KPMG

UNIVERSITY OF SOUTH ALABAMA

(A Component Unit of the State of Alabama)

Basic Financial Statements and Supplementary Information on Federal Awards Programs

September 30, 2007

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

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Introduction

The following discussion presents an overview of the financial position and financial activities of the University of South Alabama (the University), including the University of South Alabama Hospitals (the Hospitals), a division of the University, at September 30, 2007 and 2006 and for the years then ended. This discussion was prepared by University management and should be read in conjunction with the financial statements and notes thereto, which follow.

The basic financial statements of the University consist of the University and its component units. The financial position and results of operations of the component units are either blended with the University's financial position and results of operations or are discretely presented. The treatment of each component unit is governed by pronouncements issued by the Governmental Accounting Standards Board. As more fully described in note number 1 to the basic financial statements, the University of South Alabama Professional Liability Trust Fund and the University of South Alabama General Liability Trust Fund are reported as blended component units. The University of South Alabama Foundation, the University of South Alabama Health Services Foundation, and the USA Research and Technology Corporation are discretely presented.

Financial Highlights

At September 30, 2007, 2006, and 2005, the University has total assets of $707,687,000, $545,649,000, and $485,986,000, respectively; total liabilities of $323,171,000, $234,291,000, and $230,030,000, respectively; and net assets of $384,516,000, $311,358,000, and $255,956,000, respectively. University net assets increased $73,158,000 during the year ended September 30, 2007 compared to increases of $55,402,000 and $21,846,000 in the years ended September 30, 2006 and 2005, respectively.

An overview of each statement is presented herein along with a financial analysis of the transactions impacting each statement. Where appropriate, comparative financial information is presented to assist in the understanding of this analysis.

Analysis of Financial Position and Results of Operations

Statement of Net Assets

The statement of net assets presents the assets, liabilities, and net assets of the University at September 30, 2007 and 2006. The net assets are displayed in three parts: invested in capital assets, net of related debt, restricted and unrestricted. Restricted net assets may either be expendable or nonexpendable and are those assets that are restricted by law or external donor. Unrestricted net assets, while they are generally designated for specific purposes, are available for use by the University to meet current expenses for any purpose. The statement of net assets, along with all of the University's basic financial statements, are prepared under the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred by the University, regardless of when cash is exchanged.

Assets included in the statement of net assets are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, investments, and hospital patient accounts receivable. Of these amounts, cash and cash equivalents, investments, and accounts receivable comprise approximately 19%, 56%, and 11%, respectively, of current assets at September 30, 2007. Noncurrent assets at September 30, 2007 consist primarily of capital assets and restricted investments.

The Condensed Schedule of Net Assets at September 30, 2007, 2006, and 2005 follows (in thousands):

Condensed Schedule of Net Assets

		2007	2006	2005
Assets:				
Current	$	271,983	223,412	169,358
Capital assets		286,890	247,875	231,027
Other noncurrent		148,814	74,362	85,601
Total assets		707,687	545,649	485,986
Liabilities:				
Current		80,389	71,071	72,834
Noncurrent		242,782	163,220	157,196
Total liabilities		323,171	234,291	230,030
Net assets:				
Invested in capital assets, net of related debt		163,688	137,642	127,805
Restricted, nonexpendable		16,828	12,612	12,208
Restricted, expendable		35,955	25,966	9,997
Unrestricted		168,045	135,138	105,946
Total net assets	$	384,516	311,358	255,956

University cash, cash equivalents, and investments (current and noncurrent) increased between September 30, 2007 and 2006 by $117,564,000 to $335,647,000. This increase is primarily due to increases in state appropriations, investment income, the proceeds from the sale of two buildings to the USA Research and Technology Corporation, and the issuance of additional bonded indebtedness during 2007. This follows a significant increase between 2005 and 2006, which resulted from cash generated by increases in state appropriations, investment income and gifts to the University. Patient accounts receivable increased from $26,399,000 to $30,950,000 between 2006 and 2007, reflecting increased patient care activity at the USA Hospitals and the Mitchell Cancer Institute.

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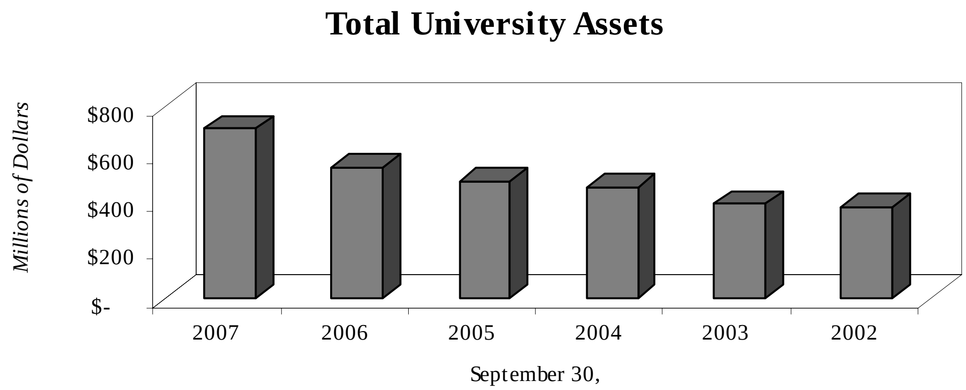
Total assets of the University as of September 30 are as follows:



Noncurrent liabilities consist primarily of bonded indebtedness and notes payable. Long-term debt (including the current portion of long-term debt) increased from $121,969,000 to $199,799,000 between September 30, 2006 and 2007 primarily as a result of the issuance of additional bonded indebtedness.

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

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

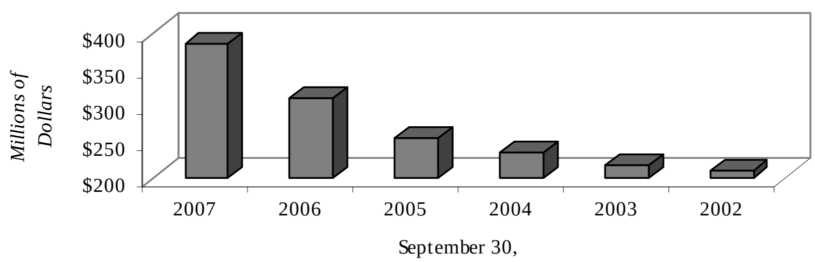
Restricted nonexpendable net assets consist primarily of the University's permanent endowment funds. While earnings from these funds may be expended, the corpus may not be expended for any reason and must remain intact with the University in perpetuity.

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

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

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

Net University Assets



Net assets invested in capital assets, net of related debt, increased approximately $26,046,000 between September 30, 2006 to 2007. This increase was due primarily to an increase in construction activity and the repayment of principal on notes and bonds payable. Restricted expendable net assets increased to $35,955,000 at September 30, 2007 primarily due to restricted gift activity primarily related to the Mitchell Cancer Institute. Unrestricted net assets increased from $135,138,000 to $168,045,000 between 2006 and 2007 primarily as the result of increases in state appropriations and unrestricted gifts.

Statement of Revenues, Expenses, and Changes in Net Assets

Changes in total University net assets as reported in the statement of net assets are based on the activity presented in the statement of revenues, expenses, and changes in net assets. The purpose of this statement is to present the change in net assets resulting from revenues earned by the University, both operating and nonoperating, and the expenses incurred by the University, both operating and nonoperating, as well as any other revenues, expenses, gains, and losses earned or incurred by the University.

Generally, operating revenues have the characteristics of exchange transactions and are received or accrued for providing goods and services to the various customers and constituencies of the University. These include hospital patient care services, tuition and fees (net of scholarship discounts and allowances), most noncapital grants and contracts and revenues from auxiliary activities and sales and services of education activities (primarily athletic activities). Operating expenses are those expenses paid or incurred to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the University.

Nonoperating revenues have the characteristics of nonexchange transactions and are revenues generally earned for which goods and services are not provided, such as investment income, capital appropriations, gifts and other contributions. State appropriations are required by the Governmental Accounting Standards Board to be classified as nonoperating revenues. Nonoperating expenses are those expenses required in the operation and administration of the University, but not directly incurred to acquire or produce the goods and services provided in return for operating revenues. Such nonoperating expenses include interest on the University's indebtedness and losses related to the disposition of capital assets.

The Condensed Schedule of Revenues, Expenses, and Changes in Net Assets for the years ended September 30, 2007, 2006, and 2005 follows (in thousands):

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

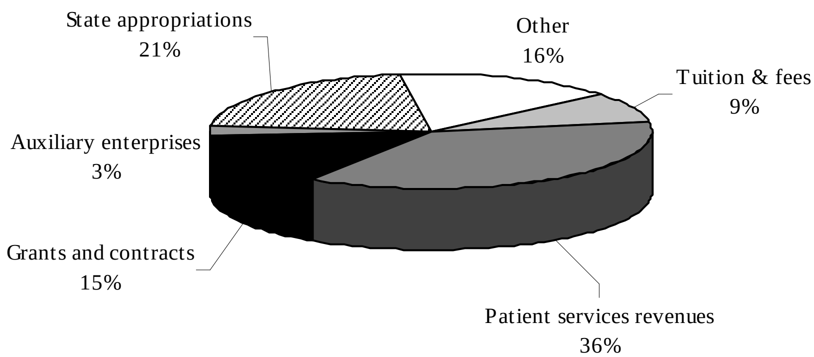
		2007	2006	2005
Operating revenues:				
Tuition and fees	$	49,579	47,236	43,737
Net patient service revenue		205,337	201,373	201,413
Federal, state and private grants and contracts		83,238	78,217	68,647
Other		45,803	47,533	45,915
		383,957	374,359	359,712
Operating expenses:				
Salaries and benefits		333,688	317,626	307,039
Supplies and other services		111,297	109,653	105,116
Other		35,977	35,336	32,432
		480,962	462,615	444,587
Operating loss		(97,005)	(88,256)	(84,875)
Nonoperating revenues (expenses):				
State appropriations		120,388	101,203	86,622
Investment income		19,534	9,418	7,121
Other, net		6,491	23,250	3,281
Net nonoperating revenues		146,413	133,871	97,024
Income before capital contributions and additions to endowment		49,408	45,615	12,149
Capital contributions and additions to endowment		23,750	9,787	9,697
Increase in net assets		73,158	55,402	21,846
Beginning net assets		311,358	255,956	234,110
Ending net assets	$	384,516	311,358	255,956

(Continued)

In 2007, 2006, and 2005, approximately 36%, 38%, and 46%, respectively, of total revenues of the University were net patient service revenue. Excluding net patient service revenue, state appropriations represent the largest component of total university revenues, approximately 21% of total revenues in fiscal 2007. Also in 2007 tuition and fees charged to students and grants and contracts (federal, state and private) represented approximately 9% and 15% of total revenues, respectively.

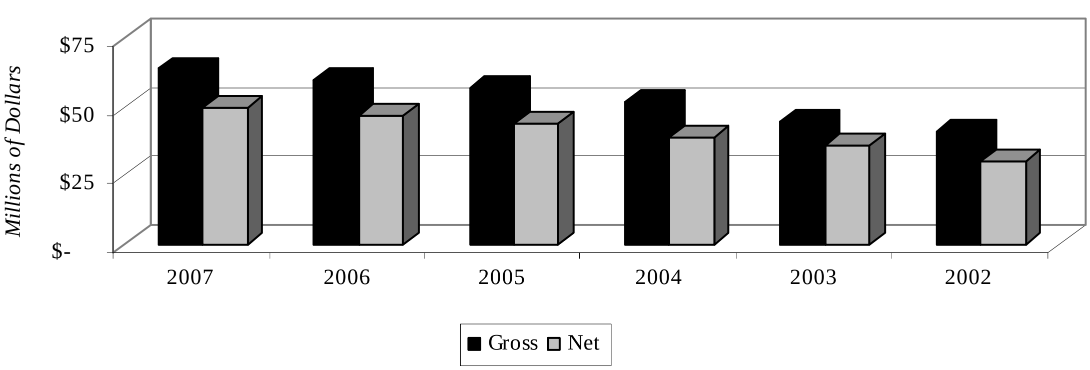
A summary of University revenues for the year ended September 30, 2007 is presented below:

Total Revenues



Tuition and fees have increased in each of the last five years. These increases are due to increases in tuition and fee rates charged to students as well as to an increase in the number of students enrolled. Additionally, tuition and fees as a percent of total operating revenue continue to increase, from 9.5% of operating revenues in 2002 to 12.9% in 2007. Tuition and fees, gross and net of scholarship allowances, for the past six fiscal years are as follows:

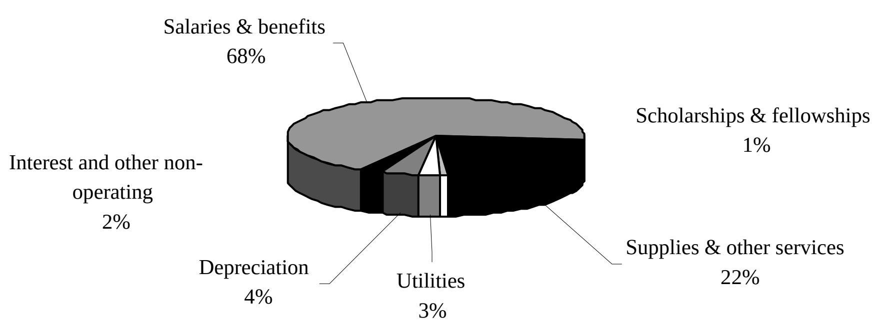
Tuition and Fees



Further, capital contributions and grants increased from $8,747,000 in 2006 to $19,907,000 in 2007 primarily due to significant increases in capital grant funding for the construction of the Mitchell Cancer Institute. Financial market conditions have resulted in significant increases in investment income from $7,121,000 in 2005 to $9,418,000 in 2006 and $19,534,000 in 2007.

