

University of
South Alabama
2017
Financial Report



2017 Financial Report



University of South Alabama Board of Trustees

Pictured from the left, President Tony G. Waldrop and Trustees Ron Jenkins, Alexis Atkins, Jimmy Shumock, Jim Yance, Steve Stokes, M.D., Tom Corcoran, Scott Charlton, M.D., Bettye Maye, Bryant Mixon, Chandra Brown Stewart, Steve Furr, M.D. John Peek, Arlene Mitchell, Ken Simon (Chair pro tempore), and Mike Windom. Not pictured: The Honorable Kay Ivey, Governor, State of Alabama (ex officio President and Chair).



UNIVERSITY OF
SOUTH ALABAMA





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

Message from the **PRESIDENT**

The mission of the University of South Alabama is to make a difference in the lives of those we serve through promoting discovery, health and learning. At South, we strive to achieve this mission through the establishment of, and adherence to, five institutional strategic priorities:

- Student access and success
- Enhancement of research and graduate education
- Global engagement
- Excellence in healthcare
- University-community engagement

Everything we do at South, including management of financial resources, is with these priorities in mind.

As the University continues to grow, it is through a sound financial position that our priorities can be accomplished. Despite the economic challenges of the past several years, the financial position of the University of South Alabama, as demonstrated in this financial report, remains strong. This financial strength allows us to continue to serve the citizens of the state of Alabama and beyond by providing top quality academic, research, healthcare and public service programs.

With a Fall 2017 enrollment of 15,569, the academic profile of our students has never been stronger. This continued improvement is a testament to the strength of our programs, the quality and dedication of our faculty and staff and the loyalty and spirit of our alumni. Similarly, USA Health continues its growth and dedication to the wellbeing of our patients.

Along with the growth in our academic programs, campus life is constantly being enhanced and improved as evidenced by an ever-increasing demand for on-campus student housing. More than 200 diverse student clubs and organizations engage students in campus life. Student leadership development is a continued area of focus in all areas of student life at the University, and the Office of Multicultural Student Affairs actively engages students in conversation and activities that encourage dialog among all students. Our student-athletes continue to excel both on the field and in the classroom.

USA students also give back to the community. Hundreds participate in community-service activities throughout the year, such as the annual MLK Day of Service, which offers numerous opportunities to help.

This is an exciting time for the University of South Alabama. Our future is bright and our vision remains true. As we continue to strive to make South more vibrant, more involved and more global, I affirm to you that my focus and the focus of the entire University will be solidly fixed on these objectives and on our students.

Tony G. Waldrop, Ph.D.
President



we

are

South

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



Kenneth O. Simon
Chair Pro Tempore, Board of Trustees
University of South Alabama

Your Board of Trustees is dedicated to enhancing and sustaining the success of the University of South Alabama and to ensuring that our core values and priorities are met and maintained. We are committed to the successful achievement of the mission of the University as well as to the success of our students, faculty and staff.

The Board of Trustees takes its responsibility for the stewardship of our financial resources and academic programs very seriously. We constantly strive to improve all aspects of the University and seek to ensure that USA is an intellectual, economic and service leader in the state of Alabama and the region for years to come.

I am privileged to work alongside my colleagues on the Board as well as with President Waldrop and our University's dedicated and outstanding leadership team as we continue to move USA forward.

Together, we are the University of South Alabama. We are South!

Kenneth O. Simon
Chair Pro Tempore, Board of Trustees
University of South Alabama

Introduction from the **VICE PRESIDENT** FOR **FINANCE AND ADMINISTRATION**



G. Scott Weldon
Vice President for Finance and Administration
University of South Alabama

I am pleased to present this annual financial report for the University of South Alabama at and for the years ended September 30, 2017 and 2016. I am confident that the accompanying financial statements fairly present the financial position and results of operations of the University and its Health System. It is the responsibility of University management to ensure that these financial statements, including management's discussion and analysis and the accompanying notes to the financial statements, are complete and fairly presented in accordance with U. S. generally accepted accounting principles.

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

G. Scott Weldon
Vice President for Finance and Administration
University of South Alabama





UNIVERSITY OF SOUTH ALABAMA
(A Component Unit of the State of Alabama)
Basic Financial Statements
September 30, 2017 and 2016
(With Independent Auditors' Report Thereon)

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

Basic Financial Statements
September 30, 2017 and 2016

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Management's Discussion and Analysis (Unaudited)
September 30, 2017 and 2016

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 Health System (USA Health), a division of the University, at September 30, 2017 and 2016, and for the years then ended. This discussion has been 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 (GASB). As more fully described in note 1 to the basic financial statements, the University of South Alabama Professional Liability Trust Fund, the University of South Alabama General Liability Trust Fund and the USA HealthCare Management, LLC are reported as blended component units. The University of South Alabama Foundation and the USA Research and Technology Corporation are discretely presented.

In May 2017, the University's Board of Trustees approved the formation of the University of South Alabama Health Care Authority (HCA). The HCA is a public corporation created under and pursuant to the provisions of the State of Alabama University Authority Act of 2016. The HCA employs physicians and staff of physician practice groups as determined by the University. For additional discussion, see note 1.

Financial Highlights

At September 30, 2017 and 2016, the University had total assets and deferred outflows of \$1,282,492,000 and \$1,184,911,000, respectively; total liabilities and deferred inflows of \$1,016,673,000 and \$966,917,000, respectively; and net position of \$265,819,000 and \$217,994,000, respectively. Net position increased \$47,825,000 during the year ended September 30, 2017 compared to an increase of \$25,905,000 for the year ended September 30, 2016.

An overview of each statement is presented herein along with 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

Statements of Net Position

The statements of net position present the assets, deferred outflows, liabilities, deferred inflows and net position of the University at September 30, 2017 and 2016. 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 the net position that is restricted by law or external donors. Unrestricted net position is generally designated by management for specific purposes, and is available for use by the University to meet current expenses for any purpose. The statements of net position, along with all of the University's basic financial statements, are prepared under the economic resources measurement focus and the accrual basis of accounting, whereby revenues are recognized when earned and expenses are recognized when incurred by the University, regardless of when cash is exchanged.

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Assets included in the statements of net position are classified as current or noncurrent. Current assets consist primarily of cash and cash equivalents, investments, and net patient receivables. Of these amounts, cash and cash equivalents, investments, and net patient receivables comprise approximately 39%, 25% and 19%, respectively, of current assets at September 30, 2017. Noncurrent assets consist primarily of restricted cash and cash equivalents, restricted investments and capital assets.

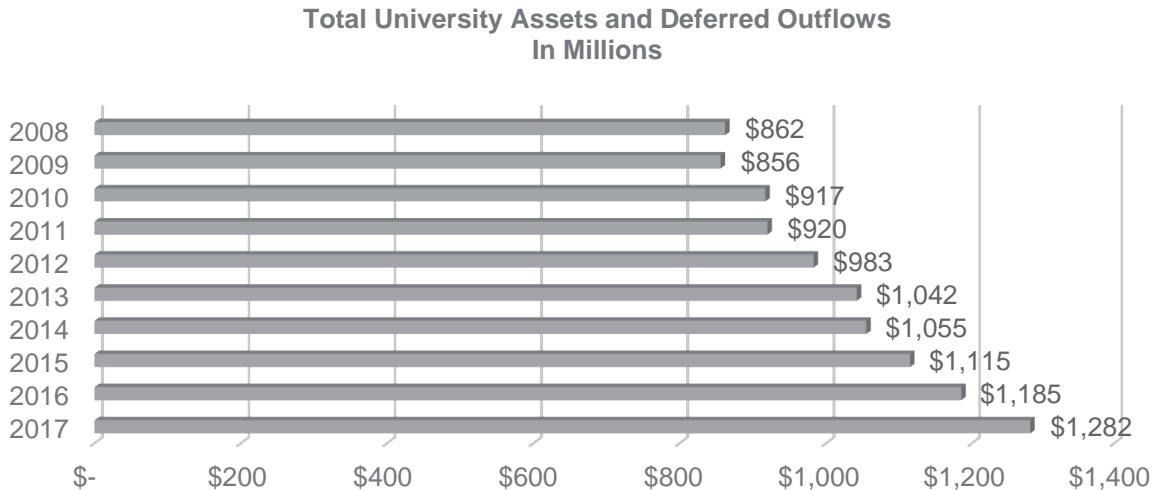
The condensed schedules of net position at September 30, 2017, 2016, and 2015 follow (in thousands):

Condensed Schedules of Net Position

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Assets:			
Current	\$ 261,407	\$ 273,634	\$ 233,940
Capital assets	693,968	653,297	609,630
Other noncurrent	<u>268,116</u>	<u>213,462</u>	<u>248,539</u>
Total assets	1,223,491	1,140,393	1,092,109
Deferred outflows	<u>59,001</u>	<u>44,518</u>	<u>22,842</u>
Total assets and deferred outflows	<u>\$ 1,282,492</u>	<u>\$ 1,184,911</u>	<u>\$ 1,114,951</u>
Liabilities:			
Current	\$ 157,803	\$ 153,887	\$ 132,128
Noncurrent	<u>818,105</u>	<u>789,016</u>	<u>751,880</u>
Total liabilities	975,908	942,903	884,008
Deferred inflows	<u>40,765</u>	<u>24,014</u>	<u>35,891</u>
Total liabilities and deferred inflows	<u>\$ 1,016,673</u>	<u>\$ 966,917</u>	<u>\$ 919,899</u>
Net position:			
Net investment in capital assets	\$ 305,898	\$ 270,127	\$ 246,567
Restricted, nonexpendable	54,961	48,760	43,425
Restricted, expendable	62,676	55,592	60,106
Unrestricted	<u>(157,716)</u>	<u>(156,485)</u>	<u>(155,046)</u>
Total net position	<u>\$ 265,819</u>	<u>\$ 217,994</u>	<u>\$ 195,052</u>

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Total assets and deferred outflows of the University as of September 30 is 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.

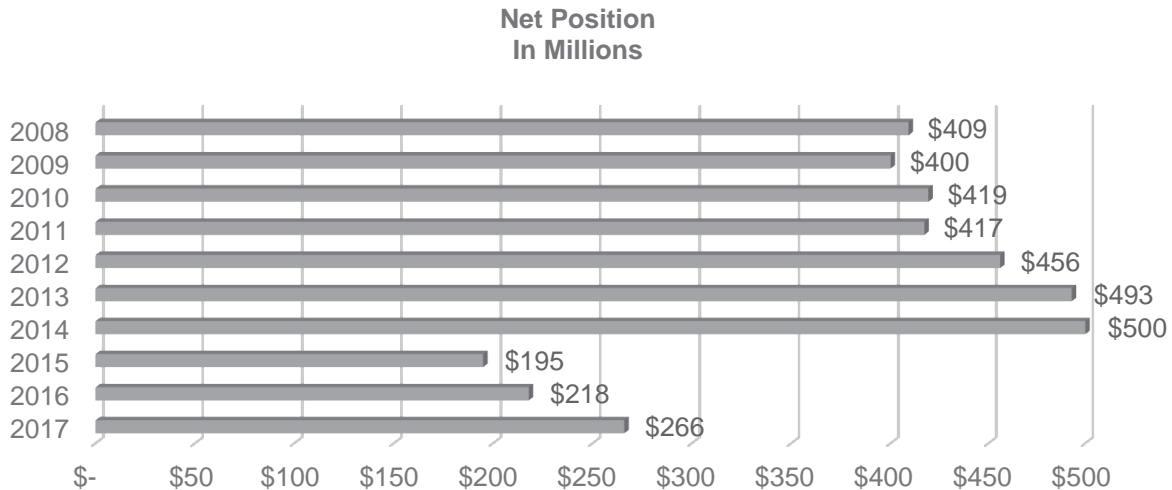
Restricted nonexpendable net position consists primarily of the University's permanent endowment funds. In accordance with the policies of the University, the earnings from these funds may be expended, but the corpus may not be expended and must remain intact with the University in perpetuity.

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 amounts 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. Also included in unrestricted net position at September 30, 2017 and 2016 is the impact of the net pension liability recorded pursuant to the requirements of GASB Statement No. 68.

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



All categories of restricted net position collectively increased by approximately 13% between September 30, 2017 and 2016, primarily due to the addition of restricted gifts to the University. Unrestricted net position decreased slightly from \$(156,485,000) to \$(157,716,000) between September 30, 2017 and 2016. A summary of unrestricted net position at September 30, 2017 is summarized as follows:

Unrestricted net position related to net pension liability	\$ (336,477,000)
Unrestricted net position related to other activity	<u>178,761,000</u>
Unrestricted net position	<u>\$ (157,716,000)</u>

Statements of Revenues, Expenses, and Changes in Net Position

Changes in total University net position are based on the activity presented in the statements of revenues, expenses, and changes in net position. The purpose of these statements is to present the changes in net position resulting from operating and nonoperating revenues earned by the University, and operating and nonoperating expenses incurred by the University, 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 patient service revenues (net of provision for bad debts), tuition and fees (net of scholarship allowances), most noncapital grants and contracts, 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.

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Nonoperating revenues have the characteristics of nonexchange transactions because generally no goods or services are provided. Such transactions include investment income, capital appropriations, gifts and other contributions. State appropriations are required by GASB 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, 2017, 2016 and 2015 follow (in thousands):

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

	2017	2016	2015
Operating revenues:			
Tuition and fees	\$ 142,024	\$ 137,074	\$ 120,265
Patient service revenues	390,931	360,657	271,655
Federal, state and private grants and contracts	36,853	38,187	85,756
Other	92,674	88,943	78,845
	662,482	624,861	556,521
Operating expenses:			
Salaries and benefits	483,113	460,219	433,679
Supplies and other services	219,362	198,518	169,873
Other	64,942	65,530	57,476
	767,417	724,267	661,028
Operating loss	(104,935)	(99,406)	(104,507)
Nonoperating revenues and expenses:			
State appropriations	107,332	105,024	103,974
Investment income (loss)	18,398	2,631	(10,718)
Other, net	20,613	8,135	13,259
Net nonoperating revenues and expenses	146,343	115,790	106,515
Income before capital contributions and grants and additions to endowment	41,408	16,384	2,008
Capital contributions and grants and additions to endowment	6,417	9,521	7,231
Increase in net position	\$ 47,825	\$ 25,905	\$ 9,239

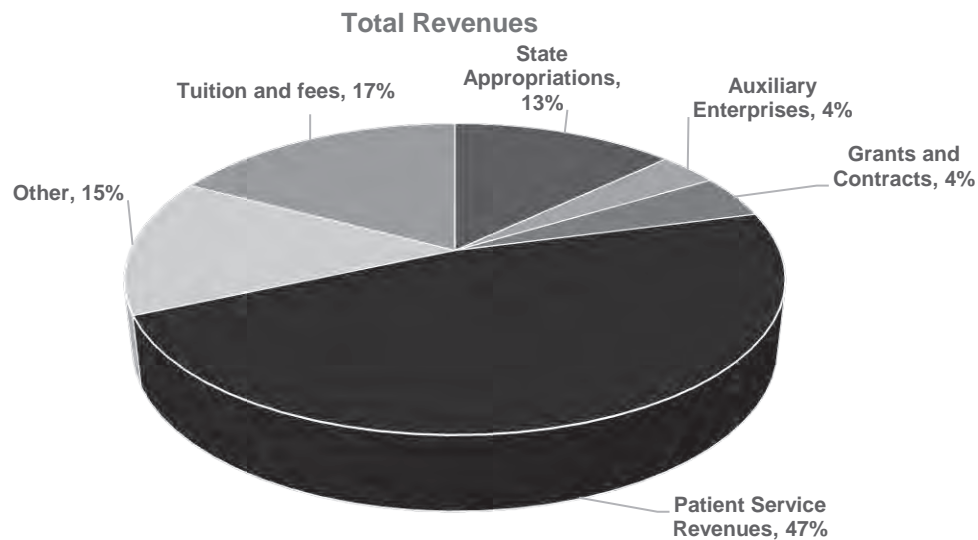
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**Condensed Schedules of Revenues, Expenses,
and Changes in Net Position**

