

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

Consolidated Financial Statements as of and for the  
Years Ended June 30, 2012 and 2011, and  
Independent Auditors' Report

UNIVERSITY OF SOUTH ALABAMA  
**FOUNDATION**

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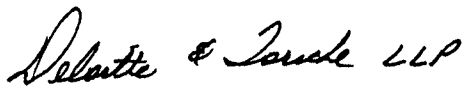
## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
University of South Alabama Foundation:

We have audited the accompanying consolidated statements of financial position of the University of South Alabama Foundation (the "Foundation") as of June 30, 2012 and 2011, and the related consolidated statements of activities and changes in net assets and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Foundation's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Foundation as of June 30, 2012 and 2011, and the consolidated related activities and changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



August 30, 2012

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2012 AND 2011 (Dollars in thousands)

	2012	2011
<b>ASSETS</b>		
CASH AND CASH EQUIVALENTS	\$ 671	\$ 775
INVESTMENTS AT FAIR VALUE:		
Equity securities	104,498	110,579
Timber and mineral properties	153,574	153,432
Real estate	31,040	27,973
Other	5,522	5,531
OTHER ASSETS	<u>768</u>	<u>1,009</u>
TOTAL	<u>\$ 296,073</u>	<u>\$ 299,299</u>
<b>LIABILITIES AND NET ASSETS</b>		
LIABILITIES:		
Accounts payable	\$ 182	\$ 76
Note payable — University of South Alabama	11,493	15,085
Other liabilities	<u>637</u>	<u>642</u>
Total liabilities	<u>12,312</u>	<u>15,803</u>
NET ASSETS:		
Unrestricted	61,628	63,177
Temporarily restricted	52,887	51,393
Permanently restricted	<u>169,246</u>	<u>168,926</u>
Total net assets	<u>283,761</u>	<u>283,496</u>
TOTAL	<u>\$ 296,073</u>	<u>\$ 299,299</u>

See notes to consolidated financial statements.

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2012 (Dollars in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, LOSSES, AND OTHER SUPPORT:				
Net realized and unrealized gains on investments	\$ 5,513	\$ 768	\$ -	\$ 6,281
Rents, royalties, and timber sales	4,255		18	4,273
Interest and dividends	611	1,230	7	1,848
Gifts			195	195
Other income	5			5
Required match of donor contributions	(100)		100	
Interfund interest	(88)	88		-
Transfers	(864)	864		-
Net assets released from program restrictions (Note 8)	<u>1,456</u>	<u>(1,456)</u>		<u>-</u>
Total revenues, gains, losses, and other support	<u>10,788</u>	<u>1,494</u>	<u>320</u>	<u>12,602</u>
EXPENDITURES:				
Program services:				
Faculty support	2,307			2,307
Scholarships	1,023			1,023
Other academic programs	<u>1,096</u>			<u>1,096</u>
Total program services	4,426	-	-	4,426
Management and general	1,653			1,653
Other investment expense	1,638			1,638
Depletion expense	4,135			4,135
Depreciation expense	77			77
Interest expense	<u>408</u>			<u>408</u>
Total expenditures	<u>12,337</u>	<u>-</u>	<u>-</u>	<u>12,337</u>
(DECREASE) INCREASE IN NET ASSETS	(1,549)	1,494	320	265
NET ASSETS — Beginning of year	<u>63,177</u>	<u>51,393</u>	<u>168,926</u>	<u>283,496</u>
NET ASSETS — End of year	<u>\$ 61,628</u>	<u>\$ 52,887</u>	<u>\$ 169,246</u>	<u>\$ 283,761</u>

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## CONSOLIDATED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2011 (Dollars in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, LOSSES, AND OTHER SUPPORT:				
Net realized and unrealized gains (losses) on investments	\$ 12,852	\$ 12,258	\$ (22)	\$ 25,088
Rents, royalties, and timber sales	4,149		22	4,171
Interest and dividends	712	1,094	7	1,813
Gifts			21	21
Other income	148	1		149
Required match of donor contributions	(12)	1	11	-
Interfund interest	(92)	92		-
Net assets released from program restrictions (Note 8)	<u>1,173</u>	<u>(1,173)</u>		<u>-</u>
Total revenues, gains, losses, and other support	<u>18,930</u>	<u>12,273</u>	<u>39</u>	<u>31,242</u>
EXPENDITURES:				
Program services:				
Faculty support	2,154			2,154
Scholarships	945			945
Other academic programs	<u>1,071</u>			<u>1,071</u>
Total program services	4,170	-	-	4,170
Management and general	1,622			1,622
Other investment expense	1,682			1,682
Depletion expense	3,534			3,534
Depreciation expense	67			67
Interest expense	<u>305</u>			<u>305</u>
Total expenditures	<u>11,380</u>	<u>-</u>	<u>-</u>	<u>11,380</u>
INCREASE IN NET ASSETS	7,550	12,273	39	19,862
NET ASSETS — Beginning of year	<u>55,627</u>	<u>39,120</u>	<u>168,887</u>	<u>263,634</u>
NET ASSETS — End of year	<u>\$ 63,177</u>	<u>\$ 51,393</u>	<u>\$ 168,926</u>	<u>\$ 283,496</u>

See notes to consolidated financial statements.

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (Dollars in thousands)

	2012	2011
OPERATING ACTIVITIES:		
Increase in net assets	\$ 265	\$ 19,862
Adjustments to reconcile increase in net assets to net cash used in operating activities:		
Net realized and unrealized gain on investments	(6,281)	(25,088)
Depletion	4,135	3,534
Depreciation and amortization	264	67
Interest expense	408	305
Changes in operating assets and liabilities:		
Other assets	37	101
Accounts payable	106	(128)
Other liabilities	(5)	26
Net cash used in operating activities	<u>(1,071)</u>	<u>(1,321)</u>
INVESTING ACTIVITIES:		
Purchase of securities	(829)	(876)
Sale of securities	6,000	6,845
Reforestation of timber property	(176)	(361)
Acquisition costs on purchase of land	-	(304)
Downpayment on purchase of land		(4,000)
Purchase of furniture, fixtures, and equipment	<u>(28)</u>	<u>(76)</u>
Net cash provided by investing activities	<u>4,967</u>	<u>1,228</u>
FINANCING ACTIVITIES		
Payment on notes payable	<u>(4,000)</u>	<u>-</u>
Net cash used in financing activities	<u>(4,000)</u>	<u>-</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	(104)	(93)
CASH AND CASH EQUIVALENTS — Beginning of year	<u>775</u>	<u>868</u>
CASH AND CASH EQUIVALENTS — End of year	<u>\$ 671</u>	<u>\$ 775</u>
SUPPLEMENTAL DISCLOSURE OF NONCASH TRANSACTIONS:		
Issuance of note payable in connection with acquisition of real estate (See Note 5)	<u>\$ -</u>	<u>\$ 14,780</u>

See notes to consolidated financial statements.

