



UNIVERSITY OF SOUTH ALABAMA
2014 Financial Report



University of South Alabama Children's & Women's Hospital doubled its size in 2014 with the completion of a nearly 200,000-square-foot expansion. The hospital is among a handful of freestanding hospitals in the United States dedicated specifically to the health care needs of children and women.



University of South Alabama Board of Trustees

Pictured from the left, Kenneth O. Simon, Arlene Mitchell, Robert D. Jenkins III, Bettye R. Maye, Michael P. Windom, E. Thomas Corcoran, Dr. Steven P. Furr, Bryant Mixon, James A. Yance, William S. Stimpson, Chandra Brown Stewart, John M. Peek, James H. Shumock, Dr. Scott A. Charlton, Dr. Steven H. Stokes and President Tony G. Waldrop. Not pictured Dr. Robert Bentley.

2014 Financial Report

The University of South Alabama is a leading comprehensive public university internationally recognized for educational, research, and health care excellence as well as for its positive intellectual, cultural, and economic impact on those it serves. In order to continue to advance our vision for the university, five priorities have been designated: i. provide access to all qualified students and to promote success for all our students; ii. enhance graduate education as well as research and scholarly activity; iii. enhance students' understanding of other cultures and foster increased exposure to individuals from other countries; iv. provide excellence in health care and; v. enhance community engagement for faculty, staff and students.

As the University moves into its second fifty years, it is only through a sound financial position that these priorities can be accomplished. Despite the challenges of the past several years and as evidenced by the accompanying financial report, the financial position of the University of South Alabama remains strong. This financial strength allows us to continue to serve the citizens of the state of Alabama and beyond by providing top quality academic, research, health care and public service programs.

In the fall of 2014, the University enjoyed an enrollment growth of almost 5% to a record number of 16,055 students. This increased enrollment is a testament to the strength of our academic programs, the hard work of our faculty and staff, and the spirit of our students and alumni. Along with our record enrollment growth comes a record number of students choosing to live in on-campus housing. Over 2,200 students are living in University-owned-and-operated housing and an additional 1,000 students live in the Grove, a private apartment complex located on the USA campus.

Over the past two years, the University has completed and placed into service a 195,000-square-foot addition to the USA Children's and Women's Hospital, a new 350-bed residence hall and an extensive renovation of the University's Student Center. The Mitchell-Moulton Scholarship Initiative was launched which will provide an enhanced permanently-endowed academic scholarship program for students in all fields of study. The USA Health System continued its service to the gulf coast region with over 250,000 patient contacts in the past year.

With this good news, however, come challenges and opportunities. I expect continued growth as we strive to reach new audiences and ensure the University remains accessible to what has historically been our core constituency. This growth must not only be in numbers, but also in quality and excellence. This will require hiring more faculty and staff to support the increased number of students. I affirm to you that quality will continue to be the goal in everything we do at USA.

Tony G. Waldrop, Ph.D.





Tony G. Waldrop, Ph.D.
President
University of South Alabama

A large, dense tree with vibrant pink blossoms, likely a flowering dogwood, is the central focus of the right side of the page. The background shows a brick building and green foliage.

Message from the **PRESIDENT**

A brick wall with a white sign that reads "SOUTH ALABAMA" in large, serif capital letters. Below the sign, there are colorful flowers and greenery. The sign also partially shows "DRIVE" on the left side.

SOUTH ALABAMA
DRIVE

Message from the
**CHAIR PRO
TEMPORE**
of the Board of Trustees



Steven P. Furr, MD
Chair Pro Tempore, Board of Trustees
University of South Alabama



Your Board of Trustees is dedicated to the success of the University of South Alabama and ensuring that our core values are met and maintained. We are dedicated to the successful achievement of the mission of the University, **AND** we are dedicated to the success of our students, faculty and staff.

The Board of Trustees takes its responsibility for the stewardship of our financial resources and academic programs very seriously. We are constantly striving for improvements in all aspects of the University and seek to ensure that USA is an intellectual and economic leader in the State of Alabama and the entire region for years to come. I am privileged to work alongside my colleagues on the Board as well as with President Waldrop and our University's dedicated and outstanding leadership team as we continue to move USA forward.

Steven P. Furr, MD



Introduction from the
VICE-PRESIDENT FOR
FINANCIAL AFFAIRS



An annual reunion for graduates of the Hollis J. Wiseman Neonatal Intensive Care Unit brings children, such as the ones pictured here, together with the medical professionals who cared for them as premature or critically ill newborns.

I am pleased to present the University of South Alabama's Annual Financial Report for the year ended September 30, 2014. It is our goal to provide useful information concerning the University's financial position and activities for the year. The Management Discussion and Analysis, the financial statements, and the notes to the financial statements document the University's financial results for this fiscal year. These financial statements present the accrual basis of accounting and, accordingly, include some amounts based upon judgment. The accompanying financial statements were prepared by USA's management in conformity with accounting principles generally accepted in the United States of America.

The management of the University of South Alabama is responsible for the integrity and objectivity of the financial statements. Management believes that the University's system of internal accounting controls provides reasonable assurance that assets are protected and that transactions and events are properly recorded. The Board of Trustees of the University of South Alabama, through the Audit Committee, monitors the financial and accounting operations of the University.

Stephen H. Simmons
Vice-President for Financial Affairs
University of South Alabama



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

Basic Financial Statements

September 30, 2014 and 2013

(With Independent Auditors' Report Thereon)

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

Basic Financial Statements
September 30, 2014 and 2013

Table of Contents

	Page
Management’s Discussion and Analysis (Unaudited)	1
Independent Auditors’ Report	12
Basic Financial Statements:	
Statements of Net Position – University of South Alabama, September 30, 2014 and 2013	14
Consolidated Statements of Financial Position – University of South Alabama Foundation, June 30, 2014 and 2013	15
Statements of Financial Position – University of South Alabama Health Services Foundation, September 30, 2014 and 2013	16
Statements of Net Position – USA Research and Technology Corporation, September 30, 2014 and 2013	17
Statements of Revenues, Expenses, and Changes in Net Position – University of South Alabama, years ended September 30, 2014 and 2013	18
Consolidated Statement of Activities and Changes in Net Assets – University of South Alabama Foundation, year ended June 30, 2014	19
Consolidated Statement of Activities and Changes in Net Assets – University of South Alabama Foundation, year ended June 30, 2013	20
Statements of Operations and Changes in Net Assets (Deficit) – University of South Alabama Health Services Foundation, years ended September 30, 2014 and 2013	21
Statements of Revenues, Expenses, and Changes in Net Position – USA Research and Technology Corporation, years ended September 30, 2014 and 2013	22
Statements of Cash Flows – University of South Alabama, years ended September 30, 2014 and 2013	23
Notes to Basic Financial Statements	25

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

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, 2014 and 2013 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 1 to the basic financial statements, the University of South Alabama Professional Liability Trust Fund, University of South Alabama General Liability Trust Fund and USA HealthCare Management, LLC 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, 2014, 2013, and 2012, the University had total assets of \$1,055,286,000, \$1,042,345,000, and \$983,800,000, respectively; total liabilities and deferred inflows of \$555,736,000, \$549,355,000, and \$530,289,000, respectively; and net position of \$499,550,000, \$492,990,000, and \$453,511,000, respectively. University net position increased by \$6,560,000 during the year ended September 30, 2014 compared to an increase of \$39,479,000 for the year ended September 30, 2013 and an increase of \$38,389,000 for the year ended September 30, 2012.

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 Position

The statement of net position presents the assets, liabilities, deferred inflows and net position of the University at September 30, 2014 and 2013. Net position is displayed in three parts: net investment in capital assets, restricted and unrestricted. Restricted net position may either be expendable or nonexpendable and is that net position that is restricted by law or external donor. Unrestricted net position is generally designated for specific purposes, and is available for use by the University to meet current expenses for any purpose. The statement of net position, along with all of the University's basic financial statements, is 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 position are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, investments, and net patient accounts receivable. Of these amounts, cash and cash equivalents, investments, and patient accounts receivable comprise approximately 29%, 50%, and 10%,

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

respectively, of current assets at September 30, 2014. Noncurrent assets at September 30, 2014 consist primarily of capital assets, restricted cash and cash equivalents, and restricted investments.

The Condensed Schedules of Net Position at September 30, 2014, 2013, and 2012 follow (in thousands):

Condensed Schedules of Net Position			
	2014	2013	2012
Assets:			
Current	\$ 303,272	333,828	292,041
Capital assets	578,303	565,830	533,199
Other noncurrent	173,711	142,687	158,560
Total assets	\$ 1,055,286	1,042,345	983,800
Liabilities:			
Current	\$ 120,646	115,149	115,088
Noncurrent	434,913	434,206	415,201
Total liabilities	555,559	549,355	530,289
Deferred inflows	177	—	—
Total liabilities and deferred inflows	\$ 555,736	549,355	530,289
Net position:			
Net investment in capital assets	\$ 237,851	227,464	227,029
Restricted, nonexpendable	40,191	36,864	33,825
Restricted, expendable	60,873	54,364	48,201
Unrestricted	160,635	174,298	144,456
Total net position	\$ 499,550	492,990	453,511

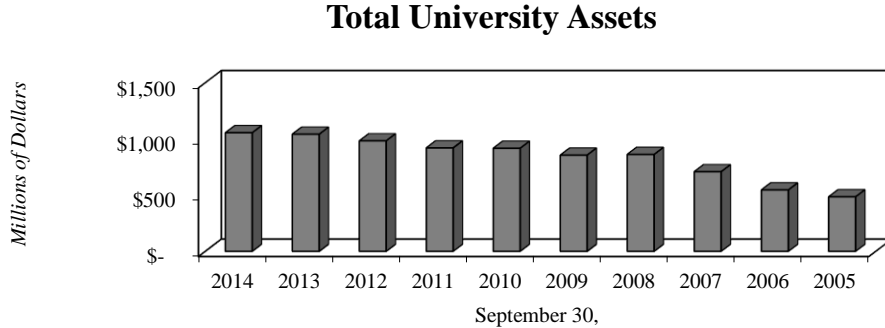
University cash, cash equivalents, and investments (current and noncurrent) increased between September 30, 2013 and 2014 by \$8,497,000 to \$403,965,000. This increase is consistent with the results of operations for the year. This follows an increase of \$47,820,000 in cash, cash equivalents, and investments between 2012 and 2013, which was due primarily to the issuance of the 2013-A, 2013-B and 2013-C bonds, net of utilization of cash from prior bond issues for various construction projects.

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

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



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

Net investment in capital assets represents 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 position consists 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 position is subject to externally imposed restrictions governing their use. The funds are restricted primarily for debt service, capital projects, student loans, and scholarship purposes.

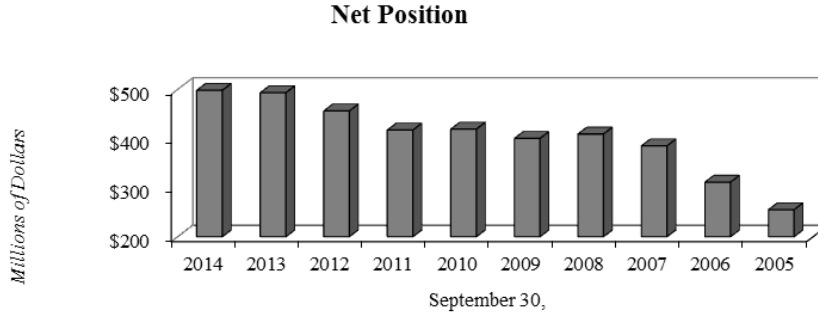
Unrestricted net position represents those net assets not subject to externally imposed stipulations. Even though these funds are not legally restricted, the majority of the University's unrestricted net position has been internally designated for various projects, all supporting the mission of the University.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

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

Net position of the University as of September 30 is as follows:



All categories of restricted net position increased by approximately 11% between September 30, 2013 and 2014, primarily due to the addition of restricted gifts to the University. Unrestricted net position decreased from \$174,298,000 to \$160,635,000 between September 30, 2013 and 2014 due primarily to changes in the fair value of the 2004 and 2006 swaptions.

Statement of Revenues, Expenses, and Changes in Net Position

Changes in total University net position as reported in the statement of net position are based on the activity presented in the statement of revenues, expenses, and changes in net position. The purpose of this statement is to present the change in net position 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 educational 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.

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

The Condensed Schedules of Revenues, Expenses, and Changes in Net Position for the years ended September 30, 2014, 2013, and 2012 follow (in thousands):

**Condensed Schedules of Revenues, Expenses,
and Changes in Net Position**

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Operating revenues:			
Tuition and fees	\$ 104,448	95,709	88,299
Net patient service revenue	268,449	258,207	247,802
Federal, state and private grants and contracts	76,719	77,302	76,448
Other	54,010	52,388	56,579
	<u>503,626</u>	<u>483,606</u>	<u>469,128</u>
Operating expenses:			
Salaries and benefits	419,966	401,872	396,170
Supplies and other services	158,615	148,597	134,841
Other	55,397	51,651	51,222
	<u>633,978</u>	<u>602,120</u>	<u>582,233</u>
Operating loss	<u>(130,352)</u>	<u>(118,514)</u>	<u>(113,105)</u>
Nonoperating revenues:			
State appropriations	103,695	102,585	105,639
Investment income	8,206	28,159	14,561
Other, net	14,475	11,986	12,197
Net nonoperating revenues	<u>126,376</u>	<u>142,730</u>	<u>132,397</u>
Income (loss) before capital appropriations, capital contributions and additions to endowment	(3,976)	24,216	19,292
Capital appropriations, capital contributions and additions to endowment	<u>10,536</u>	<u>15,263</u>	<u>19,097</u>
Change in net position	<u>6,560</u>	<u>39,479</u>	<u>38,389</u>
Beginning net position, before cumulative effect of change in accounting principle	492,990	453,511	416,896
Cumulative effect of change in accounting principle	<u>—</u>	<u>—</u>	<u>(1,774)</u>
Beginning net position – as adjusted	<u>492,990</u>	<u>453,511</u>	<u>415,122</u>
Ending net position	<u>\$ 499,550</u>	<u>492,990</u>	<u>453,511</u>

In 2014, 2013, and 2012, approximately 40%, 39%, and 39%, respectively, of total revenues of the University were net patient service revenue. Excluding net patient service revenue, net tuition and fees charged to students represent the largest component of total university revenues, approximately 16% of total revenues in fiscal 2014.

