 30, 2007, the University had commitments of approximately \$55,408,000 related to various construction projects.

During the year ended September 30, 2007, the University sold Buildings II and III in the USA Technology and Research Park to the Corporation for proceeds of approximately \$11,986,000 and

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

Notes to Basic Financial Statements
 September 30, 2008 and 2007

(b) USA Research and Technology Corporation

Changes in capital assets for the years ended September 30, 2008 and 2007 are as follows:

	2008				
	Beginning balance	Additions	Transfers	Reductions	Ending balance
Land improvements	\$ 1,828	122	—	—	1,950
Buildings	22,228	1,874	—	—	24,102
Other equipment	—	173	—	—	173
	24,056	2,169	—	—	26,225
Less accumulated depreciation for:					
Land improvements					
Buildings					
Other equipment					

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

Notes to Basic Financial Statements

September 30, 2008 and 2007

Bonds Payable

Bonds payable consisted of the following at September 30, 2008 and 2007 (in thousands):

	<u>2008</u>	<u>2007</u>
University Tuition Revenue Bonds, Series 1999 Current		
	_____	_____
	_____	_____
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UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Notes to Basic Financial Statements

September 30, 2008 and 2007

Debt Service on Long-Term Obligations

Total debt service by fiscal year is as follows as of September 30, 2008 (in thousands):

	Debt service on bonds			
	Principal	Interest	Additional maturity	Total
2009	\$ 4,785	12,480	(1,998)	15,267
2010	5,715	12,700	(2,100)	16,315
2011	5,410	12,464	(2,207)	15,667
2012	6,995	12,324	(2,143)	17,176
2013	7,295	12,219	(2,039)	17,475
2014 – 2018	45,994	60,430	(6,223)	100,201
2019 – 2023	56,635	54,904	(49)	111,490
2024 – 2028	54,695	41,568	—	96,263
2029 – 2033	65,659	27,159	—	92,818
2034 – 2038	72,489	9,199	—	81,688
Subtotal	<u>325,672</u>	<u>255,447</u>	<u>(16,759)</u>	<u>564,360</u>
Plus (less):				
Additional maturity	(16,759)			
Unamortized bond premium	8,354			
Unamortized bond discount	(69)			
Unamortized debt extinguishment cost	(964)			
Total	<u>\$ 316,234</u>			

The principal amount of debt service due on bonds at September 30, 2008 includes \$13,469,000 representing additional maturity value on Series 1999 Capital Appreciation Bonds. These bonds mature in years 2011 through 2019 and are noninterest bearing. Also included in the principal amount of debt service due on bonds at September 30, 2008, is \$3,290,000 representing additional maturity value of the borrowing resulting from the Series 2004 and Series 2006 swaption. As described in note 5, additional maturity will continue to accrue until the swaption option period in 2014 and 2016. Although this additional maturity is presented as principal on the debt service schedule above, it is also recognized as interest expense on an annual basis in the University's financial statements as it accretes.

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

Notes to Basic Financial Statements

September 30, 2008 and 2007

(b) USA Research and Technology Corporation

Notes Payable

Notes payable consisted of the following at September 30, 2008 and 2007 (in thousands):

	2008	2007
Whitney National Bank commercial mortgage note, 6.0%, payable through 2014	\$ 9,178	9,528
Wachovia Bank, N.A. construction loan convertible into promissory note, one-month LIBOR plus 0.85% (6.515% at September 30, 2007)	—	13,429
Wachovia Bank, N.A. promissory note, one-month LIBOR plus 0.85% (4.776% at September 30, 2008), payable through 2028	17,853	—
	\$ 27,031	22,957

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 ten-year term and amortization is based on a twenty-year term.

The construction loan payable to Wachovia Bank, N.A. was incurred by the Corporation to acquire Buildings II and III in the USA Technology & Research Park and to provide funds for renovations and tenant finishing costs. The maximum amount that might be borrowed under the construction loan was \$18,000,000. The loan was an interest-only loan until May 1, 2008, at which time the loan was converted to a fully amortizing promissory note with a twenty-year term. The Corporation has entered into two derivative instruments, an interest rate cap of 6.1% on the construction loan and a “receive variable, pay fixed” type of interest rate swap on the promissory note which will yield a synthetic fixed interest rate of 6.1%. The construction loan was and the promissory note payable is secured by an interest in the ground lease with respect to the parcels of land on which Buildings II and III stand, an interest in Buildings II and III, an interest in tenant leases for Buildings II and III, and an interest in income received from rental of Buildings II and III. The University also entered into an agreement with Wachovia 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. At September 30, 2008, the Corporation’s management believes the Corporation was in compliance with its debt covenants.