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (Dollars in thousands)

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### 1. ORGANIZATION

The University of South Alabama Foundation (the "Foundation") was incorporated in March 1968 for the purpose of promoting education, scientific research, and charitable purposes and to assist in developing and advancing the University of South Alabama (the "University") in furthering, improving, and expanding its properties, services, facilities, and activities. Revenues are derived principally from investment income.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation** — The accompanying consolidated financial statements include the accounts of the Foundation's wholly owned subsidiaries Knollwood Development, Inc., Shubuta Timber Services, Inc. and Brookley Bay Front Properties, LLC (hereinafter BBFP), an Alabama Limited Liability Company. All significant intercompany transactions have been eliminated in consolidation.

**Net Assets** — In order to ensure observance of limitations and restrictions placed on the use of the resources available to the Foundation, the accounts of the Foundation are maintained on the accrual basis in accordance with the principles of "fund accounting." Thus, resources for various purposes are classified into funds that are in accordance with activities or objectives specified. The Foundation presents its net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions using three classifications: permanently restricted, temporarily restricted, and unrestricted. These three classifications are defined as follows:

- Permanently restricted net assets contain donor-imposed restrictions that stipulate that resources be maintained permanently, but permit the Foundation to use or expend part or all of the income derived from the donated assets for specified or unspecified purposes.
- Temporarily restricted net assets contain donor-imposed restrictions that permit the Foundation to use or expend the donated assets as specified and are satisfied either by the passage of time or by actions of the Foundation.
- Unrestricted net assets are not restricted by donors or the donor-imposed restrictions have expired.

The Foundation considers all of its assets to be endowment assets for the support of the University. It therefore classifies all of its assets as "endowment funds" for purpose of required disclosures for such funds. In the absence of directions imposed by donors to utilize such funds for specific programs or purposes at the University, the Foundation classifies the net assets of such funds as "unrestricted."

**Support and Expenses** — Contributions received and unconditional promises to give are measured at their fair values and are reported as increases in net assets at the date of receipt. The Foundation reports gifts of cash and other assets as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets or if they are designated as support for future periods. When a donor restriction expires; i.e., when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of activities and changes in net assets as net assets released from program restrictions.



The Foundation sometimes receives restricted contributions that are conditional on the Foundation matching the contribution. Upon approval of the Board of Directors, such matches are reported as a reclassification of unrestricted net assets to restricted net assets.

**Cash Equivalents** — The Foundation considers temporary cash investments with an original maturity date of three months or less when purchased to be cash equivalents. The carrying amounts reported in the accompanying consolidated statements of financial position for cash and cash equivalents approximate their fair value.

**Investments in Securities** — Investments in marketable equity securities with readily determinable fair market values are maintained and administered in a common pool and are recorded at fair value based on quoted market prices of each security in the accompanying consolidated statements of financial position. Separate accounts are maintained for each fund, as applicable.

**Investments in Commonfund** — The Commonfund for Nonprofit Organizations (“Commonfund”) is a membership corporation that operates endowment funds for the exclusive benefit of institutions eligible for membership in the Commonfund. The Foundation holds investments in the Multi-Strategy Equity Fund and the International Equity Fund of the Commonfund. The objective of the Multi-Strategy Equity Fund is to offer an investment in a single fund to provide all of the strategy and manager diversification that an endowment would normally require for equity allocation. The fund is designed to add value over long periods of time and to reduce volatility. The investment objective of the International Equity Fund is to seek to diversify a U.S. equity portfolio with equity investments in companies domiciled abroad.

The Foundation’s units in the Multi-Strategy Equity Fund and the International Equity Fund are valued at their unit values as determined by Commonfund. Commonfund generally determines the unit values of each of its funds by reference to the fair values of the underlying investments, the majority of which consists of exchange-traded equity securities. Further information about Commonfund’s valuation procedures are as follows:

In the Multi-Strategy Equity Fund and the International Equity Fund, as managed by the Commonfund, equity securities listed on securities exchanges are valued at the last sale price except for those securities reported through the National Association of Securities Dealers Automated Quotation (NASDAQ) system, for which the NASDAQ official closing price is used. In the absence of either, the current bid price is used. Unlisted securities are valued at the current bid prices obtained from reputable brokers. Certain investments held by the funds may be traded by a market maker who may also be utilized to provide pricing information used to value such investments. Investments in units of other funds within Commonfund (known as crossfund investments) are carried at the unit value of the crossfund investment.

In these funds, investments in limited partnerships and other investment funds are valued at fair value, which is generally the latest net asset value made available by the fund manager or administrator prior to the valuation date. Other securities that are not readily marketable are also valued at fair value as deemed appropriate by management of Commonfund in consultation with the respective investment manager, with consideration given to the financial condition and operating results of the issuer, meaningful third-party transactions in the private market, and other factors deemed relevant. The amounts realized upon disposition of these investments may differ from the value reflected in the consolidated financial statements and the differences could be material.

**Timber** — Timber and timberlands, including logging roads, are stated at fair value, based on an independent appraisal, derived from the application of the cost approach, the sales comparison approach, and the income capitalization approach, less the accumulated depletion for timber when harvested. The Foundation capitalizes timber and timberland purchases and reforestation costs and other costs associated with the planting and growing of timber, such as site preparation, seedling purchases, planting, herbicide application, and thinning of tree stands to improve growth. Timber costs, such as real

estate taxes, forest management personnel salaries and fringe benefits, and other costs related to the timberlands, are expensed as incurred.

Timber sale revenues for clear-cut or lump-sum sales are recognized when legal ownership of the timber transfers to the purchaser. Timber deeds set forth the legal rights and responsibilities of the buyer, and at closing the full amount of the sale is due and payable and recognized at that time. Revenues from thinning of tree stands to improve growth are recognized as revenue as the buyer harvests the timber that is to be thinned. Timberland depletion is calculated on a unit cost basis and recognized when the related revenue is recognized.

**Mineral Properties** — Mineral properties are stated at estimated fair market value as determined by independent appraisals. Depletion of mineral properties is recognized over the remaining producing lives of the properties based on total estimated production and current-period production.

**Real Estate** — Real estate held for investment is stated at its estimated fair value based on independent appraisals.

**Common Investment Pool** — On June 5, 2006, the board of directors of the Foundation approved the establishment of a new investment pool, which consists of (1) all marketable equity securities held by the Foundation and (2) the Foundation's interest in land and timber, consisting of approximately 55,600 acres of timberland, known as the Equitable Tract, which the Foundation acquired in 1997 with financing that was provided, in part, from the Disproportionate Share Hospital Funds to the Foundation's Equitable Timber Fund.

