KPMG

UNIVERSITY OF SOUTH ALABAMA

(A Component Unit of the State of Alabama)

Basic Financial Statements and Supplementary Information
on Federal Awards Programs

September 30, 2014

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

September 30, 2014 and 2013

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Introduction

The following discussion presents an overview of the financial position and financial activities of the University of South Alabama (the University), including the University of South Alabama Hospitals (the Hospitals), a division of the University, at September 30, 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%, 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.

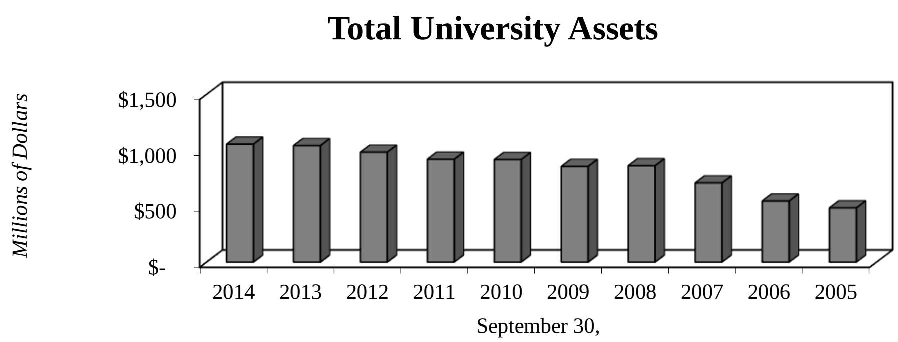
The Condensed Schedules of Net Position at September 30, 2014, 2013, and 2012 follow (in thousands):

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.

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:

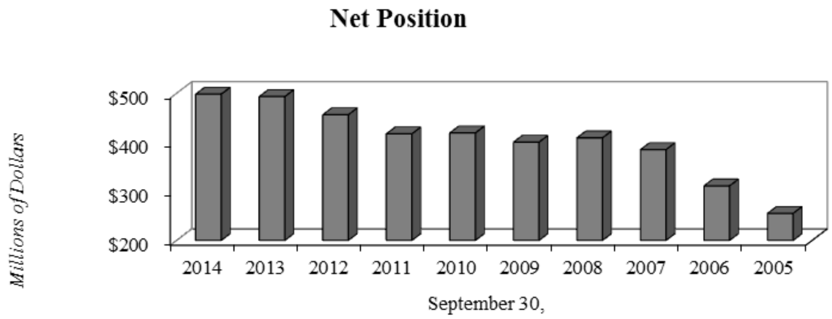
Net investment in capital assets represents the University's capital assets less accumulated depreciation and outstanding principal balances of the debt attributable to the acquisition, construction, or improvement of those assets.

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.

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.

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

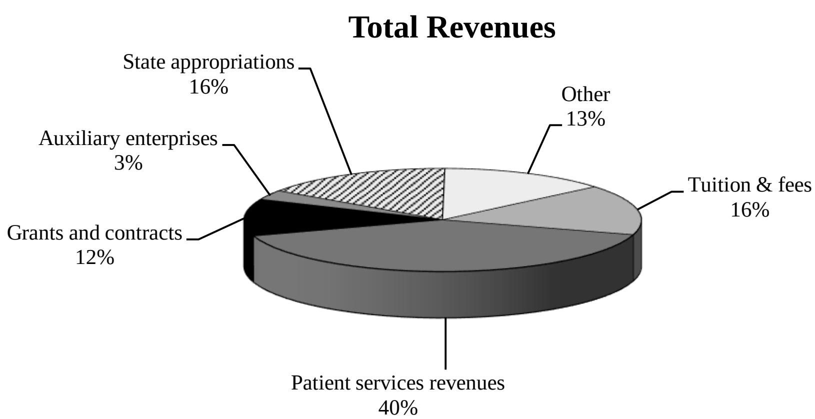
		2014	2013	2012
Operating revenues:				
Tuition and fees	$	104,448	95,709	88,299
Net patient service revenue		268,449	258,207	247,802
Federal, state and private grants and contracts		76,719	77,302	76,448
Other		54,010	52,388	56,579
		503,626	483,606	469,128
Operating expenses:				
Salaries and benefits		419,966	401,872	396,170
Supplies and other services		158,615	148,597	134,841
Other		55,397	51,651	51,222
		633,978	602,120	582,233
Operating loss		(130,352)	(118,514)	(113,105)
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		126,376	142,730	132,397
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		10,536	15,263	19,097
Change in net position		6,560	39,479	38,389
Beginning net position, before cumulative effect of change in accounting principle		492,990	453,511	416,896
Cumulative effect of change in accounting principle		—	—	(1,774)
Beginning net position – as adjusted		492,990	453,511	415,122
Ending net position	$	499,550	492,990	453,511

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.

