

CONSOLIDATED FINANCIAL STATEMENTS
AND REPORTS ON FEDERAL AWARD PROGRAMS

Texas Biomedical Research Institute
Years Ended December 31, 2016 and 2015
With Reports of Independent Auditors

Ernst & Young LLP



Building a better
working world

Texas Biomedical Research Institute
Consolidated Financial Statements
and Reports on Federal Award Programs
Years Ended December 31, 2016 and 2015

Contents

Report of Independent Auditors.....	1
Consolidated Financial Statements	
Consolidated Statements of Financial Position.....	3
Consolidated Statements of Activities	4
Consolidated Statements of Cash Flows.....	5
Notes to Consolidated Financial Statements.....	6
Reports on Federal Award Programs	
Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With <i>Government Auditing Standards</i>	26
Report of Independent Auditors on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance	28
Schedule of Expenditures of Federal Awards.....	32
Notes to Schedule of Expenditures of Federal Awards	37
Schedule of Findings and Questioned Costs.....	38



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Report of Independent Auditors

The Management and Trustees
Texas Biomedical Research Institute

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Texas Biomedical Research Institute which comprise the consolidated statement of financial position as of December 31, 2016 and 2015, and the related consolidated statement of activities, and cash flows for the years then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in conformity 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 consolidated financial statements that are free of material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated 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 consolidated 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 consolidated financial statements.

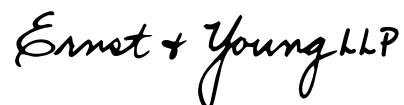
We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Texas Biomedical Research Institute as of December 31, 2016 and 2015, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated June 5, 2017, on our consideration of Texas Biomedical Research Institute'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 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 Texas Biomedical Research Institute's internal control over financial reporting and compliance.



June 5, 2017

Texas Biomedical Research Institute

Consolidated Statements of Financial Position

	December 31	
	2016	2015
Assets		
Cash and cash equivalents	\$ —	\$ 5,705,022
Accounts receivable	5,805,356	7,380,707
Prepaid expenses and supplies	158,539	340,853
Assets limited as to use:		
Cash	2,961,024	2,001,328
Investments <i>(Note 2)</i>	110,746,149	108,019,575
Investment-Evestra, Inc.	2,821,861	2,821,861
Funds held in trust by others <i>(Note 3)</i>	2,096,860	2,127,507
Land, buildings and equipment, net <i>(Note 6)</i>	66,206,621	67,993,245
Total assets	\$ 190,796,410	\$ 196,390,098
Liabilities and net assets		
Liabilities:		
Accounts payable	\$ 4,230,211	\$ 3,436,925
Accrued wages, vacation, and other liabilities	3,336,554	3,795,107
Unearned revenue	1,481,017	1,916,954
Notes payable <i>(Note 8)</i>	4,052,775	2,698,354
Total liabilities	13,100,557	11,847,340
Net assets:		
Net assets without donor restrictions	120,348,876	127,005,268
Net assets with donor restrictions	57,346,977	57,537,490
Total net assets	177,695,853	184,542,758
Total liabilities and net assets	\$ 190,796,410	\$ 196,390,098

See accompanying notes.

Texas Biomedical Research Institute

Consolidated Statements of Activities

	Year Ended December 31	
	2016	2015
Changes in net assets without donor restrictions:		
Revenues and gains:		
Grants and contracts	\$ 36,458,781	\$ 40,756,152
Contributions	2,940,156	3,003,128
Investment income	5,081,311	(2,291,899)
Royalty income	803,332	1,459,493
Insurance proceeds	1,757,541	-
Other revenue	408,413	515,973
Total revenues and gains without donor restrictions	<u>47,449,534</u>	43,442,847
Net assets released from restrictions	<u>3,933,491</u>	4,120,089
Total revenues, gains and other support without donor restrictions	51,383,025	47,562,936
Expenses and losses:		
Salaries and benefits	30,440,658	28,952,279
Supplies	7,214,646	9,679,651
Services and professional fees	6,401,701	3,637,656
Subcontracts	1,132,392	1,502,223
Utilities	2,329,964	2,315,530
General insurance	522,862	522,298
Travel	340,906	342,741
Depreciation expense	6,891,999	7,153,579
Other expenses	2,754,584	2,930,819
Total expenses	<u>58,029,712</u>	57,036,776
Loss on sale of assets	9,705	108,142
Total expenses and losses	<u>58,039,417</u>	57,144,918
Decrease in net assets without donor restrictions	<u>(6,656,392)</u>	(9,581,982)
Changes in net assets with donor restrictions:		
Investment income	2,431,111	(920,320)
Contributions	1,311,867	4,067,269
Net assets released from restrictions	<u>(3,933,491)</u>	(4,120,089)
Decrease in net assets with donor restrictions	<u>(190,513)</u>	(973,140)
Decrease in total net assets	(6,846,905)	(10,555,122)
Beginning net assets	<u>184,542,758</u>	195,097,880
Ending net assets	<u>\$ 177,695,853</u>	<u>\$ 184,542,758</u>

See accompanying notes.

Texas Biomedical Research Institute

Consolidated Statements of Cash Flows

	Year Ended December 31	
	2016	2015
Operating activities		
Decrease in net assets	\$ (6,846,905)	\$ (10,555,122)
Adjustments to reconcile decrease in net assets to net cash used in by operating activities:		
Depreciation	6,891,999	7,156,814
Loss on sale of assets, net	9,705	108,142
Net investment (income) loss	(7,726,575)	2,988,808
Contributions revenue with donor restrictions	(1,157,535)	(4,067,269)
Changes in operating assets and liabilities:		
Accounts receivable	856,600	(289,129)
Prepaid expenses and supplies	182,314	232,060
Accounts payable and accrued expenses	334,733	(521,285)
Unearned revenue	(1,383,281)	804,134
Net cash used in operating activities	(8,838,945)	(4,142,847)
Investing activities		
Purchases of plant and equipment	(5,356,852)	(1,519,518)
Sale of plant and equipment	241,775	281,719
Purchases of investments	(8,429,332)	(7,354,144)
Sale of investments	13,399,118	10,419,116
Net cash (used in) provided by investing activities	(145,291)	1,827,173
Financing activities		
Proceeds from notes payable	2,300,000	810,800
Payments on notes payable	(945,579)	(4,458,439)
Proceeds from contributions with donor restrictions	1,924,793	5,814,394
Net cash provided by financing activities	3,279,214	2,166,755
Decrease in cash and cash equivalents	(5,705,022)	(148,919)
Cash and cash equivalents at beginning of year	5,705,022	5,853,941
Cash and cash equivalents at end of year	\$ —	\$ 5,705,022
Supplemental disclosure		
Interest paid	\$ 50,009	\$ 61,003

See accompanying notes.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements

December 31, 2016

1. Significant Accounting Policies

Nature of Operations

The creation of Texas Biomedical Research Institute (Texas Biomed) was by trust indenture dated December 16, 1941, and restated November 1, 1993, appointing trustees and specifying the scientific, educational, and charitable purposes of Texas Biomed. Texas Biomed conducts scientific research and educational programs to improve the health of the global community. The main revenue sources for these activities include federal and commercial grants and contracts.

Principles of Consolidation

For the year ended December 31, 2016 and 2015, the accompanying consolidated financial statements include the accounts of Texas Biomedical Research Institute and the Tom Slick Memorial Trust for Texas Biomedical Research Institute, which is controlled by the Board of Trustees of Texas Biomed.

The Tom Slick Memorial Trust is held in the Texas Biomed endowment fund. Each month, in accordance with Texas Biomed's board-adopted spending policy, the Tom Slick Memorial Trust contributes 4% of its earnings to Texas Biomed to be used for operations. As of December 31, 2016 and 2015, all intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The accompanying consolidated financial statements of Texas Biomed are presented on the accrual basis, in accordance with U.S. generally accepted accounting principles (GAAP). Texas Biomed is required to report information regarding its financial position and activities according to two classes of net assets. As such, the accompanying consolidated financial statements reflect net assets grouped into these two classes, described as follows:

- *Net assets without donor restrictions* – Net assets that are not subject to donor-imposed restrictions and may be designated for specific purposes by action of the Board of Trustees
- *Net assets with donor restrictions* – Net assets whose use by Texas Biomed is subject to donor-imposed restrictions

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

New Accounting Pronouncement

In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 changes certain financial statement requirements for not-for-profit (NFP) entities within the scope of Accounting Standards Codification (ASC) 958. NFPs will no longer be required to distinguish between resources with temporary and permanent restrictions on the face of their financial statements, meaning they will present two classes of net assets instead of three. They will be required to present expenses by their natural and functional classification and present investment returns net of external and direct internal investment expenses. NFPs also will be required to provide more information about their available resources and liquidity. The guidance is effective for fiscal years beginning after 15 December 2017. Early application is permitted. The guidance must be initially adopted for an annual fiscal period within the fiscal year of adoption. The guidance will be applied retrospectively.

