

CONSOLIDATED FINANCIAL STATEMENTS
AND REPORTS ON FEDERAL AWARD PROGRAMS

Texas Biomedical Research Institute
Years Ended December 31, 2017 and 2016
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, 2017 and 2016

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>	27
Report of Independent Auditors on Compliance for the Major Federal Program; Report on Internal Control Over Compliance Required by the Uniform Guidance	29
Schedule of Expenditures of Federal Awards.....	32
Notes to Schedule of Expenditures of Federal Awards	36
Schedule of Findings and Questioned Costs.....	37



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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, 2017 and 2016, 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 audits. We conducted our audits 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

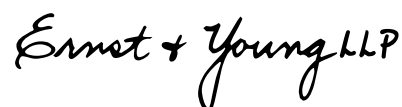
In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Texas Biomedical Research Institute as of December 31, 2017 and 2016, and the changes in its net assets and its cash flows for the year then ended in conformity with U.S. generally accepted accounting principles.

Supplementary information

Our audit was conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The schedule of expenditures of federal awards as required by Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* is presented for purposes of additional analysis and is not a required part of the consolidated 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 consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated, in all material respects, in relation to the consolidated financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we also have issued our report dated June 5, 2018, 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 solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of Texas Biomedical Research Institute's 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, 2018

Texas Biomedical Research Institute

Consolidated Statements of Financial Position

	December 31	
	2017	2016
Assets		
Cash and cash equivalents	\$ 817,384	\$ –
Accounts receivable	5,975,169	5,805,356
Prepaid expenses and supplies	242,607	158,539
Assets limited as to use:		
Cash	2,409,065	2,961,024
Investments (Note 2)	119,397,804	110,746,149
Investment – Evestra, Inc.	2,821,861	2,821,861
Funds held in trust by others (Note 3)	2,575,529	2,096,860
Land, buildings and equipment, net (Note 6)	66,627,380	66,206,621
Total assets	\$ 200,866,799	\$ 190,796,410
Liabilities and net assets		
Liabilities:		
Accounts payable	\$ 4,113,350	\$ 4,230,211
Accrued wages, vacation and other liabilities	2,894,529	3,336,554
Unearned revenue	2,091,184	1,481,017
Notes payable (Note 8)	15,058,239	4,052,775
Total liabilities	24,157,302	13,100,557
Net assets:		
Net assets without donor restrictions	115,929,384	120,348,876
Net assets with donor restrictions	60,780,113	57,346,977
Total net assets	176,709,497	177,695,853
Total liabilities and net assets	\$ 200,866,799	\$ 190,796,410

See accompanying notes.

Texas Biomedical Research Institute

Consolidated Statements of Activities

	Year Ended December 31	
	2017	2016
Changes in net assets without donor restrictions:		
Revenues and gains:		
Grants and contracts	\$ 36,909,753	\$ 36,458,781
Contributions	2,640,143	2,940,156
Investment income	13,082,210	5,081,311
Royalty income	1,030,778	803,332
Insurance proceeds	200,000	1,757,541
Other revenue	185,280	408,413
Total revenues and gains without donor restrictions	54,048,164	47,449,534
Net assets released from restrictions	4,515,606	3,933,491
Total revenues, gains and other support without donor restrictions	58,563,770	51,383,025
Expenses and losses:		
Salaries and benefits	31,868,366	30,440,658
Supplies	7,295,681	7,214,646
Services and professional fees	6,531,132	6,401,701
Subcontracts	3,746,903	1,132,392
Utilities	2,551,930	2,329,964
General insurance	586,838	522,862
Travel	459,100	340,906
Depreciation expense	7,288,845	6,891,999
Other expenses	2,620,773	2,754,584
Total expenses	62,949,568	58,029,712
Loss on sale of assets	33,694	9,705
Total expenses and losses	62,983,262	58,039,417
Decrease in net assets without donor restrictions	(4,419,492)	(6,656,392)
Changes in net assets with donor restrictions:		
Investment income	6,108,382	2,431,111
Contributions	1,840,360	1,311,867
Net assets released from restrictions	(4,515,606)	(3,933,491)
Increase (decrease) in net assets with donor restrictions	3,433,136	(190,513)
Decrease in total net assets	(986,356)	(6,846,905)
Beginning net assets	177,695,853	184,542,758
Ending net assets	\$ 176,709,497	\$ 177,695,853

See accompanying notes.