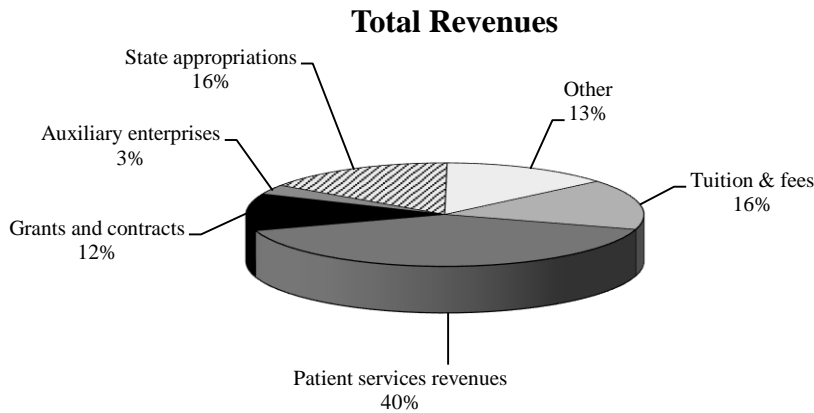
UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Management's Discussion and Analysis (Unaudited)

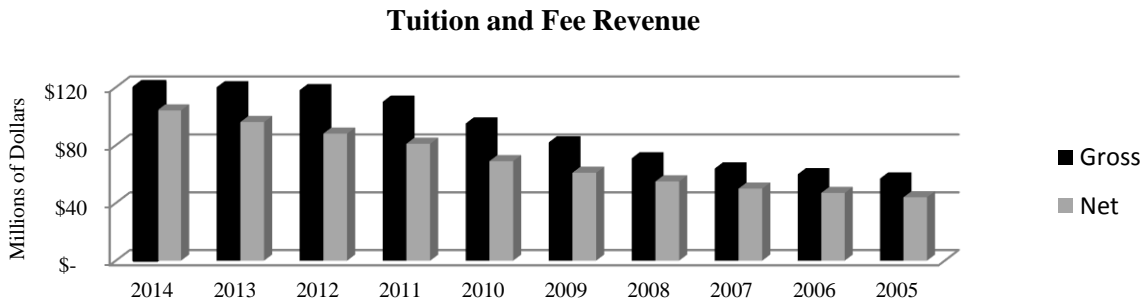
September 30, 2014 and 2013

Also in 2014, state appropriations and grants and contracts (federal, state and private) represented approximately 16% and 12% of total revenues, respectively.

A summary of University revenues for the year ended September 30, 2014 is presented below:



Tuition and fees have increased in each of the last ten years. These increases are due primarily to increases in tuition and fee rates charged to students as well as to an increase in the number of students enrolled and credit hours taken by those students. Additionally, net tuition and fees as a percent of total operating revenues continue to increase, from 9.5% of operating revenues in 2002 to 20.8% in 2014. Tuition and fees, gross and net of scholarship allowances, for the past ten fiscal years are as follows:



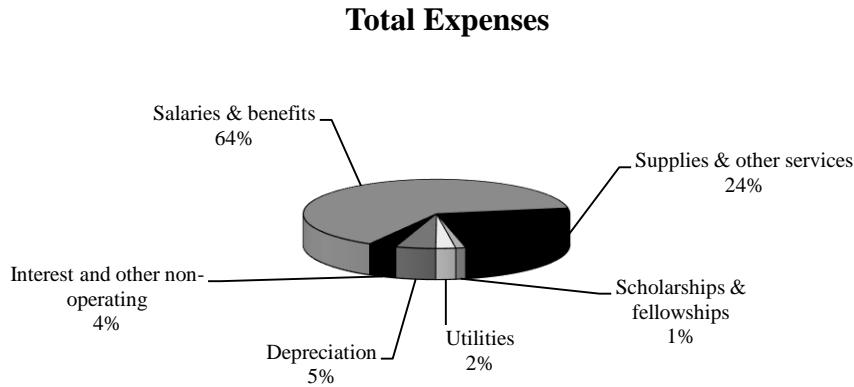
Capital contributions and grants decreased from \$10,871,000 in 2013 to \$790,000 in 2014 due to a decrease in grant funds received for construction of Shelby Hall and the ABSL-3 Laboratory Building. The University recognized \$3,482,000 in capital appropriations in 2014, compared to \$1,236,000 in 2013. The 2014 and 2013 appropriations were utilized in the renovation of the Student Center.

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

Management's Discussion and Analysis (Unaudited)

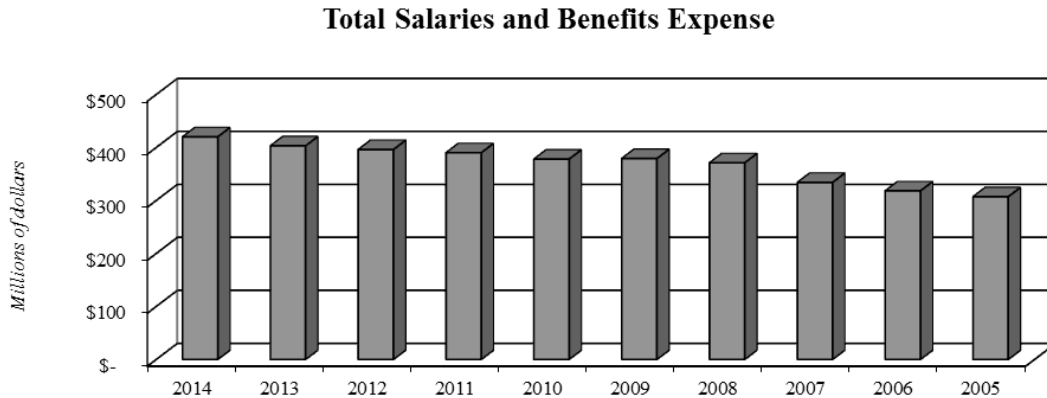
September 30, 2014 and 2013

University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2014 is presented below:



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

In 2014, 2013, and 2012, approximately 66%, 67% and 68%, respectively, of the University's total operating expenses were salaries and benefits. After steady increases from 2005 to 2008, salaries and benefits have been relatively constant since 2008, as follows:



For the years ended September 30, 2014, 2013, and 2012, the University reported operating losses of approximately \$130,352,000, \$118,514,000, and \$113,105,000, respectively. Operating losses are offset partially by state appropriations, which are reported as nonoperating revenue. After adding state appropriations and other nonoperating revenues and expenses, (primarily capital appropriations, capital contributions, and additions to

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

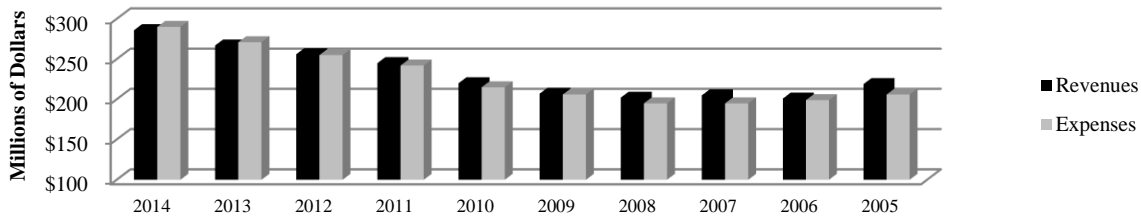
Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

endowment) the total change in net position was approximately \$6,560,000, \$39,479,000, and \$38,389,000, for the years ended September 30, 2014, 2013, and 2012, 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 ten fiscal years are presented below:

Hospital Operating Revenues and Expenses



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 \$44,237,000 in 2014. During 2014, New Hall (residence hall) and a major renovation of the Student Center were placed into service. Significant construction projects that remain in progress at September 30, 2014 included a new professional medical office building. The expansion of Children's and Women's Hospital was substantially completed in 2014. Major projects completed and placed into service in fiscal 2012 and 2013 included the Campus Entrance Portals, Stokes Hall and a major renovation of the Bookstore. At September 30, 2014, the University had outstanding commitments of approximately \$3,468,000 for various capital projects.

In a prior year, the State of Alabama made allocations from state bond issues to the University in the amount of \$21,332,000. During 2014, \$3,482,000 was recognized by the University and is reported as a capital appropriation. \$112,000 remains unspent at September 30, 2014.

In June 2013, the University issued the University Facilities Revenue Capital Improvement Bonds, Series 2013-A, 2013-B and 2013-C, with a total face value of \$50,000,000. The net proceeds of these bonds are being used to fund the construction of a new professional medical office building as well as other construction and other capital projects on the main campus of the University.

In March 2014, the University issued the University Facilities Revenue Refunding Bond, Series 2014-A, with a face value of \$41,245,000. The proceeds of this bond were used to refund the University's Series 2004 bonds in connection with the termination of the swaption, as discussed below.

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

In order to realize debt service savings currently from future debt refunding, in January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to the counterparty and resulted in an up-front payment to the University totaling \$9,328,000 in exchange for selling the counterparty the option to enter into an interest rate swap with respect to the Series 2004 and 2006 bonds. A portion of this payment was considered a borrowing and was included in the long-term debt of the University. The fair value component of the refunding associated with the swaps was considered an investment derivative and, as such, the change in the fair value component was reflected as a component of investment income in 2014, 2013 and 2012.

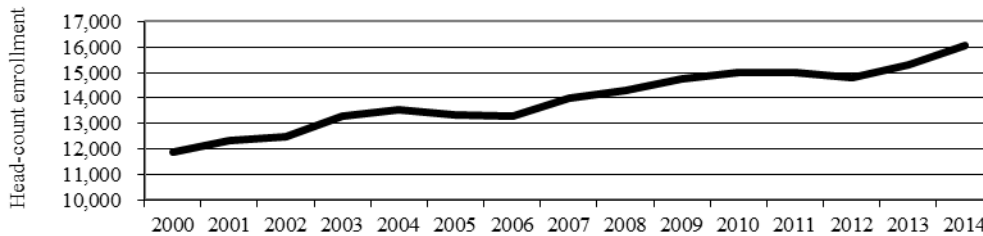
In December 2013, the counterparty exercised its option with respect to the 2004 swaption and forced the University into an underlying swap. The University refunded its Series 2004 bonds, issued the 2014-A variable rate bond and terminated the Series 2004 swaption. As a result of this termination, the borrowing arising from the Series 2004 swaption of \$1,696,000 and the investment derivative of \$5,213,000 were written off and an investment loss of \$2,229,000 was recognized. A borrowing arising from the 2014 swap of \$9,138,000 was recognized and is reported in the statement of net position at September 30, 2014.

The University's bond credit rating is A1 as rated by Moody's Investors Services and A+ as rated by Standard and Poor's Rating Services. Neither rate changed during 2014.

Economic Outlook

Student enrollment and tuition and fee rates have both increased over the past thirteen years. The University has experienced an increase in enrollment between 2000 and 2014, from 11,870 in 2000 to 16,055 for the 2014 fall semester. The enrollment trend for the University between 2000 and 2014 is as follows:

Enrollment Growth Summary



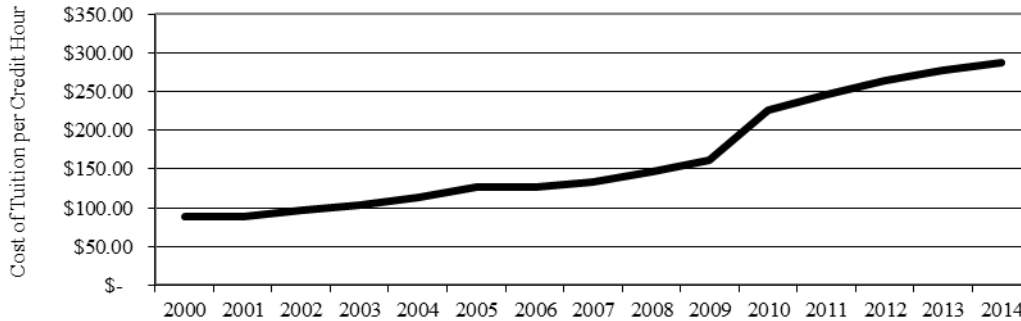
UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

In that same time period, in-state tuition per credit hour has increased by approximately 222%. The large increase in 2010 is the result of the University's bundling of tuition and required fees into a single per-hour charge. Similar increases have been experienced in out-of-state tuition and College of Medicine tuition. The trend of in-state tuition per credit hour between 2000 and 2014 is as follows:

Tuition per Credit Hour



While enrollment and tuition have both increased in recent years, state appropriations prior to 2006 were relatively flat. However, in the 2008, 2007 and 2006 fiscal years, the University experienced increases of 16%, 19% and 17%, respectively, or approximately \$19,349,000, \$19,185,000 and \$14,581,000, respectively, in its state appropriation. These increases were unusually high. For the 2009 fiscal year, the University's original state appropriation decreased 12.8% or approximately \$17,882,000. Additionally, in December 2008 the Governor of Alabama announced proration of 9%, or approximately \$10,967,000; and in July 2009, the Governor announced additional proration of 2%, or approximately \$2,437,000. Therefore, the total decrease in the 2009 state appropriation was approximately \$31,286,000 to \$108,451,000, or 22.4% lower than in 2008.