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Beginning net position, before cumulative effect of change in reporting entity/accounting principle	\$ 217,994	\$ 195,052	\$ 499,550
Cumulative effect of change in reporting entity/accounting principle	—	(2,963)	(313,737)
Beginning net position – as adjusted	<u>217,994</u>	<u>192,089</u>	<u>185,813</u>
Ending net position	<u>\$ 265,819</u>	<u>\$ 217,994</u>	<u>\$ 195,052</u>

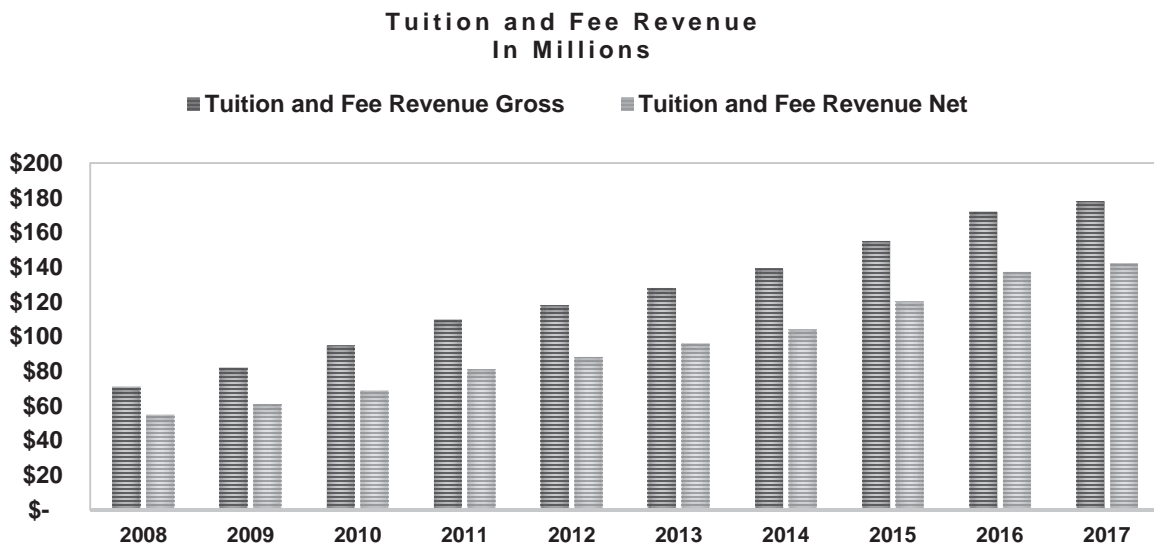
Approximately 47% of total revenues of the University were patient service revenues in 2017 and 2016. Excluding patient service revenues, tuition and fees charged to students represent the largest component of total University revenues, approximately 17% and 18% of total revenues in 2017 and 2016, respectively. Also in 2017, state appropriations and grants and contracts (federal, state and private) represented approximately 17% of total revenues compared to 19% in 2016.

A summary of University revenues for the year ended September 30, 2017 is presented as follows:



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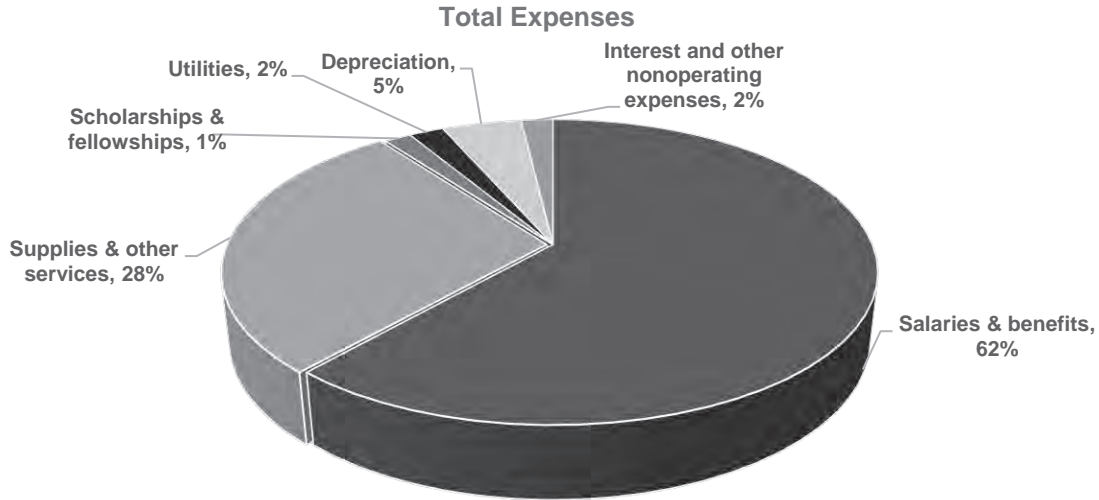
Tuition and fees have increased in each of the last ten years. These increases are primarily due to increases in tuition and fee rates charged to students and the number of enrolled students and credit hours taken by those students. Additionally, tuition and fees as a percent of total operating revenues continue to increase, from 14% of operating revenues in 2008 to 21% in 2017. Tuition and fees, gross and net of scholarship allowances, for the past ten fiscal years are as follows:



Capital contributions and grants decreased from \$3,053,000 in 2016 to \$989,000 in 2017.

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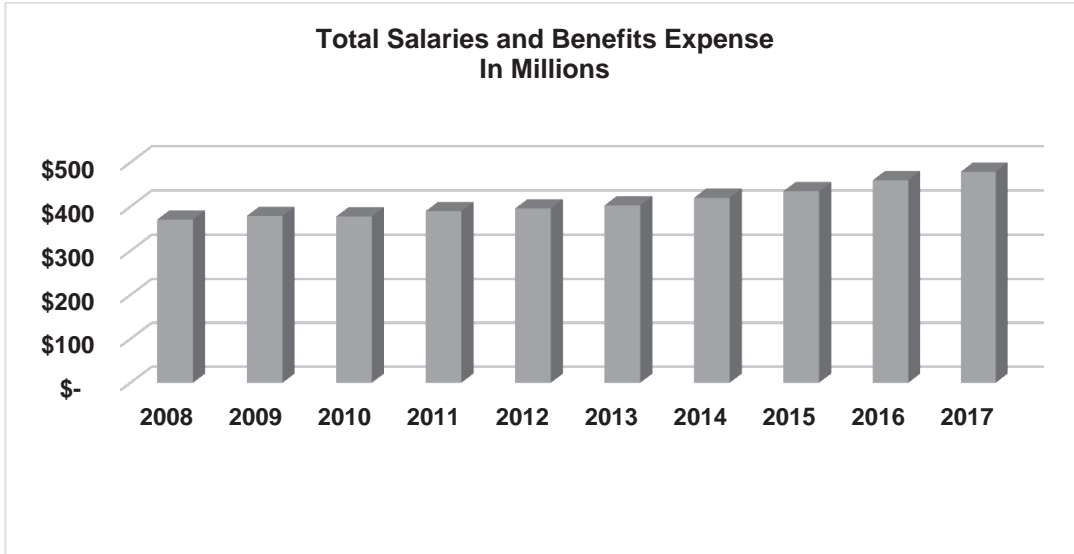
University expenses are presented using their natural expense classifications. A summary of University expenses for the year ended September 30, 2017 is presented as follows:



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 USA Health are presented separately. Functional expense information is presented in note 17 to the basic financial statements.

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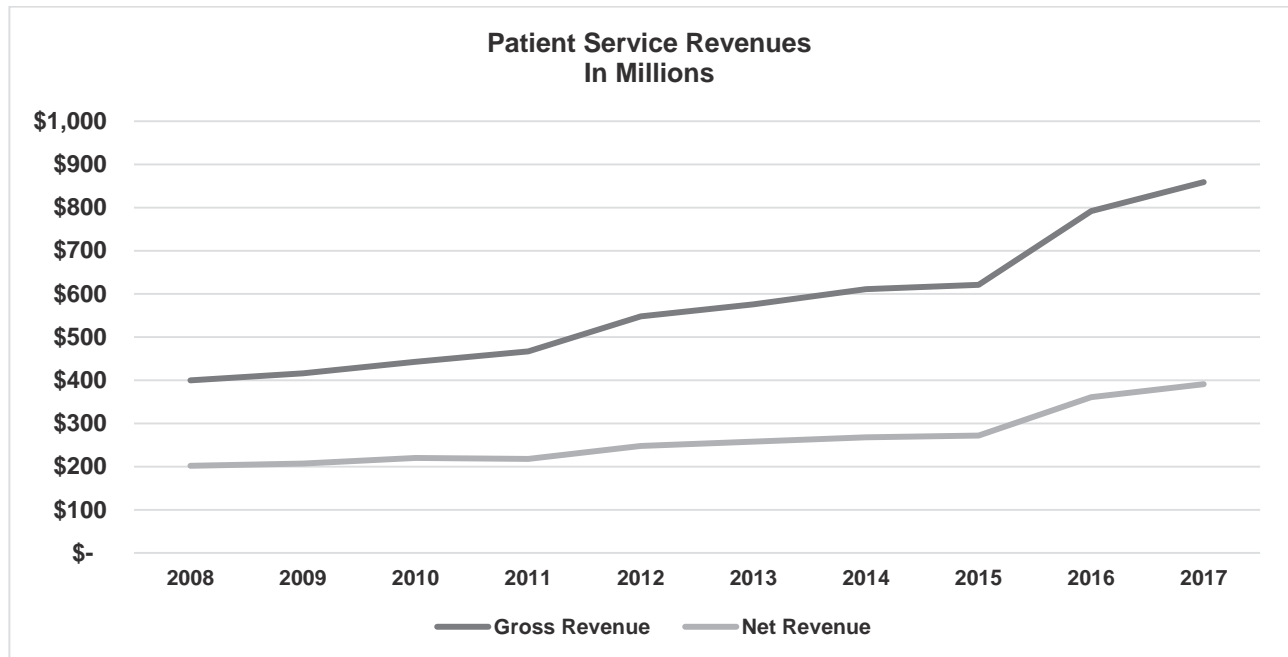
In 2017 and 2016, approximately 62% and 64%, respectively, of the University's total operating expenses were salaries and benefits.



For the years ended September 30, 2017 and 2016, the University reported operating losses of approximately \$104,935,000 and \$99,406,000, respectively. Operating losses are offset partially by state appropriations, which, as mentioned earlier, are reported as nonoperating revenues. After adding state appropriations and other nonoperating revenues and expenses (primarily capital contributions and additions to endowment), and applying the cumulative effect of the change in reporting entity related to the transfer of the Health Services Foundation (HSF) in 2016, the total change in net position was approximately \$47,825,000 and \$25,905,000, for the years ended September 30, 2017 and 2016, respectively.

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USA Health represents a significant portion of total University revenues. Operating patient service revenues, gross and net, for the last ten fiscal years are presented as follows:



Statements of Cash Flows

The statements of cash flows present information related to cash flows of the University. The statements present 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 \$25,701,000 in 2017. Significant construction projects that remain in progress at September 30, 2017 include a new residence hall and a major upgrade of infrastructure on the University's main campus. Major projects completed and placed into service in fiscal 2017 and 2016 included the Student Health Center, an addition to the Mitchell Cancer Institute, a professional medical office building near USA Children's and Women's Hospital and a professional medical office building in Fairhope, Alabama. At September 30, 2017, the University had outstanding commitments of approximately \$19,746,000 for various capital projects.

In September 2016, the University issued its University Facilities Revenue Refunding Bonds, Series 2016, with a face value of \$85,605,000. The proceeds from the Series 2016 Bonds were used to partially defease the Series 2008 Bonds. The funds were deposited into escrow trust funds to provide for the subsequent repayment of the Series 2008 Bonds when they are called in August 2018. Neither the assets of the escrow trust account, nor the defeased indebtedness is included in the accompanying statements of net position. The principal outstanding on all defeased bonds is \$90,690,000 at September 30, 2017. The refunding resulted in net present

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value savings of approximately \$15,016,000. The remaining undefeased portion of the Series 2008 Bonds at September 30, 2017 is \$2,850,000 and is included in current portion of long-term debt on the accompanying statement of net position.

In December 2016, the University issued its University Facilities Revenue Refunding Bonds, Series 2016-B, C and D, with a face value totaling \$100,000,000. The proceeds from the Series 2016 Bonds were used to refund the remaining outstanding Series 2006 Bonds.

In June 2017, the University issued its University Facilities Revenue Bonds, Series 2017, with a face value of \$38,105,000. The proceeds from the Series 2017 Bonds are being used to construct a new residence hall on the campus of the University and support ongoing infrastructure improvement projects.

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 interest rate swaps 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 swaptions was considered an investment derivative and, as such, the change in the fair value of the derivatives was reflected as a component of investment income.

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, and issued the 2014-A variable rate bonds. As a result of the exercise of the option by the counterparty, the swaption was terminated and 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 \$5,939,825 was recognized and is reported in the statement of net position at September 30, 2017.

In September 2016, the counterparty exercised its option with respect to the 2006 swaption and forced the University into an underlying swap. As a result of the exercise of the option by the counterparty, the swaption was terminated and the borrowing arising from the Series 2006 swaption of \$6,939,000 and the investment derivative of \$34,078,000 were written off. A borrowing arising from the 2016 swap of \$45,934,000 was recognized and is reported in the statement of net position at September 30, 2017.

The University's bond credit rating is A1 (Stable) as rated by Moody's Investors Services and A+ (Stable) as rated by Standard and Poor's Rating Services. Neither rating changed during 2017 or 2016.