Texas Biomedical Research Institute
Consolidated Statements of Cash Flows

	Year Ended December 31	
	2017	2016
Operating activities		
Decrease in net assets	\$ (986,356)	\$ (6,846,905)
Adjustments to reconcile decrease in net assets to net cash used in operating activities:		
Depreciation	7,288,845	6,891,999
Loss on sale of assets, net	33,694	9,705
Net investment income	(19,415,355)	(7,726,575)
Contributions revenue with donor restrictions	(1,840,360)	(1,157,535)
Changes in operating assets and liabilities:		
Accounts receivable	(395,017)	856,600
Prepaid expenses and supplies	(84,068)	182,314
Accounts payable and accrued expenses	(558,888)	334,733
Unearned revenue	1,139,828	(1,383,281)
Net cash used in operating activities	(14,817,677)	(8,838,945)
Investing activities		
Purchases of plant and equipment	(7,744,803)	(5,356,852)
Sale of plant and equipment	1,505	241,775
Purchases of investments	(23,127,701)	(8,429,332)
Sale of investments	33,913,700	13,399,118
Net cash provided by (used in) investing activities	3,042,701	(145,291)
Financing activities		
Proceeds from notes payable	11,287,380	2,300,000
Payments on notes payable	(281,917)	(945,579)
Proceeds from contributions with donor restrictions	1,586,897	1,924,793
Net cash provided by financing activities	12,592,360	3,279,214
Increase (decrease) in cash and cash equivalents	817,384	(5,705,022)
Cash and cash equivalents at beginning of year	–	5,705,022
Cash and cash equivalents at end of year	\$ 817,384	\$ –
Supplemental disclosure of cash flow information		
Interest paid	\$ 243,525	\$ 50,009

See accompanying notes.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements

December 31, 2017

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 years ended December 31, 2017 and 2016, 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 a percentage of its earnings to Texas Biomed to be used for operations. The contribution was 8% in 2017 and 4% in 2016. As of December 31, 2017 and 2016, 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 (U.S. 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)

In 2016, Texas Biomed adopted Financial Accounting Standards Board (FASB), Accounting Standards Update (ASU) 2016-14, *Not-for-Profit Entities (Topic 958), Presentation of Financial Statements of Not-for-Profit Entities*. ASU 2016-14 changed certain financial statement requirements for not-for-profit (NFP) entities within the scope of Accounting Standards Codification (ASC) 958. Texas Biomed no longer distinguishes donor restricted resources between temporary and permanent restrictions on the face of the financial statements. Texas Biomed presents expenses by their natural and functional classification and presents investment returns net of external and direct internal investment expenses. Texas Biomed also provides more information about available resources and liquidity.

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.

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 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

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

the trailing 12-quarter rolling average value of the endowment funds computed annually. For 2017, the Board temporarily increased the spending formula to 8% of the trailing 12-quarter rolling average.

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 with 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 12 limited partnerships and 2 trusts. The limited partnerships and trusts are recorded at fair value, based on the net asset value of the units held by Texas Biomed.

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 donor 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.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

1. Significant Accounting Policies (continued)

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 donor 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 donor restricted corpus being recorded as income without donor restrictions.

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

	December 31	
	2017	2016
Subject to expenditure for specified purpose:		
Research	\$ 5,293,521	\$ 5,575,566
Subject to spending policy and appropriation:		
Endowments (including amounts above original gift amount), which, once appropriated, is expendable to support:		
Research	21,036,044	17,799,533
Any activities of Texas Biomed	10,929,047	10,929,047
Not subject to appropriation or expenditure:		
Endowments held in perpetuity	23,521,501	23,042,831
Total net assets with donor restrictions	\$ 60,780,113	\$ 57,346,977

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

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. The amount of total land, buildings and equipment acquired with federal funds, less accumulated depreciation, is \$11,254,042 and \$11,713,789 as of December 31, 2017 and 2016, 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 donor restricted support.

Retirement Plan

Texas Biomed's qualified defined contribution 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 contributions 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 (the 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 for employer contributions to the plan were allocated to the various grants, contracts, and departments of Texas Biomed in the amount of \$1,950,436 and \$1,880,156 in 2017 and 2016, respectively.