Management has elected to early adopt ASU 2016-14 for fiscal year 2016. Certain prior year financial statement amounts have been reclassified to conform to the current year presentation. Unrestricted net assets is now being reported as net assets without donor restrictions. Temporarily restricted net assets and permanently restricted net assets are now being reported together as net assets with donor restrictions. Expenses on the Consolidated Statements of Activities are reported by natural classification and expenses by functional classification are included in Note 9.

Reclassifications

Certain cash balances have also been reclassified from investments to cash and cash equivalents on the consolidated balance sheets.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Cash and Cash Equivalents

Cash and cash equivalents include non-interest-bearing and interest-bearing demand deposits, as well as a money market sweep account, all of which have maturities of less than 90 days.

Restricted cash includes cash and cash equivalents that are separately maintained by management based on temporary donor restrictions or other needs.

Assets Limited as to Use and Investments

Assets limited as to use primarily include assets designated by the donor or set aside by the Board of Trustees for capital expenditures and research, scientific recruitment, and endowment funds.

The investment objectives for Texas Biomed's endowment funds are to preserve the principal value of the endowment funds in both absolute and real terms, and to maximize over the long term the total rate of return (cash income plus market appreciation) earned by the endowment funds, without assuming an unreasonable degree of risk. Accordingly, the Board of Trustees has adopted a spending formula for determining the maximum that can be expended annually, which is 4% of the trailing 12-quarter rolling average value of the endowment funds computed annually in the years ended December 31, 2016 and 2015.

Net appreciation on endowment funds whose income is unrestricted as to use should be reported as net assets without donor restrictions unless such net appreciation has been restricted by the donor or by law. In those cases where a donor has placed specific restrictions on the use of endowment income, any related net appreciation is also subject to the same restriction and is reported as a part of net assets without donor restrictions until such time as the restriction has been met.

Endowment funds are invested primarily in funds made up of U.S. equities, global equities, U.S. fixed-income securities, global fixed-income securities, alternative investments, emerging markets equities, cash, and cash equivalents. The vehicles for these investments include mutual funds and investments in limited partnerships and trusts. The basis for the investments is the aggregate fair market value. A portion of the endowment funds are invested in 11 limited partnerships and two trusts. The limited partnerships and trusts are recorded at fair value, based on the net asset value of the units held by Texas Biomed.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Realized gains and losses on investments are recognized in the period in which they occur. Investment income or loss (including realized and unrealized gains and losses on investments, interest, and dividends) is included in net assets without donor restrictions unless the income or loss is restricted by donor or law. Market appreciation or decreases on permanently restricted gifts are classified on the accompanying consolidated financial statements as either net assets with or without donor restrictions, as stipulated by the donor.

Donor-Restricted Gifts

Unconditional promises to give cash and other assets are reported at fair value at the date the promise is received, and that amount is then treated as the basis of the asset. The gifts are reported as restricted support if they are received with donor stipulations that limit the use of the donated assets. When a donor restriction expires, that is, when a stipulated time restriction ends or purpose restriction is accomplished, net assets with donor restrictions are reclassified as net assets without donor restrictions and reported on the statements of changes in net assets as net assets released from program restrictions.

Net Assets With Donor Restrictions

Net assets with donor restrictions are those whose use by Texas Biomed has been limited by donors to a specific time period or purpose or those net assets that have been restricted by donors to be maintained by Texas Biomed in perpetuity. Income from the permanently restricted net assets that can be used for current operations, subject to donor restrictions on use, is reflected as an increase to net assets without donor restrictions. This accounting policy was also used for the Tom Slick Memorial Trust consistent with the terms of the documents establishing that trust, with income from the permanently restricted corpus being recorded as income without donor restrictions.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Net assets with donor restrictions are restricted for the following purposes:

	December 31	
	2016	2015
Subject to expenditure for specified purpose:		
Research	\$ 5,575,566	\$ 6,816,806
Subject to spending policy and appropriation:		
Endowments (including amounts above original gift amount), which, once appropriated, is expendable to support:		
Research	17,799,533	16,872,491
Any activities of Texas Biomed	10,929,047	10,929,047
Not subject to appropriation or expenditure:		
Endowments held in perpetuity	23,042,831	22,919,146
Total net assets with donor restrictions	\$ 57,346,977	\$ 57,537,490

Land, Buildings and Equipment

Land, buildings and equipment are carried at cost or at estimated fair value on dates contributed. Texas Biomed provides for depreciation and amortization of property, plant, and equipment at amounts calculated to amortize the cost of the assets over their estimated useful lives, using the straight-line method. The estimated useful lives are as follows:

Buildings and improvements	30 years
Fixtures and equipment	5 years

The general policy of Texas Biomed is to relieve property accounts and related allowances for depreciation and amortization for properties retired or otherwise disposed of at amounts included therein for such properties, and any gain or loss resulting therefrom is included on the statements of activities.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Expenditures for maintenance and repairs are charged to costs or expenses; renewals and betterments are capitalized. Land, buildings and equipment acquired by federal funds are made available for use in other similar federally sponsored projects or programs as workload permits. The land, buildings and equipment acquired with federal funds are subject to use and disposition conditions, including possible repayments to the federal government if assets are disposed of. The amount of total land, buildings and equipment acquired with federal funds, less accumulated depreciation, is \$11,713,789 and \$11,932,890 as of December 31, 2016 and 2015, respectively.

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as temporarily restricted support. Absent explicit donor stipulations, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service.

Retirement Plan

Texas Biomed's retirement plan is available to all active full-time employees and those who work a minimum of 1,000 hours, immediately upon employment. Contributions to the plan consist of employer payments ranging from 7% to 9% of such employee's base salary up to the maximum amount allowed under Section 401(a)(17) of the Internal Revenue Code (Code) based on years of service. Employees are fully vested after the completion of three years of service.

The plan is carried with the Teachers Insurance and Annuity Association and College Retirement Equities Fund and is a defined contribution (money-purchase) plan. Payments to the plan were allocated to the various grants, contracts, and departments of Texas Biomed in the amount of \$1,880,156 and \$1,821,768 in 2016 and 2015, respectively.

Texas Biomed adopted the Supplemental Executive Retirement Plan, a non-qualified defined contribution plan, effective as of January 1, 1999. The plan provides non-qualified deferred compensation benefits for Texas Biomed's president, chief financial officer, and chief scientific officer. The Board of Trustees may designate, from time to time, other selected management or highly compensated employees of Texas Biomed as eligible to participate in the plan. Contributions to the plan consist of discretionary employer payments ranging from 7% to 9% of employee compensation over the maximum amount allowed under Section 401(a)(17) of the Code. No employer contributions were made to the plan in 2016 or 2015.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

Income Taxes

Texas Biomed is exempt from federal income taxes under Section 501(a) of the Code, as an organization described under Section 501(c)(3) of the Code. This status was reaffirmed in the process of converting to a corporation. This exemption does not apply to unrelated business income, as defined by Section 512(a)(1) of the Code, which is subject to federal income tax. Texas Biomed has no internal tax liability results from such unrelated business income in 2016 or 2015. U.S. generally accepted accounting principles require management to evaluate uncertain tax positions taken by Texas Biomed. The financial statement effects of a tax position are recognized when the position is more likely than not, based on its technical merits, to be sustained upon examination by the IRS. Management has analyzed the tax positions taken by Texas Biomed and has concluded that, as of December 31, 2016, there are no uncertain positions taken or expected to be taken. Texas Biomed has recognized no interest or penalties related to uncertain tax positions. Texas Biomed is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. Texas Biomed believes it is no longer subject to income tax examinations for years prior to 2012.

Subsequent Events

Texas Biomed has evaluated subsequent events through June 5, 2017, the date the accompanying consolidated financial statements were available to be issued.

2. Investments

Investments in securities with determinable fair value are stated at fair value. Fair value is 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 measurement date. See Note 4 for further discussion. The composition of these securities is set forth as follows:

	December 31	
	2016	2015
Mutual funds	\$ 45,796,849	\$ 42,821,088
Limited partnerships and trusts	64,949,300	65,198,487
	<u>\$ 110,746,149</u>	<u>\$ 108,019,575</u>

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

2. Investments (continued)

Investments traded on a national securities exchange are valued at the last reported sales price on the last business day of the year. If no sale was reported on that date, they are valued at the last reported bid price.

Limited partnerships and trusts are valued at the net asset values of units held at year-end. Purchases and sales of securities are recorded as of the trade date at cost. Realized gains and losses on sales of securities are determined on the basis of average costs. Interest income is recognized on the accrual basis. Dividend income is recognized on the ex-dividend date.