A state appropriation in the amount of approximately \$105,639,000 was authorized for the year ended September 30, 2012. In February 2011, the Governor announced proration of 3%, or approximately \$2,999,000, that reduced the amount received to \$96,948,000.

A state appropriation in the amount of approximately \$102,585,000 was authorized and received for the year ended September 30, 2013.

A state appropriation in the amount of approximately \$103,695,000 was authorized and received for the year ended September 30, 2014.

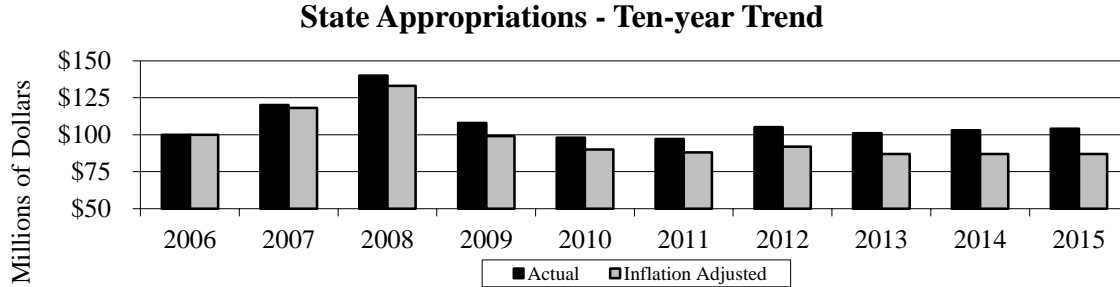
A state appropriation in the amount of approximately \$103,974,000 has been authorized for the year ending September 30, 2015. This represents a \$279,000 increase from the fiscal 2014 appropriation received. While no announcement has been made, the University is aware that reductions in its 2015 appropriation are possible.

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

Management's Discussion and Analysis (Unaudited)

September 30, 2014 and 2013

The ten-year trend of state appropriations for the University is as follows:



In addition to state appropriations, the University is subject to declines in general economic conditions in the United States and, specifically, the State of Alabama. Further weakening of the economy could have a potential further negative impact on the University's enrollment, extramural funding, endowment performance, and health care operations.

Other than the issues presented above, University administration is not aware of any other currently known facts, decisions, or conditions that are expected to have a significant effect on the University's financial position or results of operations during fiscal year 2015 beyond those unknown variables having a global effect on virtually all types of business operations.

Requests for Information

These basic financial statements are designed to provide a general overview of the University of South Alabama and its component units' financial activities and to demonstrate the University's accountability. Questions concerning any of the information provided in this report or requests for additional information should be addressed to Mr. Stephen H. Simmons; Vice-President for Financial Affairs; University of South Alabama – Room 170; Mobile, Alabama 36688. These basic financial statements can be obtained from our website at <http://www.southalabama.edu/financialaffairs/businessoffice/statements.html>.



KPMG LLP
Suite 1100
One Jackson Place
188 East Capitol Street
Jackson, MS 39201-2127

Independent Auditors' Report

The Board of Trustees
University of South Alabama:

Report on the Financial Statements

We have audited the accompanying 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, 2014 and 2013, and the related notes to the financial statements, which collectively comprise the University's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We did not audit the 2014 and 2013 consolidated financial statements of the University of South Alabama Foundation, which represents 85%, 99%, and 32%, respectively, of the 2014 assets, net assets, and revenues, gains and other support of the aggregate discretely presented component units and 83%, 100%, and 26%, respectively, of the 2013 assets, net assets, and revenues, gains and other support of the aggregate discretely presented component units. Those statements were audited by other auditors whose report 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 solely 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 from material misstatement. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.



We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, based on our audits and the report of the 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, 2014 and 2013, and the respective changes in financial position, and where applicable, cash flows thereof for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

U.S. generally accepted accounting principles require that the management's discussion and analysis on pages 1-11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2014, 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* in considering the University's internal control over financial reporting and compliance.

KPMG LLP

Jackson, Mississippi
November 14, 2014

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

Statements of Net Position

September 30, 2014 and 2013

(In thousands)

	2014	2013
Current assets:		
Cash and cash equivalents	\$ 88,317	137,610
Investments	152,776	130,694
Net patient accounts receivable, (net of allowance for doubtful accounts of \$54,106 in 2014 and \$51,159 in 2013)	30,344	29,053
Accounts receivable, affiliates	10,432	17,283
Accounts receivable, other	6,619	2,147
Notes receivable, net	4,229	6,545
Prepaid expenses, inventories, and other	10,555	10,496
Total current assets	303,272	333,828
Noncurrent assets:		
Restricted cash and cash equivalents	43,692	86,135
Restricted investments	87,646	40,553
Investments	31,534	476
Accounts receivable	3,573	4,580
Notes receivable, net	4,813	8,529
Other noncurrent assets	2,453	2,414
Capital assets, net	578,303	565,830
Total noncurrent assets	752,014	708,517
Total assets	1,055,286	1,042,345
Current liabilities:		
Accounts payable and accrued liabilities	49,138	51,056
Unrecognized revenue	54,524	48,332
Deposits	2,781	2,608
Current portion of long-term debt	14,203	13,153
Total current liabilities	120,646	115,149
Noncurrent liabilities:		
Long-term debt, less current portion	381,103	387,737
Other long-term liabilities	53,810	46,469
Total noncurrent liabilities	434,913	434,206
Total liabilities	555,559	549,355
Deferred inflows	177	—
Total liabilities and deferred inflows	555,736	549,355
Net position:		
Net investment in capital assets	237,851	227,464
Restricted, nonexpendable:		
Scholarships	18,494	16,118
Other	21,697	20,746
Restricted, expendable:		
Scholarships	14,571	13,346
Other	46,302	41,018
Unrestricted	160,635	174,298
Total net position	\$ 499,550	492,990

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2014 and 2013

(In thousands)

Assets	2014	2013
Cash and cash equivalents	\$ 670	900
Investments:		
Equity securities	133,236	114,193
Timber and mineral properties	156,320	154,332
Real estate	31,007	31,010
Other	6,054	6,040
Other assets	702	647
Total assets	\$ 327,989	307,122
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 163	126
Note payable – University of South Alabama	3,954	7,783
Other liabilities	736	677
Total liabilities	4,853	8,586
Net assets:		
Unrestricted	62,701	64,280
Temporarily restricted	90,909	64,862
Permanently restricted	169,526	169,394
Total net assets	323,136	298,536
Total liabilities and net assets	\$ 327,989	307,122

See accompanying notes to basic financial statements.

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

Statements of Financial Position

September 30, 2014 and 2013

(In thousands)

Assets	2014	2013
Current assets:		
Cash and cash equivalents	\$ 13	592
Patient accounts receivable (net of allowance for uncollectible accounts of approximately \$3,838 and \$4,651)	10,351	12,005
Other current assets	1,242	1,263
Total current assets	11,606	13,860
Interest in assets of University of South Alabama Professional Liability Trust Fund	15,710	14,726
Property and equipment, net	3,419	3,658
Total assets	\$ 30,735	32,244
Liabilities and Net Assets (Deficit)		
Current liabilities:		
Accounts payable	\$ 1,862	1,656
Due to affiliates	10,295	17,133
Total current liabilities	12,157	18,789
Estimated professional liability costs	15,710	14,726
Total liabilities	27,867	33,515
Net assets (deficit)	2,868	(1,271)
Total liabilities and net assets (deficit)	\$ 30,735	32,244

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Net Position

September 30, 2014 and 2013

(In thousands)

	2014	2013
Assets:		
Current assets:		
Unrestricted cash and cash equivalents	\$ 761	1,447
Rent receivable	263	167
Prepaid expenses and other current assets	6	10
Total current assets	1,030	1,624
Noncurrent assets:		
Intangible assets, net	77	99
Capital assets, net	23,794	24,701
Total noncurrent assets	23,871	24,800
Deferred outflows	3,053	3,225
Total assets and deferred outflows	27,954	29,649
Liabilities:		
Current liabilities:		
Deposits, other current liabilities, and accrued expenses	197	356
Payable to University of South Alabama	44	7
Unrecognized rent revenue	494	431
Current portion of notes payable	1,061	1,002
Total current liabilities	1,796	1,796
Noncurrent liabilities:		
Notes payable, excluding current portion	22,225	23,285
Interest rate swap	3,053	3,225
Total noncurrent liabilities	25,278	26,510
Total liabilities	27,074	28,306
Net position:		
Net investment in capital assets	503	284
Unrestricted	377	1,059
Total net position	\$ 880	1,343

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 Position

Years ended September 30, 2014 and 2013

(In thousands)

	2014	2013
Operating revenues:		
Tuition and fees (net of scholarship allowances of \$34,641 in 2014 and \$32,457 in 2013)	\$ 104,448	95,709
Net patient service revenue	268,449	258,207
Federal grants and contracts	19,224	18,010
State grants and contracts	7,930	7,897
Private grants and contracts	49,565	51,395
Auxiliary enterprises (net of scholarship allowances of \$1,039 in 2014 and \$974 in 2013)	20,016	18,354
Other operating revenues	33,994	34,034
Total operating revenues	503,626	483,606
Operating expenses:		
Salaries and benefits	419,966	401,872
Supplies and other services	158,615	148,597
Scholarships and fellowships	7,839	7,099
Utilities	15,700	14,703
Depreciation and amortization	31,858	29,849
Total operating expenses	633,978	602,120
Operating loss	(130,352)	(118,514)
Nonoperating revenues (expenses):		
State appropriations	103,695	102,585
Investment income	8,206	28,159
Interest expense	(12,929)	(13,093)
Other nonoperating revenues	39,111	34,299
Other nonoperating expenses	(11,707)	(9,220)
Net nonoperating revenues	126,376	142,730
Income (loss) before capital appropriations, capital contributions and grants, and additions to endowment	(3,976)	24,216
Capital appropriations	3,482	1,236
Capital contributions and grants	790	10,871
Additions to endowment	6,264	3,156
Change in net position	6,560	39,479
Net position:		
Beginning of year	492,990	453,511
End of year	\$ 499,550	492,990

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, 2014

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, and other support:				
Net realized and unrealized gains on investments	\$ 5,620	25,356	—	30,976
Rents, royalties and timber sales	3,727	193	17	3,937
Interest and dividends	194	1,879	6	2,079
Gifts	—	2	55	57
Other income	9	—	—	9
Required match of donor contributions	(54)	—	54	—
Interfund interest	(165)	165	—	—
Net assets released from program restrictions	1,548	(1,548)	—	—
Total revenues, gains, and other support	<u>10,879</u>	<u>26,047</u>	<u>132</u>	<u>37,058</u>
Expenditures:				
Program services:				
Faculty support	2,332	—	—	2,332
Scholarships	1,066	—	—	1,066
Other	1,117	—	—	1,117
Total program service expenditures	4,515	—	—	4,515
Management and general	1,771	—	—	1,771
Other investment expense	2,011	—	—	2,011
Depletion expense	3,882	—	—	3,882
Depreciation expense	108	—	—	108
Interest expense	171	—	—	171
Total expenditures	<u>12,458</u>	<u>—</u>	<u>—</u>	<u>12,458</u>
Increase (decrease) in net assets	(1,579)	26,047	132	24,600
Net assets – beginning of year	64,280	64,862	169,394	298,536
Net assets – end of year	<u>\$ 62,701</u>	<u>90,909</u>	<u>169,526</u>	<u>323,136</u>

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, 2013

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, and other support:				
Net realized and unrealized gains on investments	\$ 9,182	11,758	—	20,940
Rents, royalties and timber sales	3,501	—	16	3,517
Interest and dividends	485	1,474	6	1,965
Gifts	—	1	15	16
Other income	70	—	—	70
Required match of donor contributions	(111)	—	111	—
Interfund interest	(118)	118	—	—
Net assets released from program restrictions	1,376	(1,376)	—	—
Total revenues, gains, and other support	<u>14,385</u>	<u>11,975</u>	<u>148</u>	<u>26,508</u>
Expenditures:				
Program services:				
Faculty support	2,379	—	—	2,379
Scholarships	982	—	—	982
Other	1,088	—	—	1,088
Total program service expenditures	4,449	—	—	4,449
Management and general	1,724	—	—	1,724
Other investment expense	1,796	—	—	1,796
Depletion expense	3,391	—	—	3,391
Depreciation expense	83	—	—	83
Interest expense	290	—	—	290
Total expenditures	<u>11,733</u>	<u>—</u>	<u>—</u>	<u>11,733</u>
Increase in net assets	2,652	11,975	148	14,775
Net assets – beginning of year	61,628	52,887	169,246	283,761
Net assets – end of year	<u>\$ 64,280</u>	<u>64,862</u>	<u>169,394</u>	<u>298,536</u>