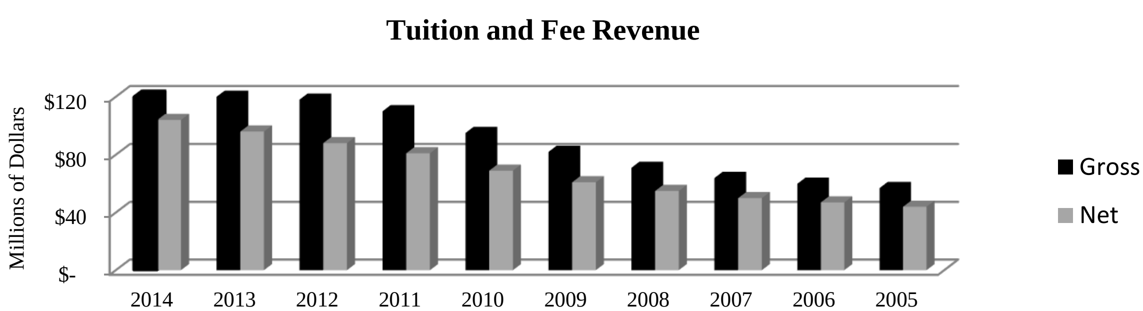
(Continued)

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:



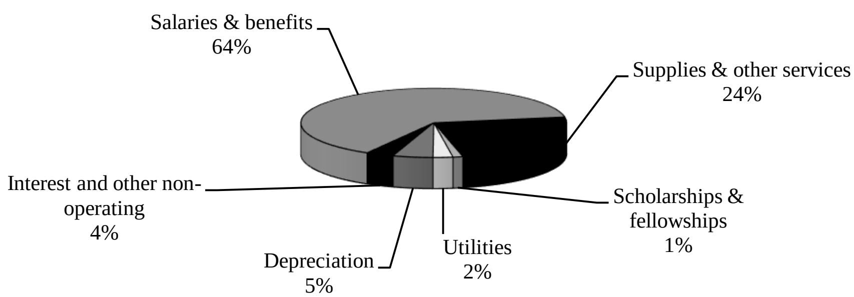
Tuition and fees have increased in each of the last ten years. These increases are due primarily to increases in tuition and fee rates charged to students as well as to an increase in the number of students enrolled and credit hours taken by those students. Additionally, net tuition and fees as a percent 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 expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2014 is presented below:

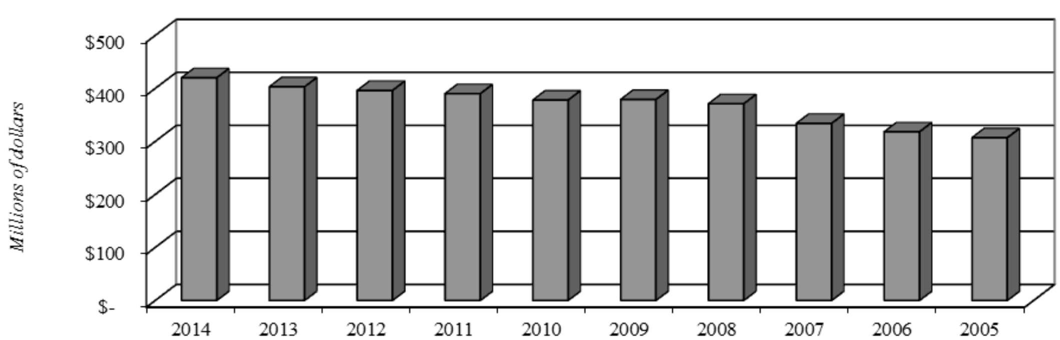
Total Expenses



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

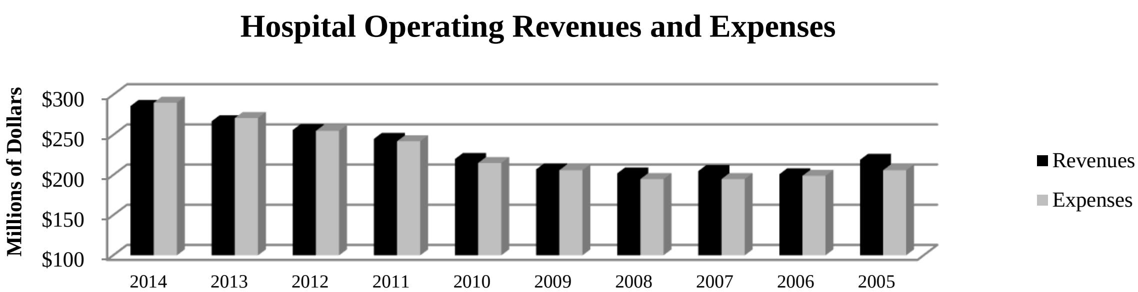
In 2014, 2013, and 2012, approximately 66%, 67% and 68%, respectively, of the University's total operating expenses were salaries and benefits. After steady increases from 2005 to 2008, salaries and benefits have been relatively constant since 2008, as follows:

Total Salaries and Benefits Expense



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 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:



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.