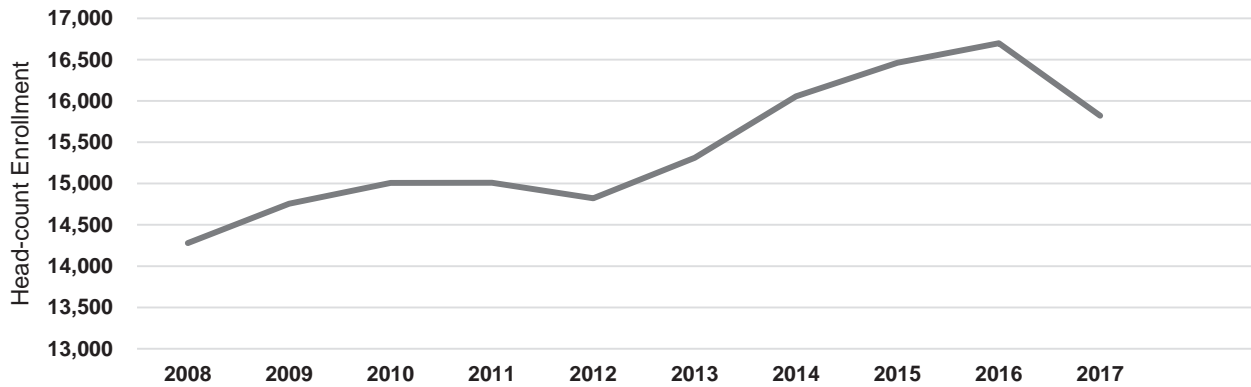
Economic Outlook

Tuition and fee rates have increased over the past ten years and student enrollment has generally increased over this same period. The University has experienced an increase in enrollment between 2008 and 2017, from 14,279 in 2008 to 15,821 for the 2017 Fall semester. However, the University did experience a decline in

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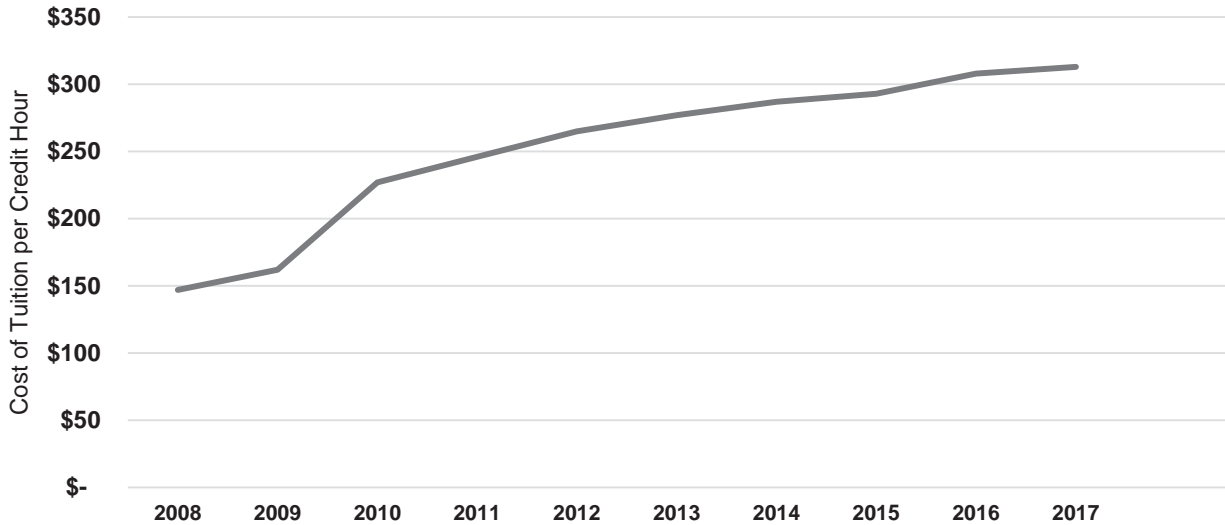
enrollment of approximately 5% in Fall 2017, primarily due to a decrease in international student enrollment. The enrollment trend for the University between 2008 and 2017 is as follows:

Enrollment Growth Summary



During the same time period, in-state tuition per credit hour has increased by approximately 113%. The large increase in 2010 is the result of the University's bundling of tuition and required fees into a single per-hour charge. Similar increases have been experienced in out-of-state tuition and College of Medicine tuition. The trend of in-state tuition per credit hour between 2008 and 2017 is as follows:

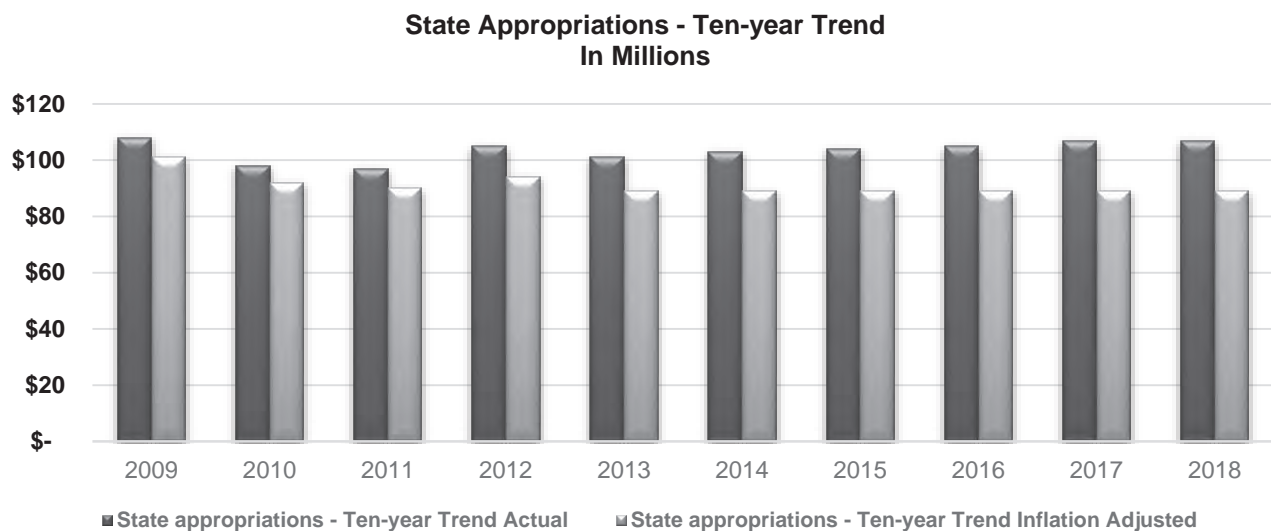
Tuition per Credit Hour



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A state appropriation in the amount of approximately \$107,332,000 and \$105,024,000 was authorized and received for the years ended September 30, 2017 and 2016 respectively. A state appropriation in the amount of \$107,285,000 has been authorized for the year ended September 30, 2018. While no announcement has been made, the University is aware that reductions in the 2018 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 and political conditions in the United States and, specifically, the State of Alabama. Weakening of the economy, as well as changes in federal and state funding policies, could potentially have a 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 2018 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 G. Scott Weldon; Vice President for Finance and Administration; University of South Alabama Administration Building Room 170; Mobile, Alabama 36688. These basic financial statements can be obtained from our website at <http://www.southalabama.edu/financialaffairs/businessoffice/statements.html>.



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

Independent Auditors' Report

The Board of Trustees
University of South Alabama:

Report on the Financial Statements

We have audited the accompanying financial statements of the University of South Alabama, a component unit of the State of Alabama, (the University) and its aggregate discretely presented component units, as of and for the years ended September 30, 2017 and 2016, 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 2017 consolidated financial statements of the University of South Alabama Foundation, which represents 94%, 100%, and 89%, respectively, of the 2017 assets, net assets, and revenues, gains and other support of the aggregate discretely presented component units. Nor did we audit the 2016 consolidated financial statements of the University of South Alabama Foundation which represented 93%, 100%, and 52%, respectively, of the 2016 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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the University of South Alabama Foundation and the USA Research and Technology Corporation 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, 2017 and 2016, 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 1-13 and the schedule of the University's proportionate share of the net pension liability and schedule of University's contributions on pages 73 and 74 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, 2017, 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, 2017

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

Statements of Net Position

September 30, 2017 and 2016

(In thousands)

	2017		2016
Current assets:			
Cash and cash equivalents	\$ 102,748	\$	100,155
Investments	65,464		85,182
Net patient receivables, (net of allowance for doubtful accounts of \$73,983 in 2017 and \$65,829 in 2016)	49,739		47,897
Accounts receivable, affiliates	5,434		464
Accounts receivable, other	17,967		20,674
Notes receivable, net	6,432		7,108
Prepaid expenses, inventories, and other	13,623		12,154
Total current assets	261,407		273,634
Noncurrent assets:			
Restricted cash and cash equivalents	33,116		18,927
Restricted investments	171,481		108,894
Investments	60,129		81,279
Accounts receivable	2,281		2,195
Other noncurrent assets	1,109		2,167
Capital assets, net	693,968		653,297
Total noncurrent assets	962,084		866,759
Total assets	1,223,491		1,140,393
Deferred outflows			
	59,001		44,518
Total assets and deferred outflows	1,282,492		1,184,911
Current liabilities:			
Accounts payable and accrued liabilities	62,877		55,234
Unrecognized revenue	59,831		62,674
Deposits	2,433		1,627
Current portion of other long-term liabilities	6,884		9,336
Current portion of long-term debt	25,778		25,016
Total current liabilities	157,803		153,887
Noncurrent liabilities:			
Long-term debt, less current portion	386,520		363,796
Net pension liability	336,477		329,294
Other long-term liabilities, less current portion	95,108		95,926
Total noncurrent liabilities	818,105		789,016
Total liabilities	975,908		942,903
Deferred inflows			
	40,765		24,014
Total liabilities and deferred inflows	1,016,673		966,917
Net position:			
Net investment in capital assets	305,898		270,127
Restricted, nonexpendable:			
Scholarships	27,045		23,905
Other	27,916		24,855
Restricted, expendable:			
Scholarships	14,287		13,368
Other	48,389		42,224
Unrestricted	(157,716)		(156,485)
Total net position	\$ 265,819	\$	217,994

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statements of Financial Position

June 30, 2017 and 2016

(In thousands)

Assets	2017	2016
Cash and cash equivalents	\$ 556	\$ 368
Investments:		
Equity securities	129,674	120,900
Timber and mineral properties	160,351	157,470
Real estate	69,186	69,070
Other	5,808	5,803
Other assets	473	532
Total assets	\$ 366,048	\$ 354,143
Liabilities and Net Assets		
Liabilities:		
Accounts payable	\$ 101	\$ 90
Other liabilities	704	649
Total liabilities	805	739
Net assets:		
Unrestricted	99,678	99,115
Temporarily restricted	95,856	84,699
Permanently restricted	169,709	169,590
Total net assets	365,243	353,404
Total liabilities and net assets	\$ 366,048	\$ 354,143

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(A Component Unit of the University of South Alabama)

Statements of Net Position

September 30, 2017 and 2016

	2017	2016
Assets:		
Current assets:		
Unrestricted cash and cash equivalents	\$ 353,058	\$ 627,125
Rent receivable, (net of allowance for doubtful accounts of \$95,703 in 2017 and \$0 in 2016, respectively)	20,483	26,018
Prepaid expenses and other current assets	6,799	15,481
Total current assets	380,340	668,624
Noncurrent assets:		
Intangible assets, net	65,482	29,855
Capital assets, net	21,689,045	22,567,316
Total noncurrent assets	21,754,527	22,597,171
Deferred outflows	2,252,005	3,414,981
Total assets and deferred outflows	24,386,872	26,680,776
Liabilities:		
Current liabilities:		
Deposits, other current liabilities, and accrued expenses	111,550	162,183
Payable to University of South Alabama	46,271	—
Unrecognized rent revenue	432,689	390,442
Current portion of notes payable	1,119,337	1,062,354
Total current liabilities	1,709,847	1,614,979
Noncurrent liabilities:		
Notes payable, excluding current portion	19,134,302	20,253,638
Interest rate swap	2,252,005	3,414,981
Payable to University of South Alabama	559,872	573,108
Total noncurrent liabilities	21,946,179	24,241,727
Total liabilities	23,656,026	25,856,706
Net position:		
Net investment in capital assets	875,534	678,216
Unrestricted	(144,688)	145,854
Total net position	\$ 730,846	\$ 824,070

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, 2017 and 2016

(In thousands)

	2017	2016
Operating revenues:		
Tuition and fees (net of scholarship allowances of \$35,523 in 2017 and \$35,179 in 2016)	\$ 142,024	\$ 137,074
Patient service revenues (net of provision for bad debts of \$88,274 in 2017 and \$83,211 in 2016)	390,931	360,657
Federal grants and contracts	19,502	20,119
State grants and contracts	8,847	8,663
Private grants and contracts	8,504	9,405
Auxiliary enterprises (net of scholarship allowances of \$1,066 in 2017 and \$1,147 in 2016)	28,347	28,861
Other operating revenues	64,327	60,082
Total operating revenues	662,482	624,861
Operating expenses:		
Salaries and benefits	483,113	460,219
Supplies and other services	219,362	198,518
Scholarships and fellowships	12,346	14,230
Utilities	15,856	15,126
Depreciation and amortization	36,740	36,174
Total operating expenses	767,417	724,267
Operating loss	(104,935)	(99,406)
Nonoperating revenues (expenses):		
State appropriations	107,332	105,024
Investment income	18,398	2,631
Interest expense	(11,479)	(14,342)
Other nonoperating revenues	35,172	38,708
Other nonoperating expenses	(3,080)	(16,231)
Net nonoperating revenues	146,343	115,790
Income before capital contributions and grants and additions to endowment	41,408	16,384
Capital contributions and grants	989	3,053
Additions to endowment	5,428	6,468
Increase in net position	47,825	25,905
Net position:		
Beginning of year, before cumulative effect of change in reporting entity	217,994	195,052
Cumulative effect of change in reporting entity (note 1 (d))	—	(2,963)
Beginning balance, as adjusted	217,994	192,089
End of year	\$ 265,819	\$ 217,994

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, 2017

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, losses and other support:				
Net realized and unrealized gains on investments	\$ 5,054	\$ 17,582	\$ —	\$ 22,636
Rents, royalties and timber sales	3,786	130	8	3,924
Interest and dividends	740	1,280	4	2,024
Gifts	—	4	54	58
Required match of donor contributions	(16)	(37)	53	—
Interfund interest	(252)	252	—	—
Other income	2	—	—	2
Net assets released from program restrictions	8,054	(8,054)	—	—
Total revenues, gains, losses and other support	<u>17,368</u>	<u>11,157</u>	<u>119</u>	<u>28,644</u>
Expenditures:				
Program services:				
Faculty support	2,230	—	—	2,230
Scholarships	1,136	—	—	1,136
Other academic programs	6,405	—	—	6,405
Total program service expenditures	9,771	—	—	9,771
Management and general	1,952	—	—	1,952
Other investment expense	1,583	—	—	1,583
Depletion expense	3,414	—	—	3,414
Depreciation expense	85	—	—	85
Total expenditures	<u>16,805</u>	<u>—</u>	<u>—</u>	<u>16,805</u>
Change in net assets	563	11,157	119	11,839
Net assets – beginning of year	<u>99,115</u>	<u>84,699</u>	<u>169,590</u>	<u>353,404</u>
Net assets – end of year	<u>\$ 99,678</u>	<u>\$ 95,856</u>	<u>\$ 169,709</u>	<u>\$ 365,243</u>

See accompanying notes to basic financial statements.

UNIVERSITY OF SOUTH ALABAMA FOUNDATION
(Discretely Presented Component Unit)

Consolidated Statement of Activities and Changes in Net Assets

Year ended June 30, 2016

(In thousands)

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Permanently restricted</u>	<u>Total</u>
Revenues, gains, losses and other support:				
Net realized and unrealized gains on investments	\$ 6,622	\$ (3,806)	\$ —	\$ 2,816
Rents, royalties and timber sales	3,243	130	13	3,386
Interest and dividends	1,172	956	3	2,131
Gifts	—	8	—	8
Required match of donor contributions	(8)	8	—	—
Interfund interest	(218)	218	—	—
Net assets released from program restrictions	8,848	(8,848)	—	—
Total revenues, gains, and other support	<u>19,659</u>	<u>(11,334)</u>	<u>16</u>	<u>8,341</u>
Expenditures:				
Program services:				
Faculty support	2,330	—	—	2,330
Scholarships	1,385	—	—	1,385
Other academic programs	6,846	—	—	6,846
Total program service expenditures	10,561	—	—	10,561
Management and general	2,040	—	—	2,040
Other investment expense	1,388	—	—	1,388
Depletion expense	3,354	—	—	3,354
Depreciation expense	86	—	—	86
Total expenditures	<u>17,429</u>	<u>—</u>	<u>—</u>	<u>17,429</u>
Change in net assets	2,230	(11,334)	16	(9,088)
Net assets – beginning of year	96,885	96,033	169,574	362,492
Net assets – end of year	<u>\$ 99,115</u>	<u>\$ 84,699</u>	<u>\$ 169,590</u>	<u>\$ 353,404</u>

See accompanying notes to basic financial statements.