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 (Deficit)

Years ended September 30, 2014 and 2013

(In thousands)

	2014	2013
Unrestricted revenues, gains and other support:		
Net patient service revenue	\$ 75,680	63,298
Provision for uncollectible accounts	(13,871)	(12,057)
Net patient service revenue less provision for uncollectible accounts	61,809	51,241
Other revenue	10,563	8,701
Total unrestricted revenues, gains, and other support	72,372	59,942
Expenses:		
Salaries and benefits	43,431	48,433
General and administrative	16,535	5,864
Depreciation and amortization	1,602	1,465
Total expenses	61,568	55,762
Operating income	10,804	4,180
Nonoperating gains	1,835	3,491
Revenues over expenses	12,639	7,671
Transfer of capital to University of South Alabama, College of Medicine	(8,500)	(5,100)
Change in net assets (deficit)	4,139	2,571
Net deficit at beginning of year	(1,271)	(3,842)
Net assets (deficit) at end of year	\$ 2,868	(1,271)

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(Discretely Presented Component Unit)

Statements of Revenues, Expenses, and Changes in Net Position

Years ended September 30, 2014 and 2013

(In thousands)

	2014	2013
Operating revenues	\$ 3,506	4,011
Total operating revenues	3,506	4,011
Operating expenses:		
Building management and operating expenses	1,240	1,427
Depreciation and amortization	1,017	981
Legal and administrative fees	231	222
Insurance	137	150
Total operating expenses	2,625	2,780
Operating income	881	1,231
Nonoperating revenues (expenses):		
Investment income	4	8
Interest expense	(1,351)	(1,409)
Donation revenue	—	2
Other	3	5
Net nonoperating expenses	(1,344)	(1,394)
Change in net position	(463)	(163)
Net position:		
Beginning of year	1,343	1,506
End of year	\$ 880	1,343

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, 2014 and 2013

(In thousands)

	2014	2013
Cash flows from operating activities:		
Receipts related to tuition and fees	\$ 107,558	99,546
Receipts from and on behalf of patients and third-party payers	267,277	255,918
Receipts from grants and contracts	84,283	86,927
Receipts related to auxiliary enterprises	20,061	18,507
Payments to suppliers and vendors	(172,409)	(149,010)
Payments to employees and related benefits	(420,000)	(396,311)
Payments for scholarships and fellowships	(7,839)	(7,099)
Other operating receipts	30,172	33,007
Net cash used in operating activities	(90,897)	(58,515)
Cash flows from noncapital financing activities:		
State appropriations	103,695	102,585
Endowment gifts	6,264	3,156
Agency funds received	1,424	1,040
Agency funds disbursed	(1,302)	(904)
Student loan program receipts	135,038	126,410
Student loan program disbursements	(135,041)	(126,936)
Other nonoperating revenues	36,883	34,729
Other nonoperating expenses	(11,476)	(9,206)
Net cash provided by noncapital financing activities	135,485	130,874
Cash flows from capital and related financing activities:		
Capital contributions and grants	917	13,464
Purchases of capital assets	(35,090)	(72,680)
Proceeds from sale of capital assets	3,698	6,030
Proceeds from issuance of capital debt	41,245	50,000
Principal payments on capital debt	(54,119)	(10,552)
Interest payments on capital debt	(15,674)	(14,324)
Net cash used in capital and related financing activities	(59,023)	(28,062)
Cash flows from investing activities:		
Interest and dividends on investments	5,959	5,030
Purchases of investments	(108,663)	(90,855)
Proceeds from sales of investments	25,403	49,672
Net cash used in investing activities	(77,301)	(36,153)
Net increase (decrease) in cash and cash equivalents	(91,736)	8,144
Cash and cash equivalents (unrestricted and restricted):		
Beginning of year	223,745	215,601
End of year	\$ 132,009	223,745

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

Statements of Cash Flows

Years ended September 30, 2014 and 2013

(In thousands)

	<u>2014</u>	<u>2013</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (130,352)	(118,514)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization expense	31,858	29,849
Changes in assets and liabilities, net:		
Student receivables	(854)	1,350
Net patient accounts receivables	(1,291)	(2,215)
Grants and contracts receivables	6,703	7,706
Other receivables	(2,914)	9,513
Prepaid expenses, inventories, and other	1,936	5,302
Accounts payable and accrued liabilities	(2,087)	9,630
Unrecognized revenue	6,104	(1,136)
Net cash used in operating activities	<u>\$ (90,897)</u>	<u>(58,515)</u>
Noncash investing, noncapital financing, and capital and related financing transactions:		
Net increase in fair value of investments recognized as a component of investment income	\$ 10,180	24,692
Additional maturity on capital appreciation on bonds payable and other borrowings recorded as interest expense	1,854	1,981
Payments on behalf of the University by the Alabama Public School and College Authority reducing purchases of capital assets	2,489	124
Increase in receivables from Alabama Public School and College Authority reducing purchases of capital assets	993	—
Gifts of capital and other assets	231	42
Pledges of operating and capital gifts	88	1,961
Capitalization of construction period interest	3,825	2,934
Decrease in accounts payable related to capital assets	(43)	(3,856)

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, 2014 and 2013

(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*, and GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*, 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. In addition, the primary government may determine, through exercise of management's professional judgment, that the inclusion of an organization that does not meet the financial accountability criteria is necessary in order to prevent the reporting entity's financial statements from being misleading. In such instances, that organization is included as a component unit. Accordingly, the basic financial statements include the accounts of the University, as the primary government, and the accounts of the entities discussed below as component units.

During 2013, the University adopted GASB Statement No. 61, *The Financial Reports Entity: Omnibus*, which amends GASB Statements No. 14 and No. 39, and 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. Such criteria include the appointment of a voting majority of the board of the organization, the ability to impose the will of the primary government on the organization and the financial benefits/burden between the primary government and the potential component unit. The statement also clarifies reporting and disclosure requirements for those organizations. Based on these criteria as of September 30, 2014 and 2013, 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.

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 Statements No. 14, 39 and 61 because the University does not consider SAMSF significant enough to warrant inclusion in the University's reporting entity (see note 14 for further discussion of this entity).

GASB Statement No. 61 requires the University, as the primary government, to include in its basic financial statements, as a blended component unit, organizations that, even though they are legally separate entities, meet certain requirements as defined by GASB Statement No. 61. Based on these criteria, the University reports the Professional Liability Trust Fund, the General Liability Trust Fund

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

and the USA HealthCare Management, LLC as blended component units. All significant transactions among the University and its blended component units have been eliminated.

(b) *USA HealthCare Management, LLC*

In June 2010, the University's Board of Trustees approved the formation of the USA HealthCare Management, LLC (the LLC). The LLC was organized for the purpose of managing and operating on behalf of, and as agent for, substantially all of the health care clinical enterprise of the University. The University is the sole member of the LLC. The LLC commenced operations in October 2010 and is reported as a blended component unit (see note 17 for further discussion of, and disclosure for, this entity).

(c) *Professional Liability and General Liability Trust Funds*

The medical malpractice liability of the University is maintained and managed in its separate Professional Liability Trust Fund (the PLTF) in which the University, USAHSF, LLC and SAMSF 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, USAHSF, LLC, SAMSF and the Corporation is maintained and managed in its 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 (see note 17 for further discussion of, and disclosure for, these entities).

(d) *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, 2014 and 2013 were \$4,451,000 and \$4,392,000, 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 position. 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 accompanying consolidated statements of financial position and statements of activities and changes in net assets for the USA Foundation as of and for the years ended June 30, 2014 and 2013 are discretely presented.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(e) *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 \$42,352,000 and \$44,786,000 for the years ended September 30, 2014 and 2013, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net position of the University. During 2014, the University reallocated a portion of faculty salaries funded by USAHSF and the University to better align funding and effort. This reallocation, a change in accounting estimate, resulted in a reduction of the payments from USAHSF to the University during the 2014 fiscal year. The USAHSF presents its financial statements in accordance with standards issued by the FASB. The accompanying statements of financial position and statements of operations and changes in net assets (deficit) for the USAHSF for the years ended September 30, 2014 and 2013 are discretely presented.

(f) *USA Research and Technology Corporation*

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

(g) *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.

(h) *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

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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.

(i) Cash and Cash Equivalents

Cash and cash equivalents are defined as petty cash, demand accounts, certificates of deposit, 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.

(j) Investments and Investment Income

Investments are recorded at fair value. The fair value of alternative investments (low-volatility multi-strategy funds, private placement fund-of-funds, relative value arbitrage funds, and other) 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 partnerships or companies. Because these investments are not marketable, the estimated fair value is subject to uncertainty and, therefore, may differ from the fair 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 (loss).

(k) Derivatives

The University has adopted the provisions of GASB Statement No. 53, *Accounting and Financial Reporting for Derivative Instruments*. GASB Statement No. 53 establishes a framework for accounting and financial reporting related to derivative instruments, requiring the fair value of derivatives to be recognized in the basic financial statements.

The University entered into two interest rate swaptions in January 2008, the Series 2004 swaption and the Series 2006 swaption. As a result of entering into the swaptions, the University received up-front payments. Swaptions are considered hybrid instruments which are required to be bifurcated into the fair value of the derivative and a piece that reflects a borrowing for financial statement purposes, which will accrete interest over time. As more fully described in notes 5 and 9, in December 2013, the counterparty, Wells Fargo Bank, N. A. (Wells Fargo), exercised its option related to the Series 2004 swaption, and as a result, the University entered into an interest rate swap. As a result of the exercise of the option, the Series 2004 swaption was terminated. The Series 2006 swaption remains outstanding at September 30, 2014.

The University determined that as of September 30, 2014, the remaining swaption was not a hedging derivative instrument; and that as of September 30, 2013, both then existing swaptions were not hedging derivative instruments. As a result of that determination, the swaptions are required to be reported as investment derivatives with the change in fair value flowing through the statements of revenues, expenses and changes in net position.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

The fair values of the outstanding swaptions were \$(14,191,000) and \$(13,333,000) at September 30, 2014 and 2013, respectively. At September 30, 2014 and 2013, the fair values of the swaptions were included in other long-term liabilities in the accompanying statements of net position. The change in fair value for the years ended September 30, 2014 and 2013 was \$(6,071,000) and \$10,276,000, respectively, and was included in investment income in the accompanying statements of revenues, expenses, and changes in net position for the years ended September 30, 2014 and 2013. See note 5 for further discussion.

In March 2014, the University entered into an interest rate swap arrangement with a counterparty. The resulting derivative is a “receive-variable, pay-fixed” interest rate swap. The University pays the counterparty a fixed semi-annual payment based on an annual rate of 4.9753% and receives on a monthly basis a variable payment of 68% of the one-month London Interbank Offered Rate plus 0.25%. The notional amount of the swap will at all times match the outstanding principal amount of the Series 2014-A bond. The change in fair value of the swap (\$177,000 at September 30, 2014) is reported as a deferred inflow on the 2014 statement of net position since the interest rate swap is a hedging derivative. See note 9 for further discussion.

(l) *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.

(m) *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.

(n) *Capital Assets*

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

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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.

The University evaluates impairment in accordance with GASB Statement No. 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. For the years ended September 30, 2014 and 2013, no impairments were recorded.

(o) Unrecognized Revenue

Student tuition, fees, and dormitory rentals are initially recorded as unrecognized revenue and then recognized over the applicable portion of each school term.

(p) Classification of Net Position

The University's net position is classified as follows:

Net investment in capital assets reflects 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 *net investment in capital assets*.

Restricted, nonexpendable net position consists 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 position includes resources that the University is legally or contractually obligated to spend in accordance with restrictions imposed by external parties.

Unrestricted net position represents 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 position 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

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

governing board to meet current expenses for any purpose. Substantially all unrestricted net position is 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.

(q) *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 position. 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.

(r) *Donor Restricted Endowments*

The University is subject to the "Uniform Prudent Management of Institutional Funds Act (UPMIFA)" 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 law also allows the University to appropriate for expenditure or accumulate to an endowment fund such amounts as the University determines to be prudent for the purposes for which the endowment fund was established. 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 position.

(s) *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.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(t) 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.

(u) 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.

(v) Net Patient Service Revenue and Electronic Health Records Incentive Program

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.

The Centers for Medicare and Medicaid Services (CMS) has implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, and hospitals, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. The Hospitals utilize a grant accounting model to recognize EHR incentive revenues. The Hospitals record EHR incentive revenue ratably throughout the incentive reporting period when it is reasonably assured that it will meet the meaningful use objectives for the required reporting period and that the grants will be received. The EHR reporting period for hospitals is based on the federal fiscal year, which runs from October 1 through September 30.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

USA Medical Center and USA Children's and Women's Hospital did not meet any meaningful use objectives for Medicare during 2014, and therefore have not recognized any revenue for this fiscal year. Both Hospitals expect to meet meaningful use objectives for Medicare during the year ending September 30, 2015. The Hospitals recognized Medicare EHR incentive revenues of \$725,000 for the year ended September 30, 2013. The Hospitals next receipt of Medicaid EHR revenues is expected to occur during the federal fiscal year ended September 30, 2015. EHR incentive revenues are included in other operating revenues in the accompanying statements of revenues, expenses and changes in net position.