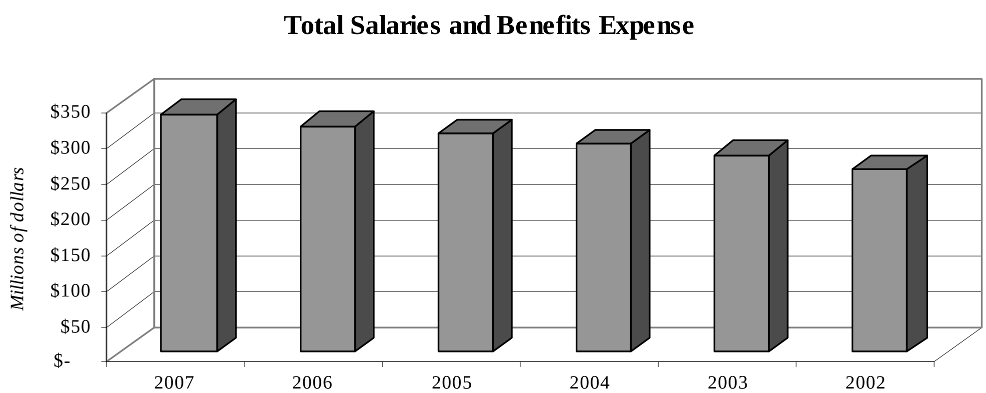
University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2007 is presented below.

Total Expenses



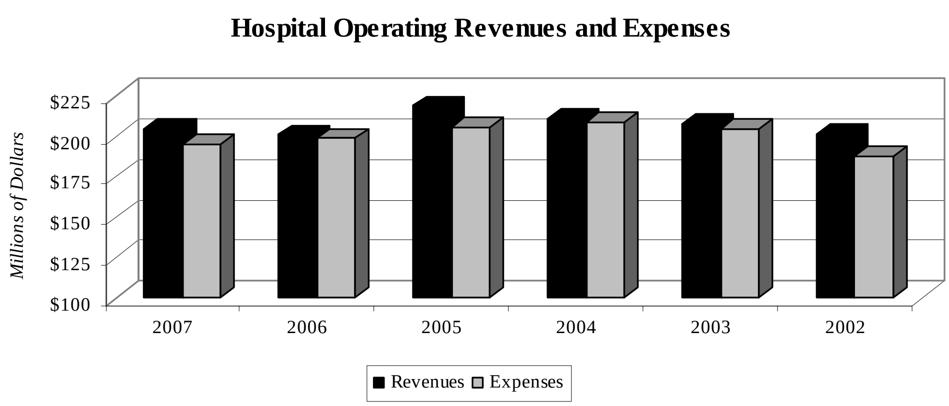
While the University reports its expenses on a natural expense classification basis, functional classifications represent expenses categorized based on the function within the University. Such University functions include instruction, research, public service, academic support, student services, institutional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

In 2007, 2006, and 2005, approximately 68%, 68%, and 69%, respectively, of the University’s total operating expenses were salaries and benefits. Salaries and benefits have steadily increased over the last five years, resulting primarily from increases in salary rates to faculty and staff, as shown below:



For the years ended September 30, 2007, 2006, and 2005, the University reported an operating loss of approximately $97,005,000, $88,256,000, and $84,875,000, respectively. Net operating losses are offset by state appropriations, which are reported as nonoperating revenue. After adding state appropriations and other nonoperating revenues and expenses, (primarily capital contributions and additions to endowment) the total increase in net assets was approximately $73,158,000, $55,402,000, and $21,846,000, for the years ended September 30, 2007, 2006, and 2005, respectively.

The Hospitals represent a significant portion of total University revenues and expenses and have remained relatively constant over the past four years. Operating hospital revenues and expenses for the last six fiscal years are presented below:



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 $68,000,000, $37,000,000, and $33,000,000 during the years ended September 30, 2007, 2006, and 2005, respectively. Significant capital asset additions in fiscal 2007 include the Nursing and Allied Health Building, the Mitchell Cancer Institute and numerous ongoing construction projects at the University and Hospitals. Significant projects in fiscal 2005 and 2006 included Building II in the USA Technology and Research Park, JagTran (the campus shuttle system), Meisler Hall and ongoing projects. In 2007, Buildings II and III in the USA Technology and Research Park were sold to the USA Research and Technology Corporation. The proceeds from this sale were approximately $11,986,000. At September 30, 2007, the University has outstanding commitments of approximately $55,408,000 for various capital projects.

In December 2005, the University and Infirmary Health System, Inc. (the Infirmary) entered into a lease agreement in which the University has agreed to lease certain land, buildings and equipment at its USA Knollwood Hospital campus to the Infirmary. The lease, which was effective April 1, 2006, extends fifty years, with an automatic forty-nine year renewal term. The portion of the lease applicable to the land and buildings is treated as an operating lease and the portion of the lease applicable to the equipment is treated as a capital lease. On April 1, 2006, the University received lease payments of $7,418,000, most of which is recorded as deferred revenue at September 30, 2007, and is receiving the majority of the remaining lease payments over a thirty year period.

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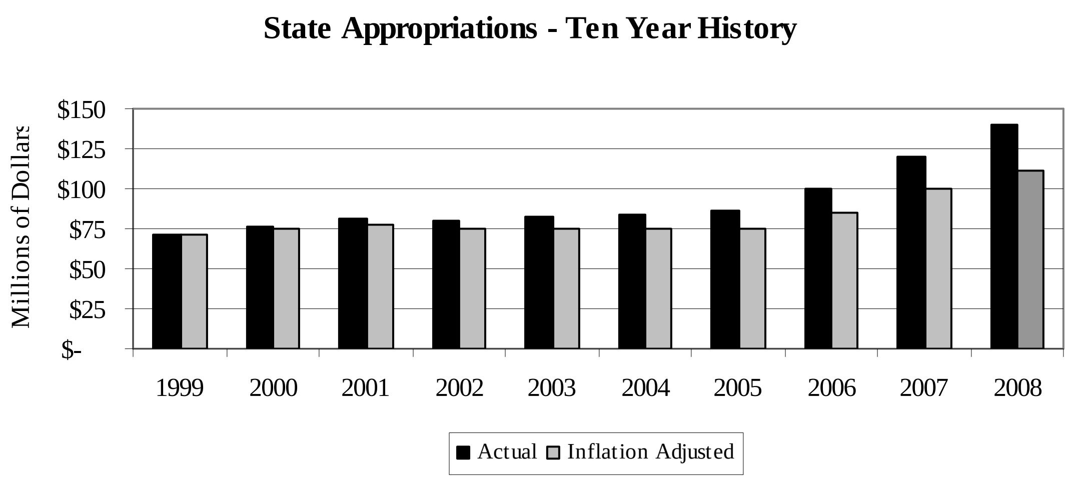
During 2007, the University sold the Health Services Building to the USA Research and Technology Corporation and also sold 100 lots in the Hillsdale area of campus to a third party. The University recognized a gain on the disposal of these assets of approximately $3,739,000.

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

During the years ended September 30, 2007 and 2006, the University's bond credit rating was unchanged at Moody's A2. The University bond credit rating was upgraded in 2004.

Economic Outlook

While enrollment and tuition have both increased in recent years, state appropriations have historically been relatively flat. However, in 2007 and 2006, the University experienced an increase of 19.0% and 17.2%, respectively, or approximately $19,185,000 and $14,581,000, respectively, in state appropriations. A similar increase has been approved and is expected for the 2008 budget year.



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 2008 beyond those unknown variables having a global effect on virtually all types of business operations.

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

The Board of Trustees
University of South Alabama:

We have audited the accompanying basic financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units as of and for the years ended September 30, 2007 and 2006, as listed in the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the 2007 and 2006 consolidated financial statements of the University of South Alabama Foundation, which represents 84%, 99% and 37%, respectively, of the 2007 assets, net assets and revenues of the aggregate discretely presented component units and 91%, 100% and 44%, respectively, of the 2006 assets, net assets and revenues of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the University of South Alabama Foundation, is based on the report of the other auditors.

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

As discussed in note 1, the financial statements of the University are intended to present the financial position, changes in financial position and, where applicable, cash flows of only that portion of the basic financial statements and the aggregate discretely presented component units of the State of Alabama that is attributable to the transactions of the University. They do not purport to, and do not, present fairly the financial position of the State of Alabama as of September 30, 2007 and 2006, the changes in its financial position, or, where applicable, its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University and of its aggregate discretely presented component units as of September 30, 2007 and 2006, and the respective changes in financial position and cash flows, where applicable, thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 15, 2007, 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 10 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 conducted 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, 2007 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.* The schedule of Expenditures of Federal Awards has been subjected to the auditing procedures applied in the audit of the 2007 basic financial statements and, in our opinion, is fairly stated in the all material respects in relation to the 2007 basic financial statements taken as a whole.

KPMG LLP

November 15, 2007

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

Statements of Net Assets

September 30, 2007 and 2006

(In thousands)

		2007	2006
Assets:			
Current assets:			
Cash and cash equivalents	$	51,864	35,560
Investments		153,292	128,055
Net patient accounts receivable, (net of allowance for doubtful accounts of $42,447 and $47,866)		30,950	26,399
Accounts receivable, affiliates		11,521	8,822
Accounts receivable, other		17,577	17,969
Notes receivable, net		787	735
Prepaid expenses, inventories, and other		5,992	5,872
Total current assets		271,983	223,412
Noncurrent assets:			
Restricted cash and cash equivalents		5,820	2,600
Restricted investments		123,050	50,112
Investments		1,621	1,756
Accounts receivable		7,235	8,316
Notes receivable, net		5,623	5,854
Other noncurrent assets		5,465	5,724
Capital assets, net		286,890	247,875
Total noncurrent assets		435,704	322,237
Total assets		707,687	545,649
Liabilities:			
Current liabilities:			
Accounts payable and accrued liabilities		49,606	42,087
Deferred revenue		24,744	21,395
Deposits		668	600
Current portion of long-term debt		5,371	6,989
Total current liabilities		80,389	71,071
Noncurrent liabilities:			
Long-term debt, less current portion		194,428	114,980
Other long-term liabilities		48,354	48,240
Total noncurrent liabilities		242,782	163,220
Total liabilities		323,171	234,291
Net assets:			
Invested in capital assets, net of related debt		163,688	137,642
Restricted, nonexpendable:			
Scholarships		7,172	4,712
Other		9,656	7,900
Restricted, expendable:			
Scholarships		4,541	3,625
Other		31,414	22,341
Unrestricted		168,045	135,138
Total net assets	$	384,516	311,358

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2007 and 2006

(In thousands)

Assets		**2007**	**2006**
Cash and cash equivalents	$	1,713	1,967
Investments:			
Securities, at fair value		142,709	121,762
Timber and mineral properties		150,364	148,863
Real estate		18,794	18,405
Other		5,500	—
Other assets		488	377
Total assets	$	319,568	291,374
Liabilities and Net Assets			
Liabilities:			
Accounts payable	$	20	98
Contributions payable to the University of South Alabama		—	11
Other liabilities		779	763
Total liabilities		799	872
Net assets:			
Unrestricted		88,012	77,205
Temporarily restricted		59,707	48,879
Permanently restricted		171,050	164,418
Total net assets		318,769	290,502
Total liabilities and net assets	$	319,568	291,374

See accompanying notes to basic financial statements.

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

Statements of Financial Position

September 30, 2007 and 2006

(In thousands)

Assets		**2007**	**2006**
Current assets:			
Cash and cash equivalents	$	690	957
Patient accounts receivable (net of allowance for uncollectible accounts of approximately $5,745 and $5,844)		10,949	9,519
Other current assets		1,621	1,274
Total current assets		13,260	11,750
Assets limited as to use, held by trustee		19,236	15,145
Property and equipment, net		2,769	1,904
Total assets	$	35,265	28,799
Liabilities and Net Assets			
Current liabilities:			
Accounts payable	$	2,035	1,550
Accrued payroll		30	87
Current portion of notes payable		935	865
Current portion of obligation under capital lease		—	47
Due to affiliates		11,137	8,512
Total current liabilities		14,137	11,061
Notes payable, less current portion		570	1,505
Estimated professional liability costs		19,236	15,145
Total liabilities		33,943	27,711
Unrestricted net assets		1,322	1,088
Total liabilities and net assets	$	35,265	28,799

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statement of Net Assets

September 30, 2007

(In thousands)

		2007
Assets:		
Current assets:		
Cash and cash equivalents	$	649
Investments		988
Tenant expense reimbursements		120
Total current assets		1,757
Noncurrent assets:		
Intangible assets, net		122
Capital assets, net		22,547
Total noncurrent assets		22,669
Total assets		24,426
Liabilities:		
Current liabilities:		
Deposits, other current liabilities, and accrued expenses		381
Current portion of note payable		465
Total current liabilities		846
Noncurrent liabilities:		
Notes payable, excluding current portion		22,492
Total noncurrent liabilities		22,492
Total liabilities		23,338
Net assets (deficit):		
Invested in capital assets, net of related debt		(459)
Unrestricted		1,547
Total net assets	$	1,088

See accompanying notes to basic financial statements.