The holdings in the limited partnerships and trusts are primarily composed of publicly traded securities with readily determinable market values. The risks associated with these investments are numerous and include non-regulation risk, managerial risk, minimal liquidity, and limited transparency. Investment income earned by Texas Biomed and its allocation among net asset classifications are as follows:

	December 31	
	2016	2015
Dividends and interest earned on investments	\$ 1,449,912	\$ 1,453,488
Net realized gain on investments reported at fair value	703,853	1,343,111
Net unrealized gain (loss) on investments reported at fair value	5,848,131	(5,333,490)
Less investment expenses netted against income	(489,474)	(675,329)
Total investment income	<u>\$ 7,512,422</u>	<u>\$ (3,212,220)</u>
Net asset classification of investment income:		
Without donor restrictions	\$ 5,081,311	\$ (2,291,900)
With donor restrictions	2,431,111	(920,320)
Total investment income	<u>\$ 7,512,422</u>	<u>\$ (3,212,220)</u>

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

2. Investments (continued)

Investments in oil and gas mineral interests are considered other investments and the investments are measured at the lower of cost or fair value. As of December 31, 2016 and 2015, Texas Biomed's investments in oil and gas mineral interests are \$0. For the years ended December 31, 2016 and 2015, royalty income from oil and gas mineral interests are \$803,332 and \$1,459,493.

In 2008, Texas Biomed helped create a new for-profit pharmaceutical development corporation named Evestra, Inc. (Evestra). Texas Biomed transferred to Evestra certain equipment, supplies, intellectual property, and a National Institutes of Health contract for steroid manufacturing. Additionally the former staff of Texas Biomed's Organic Chemistry Department became employees of Evestra. As of December 31, 2016 and 2015, Texas Biomed owns 45% of Evestra's common stock and has two of five voting representatives on Evestra's board; therefore, it is accounted for as an equity investment. Texas Biomed measures this investment at lower of cost or fair value. As of December 31, 2016 and 2015, Texas Biomed's investment in Evestra is \$2,821,861. No income has been received from Evestra for the years ended December 31, 2016 and 2015.

3. Funds Held in Trust by Others

Texas Biomed's interest in funds held in trust by others is included in net assets for the years ended December 31, 2016 and 2015. These funds are neither in the possession nor under the control of Texas Biomed. Texas Biomed is an income beneficiary of perpetual trusts held by third parties where the trustee has no discretion regarding the income beneficiaries' participation in the trust. Texas Biomed's proportionate share of the fair value of the trust, which approximates the net present value of the estimated future cash flows receivable by Texas Biomed, is reported as an asset and as permanently restricted contribution revenue at the formation of the trust. Annual income distributions from the trusts are recognized as investment income in the appropriate net asset class according to the restrictions of the trust. Changes in Texas Biomed's proportionate share of the fair value of the trust is reported as gains or losses on funds held in trust by others in the net assets with donor restrictions net asset class.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

3. Funds Held in Trust by Others (continued)

	December 31	
	2016	2015
Ruth Chapman Cowles and Andrew G. Cowles Memorial Trust:		
Texas Biomed has a 10% interest in the income generated from this perpetual trust. The income from the trust is to be used primarily for postdoctoral fellowships	\$ 2,096,860	\$ 2,127,507
Unrealized loss in Texas Biomed's 10% interest	(30,647)	(101,790)

4. Fair Value Measurements

Accounting Standards Codification (ASC) 820, *Fair Value Measurement*, establishes a framework for measuring fair value. The fair value hierarchy is based on inputs to valuation techniques that are used to measure fair value, which are either observable or unobservable. Observable inputs reflect assumptions that market participants would use in pricing an asset or liability based on market data obtained from independent sources, while unobservable inputs reflect a reporting entity's pricing based upon management's own market assumptions. The fair value hierarchy under ASC 820 consists of the following three levels:

- Level 1 – Unadjusted quoted prices in active markets for identical assets and liabilities that are accessible to the reporting entity at the measurement date.
- Level 2 – Inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability. Level 2 inputs include the following:
 - Quoted prices for similar assets and liabilities in active markets
 - Quoted prices for identical or similar assets or liabilities in markets that are not active
 - Observable inputs other than quoted prices that are used in the valuation of the asset or liabilities (e.g., interest rate and yield curve quotes at commonly quoted intervals)
 - Inputs that are derived principally from or corroborated by observable market data

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

- Level 3 – Unobservable inputs for the asset or liability (i.e., supported by little or no market activity). Level 3 inputs include management’s own judgment about the assumptions market participants would use in pricing the asset or liability, including assumptions about risk.

A financial instrument’s categorization within the valuation hierarchy is based on the lowest level of input that is significant to the fair value measurement. The following tables present the financial instruments carried at fair value as of December 31, 2016 and 2015, by caption on the consolidated balance sheets and by level in the ASC 820 fair value hierarchy. None of Texas Biomed’s holdings are concentrated in one specific industry or investment type.

	Fair Value Measurement at December 31, 2016, Using:			
	December 31, 2016	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Investments:				
Mutual funds:				
U.S. equities	\$ 14,326,256	\$ 14,326,256	\$ –	\$ –
International equities	8,187,852	8,187,852	–	–
U.S. fixed-income securities	7,158,383	7,158,383	–	–
Emerging markets	16,124,358	16,124,358	–	–
Total mutual funds	<u>45,796,849</u>	<u>\$ 45,796,849</u>	<u>\$ –</u>	<u>\$ –</u>
Investments measured at net asset value:				
Limited partnerships and trusts:				
U.S. equities	15,286,577			
International equities	20,562,565			
Global fixed-income securities	1,853,540			
Hedge funds	27,246,618			
Total measured at net asset value	<u>64,949,300</u>			
Total investments at fair value	<u>\$ 110,746,149</u>			
Funds held in trust by others	<u>\$ 2,096,860</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 2,096,860</u>

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

	Fair Value Measurement at December 31, 2015, Using:			
	December 31, 2015	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3
Investments:				
Mutual funds:				
U.S. equities	\$ 12,820,184	\$ 12,820,184	\$ –	\$ –
International equities	5,335,230	5,335,230	–	–
U.S. fixed-income securities	8,133,274	8,133,274	–	–
Emerging markets	16,532,400	16,532,400	–	–
Total mutual funds	42,821,088	\$ 42,821,088	\$ –	\$ –
Investments measured at net asset value:				
Limited partnerships and trusts:				
U.S. equities	16,861,159			
International equities	20,100,324			
Global fixed-income securities	2,135,025			
Hedge funds	26,101,979			
Total measured at net asset value	65,198,487			
Total investments at fair value	\$ 108,019,575			
Funds held in trust by others	\$ 2,127,507	\$ –	\$ –	\$ 2,127,507

The valuation methodologies used for instruments measured at fair value as presented in the table above are as follows:

Investments that are valued at quoted prices available in an active market and interest-bearing cash are classified within Level 1 of the valuation hierarchy.

The fair values of investments in limited partnerships and trusts are measured at the entities' net asset value per share. The table on the following page includes additional disclosures required by ASC 820 for the fair value measurements of investments in certain entities that calculate fair value based on net asset value per share.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

	Fair Value	Unfunded Commitments	Redemption Frequency	Redemption Notice Period
December 31, 2016				
U.S. equities ^(a)	\$ 15,286,577	\$ –	Quarterly	30 days
International equities ^(b)	20,562,565	–	Monthly	10 days
Global fixed-income securities ^(c)	1,853,540	–	Daily–monthly	10 days
Hedge funds ^(d)	27,246,618	–	Monthly–annually	30–90 days
	<u>\$ 64,949,300</u>	<u>\$ –</u>		
December 31, 2015				
U.S. equities ^(a)	\$ 16,861,159	\$ –	Quarterly	30 days
International equities ^(b)	20,100,324	–	Monthly	10 days
Global fixed-income securities ^(c)	2,135,025	–	Daily–monthly	10–15 days
Hedge funds ^(d)	26,101,979	–	Monthly–annually	10–90 days
	<u>\$ 65,198,487</u>	<u>\$ –</u>		

^(a) U.S. equities include investments in a limited partnership that invests in publicly traded securities in the United States. Management of the partnership has the ability to manage the investment portfolio.

^(b) International equities include investments in a trust and a limited partnership that invest in international securities outside the United States. Management of the trust and partnership manage their respective investment portfolios.

^(c) Global fixed-income securities include investments in a trust and limited partnership that invest in fixed-income securities such as corporate and government bonds. Management of the trust and partnership manage their respective investment portfolios.

^(d) Hedge funds include investments in limited partnerships that invest in securities and financial instruments of issuers. Management of the partnerships practice a conservative but flexible form of event-driven investing that favors safer, more predictable transactions while accepting lower expected returns.