USA RESEARCH AND TECHNOLOGY CORPORATION
(A Component Unit of the University of South Alabama)

Statements of Revenues, Expenses, and Changes in Net Position

Years ended September 30, 2017 and 2016

	2017	2016
Operating revenues	\$ 3,358,749	\$ 3,424,286
Operating expenses:		
Building management and operating expenses	1,111,116	1,150,462
Depreciation and amortization	984,117	950,543
Legal and administrative fees	181,697	185,478
Insurance	33,168	27,375
Total operating expenses	2,310,098	2,313,858
Operating income	1,048,651	1,110,428
Nonoperating revenues (expenses):		
Investment income	1,637	1,389
Interest expense	(1,145,017)	(1,198,795)
Other	1,505	4,836
Net nonoperating expenses	(1,141,875)	(1,192,570)
Change in net position	(93,224)	(82,142)
Net position:		
Beginning of year	824,070	906,212
End of year	\$ 730,846	\$ 824,070

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, 2017 and 2016

(In thousands)

	2017	2016
Cash flows from operating activities:		
Receipts related to tuition and fees	\$ 143,526	\$ 135,642
Receipts from and on behalf of patients and third-party payers	389,670	331,351
Receipts from grants and contracts	35,612	56,071
Receipts related to auxiliary enterprises	28,766	29,456
Payments to suppliers and vendors	(244,989)	(200,589)
Payments to employees and related benefits	(459,764)	(444,936)
Payments for scholarships and fellowships	(8,986)	(11,186)
Other operating receipts	64,396	51,605
Net cash used in operating activities	(51,769)	(52,586)
Cash flows from noncapital financing activities:		
State appropriations	107,332	105,024
Endowment gifts	5,428	6,468
Agency funds received	1,408	646
Agency funds disbursed	(1,042)	(1,946)
Student loan program receipts	149,508	151,365
Student loan program disbursements	(149,353)	(152,855)
Other nonoperating revenues	16,313	47,401
Other nonoperating expenses	(3,902)	(5,347)
Net cash provided by noncapital financing activities	125,692	150,756
Cash flows from capital and related financing activities:		
Capital contributions and grants	989	3,052
Purchases of capital assets	(75,767)	(75,208)
Proceeds from issuance of capital debt	146,784	107,537
Principal payments on capital debt	(121,680)	(108,463)
Interest payments on capital debt	(10,672)	(15,409)
Net cash used in capital and related financing activities	(60,346)	(88,491)
Cash flows from investing activities:		
Interest and dividends on investments	9,983	3,540
Purchases of investments	(56,502)	(122,288)
Proceeds from sales of investments	49,724	100,876
Net cash provided by (used in) investing activities	3,205	(17,872)
Net increase (decrease) in cash and cash equivalents	16,782	(8,193)
Cash and cash equivalents (unrestricted and restricted):		
Beginning of year, as adjusted	119,082	127,275
End of year	\$ 135,864	\$ 119,082

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

Statements of Cash Flows

Years ended September 30, 2017 and 2016

(In thousands)

	2017	2016
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (104,935)	\$ (99,406)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Depreciation and amortization expense	36,740	36,174
Changes in assets and liabilities, net:		
Student receivables	2,950	(3,166)
Net patient accounts receivables	(1,841)	(3,871)
Grants and contracts receivables	208	18,546
Other receivables	812	(8,936)
Prepaid expenses, inventories, and other	(7,122)	(1,422)
Accounts payable and accrued liabilities	24,262	5,045
Unrecognized revenue	(2,843)	4,450
Net cash used in operating activities	\$ (51,769)	\$ (52,586)
Noncash investing, noncapital financing, and capital and related financing transactions:		
Net increase (decrease) in fair value of investments recognized as a component of investment income	\$ 12,383	\$ (2,025)
Payment for capital lease	3,309	3,678
Additional maturity on capital appreciation on bonds payable and other borrowings recorded as interest expense	782	1,443
Gifts of capital and other assets	1,576	2,257
Capitalization of construction period interest	801	721
Increase in accounts payable related to capital assets	562	2,606

See accompanying notes to basic financial statements.

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

Notes to Basic Financial Statements

September 30, 2017 and 2016

(1) Summary of Significant Accounting Policies

(a) Reporting Entity

On May 3, 1963, the Governor of Alabama signed enabling legislation creating the University of South Alabama (the University). The accompanying basic financial statements present the financial position and activities of the University, which is a component unit of the State of Alabama. The financial statements of the University 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.

GASB Statement No. 61 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, 2017 and 2016, the University reports the University of South Alabama Foundation (USA Foundation) 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), the Gulf Coast Regional Care Organization (RCO) and the University of South Alabama Health Care Authority (HCA). These entities are not considered component units of the University under the provisions of GASB Statements No. 14, 39 and 61 because the University does not consider these entities significant enough to warrant inclusion in the University's reporting entity.

GASB Statement No. 61 and GASB Statement No. 80, *Blending Requirements for Certain Component Units*, require 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 and No. 80. Based on these criteria, the University reports the Professional Liability Trust Fund (PLTF), General Liability Trust Fund (GLTF) and USA HealthCare Management, LLC (HCM) as blended component units. All significant transactions among the University and its blended component units have been eliminated in consolidation.

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

Notes to Basic Financial Statements

September 30, 2017 and 2016

(b) 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 in which the University, University of South Alabama Health Services Foundation (USAHSF), HCM, SAMSF and HCA are the only participants. In accordance with the bylaws of the PLTF, the president of the University is responsible for appointing members of the PLTF policy committee. Additionally, the general liability of the University, USAHSF, HCM, SAMSF, the Corporation and HCA is maintained and managed in its General Liability Trust Fund for which the University, as defined by GASB Statement No. 18, 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 18 for further discussion of, and disclosure for, these entities).

(c) USA HealthCare Management, LLC

In June 2010, the University's Board of Trustees approved the formation of USA HealthCare Management, LLC. HCM 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 HCM. HCM commenced operations in October 2010, and is reported as a blended component unit (see note 18 for further discussion of, and disclosure for, this entity).

(d) University of South Alabama Health Services Foundation

During fiscal 2016, due to the Board's approval of governance changes and assignment of operational responsibility to the University, the USA Health Services Foundation met the criteria for blended component unit presentation. The cumulative effect of this change in reporting entity resulted in a decrease to the University's net position at October 1, 2015 in the amount of \$(2,963,000). All 2016 transactions for USAHSF are blended in the University's financial statements. While USAHSF as a legal entity is still in existence, there were no activities during the year ended September 30, 2017.

(e) University of South Alabama Health Care Authority

In May 2017, the University's Board of Trustees approved a resolution to form the University of South Alabama Health Care Authority. The HCA is a public corporation created under and pursuant to the provisions of the University Authority Act of 2016. The HCA will employ physicians and staff of physician practice groups as determined appropriate by the University. Operations commenced on August 1, 2017. Because the activity of the HCA is not material to the University's financial statements, the HCA is not presented as a component unit.

(f) University of South Alabama Foundation

The University of South Alabama Foundation is a not-for-profit corporation 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, 2017 and 2016

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

Notes to Basic Financial Statements

September 30, 2017 and 2016

were \$9,603,000 and \$10,455,000, respectively, and are included primarily 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, 2017 and 2016 are discretely presented.

(g) USA Research and Technology Corporation

USA Research and Technology 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 as of and for the years ended September 30, 2017 and 2016 are discretely presented.

(h) Gulf Coast Regional Care Organization

The Gulf Coast Regional Care Organization is a not-for-profit corporation that exists for the purpose of creating and operating a risk-based, community-led network to coordinate the health care of Medicaid patients in a seven county region of southwest Alabama, one of five such regions in the state of Alabama identified by the Alabama Medicaid Agency. The RCO commenced operations in April 2015 and is currently operating a Health Home program, providing certain case management services to qualifying Medicaid beneficiaries. Because the activity of the RCO is not material to the University's financial statements, the RCO is not considered a component unit.

(i) 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, *Basic Financial Statements – and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. 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.

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

Notes to Basic Financial Statements

September 30, 2017 and 2016

(j) 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.

(k) 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.

(l) Investments and Investment Income

The University reports the fair value of investments using the three-level hierarchy established under GASB Statement No. 72, *Fair Value Measurement and Application*. The fair value of alternative investments (low-volatility multi-strategy funds of funds) and private equity partnerships 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, typically based on net asset value (NAV) of the partnership or commingled vehicle. Because some of these investments are not readily 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.

(m) 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.

The counterparty exercised its option related to each swaption noted above, and, as a result, the University entered into interest rate swaps. See note 5 and note 10 for further discussion.

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(n) Accounts Receivable

Patient service receivables primarily result from hospital and ambulatory patient service revenues. Accounts receivable from affiliates primarily represent amounts due from the USA Foundation and the HCA. 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 and patient receivables are recorded net of estimated uncollectible amounts.

(o) 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.

(p) Capital Assets

Capital assets are recorded at cost, if purchased, or, if donated, at acquisition value at the date of donation. Depreciation is provided over the estimated useful life of each class of depreciable assets 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 constructed assets are capitalized as a component of the cost of acquiring those assets. The amount of interest capitalized for the years ended September 30, 2017 and 2016 was approximately \$801,000 and \$721,000, respectively.

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, 2017 and 2016, no impairments were recorded.

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(q) 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.

(r) Cost Sharing Multi-Employer Pension Plan

Employees of the University are covered by a cost sharing multiple-employer defined benefit pension plan (the Plan) administered by the Teachers' Retirement System of Alabama (TRS). The TRS financial statements are prepared using the economic resources measurement focus and accrual basis of accounting. Contributions are recognized as revenues when earned, pursuant to plan requirements. Benefits and refunds are recognized as expenses when due and payable in accordance with the terms of the Plan. Expenses are recognized when the corresponding liability is incurred, regardless of when the payment is made. Investments are reported at fair value. Financial statements are prepared in accordance with requirements of the GASB. Under these requirements, the Plan is considered a component unit of the State of Alabama and is included in the State's Comprehensive Annual Financial Report.

(s) 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 for which donors or other outside sources have stipulated, as a condition of the gift instrument, that 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, patient service revenues, 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.

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(t) *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 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 satisfy tuition and fees and certain other student charges, the University has recorded a scholarship discount and allowance.

(u) *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, of the endowment assets. 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.

(v) *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; patient service revenues; most federal, state, and local grants and contracts; and sales and services of auxiliary enterprises, net of scholarship allowances.

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

(w) *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.

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(x) 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.

(y) Patient Service Revenues and Electronic Health Records Incentive Program

Patient service revenues are 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. USA Health, which includes two hospitals and a cancer treatment center, utilizes a grant accounting model to recognize EHR incentive revenues. EHR incentive revenue is recorded 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 has met the Medicare and Medicaid meaningful use objectives for fiscal year 2016. The hospital also expects to meet meaningful use objectives in fiscal 2017. No meaningful use payment is expected for fiscal year 2017 as a result of the transition to the Merit-Based Incentive Payment System, which is an ambulatory Eligible Professional attestation. While USA Medical Center is moving to Penalty Aversion, it is still in the Meaningful Use program for eligible hospitals. Any payment adjustments for fiscal year 2017 will not be paid until 2019.

USA Health recognized Medicare EHR incentive revenues of \$208,000 and \$391,000 for the years ended September 30, 2017 and 2016, respectively. EHR incentive revenues are included in other operating revenues in the accompanying statements of revenues, expenses, and changes in net position.

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(z) *Compensated Absences*

The University accrues annual leave for employees as incurred at rates based upon length of service and job 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, 2017 and 2016, the net public deposits subject to collateral requirements for all institutions participating in the pool totaled approximately \$10.8 billion and \$10.7 billion, respectively. The University had cash and cash equivalents in the pool of \$135,864,000 and \$119,082,000 at September 30, 2017 and 2016, respectively.

At September 30, 2017, restricted cash and cash equivalents consist of \$4,055,000 related to cash included in the PLTF and GLTF to pay insurance liability claims, \$1,711,000 related to collateral requirements of HCM, \$210,000 related to monies held for a capital project at HCM, \$27,107,000 of unspent proceeds from the issuance of University bonds for capital purchases as outlined in the bond indenture, and \$33,000 related to endowment funds.

At September 30, 2016, restricted cash and cash equivalents consist of \$1,584,000 related to cash included in the PLTF and GLTF to pay insurance liability claims, \$10,000,000 related to collateral requirements of the University, \$1,701,000 related to collateral requirements of HCM and \$5,642,000 of unspent proceeds from the issuance of University bonds for capital purchases as outlined in the bond indenture.

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(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 commingled 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, certain 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, 2017 and 2016 (in thousands):

	2017	2016
U.S. Treasury notes	\$ 1,196	\$ 5,167
U.S. federal agency notes	103,345	104,895
Commingled equity funds	116,427	91,695
Commingled fixed income funds	38,181	37,439
Marketable equity securities	8,766	7,864
Real estate	308	360
Private equity	1,091	—
Managed income alternative investments (low-volatility multi-strategy funds of funds)	27,760	27,935
	\$ 297,074	\$ 275,355

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At September 30, 2017 and 2016, \$14,755,000 and \$14,852,000, respectively, of cumulative appreciation in fair value of investments of donor-restricted endowments was recognized and is included in restricted expendable net position in the accompanying statements of net position.

(i) *Credit Risk and Concentration of Credit Risk*

Nonendowment Cash Pool Investment Policy

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.

Endowment Fund Investment Policy

The University Investment Policies limit investment in fixed income securities to securities with a minimum "BAA" rating, at the time of purchase, by both Moody's and Standard and Poor's. Money Market Funds selected shall contain securities whose credit rating at the absolute minimum would be rated investment grade by Standard and Poor's, and/or Moody's. Investment in fixed income securities within the fixed income portfolio shall be restricted to only investment grade bonds rated "BAA" or higher. Any investment in below investment grade bonds shall be considered an equity or fixed income alternative investment.

Additionally, the University Investment Policies require that not more than 5% of the Endowment Fund assets of the University be allocated to an individual investment manager and no more than 25% of the Endowment Fund assets be allocated to a "Fund of Funds" or multi-manager fund.