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

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 2007 and 2006

(In thousands)

		2007	2006
Operating revenues:			
Tuition and fees (net of scholarship allowances of $14,401 and $12,991)	$	49,579	47,236
Net patient service revenue		205,337	201,373
Federal grants and contracts		31,452	29,608
State grants and contracts		6,822	6,653
Private grants and contracts		44,964	41,956
Auxiliary enterprises (net of scholarship allowances of $432 and $402)		16,633	16,586
Other operating revenues		29,170	30,947
Total operating revenues		383,957	374,359
Operating expenses:			
Salaries and benefits		333,688	317,626
Supplies and other services		111,297	109,653
Scholarships and fellowships		4,295	4,083
Utilities		12,623	12,793
Depreciation		19,059	18,460
Total operating expenses		480,962	462,615
Operating loss		(97,005)	(88,256)
Nonoperating revenues (expenses):			
State appropriations		120,388	101,203
Investment income		19,534	9,418
Interest expense		(7,654)	(4,943)
Other nonoperating revenues		19,037	30,263
Other nonoperating expenses		(4,892)	(2,070)
Net nonoperating revenues		146,413	133,871
Income before capital contributions and additions to endowment		49,408	45,615
Capital contributions and grants		19,907	8,747
Additions to endowment		3,843	1,040
Increase in net assets		73,158	55,402
Net assets:			
Beginning of year		311,358	255,956
End of year	$	384,516	311,358

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, 2007

(In thousands)

		Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:					
Net realized and unrealized gains on investments	$	16,505	13,642	274	30,421
Rents, royalties and timber sales		5,997	—	74	6,071
Interest and dividends		965	2,263	12	3,240
Gifts		—	—	6,271	6,271
Other income		32			32
Required match of donor contributions		(1)	—	1	—
Interfund interest		(643)	643	—	—
Net assets released from program restrictions		5,720	(5,720)	—	—
Total revenues, gains, and other support		28,575	10,828	6,632	46,035
Expenditures:					
Program services:					
Faculty support		2,448	—	—	2,448
Scholarships		1,031	—	—	1,031
Other		3,532	—	—	3,532
Total program service expenditures		7,011	—	—	7,011
Management and general		2,278	—	—	2,278
Other investment expense		1,693	—	—	1,693
Depreciation and depletion expense		6,786	—	—	6,786
Total expenditures		17,768	—	—	17,768
Increase in net assets		10,807	10,828	6,632	28,267
Net assets – beginning of year		77,205	48,879	164,418	290,502
Net assets – end of year	$	88,012	59,707	171,050	318,769

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, 2006

(In thousands)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
Revenues, gains, and other support:				
Net realized and unrealized gains (losses) on investments	$ 29,593	4,998	(642)	33,949
Rents, royalties and timber sales	15,952	—	120	16,072
Interest and dividends	2,188	352	3	2,543
Gifts	—	259	339	598
Required match of donor contributions	(252)	—	252	—
Interfund interest	(4,869)	4,869	—	—
Net assets released from program restrictions	4,688	(4,688)	—	—
Total revenues, gains, and other support	47,300	5,790	72	53,162
Expenditures:				
Program services:				
Faculty support	2,550	—	—	2,550
Scholarships	1,032	—	—	1,032
Other	2,492	—	—	2,492
Total program service expenditures	6,074	—	—	6,074
Management and general	2,161	—	—	2,161
Other investment expense	1,368	—	—	1,368
Interest expense	449	—	—	449
Depreciation and depletion expense	18,309	—	—	18,309
Total expenditures	28,361	—	—	28,361
Increase in net assets	18,939	5,790	72	24,801
Net assets – beginning of year	58,266	43,089	164,346	265,701
Net assets – end of year	$ 77,205	48,879	164,418	290,502

See accompanying notes to basic financial statements.

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

Statements of Operations and Changes in Net Assets

Years ended September 30, 2007 and 2006

(In thousands)

		2007	2006
Unrestricted revenues, gains and other support:			
Net patient service revenue	$	66,917	61,337
Other revenue		8,281	6,971
Total unrestricted revenues, gains and other support		75,198	68,308
Expenses:			
Salaries and benefits		43,479	38,923
General and administrative		15,945	14,194
Provision for uncollectible accounts		12,631	10,999
Depreciation and amortization		945	716
Interest		138	168
Total expenses		73,138	65,000
Operating income		2,060	3,308
Nonoperating gains		215	298
Revenues over expenses		2,275	3,606
Contributions restricted for debt service, received and expended within the same year		1,000	1,000
Transfer of capital to University of South Alabama College of Medicine		(3,041)	(3,800)
Unrealized loss on other-than-trading securities		—	(2)
Change in unrestricted net assets		234	804
Unrestricted net assets at beginning of year		1,088	284
Unrestricted net assets at end of year	$	1,322	1,088

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended September 30, 2007

(In thousands)

		2007
Operating revenues:		
Rental income	$	1,955
Tenant reimbursements		161
Total operating revenues		2,116
Operating expenses:		
Building management and operating expenses		295
Property taxes		133
Depreciation and amortization		646
Legal and administrative fees		17
Insurance		68
Total operating expenses		1,159
Operating income		957
Nonoperating revenues (expenses):		
Investment income		37
Interest expense		(765)
Net nonoperating expenses		(728)
Increase in net assets		229
Net assets:		
Beginning of year		859
End of year	$	1,088

See accompanying notes to basic financial statements.

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

Statements of Cash Flows

Years ended September 30, 2007 and 2006

(In thousands)

	2007	2006
Cash flows from operating activities:		
Receipts related to tuition and fees	$ 51,535	48,152
Receipts from and on behalf of patients and third-party payers	201,628	205,864
Receipts from grants and contracts	81,058	80,765
Receipts related to auxiliary enterprises	14,860	17,265
Payments to suppliers and vendors	(107,874)	(120,044)
Payments to employees and related benefits	(332,995)	(322,698)
Payments for scholarships and fellowships	(4,251)	(4,120)
New loans issued to students	(823)	(1,381)
Student loan repayments	634	1,055
Other operating receipts	27,476	36,808
Net cash used in operating activities	(68,752)	(58,334)
Cash flows from noncapital financing activities:		
State appropriations	120,388	101,217
Endowment gifts	3,843	981
Agency funds received	943	654
Agency funds disbursed	(871)	(467)
Stafford and PLUS loans received	62,840	63,079
Stafford and PLUS loans disbursed	(63,070)	(63,485)
Other nonoperating revenues	13,839	18,481
Other nonoperating expenses	(4,776)	(2,009)
Net cash provided by noncapital financing activities	133,136	118,451
Cash flows from capital and related financing activities:		
Capital gifts and grants	19,907	8,747
Purchases of capital assets	(67,400)	(33,972)
Proceeds from sale of capital assets	6,591	1,125
Proceeds from issuance of capital debt	106,780	284
Principal payments on capital debt	(29,625)	(5,907)
Interest payments on capital debt	(5,441)	(5,844)
Net cash provided by (used in) capital and related financing activities	30,812	(35,567)
Cash flows from investing activities:		
Interest and dividends on investments	17,924	8,450
Purchases of investments	(337,919)	(226,628)
Proceeds from sales of investments	244,323	189,698
Net cash used in investing activities	(75,672)	(28,480)
Net increase (decrease) in cash and cash equivalents	19,524	(3,930)
Cash and cash equivalents (unrestricted and restricted):		
Beginning of year	38,160	42,090
End of year	$ 57,684	38,160

(Continued)

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

Statements of Cash Flows

Years ended September 30, 2007 and 2006

(In thousands)

		2007	2006
Reconciliation of operating loss to net cash used in operating activities:			
Operating loss	$	(97,005)	(88,256)
Adjustments to reconcile operating loss to net cash used in operating activities:			
Depreciation expense		19,059	18,460
Changes in assets and liabilities, net:			
Student receivables		(93)	253
Net patient accounts receivable		(2,917)	4,846
Grants and contracts receivables		(268)	284
Student loan program receivables		(190)	(511)
Other receivables		2,403	(586)
Prepaid expenses, inventories, and other		(1,529)	1,647
Accounts payable and accrued liabilities		9,024	(3,878)
Deferred revenue		2,764	9,407
Net cash used in operating activities	$	(68,752)	(58,334)
Noncash investing, noncapital financing, and capital and related financing transactions:			
Increase in fair value of investments recognized as a component of investment income	$	2,404	2,485
Additional maturity on capital appreciation bonds payable recorded as interest expense		1,468	1,398
Promissory note issued in exchange for land		—	2,927
Gifts of capital assets		—	59
Pledges of operating and capital gifts		2,414	11,235
Capitalization of construction period interest		848	915

See accompanying notes to basic financial statements.

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

The accompanying basic financial statements present the financial position and activities of the University of South Alabama (the University), which is a component unit of the State of Alabama. The financial statements of the University are intended to present the financial position, changes in financial position and, where applicable, cash flows of only that portion of the basic financial statements and the aggregate discretely presented component units of the State of Alabama that is attributable to the transactions of the University.

The financial reporting entity, as defined by Governmental Accounting Standards Board (GASB) Statement No. 14, *The Financial Reporting Entity* and amended by GASB Statement No. 39, *Determining Whether Certain Organizations Are Component Units,* consists of the primary government and all of its component units. Component units are legally separate organizations for which the primary government is financially accountable and other organizations for which the nature and significance of their relationship with the primary government are such that exclusion would cause the financial statements to be misleading or incomplete. Accordingly, the basic financial statements include the accounts of the University, as the primary government, and the accounts of the following entities as component units.

The University has adopted GASB Statement No. 39 which provides criteria for determining whether certain organizations should be reported as component units based on the nature and significance of their relationship with the primary government. The statement also clarifies reporting requirements for those organizations. Based on these criteria as of September 30, 2007, the University reports the University of South Alabama Foundation (USA Foundation), the University of South Alabama Health Services Foundation (USAHSF), and the USA Research and Technology Corporation (the Corporation) as discretely presented component units. As of September 30, 2006, the University reported the USA Foundation and USAHSF as discretely presented component units.

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

(b) Professional Liability and General Liability Trust Funds

GASB Statement No. 14 requires the University, as the primary government, to include in its financial statements, as a component unit, organizations that, even though they are legally separate entities, meet certain requirements as defined by GASB Statement No. 14. The medical malpractice liability of the University is maintained and managed in a separate professional liability trust fund (the PLTF) in which the University and USAHSF are the only participants. In accordance with the bylaws of the trust fund, the president of the University is responsible for appointing members of the trust fund policy committee. Additionally, the general liability of the University is maintained and managed in a general liability trust fund (the GLTF) for which the University, as defined by

GASB Statement No. 14, is responsible. The PLTF and GLTF are separate legal entities which are governed by the University Board of Trustees through the University president. As such, PLTF and GLTF are reported as blended component units.

(c) University of South Alabama Foundation

The USA Foundation is a not-for-profit foundation that was organized for the purpose of promoting education, scientific research and charitable purposes, and to assist in developing and advancing the University in furthering, improving and expanding its properties, services, facilities, and activities. Because of the significance of the relationship between the University and the USA Foundation, the USA Foundation is considered a component unit of the University. The Board of Directors of the USA Foundation is not appointed or controlled by the University. The University receives distributions from the USA Foundation primarily for scholarship, faculty and other support. Total distributions received or accrued by the University for the years ended September 30, 2007 and 2006 were $7,011,000 and $5,996,000, respectively, and are primarily included in other nonoperating revenues and capital contributions and grants in the University's statements of revenues, expenses, and changes in net assets. The USA Foundation presents its financial statements in accordance with standards issued by the Financial Accounting Standards Board (FASB). The USA Foundation is reported in separate financial statements because of the difference in the financial reporting format since the USA Foundation follows FASB rather than GASB pronouncements. The USA Foundation has a June 30 fiscal year end which differs from the University's September 30 fiscal year end. In accordance with GASB Statement No. 14, this discretely presented unit has been included with the most recent fiscal year. The consolidated statements of financial position and the consolidated statements of activities and changes in net assets for the USA Foundation as of and for the years ended June 30, 2007 and 2006 are discretely presented following the statements of net assets and statements of revenues, expenses, and changes in net assets of the University.

(d) University of South Alabama Health Services Foundation

The USAHSF is a not-for-profit corporation that exists to provide a group medical practice for physicians who are faculty members of the University and to further medical education and research at the University. Because of the significance of the relationship between the University and USAHSF, USAHSF is considered a component unit of the University. The USAHSF reimburses the University for salaries, certain administrative expenses, Dean's clinical assessment and other support services. Total amounts received and accrued for such expenses were approximately $40,059,000 and $38,165,000 for the years ended September 30, 2007 and 2006, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net assets of the University. The USAHSF presents its financial statements in accordance with standards issued by the FASB. The statements of financial position and the statements of operations and changes in unrestricted net assets for the USAHSF for the years ended September 30, 2007 and 2006 are discretely presented following the statements of net assets and statements of revenues, expenses, and changes in net assets of the University.