Funds held in trust of others were classified as Level 3 because Texas Biomed must rely on the trustee's measurement of fair value of the investments held by the trust. Texas Biomed takes necessary steps to obtain a comfort level with valuation procedures used by the trustee.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

Level 3 Reconciliation

The changes in assets measured at fair value for which Texas Biomed has used Level 3 inputs to determine fair value are as follows:

	Funds Held in Trust by Others
Balance, December 31, 2014	\$ 2,229,297
Unrealized loss included in the consolidated statement of changes in net assets	(101,790)
Balance, December 31, 2015	2,127,507
Unrealized loss included in the consolidated statement of changes in net assets	(30,647)
Balance, December 31, 2016	\$ 2,096,860

5. Contributions Receivable

As of December 31, 2016 and 2015, Texas Biomed has received unconditional promises to give totaling \$282,478 and \$1,019,090, respectively. Contributions receivable are included in accounts receivable in the Consolidated Statement of Financial Position. Unconditional promises to give include both with and without donor restrictions for capital construction, research, faculty recruitment, or endowments. The amounts are recorded at the present value of estimated future cash flows. Contributions receivable are due as follows:

	December 31	
	2016	2015
Promises to give:		
Less than one year	\$ 261,827	\$ 634,896
One to five years	30,000	430,700
	291,827	1,065,596
Less amount to reduce to present value	9,349	46,506
Contributions receivable	\$ 282,478	\$ 1,019,090

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

5. Contributions Receivable (continued)

Texas Biomed records no allowance for uncollectible contributions based on the history of actual collections from donors making the promises to give. Texas Biomed expects all remaining promises to give will be received as pledged.

6. Land, Buildings & Equipment

At December 31, 2016, land, buildings, and equipment, less total accumulated depreciation, were as follows:

	December 31,	
	2016	2015
Argyle, buildings and improvements	\$ 8,751,264	\$ 8,655,747
Land	359,959	359,959
Buildings and improvements	108,534,965	106,499,550
Fixtures and equipment	35,085,564	36,530,621
Construction in progress	1,812,128	807,289
Less: Accumulated depreciation	(88,337,259)	(84,859,921)
Net land, buildings and equipment	<u>\$ 66,206,621</u>	<u>\$ 67,993,245</u>

Land, buildings, and equipment not used in the research operations of Texas Biomed are identified separately and valued at cost. Currently, this is limited to property leased to The Argyle Club (The Argyle) and is included in the table above as Argyle, buildings and improvements. The Argyle is a related party to Texas Biomed as Texas Biomed has representation (but not control) on The Argyle's board.

The Argyle is a nonprofit organization operated as a social welfare organization. Membership in The Argyle requires initial and annual contributions to Texas Biomed. Texas Biomed leases a building, its contents, surrounding land, and a parking lot to The Argyle for a monthly rental fee of \$6,000.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

7. Endowment Funds and Funds Functioning as Endowments

Texas Biomed holds donor-restricted and Board-designated endowment funds established primarily to fund specified activities for and within Texas Biomed and the research community as a whole. As required by U.S. GAAP, net assets associated with endowment funds are classified and reported based on the existence or absence of donor-imposed restrictions.

The Uniform Prudent Management of Institutional Funds Act provides statutory guidelines for management, investment, and expenditure of endowment funds held by charitable organizations, which apply in the absence of explicit donor stipulations. The intent of Texas Biomed is to preserve the historic dollar value of original permanently restricted gifts.

Texas Biomed classifies the historic value of donor-restricted gifts to be held in perpetuity as net assets with donor restrictions. The remaining accumulated earnings of the donor-restricted endowment funds are also classified as net assets with donor restrictions until those amounts are appropriated for expenditure. Board-designated endowment funds are reported in net assets without donor restrictions.

Activity of endowments and funds functioning as endowments for the years ended December 31, 2016 and 2015, is as follows:

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total
Endowment net assets at December 31, 2014	\$ 67,907,290	\$ 58,510,630	\$ 126,417,920
Contributions	961,149	4,169,059	5,130,208
Investment income	765,563	314,193	1,079,756
Net unrealized/realized loss on investments	(3,062,407)	(1,234,513)	(4,296,920)
Loss on funds held in trust by others	-	(101,790)	(101,790)
Net assets released from program restrictions	-	(4,120,089)	(4,120,089)
Appropriation of endowment assets for expenditure	(4,446,661)	-	(4,446,661)
Endowment net assets at December 31, 2015	62,124,934	57,537,490	119,662,424
Contributions	1,102,601	1,342,514	2,445,115
Investment income	769,720	369,989	1,139,709
Net unrealized/realized gain on investments	4,294,584	2,061,122	6,355,706
Loss on funds held in trust by others	-	(30,647)	(30,647)
Net assets released from program restrictions	-	(3,933,491)	(3,933,491)
Appropriation of endowment assets for expenditure	(3,815,812)	-	(3,815,812)
Transfer	11,409	-	11,409
Endowment net assets at December 31, 2016	\$ 64,487,436	\$ 57,346,977	\$ 121,834,413

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

7. Endowment Funds and Funds Functioning as Endowments (continued)

Texas Biomed has adopted investment and spending policies for endowment assets reflecting a disciplined, consistent management philosophy that accommodates reasonable and probable events. Preservation of capital and return on investment are of primary importance.

The primary investment objective is to preserve financial assets generated through donor gifts, so that the proceeds may be distributed for the purposes intended by the donors and to the benefit of Texas Biomed, at a level of risk deemed acceptable by the Board of Trustees.

To satisfy its long-term rate-of-return objectives, Texas Biomed relies on an investment policy outlined by its Investment Committee, which includes a desired mix of international and U.S. bonds, stocks, alternative investments, and cash and cash equivalents. Texas Biomed, at the direction of its Investment Committee, rebalances the portfolio periodically to maintain the desired distribution of assets within each asset class.

Texas Biomed has adopted spending policies allowing endowment funds to be utilized only in accordance with the purposes established by the donor or Board of Trustees designation. In addition, it is Texas Biomed's policy not to spend or appropriate underwater endowment funds. An underwater endowment fund is one with a fair market value lower than the value of the gift that originally created that fund.

Texas Biomed has no underwater endowment funds as of December 31, 2016.

As shown below, Texas Biomed had one underwater endowment fund as of December 31, 2015:

Fair value of underwater endowment fund	\$ 3,888,591
Original endowment gift amount or level to be maintained by donor stipulation	<u>3,900,000</u>
Deficiency of underwater fund	<u>\$ (11,409)</u>

8. Notes Payable

Borrowed funds are shown in the Statement of Financial Position as Notes Payable.

Interest expense is reported in the Consolidated Statement of Activities under Other Expenses. Interest expense totaled \$50,009 and \$61,003 for the years ended December 31, 2016 and December 31, 2015, respectively.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

8. Notes Payable (continued)

On October 12, 2012, Texas Biomed entered into a declining revolving promissory note (the note) with a financial institution to construct a new building. The note is a declining revolving line of credit in which the principal may not exceed the following:

1. Fifteen million and no/100 dollars (\$15,000,000) for the period from October 12, 2012, until and including October 11, 2014.
2. Twelve million and no/100 dollars (\$12,000,000) for the period from October 12, 2014, until and including October 11, 2015.
3. Nine million and no/100 dollars (\$9,000,000) for the period from October 12, 2015, until and including October 11, 2016.
4. Five million and no/100 dollars (\$5,000,000) for the period from October 12, 2016, until and including October 12, 2017.

The note bears interest at 2.4% and has a maturity date of October 12, 2017. The unpaid principal balance was \$2,067,775 and \$1,408,063 at December 31, 2016 and 2015, respectively. As of December 31, 2016, all interest due on the loan was paid by Texas Biomed. The building constructed is held as collateral on the note. The building held a net book value of \$25,734,558 as of December 31, 2016.

Line of Credit

Texas Biomed has a \$2,000,000 one-year line of credit with a financial institution available through July 21, 2017. The line of credit is extended each year. The amount outstanding was \$1,985,000 and \$1,290,291 as of December 31, 2016 and 2015, respectively. The interest rate is variable based on changes in the London Interbank Offered Rate for one month as quoted in the most recently published issue of The Wall Street Journal. As of December 31, 2016, all interest due on the line of credit was paid by Texas Biomed.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

9. Functional Expenses

Texas Biomed incurs expenses in three functional categories – research programs, fundraising, and general & administrative. The research programs function includes costs incurred for external research programs. The costs incurred in the efforts of gathering contributions are included in the fundraising function. The costs remaining after allocation to these two functions are categorized as general and administrative. The following table shows the allocation of expenses from the functional categories to the natural expense classifications.