The University's exposure to credit risk and concentration of credit risk at September 30, 2017 is as follows:

	<u>Credit rating</u>	<u>Percentage of total investments</u>
Federal National Mortgage Association	AAA	14.4 %
Federal Farm Credit Banks Funding Corporation	AAA	12.5
Common Fund Bond Fund	A+	10.9
Federal Farm Credit Banks Debenture	AAA/AA+	7.5
PIMCO Pooled Bond Fund	A-/BAA+/AA	1.9
Federal Home Loan Bank Corporation	AAA	0.3

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The University's exposure to credit risk and concentration of credit risk at September 30, 2016 is as follows:

	Credit rating	Percentage of total investments
Federal National Mortgage Association	AAA	9.0 %
Federal Farm Credit Banks Funding Corporation	AAA	23.9
Common Fund Bond Fund	A+	11.6
PIMCO Pooled Bond Fund	BAA+/BAA/AA	2.0
Federal Home Loan Bank Corporation	AAA	2.5
Federal Home Loan Mortgage Corporation	AAA	2.6

(ii) *Interest Rate Risk*

At September 30, 2017, the maturity dates of the University's fixed income investments are as follows (in thousands):

	Fair value	Years to maturity			
		Less than 1	1-5	6-10	More than 10
U.S. Treasury notes	\$ 1,196	\$ —	\$ 1,196	\$ —	\$ —
U.S. federal agency notes	103,345	6,696	96,649	—	—
Commingled fixed income funds	38,181	1,393	32,512	4,276	—
	<u>\$ 142,722</u>	<u>\$ 8,089</u>	<u>\$ 130,357</u>	<u>\$ 4,276</u>	<u>\$ —</u>

At September 30, 2016, the maturity dates of the University's fixed income investments are as follows (in thousands):

	Fair value	Years to maturity			
		Less than 1	1-5	6-10	More than 10
U.S. Treasury notes	\$ 5,167	\$ 3,953	\$ 1,214	\$ —	\$ —
U.S. federal agency notes	104,895	11,014	93,881	—	—
Commingled fixed income funds	37,439	1,300	33,215	2,924	—
	<u>\$ 147,501</u>	<u>\$ 16,267</u>	<u>\$ 128,310</u>	<u>\$ 2,924</u>	<u>\$ —</u>

Commingled fixed income funds are classified based on the weighted average maturity of the individual investment instruments within each fund.

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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.

(iii) *Mortgage-Backed Securities*

The University, from time to time, invests in mortgage backed securities such as the Federal Home Loan Mortgage Corporation (FHLMC), the Federal National Mortgage Association (FNMA), and other government sponsored enterprises 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.

(iv) *Fair Value Measurement*

Fair value measurements represent the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurements date. The University of South Alabama measures and records its investments using fair value measurement guidelines established by GASB Statement No. 72. These guidelines prioritize the inputs of valuation techniques used to measure fair value, as follows:

- Level 1: Quoted prices for identical investments in active markets
- Level 2: Observable inputs other than quoted market prices; and,
- Level 3: Unobservable inputs

The level in the fair value hierarchy that determines the classification of an asset or liability depends on the lowest level input that is significant to the fair value measurement. Observable inputs are derived from quoted market prices for assets or liabilities traded on an active market where there is sufficient activity to determine a readily determinable market price. Investments that are not traded on an active exchange and do not have a quoted market price are classified as unobservable inputs. The University of South Alabama's assets that have unobservable inputs consist of the investment in real estate, with fair value based on an independent third party appraisal performed by qualified appraisers specializing in real estate investments, and of investments in private capital, with fair value determined by the investment managers and primarily utilizes management assumptions and best estimates after considering internal and external factors. Other assets included in the University's investment portfolio with unobservable inputs are the shares or units in certain partnerships or other commingled funds that do not have readily determinable fair values. For these funds, fair value is estimated using the net asset value reported by the investment managers as a practical expedient to fair value. Such investments have not been categorized within the fair value hierarchy. The fair value amounts presented in this table are intended to permit reconciliation of the fair value hierarchy to the amounts presented in the statements of net position.

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The following tables summarize the fair value measurements for all investment assets and liabilities carried at fair value as of September 30, 2017 (in thousands):

Description	Asset fair value measurements at September 30, 2017			
	Level 1	Level 2	Level 3	Total
U.S. Treasury notes	\$ 1,196	\$ —	\$ —	\$ 1,196
U.S. federal agency notes	—	103,345	—	103,345
Commingled equity funds	68,084	48,343	—	116,427
Commingled fixed income funds	5,669	32,512	—	38,181
Marketable equity securities	8,766	—	—	8,766
Private equity	—	—	836	836
Real estate	—	—	308	308
Total investments at fair value	\$ <u>83,715</u>	\$ <u>184,200</u>	\$ <u>1,144</u>	269,059
Investments measured at NAV:				
Private equity				255
Managed income alternative investments (low volatility multi-strategy fund of funds)				<u>27,760</u>
Total investments			\$	<u>297,074</u>

Description	Liability fair value measurements at September 30, 2017			
	Level 1	Level 2	Level 3	Total
Interest rate exchange agreements	\$ —	\$ 45,608	\$ —	\$ 45,608

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The following tables summarize the fair value measurements for all investment assets and liabilities carried at fair value as of September 30, 2016 (in thousands):

Description	Asset fair value measurements at September 30, 2016			
	Level 1	Level 2	Level 3	Total
U.S. Treasury notes	\$ 5,167	\$ —	\$ —	\$ 5,167
U.S. federal agency notes	—	104,895	—	104,895
Commingled equity funds	49,293	42,402	—	91,695
Commingled fixed income funds	5,462	31,977	—	37,439
Marketable equity securities	7,864	—	—	7,864
Real estate	—	—	360	360
Total investments at fair value	\$ <u>67,786</u>	\$ <u>179,274</u>	\$ <u>360</u>	247,420
Investments measured at NAV:				
Managed income alternative investments (low volatility multi-strategy fund of funds)				<u>27,935</u>
Total investments				\$ <u><u>275,355</u></u>

Description	Liability fair value measurements at September 30, 2016			
	Level 1	Level 2	Level 3	Total
Interest rate exchange agreements	\$ —	\$ 56,422	\$ —	\$ 56,422

A rollforward schedule of amounts for Level 3 financial instruments for the fiscal year ended September 30, 2017 is as follows (in thousands):

Description	Real estate and private equity
Beginning balance	\$ 360
Purchases	560
Total realized/unrealized gains (losses)	283
Sales	<u>(59)</u>
Ending balance	\$ <u><u>1,144</u></u>

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A rollforward schedule of amounts for Level 3 financial instruments for the fiscal year ended September 30, 2016 is as follows (in thousands):

Description	Real estate
Beginning balance	\$ 5,548
Total realized/unrealized gains (losses)	(940)
Sales	(4,248)
Ending balance	\$ 360

(b) University of South Alabama Foundation

Investments in securities consist primarily of equity securities totaling \$129,674,000 and \$120,900,000 at June 30, 2017 and 2016, respectively.

Investment income was comprised of the following for the years ended June 30, 2017 and 2016 (in thousands):

	2017	2016
Unrealized gains	\$ 17,592	\$ 844
Realized gains	5,044	1,972
Timber sales	3,230	2,685
Interest and dividends	2,024	2,131
Rents	624	627
Royalties	70	74
	\$ 28,584	\$ 8,333

Investment related expenses in the amount of \$322,000 and \$324,000, respectively, are included in the USA Foundation's management and general expenses in the accompanying 2017 and 2016 consolidated statements of activities and changes in net assets.

Real estate at June 30, 2017 and 2016 consisted of the following property held (in thousands):

	2017	2016
Land and land improvements – held for investment	\$ 68,074	\$ 67,935
Building and building improvements – held for investment	1,112	1,135
	\$ 69,186	\$ 69,070

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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, 2017 and 2016, 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 from the trustee responsible for the management of the company and the timber valuation.

The Foundation has adopted Accounting Standards Codification (ASC) 820, *Fair Value Measurement and Disclosures*. 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, 2017, are summarized based on the criteria of ASC 820 as follows (in thousands):

<u>Description</u>	<u>Fair value measurements at June 30, 2017</u>			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity securities	\$ 78,517	\$ 51,157	\$ —	\$ 129,674
Timber and mineral properties	—	—	160,351	160,351
Real estate	—	—	69,186	69,186
Other investments	—	—	5,808	5,808
	<u>\$ 78,517</u>	<u>\$ 51,157</u>	<u>\$ 235,345</u>	<u>\$ 365,019</u>

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The Foundation's investment assets at June 30, 2016, are summarized based on the criteria of ASC 820 as follows (in thousands):

<u>Description</u>	Fair value measurements at June 30, 2016			
	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Equity securities	\$ 72,481	\$ 48,419	\$ —	\$ 120,900
Timber and mineral properties	—	—	157,470	157,470
Real estate	—	—	69,070	69,070
Other investments	—	—	5,803	5,803
	<u>\$ 72,481</u>	<u>\$ 48,419</u>	<u>\$ 232,343</u>	<u>\$ 353,243</u>

For the year ended June 30, 2017, activity in investment assets valued at fair value based on unobservable values is as follows (in thousands):

<u>Description</u>	<u>Timber and mineral properties</u>	<u>Real estate</u>	<u>Other investments</u>	<u>Total</u>
Beginning balance	\$ 157,470	\$ 69,070	\$ 5,803	\$ 232,343
Net unrealized gains	5,759	157	5	5,921
Additions	560	—	—	560
Reforestation	100	—	—	100
Sale of property	(124)	—	—	(124)
Depreciation/depletion	(3,414)	(41)	—	(3,455)
Ending balance	<u>\$ 160,351</u>	<u>\$ 69,186</u>	<u>\$ 5,808</u>	<u>\$ 235,345</u>

For the year ended June 30, 2016, activity in investment assets valued at fair value based on unobservable values is as follows (in thousands):

<u>Description</u>	<u>Timber and mineral properties</u>	<u>Real estate</u>	<u>Other investments</u>	<u>Total</u>
Beginning balance	\$ 157,064	\$ 66,320	\$ 5,803	\$ 229,187
Net unrealized gains	3,521	2,668	—	6,189
Additions	—	115	—	115
Reforestation	239	—	—	239
Depreciation/depletion	(3,354)	(33)	—	(3,387)
Ending balance	<u>\$ 157,470</u>	<u>\$ 69,070</u>	<u>\$ 5,803</u>	<u>\$ 232,343</u>

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As of June 30, 2017, the USA Foundation has no outstanding commitments to purchase securities or other investments. Additionally, substantially all of the Foundation's equity securities at June 30, 2017 are considered readily liquid. Timber and mineral properties, real estate, and other investments are generally considered illiquid.

(5) Derivative Transactions – Swaptions

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 Transactions

The objective of the transactions 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-Sep-16	1-Dec-36	7,340,000

As further discussed in note 10, in December 2013, the counterparty exercised its option with respect to the 2004 swaption. The University refunded its Series 2004 Bonds, and issued the Series 2014-A variable rate bond. As a result of the exercise of the option by the counterparty, the swaption was terminated and 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 statement of revenues, expenses and changes in net position for the year ended September 30, 2014. An original borrowing arising from the 2014 swap of \$9,138,000 was recognized and is reported, net of current year amortization and adjustments to fair market value, as other long-term liabilities, in the amounts of \$5,865,000 and \$6,854,000, in the statements of net position at September 30, 2017 and 2016, respectively.

As further discussed in note 10, in September 2016, the counterparty exercised its option with respect to the 2006 swaption. The University refunded its Series 2006 bonds, issued the Series 2016-B, C & D variable rate bonds and terminated the Series 2006 swaption. As a result of this termination, the borrowing arising from the Series 2006 swaption of \$6,939,000 and the investment derivative of \$41,017,000 were written off and an investment loss of \$19,123,000 was recognized and reported in the statement of revenues, expenses and changes in net position. An original obligation arising from the 2016 swap of \$48,530,000 was recognized and is reported, net of current year amortization and adjustments to fair market value, as other long-term liabilities, in the amounts of \$39,743,000 and \$47,893,000 in the statements of net position at September 30, 2017 and 2016, respectively.

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Interest on the 2006 swaption was being accreted on, and added to the borrowings through the exercise date of the option, September 1, 2016. For the year ended September 30, 2016, \$344,000 was accreted and is included in interest expense in the 2016 statement of revenues, expenses, and changes in net position.

The change in the fair value of the swaption derivative until the exercise date of September 1, 2016 is reported as a component of investment income in the 2016 statement of revenues, expenses and changes in net position. For the year ended September 30, 2016, the change in the fair value of the derivative was (\$19,123,000).

(6) Capital Assets

(a) University of South Alabama

A summary of the University's capital asset activity for the year ended September 30, 2017 follows (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets not being depreciated:					
Land and other	\$ 22,840	\$ —	\$ —	\$ —	\$ 22,840
Construction-in-progress	113,510	60,219	(43,705)	—	130,024
	<u>136,350</u>	<u>60,219</u>	<u>(43,705)</u>	<u>—</u>	<u>152,864</u>
Capital assets being depreciated:					
Land improvements	33,190	389	324	(89)	33,814
Buildings, fixed equipment, and infrastructure	709,648	5,793	36,649	(973)	751,117
Other equipment	155,356	15,926	6,732	(2,098)	175,916
Equipment, net	1,377	—	(1,377)	—	—
Library materials	67,477	3,593	—	—	71,070
	<u>967,048</u>	<u>25,701</u>	<u>42,328</u>	<u>(3,160)</u>	<u>1,031,917</u>

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	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Less accumulated depreciation for:					
Land improvements	\$ (20,527)	\$ (1,355)	\$ (54)	\$ 90	\$ (21,846)
Buildings, fixed equipment, and infrastructure	(257,108)	(21,214)	(1,518)	887	(278,953)
Other equipment	(120,478)	(18,143)	1,572	2,023	(135,026)
Library materials	(51,988)	(3,000)	—	—	(54,988)
	<u>(450,101)</u>	<u>(43,712)</u>	<u>—</u>	<u>3,000</u>	<u>(490,813)</u>
Capital assets being depreciated, net	<u>516,947</u>	<u>(18,011)</u>	<u>43,705</u>	<u>(1,537)</u>	<u>541,104</u>
Capital assets, net	<u>\$ 653,297</u>	<u>\$ 42,208</u>	<u>\$ —</u>	<u>\$ (1,537)</u>	<u>\$ 693,968</u>

At September 30, 2017, the University had commitments of approximately \$19,746,000 related to various construction projects.

A summary of the University's capital asset activity for the year ended September 30, 2016 follows (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Capital assets not being depreciated:					
Land and other	\$ 22,516	\$ 213	\$ 111	\$ —	\$ 22,840
Construction-in-progress	82,913	60,972	(30,375)	—	113,510
	<u>105,429</u>	<u>61,185</u>	<u>(30,264)</u>	<u>—</u>	<u>136,350</u>
Capital assets being depreciated:					
Land improvements	32,361	35	794	—	33,190
Buildings, fixed equipment, and infrastructure	676,831	4,474	28,751	(408)	709,648
Other equipment	150,661	8,104	719	(4,128)	155,356
Equipment, net	—	1,377	—	—	1,377
Library materials	63,964	3,513	—	—	67,477
	<u>923,817</u>	<u>17,503</u>	<u>30,264</u>	<u>(4,536)</u>	<u>967,048</u>

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	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Less accumulated depreciation for:					
Land improvements	\$ (19,218)	\$ (1,309)	\$ —	\$ —	\$ (20,527)
Buildings, fixed equipment, and infrastructure	(237,648)	(19,747)	—	287	(257,108)
Other equipment	(113,656)	(10,918)	—	4,096	(120,478)
Library materials	(49,094)	(2,894)	—	—	(51,988)
	<u>(419,616)</u>	<u>(34,868)</u>	<u>—</u>	<u>4,383</u>	<u>(450,101)</u>
Capital assets being depreciated, net	<u>504,201</u>	<u>(17,365)</u>	<u>30,264</u>	<u>(153)</u>	<u>516,947</u>
Capital assets, net	<u>\$ 609,630</u>	<u>\$ 43,820</u>	<u>\$ —</u>	<u>\$ (153)</u>	<u>\$ 653,297</u>

At September 30, 2016, the University had commitments of approximately \$10,867,000 related to various construction projects.