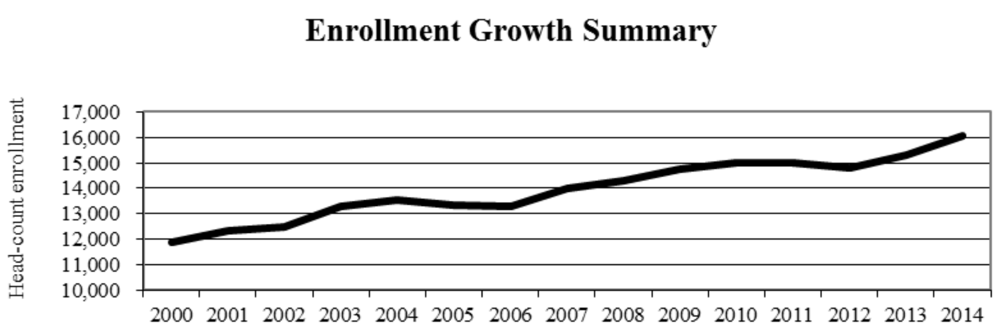
In order to realize debt service savings currently from future debt refunding, in January 2008, the University entered into a synthetic advance refunding of the outstanding Series 2004 and 2006 bonds. This transaction was effected through the sale of two swaptions by the University to the counterparty 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.

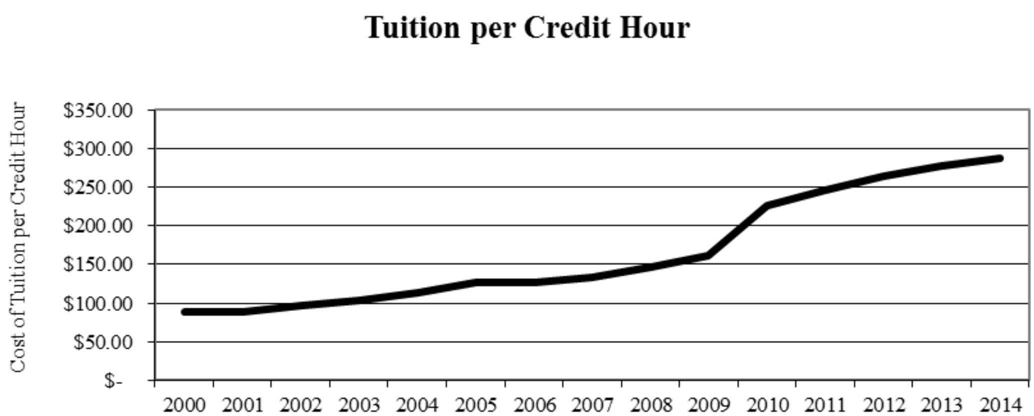
The University's bond credit rating is A1 as rated by Moody's Investors Services and A+ as rated by Standard and Poor's Rating Services. Neither rate changed during 2014.

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:



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-statetuition per credit hour between 2000 and 2014 is as follows:



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.

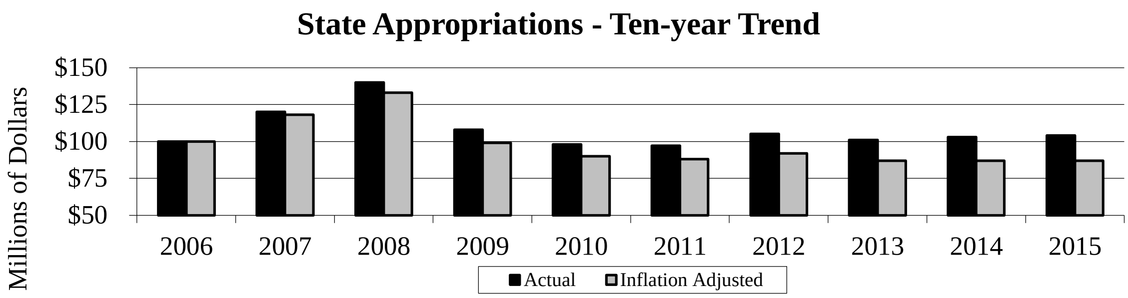
A state appropriation in the amount of approximately $105,639,000 was authorized for the year ended September 30, 2012. In February 2011, the Governor announced proration of 3%, or approximately $2,999,000, that reduced the amount received to $96,948,000.

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.

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.

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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)

	Unrestricted	Temporarily restricted	Permanently restricted	Total
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	10,879	26,047	132	37,058
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	12,458	—	—	12,458
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	$ 62,701	90,909	169,526	323,136

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)

		Unrestricted	Temporarily restricted	Permanently restricted	Total
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		14,385	11,975	148	26,508
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		11,733	—	—	11,733
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	$	64,280	64,862	169,394	298,536

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

(Continued)

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**
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	$	(90,897)	(58,515)
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.

(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 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.

(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 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.

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.

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 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.

(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.

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.

(Continued)

(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 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.

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:

	Credit rating	of total investments
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:

	Credit rating	of total investments
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

Interest Rate Risk

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

			Years to maturity			
		Fair value	**Less than 1**	**1 – 5**	**6 – 10**	**More than 10**
U.S. Treasury notes	$	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	—
	$	146,512	8,356	134,214	3,942	—

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

			Years to maturity			
		Fair value	**Less than 1**	**1 – 5**	**6 – 10**	**More than 10**
U.S. Treasury notes	$	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
	$	59,160	2,655	26,618	29,411	476

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, 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.

