



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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Management's Discussion and Analysis (Unaudited)

September 30, 2010 and 2009

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):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
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	<u>\$ 917,157</u>	<u>856,249</u>	<u>862,666</u>
Liabilities:			
Current	\$ 97,154	91,555	90,773
Noncurrent	400,732	364,382	363,566
Total liabilities	<u>\$ 497,886</u>	<u>455,937</u>	<u>454,339</u>
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	<u>\$ 419,271</u>	<u>400,312</u>	<u>408,327</u>

University cash, cash equivalents, and investments (current and noncurrent) increased between September 30, 2009 and 2010 by \$20,243,

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

Total University Assets

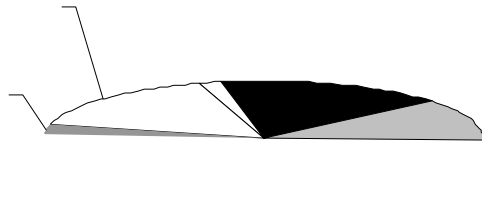
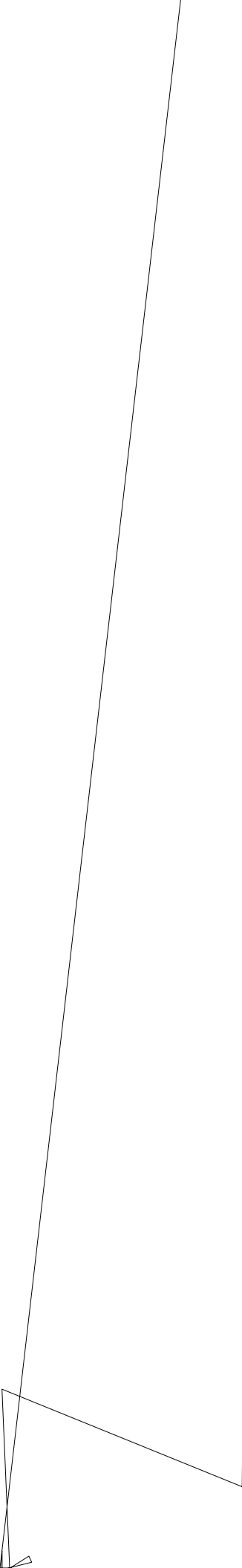
\$1,000
\$800
\$600
\$400
\$200
\$-

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 assetC 0 TD(Re0.246 BDC te87 Tw 0 -four categories:)TJEMC /P A/CID 12 BDC 0naBDC 0n3



UNIVERSITY OF SOUTH ALABAMA
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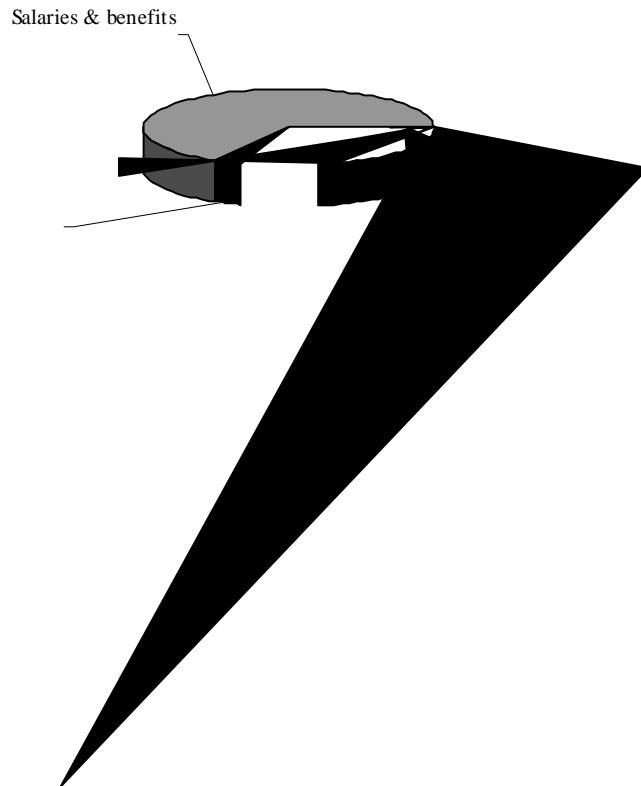
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September 30, 2010 and 2009

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.