(b) USA Research and Technology Corporation

Changes in capital assets for the year ended September 30, 2017 are as follows (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	<u>Ending balance</u>
Land and land improvements	\$ 2,199	\$ —	\$ —	\$ —	\$ 2,199
Buildings	28,148	—	143	—	28,291
Tenant improvements	1,186	71	—	(103)	1,154
Construction in progress	145	3	(143)	(2)	3
Other equipment	256	20	—	(1)	275
	<u>31,934</u>	<u>94</u>	<u>—</u>	<u>(106)</u>	<u>31,922</u>
Less accumulated depreciation for:					
Land improvements	(1,124)	(94)	—	—	(1,218)
Buildings	(7,299)	(738)	—	—	(8,037)
Tenant improvements	(751)	(110)	—	103	(758)
Other equipment	(193)	(27)	—	—	(220)
	<u>(9,367)</u>	<u>(969)</u>	<u>—</u>	<u>103</u>	<u>(10,233)</u>
Capital assets, net	<u>\$ 22,567</u>	<u>\$ (875)</u>	<u>\$ —</u>	<u>\$ (3)</u>	<u>\$ 21,689</u>

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Changes in capital assets for the year ended September 30, 2016 are as follows (in thousands):

	Beginning balance	Additions	Transfers	Reductions	Ending balance
Land and land improvements	\$ 2,199	\$ —	\$ —	\$ —	\$ 2,199
Buildings	27,923	225	—	—	28,148
Tenant improvements	972	234	—	(20)	1,186
Construction in progress	143	2	—	—	145
Other equipment	256	—	—	—	256
	<u>31,493</u>	<u>461</u>	<u>—</u>	<u>(20)</u>	<u>31,934</u>
Less accumulated depreciation for:					
Land improvements	(1,030)	(94)	—	—	(1,124)
Buildings	(6,584)	(715)	—	—	(7,299)
Tenant improvements	(672)	(99)	—	20	(751)
Other equipment	(167)	(26)	—	—	(193)
	<u>(8,453)</u>	<u>(934)</u>	<u>—</u>	<u>20</u>	<u>(9,367)</u>
Capital assets, net	<u>\$ 23,040</u>	<u>\$ (473)</u>	<u>\$ —</u>	<u>\$ —</u>	<u>\$ 22,567</u>

(7) Noncurrent Liabilities

A summary of the University's noncurrent liability activity for the year ended September 30, 2017 follows (in thousands):

	Beginning balance	Additions	Reductions	Ending balance	Less amounts due within one year	Noncurrent liabilities
Long-term debt:						
Bonds payable	\$ 367,557	\$ 145,035	\$ (123,168)	\$ 389,424	\$ 18,470	\$ 370,954
Notes payable	3,484	2,265	(207)	5,542	3,711	1,831
Capital lease obligations	17,771	3,161	(3,600)	17,332	3,597	13,735
Total long-term debt	<u>388,812</u>	<u>150,461</u>	<u>(126,975)</u>	<u>412,298</u>	<u>25,778</u>	<u>386,520</u>
Other noncurrent liabilities						
Net pension liability	329,294	7,183	—	336,477	—	336,477
Other long-term liabilities	105,262	11,956	(15,226)	101,992	6,884	95,108
Total other noncurrent liabilities	<u>434,556</u>	<u>19,139</u>	<u>(15,226)</u>	<u>438,469</u>	<u>6,884</u>	<u>431,585</u>
Total noncurrent liabilities	<u>\$ 823,368</u>	<u>\$ 169,600</u>	<u>\$ (142,201)</u>	<u>\$ 850,767</u>	<u>\$ 32,662</u>	<u>\$ 818,105</u>

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A summary of the University's noncurrent liability activity for the year ended September 30, 2016 follows (in thousands):

	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>	<u>Less amounts due within one year</u>	<u>Noncurrent liabilities</u>
Long-term debt:						
Bonds payable	\$ 373,991	\$ 101,241	\$ (107,675)	\$ 367,557	\$ 18,046	\$ 349,511
Notes payable	1,263	2,221	—	3,484	3,484	—
Capital lease obligations	15,143	3,677	(1,049)	17,771	3,486	14,285
Total long-term debt	<u>390,397</u>	<u>107,139</u>	<u>(108,724)</u>	<u>388,812</u>	<u>25,016</u>	<u>363,796</u>
Other noncurrent liabilities						
Net pension liability	297,734	31,560	—	329,294	—	329,294
Other long-term liabilities	88,789	73,332	(56,859)	105,262	9,336	95,926
Total other noncurrent liabilities	<u>386,523</u>	<u>104,892</u>	<u>(56,859)</u>	<u>434,556</u>	<u>9,336</u>	<u>425,220</u>
Total noncurrent liabilities	<u>\$ 776,920</u>	<u>\$ 212,031</u>	<u>\$ (165,583)</u>	<u>\$ 823,368</u>	<u>\$ 34,352</u>	<u>\$ 789,016</u>

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 and accrued liabilities and current portion of other long-term liabilities.

During 2017, USA Health entered into a note payable for a period of ten years payable monthly at \$18,882. This agreement commenced in November 2016 to finance improvements of the HVAC system. The amount outstanding on the note at September 30, 2017 is \$2,058,138 with no stated interest rate.

In March 2015, the University entered into a variable interest rate revolving line of credit with Compass Bank to, among other reasons, fund the acquisition of certain real property by USA Health. The total amount available under the line of credit is \$5,000,000 and interest on the outstanding amounts accrue at the rate of the London InterBank Offered Rate (LIBOR) plus 1.00% with a maturity date of April 15, 2017. During fiscal year 2017, the line of credit was renewed until April 14, 2018. The amount outstanding at September 30, 2017 and 2016 is \$3,434,000, and is reported as current portion of long-term debt in the statements of net position.

In June 2016, the University entered into a variable interest rate revolving line of credit with Compass Bank to, among other reasons, fund certain capital improvements to various health care facilities for USA Health. The total amount available under the line of credit is \$30,000,000 and interest on the outstanding amounts is accrued at the rate of 65% of the LIBOR plus 77 basis points. The maturity date is June 10, 2018. The amount outstanding at September 30, 2017 and 2016 is \$50,000, and is reported as current portion of long-term debt in the statements of net position.

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(a) USA Research and Technology Corporation

(i) Notes Payable

Notes payable consisted of the following (in thousands):

	2017		2016
Wells Fargo Bank, N.A. promissory note, one-month LIBOR plus 0.85% (2.085% and 1.377% at September 30, 2017 and 2016, respectively) payable through 2028	\$ 12,247	\$	13,034
PNC Bank promissory note, 4.50%, payable through 2021	8,007		8,282
	\$ 20,254	\$	21,316

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” types of interest rate swap on the promissory note, which will yield a synthetic fixed interest rate of 0%. 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. The Corporation agreed not to 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 2017 the Corporation’s debt service coverage ratio was 1.16 to 1. Management believes the Corporation was in compliance with its debt covenants, including the debt service coverage ratio covenant, at September 30, 2017.

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(ii) *Debt Service on Long-Term Obligations*

At September 30, 2017, total future debt service by fiscal year is as follows (in thousands):

	Debt service on notes		
	Principal	Interest	Total
2018	\$ 1,119	\$ 1,094	\$ 2,213
2019	1,194	1,020	2,214
2020	1,264	949	2,213
2021	8,111	670	8,781
2022	1,072	500	1,572
2023–2027	6,471	1,386	7,857
2028–2029	1,023	24	1,047
Total	\$ 20,254	\$ 5,643	\$ 25,897

(iii) *Derivative Transaction*

The Corporation is a party to a derivative with Wells Fargo Bank, N.A., the 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 \$555,844 and \$651,955 under the interest rate swap agreement for the years ended September 30, 2017 and 2016, respectively, which are reflected as increases in interest expense.

Fair value. The interest rate swap had a negative fair value of (\$2,252,006) and (\$3,414,981) at September 30, 2017 and 2016, 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.

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Credit risk. As of September 30, 2017 and 2016, 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 Aa2 by Moody's Investors Services and AA- by Standard & Poor's Ratings Services as of September 30, 2017 and 2016.

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, 2017 and 2016, 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, 2017, debt service requirements by fiscal year of the variable rate debt and net derivative payments, assuming current interest rates remain the same in the future, are as follows (in thousands):

	<u>Variable rate loan</u>		<u>Interest rate swap, net</u>	<u>Total</u>
	<u>Principal</u>	<u>Interest</u>		
2018	\$ 832	\$ 253	\$ 487	\$ 1,572
2019	893	232	447	1,572
2020	949	212	409	1,570
2021	1,008	193	371	1,572
2022	1,072	171	329	1,572
2023–2027	6,470	474	912	7,856
2028–2029	1,023	8	16	1,047
Total	<u>\$ 12,247</u>	<u>\$ 1,543</u>	<u>\$ 2,971</u>	<u>\$ 16,761</u>

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(8) Bonds Payable

Bonds payable consisted of the following at September 30, 2017 and 2016 (in thousands):

	<u>2017</u>	<u>2016</u>
University Tuition Revenue Bonds, Series 1999 Capital Appreciation, 4.70% to 5.25%, payable November 2011 through November 2018	\$ 14,614	\$ 21,382
University Tuition Revenue Refunding and Capital Improvement Bonds, Series 2006, 5.00%, refunded in December 2016	—	100,000
University Facilities Revenue and Capital Improvement Bonds, Series 2008, 3.00% to 5.00%, payable through August 2018	2,850	5,565
University Facilities Revenue and Capital Improvement Bonds, Series 2010, 3.81%, payable through August 2030	21,820	23,102
University Facilities Revenue Capital Improvement Bonds, Series 2012-A, 2.92% payable through August 2032	19,950	21,025
University Facilities Revenue Capital Improvement Bonds, Series 2012-B, 2.14% payable through February 2018	1,365	2,690
University Facilities Revenue Capital Improvement Bonds, Series 2013-A, 2.83% payable through August 2033	26,944	28,261
University Facilities Revenue Capital Improvement Bonds, Series 2013-B, 2.83% payable through August 2033	6,736	7,065
University Facilities Revenue Capital Improvement Bonds, Series 2013-C, 2.78% payable through August 2028	7,722	8,315
University Facilities Revenue Refunding Bonds, Series 2014-A, variable rate payable at 68% of LIBOR plus 0.73%, 1.57% at September 30, 2017, payable through March 2024	39,670	40,285
University Facilities Revenue Capital Improvement Bonds, Series 2015, 2.47% payable through August 2030	4,875	5,250
University Facilities Revenue Refunding Bonds, Series 2016-A, 3.00% to 5.00% payable through November 2037	85,605	85,605
University Facilities Revenue Refunding Bonds, Series 2016-B, variable rate payable at 68% of one-month LIBOR plus 0.72%, 1.56% at September 30, 2017, payable through December 2036, pursuant to the right of the holder to cause all principal to be due after December 1, 2021	20,000	—
University Facilities Revenue Refunding Bonds, Series 2016-C, variable rate payable at 68% of one-month LIBOR plus 0.77%, 1.61% at December 30, 2017, payable through December 2036, pursuant to the right of the holder to cause all principal to be due after December 1, 2023	35,000	—
University Facilities Revenue Refunding Bonds, Series 2016-D, variable rate payable at 68% of one-month LIBOR plus 0.83%, 1.67% at September 30, 2017, payable through December 2036, pursuant to the right of the holder to cause all principal to be due after December 1, 2026	45,000	—

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	2017	2016
University Facilities Revenue Bonds, Series 2017, 2.00% to 5.00%, payable through October 2037	\$ 37,410	\$ —
	369,561	348,545
Plus unamortized premium	21,822	20,640
Less unaccreted discount	(10)	(16)
Less prepaid bond insurance	(1,949)	(1,612)
	\$ 389,424	\$ 367,557

Substantially all student tuition and fee and auxiliary revenues secure University bonds. Additionally, security for all bonds includes Children's and Women's Hospital revenues in an amount not exceeding \$10,000,000. Series 1999 Capital Appreciation Bonds began maturing in November 2011. Series 1999 Bonds are not redeemable prior to maturity. Series 2006 Bonds were refunded in December 2016 with the issuance of the University Facilities Revenue Refunding Bonds, Series 2016-B, C and D Bonds, with a face value totaling \$100,000,000. Series 2008 Bonds began maturing in August 2009 and are redeemable beginning in August 2018. The Series 2010 Bonds began maturing in August 2011 and are redeemable beginning in February 2020. The 2012-A and 2012-B Bonds began maturing in August 2013. The 2012-A Bonds are redeemable beginning in August 2021 and the 2012-B Bonds are redeemable at any time. 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 bonds began maturing in March 2015 and are redeemable by the University at any time. The Series 2015 Bonds began maturing in August 2015 and are redeemable beginning in June 2020. The Series 2016-A Bonds will begin maturing in November 2018 and are redeemable beginning in November 2026. The Series 2016-B, C & D Bonds will begin maturing in December 2024 and are redeemable beginning in December 2017. The Series 2017 Bonds will begin maturing in October 2017 and are redeemable beginning in October 2027.

In September 2016, the University issued its University Facilities Revenue Refunding Bonds, Series 2016-A, with a face value of \$85,605,000. The proceeds from the Series 2016 Bonds were used to partially defease the Series 2008 Bonds. The funds were deposited into escrow trust funds to provide for the subsequent repayment of the Series 2008 Bonds when they are called in December 2018. Neither the asset of the escrow trust account, nor the defeased indebtedness is included in the accompanying statements of net position. The loss on the defeasement of the 2008 Bonds of \$7,859,000 is recorded as a deferred outflow and amortized over the remaining life of the 2016-A Bonds. The principal outstanding on all defeased bonds is \$93,540,000 at September 30, 2017 and 2016. The remaining undefeased portion of the Series 2008 bonds at September 30, 2017 and 2016 is \$2,850,000 and \$5,565,000, respectively, and is included in current portion of long-term debt and long-term debt, respectively, on the accompanying 2017 and 2016 statements of net position.

In December 2016, the University issued its University Facilities Revenue Refunding Bonds, Series 2016-B, C & D, with a face value totaling \$100,000,000. The proceeds from the Series 2016 Bonds were used to refund the remaining outstanding 2006 Bonds.

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In June 2017, the University issued its University Facilities Revenue Bonds, Series 2017, with a face value of \$38,105,000. The proceeds from the Series 2017 Bonds are financing a new residence hall on the campus of the University and supporting ongoing infrastructure improvement projects.

During the years ended September 30, 2017 and 2016, the maturity value of the Capital Appreciation Bonds increased \$782,000 and \$1,099,000, respectively, over the original principal amount of \$19,810,000, reflecting accretion of interest.

Approximately \$27,107,000 of proceeds from the issuance of the Series 2017 Bonds remained unspent at September 30, 2017 and is included in restricted cash and cash equivalents in the 2017 statement of net position. These funds are restricted for capital purposes as outlined in the bond indenture.

Approximately \$2,551,000, \$1,638,000 and \$1,452,000 of proceeds from the issuance of Series 2012, Series 2013-A and Series 2015 Bonds, respectively, remained unspent as of September 30, 2016. These funds were restricted for capital purposes as outlined in the respective bond indentures. During the year ended September 30, 2017, all of these remaining funds were allocated to capital projects.

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, 2017 and 2016, 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, 2017 and 2016, management believes the University was in compliance with such financial covenants.