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):

	Fair value measurements at June 30, 2014			
Description	**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
	$ 71,080	62,156	193,381	326,617

	Fair value measurements at June 30, 2013			
Description	**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
	$ 57,870	56,323	191,382	305,575

(Continued)

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	$	156,320	31,007	6,054	193,381

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	$	154,332	31,010	6,040	191,382

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.

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:

Issue	Date of issue	Option expiration date	Effective date of swap	Termination date	Payment amount
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

(Continued)

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 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):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Capital assets not being depreciated:					
Land and other	$ 22,516	—	—	—	22,516
Construction-in-progress	137,678	32,167	(61,534)	—	108,311
	160,194	32,167	(61,534)	—	130,827
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
	775,182	12,070	61,534	(4,652)	844,134

	Beginning balance	Additions	Transfers	Reductions	Ending balance
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)
	(369,546)	(27,190)	—	78	(396,658)
Capital assets being depreciated, net	405,636	(15,120)	61,534	(4,574)	447,476
Capital assets, net	$ 565,830	17,047	—	(4,574)	578,303

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):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
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
	145,291	59,549	(41,189)	(3,457)	160,194
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
	758,120	14,929	41,189	(39,056)	775,182

		Beginning balance	Additions	Transfers	Reductions	Ending balance
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)
		(370,212)	(29,748)	—	30,414	(369,546)
Capital assets being depreciated, net		387,908	(14,819)	41,189	(8,642)	405,636
Capital assets, net	$	533,199	44,730	—	(12,099)	565,830

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				
		Beginning balance	Additions	Transfers	Reductions	Ending balance
Land improvements	$	2,199	—	—	—	2,199
Buildings		27,898	19	—	—	27,917
Tenant improvements		868	45	—	—	913
Construction in progress		—	—	—	—	—
Other equipment		256	—	—	—	256
		31,221	64	—	—	31,285
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)
		(6,520)	(971)	—	—	(7,491)
Capital assets, net	$	24,701	(907)	—	—	23,794

	2013				
	Beginning balance	**Additions**	**Transfers**	**Reductions**	**Ending balance**
Land improvements	$ 2,201	—	(2)	—	2,199
Buildings	27,669	235	(6)	—	27,898
Tenant improvements	742	164	8	(46)	868
Construction in progress	—	—	—	—	—
Other equipment	256	—	—	—	256
	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:						
Bonds payable and other	$ 400,890	52,044	(57,628)	395,306	14,203	381,103
Total long-term debt	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

	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.

(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

$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.

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	190,935	(4,171)	581,401
Plus (less):				
Additional maturity	(4,171)			
Unamortized bond premium	5,134			
Unaccreted bond discount	(29)			
Unamortized debt extinguishment costs	(265)			
Total	$ 395,306			

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.

(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.

(Continued)

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.

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):

	Variable rate loan		Interest rate	
	Principal	**Interest**	**swap, net**	**Total**
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	$ 14,471	1,156	5,849	21,476

(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.

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.

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	
	Principal	**Interest**	**swap, net**	**Total**
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
	$ 41,245	13,963	8,715	63,923

(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.

(Continued)

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 Infirmary Health System, Inc. (the Infirmary) entered into a Lease Agreement (the Lease) in which the University agreed to lease certain land, buildings and equipment used in connection with the operating of its USA Knollwood Hospital campus to the Infirmary. The original lease was effective through March 2056. The lease provided for its termination, at the option of the Infirmary, 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 Infirmary as significant, as defined by the lease. The hospital was operated as Mobile Infirmary 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 Infirmary to the University. In order 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 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 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.

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.

(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

(Continued)

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		7,623
Total	$	16,639

(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.

		2014	2013
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
	$	633,978	602,120

(Continued)

(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.

(Continued)

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.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2014