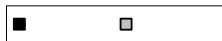
University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2010 is presented below.

Total Expenses



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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,



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Management's Discussion and Analysis (Unaudited)

September 30, 2010 and 2009

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.

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Management's Discussion and Analysis (Unaudited)

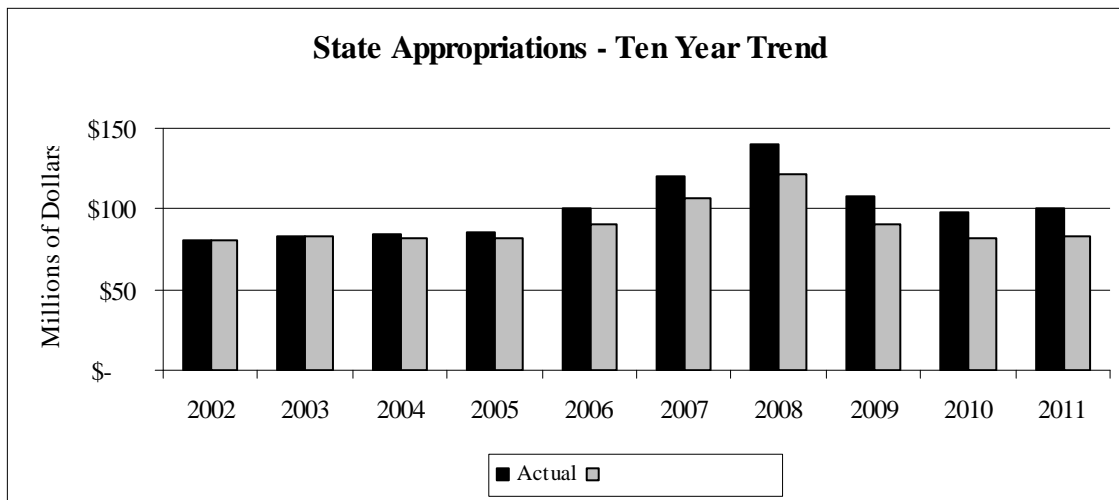
September 30, 2010 and 2009

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:



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September 30, 2010 and 2009

Other than the issues presented above, University administration is not aware of any other currently known facts, decisions, or conditions that are expected to have a significant effect on the University's financial position or results of operations during fiscal year 2011 beyond those unknown variables having a global effect on virtually

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.

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

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_____	_____
=====	=====
_____	_____
_____	_____
_____	_____
=====	=====

**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	\$ <u>39,252</u>	<u>35,991</u>
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	\$ <u>39,252</u>	<u>35,991</u>

See accompanying notes to basic financial statements.

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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			
Revenues, gains, and other support:				
Net realized and unrealized				
gains on investments	\$ 6,110			
Rents, royalties and timber sales	4,368			
Interest and dividends	389			
Gifts	—			
Other income	23			
Required match of donor contributions	(11)			
Interfund interest	(187)			
Net assets released from program restrictions	1,071			
Total revenues, gains, and other support	11,763			
Expenditures:				
Program services:				
Faculty support	2,149			
Scholarships	1,009			
Other	1,237			
Total program service expenditures	4,395			
Management and general	1,606			
Other investment expense	1,440			
Depletion expense	3,695			
Depreciation expense	53			
Total expenditures	11,189			
Increase in net assets	574			
Net assets in beginning of year	22,977	36,500	5,000	5,000
	23,551	37,076	5,000	5,000

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)