Debt Service on Long-Term Obligations

Total debt service (which includes bonds and notes payable) by fiscal year is as follows as of September 30, 2017 (in thousands):

	Debt service on notes and bonds			
	Principal	Interest	Additional maturity	Total
2018	\$ 21,235	\$ 9,247	\$ (427)	\$ 30,055
2019	17,482	9,776	(49)	27,209
2020	16,544	9,409	—	25,953
2021	17,271	9,003	—	26,274
2022	18,036	8,580	—	26,616
2023–2027	92,221	35,828	—	128,049
2028–2032	94,720	21,983	—	116,703
2033–2037	90,064	7,875	—	97,939
2038	8,006	135	—	8,141
Subtotal	375,579	\$ 111,836	\$ (476)	\$ 486,939

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Debt service on notes and bonds					
		Principal	Interest	Additional maturity	Total
Plus (less):					
Additional maturity	\$	(476)			
Unamortized bond premium		21,822			
Unaccreted bond discount		(10)			
Unamortized debt extinguishment costs		(1,949)			
Total	\$	394,966			

The principal amount of debt service due on bonds at September 30, 2017 and 2016, includes \$782,000 and \$1,099,000, respectively, representing additional maturity value on Series 1999 Capital Appreciation Bonds. These bonds mature through 2019. 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.

(9) Capital Lease Obligations

In April 2015, the University signed a seven-year purchase agreement, with a \$1,000,000 initial payment and quarterly payments thereafter of \$590,000 until March 2022, as a method of financing the purchase of certain computer software and hardware for USA Health. In July 2015, the University signed a second seven-year purchase agreement, with a \$100,000 initial payment and quarterly payments thereafter of \$62,000 until March 2022, as a method of financing additional laboratory software and hardware for USA Health. Also, in July 2015, and modified in September 2016, the University signed a three-year purchase agreement, with modified monthly payments of \$30,000 until February 2020, to finance the purchase of a heat recovery system for USA Health. In September 2016, the University signed a six-year purchase agreement, with monthly payments of \$66,000 until May 2022, as a method of financing the purchase of certain hospital equipment for USA Health. In December 2016, the University signed a five-year tax-exempt capital lease, with monthly payments of \$37,000 until October 2022, to finance the acquisition of additional hospital equipment for USA Health.

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Future minimum capital lease payments at September 30, 2017, are as follows (in thousands).

Year ending September 30:	
2018	\$ 4,138
2019	4,200
2020	3,994
2021	3,845
2022	2,474
Thereafter	37
	18,688
Less amounts representing interest	(1,356)
Net minimum lease payments	\$ 17,332

These amounts are included in other long-term liabilities (and current portion thereof) in the accompanying statements of net position.

(10) Derivative Transaction – Interest Rate Swaps

The University is a party to two derivatives 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 Bonds.

As more fully described in note 5, in September 2016, Wells Fargo exercised its option with respect to the synthetic advance refunding of the Series 2006 Bonds to enter into an interest rate swap agreement with the University with an effective date of September 1, 2016. The resulting derivative is a “receive-variable, pay-fixed” interest rate swap. As part of the overall plan of the synthetic refunding of the 2006 Bonds, the University redeemed those bonds in December 2016 with proceeds from the 2016-B, C & D Bonds (see note 8).

Objective of the transactions. As noted, both interest rate swaps were the result of the original January 2008 synthetic advance refunding of the Series 2004 and Series 2006 Bonds. The objective of these transactions was to realize debt service savings currently from future debt refunding and create an economic benefit to the University.

The 2014 swap will terminate in March 2024, when the 2014-A Bonds mature. The notional amount of the swap will at all times match the outstanding principal amount of the bonds. 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 LIBOR plus 0.25%. Conversely, the Series 2014-A Bonds bear interest on a monthly basis at 68% of the one-month LIBOR rate plus 0.73%.

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The 2016 swap will terminate in December 2036, when the 2016-B, C & D Bonds mature. The notional amount of the swap will at all times match the outstanding principal amount of the bonds. Under the swap, the University pays the counterparty a fixed semi-annual payment based on an annual rate of 5% and receives on a monthly basis a variable payment of 68% of the one-month LIBOR plus 0.25%. Conversely, the Series 2016-B, C & D Bonds bear a weighted average interest on a monthly basis at 68% of the one-month LIBOR rate plus 0.79%.

Fair value. The 2014 interest rate swap had a negative fair value of approximately \$(9,138,000) at its inception. This amount, net of any amortization and adjustments to fair market value, is reported as a borrowing arising from the 2014 interest rate swap as other long-term liabilities in the amount of \$5,865,000 in the statement of net position at September 30, 2017. The change in the fair value of the swap of \$2,664,000 and \$609,000 as of September 30, 2017 and 2016, respectively, is reported as a deferred inflow and derivative asset on the statements of net position since the interest rate swap is a hedging derivative instrument.

The 2016 interest rate swap had a negative fair value of approximately \$(48,530,000) at its inception. This amount, net of any amortization and adjustments to fair market value, is reported as a borrowing arising from the 2016 interest rate swap as other long-term liabilities in the amount of \$39,743,000 in the statement of net position at September 30, 2017. The change in the fair value of the swap of \$8,787,000 and \$637,000 as of September 30, 2017 and 2016, respectively, is reported as a deferred outflow and contra liability (other long-term liabilities) on the statements of net position since the interest rate swap is a hedging derivative instrument.

The fair values of the interest rate swaps were 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.

Risks Associated with these Transactions

Interest rate risk. As the LIBOR rate decreases, the net payments on the swaps increase. 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 payments on the Series 2014-A and Series 2016-B, C & D Bonds. The University's exposure is limited to 0.48% and 0.54% of the notional amounts, the difference in the payment from the counterparty and the interest payment on the 2014-A and 2016-B, C & D Bonds.

Credit risk. As of September 30, 2017 and 2016, the University was not exposed to credit risk on the interest rate swaps because they had a negative fair value. However, if interest rates change and the fair value of the derivatives 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 Aa2 by Moody's Investor Services and AA – by Standard & Poor's Ratings Services as of September 30, 2017 and 2016.

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

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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, 2017 and calculating interest for subsequent years using forward rates of one month LIBOR, debt service requirements for the 2014 interest rate swap payments, by fiscal year, are as follows (in thousands):

	Variable rate loan		Interest rate swap, net	Total
	Principal	Interest		
2018	\$ 640	\$ 614	\$ 1,533	\$ 2,787
2019	665	659	1,451	2,775
2020	6,925	621	1,282	8,828
2021	7,280	510	1,006	8,796
2022	7,655	385	724	8,764
2023–2024	16,505	328	585	17,418
Total	\$ 39,670	\$ 3,117	\$ 6,581	\$ 49,368

Debt service requirements for the 2016 interest rate swap payments, by fiscal year, are as follows (in thousands):

	Variable rate loan		Interest rate swap, net	Total
	Principal	Interest		
2018	\$ —	\$ 1,569	\$ 3,901	\$ 5,470
2019	—	1,704	3,766	5,470
2020	—	1,779	3,691	5,470
2021	—	1,832	3,638	5,470
2022	—	1,891	3,579	5,470
2023–2027	17,675	9,513	16,398	43,586
2028–2032	36,040	6,707	11,035	53,782
2033–2037	46,285	2,292	4,235	52,812
Total	\$ 100,000	\$ 27,287	\$ 50,243	\$ 177,530

(11) Patient Service Revenues

USA Health has 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 USA Health's 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, USA Health is reimbursed for both direct and indirect

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medical education costs (as defined), principally based on per-resident prospective payment amounts and certain adjustments to prospective rate-per-discharge operating reimbursement payments. USA Health is generally paid for certain retroactively determined items at tentative rates, with final settlement determined after submission of annual cost reports by USA Health and audits by the Medicare fiscal intermediary.

USA Medical Center's Medicare cost reports have been audited by the Medicare fiscal intermediary through September 30, 2012.

USA Children's & Women's Hospital's Medicare cost reports have been audited by the Medicare fiscal intermediary through September 30, 2013.

Revenues from the Medicare program accounted for approximately 19% and 16% of USA Health's net patient service revenues for the years ended September 30, 2017 and 2016, 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, USA Health is paid at a tentative rate with final settlement determined after submission of annual cost reports by USA Health and audits thereof by Blue Cross.

USA Medical Center's and USA Children's & Women's Hospital's Blue Cross cost reports have been audited by Blue Cross through September 30, 2016.

Revenues from the Blue Cross program accounted for approximately 36% and 27% of USA Health's net patient service revenues for the years ended September 30, 2017 and 2016, respectively.

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

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

Revenues from the Medicaid program accounted for approximately 37% and 30% of USA Health's net patient service revenues for the years ended September 30, 2017 and 2016, respectively.

Other – USA Health has entered into payment agreements with certain commercial insurance carriers, health maintenance organizations, and preferred provider organizations. The bases for payments to USA Health under these agreements include discounts from established charges and prospectively determined daily and case rates.

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The composition of net patient service revenues for the years ended September 30, 2017 and 2016 follows (in thousands):

	2017	2016
Gross patient service revenues	\$ 859,493	\$ 791,625
Less provision for contractual and other adjustments	(380,288)	(347,757)
Less provision for bad debts	(88,274)	(83,211)
	\$ 390,931	\$ 360,657

Changes in estimates related to prior cost reporting periods resulted in an increase of approximately \$1,043,000 and \$5,638,000 in patient service revenues for the years ended September 30, 2017 and 2016, respectively.

(12) Defined Benefit Cost Sharing Pension Plan

Employees of the University are covered by a cost sharing multiple-employer defined benefit pension plan administered by the TRS.

(a) Plan Description

The TRS was established in September 1939, under the provisions of Act 419 of the Legislature of 1939 for the purpose of providing retirement allowances and other specified benefits for qualified persons employed by State-supported educational institutions. The responsibility for the general administration and operation of the TRS is vested in its Board of Control. The TRS Board of Control consists of 15 trustees. The Plan is administered by the Retirement Systems of Alabama (RSA). Title 16-Chapter 25 of the code of Alabama grants the authority to establish and amend the benefit terms to the TRS Board of Control. The Plan issues a publicly available financial report that can be obtained at www.rsa-al.gov.

(b) Benefits Provided

State law establishes retirement benefits as well as death and disability benefits and any ad hoc increase in postretirement benefits for the TRS. Benefits for TRS members vest after ten years of creditable service. Tier 1 TRS members who retire after age sixty with ten years or more of creditable service or with twenty-five years of services (regardless of age) are entitled to an annual retirement benefit, payable monthly for life. Service and disability retirement benefits are based on a guaranteed minimum or formula method, with the member receiving payment under the method that yields the higher monthly benefit. Under the formula method, members of the TRS are allowed 2.0125% of their average final compensation (highest three of the last ten years) for each year of service.

Act 377 of the Legislature of 2012 established a new tier of benefits (Tier 2) for members hired on or after January 1, 2013. Tier 2 TRS members are eligible for retirement after age sixty-two with ten years or more of creditable service and are entitled to an annual retirement benefit, payable monthly for life. Service and disability retirement benefits are based on a guaranteed minimum or formula method, with the member receiving payment under the method that yields the highest monthly benefit. Under the formula method, Tier 2 members of the TRS are allowed 1.65% of their average final compensation

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(highest five of the last ten years) for each year of service. Members are eligible for disability retirement if they have ten years of credible service, are currently in-service, and determined by the RSA Medical Board to be permanently incapacitated from further performance of duty. Preretirement death benefits are calculated and paid to the beneficiary based on the member's age, service credit, employment status, and eligibility for retirement.

(c) Contributions

Covered members of the TRS contributed 5% of earnable compensation to the TRS as required by statute until September 30, 2011. From October 1, 2011, to September 30, 2012, covered members of the TRS were required by statute to contribute 7.25% of earnable compensation. Effective October 1, 2012, covered Tier 1 members of the TRS are required by statute to contribute 7.50% of earnable compensation. Certified law enforcement, correctional officers, and firefighters of the TRS contributed 6% of earnable compensation as required by statute until September 30, 2011. From October 1, 2011, to September 30, 2012, certified law enforcement, correctional officers, and firefighters of the TRS were required by statute to contribute 8.25% of earnable compensation. Effective October 1, 2012, certified law enforcement, correctional officers, and firefighters of the TRS are required by statute to contribute 8.50% of earnable compensation.

Tier 2 covered members of the TRS contribute 6% of earnable compensation to the TRS as required by statute. Tier 2 certified law enforcement, correctional officers, and firefighters of the TRS are required by statute to contribute 7% of earnable compensation.

Participating employers' contractually required contribution rates were 12.01% of annual pay for Tier 1 members and 10.82% of annual pay for Tier 2 members. These required contribution rates are a percent of annual payroll, actuarially determined as an amount that, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year, with an additional amount to finance any unfunded accrued liability. Total employer contributions to the pension plan from the University were \$23,664,000 and \$23,405,000 for the years ended September 30, 2017 and 2016, respectively.

(d) Pension Liabilities, Pension Expenses, Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

At September 30, 2017 and 2016, the University reported a liability of \$336,477,000 and \$329,294,000, respectively, for its proportionate share of the collective net pension liability. The collective net pension liability was measured as of September 30, 2016 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of September 30, 2015. The University's proportion of the collective net pension liability was based on the employer's shares of contributions to the pension plan relative to the total employer contributions of all participating TRS employers. At September 30, 2016, the University's proportion of contributions to the pension plan was 3.108048%, which was a decrease of 0.077423% from its proportion measured as of September 30, 2015.

For the years ended September 30, 2017 and 2016, the University recognized pension expense of approximately \$31,138,000 and \$20,116,000, respectively, which is included in salaries and benefits on the statement of revenues, expenses, and changes in net position.

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At September 30, 2017, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	Deferred outflows of resources	Deferred inflows of resources
Net difference between projected and actual earnings on pension plan investments	\$ 4,863	\$ —
Change of assumptions	23,757	—
Difference between expected and actual experience	—	8,665
Changes in proportion and differences between employer contributions and proportionate share of contributions	—	21,485
Employer contributions subsequent to measurement date	22,943	—
	\$ 51,563	\$ 30,150

At September 30, 2016, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources (in thousands):

	Deferred outflows of resources	Deferred inflows of resources
Net difference between projected and actual earnings on pension plan investments	\$ 21,827	\$ —
Difference between expected and actual experience	—	1,806
Changes in proportion and differences between employer contributions and proportionate share of contributions	—	20,962
Employer contributions subsequent to measurement date	22,691	—
	\$ 44,518	\$ 22,768

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At September 30, 2017, approximately \$22,943,000 reported as deferred outflows of resources related to pensions resulting from University contributions subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended September 30, 2018. Other amounts reported as deferred outflows (inflows) of resources related to pensions will be recognized in pension expense as follows (in thousands):

Year ending September 30:		
2018	\$	(2,800)
2019		(2,800)
2020		4,652
2021		(1,296)
2022		714
	\$	<u>(1,530)</u>

(e) Actuarial Assumptions

The total pension liability as of September 30, 2017 and 2016 was determined by an actuarial valuation as of September 30, 2015 and 2014, respectively, using the following actuarial assumptions, applied to all periods included in the measurement:

	2017	2016
Inflation	2.75 %	3.00 %
Investment rate of return*	7.75	8.00
Projected salary increases	3.25–5.00	3.50–8.25

* Net of pension plan investment expense

The actuarial assumptions used in the September 30, 2015 valuation were based on the results of an actuarial experience study for the period October 1, 2010 through September 30, 2015. Mortality rates for TRS were based on the RP-2000 White Collar Mortality Table projected to 2020 using Scale BB and adjusted 115% for all ages for males and 112% for ages 78 and over for females.