**Investment Income** — Investment income or loss (including gains and losses on investments, interest, dividends, rents, royalties, and timber sales) is included in the accompanying consolidated statements of activities and changes in net assets as increases or decreases in unrestricted net assets, unless the income or loss is restricted by donor or law, in which case, it is classified as temporarily or permanently restricted, as appropriate. Interfund interest is recorded at prevailing market rates on loans between funds to maintain the integrity of each fund's net assets.

**Income Tax Status** — The Internal Revenue Service has determined that the Foundation is a tax-exempt organization under Internal Revenue Code Section 501(c)(3).

**Estimates** — The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The Foundation's investments include marketable equity securities valued by reference to quoted market prices, investments in Commonfund portfolios valued at unit values based on the fair values of underlying investments and timberland, mineral properties, and other real estate valued by appraisals. Such assets are subject to fluctuation in value due to normal market volatility and to estimation risk in the case of assets for which quoted market values are not available. The values ultimately realized by the Foundation for all such assets may be different from the values reported and these fluctuations may impact the Foundation's consolidated financial statements.

**New Accounting Standards** — In May 2011, the Financial Accounting Standards Board issued Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. Non public entities are required to adopt ASU 2011-04 for annual periods beginning after December 15, 2011. Accordingly, the Foundation will be required to adopt ASU 2011-04 for the annual period ending June 30, 2013. ASU 2011-04 was issued to further explain how to measure fair value and improve the comparability of fair value measurements presented and disclosed in financial statements. The amendments expand the disclosures about fair value measurements categorized within Level 3 of the fair value hierarchy including the valuation process used by the reporting entity and the sensitivity of the fair

value measurement to changes in unobservable inputs. The amendment also requires expanded disclosure about the reporting entity's use of a nonfinancial asset in a way that differs from the asset's highest and best use and the categorization by level of the fair value hierarchy for items that are not measured at fair value in the financial statements but for which fair value is required to be disclosed. The Foundation has not completed the process of evaluating the impact that will result from adopting ASU 2011-4. The Foundation is, therefore, unable to disclose the impact that adopting ASU 2011-4 will have on its financial position, results of operation, or cash flows.

### 3. FAIR VALUE OF FINANCIAL INSTRUMENTS AND OTHER INVESTMENTS

The following methods and assumptions were used by the Foundation in estimating the fair value of its investments:

- Cash and cash equivalents: The carrying amount reported in the accompanying consolidated statements of financial position for cash and cash equivalents approximates their fair value.
- Equity securities include investments in marketable equity securities and investments in Commonfund.

*Marketable Equity Securities:* Fair values are based on quoted market prices of each security that is actively traded in a public market. The Foundation's investment in such marketable equity securities was \$51,461 and \$48,054 at June 30, 2012 and 2011, respectively.

*Investments in Commonfund:* Fair values are based on unit values, as determined by Commonfund. As more fully described in Note 2, Commonfund determines unit values for each of its portfolios based on the fair values of the underlying assets. The Foundation's investment in Commonfund portfolios was \$53,037 and \$62,525 at June 30, 2012 and 2011, respectively.

- Timber, mineral properties, and real estate: Fair values of timberland, mineral properties, and real estate are determined by independent third-party appraisers using standard appraisal practices particular to the investment being appraised.
- Other consists primarily of the Foundation's interest in the Stallworth Land Company (the "Company"), a timberland management company (see Note 4).

### 4. INVESTMENTS

Investment income for the years ended June 30, 2012 and 2011, consisted of the following:

	2012	2011
Unrealized gains	\$ 5,840	\$ 24,043
Realized gains	<u>441</u>	<u>1,045</u>
Net realized and unrealized gains on investments	<u>6,281</u>	<u>25,088</u>
Timber sales	3,473	3,351
Rents	602	614
Royalties	<u>198</u>	<u>206</u>
Rents, royalties, and timber sales	<u>4,273</u>	<u>4,171</u>
Interest and dividends	<u>1,848</u>	<u>1,813</u>
Total investment income	<u>\$ 12,402</u>	<u>\$ 31,072</u>

Investment-related expenses of \$244 and \$238 are included in the Foundation's management and general expenses in the accompanying consolidated statements of activities and changes in net assets for the years ended June 30, 2012 and 2011, respectively.

As further described in Note 5, BBFP, whose sole member is the University of South Alabama Foundation, acquired from the University certain real estate known as the Brookley Complex on November 10, 2010. The purchase price, before adjustment for imputed financing costs and transaction costs, was \$20,000. Real estate at June 30, 2012 and 2011, consisted of the following property held:

	2012	2011
Land and land improvements — held for investment	\$ 29,913	\$ 26,816
Building and building improvements — held for investment	<u>1,127</u>	<u>1,157</u>
Total	<u>\$ 31,040</u>	<u>\$ 27,973</u>

**Other** — Investments at June 30, 2012 and 2011, include an equity interest in a timberland management company. That Company's primary asset consists of timberland. The Foundation's proportionate share of the fair value of that Company is based upon the valuation of the trustee responsible for the management of the Company and the timber valuation. The equity interest resulted from a bequest known as the Stallworth Gift, which was received through bequest and devise under the Will of N. Jack Stallworth.

Fair value measurements are classified as either observable or unobservable in nature. Observable fair values are derived from quoted market prices for investments traded on an active exchange or in dealer markets where there is sufficient activity and liquidity to allow price discovery by substantially all market participants. The Foundation's observable values consist of investments in exchange-traded equity securities with a readily determinable market price. Other observable values are fair value measurements derived either directly or indirectly from quoted market prices. Investments that are not traded on an active exchange and do not have a quoted market price are classified as unobservable. The Foundation's unobservable values consist of investments in timber and real estate with fair values based on independent third-party appraisals performed by qualified appraisers specializing in timber and real estate investments.

The Foundation's investment assets at June 30, 2012 and 2011, are summarized as follows:

Description	Fair Value Measurements at June 30, 2012			Total
	Observable Values Based on Quoted Prices	Other Observable Values	Unobservable Values	
Marketable equity securities	\$ 51,461	\$ 53,037	\$ -	\$ 104,498
Timber and mineral properties			153,574	153,574
Real estate			31,040	31,040
Other investments	<u>          </u>	<u>          </u>	<u>5,522</u>	<u>5,522</u>
	<u>\$ 51,461</u>	<u>\$ 53,037</u>	<u>\$ 190,136</u>	<u>\$ 294,634</u>

Fair Value Measurements at June 30, 2011				
Description	Observable Values Based on Quoted Prices	Other Observable Values	Unobservable Values	Total
Marketable equity securities	\$ 48,054	\$ 62,525	\$ -	\$ 110,579
Timber and mineral properties			153,432	153,432
Real estate			27,973	27,973
Other investments			5,531	5,531
	<u>\$ 48,054</u>	<u>\$ 62,525</u>	<u>\$ 186,936</u>	<u>\$ 297,515</u>