(w) *Recently Adopted Accounting Pronouncements*

In 2013, the University adopted the provisions of GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*. GASB Statement No. 61 amends GASB Statements No. 14 and 39 and modifies certain requirements for inclusion of component units in the financial reporting entity. GASB Statement No. 61 requires that for organizations that previously were included as component units by meeting the fiscal dependency criterion, a financial benefit or burden relationship also would need to be present between the primary government and that organization for it to be included in the reporting entity as a component unit. Statement No. 61 also establishes criteria to require inclusion based on other additional factors, such as organization board appointment, financial benefit or burden and operational management of the organization. The adoption of this statement had no financial reporting entity impact on the University's component units; however, it did require additional disclosures for blended component units.

In 2013, the University also adopted the provisions of GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, and GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*, during the year ended September 30, 2013. Retroactive application of the standards was required for all prior periods presented.

GASB Statement No. 63 provides financial reporting guidance for deferred outflows of resources and deferred inflows of resources. GASB Statement No. 65 establishes accounting and reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The University had historically deferred certain debt financing costs related to its bond issues and was amortizing those costs over the term of the related bond issue. GASB Statement 65 requires that debt issuance costs, except any portion related to prepaid insurance costs, be recognized as an expense in the period incurred. The adoption of the provisions of GASB Statement No. 65 decreased beginning net position at October 1, 2011 by \$1,774,000.

(x) *Compensated Absences*

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

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(y) ***Reclassifications***

Certain amounts in the 2013 basic financial statements have been reclassified in order to conform to 2014 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 these designations, 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, 2014, the net public deposits subject to collateral requirements for all institutions participating in the pool totaled approximately \$9,342,196,000. The University had cash and cash equivalents totaling \$132,009,000 and \$223,745,000 at September 30, 2014 and 2013, respectively.

At September 30, 2014, restricted cash and cash equivalents consist of \$3,760,000 related to cash included in the PLTF and GLTF to pay insurance liability claims, and \$39,932,000 of unspent proceeds from the issuance of University bonds for capital purchases as outlined in the bond indenture. At September 30, 2013, restricted cash and cash equivalents consist of \$28,547,000 related to swaption collateral obligations, \$2,621,000 related to cash included in the PLTF and GLTF to pay insurance liability claims and \$54,967,000 of unspent proceeds from the issuance of University bonds for capital purchases as outlined in the bond indenture.

(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

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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 shared by the PLTF and GLTF (the Trust Fund Investment Policy.) The objectives of the Trust Fund Investment Policy are to provide a source of funds to pay general and professional liability claims and to achieve long-term capital growth to help defray future funding requirements. Additionally, investments of the University’s component units both blended and discretely presented are subject to UPMIFA as well as any requirements placed on them by contract or donor agreements.

Certain investments, primarily related to the University’s endowment assets, are pooled. The University uses this pool to manage its investments and distribute investment income to individual endowment funds.

Investments of the University, by type, at fair value, are as follows at September 30, 2014 and 2013 (in thousands):

	2014	2013
U.S. Treasury notes	\$ 8,885	8,496
U.S. federal agency notes	101,201	19,676
Pooled equity mutual funds	82,233	71,406
Pooled debt mutual funds	36,426	30,594
Managed income alternative investments (low-volatility multi-strategy funds, private placement fund-of-funds, relative value arbitrage funds, and other)	29,224	27,791
State agency obligations	—	394
Other	13,987	13,366
	\$ 271,956	171,723

At September 30, 2014 and 2013, \$16,395,000 and \$10,272,000, respectively, of appreciation in fair value of investments of donor-restricted endowments was recognized and are included in restricted expendable net position in the accompanying statements of net position.

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.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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, 2014 is as follows:

	<u>Credit rating</u>	<u>of total investments</u>
Federal Home Loan Mortgage Corporation	AAA	7.8%
Federal Home Loan Bank Corporation	AAA	13.4
Federal National Mortgage Association	AAA	5.5
Common Fund Bond Fund	A+	11.5
PIMCO Pooled Bond Fund	A/BA/AA	2.0
Federal Farm Credit Banks Funding Corporation	AAA	9.6
Federal Agricultural Mortgage Corporation	AAA	1.0
Common Fund Equity Fund	N/A*	13.3

The University's exposure to credit risk and concentration of credit risk at September 30, 2013 is as follows:

	<u>Credit rating</u>	<u>of total investments</u>
Federal Home Loan Mortgage Corporation	Aaa	4.9%
Federal Home Loan Bank Corporation	Aaa	2.3
Federal National Mortgage Association	Aaa	1.3
Common Fund Bond Fund	AA	15.2
Various State Agency Obligations	Aaa/A2	0.2
PIMCO Pooled Bond Fund	AA+/NR	2.7
Federal Farm Credit Banks Funding Corporation	Aaa	2.9
Federal Agricultural Mortgage Corporation	Aaa	0.1
Common Fund Equity Fund	N/A*	17.4

*Credit rating in not applicable

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

Interest Rate Risk

At September 30, 2014, the maturity dates of the University's debt investments were as follows (in thousands):

	Fair value	Years to maturity			
		Less than 1	1 – 5	6 – 10	More than 10
U.S. Treasury notes	\$ 8,885	70	8,815	—	—
U.S. federal agency notes	101,201	8,286	92,915	—	—
Pooled debt mutual funds	36,426	—	32,484	3,942	—
	<u>\$ 146,512</u>	<u>8,356</u>	<u>134,214</u>	<u>3,942</u>	<u>—</u>

At September 30, 2013, the maturity dates of the University's debt investments were as follows (in thousands):

	Fair value	Years to maturity			
		Less than 1	1 – 5	6 – 10	More than 10
U.S. Treasury notes	\$ 8,496	808	7,688	—	—
U.S. federal agency notes	19,676	664	18,930	—	82
Pooled debt mutual funds	30,594	1,183	—	29,411	—
State agency obligations	394	—	—	—	394
	<u>\$ 59,160</u>	<u>2,655</u>	<u>26,618</u>	<u>29,411</u>	<u>476</u>

Pooled debt mutual funds are classified based on the weighted average maturity of the individual investment instruments within each fund.

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,

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

prepayment rates and various liquidity factors related to their specific markets. There were no CMOs in the University's investment portfolio at September 30, 2014 or 2013.

At September 30, 2014, restricted investments consist of \$45,946,000 related to investments included in the PLTF and GLTF to pay insurance liability claims and \$41,700,000 in required collateral related to the 2006 swaption and the 2014 interest rate swap. At September 30, 2013, restricted investments consist of \$40,553,000 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 equity securities totaling \$133,236,000 and \$114,193,000, at June 30, 2014 and 2013, respectively.

Investment income was comprised of the following for the years ended June 30, 2014 and 2013 (in thousands):

	2014	2013
Unrealized gains	\$ 28,429	18,296
Realized gains	2,547	2,644
Timber sales	3,132	2,764
Interest and dividends	2,079	1,965
Rents	634	605
Royalties	171	148
	\$ 36,992	26,422

Investment related expenses in the amount of \$295,000 and \$259,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2014 and 2013 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2014 and 2013 consisted of the following property held (in thousands):

	2014	2013
Land and land improvements – held for investment	\$ 29,926	29,910
Building and building improvements – held for investment, net of depreciation	1,081	1,100
	\$ 31,007	31,010

Timber and mineral properties are stated at fair 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, 2014 and 2013

Investments at June 30, 2014 and 2013, include an equity interest in a timberland management company. The company's primary assets consist of timberland. The Foundation's proportionate share of the fair value of the company is based upon the valuation of the trustee responsible for the management of the company and the timber valuation.

The Foundation has adopted Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, (formally FASB Statement No. 157, *Fair Value Measurements*). ASC 820 provides a single definition of fair value and a hierarchical framework for measuring it, as well as establishing additional disclosure requirements about the use of fair value to measure assets and liabilities. Fair value measurements are classified as either observable or unobservable in nature. Observable fair values are derived from quoted market prices for investments traded on an active exchange or in dealer markets where there is sufficient activity and liquidity to allow price discovery by substantially all market participants (Level 1). The Foundation's observable values consist of investments in exchange-traded equity securities with a readily determinable market price. Other observable values are fair value measurements derived either directly or indirectly from quoted market prices (Level 2). Investments that are not traded on an active exchange and do not have a quoted market price are classified as unobservable (Level 3). The Foundation's unobservable values consist of investments in timber and real estate with fair values based on independent third-party appraisals performed by qualified appraisers specializing in timber and real estate investments.

The Foundation's investment assets at June 30, 2014 and 2013, respectively, are summarized based on the criteria of ASC 820 as follows (in thousands):

Description	Fair value measurements at June 30, 2014			
	Level 1	Level 2	Level 3	Total
Equity securities	\$ 71,080	62,156	—	133,236
Timber and mineral properties	—	—	156,320	156,320
Real estate	—	—	31,007	31,007
Other investments	—	—	6,054	6,054
	<u>\$ 71,080</u>	<u>62,156</u>	<u>193,381</u>	<u>326,617</u>

Description	Fair value measurements at June 30, 2013			
	Level 1	Level 2	Level 3	Total
Equity securities	\$ 57,870	56,323	—	114,193
Timber and mineral properties	—	—	154,332	154,332
Real estate	—	—	31,010	31,010
Other investments	—	—	6,040	6,040
	<u>\$ 57,870</u>	<u>56,323</u>	<u>191,382</u>	<u>305,575</u>

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

For the year ended June 30, 2014, activity in investment assets valued at fair value based on unobservable values is as follows (in thousands):

Description	Timber and mineral properties	Real estate	Other investments	Total
Beginning balance	\$ 154,332	31,010	6,040	191,382
Total gains (losses) (realized/unrealized)	5,503	28	14	5,545
Acquisitions	—	2	—	2
Reforestation	367	—	—	367
Depreciation/depletion	(3,882)	(33)	—	(3,915)
Ending balance	<u>\$ 156,320</u>	<u>31,007</u>	<u>6,054</u>	<u>193,381</u>

For the year ended June 30, 2013, activity in investment assets valued at fair value based on unobservable values is as follows (in thousands):

Description	Timber and mineral properties	Real estate	Other investments	Total
Beginning balance	\$ 153,574	31,040	5,522	190,136
Total gains (losses) (realized/unrealized)	3,876	—	518	4,394
Acquisitions	—	3	—	3
Reforestation	273	—	—	273
Depreciation/depletion	(3,391)	(33)	—	(3,424)
Ending balance	<u>\$ 154,332</u>	<u>31,010</u>	<u>6,040</u>	<u>191,382</u>

As of June 30, 2014, the Foundation has no outstanding commitments to purchase securities or other investments. Additionally, substantially all of the Foundation's equity securities at June 30, 2014 and 2013 are considered readily liquid. Timber and mineral properties, real estate, and other investments are generally considered illiquid.

(5) Derivative Transactions – Swaption

In January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds with a counterparty. This transaction was effected through the sale of two swaptions by the University to the counterparty. The transactions resulted in an up-front payment to the University totaling \$9,328,000, which was recorded as a liability, in exchange for selling the counterparty the option to enter into an interest rate swap with respect to the Series 2004 and 2006 bonds in 2014 and 2016, respectively.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

Objective of the Derivative Transaction

The objective of this transaction was to realize debt service savings currently from future debt refunding and create an economic benefit to the University.

Terms

A summary of the transactions is as follows:

<u>Issue</u>	<u>Date of issue</u>	<u>Option expiration date</u>	<u>Effective date of swap</u>	<u>Termination date</u>	<u>Payment amount</u>
Series 2004 bonds	2-Jan-08	16-Dec-13	15-Mar-14	15-Mar-24	\$ 1,988,000
Series 2006 bonds	2-Jan-08	1-Sep-16	1-Dec-16	1-Dec-36	7,340,000

As further discussed in note 9, in December 2013, the counterparty exercised its option with respect to the 2004 swaption. The University refunded its Series 2004 bonds, issued the Series 2014-A variable rate bond and terminated the Series 2004 swaption. As a result of this termination, the borrowing arising from the Series 2004 swaption of \$1,696,000 and the investment derivative (liability) of \$5,213,000 were written off and an investment loss of \$2,229,000 was recognized and reported in the statements of revenues, expenses and changes in net position for the year ended September 30, 2014. A borrowing arising from the 2014 swap of \$9,138,000 was recognized and is reported, net of current year amortization, as long-term debt in the statement of net position at September 30, 2014.

As outlined in the 2008 agreement, if the counterparty exercises its option in 2016 related to the 2006 swaption, the University would, at the counterparty's option, be compelled to enter into an underlying swap. If the option is exercised, the University would begin to make payments on the notional amount, currently \$100,000,000 for the 2006 bonds of the underlying swap contract. Simultaneously, the University would call outstanding 2006 bonds and issue variable rate demand notes (VRDNs) in their place. Under the swap contract, the University would pay a fixed rate of 5.0% on the 2006 bonds to the counterparty and would receive payments based on 68% of the one-month LIBOR index plus 0.25%. Alternatively, although it is not anticipated that this option would be to the University's advantage, the University could, at its option, cash settle the swap and retain its right to refund the 2006 bonds.

If the interest rate environment is such that the counterparty chooses to not exercise its option related to the 2006 swaption, the swaption would be canceled and the University would have no further obligation under this agreement.