	Program Activities		Supporting Activities			Total Expenses
	Research Programs	General & Admin	Fund-Raising	Supporting Subtotal		
Salaries and benefits	\$ 13,281,326	\$ 16,636,387	\$ 522,945	\$ 17,159,332	\$ 30,440,658	
Supplies	4,181,165	3,007,538	25,943	3,033,481	7,214,646	
Services and professional fees	3,414,935	2,824,669	162,097	2,986,766	6,401,701	
Subcontracts	1,124,567	7,825	–	7,825	1,132,392	
Utilities	–	2,329,964	–	2,329,964	2,329,964	
General insurance	–	522,862	–	522,862	522,862	
Travel	59,382	275,936	5,588	281,524	340,906	
Depreciation Expense	86,352	6,805,647	–	6,805,647	6,891,999	
Other Expenses	250,781	2,359,459	144,344	2,503,803	2,754,584	
	<u>\$ 22,398,508</u>	<u>\$ 34,770,287</u>	<u>\$ 860,917</u>	<u>\$ 35,631,204</u>	<u>\$ 58,029,712</u>	

10. Liquidity Management

The following reflects Texas Biomed’s financial assets as of the balance sheet date, reduced by amounts not available for general use because of contractual or donor-imposed restrictions within one year of the balance sheet date. Amounts not available include amounts set aside for long term investing in the endowment that could be drawn upon if the governing board approves that action. However, amounts already appropriated from the donor-restricted endowment for general expenditure within one year of the balance sheet have not been subtracted as unavailable.

Financial assets, at December 31, 2016	\$ 124,589,789
Less those unavailable for general expenditures within one year, due to:	
Contractual or donor-imposed restrictions	<u>(57,346,977)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 67,242,812</u>

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

10. Liquidity Management (continued)

Texas Biomed is substantially supported by contributions with donor restrictions. Because a donor's restriction requires resources to be used in a particular manner or in a future period, Texas Biomed must maintain sufficient resources to meet those responsibilities to its donors. Thus, financial assets may not be available for general expenditure within one year. As part of Texas Biomed's liquidity management, it has a policy to structure its financial assets to be available as its general expenditures, liabilities, and other obligations come due. In the event of an unanticipated liquidity need, Texas Biomed could also draw upon the line of credit (as further discussed in Note 8).

11. Contingencies

Texas Biomed is involved in various claims and legal actions arising in the ordinary course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on Texas Biomed's consolidated financial position.

Reports on Federal Award Programs



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

Management and Trustees
Texas Biomedical Research Institute

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Texas Biomedical Research Institute, which comprise the consolidated balance sheet as of December 31, 2016, and the related consolidated statements of unrestricted revenues, expenses, and other changes in unrestricted net assets; changes in net assets; and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated June 5, 2017.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of this Report

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

Ernst + Young LLP

June 5, 2017

Report of Independent Auditors on Compliance for Each Major Federal Program; Report on Internal Control Over Compliance and Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

Management and Trustees
Texas Biomedical Research Institute

Report on Compliance for the Major Federal Program

We have audited Texas Biomedical Research Institute's compliance with the types of compliance requirements described in the US Office of Management and Budget (OMB) *Compliance Supplement* that could have a direct and material effect on Texas Biomedical Research Institute's major federal program for the year ended December 31, 2016. Texas Biomedical Research Institute's major federal program is identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with federal statutes, regulations and the terms and conditions of its federal awards applicable to its federal programs.

Auditor's Responsibility

Our responsibility is to express an opinion on compliance for Texas Biomedical Research Institute's major federal program based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Those standards and the Uniform Guidance require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about Texas Biomedical Research Institute's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

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

Opinion on the Major Federal Program

In our opinion, Texas Biomedical Research Institute complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on its major federal program for the year ended December 31, 2016.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as item 2016-01 – Equipment and Real Property Management. Our opinion on the major federal program is not modified with respect to these matters.

Texas Biomedical Research Institute’s response to the noncompliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Texas Biomedical Research Institute’s response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Report on Internal Control Over Compliance

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

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

requirement of a federal program that is less severe than a material weakness in internal control over compliance, yet important enough to merit attention by those charged with governance.

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified certain deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item 2016-001–Equipment and Real Property Management, that we consider to be significant deficiencies.

Texas Biomedical Research Institute’s response to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Texas Biomedical Research Institute’s response was not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

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

Report on Schedule of Expenditures of Federal Awards Required by the Uniform Guidance

We have audited the financial statements of Texas Biomedical Research Institute as of and for the year ended December 31, 2016, and have issued our report thereon dated June 5, 2017, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance and is not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards



generally accepted in the United States. In our opinion, the schedule of expenditure of federal awards is fairly stated in all material respects in relation to the financial statements as a whole.

Ernst + Young LLP

June 7, 2017

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards
Year Ended December 31, 2016

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Contract/ Grant Number	Federal Expenditures			Amounts Provided to Subrecipients
						Direct	Pass-Through	Total	
Research and Development									
U.S. Department of Defense									
Advanced Research Projects Agency	Research and Technology Development	12.910	The General Hospital Corporation	227668	16-04615	\$ -	\$ 3,004	\$ 3,004	\$ -
	<i>Subtotal Research and Technology Development</i>					-	3,004	3,004	-
TOTAL Advanced Research Projects Agency						-	3,004	3,004	-
Defense Threat Reduction Agency	Cepharanthine/Chloroquine Combination for Prophylaxis for Treatment of Ebola	12.HDTRA1-16-C-0020	Southwest Research Institute	J999050CP	16-04605	-	30,355	30,355	-
	<i>Subtotal Cepharanthine/Chloroquine Combination for Prophylaxis for Treatment of Ebola</i>					-	30,355	30,355	-
TOTAL Defense Threat Reduction Agency						-	30,355	30,355	-
Office of the Secretary of Defense	In vitro and in vivo characterization of Filoviruses Through the exploration of various vaccine candidates	12.unknown			15-04529	90,393	-	90,393	
	In vitro and in vivo characterizations of alphaviruses	12.unknown			15-04548	1,278,839	-	1,278,839	
	In vitro and in vivo Characterization of Filoviruses through the Exploration of Various Vaccine Candidates	12.unknown			16-04587	693,182	-	693,182	
	Challenge Phase for Profectus BioSciences Trivalent Pan-Filovirus Vaccine	12.unknown	Battelle	512256	15-04569	-	669,956	669,956	
	<i>Subtotal</i>					2,062,414	669,956	2,732,370	-
TOTAL Office of the Secretary of Defense						2,062,414	669,956	2,732,370	-
U.S. Army Medical Command	Military Medical Research and Development	12.420			10-04258	1,273	-	1,273	
		12.420			15-04571	13,291	-	13,291	
		12.420	Henry M. Jackson Foundation	798196	13-04423	-	53,084	53,084	
		12.420	Henry M. Jackson Foundation	798196	13-04423	-	-	-	
		12.420	University of Texas Health Science Center at San Antonio	159421/155536	Tasks 004-005	-	71,612	71,612	
	<i>Subtotal Military Medical Research and Development</i>					14,564	215,597	230,161	-
TOTAL U.S. Army Medical Command						14,564	215,597	230,161	-
TOTAL U.S. Department of Defense						2,076,978	918,912	2,995,890	-
US Department of Health and Human Services									
Food and Drug Administration	Bordetella-Free Weanling Baboons	93.unknown			16-04602	905	-	905	
	<i>Subtotal Bordetella-Free Weanling Baboons</i>					905	-	905	-
TOTAL Food and Drug Administration						905	-	905	-

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2016

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Contract/ Grant Number	Federal Expenditures			Amounts Provided to Subrecipients
						Direct	Pass-Through	Total	
Research and Development (continued)									
U.S. Department of Health and Human Services (continued)									
Office of the Secretary									
Office of the Assistant Secretary for Preparedness and Response									
	Biomedical Advanced Research and Development Authority (BARDA), Biodefense Medical Countermeasure Development	93.360	IIT Research Institute	144-0-2378-001-RL	15-04537	\$ -	\$ 459,678	\$ 459,678	\$ -
		93.360	IIT Research Institute	144-0-2378-001-RL/TO 002	15-04558	-	363,434	363,434	-
		93.360	IIT Research Institute	144-0-2378-001-RL/TO 002	16-04584	-	694,875	694,875	-
		93.360	IIT Research Institute	144-0-2378-001-RL	16-04616	-	9,963	9,963	-
	Subtotal Biomedical Advanced Research and Development Authority (BARDA), Biodefense Medical Countermeasure Development					-	1,527,950	1,527,950	-
						-	1,527,950	1,527,950	-
TOTAL Office of the Secretary									
National Institute of Health									
National Institute of Environmental Health Sciences									
	Environmental Health	93.113	Johns Hopkins University Bloomberg School of Public Health	2001669755	15-04367	-	13,296	13,296	-
		93.113	Johns Hopkins University Bloomberg School of Public Health	2002698260	15-04543	-	30,982	30,982	-
		93.113	Johns Hopkins University Bloomberg School of Public Health	2002698260	16-04543	-	17,130	17,130	-
	Subtotal Environmental Health					-	61,408	61,408	-
National Institute of Dental and Craniofacial Research									
	Oral Diseases and Disorders Research	93.121			15-04442	572,248	-	572,248	181,500
		93.121			16-04442	345,599	-	345,599	182,248
	Subtotal Oral Diseases and Disorders Research					917,847	-	917,847	363,748
National Human Genome Research Institute									
	Human Genome Research	93.172	University of North Carolina	5033727	15-04436	-	7,188	7,188	-
		93.172	University of North Carolina	5104465	16-04436	-	9,504	9,504	-
		93.172			13-04410	340,670	-	340,670	87,670
	Subtotal Human Genome Research					340,670	16,692	357,362	87,670
National Institute of Mental Health									
	Mental Health Research Grants	93.242	University of Texas Health Science Center at San Antonio	159031/159029	15-04568R	-	77,704	77,704	-
		93.242	The University of Texas Rio Grande Valley	5R01MH094115(01)	16-04599	-	20,272	20,272	-
		93.242			14-04232	32,821	-	32,821	-
	Subtotal Mental Health Research Grants					32,821	97,976	130,797	-
NIH Office of the Director									
	Trans-NIH Research Support	93.310			15-03500-182 Task 182	418,720	-	418,720	-
		93.310			16-03508 Tasks 016-017	171,863	-	171,863	-
	Subtotal Trans-NIH Research Support					590,583	-	590,583	-