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Student Financial Aid Cluster*:						
U.S. Department of Education:						
Federal Supplemental Educational Opportunity Grant Program	84.007			$ 294,223	—	294,223
Federal Work Study Program	84.033			506,671	—	506,671
Federal Pell Grant Program	84.063			19,870,057	—	19,870,057
Federal Direct Student Loan Program	84.268			113,234,065	—	113,234,065
Teacher Education Assistance for College and Higher Education	84.379			32,980	—	32,980
Nurse Faculty Loan Program	93.264			158,581	—	158,581
Total Student Financial Aid Cluster				134,096,577	—	134,096,577
Research and Development Cluster:						
U.S. Department of Agriculture:						
Plant and Animal Disease Pest Control and Animal Care	10.025			29,160	—	29,160
Wetlands Reserve Program	10.072			(10,959)	—	(10,959)
Forestry Research	10.652			72,872	—	72,872
Total U.S. Department of Agriculture				91,073	—	91,073
U.S. Department of Commerce:						
Sea Grant Support	11.417	USM-GR04867-01	MS-AL Sea Grant	—	21,861	21,861
Sea Grant Support	11.417	USM-GR03924-R/HCE-01	University of Southern Mississippi	—	26,162	26,162
Sea Grant Support	11.417	USM-GR03924-R/HCE-03-PD	University of Southern Mississippi	—	9,965	9,965
Total CFDA				—	57,988	57,988
Fisheries Development and Utilization	11.427			2,404	—	2,404
Marine Fisheries Initiative	11.433			157,382	—	157,382
Unallied Management Projects	11.454			131,708	—	131,708
Congressionally Identified Award and Projects	11.469	10-62-08-A3	Exxon Valdez Oil Spill Trustee	—	3,943	3,943
Center for Sponsored Coastal Ocean Research – Coastal Ocean	11.478	ORSP-10097-20096-1	Florida Gulf Coast University	—	78,074	78,074
Center for Sponsored Coastal Ocean Research – Coastal Ocean	11.478			26,085	—	26,085
Total CFDA				26,085	78,074	104,159
Total U.S. Department of Commerce				317,579	140,005	457,584
U.S. Department of Defense:						
Procurement Technical Assistance For Business Firms	12.002	140,151	Small Business Innovation Research	—	27,238	27,238
Basic and Applied Scientific Research	12.300	TAI-13-1113	Thermoanalytics, Inc.	—	14,452	14,452
Basic Scientific Research – Combating Weapons of Mass Destruction	12.351			205,477	—	205,477
Military Medical Research and Development	12.420			2,172	—	2,172
Basic Scientific Research	12.431			30,684	—	30,684
Air Force Defense Research Sciences Program	12.800			97,166	—	97,166
Information Security Grant Program	12.902			3,150	—	3,150
Total U.S. Department of Defense				338,649	41,690	380,339
U.S. Department of Interior:						
Mineral Management Services Environmental Studies Program	15.423	50065.13	University of New Orleans	—	115,344	115,344
Sport Fish Restoration Program	15.605	130033/140103/130032	Alabama Department of Conservation and Natural Resources	—	198,704	198,704
Historic Preservations Funds	15.904	130349	J O Collins Contractor, Inc.	—	152	152
National Park Service Conservation, Protection, Outreach and Education	15.954			4,473	—	4,473
National Park Service Conservation, Protection, Outreach and Education	15.954	P11AC90959	National Park Service	—	8,346	8,346
Total CFDA				4,473	8,346	12,819
Total U.S. Department of Interior				4,473	322,546	327,019
U.S. Department of Transportation:						
Highway Planning and Construction	20.205	930-811R/841R/839R/856R	Alabama Department of Transportation	—	362,194	362,194
Highway Planning and Construction	20.205	TASK ORDER 5000	Kilgore Consulting & Management	—	37,448	37,448
Highway Planning and Construction	20.205	130073	University of Alabama	—	46,280	46,280
Total U.S. Department of Transportation				—	445,922	445,922

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2014

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
National Aeronautics and Space Administration:						
Aerospace Education Services Program	43.001	SUB2010-2006	University of Alabama in Huntsville	$ —	169,834	169,834
Technology Transfer	43.002	SUB2010-176-A2-02	University of Alabama in Huntsville	—	6,171	6,171
Education	43.008	XHAB 2014-02	National Space Grant Foundation	—	15,186	15,186
Education	43.008	2013-067	University of Alabama in Huntsville	—	15,054	15,054
Education	43.008	USM GRO4613-001	University of Southern Mississippi	—	(4,926)	(4,926)
Total CFDA				—	25,314	25,314
Total National Aeronautics and Space Administration				—	201,319	201,319
National Science Foundation:						
Engineering Grants	47.041			155,923	—	155,923
Engineering Grants	47.041	120084	National Science Foundation	—	1,604	1,604
Total CFDA				155,923	1,604	157,527
Mathematical and Physical Sciences	47.049			85,863	—	85,863
Geosciences	47.050			123,191	—	123,191
Geosciences	47.050	TASK ORDER D-9	Dauphin Island Sea Lab	—	(1,377)	(1,377)
Total CFDA				123,191	(1,377)	121,814
Computer and Information Science and Engineering	47.070			369,191	—	369,191
Biological Sciences	47.074			218,506	—	218,506
Biological Sciences	47.074	NYBG-120619710-USAM	New York Botanical Gardens	—	15,941	15,941
Total CFDA				218,506	15,941	234,447
Social Behavioral and Economic Sciences	47.075			13,265	—	13,265
Education and Human Resources	47.076			709,645	—	709,645
Polar Programs	47.078			86,493	—	86,493
Office of Experimental Programs	47.081	34-21530-200-76190	Tuskegee University	—	69,871	69,871
Office of Experimental Programs	47.081	SUB2011-026	University of Alabama in Huntsville	—	(1,664)	(1,664)
Total CFDA				—	68,207	68,207
Total National Science Foundation				1,762,077	84,375	1,846,452
U.S. Environmental Protection Agency:						
Dendritic Polymers as Biocompatible	66.509	1614-218-2008962	Clemson University	—	69,064	69,064
U.S. Department of Energy:						
Basic Energy Sciences University and Science Education	81.049			5,352	—	5,352
Basic Energy Sciences University and Science Education	81.049	DE-SC0002470	University of Alabama	—	442	442
Basic Energy Sciences University and Science Education	81.049	UA13-073	University of Alabama	—	10,188	10,188
Basic Energy Sciences University and Science Education	81.049	10-ENG-246590-USA	Auburn University	—	17,283	17,283
Total U.S. Department of Energy				5,352	27,913	33,265
U.S. Department of Education:						
Research in Special Education	84.324			(921)	—	(921)
Project C. A. R. E	84.377	110347	Information Transport Solutions, Inc.	—	52,981	52,981
Total U.S. Department of Education				(921)	52,981	52,060
U.S. Department of Health and Human Services:						
Environmental Health	93.113	100,340	Exscien	—	12,084	12,084
Environmental Health	93.113	HSR-SSS-S-14-003667	Social and scientific Systems Inc.	—	235,685	235,685
Environmental Health	93.113			(16,325)	—	(16,325)
Total CFDA				(16,325)	247,769	231,444
Minority Health and Health Disparities Research	93.307			1,288,453	—	1,288,453
Minority Health and Health Disparities Research	93.307	USM-GR04826-01	University of Southern Mississippi	—	35,778	35,778
Total CFDA				1,288,453	35,778	1,324,231
Trans – NIH Research Support	93.310			113,556	—	113,556
National Center for Research Resources	93.389			241,011	—	241,011