(e) USA Research and Technology Corporation

The Corporation is a not-for-profit corporation that exists for the purpose of furthering the educational and scientific mission of the University by developing, attracting, and retaining technology and research industries in Alabama that will provide professional and career opportunities to the University's students and faculty. Because of the significance of the relationship between the University and the Corporation, the Corporation is considered a component unit of the University. The Corporation presents its financial statements in accordance with GASB.

(f) Measurement Focus and Basis of Accounting

For financial reporting purposes, the University is considered a special purpose governmental agency engaged only in business type activities, as defined by GASB Statement No. 34. Accordingly, the University's basic financial statements have been presented using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis, revenues are recognized when earned, and expenses are recorded when an obligation has been incurred.

The University prepares its basic financial statements in accordance with U. S. generally accepted accounting principles, as prescribed by GASB, including all applicable effective statements of the GASB and all statements of the FASB issued through November 30, 1989 that do not conflict with GASB pronouncements. The University has elected not to apply the provisions of any pronouncements of the FASB issued after November 30, 1989.

(g) Use of Estimates

The preparation of financial statements in conformity with U. S. generally accepted accounting principles requires that management make estimates and assumptions affecting the reported amounts of assets and liabilities, revenues and expenses, as well as disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

In particular, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs could change by a material amount in the near term.

(h) Cash and Cash Equivalents

Cash and cash equivalents are defined as petty cash, demand accounts and any short-term investments that take on the character of cash. These investments have maturities of less than three months and include repurchase agreements and money market accounts.

(i) Investments and Investment Income

Investments are recorded at fair value. The fair value of alternative investments (limited partnerships, private equity securities, etc.) do not have readily ascertainable market values and the University values these investments in accordance with valuations provided by the general partners or fund managers of the underlying partnership or companies. Because these investments are not marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investment existed. Investments received by gift are recorded at fair value at the date of receipt. Changes in the fair value of investments are reported in investment income.

(j) Accounts Receivable

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

(k) Inventories

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

(l) Capital Assets

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

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

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

Certain buildings are componentized for depreciation purposes.

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

During the year ended September 30, 2006, the University adopted GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. The implementation of this standard did not have a material impact on the University's basic financial statements.

(m) Deferred Revenue

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

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

(n) Classification of Net Assets

The University's net assets are classified as follows:

Invested in capital assets, net of related debt represents the University's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such debt is excluded from the calculation of *invested in capital assets, net of related debt.*

Restricted, nonexpendable net assets consist of endowment and similar type funds which donors or other outside sources have stipulated, as a condition of the gift instrument, the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may either be expended or added to principal.

Restricted, expendable net assets include resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, net patient service revenue, sales and services of educational activities and auxiliary enterprises. Auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff. While unrestricted net assets may be designated for specific purposes by action of management or the Board of Trustees, they are available for use at the discretion of the governing board, to meet current expenses for any purpose. Substantially all unrestricted net assets are designated for academic and research programs and initiatives, and capital programs.

When an expense is incurred that can be paid using either restricted or unrestricted resources, the University addresses each situation on a case-by-case basis prior to determining the resources to be used to satisfy the obligation.

(o) Scholarship Allowances and Student Financial Aid

Student tuition and fees, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statements of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the University and the amount that is paid by students and/or third parties making payments on the students' behalf. Certain governmental grants, such as Pell grants and other federal, state, or nongovernmental programs are recorded as either operating or nonoperating revenues in the University's basic financial statements based on their classification as either an exchange or nonexchange transaction. To the extent that revenues from such programs are used to satisfy tuition and fees and certain other student charges, the University has recorded a scholarship discount and allowance.

(p) Donor Restricted Endowments

The University is subject to the "Uniform Management of Institutional Funds Act (UMIFA)" of the Code of Alabama. This law allows the University, unless otherwise restricted by the donor, to spend net appreciation, realized and unrealized, on the endowment. The University's endowment spending policy provides that 5% of the three-year invested net asset moving average value (inclusive of net realized and unrealized gains and losses), as measured at September 30, is available annually for spending. The University's policy is to retain the endowment net interest and dividend income and net realized and unrealized appreciation with the endowment after distributions allowed by the spending policy have been made. These amounts, unless otherwise directed by the donor, are included in restricted, expendable net assets.

(q) Classification of Revenues

The University has classified its revenues as either operating or nonoperating revenues.

Operating revenues include activities that have the characteristics of exchange transactions such as student tuition and fees, net of scholarship discounts and allowances; sales and services of auxiliary enterprises, net of scholarship allowances; most federal, state, and local grants and contracts; and, net patient service revenue.

Nonoperating revenues include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other revenue sources such as state appropriations and investment income.

(r) Gifts and Pledges

Pledges of financial support from organizations and individuals representing an unconditional promise to give are recognized in the basic financial statements once all eligibility requirements, including time requirements, have been met. In the absence of such a promise, revenue is recognized when the gift is received. Endowment pledges generally do not meet eligibility requirements, as defined by GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions* and are not recorded as assets until the related gift has been received. Unconditional promises that are expected to be collected in future years are recorded at the present value of the estimated future cash flows.

(s) Grants and Contracts

The University has been awarded grants and contracts for which funds have not been received or expenditures made for the purpose specified in the award. These awards have not been reflected in the basic financial statements, but represent commitments of sponsors to provide funds for specific research or training projects. For grants that have allowable cost provisions, the revenue will be recognized as the related expenditures are made. For grants with work completion requirements, the revenue is recognized as the work is completed. For grants without either of the above requirements, the revenue is recognized as it is received.

(t) Net Patient Service Revenue

Net patient service revenue is reported at estimated net realizable amounts due from patients, third-party payers and others for healthcare services rendered, including estimated retroactive revenue adjustments due to future audits, reviews and investigations. Retroactive adjustments are considered in the recognition of revenue on an estimated basis in the period the related services are rendered and such amounts are adjusted in future periods, as adjustments become known or as years are no longer subject to such audits, reviews and investigations.

(u) Costs of Borrowing

Debt financing costs and bond premium and discounts are deferred and amortized using the straight-line method, which approximates the effective interest rate method, over the term of the related bond issue.

(v) Compensated Absences

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

(w) Reclassifications

Certain amounts in the 2006 basic financial statements have been reclassified in order to conform to the 2007 classification.

(2) Income Taxes

The University is classified as both a governmental entity under the laws of the State of Alabama and as a tax-exempt entity under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). Consistent with that designation, no provision for income taxes has been made in the accompanying basic financial statements.

In addition, the University’s discretely presented component units are tax-exempt entities under section 501(a) of the Internal Revenue Code as organizations described in section 501(c)(3). Consistent with that designation, no provision for income taxes has been made in the accompanying discretely presented financial statements.

(3) Cash

Pursuant to the Security for Alabama Funds Enhancement Act, funds on deposit may be placed in an institution designated as a qualified public depository (QPD) by the State of Alabama. QPD institutions pledge securities to a statewide collateral pool administered by the State Treasurer’s office. Such financial institutions contribute to this collateral pool in amounts proportionate to the total amount of public fund deposits at their respective institutions. The securities are held at the Federal Reserve Bank and are designated for the State of Alabama. Additional collateral was not required for University funds on deposit with QPD institutions. At September 30, 2007, the net public deposits subject to collateral requirements for all institutions participating in the pool totaled approximately $7,740,541,068. The University had cash and cash equivalents totaling $57,684,000 and $38,160,000 at September 30, 2007 and 2006, respectively.

(4) Investments

(a) University of South Alabama

The investments of the University are invested pursuant to the University of South Alabama "Nonendowment Cash Pool Investment Policies," the "Endowment Fund Investment Policy," and the "Derivatives Policy" (collectively referred to as the University Investment Policies) as adopted by the Board of Trustees. The purpose of the nonendowment cash pool investment policy is to provide guidelines by which pooled funds not otherwise needed to meet daily operational cash flows can be invested to earn a maximum return, yet still maintain sufficient liquidity to meet fluctuations in the inflows and outflows of University operational funds. Further, endowment fund investment policies exist to provide earnings to fund specific projects of the endowment fund, while preserving principal. The University Investment Policies require that management apply the "prudent person" standard in the context of managing its investment portfolio.

The investments of the blended component units of the University are invested pursuant to the separate investment policy of the PLTF and GLTF (the Trust Fund Investment Policy.) The objectives of the Trust Fund Investment Policy are to provide a source of funds to pay general and professional liability claims and to achieve long-term capital growth to help defray future funding requirements. Additionally, investments of the University's component units both blended and discretely presented are subject to UMIFA 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, 2007 and 2006 (in thousands).

	2007	2006
U.S. Treasury notes	$ 14,402	12,274
U.S. Federal agency notes	103,572	42,232
Commercial paper	100,554	92,600
Pooled equity mutual funds	35,938	23,964
Pooled debt mutual funds	12,710	2,116
Managed income alternative investments (limited partnerships, private equity securities and other)	10,532	6,318
Other	255	419
	$ 277,963	179,923

At September 30, 2007 and 2006, $5,182,000 and $2,957,000, respectively, of appreciation in fair value of investments of donor-restricted endowments was recognized and are included in restricted expendable net assets in the accompanying statements of net assets.

Credit Risk and Concentration of Credit Risk

The University Investment Policies limit investment in corporate bonds to securities with a minimum "A" rating, at the time of purchase, by both Moody's and Standard and Poor's. Investments in corporate paper are limited to issuers with a minimum quality rating of P-1 by Moody's, A-1 by Standard and Poor's or F-1 by Fitch.

Additionally, the University Investment Policies require that not more than 10% of the cash, cash equivalents and investments of the University be invested in the obligations of a single private corporation and not more than 35% of the cash, cash equivalents and investments of the University be invested in the obligations of a single government agency.

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

	Credit rating	% of total investments
Federal Home Loan Mortgage Corporation	AAA	16.4%
Federal Home Loan Bank Corporation	AAA	14.2
G. E. Capital Corporation	A-1+	10.7
UBS Finance	A-1+	9.0
AIG Funding Corporation	A-1+	7.7
Federal National Mortgage Association	AAA	6.2
American Express Credit Corporation	A-1	5.2
Common - Bond Fund	AA	4.6
Citigroup Funding, Inc.	A-1+	3.5
Federal Farm Credit Banks Funding Corporatioin	AAA	0.4
Government National Mortgage Association	AAA	0.1

(Continued)

The University's exposure to credit risk and concentration of credit risk at September 30, 2006 is as follows:

	Credit rating	% of total investments
Federal Home Loan Mortgage Corporation	AAA	13.9%
Citigroup Funding, Inc.	A1+	12.7
G. E. Capital Corporation	A-1	8.8
LaSalle Bank Corporation	A1+	6.7
Bear Stearns Company, Inc	A1+	6.0
American Express Credit Corporation	A1+	6.0
Federal National Mortgage Association	AAA	6.0
AIG Funding Corporation	A1+	5.5
Societe Generale	A1+	5.4
Federal Home Loan Bank Corporation	AAA	3.4
Common - Bond Fund	AA	1.2
Federal Farm Credit Banks Funding Corporatioin	AAA	0.2
Government National Mortgage Association	AAA	0.1

Interest Rate Risk

At September 30, 2007, the maturity dates of the University's debt investments were as follows (in thousands):

		Years to maturity			
	Fair value	Less than 1	1-5	6-10	More than 10
U.S. Treasury notes	$ 14,402	3,240	11,162	—	—
U.S. Federal agency notes	103,572	86,232	16,187	757	396
Commercial paper	100,554	100,554	—	—	—
Pooled debt mutual funds	12,710	—	—	12,710	—
	$ 231,238	190,026	27,349	13,467	396

At September 30, 2006, the maturity dates of the University's debt investments were as follows (in thousands):

		Years to maturity			
	Fair value	Less than 1	1-5	6-10	More than 10
U.S. Treasury notes	$ 12,274	4,767	7,507	—	—
U.S. Federal agency notes	42,232	28,218	13,186	731	97
Commercial paper	92,600	91,613	987	—	—
Pooled debt mutual funds	2,116	—	2,116	—	—
	$ 149,222	124,598	23,796	731	97

Because the debt mutual funds had a weighted average maturity of 6.5 and 5.2 years, the investments were presented in the 6-10 year and the 1-5 year maturity category at September 30, 2007 and 2006, respectively.

The University's Investment Policies do not specifically address the length to maturity on investments which the University must follow; however, they do require that the maturity range of investments be consistent with the liquidity requirements of the University.

Mortgage-Backed Securities

The University, from time to time, invests in mortgage-backed securities issued by the Government National Mortgage Association (GNMA) and the Federal National Mortgage Association (FNMA), agencies of the United States government. The University invests in these securities to increase the yield and return on its investment portfolio given the available alternative investment opportunities.

The fair value of mortgage-backed securities is generally based on the cash flows from principal and interest receipts on the underlying mortgage pools. These securities include collateralized mortgage obligations (CMOs). In CMOs, the cash flow from principal and interest payments from one or more mortgage pass-through securities or a pool of mortgages may be reallocated to multiple security classes with different priority claims and payment streams (commonly referred to as tranches). A holder of the CMO security thus chooses the class of security that best meets its risk and return objectives. CMOs are subject to significant market risk due to fluctuations in interest rates, prepayment rates and various liquidity factors related to their specific markets. There are no CMOs in the University's investment portfolio at September 30, 2007 or 2006.