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2016

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Contract/ Grant Number	Federal Expenditures			Amounts Provided to Subrecipients
						Direct	Pass-Through	Total	
Research and Development (continued)									
U.S. Department of Health and Human Services (continued)									
NIH Office of the Director	Research Infrastructure Programs	93.351	The Regents of the University of California, San Francisco	8313sc	15-04495	\$ -	\$ 287,206	\$ 287,206	\$ -
		93.351	The Regents of the University of California, San Francisco	8313sc	16-04495	-	217,986	217,986	
		93.351	University of Wyoming	1002740C-TBRI	15-04504	-	402,287	402,287	
		93.351	University of Colorado Denver	FY16.745.001	15-04540	-	67,814	67,814	
		93.351	University of Colorado Denver	FY16.745.001	16-04540	-	108,929	108,929	
		93.351			15-03500	2,539,715	-	2,539,715	14,662
		93.351			16-03508	5,577,771	-	5,577,771	82,995
		93.351			15-04524	485,525	-	485,525	
		93.351			15-01117	475,505	-	475,505	
		93.351			16-01117	1,673,862	-	1,673,862	
		93.351			15-04304	217,816	-	217,816	
		93.351			16-04583	251,728	-	251,728	69,990
	Subtotal Research Infrastructure Programs					11,221,922	1,084,222	12,306,144	167,647
National Cancer Institute	Cancer Treatment Research	93.395			14-04398	19,952	-	19,952	
	Subtotal - Cancer Treatment Research					19,952	-	19,952	-
National Heart, Lung, and Blood Institute	Cardiovascular Diseases Research	93.837			15-04407	218,054	-	218,054	
		93.837			16-04407	352,444	-	352,444	
		93.837			15-04417	230,104	-	230,104	
		93.837			16-04417	180,744	-	180,744	
		93.837			16-04604	37,664	-	37,664	
	Subtotal Cardiovascular Diseases Research					1,019,010	-	1,019,010	-
National Institute of Arthritis and Musculoskeletal and Skin Diseases	Arthritis, Musculoskeletal and Skin Diseases Research	93.846	Southwest Research Institute	1418GC0001	15-04432	-	130,371	130,371	
		93.846	Southwest Research Institute	1418GC0001	16-04432	-	49,379	49,379	
		93.846	Southwest Research Institute	H99062RI	15-04532	-	65,013	65,013	
	Subtotal Arthritis, Musculoskeletal and Skin Diseases Research					-	244,763	244,763	-
National Institute of Diabetes, Digestive and Kidney Diseases	Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	University of North Carolina	5034514	15-04435	-	73,666	73,666	
		93.847	Georgia Regents University	25034-78	15-04553	-	81,850	81,850	
		93.847	University of North Carolina	5102861	15-04570	-	11,398	11,398	
		93.847	Augusta University	30835/25034-78	16-04614	-	7,664	7,664	
		93.847			14-04242	89,572	-	89,572	
		93.847			14-04318	110,266	-	110,266	
		93.847			16-04613	7,976	-	7,976	
	Subtotal Diabetes, Digestive, and Kidney Diseases Extramural Research					207,814	174,578	382,392	-
National Institute of Neurological Disorders and Stroke	Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	University of Texas Health Science	156125/155979	15-04465	-	7,820	7,820	
	Subtotal Extramural Research Programs in the Neurosciences and Neurological Disorders					-	7,820	7,820	-

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2016

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Contract/ Grant Number	Federal Expenditures			Amounts Provided to Subrecipients
						Direct	Pass-Through	Total	
Research and Development (continued)									
U.S. Department of Health and Human Services (continued)									
National Institute of Allergy and Infectious Diseases	Allergy and Infectious Diseases Research	93.855	Battelle Memorial Institute	403732	14-04450	\$ -	\$ 1,581,114	\$ 1,581,114	\$ -
		93.855	Battelle Memorial Institute	521876	16-04601	-	3,431	3,431	-
		93.855	Emory University	T058636 (S611293)	15-04295	-	152,063	152,063	-
		93.855	The Regents of the University of California, Santa Cruz	S0183838	15-04358	-	49,260	49,260	-
		93.855	The Regents of the University of California, Santa Cruz	A00-2044-S002-S0183838	16-04358	-	119,552	119,552	-
		93.855	University of Louisville Research Foundation, Inc	ULRF 12-0393-02	14-04468	-	(2,220)	(2,220)	-
		93.855	University of Texas Health Science Center at San Antonio	158423/158421	15-04536	-	52,819	52,819	-
		93.855	University of Texas Health Science Center at San Antonio	158423/158421	16-04536	-	69,651	69,651	-
		93.855	Purdue University	4102-68572	15-04549	-	78,628	78,628	-
		93.855	Purdue University	4102-68572	16-04549	-	117,266	117,266	-
		93.855	The Scripps Research Institute	PO No.5-52639	16-04591	-	41,507	41,507	-
		93.855	The Washington University	WU-17-31	16-04607	-	136,844	136,844	-
		93.855	The Washington University	WU-17-48	16-04608	-	112,434	112,434	-
		93.855			14-01112	17,077	-	17,077	17,077
		93.855			15-01112	638,951	-	638,951	109,278
		93.855			14-04294	115,319	-	115,319	-
		93.855			13-04332	28,552	-	28,552	613
		93.855			14-04397	3,607	-	3,607	-
		93.855			13-04418	536,009	-	536,009	-
		93.855			15-04441	304,735	-	304,735	-
		93.855			16-04441	234,744	-	234,744	-
		93.855			15-04497	435,092	-	435,092	-
		93.855			16-04497	27,050	-	27,050	-
		93.855			15-04514	48,905	-	48,905	-
		93.855			16-04514	426,072	-	426,072	-
		93.855			15-04517	194,743	-	194,743	14,848
		93.855			16-04517	648,808	-	648,808	-
		93.855			15-04534	121,567	-	121,567	-
		93.855			16-04534	103,126	-	103,126	-
		93.855			15-04542	152,136	-	152,136	-
		93.855			16-04542	38,728	-	38,728	-
		93.855			15-04547	389,051	-	389,051	34,892
		93.855			16-04547	190,165	-	190,165	-
		93.855			16-04595	122,368	-	122,368	-
		93.855			16-04595C	109,510	-	109,510	-
		93.855			16-04600	164,095	-	164,095	-
		93.855			16-04603	994,007	-	994,007	181,447
	Subtotal Allergy and Infectious Diseases Research					6,044,417	2,512,349	8,556,766	358,155
National Institute of Allergy and Infectious Diseases	Targeting Therapeutics Development to Relieve Bottlenecks: Optimizing Lead Therapeutic Compounds against Infectious Pathogens	93.HHSN272201500015C	Southwest Research Institute	H99067CP	15-04564	-	229,568	229,568	-
	Subtotal Targeting Therapeutics Development to Relieve Bottlenecks: Optimizing Lead Therapeutic Compounds against Infectious Pathogens					-	229,568	229,568	-
National Institute of General Medical Sciences	Biomedical Research and Research Training	93.859			15-04477	310,987	-	310,987	77,137
		93.859			16-04477	320,598	-	320,598	34,570
	Subtotal Biomedical Research and Research Training					631,585	-	631,585	111,707