Texas Biomed's Supplemental Executive Retirement Plan, a non-qualified defined contribution plan, provides 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. During the year ended December 31, 2017, contributions were made to the plan totaling \$4,568. No employer contributions were made to the plan in 2016.

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 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 tax liability resulting from such unrelated business income in 2017 or 2016. 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 Internal Revenue Service (IRS). Management has analyzed the tax positions taken by Texas Biomed and has concluded that, as of December 31, 2017, 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.

The Tax Cuts and Jobs Act (Act) was enacted on December 22, 2017. The Act reduces the U.S. federal corporate tax rate from 35% to 21%. For tax-exempt entities, the Act also requires organizations to categorize certain fringe benefit expenses as a source of unrelated business income, pay an excise tax on remuneration above certain thresholds that is paid to certain executives by the organization, and report income or loss from unrelated business activities on an activity-by-activity basis, among other provisions. Certain regulatory guidance provides for a measurement period of up to one year during which the accounting for the tax effects of the Act may be completed. Texas Biomed will continue to evaluate the impact of the Act and may record adjustments as additional information and guidance is released by the IRS on provisions of the Act that impact tax-exempt organizations.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

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) The composition of these securities is set forth as follows:

	December 31	
	2017	2016
Mutual funds	\$ 56,962,073	\$ 45,796,849
Limited partnerships and trusts	62,435,731	64,949,300
	\$ 119,397,804	\$ 110,746,149

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	
	2017	2016
Dividends and interest earned on investments	\$ 1,674,216	\$ 1,449,912
Net realized gain on investments reported at fair value	1,254,228	703,853
Net unrealized gain on investments reported at fair value	16,758,132	5,848,131
Investment expenses netted against income	(495,984)	(489,474)
Total investment income	\$ 19,190,592	\$ 7,512,422

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

2. Investments (continued)

	December 31	
	2017	2016
Net asset classification of investment income:		
Without donor restrictions	\$ 13,082,210	\$ 5,081,311
With donor restrictions	6,108,382	2,431,111
Total investment income	<u>\$ 19,190,592</u>	<u>\$ 7,512,422</u>

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, 2017 and 2016, Texas Biomed's investments in oil and gas mineral interests are \$0. For the years ended December 31, 2017 and 2016, royalty income from oil and gas mineral interests are \$1,030,778 and \$803,332.

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, 2017 and 2016, Texas Biomed owns 37% and 45%, respectively, of Evestra's common stock and has two of four voting representatives on Evestra's board; therefore, it is accounted for as an equity investment. As of December 31, 2017 and 2016, Texas Biomed's investment in Evestra is \$2,821,861. No income has been received from Evestra for the years ended December 31, 2017 and 2016.

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, 2017 and 2016. 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 net assets with donor restrictions.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

3. Funds Held in Trust by Others (continued)

	December 31	
	2017	2016
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	\$ 2,575,529	\$ 2,096,860
Unrealized gain (loss) in Texas Biomed’s 10% interest	478,669	(30,647)

4. Fair Value Measurements

ASC 820, *Fair Value Measurement and Disclosure*, 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, 2017 and 2016, 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, 2017, Using:			
	December 31, 2017	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	\$ 32,424,363	\$ 32,424,363	\$ –	\$ –
International equities	11,831,831	11,831,831	–	–
U.S. fixed-income securities	7,590,026	7,590,026	–	–
Emerging markets	5,115,853	5,115,853	–	–
Total mutual funds	<u>56,962,073</u>	<u>\$ 56,962,073</u>	<u>\$ –</u>	<u>\$ –</u>
Investments measured at net asset value:				
Limited partnerships and trusts:				
U.S. equities	16,789,322			
International equities	24,732,111			
Global fixed-income securities	1,679,352			
Hedge funds	19,234,946			
Total measured at net asset value	<u>62,435,731</u>			
Total investments at fair value	<u>\$ 119,397,804</u>			
Funds held in trust by others	<u>\$ 2,575,529</u>	<u>\$ –</u>	<u>\$ –</u>	<u>\$ 2,575,529</u>

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

	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	45,796,849	\$ 45,796,849	\$ –	\$ –
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	64,949,300			
Total investments at fair value	\$ 110,746,149			
Funds held in trust by others	\$ 2,096,860	\$ –	\$ –	\$ 2,096,860