Financial Statement Presentation

A swaption is considered a hybrid instrument and as such the payment by the counterparty to the University must be bifurcated into two components, a borrowing component and an embedded derivative component, and each component treated separately. The embedded derivative value of the swaption represents the fair value resulting from the fact that the fixed rate stated in the swaption is greater than the at-the-market rate. The initial value of the borrowing is the difference between the upfront payment and the

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

fair value of the embedded derivative and represents the time value to the counterparty for holding the option, or the probability-weighted, discounted values of a range of future possible outcomes. The values of the derivatives and borrowings at the date of execution of this transaction were as follows:

	2004 Bonds	2006 Bonds
Embedded derivatives	\$ 918,000	3,343,000
Borrowings	1,070,000	3,997,000
	\$ 1,988,000	7,340,000

The values of any remaining borrowings are included in long-term debt on the University's 2014 and 2013 statements of net position. Interest is being accreted on, and added to, the borrowings through the expiration date of the option. For the years ended September 30, 2014 and 2013, \$379,000 and \$400,000, respectively, was accreted and is included in interest expense in the statements of revenues, expenses, and changes in net position.

The fair values of the embedded investment derivatives are reported as investment assets, if the swaption derivatives are assets, or other noncurrent liabilities, depending on the fair values of the swaption derivatives. The change in the fair market values of the swaption derivatives is reported as a component of investment income (loss) in the statements of revenues, expenses and changes in net position. At September 30, 2014 and 2013, the negative fair values of the swaption derivatives are approximately \$(14,191,000) and \$(13,333,000) and are included in other long-term liabilities in the accompanying statements of net position. For the years ended September 30, 2014 and 2013, the changes in the fair value of the derivatives were \$(6,071,000) and \$10,276,000, respectively.

Fair Value

At September 30, 2014 and 2013, the total of the embedded derivatives associated with the outstanding swaptions had negative fair values of \$(14,191,000) and \$(13,333,000), respectively. The fair values of these swaption derivatives were estimated using the zero-coupon method. This method calculates the future net settlement payments required by the instruments, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement.

Risks Associated with this Transaction

Certain risks are inherent to derivative transactions.

Interest rate risk. Interest rate risk, as a result of rising short-term interest rates causing higher interest rate payments, is effectively hedged by the University's fixed rate bonds. If the counterparty exercises its options, the underlying swaps are expected to effectively hedge the potentially higher payments on VRDNs as well. The University is also subject to interest rate risk, as a result of changes in long-term interest rates, which may cause the value of fixed rate bonds or interest rate derivatives to change. If long-term interest

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

rates fall subsequent to the execution of this transaction, the value of the swaption will change, with negative consequences for the University.

Market access risk. This transaction assumes that VRDNs will be issued as a replacement of the 2006 bonds. If the University is unable to issue variable rate bonds after the counterparty exercises its right under the remaining swaption, the University would still be required to begin making periodic payments on the swap, even though there are no related bonds. Alternatively, the University could choose to liquidate the swap, which may create a substantial cash outlay.

Basis risk. If the counterparty exercises its option, there is a risk that the floating payments received under the swap will not fully offset the variable rate payments due on the assumed VRDNs.

Credit risk. Although the underlying swap exposes the University to credit risk should the swap be executed, the swaption itself does not expose the University to credit risk. If the option is exercised, the University would begin to make payments on the appropriate notional amount of the underlying swap contract. In that situation, if the fair value of the swap is positive, the University would be exposed to credit risk on the swap in the amount of its fair value. As of September 30, 2014 and 2013, the swap counterparty was rated Aa3 by Moody's Investors Services and AA – by Standard and Poor's Rating Services.

Termination risk. The University may be required to terminate the swaption or swap under certain circumstances, such as credit downgrades or other events specified in the contracts. In the event that a position needs to be terminated, the University may owe a substantial amount of money to terminate the contracts. At September 30, 2014 and 2013, no events of termination have occurred.

(6) Capital Assets

(a) University of South Alabama

A summary of the University's capital asset activity for the year ended September 30, 2014 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 and other	\$ 22,516	—	—	—	22,516
Construction-in-progress	137,678	32,167	(61,534)	—	108,311
	<u>160,194</u>	<u>32,167</u>	<u>(61,534)</u>	<u>—</u>	<u>130,827</u>
Capital assets being depreciated:					
Land improvements	30,934	4	457	—	31,395
Buildings, fixed equipment, and infrastructure	555,661	2,819	43,563	(618)	601,425
Other equipment	130,979	6,223	17,514	(4,034)	150,682
Library materials	57,608	3,024	—	—	60,632
	<u>775,182</u>	<u>12,070</u>	<u>61,534</u>	<u>(4,652)</u>	<u>844,134</u>

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Less accumulated depreciation for:					
Land improvements	\$ (17,216)	(1,203)	—	—	(18,419)
Buildings, fixed equipment, and infrastructure	(205,155)	(15,913)	—	8	(221,060)
Other equipment	(103,546)	(7,395)	—	70	(110,871)
Library materials	(43,629)	(2,679)	—	—	(46,308)
	<u>(369,546)</u>	<u>(27,190)</u>	<u>—</u>	<u>78</u>	<u>(396,658)</u>
Capital assets being depreciated, net	<u>405,636</u>	<u>(15,120)</u>	<u>61,534</u>	<u>(4,574)</u>	<u>447,476</u>
Capital assets, net	<u>\$ 565,830</u>	<u>17,047</u>	<u>—</u>	<u>(4,574)</u>	<u>578,303</u>

At September 30, 2014, the University had commitments of approximately \$3,468,000 related to various construction projects.

A summary of the University's capital asset activity for the year ended September 30, 2013 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 and other	\$ 25,528	445	—	(3,457)	22,516
Construction-in-progress	119,763	59,104	(41,189)	—	137,678
	<u>145,291</u>	<u>59,549</u>	<u>(41,189)</u>	<u>(3,457)</u>	<u>160,194</u>
Capital assets being depreciated:					
Land improvements	31,256	244	—	(566)	30,934
Buildings, fixed equipment, and infrastructure	539,118	3,442	40,922	(27,821)	555,661
Other equipment	133,090	8,291	267	(10,669)	130,979
Library materials	54,656	2,952	—	—	57,608
	<u>758,120</u>	<u>14,929</u>	<u>41,189</u>	<u>(39,056)</u>	<u>775,182</u>

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Less accumulated depreciation for:					
Land improvements	\$ (16,588)	(1,194)	—	566	(17,216)
Buildings, fixed equipment, and infrastructure	(208,499)	(15,954)	—	19,298	(205,155)
Other equipment	(104,084)	(10,012)	—	10,550	(103,546)
Library materials	(41,041)	(2,588)	—		(43,629)
	<u>(370,212)</u>	<u>(29,748)</u>	<u>—</u>	<u>30,414</u>	<u>(369,546)</u>
Capital assets being depreciated, net	<u>387,908</u>	<u>(14,819)</u>	<u>41,189</u>	<u>(8,642)</u>	<u>405,636</u>
Capital assets, net	<u>\$ 533,199</u>	<u>44,730</u>	<u>—</u>	<u>(12,099)</u>	<u>565,830</u>

At September 30, 2013, the University had commitments of approximately \$13,918,000 related to various construction projects.

(b) USA Research and Technology Corporation

Changes in capital assets for the years ended September 30, 2014 and 2013 are as follows (in thousands):

	2014				
	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Land improvements	\$ 2,199	—	—	—	2,199
Buildings	27,898	19	—	—	27,917
Tenant improvements	868	45	—	—	913
Construction in progress	—	—	—	—	—
Other equipment	256	—	—	—	256
	<u>31,221</u>	<u>64</u>	<u>—</u>	<u>—</u>	<u>31,285</u>
Less accumulated depreciation for:					
Land improvements	(842)	(94)	—	—	(936)
Buildings	(5,146)	(721)	—	—	(5,867)
Tenant improvements	(417)	(130)	—	—	(547)
Other equipment	(115)	(26)	—	—	(141)
	<u>(6,520)</u>	<u>(971)</u>	<u>—</u>	<u>—</u>	<u>(7,491)</u>
Capital assets, net	<u>\$ 24,701</u>	<u>(907)</u>	<u>—</u>	<u>—</u>	<u>23,794</u>

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

		2013				
		Beginning balance	Additions	Transfers	Reductions	Ending balance
	\$	2,201	—	(2)	—	2,199
Land improvements		27,669	235	(6)	—	27,898
Buildings		742	164	8	(46)	868
Tenant improvements		—	—	—	—	—
Construction in progress		256	—	—	—	256
Other equipment		30,868	399	—	(46)	31,221
Less accumulated depreciation						
for:						
Land improvements		(748)	(94)	—	—	(842)
Buildings		(4,261)	(702)	(183)	—	(5,146)
Tenant improvements		(528)	(118)	183	46	(417)
Other equipment		(89)	(26)	—	—	(115)
		(5,626)	(940)	—	46	(6,520)
Capital assets, net	\$	25,242	(541)	—	—	24,701

(7) Noncurrent Liabilities

A summary of the University's noncurrent liability activity for the years ended September 30, 2014 and 2013 follows (in thousands):

		2014					
		Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:							
	\$	400,890	52,044	(57,628)	395,306	14,203	381,103
		400,890	52,044	(57,628)	395,306	14,203	381,103
Other long-term liabilities							
		59,102	42,411	(35,589)	65,924	12,114	53,810
Total noncurrent liabilities							
	\$	459,992	94,455	(93,217)	461,230	26,317	434,913

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

		2013					
		Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:							
Bonds payable and other	\$	359,699	51,981	(10,790)	400,890	13,153	387,737
Total long-term debt		359,699	51,981	(10,790)	400,890	13,153	387,737
Other long-term liabilities		80,065	32,392	(53,355)	59,102	12,633	46,469
Total noncurrent liabilities	\$	439,764	84,373	(64,145)	459,992	25,786	434,206

Other long-term liabilities primarily consist of self-insurance liabilities, liabilities related to compensated absences, and the fair value of derivatives. Amounts due within one year are included in accounts payable, accrued liabilities and unrecognized revenue.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(8) Bonds Payable

Bonds payable consisted of the following at September 30, 2014 and 2013 (in thousands):

	2014	2013
University Tuition Revenue Bonds, Series 1999 Capital Appreciation, 4.70% to 5.25%, payable November 2011 through November 2018	\$ 28,312	31,530
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2004, 2.00% to 5.00%, repaid in April 2014	—	41,690
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2006, 5.00%, payable through December 2036	100,000	100,000
University Facilities Revenue and Capital Improvement Bonds, Series 2008, 3.00% to 5.00%, payable through August 2038	104,200	106,565
University Facilities Revenue and Capital Improvement Bond, Series 2010, 3.81%, payable through August 2030	25,508	26,636
University Facilities Revenue Capital Improvement Bond, Series 2012-A, 2.92% payable through August 2032	23,075	24,050
University Facilities Revenue Capital Improvement Bond, Series 2012-B, 2.14% payable through August 2018	5,265	6,515
University Facilities Revenue Capital Improvement Bond, Series 2013-A, 2.83% payable through August 2033	30,788	32,000
University Facilities Revenue Capital Improvement Bond, Series 2013-B, 2.83% payable through August 2033	7,697	8,000
University Facilities Revenue Capital Improvement Bond, Series 2013-C, 2.78% payable through August 2025	9,454	10,000
University Facilities Revenue Refunding Bond, Series 2014-A, variable rate payable at 68% of LIBOR plus .73%, payable through March 2024	41,245	—
Borrowing arising from swaption, Series 2004 Bonds	—	1,653
Borrowing arising from swaption, Series 2006 Bonds	6,240	5,904
Borrowing arising from interest rate swap	8,682	—
	390,466	394,543
Plus unamortized premium	5,134	6,609
Less unaccreted discount	(29)	(36)
Less unamortized debt extinguishment costs	(265)	(226)
	\$ 395,306	400,890

Substantially all student tuition and fee revenues secure University bonds. Additionally, security for Series 2008 bonds includes Children's and Women's Hospital revenues in an amount not exceeding

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

\$10,000,000. Series 1999 Current Interest Bonds began maturing November 2002, and Capital Appreciation Bonds began maturing in November 2011. Series 1999 Bonds are not redeemable prior to maturity. Series 2004 Bonds began maturing in March 2005 and were redeemed in April 2014. Series 2006 Bonds begin maturing in December 2024 and are redeemable beginning in December 2016. Series 2008 Bonds began maturing in August 2009 and are redeemable beginning in August 2018. The Series 2010 Bond began maturing in August 2011 and is redeemable beginning in February 2020. The 2012-A and 2012-B Bonds began maturing in August 2013. The 2012-A Bond is redeemable beginning in August 2021. The 2012-B Bond is redeemable beginning in January 2015. The 2013-A, 2013-B and 2013-C Bonds began maturing in August 2014 and are redeemable beginning in June 2023. The Series 2014-A bond begins maturing in March 2015 and is redeemable at any time.

In January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to a counterparty. The proceeds from each sale, totaling \$9,328,000, consist of two components, a borrowing and an embedded derivative. The borrowing is included in long-term debt. As a result of this transaction, the counterparty has the option to compel the University to redeem its Series 2004 (occurred in March 2014) and 2006 bonds at their respective redemption dates. See note 5 for a complete description of this transaction.

During the years ended September 30, 2014 and 2013, the maturity value of the Capital Appreciation Bonds increased \$1,432,000 and \$1,581,000, respectively, over the original principal amount of \$19,810,000, reflecting accretion of interest.

Approximately \$1,570,000 of proceeds from the issuance of the Series 2012-A and 2012-B bonds remained unspent at September 30, 2014 and is included in restricted cash and cash equivalents in the 2014 statement of net position. These funds are restricted for capital purposes as outlined in the indenture.