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

	Timber and Mineral Properties	Real Estate	Other Investments	Total
Beginning balance	\$ 153,432	\$ 27,973	\$ 5,531	\$ 186,936
Total gains (losses) realized/unrealized	3,793	3,100	(9)	6,884
Reforestation	484			484
Depreciation/depletion	<u>(4,135)</u>	<u>(33)</u>		<u>(4,168)</u>
Ending balance	<u>\$ 153,574</u>	<u>\$ 31,040</u>	<u>\$ 5,522</u>	<u>\$ 190,136</u>

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

	Timber and Mineral Properties	Real Estate	Other Investments	Total
Beginning balance	\$ 156,465	\$ 8,727	\$ 5,535	\$ 170,727
Total gains (losses) realized/unrealized	(160)	457	(4)	293
Additions		18,820		18,820
Reforestation	661			661
Depreciation/depletion	<u>(3,534)</u>	<u>(31)</u>		<u>(3,565)</u>
Ending balance	<u>\$ 153,432</u>	<u>\$ 27,973</u>	<u>\$ 5,531</u>	<u>\$ 186,936</u>

### Endowment

The Foundation's endowment funds consist of individual funds established for a variety of purposes. Endowment funds include both donor-restricted endowment funds and board-designated endowment funds. Net assets associated with endowments are classified and reported based on the existence or absence of donor-imposed restrictions.

### Interpretation of the Law

The Foundation conducts the operations of the Foundation in accordance with the Alabama Uniform Prudent Management of Institutional Funds Act (UPMIFA), effective January 1, 2009, and continuing thereafter, unless otherwise determined by the Foundation. The Board of Directors and management of

the Foundation interpret UPMIFA as obligating the Foundation to preserve, as donor-restricted assets, each original gift received by the Foundation as donor-restricted endowment funds. The Foundation, accordingly, classifies each such original gift, and any subsequent gifts, as permanently restricted. The remaining portion of any donor-restricted endowment that is not classified as permanently restricted is classified as temporarily restricted net assets, until such time as any of such remaining portion is appropriated for expenditure. In managing each endowment fund held by it, the Foundation considers, if relevant, the duration and preservation of the fund, the purposes of the Foundation and the fund, general economic conditions, any restrictions imposed by the donor, the possible effect of inflation or deflation, the expected total return from income and appreciation of investments, the other resources of the Foundation, and the investment policy of the Foundation.

Endowment net asset composition at June 30, 2012, by type of fund is as follows:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-Restricted Endowment Funds	\$ 38,518	\$ 52,887	\$ 169,246	\$ 260,651
Board-Designated Endowment Funds	<u>23,110</u>	<u>          </u>	<u>          </u>	<u>23,110</u>
Total	<u>\$ 61,628</u>	<u>\$ 52,887</u>	<u>\$ 169,246</u>	<u>\$ 283,761</u>

Endowment net asset composition at June 30, 2011, by type of fund is as follows:

	<b>Unrestricted</b>	<b>Temporarily Restricted</b>	<b>Permanently Restricted</b>	<b>Total</b>
Donor-Restricted Endowment Funds	\$ 39,405	\$ 51,393	\$ 168,926	\$ 259,724
Board-Designated Endowment Funds	<u>23,772</u>	<u>          </u>	<u>          </u>	<u>23,772</u>
Total	<u>\$ 63,177</u>	<u>\$ 51,393</u>	<u>\$ 168,926</u>	<u>\$ 283,496</u>

Changes in endowment net assets during the year ended June 30, 2012, are as follows:

	Unrestricted	Board Designated	Temporarily Restricted	Permanently Restricted	Total
Beginning balance	<u>\$ 39,405</u>	<u>\$23,772</u>	<u>\$ 51,393</u>	<u>\$168,926</u>	<u>\$283,496</u>
Investment return:					
Investment income	4,573	298	1,230	25	6,126
Net unrealized and realized gains	5,472	41	768		6,281
Interfund interest	<u>(93)</u>	<u>5</u>	<u>88</u>	<u></u>	<u>-</u>
Total investment return	9,952	344	2,086	25	12,407
Gifts				195	195
Required match	(100)			100	-
Net assets released from restrictions	2,512	(1,056)	(1,456)		-
Transfers	(914)	50	864		
Expenditures	<u>(12,337)</u>	<u></u>	<u></u>	<u></u>	<u>(12,337)</u>
Net change	<u>(887)</u>	<u>(662)</u>	<u>1,494</u>	<u>320</u>	<u>265</u>
Ending balance	<u>\$ 38,518</u>	<u>\$23,110</u>	<u>\$ 52,887</u>	<u>\$169,246</u>	<u>\$283,761</u>

Changes in endowment net assets during the year ended June 30, 2011, are as follows:

	Unrestricted	Board Designated	Temporarily Restricted	Permanently Restricted	Total
Beginning balance	<u>\$ 31,774</u>	<u>\$23,853</u>	<u>\$ 39,120</u>	<u>\$ 168,887</u>	<u>\$263,634</u>
Investment return:					
Investment income	4,735	274	1,095	29	6,133
Net unrealized and realized gains	12,171	681	12,258	(22)	25,088
Interfund interest	<u>(98)</u>	<u>6</u>	<u>92</u>	<u></u>	<u>-</u>
Total investment return	16,808	961	13,445	7	31,221
Gifts				21	21
Required match	(12)		1	11	-
Net assets released from restrictions	2,215	(1,042)	(1,173)		-
Expenditures	<u>(11,380)</u>	<u></u>	<u></u>	<u></u>	<u>(11,380)</u>
Net change	<u>7,631</u>	<u>(81)</u>	<u>12,273</u>	<u>39</u>	<u>19,862</u>
Ending balance	<u>\$ 39,405</u>	<u>\$23,772</u>	<u>\$ 51,393</u>	<u>\$ 168,926</u>	<u>\$283,496</u>

## Funds with Deficiencies

From time to time, the fair value of assets associated with donor-restricted endowment funds may fall below the amount classified as permanently restricted. These deficiencies are typically a result of unfavorable market fluctuations. The total amount of deficiencies reported in donor-restricted funds are \$4 and \$8 as of June 30, 2012 and 2011, respectively. Such deficiencies have been charged to unrestricted net assets reflecting the Foundation's requirement to maintain the original contributed value of the related funds in perpetuity.

## 5. NOTE PAYABLE

In an effort to assist the University in furtherance of its tax-exempt purpose and in order to accelerate its support of the Pediatric Expansion of USA Children's and Women's Hospital, the Board of Directors authorized, in a resolution adopted May 27, 2010, the Foundation to negotiate an agreement to purchase the Brookley Center campus owned by the University. The May 27, 2010, resolution revoked the May 22, 2008, resolution as it pertained to the support of the Pediatric Expansion of USA Children's and Women's Hospital. On November 10, 2010, BBFP, an Alabama limited liability company, having as its sole member the Foundation, purchased the Brookley Complex from the University of South Alabama for \$20,000 payable in five annual installments of Four Million Dollars (\$4,000). BBFP paid the University Four Million Dollars (\$4,000) at closing and entered into a non-interest bearing installment note for Sixteen Million Dollars (\$16,000). The installment note was discounted to its present value at the prime interest rate of 3.25% which approximates the rate at which BBFP could have borrowed the amount payable. Imputed interest expense was approximately \$408 for the year ended June 30, 2012.