	<u>2010</u>	<u>2009</u>
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	<u>2,136</u>	<u>1,696</u>
Operating income	<u>1,630</u>	<u>1,818</u>
Nonoperating revenues (expenses):		
Investment income	8	31
Interest expense	(1,633)	(1,635)
Donation revenue	19	159
Other	(12)	5
Net nonoperating expenses	<u>(1,618)</u>	<u>(1,440)</u>
Transfer of building to University of South Alabama	<u>—</u>	<u>(423)</u>
Change in net assets	12	(45)
Net assets:		
Beginning of year	<u>1,447</u>	<u>1,492</u>
End of year	<u>\$ 1,459</u>	<u>1,447</u>

See accompanying notes to basic financial statements.

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Notes to Basic Financial Statements

September 30, 2010 and 2009

(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 state

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Notes to Basic Financial Statements

September 30, 2010 and 2009

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

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Notes to Basic Financial Statements

September 30, 2010 and 2009

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.

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UNIVERSITY OF SOUTH ALABAMA
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Notes to Basic Financial Statements

September 30, 2010 and 2009

Terms

A summary of the transactions is as follows:

<u>Issue</u>	<u>Date of issue</u>	<u>Option expiration date</u>	<u>Effective date of swap</u>	<u>Termination date</u>	<u>Payment amount</u>
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 indMC 1 0.1481 T

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Notes to Basic Financial Statements

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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

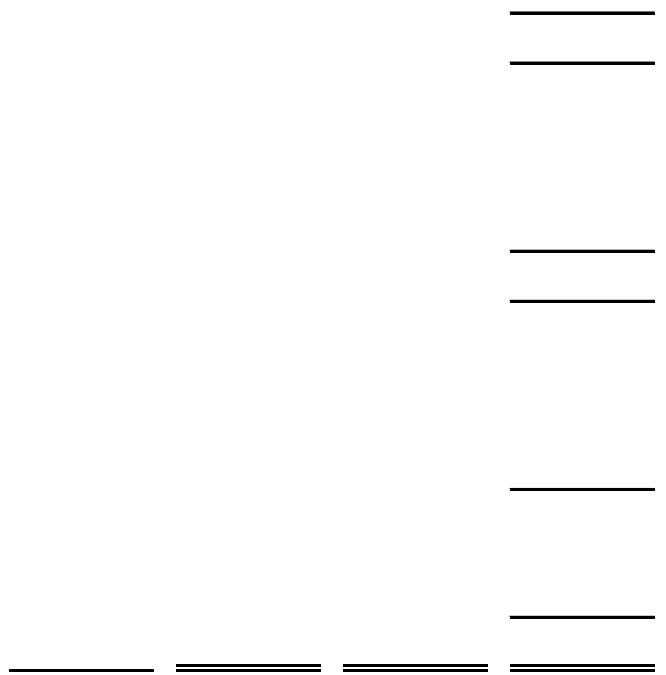
Certain risks are inherent to derivative transactions.

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.



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(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	<u>\$ 381,509</u>	<u>56,873</u>	<u>(19,005)</u>	<u>419,377</u>	<u>18,645</u>	<u>400,732</u>
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	<u>\$ 379,896</u>	<u>27,865</u>	<u>(26,252)</u>	<u>381,509</u>	<u>17,127</u>	<u>364,382</u>

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.

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(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.

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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.

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September 30, 2010 and 2009

(a) *USA Research and Technology Corporation*

Notes Payable

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

	<u>2010</u>	<u>2009</u>
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%		
	<u> </u>	<u> </u>
	<u> </u>	<u> </u>

UNIVERSITY OF SOUTH ALABAMA
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September 30, 2010 and 2009

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.

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Fair value

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Derivative payments and hedged debt. As interest rates fluctuate, variable rate debt interest and net

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_____	_____	_____	_____
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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):

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September 30, 2010 and 2009

UNIVERSITY OF SOUTH ALABAMA
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September 30, 2010 and 2009

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		<u>277,000</u>
		1,248,000
Less amounts representing interest		<u>(64,000)</u>
Total capital lease receivable	\$	<u><u>1,184,000</u></u>

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

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September 30, 2010 and 2009

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.