Approximately \$38,362,000 of proceeds from the issuance of the Series 2013-A, 2013-B and 2013-C Bonds remained unspent at September 30, 2014 and is included in restricted cash and cash equivalents in the 2014 statement of net position. These funds are restricted for capital purposes as outlined in the indenture.

The University is subject to arbitrage restrictions on its bonded indebtedness prescribed by the U. S. Internal Revenue Service. As such, amounts are accrued as needed in the University's basic financial statements for any expected arbitrage liabilities. At September 30, 2014 and 2013, no amounts were due or recorded in the financial statements.

The University is subject to restrictive covenants related to its bonds payable. At September 30, 2014, management believes the University was in compliance with such financial covenants.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

Debt Service on Long-Term Obligations

Total debt service by fiscal year is as follows as of September 30, 2014 (in thousands):

	Debt service on bonds			
	Principal	Interest	Additional maturity	Total
2015	\$ 14,099	14,364	(1,627)	26,836
2016	14,643	13,825	(1,286)	27,182
2017	18,178	13,375	(782)	30,771
2018	18,525	12,959	(427)	31,057
2019	17,456	12,650	(49)	30,057
2020–2024	88,565	54,283	—	142,848
2025–2029	84,853	40,914	—	125,767
2030–2034	82,734	23,051	—	105,785
2035–2038	55,584	5,514	—	61,098
Subtotal	394,637	<u>190,935</u>	<u>(4,171)</u>	<u>581,401</u>
Plus (less):				
Additional maturity	(4,171)			
Unamortized bond premium	5,134			
Unaccreted bond discount	(29)			
Unamortized debt extinguishment costs	<u>(265)</u>			
Total	\$ <u>395,306</u>			

The principal amount of debt service due on bonds at September 30, 2014 includes \$3,629,000 representing additional maturity value on Series 1999 Capital Appreciation Bonds. These bonds mature through 2019. Also included in the principal amount of debt service due on bonds at September 30, 2014, is \$542,000 representing additional maturity value of the borrowing resulting from the Series 2006 swaption. As described in note 5, additional maturity will continue to accrue until the swaption option period in 2016. Although this additional maturity is presented as principal on the debt service schedule above, it is also recognized as interest expense on an annual basis in the University's basic financial statements as it accretes.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(a) **USA Research and Technology Corporation**

Notes Payable

Notes payable consisted of the following at September 30, 2014 and 2013 (in thousands):

	2014	2013
Wells Fargo, N.A. promissory note, one-month LIBOR plus 0.85% (1.007% at September 30, 2014) payable through 2028	\$ 14,471	15,128
PNC Bank promissory note, 4.88%, payable through 2021	8,814	9,159
	\$ 23,285	24,287

The note payable to Wells Fargo Bank, N.A. was incurred by the Corporation to acquire Buildings II and III in the USA Technology & Research Park and to provide funds for renovations and tenant finishing costs. The loan is a fully amortizing promissory note with a 20-year term. As more fully described below, the Corporation entered into 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 promissory note payable is secured by an interest in the ground lease with respect to the parcels of land on which Buildings II and III stand, an interest in Buildings II and III, an interest in tenant leases for Buildings II and III, and an interest in income received from rental of Buildings II and III.

The promissory note payable to PNC Bank has a 10-year term and amortization is based on a 20-year term. PNC Bank acquired the promissory note as part of its acquisition of RBC Bank (USA) on March 20, 2012. The Corporation agreed to not transfer or encumber the buildings or its leasehold interest in the real estate on which the buildings stand. The promissory note payable is secured by an interest in tenant leases for Building I and the dialysis services building, and an interest in income received from rental of Building I and the dialysis services building.

In connection with each note, the University entered into an agreement with the lender providing that for any year in which the Corporation’s debt service coverage ratio is less than 1 to 1, the University will pay the Corporation rent equal to the amount necessary to bring the ratio to 1 to 1. The debt service coverage ratio is calculated by dividing the sum of unrestricted cash and cash equivalents at the beginning of the year (reduced by current year capital assets additions) and current year change in net position (determined without depreciation, amortization, and interest expense) by current year debt service. For fiscal 2014 the Corporation’s debt service coverage ratio was 1.34 to 1. Management believes the Corporation was in compliance with its debt covenants, including the debt service coverage ratio covenant, at September 30, 2014. Further, management believes that, based on existing leases and service contracts and agreements, the debt service coverage ratio for fiscal 2015 will be less than the fiscal 2014 debt service coverage ratio of 1.34 to 1, but will still exceed 1 to 1.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

Debt Service on Long-Term Obligations

At September 30, 2014, total debt service by fiscal year is as follows (in thousands):

	Debt service on note and loan		
	Principal	Interest	Total
2015	\$ 1,061	1,295	2,356
2016	1,118	1,238	2,356
2017	1,186	1,169	2,355
2018	1,251	1,105	2,356
2019	1,332	1,023	2,355
2020–2024	12,192	2,904	15,096
2025–2028	5,145	617	5,762
Total	\$ 23,285	9,351	32,636

Derivative Transaction

The Corporation is a party to a derivative with Wells Fargo Bank, N.A., the counterparty (successor to Wachovia Bank, N.A. the original counterparty). The derivative is a “receive-variable, pay-fixed” interest rate swap entered into in connection with the promissory note to Wells Fargo Bank, N.A.

Objective of the derivative transaction. The Corporation utilizes the interest rate swap to convert its variable rate on the promissory note to a synthetic fixed rate.

The swap will terminate on May 1, 2028, when the loan matures. The notional amount of the swap will at all times match the outstanding principal amount of the loan. Under the swap, the Corporation pays the counterparty a fixed payment of 6.10% and receives a variable payment of the one-month LIBOR rate plus 0.85%. Conversely, the loan bears interest at the one-month LIBOR rate plus 0.85%. The Corporation paid approximately \$762,000 and \$789,000 under the interest rate swap agreement for the years ended September 30, 2014 and 2013, respectively, which is reflected as an increase in interest expense.

Fair value. The interest rate swap had a negative fair value of approximately \$(3,053,000) and \$(3,225,000) at September 30, 2014 and 2013, respectively. The changes in fair value are reported as deferred outflows on the accompanying statements of net position since the interest rate swap is a hedging derivative instrument.

The fair value of the interest rate swap was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming that the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero coupon bonds due on the date of each future net settlement.

Interest rate risk. On the Corporation’s “receive-variable, pay-fixed” interest rate swap, as LIBOR decreases, the net payment on the swap increases.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

Credit risk. As of September 30, 2014 and 2013, the Corporation was not exposed to credit risk on the interest rate swap because it had a negative fair value. However, if interest rates change and the fair value of the derivative becomes positive, the Corporation would have a gross exposure to credit risk in the amount of the derivative's fair value. The counterparty was rated Aa3 by Moody's Investors Services and AA –by Standard & Poor's Ratings Services as of September 30, 2014 and 2013.

Termination risk. The interest rate swap 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, 2014 and 2013, no events of default or termination had occurred. If the interest rate swap is terminated, interest rate risk associated with the variable rate debt would no longer be hedged. Also, if at the time of termination the interest rate swap had a negative fair value, the Corporation would be liable to the counterparty for a payment equal to the interest rate swap's 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, 2014, debt service requirements by fiscal year of the variable rate debt and net derivative payments, assuming current interest rates remain the same in the future, are as follows (in thousands):

	<u>Variable rate loan</u>		<u>Interest rate swap, net</u>	<u>Total</u>
	<u>Principal</u>	<u>Interest</u>		
2015	\$ 698	144	729	1,571
2016	738	138	696	1,572
2017	787	129	655	1,571
2018	832	122	618	1,572
2019	893	112	566	1,571
2020–2024	5,378	409	2,070	7,857
2025–2028	5,145	102	515	5,762
Total	<u>\$ 14,471</u>	<u>1,156</u>	<u>5,849</u>	<u>21,476</u>

(9) Derivative Transaction – Interest Rate Swap

The University is a party to a derivative with Wells Fargo Bank, the counterparty. As more fully described in note 5, in December 2013, Wells Fargo exercised its option with respect to the synthetic advance refunding of the Series 2004 bonds to enter into an interest rate swap agreement with the University with an effective date of March 15, 2014. The resulting derivative is a “receive-variable, pay-fixed” interest rate swap. As part of the overall plan of the synthetic refunding of the 2004 bonds, the University redeemed those bonds in April 2014 with proceeds from the 2014-A bond.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

Objective of the transaction. As noted the interest rate swap was the result of the original January 2008 synthetic advance refunding of the Series 2004 bonds. The objective of that transaction was to realize debt service savings currently from future debt refunding and create an economic benefit to the University.

The swap will terminate in March 2024, when the 2014-A bond matures. The notional amount of the swap will at all times match the outstanding principal amount of the bond. Under the swap, the University pays the counterparty a fixed semi-annual payment based on an annual rate of 4.9753% and receives on a monthly basis a variable payment of 68% of the one-month London Interbank Offered Rate (LIBOR) plus 0.25%. Conversely, the Series 2014-A bond bears interest on a monthly basis at 68% of the one-month LIBOR rate plus 0.73%.

Fair value. The interest rate swap had a negative fair value of approximately \$(9,138,000) at its inception. This amount, net of any amortization, is reported as a borrowing arising from the 2014 interest rate swap as long-term-debt in the 2014 statement of net position.

The change in fair value during the current year is reported as a deferred inflow and derivative asset on the statement of net position since the interest rate swap is a hedging derivative instrument. At September 30, 2014, \$177,000 is reported as a derivative asset and deferred inflow.

The fair value of the interest rate swap was estimated using the zero-coupon method. This method calculates the future net settlement payments required by the swap, assuming the current forward rates implied by the yield curve correctly anticipate future spot interest rates. These payments are then discounted using the spot rates implied by the current yield curve for hypothetical zero-coupon bonds due on the date of each future net settlement.

Interest rate risk. As the LIBOR rate decreases, the net payment on the swap increases. This, however, is mitigated by the fact that a decline in the LIBOR rate will also result in a decrease of the University's interest payment on the Series 2014-A bond. The University's exposure is limited to 0.48% of the notional amount, the difference in the payment from the counterparty and the interest payment on the 2014-A bond.

Credit risk. As of September 30, 2014, the University was not exposed to credit risk on the interest rate swap because it had a negative fair value. However, if interest rates change and the fair value of the derivative become positive, the University would have a gross exposure to credit risk in the amount of the derivative's fair value. The counterparty was rated Aa3 by Moody's Investor Services and AA – by Standard & Poor's Ratings Services as of September 30, 2014.

Termination risk. The University may be required to terminate the swap based on certain standard default and termination events, such as failure to make payments, breach of agreement, and bankruptcy. As of the current date, no events of termination have occurred.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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

	Variable rate loan		Interest rate swap, net	Total
	Principal	Interest		
2015	\$ 470	400	1,838	2,708
2016	490	643	1,568	2,701
2017	615	917	1,265	2,797
2018	640	1,088	1,060	2,788
2019	665	1,185	915	2,765
2020-2024	38,365	9,730	2,069	50,164
	<u>\$ 41,245</u>	<u>13,963</u>	<u>8,715</u>	<u>63,923</u>

(10) 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 and settled through 2009. The cost report for USA Children's and Women's Hospital has been audited and settled through 2010. Revenue from the Medicare program accounted for approximately 15% and 14% of the Hospitals' net patient service revenue for the years ended September 30, 2014 and 2013, 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 through 2011 and settled for all fiscal years through 2010. Revenue from the Blue Cross program accounted for approximately 21% and 20% of the Hospitals' net patient service revenue for the years ended September 30, 2014 and 2013, respectively.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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 24% and 22% of the Hospitals’ net patient service revenue for the years ended September 30, 2014 and 2013, 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, 2014 and 2013 follows (in thousands):

	2014	2013
Gross patient service revenue	\$ 610,092	575,718
Less provision for contractual and other adjustments	(271,468)	(250,047)
Less provision for bad debts	(70,175)	(67,464)
	\$ 268,449	258,207

Changes in estimates related to prior cost reporting periods resulted in an increase of approximately \$802,000 and \$1,279,000 in net patient service revenue for the years ended September 30, 2014 and 2013, respectively.

(11) Hospital Lease

In 2006, the University and Infirmiry Health System, Inc. (the Infirmiry) entered into a Lease Agreement (the Lease) in which the University agreed to lease certain land, buildings and equipment used in connection with the operating of its USA Knollwood Hospital campus to the Infirmiry. The original lease was effective through March 2056. The lease provided for its termination, at the option of the Infirmiry, in the event that a change in any law, statue, rule, or a regulation of any governmental or other regulatory body was deemed by the Infirmiry as significant, as defined by the lease. The hospital was operated as Mobile Infirmiry West.

The total amount of the lease payments due the University was based on the fair value of the appraised assets, \$32,418,000. The allocation of the appraised fair value was \$29,370,000 for land and buildings and \$3,048,000 for medical equipment, office furnishings and other equipment. In addition to an up-front payment, the lease agreement required monthly lease payments by the Infirmiry to the University. In order

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

to properly report this transaction, the University bifurcated the lease into an equipment component and a real property component. The equipment component of the lease was considered a capital lease and as such, a lease receivable was reported in the accompanying basic financial statements of the University. The component of the lease attributable to land and buildings was considered an operating lease. As such, lease revenue was recorded and is being earned over the life of the lease. Lease revenue in the amounts of approximately \$0 and \$164,000 was reported as other operating revenue in the accompanying basic financial statements for the years ended September 30, 2014 and 2013, respectively. Payments received in excess of the amount recognized as lease revenue were unrecognized and amortized over the term of the lease.