Future maturities of the note for years ending June 30 are as follows:

2013	\$ 4,000
2014	4,000
2015	4,000
2016	
Discount on Note Payable	
	<u>\$ 12,000</u>

It is further the intention and expectation of the Board of the Foundation, as reflected in the resolution adopted May 27, 2010, that after BBFP has completed payment of the purchase price, the Foundation would begin funding to the University an annual target distribution of 3% of the net assets of the DSH Funds held by the Foundation, subject to certain financial and other conditions.

During the period over which the note is outstanding, the University retains ownership and usage rights of all buildings and improvements on the Brookley Complex property and an exclusive easement over the land for five years. Ownership of such buildings and improvements transfers to BBFP at the time the note is fully paid. BBFP may at its option, prepay the note, and take ownership of the buildings and improvements prior to the scheduled maturity date of the note.



## 6. NATURE AND AMOUNT OF TEMPORARILY RESTRICTED NET ASSETS

At June 30, 2012 and 2011, temporarily restricted net assets were available for the following purposes:

	2012	2011
Instruction	\$20,544	\$20,408
Hospital, clinics, and related programs	15,380	14,562
College of medicine — other than instruction	8,711	8,371
Student aid	4,827	4,799
Other	<u>3,425</u>	<u>3,253</u>
Total	<u>\$52,887</u>	<u>\$51,393</u>

## 7. NATURE AND AMOUNT OF PERMANENTLY RESTRICTED NET ASSETS

At June 30, 2012 and 2011, only the income from the following permanently restricted net assets was permitted to be used for the purposes indicated:

	2012	2011
Hospital, clinics, and related programs	\$131,586	\$131,586
Instruction	19,190	19,185
Student aid	9,193	9,190
College of medicine — other than instruction	2,129	2,127
Other	<u>7,148</u>	<u>6,838</u>
Total	<u>\$169,246</u>	<u>\$168,926</u>

## 8. NET ASSETS RELEASED FROM PROGRAM RESTRICTIONS

Expenses were incurred that met temporary purpose-related restrictions on the use of certain net assets, resulting in a reclassification of net assets from temporarily restricted to unrestricted during the years ended June 30, 2012 and 2011, as follows:

	2012	2011
Instruction	\$1,195	\$1,021
Student aid	159	86
Other	<u>102</u>	<u>66</u>
Total	<u>\$1,456</u>	<u>\$1,173</u>

## 9. OTHER RELATED-PARTY TRANSACTIONS

At June 30, 2012 and 2011, net assets held by the Foundation, irrevocably for the benefit, as determined by the Foundation, of the University's hospitals, clinics, and related programs (Disproportionate Share Hospital Funds), were \$143,224 and \$139,971, respectively.

## 10. RETIREMENT PLANS

The Foundation sponsors a contributory defined-contribution retirement plan for certain employees. The Foundation's contributions to the retirement plan were approximately \$119 and \$131 for the years ended June 30, 2012 and 2011, respectively.

\* \* \* \* \*

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

*Disproportionate Share Hospital Funds  
Combined Financial Statements as of and  
for the Years Ended June 30, 2012 and 2011, and  
Independent Auditors' Report*

UNIVERSITY OF SOUTH ALABAMA  
**FOUNDATION**

**DISPROPORTIONATE SHARE HOSPITAL FUNDS  
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## INDEPENDENT AUDITORS' REPORT

To the Board of Directors of  
University of South Alabama Foundation:

We have audited the accompanying combined statements of financial position of the Disproportionate Share Hospital Funds (the "DSH Funds") of the University of South Alabama Foundation (the "Foundation") as of June 30, 2012 and 2011, and the related combined statements of activities and changes in net assets and cash flows for the years then ended. These combined financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these combined financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the DSH Funds' internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the combined financial position of the DSH Funds as of June 30, 2012 and 2011, and the related activities and changes in net assets and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.



August 30, 2012

UNIVERSITY OF SOUTH ALABAMA  
**FOUNDATION**

**DISPROPORTIONATE SHARE HOSPITAL FUNDS**  
**COMBINED STATEMENTS OF FINANCIAL POSITION**  
**AS OF JUNE 30, 2012 AND 2011**  
**(Dollars in thousands)**

<b>ASSETS</b>	<b>2012</b>	<b>2011</b>
INVESTMENTS:		
New Investment Pool—at fair value	\$ 139,110	\$ 135,688
Real estate	3,700	3,600
RECEIVABLE FROM AFFILIATES	<u>414</u>	<u>683</u>
TOTAL	<u>\$ 143,224</u>	<u>\$ 139,971</u>
<b>NET ASSETS</b>		
NET ASSETS:		
Unrestricted	\$ (3,742)	\$ (6,177)
Temporarily restricted	15,380	14,562
Permanently restricted	<u>131,586</u>	<u>131,586</u>
Total net assets	<u>143,224</u>	<u>139,971</u>
TOTAL	<u>\$ 143,224</u>	<u>\$ 139,971</u>

See notes to combined financial statements.

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## DISPROPORTIONATE SHARE HOSPITAL FUNDS COMBINED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2012 (Dollars in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, AND OTHER SUPPORT:				
Net realized and unrealized gains on investments	\$ 715	\$ 215	\$ -	\$ 930
Interest and dividends	953	329		1,282
Interfund interest	68	29		97
Transfers	<u>711</u>	<u>245</u>	<u></u>	<u>956</u>
Total revenues, gains, and other support	2,447	818	-	3,265
EXPENDITURES:				
Other investment expense	<u>12</u>	<u></u>	<u></u>	<u>12</u>
Total expenditures	<u>12</u>	<u>-</u>	<u>-</u>	<u>12</u>
INCREASE IN NET ASSETS	2,435	818		3,253
NET ASSETS AT BEGINNING OF YEAR	<u>(6,177)</u>	<u>14,562</u>	<u>131,586</u>	<u>139,971</u>
NET ASSETS AT END OF YEAR	<u>\$ (3,742)</u>	<u>\$ 15,380</u>	<u>\$ 131,586</u>	<u>\$ 143,224</u>

See notes to combined financial statements.