At September 30, 2007, restricted investments consist of $73,181,000 related to unspent bond proceeds and $49,869,000 related to investments included in the PLTF and GLTF to pay insurance liability claims. At September 30, 2006, restricted investments consist of $10,852,000 related to unspent bond proceeds and $39,260,000 related to investments included in the PLTF and GLTF to pay insurance liability claims.

(b) University of South Alabama Foundation

Investments in securities consist primarily of marketable equity securities totaling $142,709,000 and $121,762,000, at June 30, 2007 and 2006, respectively.

Investment income was comprised of the following for the years ended June 30, 2007 and 2006 (in thousands):

		2007	2006
Unrealized gains	$	28,451	32,437
Realized gains		1,970	1,512
Timber sales		5,373	15,330
Interest and dividends		3,240	2,543
Rents		549	462
Royalties		149	280
	$	39,732	52,564

Investment related expenses in the amount of $339,000 and $335,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2007 and 2006 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2007 and 2006 consisted of the following property held (in thousands):

		2007	2006
Land and land improvements – held for investment	$	16,525	16,429
Building and building improvements – held for investment		5,588	5,072
		22,113	21,501
Less accumulated depreciation		3,319	3,096
	$	18,794	18,405

Depreciation expense on real estate available for rent and occupied was $223,000 and $245,000 in 2007 and 2006, respectively.

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

(5) Capital Assets

(a) University of South Alabama

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

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

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

During the year ended September 30, 2007, the University sold Buildings II and III in the USA Technology and Research Park to the Corporation for proceeds of approximately $11,986,000 and recognized a gain of approximately $2,638,000.

A summary of the University's capital asset activity for the year ended September 30, 2006 follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land	$ 23,886	3,746	895	(37)	28,490
Construction-in-progress	28,078	24,619	(6,907)	(119)	45,671
	51,964	28,365	(6,012)	(156)	74,161
Capital assets being depreciated:					
Land improvements	17,434	36	—	—	17,470
Buildings, fixed equipment, and infrastructure	285,604	1,838	5,029	(5,244)	287,227
Other equipment	96,066	4,626	983	(13,334)	88,341
Library materials	35,527	2,512	—	—	38,039
	434,631	9,012	6,012	(18,578)	431,077
Less accumulated depreciation for:					
Land improvements	(8,973)	(937)	—	—	(9,910)
Buildings, fixed equipment, and infrastructure	(154,524)	(7,518)	—	5,223	(156,819)
Other equipment	(66,075)	(8,333)	—	11,442	(62,966)
Library materials	(25,996)	(1,672)	—	—	(27,668)
	(255,568)	(18,460)	—	16,665	(257,363)
Capital assets being depreciated, net	179,063	(9,448)	6,012	(1,913)	173,714
Capital assets, net	$ 231,027	18,917	—	(2,069)	247,875

At September 30, 2006, the University had commitments of approximately $30,042,000 related to various construction projects.

(b) USA Research and Technology Corporation

Changes in capital assets for the year ended September 30, 2007 are as follows (in thousands):

	October 1, 2006	Additions	Transfers	Reductions	September 30, 2007
Land improvements	$ 1,524	306	(2)	—	1,828
Buildings	9,051	13,175	2	—	22,228
Other equipment	1	—	—	(1)	—
	10,576	13,481	—	(1)	24,056
Less accumulated depreciation for:					
Land improvements	(215)	(77)	—	—	(292)
Buildings	(660)	(557)	—	—	(1,217)
Other equipment	(1)	—	—	1	—
	(876)	(634)	—	1	(1,509)
Capital assets, net	$ 9,700	12,847	—	—	22,547

(6) Noncurrent Liabilities

A summary of the University's noncurrent liability activity for the years ended September 30, 2007 and 2006 follows (in thousands):

	2007					
	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Note payable	$ 2,871	—	(1,415)	1,456	1,456	—
Bonds payable	118,821	107,325	(27,991)	198,155	3,820	194,335
Capital lease payable	277	—	(89)	188	95	93
Total long-term debt	121,969	107,325	(29,495)	199,799	5,371	194,428
Other long-term liabilities	60,150	23,693	(25,281)	58,562	10,208	48,354
Total noncurrent liabilities	$ 182,119	131,018	(54,776)	258,361	15,579	242,782

	2006					
	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Note payable	$ 4,246	—	(1,375)	2,871	1,423	1,448
Bonds payable	122,887	1,397	(5,463)	118,821	5,476	113,345
Capital lease payable	—	284	(7)	277	90	187
Total long-term debt	127,133	1,681	(6,845)	121,969	6,989	114,980
Other long-term liabilities	51,224	26,029	(17,103)	60,150	11,910	48,240
Total noncurrent liabilities	$ 178,357	27,710	(23,948)	182,119	18,899	163,220

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

(7) Note and Bonds Payable

(a) University of South Alabama

Note Payable

Note payable consisted of the following at September 30, 2007 and 2006 (in thousands):

		2007	2006
Compass Bank limited obligation note, 2.743% payable through September 2008, unsecured	$	1,456	2,871

Bonds Payable

Bonds payable consisted of the following at September 30, 2007 and 2006 (in thousands):

		2007	2006
University Tuition Revenue Refunding Bonds, Series 1996, 3.80% to 5.00%, repaid in 2007	$	—	24,825
University Tuition Revenue Bonds, Series 1999 Current Interest, 3.70% to 4.35%, payable through November 2010		13,075	15,230
University Tuition Revenue Bonds, Series 1999 Capital Appreciation, 4.70% to 5.25%, payable November 2011 through November 2018		30,276	28,809
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2004, 2.00% to 5.00%, payable through March 2024		47,525	48,754
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2006, 5.00%, payable through December 2036		100,000	—
		190,876	117,618
Plus unamortized premium		8,566	2,074
Less unamortized discount		(75)	(370)
Less unamortized debt extinguishment costs		(1,212)	(501)
	$	198,155	118,821

Substantially all student tuition and fee revenues secure University bonds. Series 1996 Bonds began maturing November 2000, and were refunded from a portion of the proceeds of the Series 2006 Bonds. 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.

During the years ended September 30, 2007 and 2006, the maturity value of the Capital Appreciation Bonds increased $1,468,000 and $1,398,000, respectively, over the original principal amount of $19,810,000, reflecting accretion of interest.

During the year ended September 30, 2007, the University refunded the Series 1996 bonds with a portion of the proceeds from the issuance of the Series 1996 bonds. The 2006 refunding transaction resulted in an accounting loss totaling $924,000, which has been deferred and is being amortized using the straight-line method through 2016. Aggregate cash flows from the refunding date through contractual maturity of the Series 1996 bonds totals approximately $28,826,000, while aggregate cash flows from the portion of the refunding Series 2006 bonds applicable to the refunding totaled approximately $48,588,000 through the maturity date of the Series 2006 bonds, resulting in a negative net cash flow differential for the refunding of approximately $19,762,000. The economic gain (generally referred to as the present value of the net cash flow differential discounted at the effective interest rate of the new debt) on the 2006 refunding transaction totals approximately $1,328,000.

Approximately $0 and $12,362,000 of proceeds from the issuance of the Series 2004 Bonds remained unspent at September 30, 2007 and 2006, respectively. These amounts are included in restricted cash and cash equivalents ($0 in 2007 and $1,510,000 in 2006) and restricted investments ($0 in 2007 and $10,852,000 in 2006) on the statements of net assets and are restricted for capital purposes as outlined in the indenture.

Approximately $78,279,000 of proceeds from the issuance of the Series 2006 Bonds remained unspent at September 30, 2007 ($5,098,000 is included in restricted cash and cash equivalents and $73,181,000 is included in restricted investments in the 2007 statement of net assets) and are restricted for capital purposes as outlined in the indenture.

The University defeased certain indebtedness during 1978 and 1984 by depositing funds in escrow trust accounts sufficient to provide for the subsequent payment of principal and interest on the defeased indebtedness. Neither the assets of the escrow trust accounts nor the defeased indebtedness is included in the accompanying statements of net assets. The principal outstanding on all defeased issues was $9,040,000 at September 30, 2007.

The University is subject to restrictive covenants, primarily certain operating ratios and other restrictive covenants, related to certain note and bonds payable. At September 30, 2007, management believes the University was in compliance with such financial covenants.

(Continued)

Debt Service on Long-Term Obligations

Total debt service by fiscal year is as follows as of September 30, 2007 (in thousands):

	Debt service on bonds			Debt service on note		
	Principal	Interest	Additional maturity	Principal	Interest	Total
2008	$ 3,730	7,824	(1,544)	1,456	21	11,487
2009	4,410	7,644	(1,622)	—	—	10,432
2010	5,025	7,436	(1,705)	—	—	10,756
2011	4,650	7,220	(1,792)	—	—	10,078
2012	4,785	7,103	(1,708)	—	—	10,180
2013-2017	28,530	35,146	(6,166)	—	—	57,510
2018-2022	38,255	33,043	(477)	—	—	70,821
2023-2027	34,180	24,539	—	—	—	58,719
2028-2032	36,040	16,256	—	—	—	52,296
2033-2037	46,285	6,017	—	—	—	52,302
Subtotal	205,890	152,228	(15,014)	1,456	21	344,581
Plus (less):						
Additional maturity	(15,014)					
Unamortized bond premium	8,566					
Unamortized bond discount	(75)					
Unamortized debt extinguishment cost	(1,212)					
Total	$ 198,155					

The principal amount of debt service due on bonds at September 30, 2007 includes $15,014,000 representing additional maturity value on Series 1999 Capital Appreciation Bonds. These bonds mature in years 2011 through 2019 and are noninterest bearing. Although this additional maturity is presented as principal on the debt service schedule above, it is also recognized as interest expense on an annual basis in the University's financial statements as it accretes.

(b) University of South Alabama Foundation

In 1997, the Foundation financed the purchase of timber property through issuance of a variable rate note payable to Regions Bank. The note was repaid during the year ended June 30, 2006. Interest expense was approximately $401 for the year ended June 30, 2006.

On October 16, 2001, the Foundation entered into a five-year interest rate swap agreement with Regions Financial Corporation that effectively fixed the interest rate on the Foundation's note at 4.39%. This swap agreement was settled when the note to Regions was repaid. For the year ended June 30, 2006, the Foundation incurred interest expense of $25,000 on a notional amount approximating $11,333,000 and a gain of $101,000.

On April 17, 2003, the Foundation financed the purchase of an office building through issuance of a fixed rate unsecured note payable to AmSouth Bank at 4.55% per annum. This note was paid in full during the year ended June 30, 2006. Interest expense was approximately $23,000 for the year ended June 30, 2006.

(c) USA Research and Technology Corporation

Notes Payable

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

Whitney National Bank commercial mortgage note, 6.0%, payable through 2014	$	9,528
Wachovia Bank, N.A. construction loan convertible into promissory note, one-month LIBOR plus .85% (6.515% at September 30, 2007), payable through 2028		13,429
	$	22,957

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

The construction loan payable to Wachovia Bank, N.A. was incurred by the Corporation to acquire Buildings II and III of the USA Technology and Research Park and to provide funds for renovations and tenant finishing costs. The maximum amount that may be borrowed under the construction loan is $18,000,000. The loan is an interest-only loan until May 1, 2008, at which time the loan will be converted to a fully-amortizing promissory note with a twenty-year term. As is more fully described below, the Corporation entered into two derivative instruments, an interest rate cap of 6.1% on the construction loan and a “receive variable, pay fixed” type of interest rate swap on the promissory note which will yield a synthetic fixed interest rate of 6.1%. The construction loan and promissory note payable are secured by an interest in the ground lease with respect to the parcels of land on which Buildings II and III stand, an interest in Buildings II and III, an interest in tenant leases for Buildings II and III, and an interest in income received from rental of Buildings II and III**.** The University also entered into an agreement with Wachovia Bank, N.A. providing that, for a year in which the Corporation’s debt service coverage ratio is less than one to one, the University will pay the Corporation rent equal to the amount necessary to bring the ratio to one to one. At September 30, 2007, the Corporation’s management believes the Corporation was in compliance with its debt covenants.

Debt Service on Long-Term Obligations

At September 30, 2007, total debt service by fiscal year is as follows (in thousands):

		Principal	Interest	Total
2008	$	465	1,384	1,849
2009		731	1,367	2,098
2010		777	1,321	2,098
2011		826	1,271	2,097
2012		877	1,220	2,097
2013 – 2017		10,135	3,867	14,002
2018 – 2022		3,545	2,333	5,878
2023 – 2027		4,835	1,043	5,878
2028		766	18	784
Total	$	22,957	13,824	36,781

Derivative Transactions

On February 27, 2007, the Corporation entered into two derivative transactions with Wachovia Bank, N.A. The first transaction was an interest rate cap entered into in connection with the construction loan. The second transaction was a "receive variable, pay fixed" interest rate swap entered into in connection with the promissory note that will come into effect upon conversion of the construction loan into a promissory note on May 1, 2008.

