

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

Table of Contents

	Page
Management's Discussion and Analysis (Unaudited)	1
Independent Auditors' Report on Basic Financial Statements and Schedule of Expenditures of Federal Awards	11
Basic Financial Statements:	
Statements of Net Assets – University of South Alabama, September 30, 2007 and 2006	13
Consolidated Statements of Financial Position – University of South Alabama Foundation, June 30, 2007 and 2006	14
Statements of Financial Position – University of South Alabama Health Services Foundation, September 30, 2007 and 2006	15
Statement of Net Assets – USA Research and Technology Corporation, September 30, 2007	16
Statements of Revenues, Expenses, and Changes in Net Assets – University of South Alabama, years ended September 30, 2007 and 2006	17
Consolidated Statement of Activities and Changes in Net Assets – University of South Alabama Foundation, year ended June 30, 2007	18
Consolidated Statement of Activities and Changes in Net Assets – University of South Alabama Foundation, year ended June 30, 2006	19
Statements of Operations and Changes in Net Assets – University of South Alabama Health Services Foundation, years ended September 30, 2007 and 2006	20
Statement of Revenues, Expenses and Changes in Net Assets – USA Research and Technology Corporation, year ended September 30, 2007	21
Statements of Cash Flows – University of South Alabama, years ended September 30, 2007 and 2006	22
Notes to Basic Financial Statements	24
Schedule of Expenditures of Federal Awards, year ended September 30, 2007	57
Notes to Schedule of Expenditures of Federal Awards	63
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 <i>Government Auditing Standards</i>	65

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	67
Schedule of Findings and Questioned Costs – year ended September 30, 2007	70

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

Management's Discussion and Analysis (Unaudited)

September 30, 2007 and 2006

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.

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

Management's Discussion and Analysis (Unaudited)

September 30, 2007 and 2006

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

Condensed Schedule of Net Assets

	<u>2007</u>	<u>2006</u>	<u>2005</u>
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	<u>707,687</u>	<u>545,649</u>	<u>485,986</u>
Liabilities:			
Current	80,389	71,071	72,834
Noncurrent	242,782	163,220	157,196
Total liabilities	<u>323,171</u>	<u>234,291</u>	<u>230,030</u>
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	<u>\$ 384,516</u>	<u>311,358</u>	<u>255,956</u>

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 OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Management's Discussion and Analysis (Unaudited)
September 30, 2007 and 2006

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

Total University Assets

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Management's Discussion and Analysis (Unaudited)
September 30, 2007 and 2006

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

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

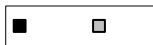
Management's Discussion and Analysis (Unaudited)

September 30, 2007 and 2006

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



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

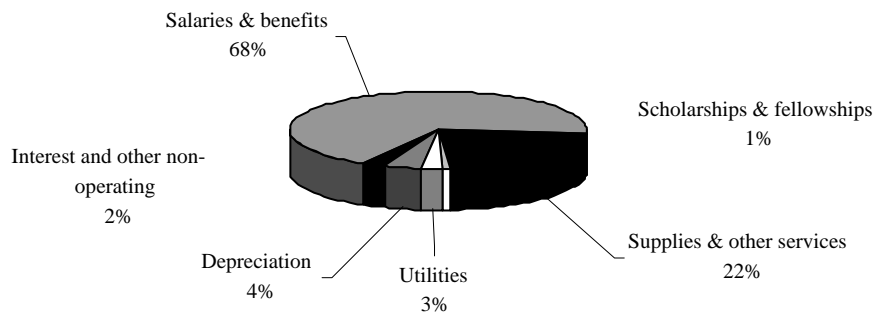
Management's Discussion and Analysis (Unaudited)

September 30, 2007 and 2006

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.

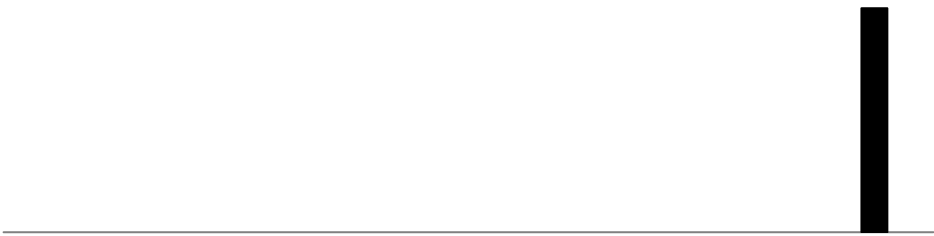
Total Expenses



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.



UNIVERSITY OF SOUTH ALABAMA





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188 East Capitol Street
Jackson, MS 39201

**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 ats esponsibility i.42..148 Td()Tjb at2rdit 15tor

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
 (Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2007 and 2006

(In thousands)

	Assets	
Cash and cash equivalents	_____	_____
Investments:		
Securities, at fair value		
Timber and mineral properties		
Real estate		
Other		
Other assets	_____	_____
Total assets	=====	=====
Liabilities and Net Assets		
Liabilities:		
Accounts payable		
Contributions payable to the University of South Alabama		
Other liabilities	_____	_____
Total liabilities	_____	_____
Net assets:		
Unrestricted		
Temporarily restricted		
Permanently restricted	_____	_____
Total net assets	_____	_____
Total liabilities and net assets	=====	=====

See accompanying notes to basic2d Nencial Possibilities yFEMC P MCID 15 6

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

Statements of Revenues, Expenses, and Changes in Net Assets

Years ended September 30, 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
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	
Other revenue		
Total unrestricted revenues, gains and other support		
Expenses:		
Salaries and benefits		
General and administrative		
Provision for uncollectible accounts		
Depreciation and amortization		
Interest		
Total expenses		
Operating income		
Nonoperating gains		
Revenues over expenses		
Contributions restricted for debt service, received and expended within the same year		
Transfer of capital to University of South Alabama College of Medicine		
Unrealized loss on other-than-trading securities		
Change in unrestricted net assets		
Unrestricted net assets at beginning of year		
Unrestricted net assets at end of year		

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

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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.