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, 2017				
U.S. equities ^(a)	\$ 16,789,322	\$ –	Quarterly	30 days
International equities ^(b)	24,732,110	–	Monthly	10 days
Global fixed-income securities ^(c)	1,679,352	–	Daily–monthly	10 days
Hedge funds ^(d)	19,234,946	–	Monthly–annually	30–90 days
	<u>\$ 62,435,730</u>	<u>\$ –</u>		
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	10–15 days
Hedge funds ^(d)	27,246,618	–	Monthly–annually	10–90 days
	<u>\$ 64,949,300</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. Their strategy is to invest in a broad spectrum of stocks covering growth and value stocks and a range of industries. This includes seeking long-term capital appreciation and investing in out-of-favor companies at attractive valuations.

^(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. They focus on maximizing intrinsic value in the form of earnings, assets and dividends provided by their companies and aggregated within their portfolio by implementing a strong price discipline and by quality appraisals which seeks to identify strong companies.

^(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. Their strategy is to seek global bond investments offering high yield and attractive fundamentals, maintaining primary focus on sovereign debt with a goal of unlocking potential benefits of mean-reversion tendencies in interest rates and currency valuations.

^(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.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

4. Fair Value Measurements (continued)

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.

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, 2015	\$ 2,127,507
Unrealized loss included in the consolidated statement of changes in net assets	<u>(30,647)</u>
Balance, December 31, 2016	2,096,860
Unrealized gain included in the consolidated statement of changes in net assets	<u>478,669</u>
Balance, December 31, 2017	<u><u>\$ 2,575,529</u></u>

5. Contributions Receivable

As of December 31, 2017 and 2016, Texas Biomed has received unconditional promises to give totaling \$57,272 and \$282,478, 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:

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

5. Contributions Receivable (continued)

	December 31	
	2017	2016
Promises to give:		
Less than one year	\$ 42,000	\$ 261,827
One to five years	17,500	30,000
	59,500	291,827
Less amount to reduce to present value	2,228	9,349
Contributions receivable	\$ 57,272	\$ 282,478

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 and Equipment

At December 31, 2017 and 2016, land, buildings and equipment, less total accumulated depreciation were as follows:

	December 31,	
	2017	2016
Argyle, buildings and improvements	\$ 9,471,062	\$ 8,751,264
Land	359,959	359,959
Buildings and improvements	112,916,394	108,534,965
Fixtures and equipment	35,857,695	35,085,564
Construction in progress	1,122,508	1,812,128
Less: Accumulated depreciation	(93,100,238)	(88,337,259)
Net land, buildings and equipment	\$ 66,627,380	\$ 66,206,621

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.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

6. Land, Buildings and Equipment (continued)

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.

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, 2017 and 2016, is as follows:

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

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

	Net Assets Without Donor Restrictions	Net Assets With Donor Restrictions	Total
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
Contributions	489,402	1,361,691	1,851,093
Investment income	910,482	441,271	1,351,753
Net unrealized/realized gain on investments	12,164,347	5,667,111	17,831,458
Gain on funds held in trust by others	–	478,669	478,669
Net assets released from program restrictions	–	(4,515,606)	(4,515,506)
Appropriation of endowment assets for expenditure	(6,455,139)	–	(6,455,139)
Endowment net assets at December 31, 2017	<u>\$ 71,596,528</u>	<u>\$ 60,780,113</u>	<u>\$ 132,376,741</u>

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 Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

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

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, 2017 and December 31, 2016.

8. Notes Payable

Borrowed funds are shown in the consolidated statement of financial position as notes payable.

Interest expense is reported in the consolidated statement of activities under other expenses. Interest expense totaled \$243,525 and \$50,009 for the years ended December 31, 2017 and 2016, respectively.

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 was a declining revolving line of credit in which the principal could not exceed the following:

1. For the period from October 12, 2012 through October 11, 2014, \$15,000,000.
2. For the period from October 12, 2014 through October 11, 2015, \$12,000,000.
3. For the period from October 12, 2015 through October 11, 2016, \$9,000,000.
4. For the period from October 12, 2016 through October 12, 2017, \$5,000,000.