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

Terms. The construction loan and the associated interest rate cap were entered into on July 17, 2007 and February 27, 2007, respectively. The interest rate cap will terminate on May 1, 2008 when the loan will be converted into a promissory note. The interest rate cap's notional amount is equal to the construction loan balance and is limited to a maximum of $18,000,000. The construction loan bears variable rate interest equal to the one-month London Interbank Offered Rate (LIBOR) plus .85%. When the variable rate exceeds 6.1%, the cap operates to cause the counterparty, Wachovia Bank, N.A., to pay the Corporation the difference between the variable rate and 6.1%. For the year ended September 30, 2007 the Corporation received $4,410 under the interest rate cap agreement, which is reflected as a reduction of interest expense.

The promissory note will come 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 will become 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, Wachovia Bank, N.A., a fixed payment of 6.1% and receives a variable payment of the one-month LIBOR rate plus .85%. Conversely, the loan bears interest at the one-month LIBOR rate plus .85%.

Fair value. The derivative transactions had fair values at September 30, 2007 as follows (in thousands):

Interest rate swap	$	(96)
Interest rate cap		18
Total	$	(78)

Credit risk. As of September 30, 2007, the Corporation was not exposed to credit risk on the derivatives because they had a net negative fair value. However, if interest rates change and the fair value of the derivatives become positive, the Corporation would have a gross exposure to credit risk in the amount of the derivatives' fair value. The counterparty was rated A+/A-1 by Standard & Poor's Ratings Services as of September 30, 2007.

Termination risk. The derivative contracts use the International Swaps and Derivatives Association, Inc. Master Agreement, which includes standard default and termination events, such as failure to make payments, breach of agreement, and bankruptcy. At September 30, 2007, no events of default or termination had occurred. If the derivatives are terminated, interest rate risk associated with the variable rate debt would no longer be hedged. Also, if at the time of termination the derivatives have a net negative fair value, the Corporation would be liable to the counterparty for a payment equal to the derivatives' fair value. To allow the Corporation the maximum flexibility to manage the utilization of Buildings II and III while at the same time providing protection for the counterparty, the Corporation granted the counterparty a $2,000,000 mortgage secured by an interest in the ground lease with respect to the parcel of land on which Building II stands, an interest in Building II, a security interest in Building II tenant leases and a security interest in income received from rental of Building II.

Derivative payments and hedged debt. As interest rates fluctuate, variable rate debt interest and net derivative payments will fluctuate. Using interest rates as of September 30, 2007, debt service requirements by fiscal year of the variable rate debt and net derivative payments, assuming current interest rates remain the same, are as follows (in thousands):

	Variable rate loan		Interest rate	
	Principal	**Principal**	**swap, net**	**Total**
2008	$ 114	807	6	927
2009	357	802	17	1,176
2010	379	780	16	1,175
2011	404	756	16	1,176
2012	430	731	15	1,176
2013 – 2017	2,599	3,213	66	5,878
2018 – 2022	3,545	2,286	47	5,878
2023 – 2027	4,835	1,021	21	5,877
2028	766	18	—	784
Total	$ 13,429	10,414	204	24,047

(8) Capital Lease Obligation

In September 2006, the University signed a three-year purchase agreement as a method of financing the purchase of certain computer equipment for the USA Hospitals.

Future minimum capital lease payments at September 30, 2007, are as follows (in thousands):

Year ending September 30:	
2008	$ 103
2009	95
	198
Less amounts representing interest	(10)
Net minimum lease payments	$ 188

(9) Net Patient Service Revenue

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

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

Medicare – Substantially all acute-care services rendered to Medicare program beneficiaries are paid at prospectively determined rates. These rates vary according to patient classification systems that are based on clinical, diagnostic, and other factors. Additionally, the Hospitals are reimbursed for both direct and indirect medical education costs (as defined), principally based on per-resident prospective payment amounts and certain adjustments to prospective rate-per-discharge operating reimbursement payments. The Hospitals generally are reimbursed for certain retroactively settled items at tentative rates, with final settlement determined after submission of annual cost reports by the Hospitals and audits by the Medicare fiscal intermediary. The cost report for the USA Medical Center has been audited through 2004. The 2005 cost report has been audited and settlement is pending. The cost report for USA Children's and Women's Hospital has been audited and settled through 2006. The cost report for USA Knollwood Hospital has been audited and settled through March 2006. Revenue from the Medicare program accounted for approximately 12% and 14% of the Hospitals' net patient service revenue for the years ended September 30, 2007 and 2006, respectively.

Blue Cross – Inpatient services rendered to Blue Cross subscribers are paid at a prospectively determined per diem rate. Outpatient services are reimbursed under a cost reimbursement methodology. For outpatient services, the Hospitals are reimbursed at a tentative rate with final settlement determined after submission of annual cost reports by the Hospitals and audits thereof by Blue Cross. The Hospitals' Blue Cross cost reports have been audited and settled for all fiscal years through 2006. Revenue from the Blue Cross program accounted for approximately 12% and 16% of the Hospitals' net patient service revenue for the years ended September 30, 2007 and 2006, respectively.

Medicaid – Inpatient services rendered to Medicaid program beneficiaries are reimbursed at all-inclusive prospectively determined per diem rates. Outpatient services are reimbursed based on an established fee schedule.

The Hospitals qualify as Medicaid essential providers and, therefore, also receive supplemental payments based on formulas established by the Alabama Medicaid Agency. There can be no assurance that the Hospitals will continue to qualify for future participation in this program or that the program will not ultimately be discontinued or materially modified.

Revenue from the Medicaid program accounted for approximately 42% and 33% of the Hospitals' net patient service revenue for the years ended September 30, 2007 and 2006, 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, 2007 and 2006 follows (in thousands):

		2007	2006
Gross patient service revenue	$	370,976	394,741
Less provision for contractual and other adjustments		97,998	118,230
Less provision for bad debts		67,641	75,138
	$	205,337	201,373

Changes in estimates related to prior cost reporting periods resulted in an increase of approximately $1,058,000 in net patient service revenue for the year ended September 30, 2007.

(10) Hospital Lease

(a) Background

In December 2005, the University and Infirmary Health System, Inc. (the Infirmary) entered into a Lease Agreement (the Lease) in which the University agreed to lease certain land, buildings and equipment at its USA Knollwood Hospital campus to the Infirmary. Assets leased include the Knollwood 124-bed acute care hospital, the Knollwood 191-bed long-term care acute hospital and, with the exception of four condominium units not owned by the University, four professional office buildings located on the Knollwood campus. Additional assets leased include significantly all of the equipment, fixtures, furnishings and other personal property of the University used in connection with the operation of the hospitals.

The lease was effective as of April 1, 2006 and extends fifty years through March 31, 2056 with an automatic renewal, for an additional forty-nine years, through March 31, 2105. The lease may be terminated after the initial fifty-year term by the Infirmary. Upon the expiration or termination of the lease, the assets, along with responsibility for the operation of such assets, will revert to the University and the University will pay the Infirmary, at fair market value, for any capital improvements to the assets.

Additionally, the lease may be terminated at any time, at the option of the Infirmary, in the event that a change in any law, statute, rule, or a regulation of any governmental or other regulatory body or any third-party payment program is deemed by the Infirmary to be significant. Significance is defined as anything that materially affects the operations, including financial and otherwise, of the hospital. If the Infirmary exercises this option, the University has the option of paying the Infirmary an amount equal to the fair market value of the capital improvements to the leased assets or selling the leased assets to the Infirmary for an amount equal to their fair market value. The University's management does not anticipate that this option will be exercised by the Infirmary.

(Continued)

Also in December 2005, and in connection with the lease, the University and Infirmary executed a promissory note, due in June 2006, in which the University agreed to pay the Infirmary $2,927,000, plus interest at an annual rate of 3.25%. This note was given in consideration for approximately 6.7 acres of land in the vicinity of the Mobile Infirmary Medical Center and the University of South Alabama Children's and Women's Hospital. The Mitchell Cancer Institute is currently being constructed on this property.

(b) Financial Considerations

The total amount of lease payments due the University was based on the fair market value of the assets, $32,418,000, as appraised in September 2005. The allocation of the appraised fair market value is $29,370,000 for the land and buildings and $3,048,000 for medical equipment, office furnishings and other equipment.

Upon execution of the lease, a partial lease prepayment in the amount of $7,418,000 was made by the Infirmary. This prepayment consisted of cash and a credit for the promissory note executed in consideration for the property as described above. The specific components of the prepayment were as follows:

Cash	$	4,460,000
Credit for promissory note		2,927,000
Interest on promissory note		31,000
	$	7,418,000

In addition to the prepayment, required lease payments by the Infirmary to the University are as follows:

- Years one through five of the initial lease term – $83,333 per month ($1,000,000 annually)
- Years six through ten of the initial lease term – $104,168 per month ($1,250,000 annually)
- Years eleven through fifteen of the initial lease term – $125,000 per month ($1,500,000 annually)
- Years sixteen through thirty of the initial lease term – The monthly payment will be the remaining unpaid balance of the lease payments amortized over years sixteen through thirty using an interest rate calculated from the immediately previous 15-year monthly average of the 20-year state and local tax exempt general obligation bond issues as determined by the United States Federal Reserve System. The remaining unpaid balance at the end of year fifteen, $17,401,000, is derived by taking the initial unpaid balance of rent due after the partial lease prepayment, $25,000,000 plus accrued interest at an annual rate of 3.75%, less monthly lease payments.
- Years thirty-one through fifty of the initial lease term – $1 annually
- Year fifty-one through ninety-nine of the extended lease term – $1 annually

For reporting purposes, management assumed that the interest rate utilized in years sixteen through thirty would remain at 3.75%. This assumption will be reviewed, and amortization schedules adjusted, if necessary, when the actual interest rate is determined.

(c) Financial Statement Presentation

As required by FASB Statement No. 13, related to leases involving both real property and equipment, the equipment component of the lease must be considered separately in determining whether or not the lease is a capital or an operating lease. As such, the University has bifurcated the lease into an equipment component and a real property component based on the appraised fair value of each such component. The financial considerations of the lease are then applied to, and the accounting treatment is determined for, each component based on this bifurcation.

Pursuant to FASB Statement No. 13, the equipment component of the lease is considered a capital lease (sales-type lease) and as such has been recorded as a capital lease receivable, both current and noncurrent, in the accompanying basic financial statements of the University. Equipment with a cost and accumulated depreciation of approximately $14,643,000 and $12,812,000, respectively, has been written off and a resulting gain on the sale of assets in the amount of $1,217,000 has been recognized in fiscal 2006. The capital equipment lease is being amortized over a five-year period at a fixed rate of 3.75%. Future receipts from this capital lease are expected as follows:

Year ending September 30:		
2008	$	515,000
2009		515,000
2010		515,000
2011		257,000
		1,802,000
Less amounts representing interest		(116,000)
Total capital lease receivable	$	1,686,000

The component of the lease attributable to land and buildings is considered an operating lease. As such, lease revenue will be recorded as it is earned over the ninety-nine year lease term (the fifty-year initial term and the forty-nine year automatic renewal term). The expected total lease payments to be received over the next twenty-nine years are approximately $40,551,000. These total receipts will be recognized as revenue in the amount of approximately $478,000 annually. Payments received in excess of this amount, along with cash and other consideration already received in the amount of $6,721,000, will be deferred and amortized over the ninety-nine year lease term.

(Continued)

(11) Employee Benefits

(a) Retirement and Pension Plans

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

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

All employees covered by this retirement plan must contribute 5% of their eligible earnings to TRS. An actuary employed by the TRS Board of Control establishes the employer-matching amount annually. During 2007, 2006 and 2005, the University made total contributions of $22,023,000, $18,468,000, and $15,758,000 (100% of the required contributions), respectively, to TRS on behalf of participants, which represents 9.36%, 8.17%, and 7.03%, respectively, of each participant's gross earnings. The University's payroll for all employees was approximately $264,021,000 and $254,325,000 in 2007 and 2006, respectively. Total payroll for University employees participating in the Teachers' Retirement System of Alabama was approximately $235,285,000 and $226,042,000 in 2007 and 2006, 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 $907,000 and $836,000 in 2007 and 2006, respectively, representing 427 and 441 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 $15,105,000 and $14,580,000 at

(Continued)

September 30, 2007 and 2006, respectively. No accrual is recognized for sick leave benefits since no terminal cash benefit is available to employees for accumulated sick leave.

(c) Other Postretirement Employee Benefits

In September 2003, the State of Alabama Legislature passed legislation that requires all colleges and universities to fund the healthcare premiums of its participating retirees. In prior years, such costs have been paid by the State. Beginning in October 2003, the University was assessed a monthly premium by the Public Education Employees' Health Insurance Plan (PEEHIP) based on the number of retirees in the system and an actuarially determined premium. During the years ended September 30, 2007 and 2006, the University's expense related to PEEHIP was $5,167,000 and $4,576,000, respectively.

(12) Risk Management

The University and USAHSF participate in the professional liability trust fund and the University participates in the general liability trust fund. Both funds are administered by an independent trustee. These trust funds are revocable and use contributions by the University and USAHSF, together with earnings thereon, to pay liabilities arising from the performance of its employees, trustees and other individuals acting on behalf of the University. If the trust funds are ever terminated, appropriate provision for payment of related claims will be made and any remaining balance will be distributed to the University and USAHSF in proportion to contributions made.