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

Notes to Basic Financial Statements

September 30, 2008 and 2007

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

Notes to Basic Financial Statements

September 30, 2008 and 2007

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 through 2006 and settled through 2005. The cost report for USA Children's and Women's Hospital has been audited through 2007 and settled through 2006. The cost report for USA Knollwood Hospital has been audited and settled through March 2006 and settled through September 2004. Revenue from the Medicare program accounted

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

Notes to Basic Financial Statements

September 30, 2008 and 2007

Changes in estimates related to prior cost reporting periods resulted in an increase of approximately

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**SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
AND OMB CIRCULAR A-133 REPORTS**

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2008

<u>Federal grantor/pass-through grantor/ program or cluster title</u>	<u>Federal CFDA number</u>	<u>Pass-through entity identifying number</u>	<u>Federal expenditures</u>
Student Financial Aid Cluster*:			
U.S. Department of Education:			
Federal Pell Grant Program	84.063		\$ 9,331,972
Federal Supplemental Educational Opportunity Grant Program	84.007		466,356
Federal Family Educational Loan Program	84.032		64,474,598
Federal Work Study Program	84.033		264,498
Academic Competitiveness Grant	84.375		151,775
National Science and Mathematics Access to Retain Talent Grant	84.376		<u>128,650</u>
Total Student Financial Aid Cluster			<u>74,817,849</u>
Research and Development Cluster*:			
Direct awards:			
U.S. Department of Health and Human Services:			
Biological Response to Environmental Health Hazard	93.113		499,726
Research Related to Deafness and Communicative Disorders	93.173		107,719
Comparative Medicine	93.306		139,459
Minority Health and Health Disparities Research	93.307		797,156
International Research and Research Training	93.989		14,410
Cancer Cause and Prevention Research	93.393		289,229
Cancer Detection and Diagnosis Research	93.394		59,370
Cancer Treatment Research	h		

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2008

Pass-through entity identifying number	Federal expenditures
	\$ 33,555
	161,013
	17,905
	3,795
	12,446
	<u>232,455</u>
	<u>15,980,867</u>
C60114233	2,721
RO1 MH075026-02	49,438
70190	1,002
7U10CA76001-4	392
FY07.032.008	90,006
20526-98010395	461,070
UAB LINK NO	
-238575-04	18,208
UO1 NS0404060	8,802
116447/115709-02	35,304
U1 UO1	
A1071283-03	108,088
UO1 CA98543-04	
/AGREE#9854	(8,625)
RO1 NS39131-01	2,393
No2-CM-97024	6,858
AO5648	162,266
5RO1HL019278-29	(645)
CHECK #23854	26,226
SWISS	584
5401 A141025-09	(139)
80040	72,145
RR100-391/8920207	25,307
1021RR100513	
-3506498	31,074
SUB2005-291	31,545
AAMURI-08-C-0009	25,000
34-21530-038-621	69,874
06-006	2,988
BLOS 2003-2	45,523
SUB2005-152-A5	18,721
08-08-025	48,294
70358	12,673

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2008

**Federal grantor/pass-through grantor/
program or cluster title**

Pass-through from U.S. Department of Commerce:
Alabama Department of Conservation and Natural Resources
Prince William Sound Science Center

University of Mississippi
University of Southern Mississippi

Pass-through from National Oceanographic and Atmospheric
Association:
Prince William Sound Science Center

Pass-through from U.S. Department of Transportation:
Kilgore Consulting Management

Pass-through from Environmental Protection Agency:
Mobile Water and Sewer Service

Pass-through from U. S. Department of Interior:
Alabama Historical Commission
Louisiana State University