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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 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.

USA Foundation 8/25/09 Td12lo

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

Notes to Basic Financial Statements

September 30, 2007 and 2011. C19367 57.600n AMCID 4 BDC /TT3 1 Tf-0.0005 T

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

recorded at fair value at the date of receipt. Changes in the fair value of investments are reported in

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

(m) Deferred Revenue

Student tuition, fees, and dormitory rentals are defe

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

exchange or nonexchange transaction. To the extent that revenues from such programs are used to satisfy tuition and fees and certain other student ch

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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

UNIVERSITY OF SOUTH ALABAMA

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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

	<u>Credit rating</u>	<u>% of total investments</u>
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 Corporation	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):

	<u>Fair value</u>	<u>Years to maturity</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
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	—
	<u>\$ 231,238</u>	<u>190,026</u>	<u>27,349</u>	<u>13,467</u>	<u>396</u>

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

	<u>Fair value</u>	<u>Years to maturity</u>			
		<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
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	—	—
	<u>\$ 149,222</u>	<u>124,598</u>	<u>23,796</u>	<u>731</u>	<u>97</u>

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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),

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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.

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets not being depreciated:					
Land	\$ 23,886	3,746	895	(37)	28,490
Construction-in-progress	28,078	24,619	(6,907)	(119)	45,671
	<u>51,964</u>	<u>28,365</u>	<u>(6,012)</u>	<u>(156)</u>	<u>74,161</u>
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
	<u>434,631</u>	<u>9,012</u>	<u>6,012</u>	<u>(18,578)</u>	<u>431,077</u>
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)
	<u>(255,568)</u>	<u>(18,460)</u>	<u>—</u>	<u>16,665</u>	<u>(257,363)</u>
Capital assets being depreciated, net	<u>179,063</u>	<u>(9,448)</u>	<u>6,012</u>	<u>(1,913)</u>	<u>173,714</u>
Capital assets, net	<u>\$ 231,027</u>	<u>18,917</u>	<u>—</u>	<u>(2,069)</u>	<u>247,875</u>

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

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

(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)	—
	<u>10,576</u>	<u>13,481</u>	<u>—</u>	<u>(1)</u>	<u>24,056</u>
Less accumulated depreciation for:					
Land improvements	(215)	(77)	—	—	(292)
Buildings	(660)	(557)	—	—	(1,217)
Other equipment	(1)	—	—	1	—
	<u>(876)</u>	<u>(634)</u>	<u>—</u>	<u>1</u>	<u>(1,509)</u>
Capital assets, net	<u>\$ 9,700</u>	<u>12,847</u>	<u>—</u>	<u>—</u>	<u>22,547</u>

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

Appreciation Bonds mature beginning November 2011. Series 1999 Bonds are not redeemable prior

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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	<u>13,429</u>
	<u>\$ 22,957</u>

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

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

Debt Service on Long-Term Obligations

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

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
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	\$ <u>22,957</u>	<u>13,824</u>	<u>36,781</u>

Derivative Tra.2

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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.

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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 Infirmity Health System, Inc. (the Infirmity) 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 Infirmity. 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 Infirmity. 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 Infirmity, 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 Infirmity, 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 Infirmity to be significant. Significance is defined as anything that materially affects the operations, including financial and otherwise, of the hospital. If the Infirmity exercises this option, the University has the option of paying the Infirmity an amount equal to the fair market value of the capital improvements to the leased assets or selling the leased assets to the Infirmity for an amount equal to their fair market value. The University's management does not anticipate that this option will be exercised by the Infirmity.

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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	<u>31,000</u>
	<u>\$ 7,418,000</u>

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

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

For reporting purposes, management assumed that the interest rate utilized in years sixteen through

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

(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

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

(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, \$15,500,00

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

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 Public7service

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

Notes to Basic Financial Statements

September 30, 2007 and 2006

(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

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		
University Transportation Centers Program		
U.S. Department of Interior: D.431		
National Cooperative Geologic Mapping Program		
Conservation Grants Private Stewardship for Imperiled Species		
U.S. Department of Justice:		
Developing, Testing and Demonstrating Promising New Programs		
Part D - Research, Evaluation, Technical Assistance and Training		
Total direct programs		<hr/> <hr/>

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

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		<u>1,679,392</u>
Total Research and Development Cluster		<u>18,373,738</u>
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

UNIVERSITY OF SOUTH ALABAMA

UNIVERSITY OF SOUTH ALABAMA

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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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188 East Capitol Street
Jackson, MS 39201

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

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. (e control does xpress)-5ents for ose o



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



Suite 1100
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188 East Capitol Street
Jackson, MS 39201

**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



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.



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

**Section II – Findings Related to Financial Statements Reported in
Accordance with *Government Auditing Standards***

There were no findings related to the financial statements reported in accordance with *Government Auditing Standards*.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Findings and Questioned Costs
Year ended September 30, 2007

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 nummt0d22DC 6 ssoci Wads

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Findings and Questioned Costs
Year ended September 30, 204fMA

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Findings and Questioned Costs
Year ended September 30, 2007

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