The note had a fixed interest rate of 2.4% and matured on October 12, 2017. The unpaid principal balance was \$0 and \$2,067,775 at December 31, 2017 and 2016, respectively.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

8. Notes Payable (continued)

Line of Credit

Texas Biomed had a \$2,000,000 one-year line of credit with a financial institution that was paid off on September 5, 2017. The interest rate was variable based on changes in the London Interbank Offered Rate (LIBOR) for one month as quoted in the most recently published issue of *The Wall Street Journal*. As of December 31, 2017, all interest due on the line of credit was paid by Texas Biomed.

On June 6, 2017, Texas Biomed entered into a new unsecured promissory note for a \$3,000,000 one-year line of credit with a financial institution available through June 5, 2018. The line of credit may be extended each year. The interest rate was variable based on changes in LIBOR for three months as quoted in the most recently published issue of *The Wall Street Journal*. The amount outstanding was \$3,000,000 as of December 31, 2017.

On August 25, 2017, Texas Biomed entered into an agreement for a \$15,000,000 secured revolving line of credit with a financial institution available through August 25, 2020. As of December 31, 2017, the amount outstanding was \$12,058,239. The interest rate is variable based on changes in the LIBOR for one month as quoted in the most recently published issue of *The Wall Street Journal* plus 1.50% per annum. As of December 31, 2017, all interest due on the line of credit was paid by Texas Biomed. Unrestricted securities are pledged as collateral on the line of credit.

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 and 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.

	Research Program Activities	Supporting Activities			Total Expenses
		General & Admin	Fund-Raising	Supporting Subtotal	
Salaries and benefits	\$ 13,675,421	\$ 17,654,472	\$ 538,473	\$ 18,192,945	\$ 31,868,366
Supplies	4,501,247	2,793,676	758	2,794,434	7,295,681
Services and professional fees	976,439	5,328,037	226,656	5,554,693	6,531,132
Subcontracts	3,673,886	73,017	–	73,017	3,746,903
Utilities	–	2,551,930	–	2,551,930	2,551,930
General insurance	–	586,838	–	586,838	586,838
Travel	95,536	354,659	8,905	363,564	459,100
Depreciation expense	211,228	7,077,617	–	7,077,617	7,288,845
Other expenses	227,327	2,330,005	63,441	2,393,446	2,620,773
	<u>\$ 23,361,084</u>	<u>\$ 38,750,251</u>	<u>\$ 838,233</u>	<u>\$ 39,588,484</u>	<u>\$ 62,949,568</u>

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

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.

	December 31	
	2017	2016
Financial assets	\$ 134,239,419	\$ 124,589,789
Less those unavailable for general expenditures within one year, due to:		
Contractual or donor-imposed restrictions	<u>(60,780,113)</u>	<u>(57,346,977)</u>
Financial assets available to meet cash needs for general expenditures within one year	<u>\$ 73,459,306</u>	<u>\$ 67,242,812</u>

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.

Texas Biomedical Research Institute

Notes to Consolidated Financial Statements (continued)

12. Subsequent Events

Texas Biomed has evaluated subsequent events through June 5, 2018, the date the accompanying consolidated financial statements were available to be issued.

On April 4, 2018, Texas Biomed increased the \$15,000,000 revolving line of credit by \$5,000,000 in order to consolidate outstanding balances on other loan agreements and to allow for spending in accordance with the strategic plan. The amount outstanding as of June 5, 2018 was \$20,000,000.

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 statement of financial position as of December 31, 2017, and the related consolidated statements of activities, 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, 2018.

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 effectiveness of 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, 2018



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Report of Independent Auditors on Compliance for the Major Federal Program; Report on Internal Control Over Compliance 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, 2017. 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 the requirements of 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, 2017.

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 2017-001 – Period of Performance. 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 a 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 have not been identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified a deficiency in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item 2017-001 – Period of Performance, that we consider to be a significant deficiency.

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.