Pass-through from U.S. Department of Defense:
Trinity University

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2008

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number	Pass-through entity identifying number	Federal expenditures
Americorp: Corporation of National and Community Service	94.006		\$ 23,105
U.S. Department of Commerce: Coastal Zone Management Estuarine Research	11.420		6,618
U.S. Department of Transportation: National Motor Carrier Safety	20.218		408,908
Total direct awards			<u>21,030,266</u>
Pass-through awards:			
Pass-through from U.S. Department of Education:			
Alabama Department of Education	84.027	80035	20,000
Alabama Department of Education	84.323	C7U0133	82,090
Alabama Department of Education	84.357	370684-005503 -170030-1	310,145
Auburn University	84.287	08-TPI-222015-USA	16,675
Alabama Commission of Higher Education	84.367	50406	188,440
National Writing Project	84.928	NAT'L WRITING PROJECT	55,595
Pass-through from NASA:			
University of Alabama in Huntsville	43.002	SUB2005	18,467
Pass-through from National Institutes of Health**:			
Mayo Foundation for Medical Research	93.853	RO1 NS039987-7	1,993
Medical Library Association	93.879	CHECK #12461	2,286
SEA National Network of Libraries	93.879	80203	1,821
Moorehouse School of Medicine	93.004	US2MP002001-03-4	15,387
University of Maryland Baltimore	93.879	070106-MOA	3,505
United Way of Central Alabama	93.917	RW-USAF-0809	16,968
Pass-through from States Administration on Aging**:			
South Alabama Regional Planning Commission	93.051	80273	4,435
Pass-through from Administration for Children and Families:			
University of Alabama	93.658	80055	55,543
Pass-through from Health Resources Services Administration**:			
Alabama Department of Public Safety	93.289	C70119129	38,272
Alabama Department of Public Health	93.889	C80117142	538,285
Alabama Department of Public Health	93.289	C60114173	260,277
Alabama Department of Public Health	93.926	C80117121	20,000
Florida State University	93.969	R00891	58,881
Pass-through from National Science Foundation:			
University of Alabama at Birmingham	47.076	0602359-011-A1	25,620
Pass-through from U.S. Department of Justice:			
Alabama Department of Public Safety	16.579	60429	(373)
Alabama Department of Public Safety	16.579	17PGCP5042	1,844
Pass-through from U. S. Small Business Administration:			
University of Alabama at Birmingham	59.037	SBA FY2007-2008	127,529

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2008

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number	Pass-through entity identifying number	Federal expenditures
Pass-through from U.S. Department of Defense: University of Alabama Birmingham	12.002	DOD 07-70	\$ <u>23,599</u>
Total pass-through awards			<u>1,887,284</u>
Total other federal assistance			<u>22,917,550</u>
Total federal expenditures			<u>\$ <u>115,593,552</u></u>

* Denotes major program.

** Denotes a subagency of the U.S. Department of Health and Human Services.

See accompanying notes to schedule of expenditures of federal awards.

See accompanying independent auditors' report on supplementary information.



Suite 1100
One Jackson Place
188 East Capitol Street
Jackson, MS 39201

**Independent Auditors' 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***



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

Compliance and Other Matters

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

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.



November 14, 2008



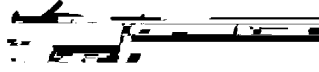
Suite 1100
One Jackson Place
188 East Capitol Street
Jackson, MS 39201

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In our opinion, the University complied, in all material respects, with the requirements referred to in the first paragraph above that are applicable to each of its major federal programs for the year ended September 30, 2008. However, the results of our auditing procedures disclosed an instance of



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.



November 14, 2008

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

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UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Findings and Questioned Costs
Year ended September 30, 2008

**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*.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Findings and Questioned Costs
Year ended September 30, 2008

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

Finding No. 2008-01 Allowable Costs / Activities Allowed

Federal Agency:

U.S. Department of Health and Human Services

CFDA Number:

93.247

Program:

Advanced Education Nursing Grants

Award Numbers:

5D09HP05319-03-00
5D09HP00231-07-00
1D09HP07984-01-00
1D09HP07971-01-00
6D09HP07965-01-01
5D09HP07319-02-00
5D09HP07330-02-00
5D09HP07329-02-00
5D09HP07325-02-00
5D09HP05321-02-00
1D09HP05319-01-00
5D09HP05321-03-00

Award Years:

July 1, 2007 through June 30, 2009

Criteria

OMB Circular A-21 (A-21) establishes principles for determining the costs applicable to activities performed by educational institutions under grants