(Continued)

UNIVERSITY OF SOUTH ALABAMA
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Schedule of Expenditures of Federal Awards
Year ended September 30, 2014

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity	Direct expenditures	Pass-through expenditures	Total expenditures
Cancer Cause and Prevention Research	93.393			$ 1,364,991	—	1,364,991
Cancer Cause and Prevention Research	93.393	000369558-001	University of Alabama at Birmingham	—	2,405	2,405
Cancer Cause and Prevention Research	93.393	S12001	Southern Research Institute	—	15,126	15,126
Total CFDA				1,364,991	17,531	1,382,522
Cancer Detection and Diagnosis Research	93.394			413,589	—	413,589
Cancer Treatment Research	93.395			206,215	—	206,215
Cancer Treatment Research	93.395	98543-1234	National Childhood Cancer Foundation	—	(80,587)	(80,587)
Cancer Treatment Research	93.395	AL0088	Brigham and Women's Hospital	—	(53)	(53)
Cancer Treatment Research	93.395	27469-02	University of Alabama	—	3,680	3,680
Total CFDA				206,215	(76,960)	129,255
Cancer Biology Research	93.396			348,356	—	348,356
Cancer Centers Support	93.397	000402714-001	University of Alabama at Birmingham	—	15,195	15,195
NIH Recovery Act Research Support	93.701	9500010213	Children's Hospital of Philadelphia	—	102,003	102,003
ARRA-National Center for Research Resources, Recovery Act Construction Support	93.702			320,170	—	320,170
Cardiovascular Diseases Research	93.837			698,455	—	698,455
Cardiovascular Diseases Research	93.837	PS#107223	Brigham and Women's Hospital	—	8,167	8,167
Total CFDA				698,455	8,167	706,622
Lung Diseases Research	93.838			3,709,768	—	3,709,768
Lung Diseases Research	93.838	080-18007-S11201	Thomas Jefferson University	—	28,676	28,676
Total CFDA				3,709,768	28,676	3,738,444
Blood Diseases and Resources Research	93.839	130317	Cincinnati Children's Hospital Medical Center	—	28,336	28,336
Blood Diseases and Resources Research	93.839	T098327	Emory University	—	56,352	56,352
Total CFDA				—	84,688	84,688
Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	VUMC37157	Vanderbilt University	—	1,907	1,907
Clinical Research Related to Neurological Disorders	93.853	AO9014 – M10A10568	Yale University	—	(4,443)	(4,443)
Allergy Immunology and Transplantation Research	93.855			807,638	—	807,638
Allergy Immunology and Transplantation Research	93.855	2012-2764	The Regents of the University of California	—	119,673	119,673
Total CFDA				807,638	119,673	927,311
Pharmacology Physiology and Biological Chemistry	93.859			396,133	—	396,133
Pharmacology Physiology and Biological Chemistry	93.859	HSR-SSS-S-13-003170	Social and Scientific Systems, Inc.	—	75,215	75,215
Total CFDA				396,133	75,215	471,348
Vision Research	93.867			22,840	—	22,840
Total U.S. Department of Health and Human Services				9,914,850	655,199	10,570,049
Total Research and Development Cluster				12,433,132	2,041,014	14,474,146
Other federal assistance:						
U.S. Department of Commerce:						
Congressionally Identified Projects	11.617			202,199	—	202,199
U.S. Department of Transportation:						
Highway Research and Development Program	20.200	TASK ORDER 12005	Kilgore Consulting & Management	—	3,822	3,822
National Aeronautics and Space Administration:						
Aerospace Education Services Program	43.001	Various	University of Alabama in Huntsville	—	21,317	21,317
Technology Transfer	43.002	Various	University of Alabama in Huntsville	—	27,221	27,221
Total National Aeronautics and Space Administration				—	48,538	48,538
National Endowment for the Humanities:						
Promotion of the Humanities Federal-State Partnership	45.129	0913-2141 EX	Alabama Humanities Foundation	—	4,000	4,000
National Science Foundation:						
Education and Human Resources	47.076	000398033-006	University of Alabama at Birmingham	—	41,153	41,153
Education and Human Resources	47.076	12-120333	Mobile Area Education Foundation Inc.	—	52,217	52,217
Total CFDA				—	93,370	93,370