As discussed in note 1, the PLTF and GLTF are blended component units of the University, as defined by GASB Statement No. 14, and as such are included in the basic financial statements of the University for the years ended September 30, 2007 and 2006. 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 $1,296,000 and $1,257,000 in 2007 and 2006, 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, 2007 and 2006 for the PLTF, GLTF and health plan are summarized as follows (in thousands):

		2007	2006
Balance, beginning of year	$	35,854	34,485
Liabilities incurred and other additions		41,200	29,955
Claims, administrative fees paid and other reductions		(43,098)	(28,586)
Balance, end of year	$	33,956	35,854

(13) Other Related Party

SAMSF is a not-for-profit corporation that exists for the purpose of promoting education and research at the University. SAMSF reimburses the University for certain administrative expenses and other related support services. Total amounts received for such expenses were approximately $1,326,000 and $958,000 in 2007 and 2006, 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, 2007 and 2006, the University had been awarded approximately $48,103,000 and $49,102,000, respectively, in grants and contracts for which resources had not been received and for which reimbursable expenditures had not been made for the purposes specified. These awards, which represent commitments of sponsors to provide funds for research or training projects, have not been reflected in the accompanying basic financial statements as the eligibility requirements of the award have not been met. Advances include amounts received from grant and contract sponsors which have not been earned under the terms of the agreements and, therefore, have not yet been included in revenues in the accompanying basic financial statements. Federal awards are subject to audit by Federal agencies. The University's management believes any adjustment from such audits will not be material.

(b) Letter of Credit

In connection with the Hospitals' participation in the State of Alabama Medicaid Program, the University has established a $1,400,000 irrevocable standby letter of credit with Wachovia Bank. The Alabama Medicaid Agency is the beneficiary of this letter of credit. No funds were advanced under this letter during the years ended September 30, 2007 and 2006.

(c) Litigation

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

In December 1999, the University and the State of Alabama entered into an "Agreement to Dismiss Litigation." This agreement called for the dismissal of the University's pending lawsuit against tobacco manufacturers in return for the payment of $20,000,000 from the State to the University. The timing of the receipt of these funds is subject to availability. The payment is to be made over a period of not more than ten years. Pursuant to a separate agreement, 14% of all funds received are to be paid to the attorneys who represented the University in the litigation. At September 30, 2007, $2,000,000 related to this settlement has been received and was recognized as state appropriations in prior years. Additionally, $2,500,000 related to the settlement has been allocated to the University by the Alabama Public School and College Authority, all of which has been expended by the University as of September 30, 2007. Accordingly, $15,500,000 of the original amount remained unpaid at

September 30, 2007. At September 30, 2007, the $15,500,000 has not been recorded in the University's basic financial statements because it is considered to be a contingent asset in accordance with FASB Statement No. 5.

(d) Rent Supplement Agreement

During the 2007 fiscal year, the University entered into an irrevocable rent supplement agreement with the Corporation and a financial institution. The agreement requires 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 7(c)). As of September 30, 2007, no amounts were payable pursuant to this agreement.

(e) 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 ten-year initial term with two five-year renewal options. Under the lease, the tenant must also pay, or reimburse to the Corporation for expenses paid by the Corporation, property taxes on the building, common area maintenance, utilities, and general liability and property damage insurance. In 2009, the lease calls for a one-time increase in monthly rent of 4%. For the lease year beginning on November 1, 2007, after providing a one-year advance notice, the tenant had the option to terminate up to 5% of the square footage covered under the lease. Such advance notice was not received by November 1, 2006. Beginning on November 1, 2008, after providing a one-year advance notice, the tenant has the annual non-cumulative option to terminate up to 10% of the square footage covered under the lease. Such advance notice was not received by November 1, 2007.

Space in Buildings II and III is leased under operating leases to the University and various other tenants. 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 five years, and were acquired by the Corporation from the University as part of the acquisition of Buildings II and III.

During the year ended September 30, 2006, the Corporation entered into two ground leases. One lease is for a forty-year initial term with twenty-year and fifteen-year renewal options. The second lease is for a thirty-year initial term with four five-year renewal options. The Corporation began receiving revenue from these leases during the year ended September 30, 2007.

Minimum future rentals by fiscal year are as follows (in thousands):

2008	$	2,594
2009		2,599
2010		2,521
2011		2,422
2012		2,072
2013 – 2046		5,146
Total	$	17,354

(15) Functional Information

Operating expenses by functional classification for the years ended September 30, 2007 and 2006 are listed below (in thousands). In preparing the basic financial statements, all significant transactions and balances among accounts have been eliminated.

		2007	2006
Instruction	$	104,904	91,832
Research		20,224	19,828
Public service		42,140	46,677
Academic support		11,901	16,546
Student services		20,653	17,348
Institutional support		26,913	20,193
Operation and maintenance of plant		18,804	15,552
Scholarships		1,218	735
Hospital		194,336	198,590
Auxiliary enterprises		15,576	14,577
Depreciation		19,059	18,460
Other		5,234	2,277
	$	480,962	462,615

(16) Significant New Accounting Pronouncements

In June 2004, the GASB issued Statement No. 45, *Accounting and Financial Reporting by Employers for Post Employment Benefits (OPEB) other than Pensions.* GASB Statement No. 45 establishes standards for the measurement, recognition and disclosure of OPEB expenses and related liabilities and is effective for the University for the year ending September 30, 2008. In September 2006, the GASB issued Statement No. 48, *Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfer of Assets and Future Revenues*. GASB Statement No. 48 establishes criteria governing whether proceeds received from the sale or pledge of receivables should be reported as revenue or as a liability and will be effective for the year ending September 30, 2008. In November 2006, the GASB issued Statement No. 49, *Accounting and Financial Reporting for Pollution Remediation Obligations.* GASB Statement No. 49 addresses accounting and reporting standards for pollution remediation obligations, which are obligations with respect to current operations and will be effective for the year ending September 30, 2009. In May 2007, GASB issued Statement No. 50, *Pension Disclosures*. GASB Statement No. 50 establishes standards for disclosure in notes to financial statements related to pension plans and will be effective for the year ending September 30, 2008. In June 2007, GASB issued Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*. GASB Statement No. 51 requires that certain intangible assets be classified and reported as capital assets and will be effective for the year ending September 30, 2010.

The effect of the implementation of GASB Statements Nos. 45, 48, 49, 50 and 51 on the University has not been determined.

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

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2007

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number	Federal expenditures
Student Financial Aid Cluster*:		
U.S. Department of Education:		
Federal Pell Grant Program	84.063	$ 8,394,076
Federal Supplemental Educational Opportunity Grant Program	84.007	717,275
Federal Family Educational Loan Program	84.032	57,646,805
Federal College Work Study Program	84.033	360,134
Federal Perkins Loan Program	84.038	678,000
Academic Competitiveness Grant	84.375	136,263
National Science and Mathematics Access to Retain Talent Grant	84.376	218,422
Total U.S. Department of Education		68,150,975
Total Student Financial Aid Cluster		68,150,975
Research and Development Cluster*:		
Direct programs:		
U.S. Department of Health and Human Services:		
Food and Drug Administration Research	93.103	(367)
Biological Response to Environmental Health Hazard	93.113	319,407
Research Related to Deafness and Communicative Disorders	93.173	216,737
Centers for Disease Control and Prevention – Investigations and Technical Assistance	93.283	(9,477)
Comparative Medicine	93.306	168,951
Minority Health and Health Disparities Research	93.307	431,829
International Research and Research Training	93.989	18,621
Cancer Cause and Prevention Research	93.393	318,701
Cancer Detection and Diagnosis Research	93.394	121,318
Cancer Treatment Research	93.395	35,359
Cancer Biology Research	93.396	238,805
Allergy, Immunology and Transplantation	93.855	406,334
Heart and Vascular Disease Research	93.837	1,014,760
HIV Demonstration Program for Children	93.153	7,605
Health Activities Recommendation Panel	93.203	77,032
Lung Disease Research	93.838	4,182,724
Diabetes Endocrinology and Metabolism Research	93.847	46,052
Pharmacology, Physiology and Biological Chemistry	93.859	50,541
Extramural Research Programs in Neurosciences and Neurological Disorders	93.853	305,193
Mental Health Research Grants	93.242	(28,395)
Microbiology and Infectious Diseases Research	93.856	1,311,571
National Center for Research Resources	93.389	1,018,624
Aging Research	93.866	14,458
Vision Research	93.867	36,947
Specially Selected Health Projects	93.888	201,518

(Continued)

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2007

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number		Federal expenditures
National Science Foundation:			
Mathematical and Physical Sciences	47.049	$	485,140
Geosciences	47.050		220,995
Engineering Grants	47.041		44,135
Biological Sciences	47.074		60,335
Social, Behavioral, and Economic Sciences	47.075		(4,180)
Polar Programs	47.078		71,720
National Aeronautics and Space Administration:			
Technology Transfer	43.002		698,716
Environmental Protection Agency:			
Office of Research and Development Consolidated	66.511		848,376
U.S. Department of Commerce:			
Habitat Conservation	11.463		1,650,773
Cooperative Institute for Applied Meteorological Studies	11.468		812,567
U.S. Department of Defense:			
Basic Scientific Research	12.431		336
Military Medical Research and Development	12.420		185,474
U.S. Department of Energy:			
Basic Energy Sciences University and Science	81.049		30,966
U.S. Department of Transportation:			
Highway Planning and Construction	20.205		268,148
University Transportation Centers Program	20.701		71,252
U.S. Department of Interior:			
National Cooperative Geologic Mapping Program	15.810		2,727
Conservation Grants Private Stewardship for Imperiled Species	15.632		236
U.S. Department of Justice:			
Developing, Testing and Demonstrating Promising New Programs	16.541		745,851
Part D - Research, Evaluation, Technical Assistance and Training	16.542		(4,069)
Total direct programs			16,694,346

(Continued)

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2007

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number		Federal expenditures
Pass-through programs:			
Pass-through from National Institutes of Health:			
Sequella, Inc.	93.371	$	(1,659)
Mallard Medical, Inc.	93.838		(10,832)
Alabama Department of Public Health	93.283		11,597
Columbia University	93.242		108,645
Duke University Medical Center	93.395		307
Duke University Medical Center	93.856		75,394
University of Colorado	93.838		142,868
M. D. Anderson Cancer Center	93.389		325,868
University of Alabama Birmingham	93.113		26,173
University of Miami	93.853		3,975
University of Texas	93.855		93,281
Westat, Inc.	93.395		(10,393)
Yale University	93.853		82,725
Rockefeller University	93.839		10,670
Emory University	93.839		(993)
PR Rho, Inc	93.839		43,293
National Childhood Cancer Foundation	93.395		8,625
University of Texas	93.853		54,494
University of Alabama at Birmingham	93.856		34,038
Pass-through from National Science Foundation:			
University of Georgia	47.074		16,293
University of Alabama in Huntsville	47.076		70,727
Tuskegee University	47.076		74,274
Bigelow Laboratory for Ocean Sciences	47.078		87,755
Pass-through from National Aeronautics and Space Administration:			
University of Alabama in Huntsville	43.002		18,941
University of Mississippi	43.002		12,135
Pass-through from U.S. Veterans Administration			
Civil Consultants, Inc.	64.201		21,681
Pass-through from U.S. Department of Commerce:			
Alabama Department of Conservation and Natural Resources	11.419		23,131
Pass-through from U.S. Department of Interior:			
Alabama Department of Conservation and Natural Resources	15.605		7,572
Louisiana State University	15.231		10,271
Prince William Sound Science Center	15.630		8,946
Pass-through from U.S. Department of Transportation:			
Volkert and Associates, Inc.	20.205		21,984
Kilgore Consulting Management	20.215		18,733

(Continued)

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2007

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number		Federal expenditures
Pass-through from U.S. Department of Energy:			
Lawrence Livermore National Laboratory	81.108	$	1,980
Radiance Technologies, Inc.	81.049		183,211
Pass-through from Environmental Protection Agency:			
Mobile Water and Sewer Service	66.606		31,991
Pass-through from Exxon Valdez Oil Spill Trustee Council:			
Prince William Sound Science Center	04.03-PWSSC-01		36,422
Prince William Sound Science Center	04.PWSSC-05		(1,570)
Pass-through from U.S. Department of Defense:			
Trinity University	12.800		12,840
Aerostart Environmental Services, Inc.	15.224		3,392
Radiance Technologies, Inc.	12.630		(6,082)
Auburn University	12.431		1,050
Pass-through from U.S. Department of Justice:			
Mobile Children's Policy Council	16.585		13,072
Pass-through from National Oceanographic and Atmospheric Association			
University of Alabama in Huntsville	11.472		12,567
Total pass-through programs			1,679,392
Total Research and Development Cluster			18,373,738
Other federal assistance:			
Direct programs:			
U.S. Department of Education:			
TRIO Talent Search	84.044		274,471
TRIO Upward Bound	84.047		173,048
Transition to Teaching	84.350		150,322
U.S. Department of Health and Human Services:			
Maternal and Child Health Federal Consolidated Programs	93.110		56,787
Advanced Education Nursing Grant Programs	93.247		2,399,088
HIV Demonstration Program for Children	93.153		317,595
Basic Nurse Education and Practice Grants	93.359		369,435
U.S. Department of Energy:			
Basic Energy Sciences University and Science	81.049		463,552
U.S. Department of Housing and Urban Development:			
Community Development Block Grants	14.246		1,191,237