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## DISPROPORTIONATE SHARE HOSPITAL FUNDS COMBINED STATEMENT OF ACTIVITIES AND CHANGES IN NET ASSETS FOR THE YEAR ENDED JUNE 30, 2011 (Dollars in thousands)

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
REVENUES, GAINS, AND OTHER SUPPORT:				
Net realized and unrealized gains on investments	\$ 8,327	\$ 4,171	\$ -	\$ 12,498
Interest and dividends	927	278		1,205
Interfund interest	<u>94</u>	<u>23</u>		<u>117</u>
Total revenues, gains, and other support	9,348	4,472	-	13,820
EXPENDITURES:				
Other investment expense	<u>12</u>			<u>12</u>
Total expenditures	<u>12</u>	<u>-</u>	<u>-</u>	<u>12</u>
INCREASE IN NET ASSETS	9,336	4,472		13,808
NET ASSETS AT BEGINNING OF YEAR	<u>(15,513)</u>	<u>10,090</u>	<u>131,586</u>	<u>126,163</u>
NET ASSETS AT END OF YEAR	<u>\$ (6,177)</u>	<u>\$ 14,562</u>	<u>\$ 131,586</u>	<u>\$ 139,971</u>

See notes to combined financial statements.

# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## DISPROPORTIONATE SHARE HOSPITAL FUNDS COMBINED STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (Dollars in thousands)

	2012	2011
OPERATING ACTIVITIES:		
Increase in net assets	\$ 3,253	\$ 13,808
Adjustments to reconcile increase in net assets to		
Net cash provided in operating activities:		
Net unrealized gain on investments	(2,844)	(13,698)
Loss on sale of investments	958	1,200
Changes in operating assets and liabilities:		
Receivable from affiliate	269	(110)
Net cash provided by operating activities	1,636	1,200
INVESTING ACTIVITIES:		
Purchases of securities	(1,636)	(1,336)
Sale of securities		136
Net cash used in investing activities	(1,636)	(1,200)
NET CHANGE IN CASH AND CASH EQUIVALENTS	-	-
CASH AND CASH EQUIVALENTS—Beginning of year		
CASH AND CASH EQUIVALENTS—End of year	\$ -	\$ -

See notes to combined financial statements.



# UNIVERSITY OF SOUTH ALABAMA FOUNDATION

## DISPROPORTIONATE SHARE HOSPITAL FUNDS NOTES TO COMBINED FINANCIAL STATEMENTS AS OF AND FOR THE YEARS ENDED JUNE 30, 2012 AND 2011 (Dollars in thousands)

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### 1. ORGANIZATION

The University of South Alabama Foundation (the "Foundation" or "USAF") was incorporated in March 1968 for the purpose of promoting education, scientific research, and charitable purposes, and to assist in developing and advancing the University of South Alabama (the "University") in furthering, improving, and expanding its properties, services, facilities, and activities. Revenues are derived principally from investment income and contributions.

The Disproportionate Share Hospital Funds (the "DSH Funds") were matching funds disbursed by the Health Care Financing Administration of the U.S. Department of Health and Human Services to the states through their Medicaid agencies for the purpose of compensating hospitals, such as those operated by the University, that provided medical care and treatment to a disproportionate share of indigent patients in their respective areas.

Access to the DSH Funds for Alabama was made possible by the University of South Alabama Foundation Board, beginning in October 1989, when the Board of the Foundation approved the entry into the matching program. Over a one-year period, the Foundation made a monthly revolving contribution of \$2 million, which yielded approximately \$24 million in federal grant monies. The Board of Trustees of the University adopted a resolution in March 1990, authorizing the transfer of the DSH Funds to the Foundation to be held by it to preserve and ensure the continued viability of the University of South Alabama Hospitals ("University Hospitals") and their overall mission.

Litigation relating to the transfer of the DSH Funds was settled in November 1993, when an agreement was reached among the Department of Examiners of Public Accounts of the State of Alabama, the Board of Trustees of the University, and the Board of Directors of the Foundation, which required that all Medicaid disproportionate share hospital funds received through September 30, 1994, be transferred to the Foundation and held irrevocably for the benefit, as determined by the Foundation, of the University Hospitals and clinics and the other programs of the University that benefit such hospitals and clinics. Further, the agreement recognized the Foundation as the lawful holder and owner of the DSH Funds and that the investment and management of the DSH Funds were solely within the authority of the Foundation's Board.

### 2. SIGNIFICANT ACCOUNTING POLICIES

**Basis of Presentation**—The accompanying combined financial statements include the DSH Funds and Knollwood Development, Inc., a wholly owned subsidiary of the Foundation and an affiliate originally funded by DSH Funds. All significant interfund transactions have been eliminated in combination.

**Net Assets**—In order to ensure observance of limitations and restrictions placed on the use of the resources available to the DSH Funds, the accounts of the DSH Funds are maintained on the accrual basis in accordance with the principles of “fund accounting.” Thus, resources for various purposes are classified into funds that are in accordance with activities or objectives specified. The Foundation presents its net assets and its revenues, expenses, gains, and losses based on the existence or absence of donor-imposed restrictions, using three classifications: permanently restricted; temporarily restricted; and unrestricted. These three classifications are defined as follows:

- Permanently restricted net assets contain donor-imposed restrictions that stipulate that resources be maintained permanently but permit the use or expenditure of part or all of the income derived from the donated assets for specified or unspecified purposes.
- Temporarily restricted net assets contain donor-imposed restrictions that permit the use or expenditure of the donated assets as specified and are satisfied either by the passage of time or by actions of the Foundation.
- Unrestricted net assets are not restricted by donors or the donor-imposed restrictions have expired.

**Support**—Contributions received and unconditional promises to give are measured at their fair values and are reported as increases in net assets at the date of receipt. Gifts of cash and other assets are reported as temporarily restricted support if they are received with donor stipulations that limit the use of the donated assets, or if they are designated as support for future periods. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the combined statements of activities and changes in net assets as net assets released from restrictions.

**Cash Equivalents**—Temporary cash investments with an original maturity date of three months or less when purchased are considered to be cash equivalents. The carrying amounts reported in the accompanying combined statements of financial position for cash and cash equivalents approximate their fair values.

**Investments in Securities**—Investments in equity securities are maintained and administered in a common pool by the Foundation. Amounts presented in these combined financial statements represent the DSH Funds proportionate share of the Foundation’s investments.

**Investments in Commonfund**—The Commonfund for Nonprofit Organizations (“Commonfund”) is a membership corporation that operates investment funds for the exclusive benefit of institutions eligible for membership in the Commonfund. The Foundation holds investments in the Multi-Strategy Equity Fund and the International Equity Fund of the Commonfund. The objective of the Multi-Strategy Equity Fund is to offer an investment in a single fund to provide all of the strategy and manager diversification that an endowment would normally require for equity allocation. The fund is designed to add value over long periods of time and to reduce volatility. The investment objective of the International Equity Fund is to seek to diversify a U.S. equity portfolio with equity investments in companies domiciled abroad.