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Expenditures of Federal Awards
Year ended September 30, 2014

Federal sponsor / Program title	CFDA	Pass-through award number	Pass-through entity		Direct expenditures	Pass-through expenditures	Total expenditures
ARRA-Pathway to Science	47.082	AA-5-31980	National Science Foundation	$	—	(88)	(88)
ARRA-Pathway to Science	47.082				190,595	—	190,595
Total CFDA					190,595	(88)	190,507
Total National Science Foundation					190,595	93,282	283,877
U.S. Environmental Protection Agency							
Science to Achieve Results	66.514				9,844	—	9,844
U.S. Department of Education:							
TRIO Cluster:							
TRIO Talent Search	84.044				281,711	—	281,711
TRIO Upward Bound	84.047				252,681	—	252,681
Total TRIO Cluster					534,392	—	534,392
Special Education – State Personnel Development	84.323	C3U0473	Alabama State Department of Education		—	55,319	55,319
Mathematics and Science Partnerships	84.366	Various	Alabama Department of Education		—	467,767	467,767
Improving Teacher Quality State Grants	84.367	Various	Alabama Commission of Higher Education		—	196,145	196,145
Improving Teacher Quality State Grants	84.367	13-130286	Alabama State Department of Education		—	6,390	6,390
Total CFDA					—	202,535	202,535
Total U.S. Department of Education					534,392	725,621	1,260,013
U.S. Department of Health and Human Services:							
Alzheimer's Disease Demonstration Grants to States	93.051	13-130338	South Alabama Regional Planning Commission		—	10,679	10,679
Personal Responsibility Education Program	93.092	C30117231(GC 13-372)	State of Alabama Department of Public Health		—	1,339	1,339
HIV Demonstration Program for Children, Adolescence, and Women	93.153				355,588	—	355,588
Advanced Education Nursing Grant Programs	93.247				1,436,911		1,436,911
Centers for Disease Control	93.283	C30117286(GC 13-480)	State of Alabama Department of Public Health		—	221,881	221,881
Basic Nurse Education and Practice Grants*	93.359				691,792	—	691,792
Strong Start for Mothers and Newborns	93.611				297,623	—	297,623
Foster Care Title IV-E	93.658	UA14-030	Health and Human Services Office of the Secretary		—	101,414	101,414
ARRA-Health Information Technology Regional Extension Centers Program	93.718				1,191,069	—	1,191,069
Lung Diseases Research	93.838				20,106	—	20,106
Medical Library Assistance	93.879	8278	University of Maryland		—	45,502	45,502
Grants for Residency Training for General Pediatrics	93.884				568,109	—	568,109
Health Care and Other Facilities	93.887				(3,372)	—	(3,372)
National Bioterrorism Hospital Preparedness Program*	93.889	Various	Alabama Department of Public Health		—	1,239,617	1,239,617
HIV Care Formula Grants	93.917	RW-USAF-1314	United Way of Central Alabama		—	25,134	25,134
Cooperative Agreements to Support State-Based Infant	93.946	140012	Mobile County Health Department		—	132,296	132,296
Maternal and Child Health Services Block Grant	93.994	Various	State of Alabama Department of Public Health		—	12,556	12,556
Total U.S. Department of Health and Human Services					4,557,826	1,790,418	6,348,244
Corporation for National and Community Service:							
AmeriCorps	94.006				29,252	—	29,252
Office of National Drug Control Policy							
High Intensity Drug Trafficking Areas Program	95.001	3HUS	State of Alabama Dept of Public Health		—	9,030	9,030
Total other federal assistance					5,524,108	2,674,711	8,198,819
Total federal expenditures				$	152,053,817	4,715,725	156,769,542

* Denotes a major program.

See accompanying notes to the schedule of expenditures of federal awards.

See accompanying independent auditors' report.

(1) Basis of Presentation

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

(2) Campus-Based Loan Programs

Outstanding campus-based federal loans made by the University are included in notes receivable in the University's 2014 statement of net position and consist of the following loan programs:

	CFDA #		Outstanding amount at September 30, 2014	Amount advanced in 2014
Federal Perkins Loan Program	84.038	$	3,491,337	276,000
Nurse Faculty Loan Program	93.264		481,481	112,069
Nurse Faculty Loan Program ARRA	93.408		39,633	—
		$	4,012,451	388,069

(3) Contingencies

The University's federal programs are subject to financial and compliance audits by grantor agencies which may result in disallowed expenditures and affect the University's continued participation in specific programs.

(4) Federal Direct Student Loans (CFDA #84.268)

The University's Federal Direct Student Loan Program (Direct Loan) included in the Schedule represents loans advanced to students of the University during fiscal year 2014, which were not made by the University. Accordingly, Direct Loan amounts are not reflected in the University's basic financial statements. It is not practicable to determine the balance of loans outstanding to students and former students of the University under these programs as of September 30, 2014.

