The University of Alabama System
The University of Alabama
The University of Alabama at Birmingham
The University of Alabama in Huntsville
The University of Alabama Hospital
Report to Management
September 30, 2011
January 25, 2012

Dr. Malcolm Portera
Chancellor
The University of Alabama System

Dear Dr. Portera:

In planning and performing our audit of the consolidated financial statements of entities of The University of Alabama System (the “System”) as of and for the year ended September 30, 2011, in accordance with auditing standards generally accepted in the United States of America, we considered each entity’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the entities’ financial statements, but not for the purpose of expressing an opinion on each entity’s internal control over financial reporting. Accordingly, we do not express an opinion on each entity’s internal control over financial reporting.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified.

AU 325, Communicating Internal Control Related Matters Identified in an Audit, of the AICPA Professional Standards includes the following definitions of a deficiency, a significant deficiency and a material weakness:

- Deficiency—a deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis.

- Significant Deficiency—a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

- Material Weakness—a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis.

As agreed in the Audit Committee meeting on September 15, 2011, we are providing you with a report of control deficiencies, including any significant deficiencies. We noted no material weaknesses as a result of our audits. Our comments herein reflect our desire to be of a continuing assistance to the System. Managements’ responses to these comments are included as an addendum to our letter. Managements’ responses to these comments have not been subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.
Our consideration of internal controls does not cover the internal controls for Southern Research Institute or University of Alabama Huntsville Foundation. These entities were audited by other auditors, whose report thereon has been furnished to us.

Management should also refer to the required communications to the Audit Committee included in the "Report to the Audit Committee" that will be presented to the Audit Committee on February 2, 2012.

This letter is intended solely for the information and use of management of the System entities, the Board of Trustees of the University of Alabama, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

If you would like any further information or would like to discuss any of the issues raised, please contact Michael Lammons at (678) 419-1217.

Very truly yours,

PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP
3. Revision of Statement of Cash Flows (UA) – Significant Deficiency

During 2011, the University determined that a non-cash intragovernmental transfer of approximately $55.5 million was improperly included as cash activity on the statement of cash flows included in the previously issued financial statements for the year ended September 30, 2010. The error understated cash flows from noncapital financing activities and overstated cash flows from investing activities by $55.5 million. There was no impact on the total change in cash and cash equivalents, and there was no impact on the balance of cash and cash equivalents. The non-cash transfer was related to the transfer of the Bryce Property from the Alabama Department of Mental Health and was appropriately reflected on the statement of revenues, expenses, and changes in net assets. Management does not believe this error in the statement of cash flows is material to the financial statements taken as a whole. However, the 2010 statement of cash flows has been revised to correct this item. We concur with management’s conclusion on this matter.

We consider this adjustment to be a significant deficiency given the quantitative impact to certain line items of the 2010 cash flow statement. The deficiency existed in 2010 and 2011 up until the point that it was remediated in 2011. However, we do not consider the misstatement to be material to the financial statements taken as a whole, in part because it had no impact on the total change in cash and cash equivalents and no impact on the balance of cash and cash equivalents. We also note that management identified this error during the preparation of the 2011 cash flow statement. The error was detected under the enhanced procedures instituted by the University. Accordingly, we now consider this deficiency remediated.
Revision of 2010 Statement of Cash Flows (UA)

During 2011, the University determined that a non-cash intergovernmental transfer of approximately $55.5 million was improperly included as cash activity on the statement of cash flows included in the previously issued statement for the year ended September 30, 2010. The error understated cash flows from noncapital financing activities and overstated cash flows from investing activities by $55.5 million. There was no impact on the total change in cash and cash equivalents, and there was no impact on the balance of cash and cash equivalents. The non-cash transfer was related to the transfer of the Bryce Property from the Alabama Department of Mental Health and was appropriately reflected on the statement of revenues, expenses, and changes in net assets. Management does not believe this error in the statement of cash flows is material to the financial statements taken as a whole. However, the 2010 statement of cash flows has been revised to correct this item. We concur with management’s conclusion on this matter.

We consider this adjustment to be a significant deficiency given the quantitative impact to certain line items of the 2010 cash flow statement. The deficiency existed in 2010 and 2011 up until the point that it was remediated in 2011. However, we do not consider the misstatement to be material to the financial statements taken as a whole, in part because it had no impact on the total change in cash and cash equivalents and no impact on the balance of cash and cash equivalents. We also note that management identified this error during the preparation of the 2011 cash flow statement. The error was detected under the enhanced procedures instituted by the University. Accordingly, we now consider this deficiency remediated.

Management View

In the preparation of the 2011 financial statements, management noted and corrected the 2010 cash flow as discussed above for the non-cash activity related to the Bryce property purchase. The University’s financial statement
primary users—Bondholders, Donors, Regulators, Board of Trustees and Audit Committee members—rely primarily on the balance sheet and income statement for trends and analysis, which this overstatement did not affect. Rating agencies, such as, Moody’s and S&P, focus on the balance sheet and the income statement for making a determination of institutional credit ratings. Further, the 2009-2010 audited financial statements were not presented in official statements for the issuance of bonds. Finally, the University gained no benefit or advantage from the 2010 cash flow presentation, and Management believes that the correction to the 2010 cash flow statement is not material to the users of the financial statements.

Corrective Action Plan

Even though the significant deficiency is considered remediated due to its enhanced procedures around the statement of cash flows for the year ended September 30, 2011, the University will continue to enhance and monitor its procedures around the preparation of the statement of cash flows, particularly with respect to unusual and infrequent non-cash items that could have a quantitative impact on the statement of cash flows.

Respectfully,

Lynda Gilbert
Vice President for Financial Affairs