Ernst + Young LLP

June 5, 2018

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards
Year Ended December 31, 2017

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Federal Expenditures			Amounts Provided to Subrecipients
					Direct	Pass-Through	Total	
Research and Development Cluster								
U.S. Department of Defense								
Advanced Research Projects Agency	Advanced Research Projects Agency							
	Research and Technology Development	12.910	The General Hospital Corporation	227668	\$ -	\$ 61,490	\$ 61,490	\$ -
	Subtotal Research and Technology Development				-	61,490	61,490	-
TOTAL Advanced Research Projects Agency					-	61,490	61,490	-
Defense Threat Reduction Agency	Defense Threat Reduction Agency							
	Cepharanthine/Chloroquine Combination for Prophylaxis for Treatment of Ebola	12.HDTRA1-16-C-0020	Southwest Research Institute	I999050CP	-	228,230	228,230	-
	Subtotal Cepharanthine/Chloroquine Combination for Prophylaxis for Treatment of Ebola				-	228,230	228,230	-
TOTAL Defense Threat Reduction Agency					-	228,230	228,230	-
Office of the Secretary of Defense	Department of Defense							
	In vitro and in vivo Characterizations of Alphaviruses	12.unknown			677,527	-	677,527	-
	In vitro and in vivo Characterization of Filoviruses through the Exploration of Various Vaccine Candidates	12.unknown			727,087	-	727,087	-
	Subtotal				1,404,614	-	1,404,614	-
TOTAL Office of the Secretary of Defense					1,404,614	-	1,404,614	-
U.S. Army Medical Command	U.S. Army Medical Research Acquisition Activity							
	Military Medical Research and Development	12.420			199,943	-	199,943	-
		12.420	University of Texas Health Science Center at San Antonio	159421/155536	-	99,133	99,133	-
	Subtotal Military Medical Research and Development				199,943	99,133	299,076	-
TOTAL U.S. Army Medical Command					199,943	99,133	299,076	-
TOTAL U.S. Department of Defense					1,604,557	388,853	1,993,410	-
U.S. Department of Health and Human Services								
Food and Drug Administration	DHHS/FDA/OAGS							
	Bordetella-Free Weanling Baboons Purchase of 20 Baboons (10 males and 10 females); all laboratory work; and transport to Maryland.	93.unknown	Board of Regents of the University of Oklahoma	OUHSC-0000078843	257,367	-	257,367	-
	Subtotal				-	145,749	145,749	-
TOTAL Food and Drug Administration					257,367	145,749	403,116	-
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	-	-	-	-
		93.360	IIT Research Institute	144-0-2378-001-RL/TO 002	-	3,557	3,557	-
		93.360	IIT Research Institute	144-0-2378-001-RL/TO 002	-	212,707	212,707	-
		93.360	IIT Research Institute	144-0-2378-001-RL	-	1,992,161	1,992,161	-
	Subtotal Biomedical Advanced Research and Development Authority (BARDA), Biodefense Medical Countermeasure Development				-	2,208,425	2,208,425	-
TOTAL Office of the Secretary					-	2,208,425	2,208,425	-

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2017

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Federal Expenditures			Amounts Provided to Subrecipients
					Direct	Pass-Through	Total	
Research and Development Cluster (continued)								
U.S. Department of Health and Human Services (continued)								
National Institute of Health								
National Institute of Environmental Health Sciences	Environmental Health	93.113	Johns Hopkins University Bloomberg School of Public Health	PO#2002698260	\$ -	\$ (17,130)	\$ (17,130)	\$ -
		93.113	The Trustees of Columbia University in the City of New York	3(GG013113-01)	-	114,345	114,345	-
	Subtotal Environmental Health				-	97,215	97,215	-
National Institute of Dental and Craniofacial Research	Oral Diseases and Disorders Research	93.121			339,150	-	339,150	118,309
	Subtotal Oral Diseases and Disorders Research				339,150	-	339,150	118,309
National Human Genome Research Institute	Human Genome Research	93.172	University of North Carolina	5104465	-	9,957	9,957	-
	Subtotal Human Genome Research				-	9,957	9,957	-
National Institute of Mental Health	Mental Health Research Grants	93.242	The University of Texas Rio Grande Valley	5R01MH094115(01)	-	39,071	39,071	-
		93.242			31,488	-	31,488	3,015
	Subtotal Mental Health Research Grants				31,488	39,071	70,559	3,015
NIH Office of the Director	Trans-NIH Research Support	93.310			224,956	-	224,956	-
	Subtotal Trans-NIH Research Support				224,956	-	224,956	-
NIH Office of the Director	Research Infrastructure Programs	93.351	The Regents of the University of California, San Francisco	8313sc	-	390,289	390,289	-
		93.351	University of Wyoming	1002740C-TBRI	-	226,728	226,728	-
		93.351	University of Colorado Denver	FY16.745.001	-	161,900	161,900	-
		93.351			7,563,999	-	7,563,999	144,333
		93.351			2,763,840	-	2,763,840	-
		93.351			642,277	-	642,277	336,234
	Subtotal Research Infrastructure Programs				10,970,116	778,917	11,749,033	480,567
National Heart, Lung, and Blood Institute	Cardiovascular Diseases Research	93.837	University of Alabama at Birmingham	000509019-001	-	7,295	7,295	-
		93.837			633,283	-	633,283	-
		93.837			192,075	-	192,075	-
		93.837			96,898	-	96,898	-
	Subtotal Cardiovascular Diseases Research				922,256	7,295	929,551	-
National Institute of Arthritis and Musculoskeletal and Skin Diseases	Arthritis, Musculoskeletal and Skin Diseases Research	93.846	Southwest Research Institute	1418GC0001	-	130,787	130,787	-
		93.846	Southwest Research Institute	H99062RI	-	22,415	22,415	-
		93.846	Regents of the University of Colorado	1418GC0001	-	35,833	35,833	-
	Subtotal Arthritis, Musculoskeletal and Skin Diseases Research				-	189,035	189,035	-
National Institute of Diabetes and Digestive and Kidney Diseases	Diabetes, Digestive, and Kidney Diseases Extramural Research	93.847	University of North Carolina	5102861	-	(4,479)	(4,479)	-
		93.847	University of North Carolina	5106663	-	4,479	4,479	-
		93.847	Andrew Technologies, LLC	17-04656	-	77,154	77,154	-
		93.847			31,582	-	31,582	-
		93.847			582,437	-	582,437	382,266
		93.847			20,861	-	20,861	-
	Subtotal Diabetes, Digestive, and Kidney Diseases Extramural Research				634,880	77,154	712,034	382,266