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2016

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Contract/ Grant Number	Federal Expenditures			Amounts Provided to Subrecipients
						Direct	Pass-Through	Total	
Research and Development (continued)									
U.S. Department of Health and Human Services (continued)									
Eunice Kennedy Shriver National Institute of Child Health and Human Development	Child Health and Human Development Extramural Research	93.865	The Board of Trustees University of Illinois	2012-06136-03-02 KM	15-04439	\$ -	\$ 55,936	\$ 55,936	\$ -
		93.865	The Board of Trustees University of Illinois	083814-00001	16-04439	-	53,969	53,969	-
		93.865	University of Wyoming	1002696-TBRI-Year2	16-04511	-	195,513	195,513	-
		93.865	University of Wyoming	1002696-TBRI	15-04512	-	27,309	27,309	-
		93.865	University of Wyoming	1002696-TBRI-Year2	16-04512	-	176,336	176,336	-
		93.865	University of Wyoming	1002696-TBRI	15-04513	-	1,788	1,788	-
		93.865	University of Wyoming	1002696-TBRI-Year2	16-04513	-	11,908	11,908	-
	Subtotal Child Health and Human Development Extramural Research					-	522,759	522,759	-
National Institute on Aging	Aging Research	93.866	Emory University	T360102	14-04527	-	60,106	60,106	-
	Subtotal Aging Research					-	60,106	60,106	-
TOTAL National Institute of Health						21,026,621	5,012,241	26,038,862	1,088,927
TOTAL U.S. Department of Health and Human Services						21,027,526	6,540,191	27,567,717	1,088,927
TOTAL RESEARCH AND DEVELOPMENT CLUSTER						23,104,504	7,459,103	30,563,607	1,088,927
TOTAL EXPENDITURES OF FEDERAL AWARDS						\$ 23,104,504	\$ 7,459,103	\$ 30,563,607	\$ 1,088,927

See accompanying notes to schedule of expenditures of federal awards.

Texas Biomedical Research Institute

Notes to Schedule of Expenditures of Federal Awards

December 31, 2016

1. Basis of Presentation

The accompanying schedule of expenditures of federal awards (the Schedule) includes the federal grant activity of Texas Biomedical Research Institute (Texas Biomed) under programs of the federal government for the year ended December 31, 2016. The information in this Schedule is presented in accordance with the Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the consolidated financial statements.

2. Summary of Significant Accounting Policies

Expenditures reported on the Schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in the Uniform Guidance or OMB Circular A-122, *Cost Principles for Non-Profit Organizations*. Negative amounts shown on the Schedule represent adjustments or credits made in the normal course of business to amounts reported as expenditures in prior years. Texas Biomed has elected not to use the 10% de minimis indirect cost rate allowed under the Uniform Guidance.

3. Reconciliation to Financial Statements

Texas Biomed recognizes revenues from grants and contracts at the time eligible direct and indirect costs are incurred under terms of the awards and recognized as expenditures. Revenue recognized from expenditure of federal awards is reconciled to Texas Biomed's consolidated statement of unrestricted revenues, expenses, and other changes in unrestricted net assets as follows:

Revenues reported in Texas Biomed's consolidated financial statements:	
Grants and contracts	\$ 36,458,781
Less amounts not subject to Uniform Guidance	<u>5,895,174</u>
Total federal award expenditures	<u><u>\$ 30,563,607</u></u>

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs

Year Ended December 31, 2016

Section I – Summary of Auditor’s Results

Financial Statements

Type of report the auditor issued on whether the financial statements audited were prepared in accordance with GAAP (unmodified, qualified, adverse or disclaimer):

Unmodified

Internal control over financial reporting:

Material weakness(es) identified?

 yes X no

Significant deficiency(ies) identified?

 yes X none reported

Noncompliance material to financial statements noted?

 yes X no

Federal Awards

Internal control over major federal programs:

Material weakness(es) identified?

 yes X no

Significant deficiency(ies) identified?

 X yes none reported

Type of auditor’s report issued on compliance for major federal programs (unmodified, qualified, adverse or disclaimer):

Unmodified

Any audit findings disclosed that are required to be reported in accordance with 2 CFR 200.516(a)?

 X yes no

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

Section III – Federal Award Findings and Questioned Costs

This section identifies the audit findings required to be reported by the 2 CFR 200.516(a) (for example, significant deficiencies, material weaknesses, material instances of noncompliance, including questioned costs, and material abuse).

Finding 2016-001 – Equipment and Real Property Management

Information on the federal program:

Research and Development Cluster

Criteria or specific requirement (including statutory, regulatory or other citation)

In accordance with 45 CFR Section 75.320 (d) Management requirements, procedures for managing equipment (including replacement equipment), whether acquired in whole or in part under a Federal award, until disposition takes place will, as a minimum, meet the following requirements:

(1) Property records must be maintained that include a description of the property, a serial number or other identification number, the source of funding for the property (including the FAIN), who holds title, the acquisition date, and cost of the property, percentage of Federal participation in the project costs for the Federal award under which the property was acquired, the location, use and condition of the property, and any ultimate disposition data including the date of disposal and sale price of the property.

(2) A physical inventory of the property must be taken and the results reconciled

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

with the property records at least once every two years.

(3) A control system must be developed to ensure adequate safeguards to prevent loss, damage, or theft of the property. Any loss, damage, or theft must be investigated.

(4) Adequate maintenance procedures must be developed to keep the property in good condition.

(5) If the non-Federal entity is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.

(e) Disposition. When original or replacement equipment acquired under a Federal award is no longer needed for the original project or program or for other activities currently or previously supported by a HHS awarding agency, except as otherwise provided in Federal statutes, regulations, or HHS awarding agency disposition instructions, the non-Federal entity must request disposition instructions from the HHS awarding agency if required by the terms and conditions of the Federal award. Disposition of the equipment will be made as follows, in accordance with HHS awarding agency disposition instructions:

(1) Items of equipment with a current per unit fair market value of \$5,000 or less may be retained, sold or otherwise disposed of with no further obligation to the HHS awarding agency.

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

(2) Except as provided in §75.319(b), or if the HHS awarding agency fails to provide requested disposition instructions within 120 days, items of equipment with a current per-unit fair-market value in excess of \$5,000 may be retained by the non-Federal entity or sold. The HHS awarding agency is entitled to an amount calculated by multiplying the current market value or proceeds from sale by the HHS awarding agency's percentage of participation in the cost of the original purchase. If the equipment is sold, the HHS awarding agency may permit the non-Federal entity to deduct and retain from the Federal share \$500 or ten percent of the proceeds, whichever is less, for its selling and handling expenses.

(3) The non-Federal entity may transfer title to the property to the Federal Government or to an eligible third party provided that, in such cases, the non-Federal entity must be entitled to compensation for its attributable percentage of the current fair market value of the property.

(4) In cases where a non-Federal entity fails to take appropriate disposition actions, the HHS awarding agency may direct the non-Federal entity to take disposition actions.

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

Condition:

One of 44 equipment items selected for observation did not include an asset identification number or tag and was, therefore, unable to be matched to the selected items on the equipment listing.

One of 44 equipment items selected for observation could not be located and upon further investigation by Texas Biomed, it was determined that the equipment was contributor-funded and not federally funded and should not have been on the federally funded equipment list.

Three of 44 federally funded equipment items selected for observation could not be located. During the most recent physical inventory performed by Texas Biomed in October 2016, these three items were not located by Texas Biomed and the discrepancies between the physical inventory and the equipment records were not investigated further.

Questioned costs:

\$0

Context:

We selected 44 equipment items from the federal equipment listing for testing by observation.

The equipment item that did not include an asset identification number was a walk-in cooler placed in service in 2006, with a cost of \$5,169.

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

The equipment item that was determined to not be federally funded after further review by Texas Biomed was a ventilator (Asset #10721) placed in service in 2003, with a cost of \$6,667.

The three federally funded equipment items that were unable to be located by Texas Biomed for our observation were as follows:

- Sonometer (Asset #10819), placed in service on January 18, 2012, with a cost of \$7,650
- Ultrascan (Asset #2135), placed in service on December 6, 1993, with a cost of \$10,032
- Geneamp PCR System (Asset #1349), placed in service on March 22, 2002, with a cost of \$7,035

All of the above equipment items were fully depreciated at December 31, 2016, with a net book value of zero.

The total cost of federally funded equipment recorded in the general ledger at December 31, 2016, was \$10,201,551. The total cost of the 44 equipment items selected at December 31, 2016, per the equipment records was \$1,507,880.