(Continued)

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2007

Federal grantor/pass-through grantor/ program or cluster title	Federal CFDA number		Federal expenditures
Health Resources and Services Administration:			
Grants for Residency Training for General Pediatrics	93.884	$	223,806
Specially Selected Health Projects	93.888		(2,008)
Telehealth Network Grants	93.211		(50,065)
Professional Nurse Traineeships	93.358		287,305
Healthcare and Other Facilities	93.887		6,365,872
National Science Foundation:			
Education and Human Resources	47.076		58,577
Geosciences	47.050		330
Biological Sciences	47.074		106,575
U.S. Department of Justice:			
Drug Control and System Improvement Formula Grant	16.579		13,248
U.S. Department of Transportation:			
National Motor Carrier Safety	20.218		544,512
Federal Transit – Capital Investment Grants	20.500		93,623
Total direct programs			13,037,310
Pass-through programs:			
Pass-through from U.S. Department of Education:			
Alabama Department of Education	84.027		20,000
Alabama Department of Education	84.323		57,812
Alabama Department of Education	84.357		52,424
Alabama Department of Education	84.366		62
Auburn University	84.287		17,388
Alabama Commission of Higher Education	84.367		188,192
National Writing Project	84.928		58,453
Pass-through from NASA:			
Alabama Department of Education	43.002		4,949
University of Alabama in Huntsville	43.002		29,324
Pass-through from National Institutes of Health;			
Mayo Foundation for Medical Research	93.853		54
SEA National Network of Libraries	93.879		628
Moorehouse School of Medicine	93.004		37,969
University of Maryland Baltimore	93.879		5,657
University of Pittsburg	93.853		1,446
Pass-through from National Science Foundation:			
University of Alabama at Birmingham	47.076		99

(Continued)

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

Schedule of Expenditures of Federal Awards

Year ended September 30, 2007

Federal grantor/pass-through grantor/ program or cluster title	**Federal CFDA number**	**Federal expenditures**
Pass-through from Small Business Administration:		
University of Alabama at Birmingham	59.037	117,628
Pass-through from U.S. Department of Justice:		
Alabama Department of Public Safety	16.579	11,052
Pass-through from States Administration on Aging:		
South Alabama Regional Planning Commission	93.051	10,081
Pass-through from Office of National Drug Control:		
Alabama Department of Public Health	16.579	9,922
Pass-through from Administration for Children and Families:		
University of Alabama	93.658	47,301
Pass-through from Health Resources Services Administration:		
Alabama Department of Public Safety	93.289	291,079
Alabama Department of Public Health	93.003	111,718
Alabama Department of Public Health	93.251	7,500
Alabama Department of Public Health	93.289	146,350
Alabama Department of Public Health	93.926	10,000
Mobile County Department of Health	93.283	4,443
Florida State Universitiy	93.969	26,024
Northrup Grumman Information Technology	93.243	195,574
Pass-through from U.S. Department of Defense:		
University of Alabama Birmingham	12.002	17,670
Total pass-through programs		1,480,799
Total other federal assistance		14,518,109
Total federal expenditures		$ 101,042,822

* Denotes major program.

See accompanying notes to schedule of expenditures of federal awards.

See accompanying independent auditors' report on supplementary information.

(1) Basis of Presentation

The accompanying schedule of expenditures of federal awards includes the federal grant activity of University of South Alabama (the University) and is presented in accordance with U.S. generally accepted accounting principles. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

Expenditures listed on the accompanying schedule of expenditures of federal awards, except for Perkins Loans, Federal Family Educational Loan (FFEL) Programs, Parent Loans-PLUS loans, Loans to Disadvantaged Students and Health Education Assistance Loans (HEAL), represent actual expenditures incurred under the accrual basis of accounting for the year ended September 30, 2007. The loan programs representing loans made by the University are included in notes receivable in the accompanying 2007 statement of net assets and consist of the following:

Perkins loan program	$	4,673,997
Loans to disadvantaged students		1,921
Health professional loans		129,862
		4,805,780
Less outstanding balance of loans granted in previous years		(4,127,780)
New loans granted to eligible students of the University	$	678,000

The FFEL and HEAL federal awards represent loans received by students of the University during fiscal year 2007 which were not made by the University. Accordingly, FFEL and HEAL amounts are not reflected in the University's basic financial statements.

(2) Contingencies

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

(3) Federal Family Education Loan Programs

During fiscal year ended September 30, 2007, the University processed the following amount of new loans under the Federal Family Education Loan Program:

	CFDA #		Amount expended
Subsidized Stafford loans	84.032	$	23,977,221
Unsubsidized Stafford loans	84.032		30,471,724
Parents' loans for undergraduate students	84.032		3,197,860
Total		$	57,646,805

(Continued)

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

Notes to Schedule of Expenditures of Federal Awards

September 30, 2007

(4) Administrative Cost Allowance

The accompanying schedule of expenditures of federal awards includes administrative costs for the College Work Study program of $114,785.

(5) Subrecipients

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

	Federal CFDA #		Amounts expended
Direct programs:			
Habitat Conservation	11.463	$	391,661
National Motor Carrier Safety	20.218		7,380
Environmental Protection Comprehensive Research Grants	66.511		428,122
Biological Response to Environmental Health Hazard	93.113		8,032
Coordinated HIV Services and Access to Research for Children, Youth, Women, and Families	93.153		7,162
Highway Planning and Construction	20.205		83,601
Technology Transfer	43.002		186,544
Mathematical and Physical Sciences	47.049		91,859
Transition to Teaching	84.350		12,000
International Research and Research Training	93.989		38,958
Cancer Biology Research	93.396		6,187
Advanced Education Nursing Grant Programs	93.247		2,525
Pass-through programs:			
U.S. Department of Health and Human Services/ Northrup Grumman Information Technology	93.243		99,769
Health Resources and Services Administration/Alabama Department of Public Health	93.926		10,000
U.S. Department of Energy/Radiance Technologies, Inc.	81.049		116,546
U.S. Department of Education/Alabama Commission of Higher Education	84.367		67,621
		$	1,557,967

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Independent Auditors' Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Trustees
University of South Alabama:

We have audited the basic financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units as of and for the year ended September 30, 2007, and have issued our report thereon dated November 15, 2007. We did not audit the 2007 consolidated financial statements of the University of South Alabama Foundation, which represents 84%, 99% and 37%, respectively, of the 2007 assets, net assets and revenues of the aggregate discretely presented component units. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the University of South Alabama Foundation, is based on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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

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Compliance and Other Matters

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

We noted certain matters that we report to management of the University in a separate letter dated November 15, 2007.

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

KPMG LLP

November 15, 2007

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Independent Auditors' Report on Compliance With Requirements Applicable to Each Major Program and on Internal Control Over Compliance in Accordance with OMB Circular A-133

The Board of Trustees
University of South Alabama:

Compliance

We have audited the compliance of the University of South Alabama (the University) with the types of compliance requirements described in the U. S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* (Compliance Supplement) that are applicable to each of its major federal programs for the year ended September 30, 2007, except the requirements discussed in the second paragraph of this report. The University's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts and grants applicable to each of its major federal programs is the responsibility of the University's management. Our responsibility is to express an opinion on the University's compliance based on our audit.

We did not audit the University's compliance with requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan program in accordance with the requirements of the Student Financial Assistance Cluster: Federal Perkins Loan program as described in the Compliance Supplement. Those requirements govern functions performed by Affiliated Computer Services, Inc. (ACS). Since we did not apply auditing procedures to satisfy ourselves as to compliance with those requirements, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on compliance with those requirements. ACS's compliance with the requirements governing the functions that it performs for the University for the year ended September 30, 2007 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, *Audits of States, Local Governments, and Non-Profit Organizations.* Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements described in the U.S. Office of Management and Budget (OMB) *Circular A-133 Compliance Supplement* that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the University's compliance with those requirements.

In our opinion, the University complied, in all material respects, with the requirements referred to in the first paragraph above that are applicable to each of its major federal programs for the year ended September 30, 2007. However, the results of our auditing procedures disclosed instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 2007-01 and 2007-02.

Internal Control Over Compliance

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

Requirements governing maintaining contact with and billing borrowers and processing deferment and cancellation requests and payments for the Federal Perkins Loan program in the Student Financial Assistance Cluster: Federal Perkins Loan program as described in the Compliance Supplement are performed by ACS. Internal control over compliance related to such functions for the year ended September 30, 2007 was reported on by accountants in accordance with the U.S. Department of Education's Audit Guide, *Audits of Federal Student Financial Assistance Programs at Participating Institutions and Institution Servicers.* Our report does not include the results of the other accountants' testing of the University's internal control over compliance related to such functions.

A control deficiency in an entity's internal control over compliance exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect noncompliance with a type of compliance requirement of a federal program on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to administer a federal program such that there is more than a remote likelihood that noncompliance with a type of compliance requirement of a federal program that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

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

The University's response to the findings identified in our audit are described in the accompanying schedule of findings and questioned costs. We did not audit the University's response, and accordingly, we express no opinion on it.

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

KPMG LLP

November 15, 2007

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

Schedule of Findings and Questioned Costs

Year ended September 30, 2007

I – Summary of Auditor's Results

Financial Statements

Type of auditors' report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	____ yes _x_ no
Significant deficiency(ies) identified that are: not considered to be material weaknesses?	____ yes _x_ none reported
Noncompliance material to financial statements noted?	____ yes _x_ no

Federal Awards

Internal control over major programs:	
Material weakness(es) identified?	____ yes _x_ no
Significant deficiency(ies) identified that are: not considered to be material weaknesses?	____ yes _x_ none reported
Type of auditors' report issued on compliance for major programs:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	_x_ yes ____ no

Identification of major programs:

CFDA Numbers	Name of Federal Program Cluster
84.063, 84.007, 84.032, 84.033, 84.038, 84.375, 84.376	Student Financial Aid Cluster
Various	Research and Development Cluster

Dollar threshold used to distinguish between type A and type B programs:	$3,000,000
Auditee qualified as low-risk auditee?	_x_ yes ____ no

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.*

(Continued)

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

Finding No. 2007-01 Subrecipient Monitoring

Research and Development Cluster

Federal Agencies:

Department of Commerce (DOC), Environmental Protection Agency (EPA)

CFDA Numbers:

11.463, 66.511

Programs:

Educational Outreach Component (11.463), Predicting Seagrass Survival in Nutrient Enriched Waters: Toward a New View of an Existing Paradigm (66.511), Survey of Diamondback Terrapin Populations in Alabama Estuaries (66.511)

Award Numbers:

NA17FZ2602-A2-09 (11.463), R-83065101-0-07 (66.511), R-83065101-1-01 (66.511)

Award Years:

10/01/04 to 08/31/07 (11.463), 01/01/03 to 12/31/06 (66.511), 08/01/04 to 10/31/06 (66.511)

Criteria

OMB Circular A-110 requires that CFDA numbers associated with originating grant agreements be formally communicated to pass-through entities in the subrecipient agreement.

Condition

The University did not state the correct CFDA number on the subrecipient agreement for three of the subrecipient agreements tested.

Questioned Costs

None

Context

Of the thirty-two subrecipient agreements tested, there were three exceptions. Audit procedures were performed on 100% of the subrecipient agreements of the University.

Effect

The University is not in compliance with federal policies regarding proper inclusion of CFDA numbers in subrecipient agreements.

Recommendation

The University should strengthen the review process of all new subrecipient agreements before they are processed and sent to the subrecipients.

Management Views

Management concurs with the finding. Management will strengthen the procedures to ensure that at least two people review and approve each subrecipient agreement to make sure it includes the correct CFDA number before the agreement is executed.

Finding No. 2007-02 Reporting

Research and Development Cluster

Federal Agencies:

Environmental Protection Agency (EPA), Department of Health and Human Services (HHS)

CFDA Numbers:

66.511, 93.855

Programs:

Alabama Center for Estuarine Studies (66.511), Permeability of the Epidemic Typhus Rickettsia (93.855)

Award Numbers:

R830651-02 (66.511), 5 R01 A1015035-30 Revised (93.855)

Award Years:

11/01/06 to 10/31/07 (66.511), 01/01/07 to 12/31/07 (93.855)

Criteria

OMB Circular A-133 requires timely submission of required reports.

Condition

The University did not file three of the required quarterly SF-272 reports timely.

Questioned Costs

None

Context

Of the quarterly reports filed by the University, three of the sixteen quarterly reports tested were late. All other reports tested were filed on a timely basis.

Effect

The University is not in compliance with federal policies regarding timely submission of required reports.

Recommendation

The University should establish policies and procedures to ensure timely submission of reports.

Management Views

Management concurs with the finding. Management feels that there are adequate controls in place to ensure timely reporting. CFDA number 66.511 only allows 15 days to file the report. This specific grant is complex with numerous sub-grants. Given the time of the fiscal period close, filing this report on a timely basis is extremely difficult. In the instances noted, the reports were filed less than five days late. CFDA number 93.855 was filed one day late.