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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

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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

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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 bear the cost of finishing the building's interior.

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September 30, 2010 and 2009

(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.

	<u>2010</u>	<u>2009</u>
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
	<u>\$ 556,358</u>	<u>548,572</u>

(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

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September 30, 2010 and 2009

(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 Septem

UNIVERSITY OF SOUTH ALABAMA
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Schedule of Expenditures of Federal Awards
Year ended September 30, 2010

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity			
Student Financial Aid Cluster*:						
U.S. Department of Education:						
Federal Pell Grant Program	84.063					
Federal Supplemental Educational Opportunity Grant Program	84.007					
Federal Family Educational Loans	84.032					
Federal Work Study Program	84.033					
Academic Competitiveness Grant	84.375					
National Science and Mathematics Access to Retain Talent Grant	84.376					
Teacher Education Assistance for College and Higher Education	84.379					
Federal Perkins Loan Program	84.038					
Loans for Disadvantaged Students	93.342					
Health Professions Student Loans	93.342					
Total Student Financial Aid Cluster						
Research and Development Cluster*:						
U.S. Department of Commerce:						
Sea Grant Support	11.417	2375HM	Dauphin Island Sea Lab			
Cooperative Fishery Statistics	11.434	EDP-ESF-RB-2010-USA	Gulf States Marine Fisheries Commission			
Marine Fisheries Initiative	11.433					
Unallied Management Projects	11.454	80182	Alabama Department of Conserpg			
Unallied Management Projects	11.454	Task Order D-3	MESC)/P Δ(CID 55 BDC 9.001 -3.362 Td(ALFO SA 3TheaNature)TJETQncy/P ΔCID 55 BDC 6-0.001 -4.489 Td(15.615)Tsland Sea LaMESC)/P Δ			
Total CFDA						
Habitat Conservation	11.463					
Habitat Conservation	11.463	ALFO SA 3807-02				
Total CFDA						
Applied Meteorological Research	11.468					
Congressionally Identified Award and Projects	11.469	TASK ORDER D-1				
Total U.S. Department of Commerce						
U.S. Department of Defense:						
Military Medical Research and Development	12.420					
Information Security Grant Program	12.902	360356-062900-01				
Research and Technology Development	12.910					
Cultural Resource Assessment	12.000	12.W912P9-09-D-0537				
Total U.S. Department of Defense						
U.S. Department of Housing and Urban Development:						
Community Development Block Grants	14.228	CDBG/HUD				
Community Development Block Grants	14.228	10-1001122				
Total CFDA						
Resident Opportunity and Supportive Services - Elderly and Persons with Disabilities	14.876	100279				
Total U. S. Department of Housing and Urban Development						
U.S. Department of Interior:						
Cooperative Endangered Species Conservation Fund	15.615	80240				
Cooperative Endangered Species Conservation Fund	15.615	90256				
Total CFDA						
National Cooperative Geologic Mapping Program	15.810					
Historic Preservation Fund Grants-In-Aid	15.904	AL-06-003				
American Battlefield Protection	15.926					
Total U.S. Department of Interior						
U.S. Department of Justice:						
Developing, Testing and Demonstrating Promising New Programs	16.541					

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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:

	<u>CFDA #</u>		<u>Amount</u>
Federal Perkins Loan Program	84.038	\$	3,739,803
Loans for Disadvantaged Students	93.342		1,193
Health Professiount			
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Notes to Schedule of Expenditures of Federal Awards
September 30, 2010

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

(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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188 East Capitol Street
Jackson, MS 39201

**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 th

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

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**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.

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.

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
10.975x10⁰⁸ (n)13 ((n)7..4 (m)i-6.7 6i)-6.3 (m)c0 6i)-

Internal control over financial reporting:

Material weakness(es) identified?

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.