(Continued)

During fiscal year ended September 30, 2014, the University advanced to students the following amounts of new loans under Direct Loan Programs:

		Amount advanced
Stafford loans	$	23,469,979
Unsubsidized Stafford loans		72,701,361
Parent Loans for Undergraduate Students		17,062,725
Total	$	113,234,065

(5) Subrecipients

Of the federal expenditures presented in the Schedule, the University provided federal awards to subrecipients under the following programs during the year ended September 30, 2014:

	Federal CFDA #		Amounts expended
Marine Fisheries Initiative	11.433	$	65,839
Unallied Management Projects	11.454		5,080
Basic Scientific Research- Combating Weapons of Mass Destruction	12.351		5,900
Geosciences	47.050		2,436
Education and Human Resources	47.076		13,222
Environmental Health	93.113		2,287
HIV Demonstration Program for Children Adolescents and Women	93.153		10,141
Trans- NIH Research Support	93.310		27,059
National Center for Research Resources	93.389		78,609
Cancer Cause and Prevention Research	93.393		207,429
ARRA-Health Information Technology Regional Extension Centers Program	93.718		284,705
Lung Diseases Research	93.838		398,895
Allergy Immunology and Transplantation Research	93.855		61,278
Grants for Residency Training for General Pediatrics	93.884		8,661
Center for Sponsored Coastal Ocean Research - Coastal Ocean	11.478		1,589
Mineral Management Services Environmental Studies Program	15.423		6,021
Sport Fish Restoration Program	15.605		3,810
Aerospace Education Services Program	43.001		112,183
Mathematics and Science Partnerships	84.366		35,051
Improving Teacher Quality State Grants	84.367		92,740
		$	1,422,935

(Continued)

(6) Matching

Under the Federal Supplemental Education Opportunity Grant Program, the University matched $133,994 in funds awarded to students for the year ended September 30, 2014 in addition to the Federal share of expenditures included in the Schedule.

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

The Board of Trustees
University of South Alabama:

We have audited, in accordance with the 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, the basic financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise the University's basic financial statements, and have issued our report thereon dated November 14, 2014. Our report includes a reference to other auditors who audited the financial statements of the University of South Alabama Foundation, as described in our report on the University's financial statements. This report does not include the results of the other auditors' testing on internal control over financial reporting or compliance and other matters that are reported on separately by those auditors. 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.*

Internal Control Over Financial Reporting

In planning and performing our audit of the basic financial statements, we considered the University's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the basic financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given those limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the effectiveness of the University's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Jackson, Mississippi
November 14, 2014

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Independent Auditors' Report on Compliance for Each Major Program; Report on Internal Control Over Compliance; and Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*

The Board of Trustees
University of South Alabama:

Report on Compliance for Each Major Federal Program

We have audited the University of South Alabama's (the University) compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the University's major federal programs for the year ended September 30, 2014. The University's major federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the University's major federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the University's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major federal program. However, our audit does not provide a legal determination of the University's compliance.

Opinion on Each Major Federal Program

In our opinion, the University complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended September 30, 2014.

Report on Internal Control Over Compliance

Management of the University is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered the University's internal control over compliance with the types of requirements that could have a direct and material effect on each major federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over compliance.

A deficiency in internal control over compliance exists when the design or operation of a control over compliance does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, noncompliance with a type of compliance requirement of a federal program on a timely basis. A material weakness in internal control over compliance is a deficiency, or combination of deficiencies, in internal control over compliance, such that there is a reasonable possibility that material noncompliance with a type of compliance requirement of a federal program will not be prevented, or detected and corrected, on a timely basis. A significant deficiency in internal control over compliance is a deficiency, or a combination of deficiencies, in internal control over compliance with a type of compliance requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

Report on Schedule of Expenditures of Federal Awards Required by OMB Circular A-133

We have audited the basic financial statements of the University and its aggregate discretely presented component units as of and for the year ended September 30, 2014, and the related notes to the financial statements, which collectively comprise the University's basic financial statements. We issued our report thereon dated November 14, 2014, which contained unmodified opinions on those financial statements. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

KPMG LLP

Jackson, Mississippi
November 14, 2014

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

Schedule of Findings and Questioned Costs

Year ended September 30, 2014

I – Summary of Auditor's Results

Financial Statements

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

Federal Awards

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

Identification of major programs:

CFDA Numbers	Name of Federal Program/Cluster
84.007, 84.033, 84.038, 84.063, 84.268, 84.379, 93.264, 93.408	Student Financial Aid Cluster
93.359	Basic Nurse Education and Practice Grants
93.889	National Bioterrorism Hospital Preparedness Program

Dollar threshold used to distinguish between type A and type B programs:	$ 680,189
Auditee qualified as low-risk auditee?	______ yes __x__ no

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

There were no findings related to the financial statements reported in accordance with *Government Auditing Standards* for the year ended September 30, 2014.

UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Schedule of Findings and Questioned Costs
Year ended September 30, 2014

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

There were no findings related to federal awards for the year ended September 30, 2014.