In October 2012, officials of the Infirmary publically announced the closing of the Mobile Infirmary West effective October 31, 2012.

As a result of the closing of the hospital, in May 2013, the University Board of Trustees determined that it was in the best interest of the University to sell Knollwood Hospitals, all related furniture and equipment, adjacent medical office buildings and land. As such, the Board approved a resolution authorizing University management to seek proposals for the sale of Knollwood Hospitals and proceed with negotiations with potential buyers. Subsequent to a public advertisement and negotiation period, the University and the Infirmary entered into a Purchase and Sale Agreement (the Agreement), dated June 5, 2013. The Agreement called for the sale of all land, buildings, furniture and equipment at Knollwood Hospitals to the Infirmary for a purchase price of \$5,000,000 and effectively canceled the original 2006 lease agreement. Following a period of due diligence the transaction was closed on July 19, 2013. At closing, the Infirmary made a payment of \$2,500,000 to the University and issued a promissory note, dated July 19, 2013, for the remaining \$2,500,000 which was received by the University in July 2014.

At the time of the closing, the University wrote off capital assets with a cost of approximately \$31,597,000 and accumulated depreciation of approximately \$19,601,000. Unrecognized revenue related to the original lease of approximately \$5,692,000 was also written off. As of September 30, 2013, a note receivable in the amount of \$2,500,000, due July 19, 2014, was recognized and is reported as a current note receivable in the University's 2013 statement of net position. As a result of the transaction, the University recognized a loss on the sale of \$1,304,000 which is reported as an other nonoperating expense in the 2013 statement of revenues, expenses and changes in net position.

(12) 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

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

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.

Prior to October 1, 2011, essentially all employees covered by this retirement plan were required to contribute 5% of their eligible earnings to TRS. Effective October 1, 2011 and 2012, the required employee contribution was increased to 7.25% and 7.5%, respectively, of their eligible earnings. An actuary employed by the TRS Board of Control establishes the employer-matching amount annually. During 2014, 2013 and 2012, the University made total contributions of \$24,573,000, \$21,879,000, and \$23,381,000 (100% of the required contributions), respectively, to TRS on behalf of participants. For employees that were hired before January 1, 2013, the University contribution rate was 11.7%, 10.1%, and 10.0% in 2014, 2013 and 2012, respectively, of each participant's gross earnings. For employees hired after January 1, 2013, the University contribution rate was 11.1% and 9.4% in 2014 and 2013, respectively, of each participant's gross earnings. The University's payroll for all employees was approximately \$246,896,000 and \$254,249,000 in 2014 and 2013, respectively. The LLC's payroll for all employees was approximately \$78,975,000 and \$61,645,000 in 2014 and 2013, respectively. Total payroll for University employees participating in the Teachers' Retirement System of Alabama was approximately \$210,359,000 and \$217,164,000 in 2014 and 2013, 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 \$840,000 and \$928,000 in 2014 and 2013, respectively, representing 344 and 436, respectively, employees participating in this Plan.

All employees of the LLC working at least half time are eligible to participate in a defined contribution pension plan. Under this plan, contributions by eligible employees are matched equally by the LLC up to a maximum of 5% of current annual pay. The LLC and the employees contributed \$2,454,000 and \$1,885,000, respectively, in 2014 and 2013 representing 867 and 679, employees participating in this plan. University employees as of September 30, 2011 who later transfer to the LLC are immediately vested in the plan. All other employees do not vest until they have held employment with the LLC for thirty-six months; at which time they become 100% vested in the plan.

(b) *Compensated Absences*

Regular University employees accumulate vacation and sick leave and hospital and clinical employees accumulate paid time off. These are subject to maximum limitations, at varying rates depending upon their employee classification and length of service. Upon separation of employment, employees who were hired before January 1, 2012 are paid all unused accrued vacation at their

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

regular rate of pay up to a maximum of two times their annual accumulation rate. Employees hired after January 1, 2012 are not eligible for payment of unused accrued vacation or PTO hours upon separation of employment. The accompanying statements of net position include accruals for vacation pay and paid time off of approximately \$15,535,000 and \$15,763,000 at September 30, 2014 and 2013, respectively. The current portion of the accrual is included in accounts payable and accrued liabilities and the noncurrent portion is included in other long term liabilities in the accompanying basic financial statements. No accrual is recognized for sick leave benefits since no terminal cash benefit is available to employees for accumulated sick leave.

(c) Other Postretirement Employee Benefits

As the provider of postretirement benefits to state retirees, the state is responsible for implementing GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. 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, 2014 and 2013, the University's expense related to PEEHIP was \$7,963,000 and \$7,130,000, respectively.

(13) Risk Management

The University, USAHSF, LLC and SAMSF participate in the professional liability trust fund and the University, USAHSF, LLC, SAMSF and the Corporation participate 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 participating entities 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, 2014 and 2013. 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 and LLC participate in a self-insured health plan, administered by an unaffiliated entity. Administrative fees paid by the University for such services were approximately \$1,770,000 and \$1,697,000 in 2014 and 2013, 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.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

The changes in the total self insurance liabilities for the years ended September 30, 2014 and 2013 for the PLTF, GLTF and health plan are summarized as follows (in thousands):

	2014	2013
Balance, beginning of year	\$ 21,297	22,747
Liabilities incurred and other additions	58,311	60,804
Claims, administrative fees paid and other reductions	(49,816)	(62,254)
Balance, end of year	\$ 29,792	21,297

Self-insurance liabilities due within one year are included in accounts payable and accrued liabilities. The noncurrent portion is included in other long-term liabilities in the accompanying basic financial statements.

(14) Other Related Party

SAMSF is a not-for-profit corporation that exists for the purpose of promoting education and research at the University. At September 30, 2014 and 2013, SAMSF had total assets of \$12,882,000 and \$12,235,000, net assets of \$9,899,000 and \$9,501,000, and total revenues of \$3,635,000 and \$3,474,000, respectively. SAMSF reimburses the University for certain administrative expenses and other related support services. Total amounts received for such expenses were approximately \$707,000 and \$711,000 in 2014 and 2013, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net position.

(15) Commitments and Contingencies

(a) Grants and Contracts

At September 30, 2014 and 2013, the University had been awarded approximately \$23,990,000 and \$24,175,000, 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 \$77,000 irrevocable standby letter of credit with Wells Fargo, N.A. The Alabama Medicaid Agency is the beneficiary of this letter of credit. No funds were advanced under this letter during the years ended September 30, 2014 and 2013.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(c) ***Litigation***

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

(d) ***Rent Supplement Agreements***

The University has entered into two irrevocable rent supplement agreements with the Corporation and a financial institution. The agreements require that, in the event the Corporation fails to maintain a debt service coverage ratio of one to one with respect to all of its outstanding indebtedness, the University will pay to the Corporation any and all rent amounts necessary to cause the Corporation's net operating income to be equal to the Corporation's annual debt service obligations (see note 8). As of September 30, 2014 and 2013, no amounts were payable pursuant to these agreements.

(e) ***State Bond Issues***

The State of Alabama has made allocations to the University from bond issues in prior years. Pursuant to these allocations, at September 30, 2014, approximately \$112,000 is unspent and remains available to the University for certain future construction costs. The allocations have not been reflected in the accompanying basic financial statements.

(f) ***Sale of Brookley Campus***

On September 29, 2010, the University and the USA Foundation executed purchase and sale agreement calling for the University to sell approximately 327 acres on Mobile Bay, known as the Brookley campus, to the Foundation. The terms of the agreement required the Foundation to pay the University \$20,000,000; \$4,000,000 at closing and \$4,000,000 annually thereafter through the 2015 fiscal year. The sale closed on November 10, 2010 and the initial payment was received by the University at that point. The transaction is recorded as an installment sale. As such, during the years ended September 30, 2014 and 2013, the University reported a gain on the sale of \$2,201,000 and \$2,116,000, respectively, which is reported as other nonoperating revenues in the statements of revenues, expenses and changes in net position. At September 30, 2014, the University is reporting a note receivable from the Foundation in the amount of \$3,846,000 (reported as a current asset in notes receivable) and unrecognized revenue in the amount of \$2,289,000 (reported as current unrecognized revenue). At September 30, 2013, the University is reporting a note receivable from the Foundation in the amount of \$7,544,000 (\$3,698,000 is reported as a current asset in notes receivable and \$3,846,000 is reported as a noncurrent asset in noncurrent notes receivable) and unrecognized revenue in the amount of \$4,489,000 (\$2,201,000 is reported as current unrecognized revenue and \$2,288,000 as other noncurrent liabilities). The unrecognized revenue will be amortized as an installment gain as payments are received through 2015.

(g) ***USA Research and Technology Corporations Leases***

The Corporation leases space in Building I to three tenants under operating leases. One lease has a 5-year initial term expiring in October 2018 with two 5-year renewal options. Another lease has a

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

10-year initial term expiring in March 2021, an option to cancel at the end of 6 years, and two 5-year renewal options. The third lease has a 67-month initial term expiring in December 2018 with no renewal options.

Space in Buildings II and III is leased under operating leases to the University and various other tenants. These leases have terms varying from month-to-month to ten years.

The Corporation leases from the University the third floor of a campus building. Located on that floor is the Coastal Innovation Hub (the Hub), a technology incubator, which currently houses three tenants with month-to-month leases.

Under leases for Buildings I, II, and III, 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). Under Hub leases, the Corporation must pay all operating expenses of the space, without reimbursement from tenants.

Space under lease to the University was 46,700 and 48,900 square feet at September 30, 2014 and 2013, respectively.

The Corporation owns a building located on the premises of the USA Medical Center which is leased to a single tenant. The Corporation paid for construction of the building shell and land improvements while the tenant paid for the cost of finishing the building's interior. The lease has a ten year initial term with three five-year renewal options. Under the lease, the tenant must also pay for utilities, taxes, insurance, and interior repairs and maintenance. The Corporation is responsible for repairs and maintenance to the exterior and HVAC system.

The Corporation, as lessor, had three ground leases in place at September 30, 2014 and 2013. One lease is for a 40-year initial term with 20-year, and 15-year renewal options. The second lease is for a 30-year initial term with four 5-year renewal options. The third lease has a 38.5-year initial term with 20-year and 15-year renewal options.

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

2015	\$	2,454
2016		1,894
2017		1,831
2018		1,721
2019		1,116
2020–2046		<u>7,623</u>
Total	\$	<u><u>16,639</u></u>

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(16) Functional Information

Operating expenses by functional classification for the years ended September 30, 2014 and 2013 are listed below (in thousands). In preparing the basic financial statements, all significant transactions and balances among accounts have been eliminated.

	<u>2014</u>	<u>2013</u>
Instruction	\$ 128,785	118,254
Research	22,454	21,095
Public service	39,601	46,723
Academic support	16,791	15,999
Student services	31,421	28,673
Institutional support	25,903	28,528
Operation and maintenance of plant	27,978	26,459
Scholarships	7,299	6,532
Hospital	286,387	265,775
Auxiliary enterprises	15,501	14,233
Depreciation and amortization	31,858	29,849
	<u>\$ 633,978</u>	<u>602,120</u>

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

(17) Blended Component Units

As more fully described in notes 1(b) and 1(c), the LLC, PLTF and GLTF are considered component units pursuant to the provisions of GASB Statement No. 61. In accordance with that statement, the LLC, PLTF and GLTF are reported as blended component units. Required combining financial information of the aggregate blended component units is presented below (in thousands):

	2014	2013
Current assets	\$ 9,257	21,018
Noncurrent assets	49,706	29,755
Total assets	58,963	50,773
Current liabilities	33,460	34,187
Noncurrent liabilities	24,981	16,301
Total liabilities	58,441	50,488
Net position	\$ 522	285
Operating revenues	\$ 103,895	83,710
Operating expenses	(105,665)	(86,948)
Operating loss	(1,770)	(3,238)
Nonoperating revenues	2,006	3,325
Change in net position	\$ 236	87

(18) Significant New (Future) Accounting Pronouncements

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions*. GASB Statement No. 68 changes accounting and financial reporting for entities participating in certain pension plans and will be effective for the year ending September 30, 2015. Statement No. 68 will require the University to record its share, as determined by an independent actuary, of the net unfunded pension liability, and its share of the changes in that net pension liability, for all cost-sharing defined benefit plans in which it participates.

In January 2013, the GASB issued Statement No. 69, *Government Combinations and Disposals of Government Operations*. GASB Statement No. 69 establishes accounting and financial reporting standards related to government combinations and disposal of government operations and will be effective for the year ending September 30, 2015. In November 2013, the GASB issued Statement No. 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. GASB Statement No. 71 was issued as an amendment of GASB Statement No. 68 with an objective of addressing an issue regarding application of the transition provisions of Statement No. 68 relating to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. Statement 71 will be effective for the year ending September 30, 2015.

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

Notes to Basic Financial Statements

September 30, 2014 and 2013

While the impact of the implementation of GASB Statement No. 68 has not yet been determined, it is expected that such implementation will have a material effect on the net position of the University. The effect of the implementation of GASB Statements Nos. 69 and 71 on the University has not been determined.