The actuarial assumptions used in the September 30, 2014 valuation were based on the results of an investigation of the economic and demographic experience for the TRS based upon participant data as of September 30, 2010. The Board of Control accepted and approved these changes on January 27, 2012, which was effective at the beginning of the fiscal year 2012. Mortality rates for TRS were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on Scale AA projected to 2015 and set back one year for females.

The long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected

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future real rates of return by the target asset allocation percentage and by adding expected inflation. The target asset allocation and best estimates of geometric real rates of return for each major asset class are as follows:

	Target allocation	Long-term expected rate of return*
Fixed income	17.00 %	4.40 %
U.S. large stocks	32.00	8.00
U.S. mid stocks	9.00	10.00
U.S. small stocks	4.00	11.00
International developed market stocks	12.00	9.50
International emerging market stocks	3.00	11.00
Alternatives	10.00	10.10
Real estate	10.00	7.50
Cash	3.00	1.50
	100.00 %	

* Includes assumed rate of inflation of 2.50%

(f) Discount Rate

The discount rate used to measure the total pension liability as of September 30, 2017 was 7.75%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that the employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

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(g) Sensitivity of the University's Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following table presents the University's proportionate share of the net pension liability calculated using the discount rate of 7.75%, as well as what the University's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage point lower (6.75%) or 1-percentage point higher (8.75%) than the current rate (in thousands):

	1% Decrease (6.75)%	Current rate (7.75)%	1% Increase (8.75)%
University's proportionate share of collective net pension liability	\$ 448,262	\$ 336,477	\$ 241,839

(h) Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in the separately issued RSA Comprehensive Annual Report for the fiscal year ended September 30, 2016 as well as prior year reports. The supporting actuarial information is included in the GASB Statement No. 67 Report for the TRS prepared as of September 30, 2016. The auditors' report dated August 1, 2017 on the total pension liability, total deferred outflows of resources, total deferred inflows of resources, and total pension expense for the sum of all participating entities as of September 30, 2016 along with supporting schedules is also available. The additional financial and actuarial information is available at www.rsa-al.gov.

(13) Other Employee Benefits

(a) Other Pension Plans

Employees of the University also participate in a defined contribution pension plan. 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 contributed \$643,000 and \$711,000 in 2017 and 2016, respectively, representing 270 and 350 employees, respectively, participating in this Plan.

All employees of HCM working at least half time are eligible to participate in a defined contribution pension plan, administered by TIAA-CREF or Variable Annuity Life Insurance Company of America (VALIC). Under this plan, contributions by eligible employees are matched equally by HCM up to a maximum of 5% of current annual pay. HCM contributed \$4,468,000 and \$3,900,000 in 2017 and 2016, respectively, representing 1,345 and 1,425 employees, respectively, participating in this plan. University employees as of September 30, 2010, who later transfer to HCM, are immediately vested in the plan. All other employees do not vest until they have held employment with HCM for thirty-six months; at which time they become 100% vested in the plan.

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(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 \$14,596,000 and \$15,158,000 at September 30, 2017 and 2016, 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 applying 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, 2017 and 2016, the University's expense related to PEEHIP was \$8,413,000 and \$9,184,000, respectively.

(14) Risk Management

The University, USAHSF, HCM, and SAMSF participate in the professional liability trust fund and the University, USAHSF, HCM, 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, 2017 and 2016. 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 HCM participate in a self-insured health plan, administered by an unaffiliated entity. Administrative fees paid by the University for such services were approximately \$2,237,000 and \$2,019,000 in 2017 and 2016, respectively. Contributions by the University and its employees, together with earnings

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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, 2017 and 2016 for the PLTF, GLTF and health plan are summarized as follows (in thousands):

	2017	2016
Balance, beginning of year	\$ 39,581	\$ 23,130
Liabilities incurred and other additions	65,690	79,226
Claims, administrative fees paid and other reductions	(66,156)	(62,775)
Balance, end of year	\$ 39,115	\$ 39,581

These amounts are included in other long-term liabilities (and current portion thereof) in the accompanying statements of net position.

(15) Other Related Parties

SAMSF is a not-for-profit corporation that exists for the purpose of promoting education and research at the University. At September 30, 2017, SAMSF had total assets of \$13,112,000, net assets of \$11,121,000, and total revenues of \$2,403,000. At September 30, 2016, SAMSF had total assets of \$13,884,000, net assets of \$10,935,000, and total revenues of \$3,544,000. SAMSF reimburses the University for certain administrative expenses and other related support services. Total amounts received for such expenses were approximately \$672,000 and \$775,000 in 2017 and 2016, respectively, and are reflected as private grants and contracts in the accompanying statements of revenues, expenses, and changes in net position.

HCA, formed in May 2017, is a public corporation that employs physicians and staff of physician practice groups. At September 30, 2017, \$5,002,000 is due to the University and is reported in accounts receivable, affiliates on the 2017 statement of net position.

(16) Commitments and Contingencies

(a) Grants and Contracts

At September 30, 2017 and 2016, the University had been awarded approximately \$20,465,000 and \$25,411,000, 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 awards have not been met. Advances are included in unrecognized revenue, and include amounts received from grant and contract sponsors which have not been expended 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 potential adjustment from such audits will not be material.

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(b) Letters of Credit

In connection with USA Health's participation in the State of Alabama Medicaid Program, the University has established a \$55,382 irrevocable standby letter of credit with Wells Fargo. 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, 2017 and 2016.

In connection with RCO participation in the Alabama Medicaid Agency's Health Home Regional Care Organization Program, HCM has established a \$1,689,000 irrevocable standby letter of credit with Hancock Bank. The Alabama Medicaid Agency is the beneficiary of this letter of credit. No funds were advanced under this letter during the years ended September 30, 2017 and 2016. As a requirement of the issuance of this letter of credit, HCM is required to establish collateral in the same amount as the letter of credit. As such, a collateral account in the amount of \$1,689,000 has been established and is included in restricted cash and cash equivalents on the statements of net position as of September 30, 2017 and 2016.

(c) Federal Program Review

In November 2014, the University was the subject of a program review conducted by the U. S. Department of Education. The program review assessed the University's administration of Title IV, Higher Education Act programs for the 2013-2014 fiscal year and the first two months of the 2015 fiscal year. A draft report was subsequently received by the University and a response to this draft was sent to the U.S. Department of Education. On October 10, 2017, the University received the final program review determination letter. Management is currently evaluating the letter, but believes there will be no liability to the University beyond that which is accrued in the financial statements.

(d) 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.

(e) 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, 2017 and 2016, no amounts were payable pursuant to these agreements.

(f) USA Research and Technology Corporation Leases

The Corporation leases space in Building I to two 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 67-month initial term expiring in December 2018 with no renewal options.

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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 five 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 nine 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 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 51,168 and 40,345 square feet at September 30, 2017 and 2016, 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 expiring in March 2020 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, 2017 and 2016. One lease is for a 40-year initial term expiring in October 2046 with 20-year, and 15-year renewal options. The second lease is for a 30-year initial term expiring in October 2036 with four 5-year renewal options. The third lease has a 38.5-year initial term expiring in September 2046 with 20-year and 15-year renewal options.

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

2018	\$	2,311
2019		1,517
2020		1,068
2021		859
2022		779
2023–2048		6,010
Total	\$	12,544

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(17) Functional Expense Information

Operating expenses by functional classification for the years ended September 30, 2017 and 2016 are listed below (in thousands). In preparing the basic financial statements, all significant transactions and balances among accounts have been eliminated.

	<u>2017</u>	<u>2016</u>
Instruction	\$ 113,700	\$ 112,521
Research	25,764	25,229
Public service	1,304	3,209
Academic support	24,921	21,465
Student services	34,512	32,920
Institutional support	36,865	22,464
Operation and maintenance of plant	33,955	35,184
Scholarships	13,218	13,106
USA Health	424,788	397,353
Auxiliary enterprises	21,650	24,642
Depreciation and amortization	36,740	36,174
	<u>\$ 767,417</u>	<u>\$ 724,267</u>

(18) Blended Component Units

As more fully described in note 1, HCM, PLTF and GLTF are component units pursuant to the provisions of GASB Statement No. 61. In accordance with that statement, the HCM, PLTF and GLTF are reported as blended component units. Required combining financial information of the aggregate blended component units as of and for the years ended September 30, 2017 and 2016 is presented below (in thousands):

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	2017	2016
Current assets	\$ 13,500	\$ 15,292
Noncurrent assets	62,016	56,041
Total assets	75,516	71,333
Current liabilities	39,596	34,453
Noncurrent liabilities	34,302	35,833
Total liabilities	73,898	70,286
Net position	\$ 1,618	\$ 1,047
Operating revenues	\$ 176,060	\$ 212,376
Operating expenses	(179,535)	(216,869)
Operating loss	(3,475)	(4,493)
Nonoperating revenues	4,046	3,007
Change in net position	\$ 571	\$ (1,486)

(19) Recently Issued Accounting Pronouncements

In June 2015, the GASB issued Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*. GASB Statement No. 75 changes accounting and financial reporting for entities which participate in plans providing postemployment benefits other than pensions and will be effective for the University's year ending September 30, 2018. In August 2015, the GASB issued Statement No. 77, *Tax Abatement Disclosures*. This statement requires governments that enter into tax abatement agreements to disclose specific information about the agreements. This statement is effective for the University beginning with the fiscal year ending September 30, 2017. In December 2015, the GASB issued Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. This statement amends Statement No. 68 to exclude pensions that are not governmental pension plans and establishes requirements for the recognition and measurement of nongovernmental pension plans that are offered to government employees. Also in December 2015, the GASB issued Statement No. 79, *Certain External Investment Pools and Pool Participants*. This statement addresses accounting and financial reporting for certain external investment pools and pool participants. It establishes criteria for an external investment pool to qualify for making the election to measure all of its investments at amortized cost for financial statement purposes. Both Statements No. 78 and 79 are effective for the University beginning with the fiscal year ending September 30, 2017.

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In January 2016, the GASB issued Statement No. 80, *Blending Requirements for Certain Component Units*. This statement is effective for the University of South Alabama beginning with the fiscal year ending September 30, 2017. Statement No. 80 amends the blending requirements for financial statement presentation and requires the blending of a component unit that is incorporated as a not-for-profit corporation in which the primary government is the sole corporate member. In March 2016, the GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements* and Statement No. 82, *Pension Issues*. Both statements are effective for the University of South Alabama beginning with the fiscal year ending September 30, 2017. Statement No. 81 changes the reporting requirements for gifts given to the University in which USA is a beneficiary of a split-interest agreement. Statement No. 82 was issued to address certain matters that have been raised from Statements No. 67, 68 and 73 and clarifies the presentation of payroll-related measures in the required supplementary information, the selection of assumptions and treatment of deviations from the guidance, and the classification of payments made by employers to satisfy employee contribution requirements. In November 2016, the GASB issued Statement No. 83, *Certain Asset Retirement Obligations*. This statement will be effective for the University beginning with the fiscal year ending September 30, 2019. Statement 83 establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for ARO's. The GASB issued Statement No. 84, *Fiduciary Activities*, in January 2017. This statement will be effective for the University beginning with the fiscal year ending September 30, 2020. Statement No. 84 addresses the criteria for identifying fiduciary activities of all state and local governments. In March 2017 the GASB issued Statement No. 85, *Omnibus 2017*, which will be effective for the University beginning with the fiscal year ending September 30, 2018. The objective of Statement No. 85 is to ensure consistency in the application of accounting and financial reporting requirements related to various topics, including blending component units, goodwill, fair value measurement and application, and postemployment benefits. The GASB issued Statement No. 86, *Certain Debt Extinguishment Issues*, in May 2017. This statement will be effective for the University beginning with the fiscal year ending September 30, 2018. Statement 86 addresses financial reporting for in-substance defeasance of debt and prepaid insurance on debt that is extinguished. In June 2017 the GASB issued Statement No. 87, *Leases*, which will be effective for the University beginning with the fiscal year ending September 30, 2021. This statement establishes a single model for lease accounting whereby certain leases that were previously classified as operating leases will now be reported on the statement of net position.

The effect of the implementation of GASB Statements Nos. 75, 84, 85, 86 and 87 on the University has not yet been determined.

Statement Nos. 77, 78, 79, 80, 81, 82 and 83 do not have an impact on the University's financial statements.

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Required Supplementary Information

Schedule of the University's Proportionate Share of the Net Pension Liability (Unaudited)

Teachers' Retirement Plan of Alabama

September 30, 2017

(In thousands)

	<u>2017</u>		<u>2016</u>		<u>2015</u>
University's proportion of the net pension liability	3.108048 %		3.185471 %		3.322348 %
University's proportionate share of the net pension liability	\$ 336,477	\$	329,294	\$	297,734
University's covered-employee payroll	\$ 200,464	\$	198,378	\$	201,858
University's proportionate share of the net pension liability as a percentage of its covered-employee payroll	167.85 %		165.99 %		147.50 %
Plan fiduciary net position as a percentage of the total pension liability	67.93 %		67.51 %		71.01 %

Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report.

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Required Supplementary Information
Schedule of University's Contributions (Unaudited)
Teachers' Retirement Plan of Alabama
September 30, 2017
(In thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contribution	\$ 23,664	\$ 23,405	\$ 23,524
Contributions in relation to the contractually required contribution	<u>23,664</u>	<u>23,405</u>	<u>23,524</u>
Contribution deficiency (excess)	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>
University's covered-employee payroll	\$ 200,464	\$ 198,378	\$ 201,858
Contributions as a percentage of covered-employee payroll	11.80 %	11.80 %	11.65 %

Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

See accompanying independent auditors' report.

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Notes to Required Supplementary Schedules
September 30, 2017

(1) Summary of Cost Sharing Pension Plan Provisions and Assumptions

Employees of the University of South Alabama are covered by a cost sharing multiple-employer defined benefit pension plan administered by the Teachers Retirement System (TRS) of the State of Alabama.

(a) Actuarial Assumptions

The total pension liability as of September 30, 2017 and 2016 was determined by an actuarial valuation as of September 30, 2015 and 2014, respectively, using the following actuarial assumptions, applied to all periods included in the measurement:

	2017	2016
Inflation	2.75 %	3.00 %
Investment rate of return*	7.75	8.00
Projected salary increases	3.25–5.00	3.50–8.25

* Net of pension plan investment expense

The actuarial assumptions used in the September 30, 2015 valuation were based on the results of an actuarial experience study for the period October 1, 2010 through September 30, 2015. Mortality rates for TRS were based on the RP-2000 White Collar Mortality Table projected to 2020 using Scale BB and adjusted 115% for all ages for males and 112% for ages 78 and over for females.

The actuarial assumptions used in the September 30, 2014 valuation were based on the results of an investigation of the economic and demographic experience for the TRS based upon participant data as of September 30, 2010. The Board of Control accepted and approved these changes on January 27, 2012, which became effective at the beginning of the fiscal year 2012. Mortality rates for TRS were based on the RP-2000 Combined Mortality Table for Males or Females, as appropriate, with adjustments for mortality improvements based on Scale AA projected to 2015 and set back one year for females.

The long-term expected rate of return on pension plan investments was determined using a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation.

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September 30, 2017

(b) *Discount Rate*

The discount rate used to measure the total pension liability as of September 30, 2017 was 7.75%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rate and that the employer contributions will be made at rates equal to the difference between actuarially determined contribution rates and the member rate. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.



USATM