Effect

Misappropriation or loss of equipment purchased with federal funds could occur when inadequate records are kept and when investigations into differences in the

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

	physical inventory are not performed in accordance with federal requirements.
<u>Cause</u>	Controls are not sufficiently in place to ensure all equipment items include identifying numbers, include proper funding source on the equipment list, and physical inventory results are reconciled to equipment records.
<u>Identification as a repeat finding, if applicable</u>	N/A
<u>Recommendation</u>	Texas Biomed should ensure that all equipment items include asset identification numbers. Texas Biomed should ensure the equipment records include correct funding sources for each item. Texas Biomed should perform a full physical inventory of federally funded equipment in 2017 and reconcile differences to equipment records. This should include investigating and correcting differences between the physical inventory results and the equipment records in accordance with federal regulations.
<u>Views of responsible officials and planned corrective actions:</u>	Texas Biomed has assembled a team from all departments to collaborate in performing a comprehensive physical inventory, and to redesign our processes to provide stronger internal controls over fixed assts. We expect the physical inventory process to be completed in

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

August 2017. By October 2017, we plan to have all updates to our Federal assets recorded in Oracle. In the future, Texas Biomed will perform a full physical inventory of fixed assets every two years, with supplementary inventories performed for the intervening years.

Responsible Official: Keith Davis, Chief Financial Officer

Daniel Anzak, Director of Finance

Implementation Date: June 2017 through October 2017

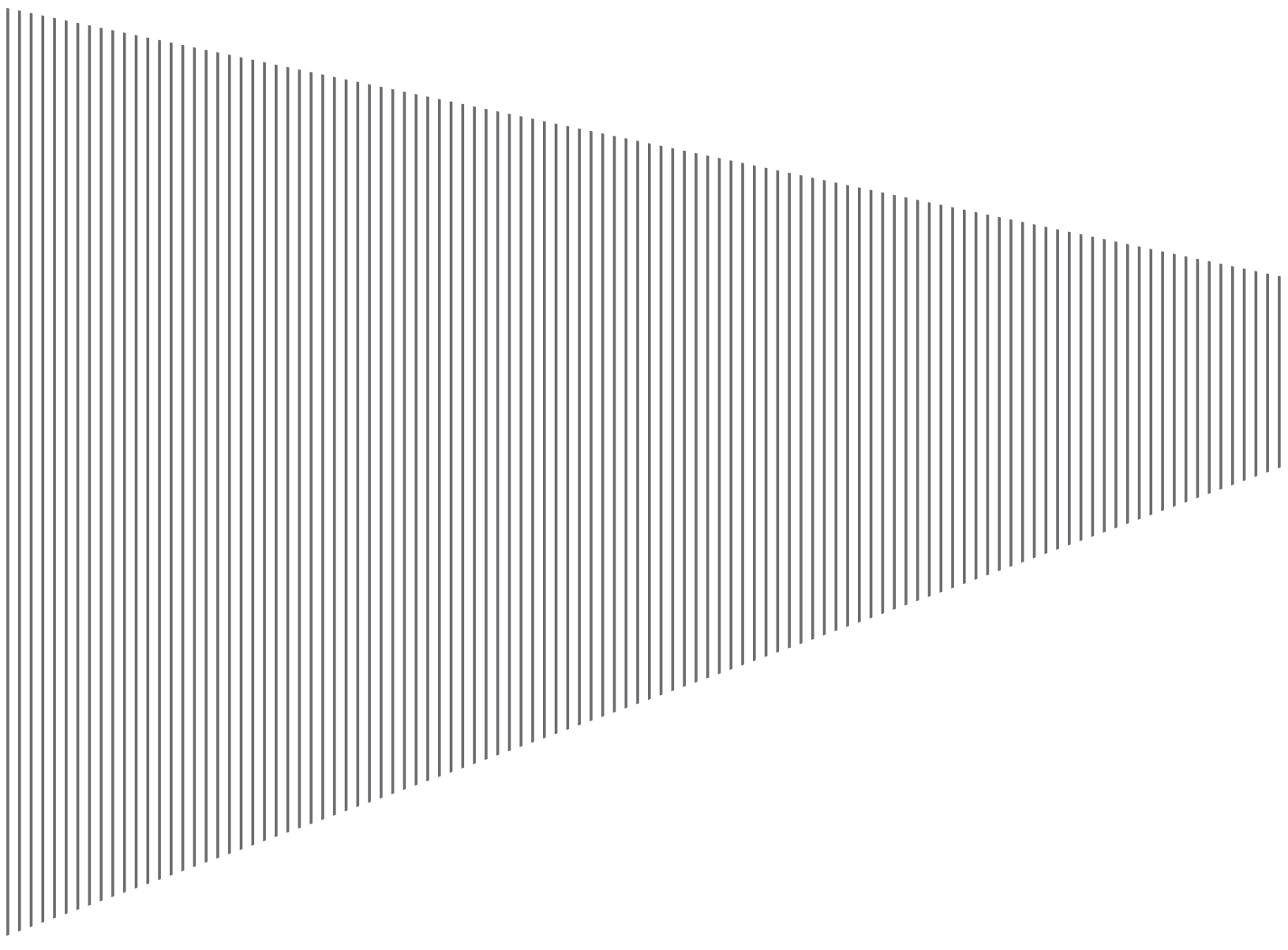
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Summary Schedule of Prior Audit Findings

Year Ended December 31, 2016

No uncorrected findings were noted in 2015 or 2014.

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PRELIMINARY AND TENTATIVE FOR DISCUSSION ONLY

Corrective Action Plan

Finding 2016-001 Internal Controls – Equipment and Real Property Management

In accordance with 45 CFR Section 75.320 (d) Management requirements, procedures for managing equipment (including replacement equipment), whether acquired in whole or in part under a Federal award, until disposition takes place will, as a minimum, meet the following requirements:

(1) Property records must be maintained, (2) A physical inventory of the property must be taken and the results reconciled with the property records at least once every two years, (3) A control system must be developed to ensure adequate safeguards to to equipment, (4) Adequate maintenance procedures must be developed to keep the property in good condition, and (5) If the non-Federal entity is authorized or required to sell the property, proper sales procedures must be established to ensure the highest possible return.

One of 40 equipment items selected for observation did not include an asset identification number or tag and was therefore unable to be matched to the selected items on the equipment listing.

One of 40 equipment items selected for observation could not be located and upon further investigation by Texas Biomed, it was determined that the equipment was contributor-funded and not federally funded and should not have been on federally funded equipment list.

Three of 40 federally funded equipment items selected for observation could not be located. During the most recent physical inventory performed by Texas Biomed in October 2016, these three items were not located by Texas Biomed and the discrepancies between the physical inventory and the equipment records were not investigated further.

Corrective Action:

It is our intention to both address inaccuracies in our records and to improve our processes and controls. This will be done in two phases:

Phase 1 – Assess and Correct Existing Records

Confirm accurate records for all federal assets at TBRI

In conjunction with the 2017 physical inventory, we will conduct a thorough analysis of our asset records within Oracle, to verify that all assets are accurately classified as Federal or Nonfederal. Part of this process will include reviewing purchase records for assets in order to identify the correct funding source.

Confirm all required data in each record, including tag number and location

Per the Uniform Guidance, property records must be maintained that include:



- A description of the property
- A serial number or other identification number
- The source of funding for the property (including the FAIN)
- Title holder
- Acquisition date
- Historical Cost
- Percentage of Federal participation in the project costs for the Federal award under which the property was acquired
- Location
- Condition
- Ultimate disposition data including the date of disposal and sale price of the property.

Part of the analysis of our asset records will be to verify that all required information is recorded for each Federal asset. Records will be updated to include any elements found to be missing.

Phase 2 – Implement Process Improvements

Acquisition of Capital Property:

Inventory records for each asset will reviewed and updated as necessary, to ensure that all information required by the Uniform Guidance is included. In addition, all documentation related to the creation of a new asset record will be centrally located for future reference. Processes for managing property acquisition will consider the acquisition of assets via purchases, transfers between department, and transfers to/from another institution. It is anticipated that assets may also be located that are of an unknown origin. These assets will be recorded as a new internal asset with an estimated book value.

Asset Management

Processes and controls for managing active assets will be evaluated and enhanced. Such processes will take into consideration, at a minimum, permanent location changes, changes in departmental management, and changes in asset manager. A key element in these processes will be the physical inventory, which will be performed at least every two years. After the physical inventory is complete, the Accounting Manager or Accounting Director will verify that all changes noted during the inventory process have been updated in Oracle, and that all documentation for each update to Oracle has been completed, signed, and filed for future reference.

After records are updated in Oracle, updated inventory lists will be forwarded to each department. After review of the updated lists, the Department Chair or Director will be required to sign off on the accuracy of the list.

Throughout 2017, we will be evaluating the potential benefits of performing the physical inventory on an annual basis, or on a “rolling” schedule. We also intend to evaluate barcoding systems for implementation in 2018.

Retirement of Assets



Assets will be retired from official inventory if they are found to be obsolete. In the case of Federal assets, retirements will be coordinated with the Office of Sponsored Programs to ensure full compliance with the requirements of the grant/contract that funded the asset purchase.

Responsible Party: Keith Davis, CFO

Daniel Anzak, Director of Finance

Anticipated Completion Date: October 31, 2017