The Foundation’s units in the Multi-Strategy Equity Fund and the International Equity Fund are valued at their unit values as determined by Commonfund. Commonfund generally determines the

unit values of each of its Funds by reference to the fair values of the underlying investments, the majority of which consists of exchange-traded equity securities. Further information about Commonfund's valuation procedures follows.

In the Multi-Strategy Equity Fund and the International Equity Fund, as managed by Commonfund, equity securities listed on securities exchanges are valued at the last sale price, except for those securities reported through the National Association of Securities Dealers Automated Quotation System (NASDAQ), for which the NASDAQ Official Closing Price is used. In the absence of either, the current bid price is used. Unlisted securities are valued at the current bid prices obtained from reputable brokers. Certain investments held by the funds may be traded by a market maker who may also be utilized to provide pricing information used to value such investments. Investments in units of other funds within Commonfund (known as "crossfund investments") are carried at the unit value of the crossfund investment.

In these funds, investments in limited partnerships and other investment funds are valued at fair value, which is generally the latest net asset value made available by the fund manager or administrator prior to the valuation date. Other securities that are not readily marketable are also valued at fair value as deemed appropriate by management of Commonfund in consultation with the respective investment manager, with consideration given to the financial condition and operating results of the issuer, meaningful third-party transactions in the private market, and other factors deemed relevant. The amounts realized upon disposition of these investments may differ from the value reflected in the financial statements and the differences could be material.

***Investment Income***—Investment income or loss (including gains and losses on investments, interest, dividends, rents, royalties, and timber sales) is included in the accompanying combined statement of activities and changes in net assets as increases or decreases in unrestricted net assets, unless the income or loss is restricted by donor or law, in which case it is classified as temporarily or permanently restricted, as appropriate. Interfund interest is recorded at prevailing market rates on loans between funds to maintain the integrity of each fund's net assets.

***Income Allocation***—The DSH Funds participate in the New Investment Pool (the "Pool") as described in Note 4. Funds that participate in the Pool, including DSH Funds, receive a monthly allocation of income and loss experienced by the Pool. Allocations made by the Pool to its participants are based on the relative participation levels of investment in the Pool by each participating fund.

***Income Tax Status***—The Internal Revenue Service has determined that the Foundation is a tax-exempt organization under Internal Revenue Code Section 501(c)(3).

***Estimates***—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenditures during the reporting period. Actual results could differ from those estimates. The DSH Funds participate in the Foundation's New Investment Pool (see Note 4). The New Investment Pool consists of the Foundation's investment in marketable securities, valued by reference to quoted market prices, investments in Commonfund portfolios valued at unit values based on the fair values of the underlying investments, and timberland, mineral properties, and other real estate valued by appraisals. Such assets are subject to fluctuation in value due to normal market volatility, and to estimation risk in the case of assets for which market values are not available. The values ultimately

realized by the Foundation for all such assets may be different from the values reported and these fluctuations may impact the DSH Fund's financial statements.

**New Accounting Standards** — In May 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-04, *Fair Value Measurement: Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS*. Non public entities are required to adopt ASU 2011-04 for annual periods beginning after December 15, 2011. Accordingly, the DSH Funds will be required to adopt ASU 2011-04 for the annual period ending June 30, 2013. ASU 2011-04 was issued to further explain how to measure fair value and improve the comparability of fair value measurements presented and disclosed in financial statements. The amendments expand the disclosures about fair value measurements categorized within Level 3 of the fair value hierarchy including the valuation process used by the reporting entity and the sensitivity of the fair value measurement to changes in unobservable inputs. The amendment also requires expanded disclosure about the reporting entity's use of a nonfinancial asset in a way that differs from the asset's highest and best use and the categorization by level of the fair value hierarchy for items that are not measured at fair value in the financial statements but for which fair value is required to be disclosed. The DSH Funds have not completed the process of evaluating the impact that will result from adopting ASU 2011-4. The DSH Funds are therefore unable to disclose the impact that adopting ASU 2011-4 will have on its financial position, results of operation, or cash flows.

### 3. FAIR VALUE OF FINANCIAL INSTRUMENTS AND OTHER INVESTMENTS

The following methods and assumptions were used by the Foundation in estimating the fair value of its investments:

- **Cash and Cash Equivalents:** The carrying amount reported in the accompanying combined statement of financial position for cash and cash equivalents approximates its fair value.
- **Equity Securities:** Includes investments in marketable securities and investments in Commonfund:

*Marketable Equity Securities:* Fair values are based on quoted market prices of each security with readily determinable fair values.

*Investments in Commonfund:* Fair values are based on unit values, as determined by Commonfund. As more fully described in Note 2, Commonfund determines unit values for each of its portfolios based on the fair values of the underlying assets.

- **Timberland, Mineral Properties, and Real Estate:** Fair values of timberland, mineral properties, and real estate are determined by independent third-party appraisers using standard appraisal practices particular to the investment being appraised.

### 4. INVESTMENTS

Investments consisted of participation in the Foundation's pooled investment funds. On June 5, 2006, the Board of the Foundation approved the establishment of a New Investment Pool, which consists of (1) all marketable equity securities held by the Foundation, and (2) the Foundation's interest in the land and timber consisting of approximately 55,600 acres of timberland known as the

Equitable Tract, which the Foundation acquired in 1997 with financing that was provided, in part, from the DSH Funds to the Foundation's Equitable Timber Fund (3) and the Foundation's interest in the Brookley Complex acquired November 10, 2010. Effective June 30, 2006, upon establishment of the Pool, the interest in the Pool allocated to the DSH Funds was equal in value to the sum of (1) the value of the interest that was allocated to the DSH Funds in the Foundation's existing securities pool at June 30, 2006, and (2) the amount of the aggregate receivable for principal and interest owed by the Equitable Timber Fund to the DSH at June 30, 2006. All pooled investment activity subsequent to June 30, 2006, is allocated between DSH Funds and other USAF funds based on each fund's initial share of the Pool, adjusted for subsequent contributions and distributions.

Investment income for the years ended June 30, 2012 and 2011, consisted of the following:

	<b>2012</b>	<b>2011</b>
Unrealized gains	\$ 1,888	\$ 13,698
Realized losses	(958)	(1,200)
Interest and dividends	1,282	1,205
Interfund interest	<u>97</u>	<u>117</u>
	<u>\$ 2,309</u>	<u>\$ 13,820</u>

Real estate at June 30, 2012 and 2011, consisted of land and land improvements.

Fair value measurements are classified as either observable or unobservable in nature. Observable fair values are derived from quoted market prices for investments traded on an active exchange or in dealer markets where there is sufficient activity and liquidity to allow price discovery by substantially all market participants. The New Investment Pool's observable values consist of investments in exchange traded equity securities with a readily determinable market price. Other observable values are fair value measurements derived either directly or indirectly from quoted market prices. The New Investment Pool's other observable values are an investment in a managed fund held by a third party. Investments that are not traded on an active exchange and do not have a quoted market price are classified as unobservable. The DSH Funds' unobservable values consist of its interest in the New Investment Pool's timberland and real estate with fair values based on extensive independent third-party appraisals performed by qualified appraisers specializing in timber and real estate investments.

The Foundation's Investment Pool assets are summarized as follows:

<b>Fair Value Measurements at June 30, 2012</b>				
<b>Description</b>	<b>Observable Values Based on Quoted Prices</b>	<b>Other Observable Values</b>	<b>Unobservable Values</b>	<b>Total</b>
New Investment Pool interest in marketable equity securities	\$ 51,461	\$ 53,037	\$ -	\$ 104,498
New Investment Pool interest in timber			105,500	105,500
New Investment Pool interest in real estate			23,000	23,000
Real estate			3,700	3,700
	<u>\$ 51,461</u>	<u>\$ 53,037</u>	<u>\$ 132,200</u>	<u>\$ 236,698</u>

<b>Fair Value Measurements at June 30, 2011</b>				
<b>Description</b>	<b>Observable Values Based on Quoted Prices</b>	<b>Other Observable Values</b>	<b>Unobservable Values</b>	<b>Total</b>
New Investment Pool interest in marketable equity securities	\$ 48,054	\$ 62,525	\$ -	\$ 110,579
New Investment Pool interest in timber			104,900	104,900
New Investment Pool interest in real estate			20,000	20,000
Real estate			3,600	3,600
	<u>\$ 48,054</u>	<u>\$ 62,525</u>	<u>\$ 128,500</u>	<u>\$ 239,079</u>

For the year ended June 30, 2012, activity in the Foundation's Pooled Investment assets valued at fair value based on unobservable values is as follows:

	<b>Investment Pool Interest in Timber</b>	<b>Investment Pool Interest in Real Estate</b>	<b>Real Estate</b>	<b>Total</b>
Beginning balance	\$ 104,900	\$ 20,000	\$ 3,600	\$ 128,500
Total realized and unrealized gains	3,116	3,000	100	6,216
Reforestation	367			367
Depletion	(2,883)			(2,883)
Ending balance	<u>\$ 105,500</u>	<u>\$ 23,000</u>	<u>\$ 3,700</u>	<u>\$ 132,200</u>

For the year ended June 30, 2011, activity in the Foundation's Pooled Investment assets valued at fair value based on unobservable values is as follows:

	Investment Pool Interest in Timber	Investment Pool Interest in Real Estate	Real Estate	Total
Beginning balance	\$ 107,300	\$ -	\$ 3,600	\$ 110,900
Total realized and unrealized gains (losses)	(333)	1,220		887
Additions		18,780		18,780
Reforestation	597			597
Depletion	(2,664)			(2,664)
Ending balance	<u>\$ 104,900</u>	<u>\$ 20,000</u>	<u>\$ 3,600</u>	<u>\$ 128,500</u>

The DSH Funds' holds a proportionate interest in the value of the Foundation's Investment Pool. On June 30, 2012, the value of DSH units in the Pool was \$139,110 and at June 30, 2011, the value of DSH units in the Pool was \$135,688.

## 5. RELATED-PARTY TRANSACTIONS

At June 30, 2012 and 2011, receivables from affiliated entities totaled \$414 and \$683, respectively. These amounts are due to the DSH Funds from other entities owned by the Foundation. These receivables earn interest at a standard market rate, based on the applicable federal rates (rates used for federal tax purposes). Interest income was \$97 and \$117 for the years ended June 30, 2012 and 2011, respectively. As described in Note 4, effective June 30, 2006, the DSH Funds participate in the Pool of the Foundation and the DSH Funds earn a proportionate share of investment income of the Pool.

In an effort to assist the University in furtherance of its tax-exempt purpose and in order to accelerate its support of the Pediatric Expansion of USA Children's and Women's Hospital, the Foundation's Board of Directors authorized in a resolution adopted on May 27, 2010, the Foundation to negotiate an agreement to purchase the Brookley Center campus owned by the University. The May 27, 2010, resolution revoked the May 22, 2008, resolution as it pertained to the support of the Pediatric Expansion of USA Children's and Women's Hospital. On November 10, 2010, Brookley Bay Front Properties, LLC (hereinafter BBFP), an Alabama Limited Liability Company, whose sole member is the University of South Alabama Foundation, purchased the Brookley Complex from the University of South Alabama for Twenty Million Dollars (\$20,000) payable in five annual installments of Four Million Dollars (\$4,000). BBFP paid the University Four Million Dollars (\$4,000) at closing and entered into a non-interest bearing installment note for Sixteen Million Dollars (\$16,000).

It is further the intention and expectation of the Board of the Foundation, as reflected in the resolution adopted May 27, 2010, that after BBFP has completed payment of the purchase price, the Foundation would begin funding to the University an annual target distribution of 3% of the net assets of the DSH Funds held by the Foundation, subject to certain financial and other conditions.

During the period over which the note is outstanding, the University retains ownership and usage rights of all buildings and improvements on the Brookley Complex property and an exclusive easement over the land for five years. Ownership of such buildings and improvements transfers to

BBFP at the time the note is fully repaid. BBFP, may at its option, prepay the note, and take ownership of the buildings and improvements prior to the scheduled maturity of such note.

#### **6. NATURE AND AMOUNT OF TEMPORARILY RESTRICTED NET ASSETS**

At June 30, 2012 and 2011, temporarily restricted net assets of \$15,380 and \$14,562, respectively, were available for the support of hospitals, clinics, and related programs of the University.

#### **7. NATURE AND AMOUNT OF PERMANENTLY RESTRICTED NET ASSETS**

At June 30, 2012 and 2011, permanently restricted net assets of \$131,586 and \$131,586, respectively, are restricted to investments in perpetuity, the income from which may be used for the support of hospitals, clinics, and related programs of the University.

#### **8. ENDOWMENT**

##### **Interpretation of the Law**

The University of South Alabama Foundation conducts the operations of the Foundation in accordance with the Alabama Uniform Prudent Management of Institutional Funds Act (UPMIFA), effective January 1, 2009, and continuing thereafter unless otherwise determined by the Foundation. The Board of Directors and management of the Foundation interpret UPMIFA as obligating the Foundation to preserve, as donor-restricted assets, each original gift received by the Foundation as donor-restricted endowment funds.

The Foundation, accordingly, classifies each such original gift, and any subsequent gifts, as permanently restricted. The remaining portion of any donor-restricted endowment that is not classified as permanently restricted is classified as temporarily restricted net assets, until such time as any of such remaining portion is appropriated for expenditure. In managing each endowment fund held by it, the Foundation considers, if relevant, the duration and preservation of the fund, the purposes of the Foundation and the fund, general economic conditions, any restrictions imposed by the donor, the possible effect of inflation or deflation, the expected total return from income and appreciation of investments, the other resources of the Foundation, and the investment policy of the Foundation.

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