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2017

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Federal Expenditures			Amounts Provided to Subrecipients
					Direct	Pass-Through	Total	
Research and Development Cluster (continued)								
U.S. Department of Health and Human Services (continued)								
National Institute of Health (continued)								
National Institute of Neurological Disorders and Stroke	Extramural Research Programs in the Neurosciences and Neurological Disorders	93.853	Trinity University	26-1342523-TXBIO	\$ -	\$ 7,239	\$ 7,239	\$ -
	<i>Subtotal Extramural Research Programs in the Neurosciences and Neurological Disorders</i>				-	7,239	7,239	-
National Institute of Allergy and Infectious Diseases	Allergy and Infectious Diseases Research	93.855	Battelle	403732	-	214,646	214,646	-
		93.855	Battelle	521876	-	823,682	823,682	-
		93.855	Emory University	T058636 (S611293)	-	194,029	194,029	-
		93.855	The Regents of the University of CA, Santa Cruz	A00-2044-S002-S0183838	-	66,873	66,873	-
		93.855	University of Louisville Research Foundation, Inc	ULRF 12-0393-02	-	2,029	2,029	-
		93.855	UTHSCSA	158423/158421	-	132,622	132,622	-
		93.855	Purdue University	4102-68572	-	234,206	234,206	-
		93.855	The Scripps Research Institute	PO No.5-52639	-	43,095	43,095	-
		93.855	The Scripps Research Institute	PO No.5-53116	-	33,241	33,241	-
		93.855	The Washington University	WU-17-31	-	199,026	199,026	-
		93.855	The Washington University	WU-17-31-Mod 1	-	47,995	47,995	-
		93.855	The Washington University	WU-17-48	-	258,910	258,910	-
		93.855	The Washington University	WU-17-48-Mod 1	-	47,559	47,559	-
		93.855	The Rector and Visitors of the University of Virginia	GB10400 154344	-	20,175	20,175	-
		93.855	Board of Regents of University of Georgia	SP00012813-03	-	116,795	116,795	-
		93.855	University of Notre Dame	203189TBRI	-	22,090	22,090	-
		93.855	The UTHSC at Houston	0012911A	-	23,196	23,196	-
		93.855			795,285	-	795,285	-
		93.855			536,925	-	536,925	-
		93.855			410,062	-	410,062	-
		93.855			466,743	-	466,743	-
		93.855			752,804	-	752,804	52,675
		93.855			203,618	-	203,618	-
		93.855			176,343	-	176,343	-
		93.855			915,039	-	915,039	287,484
		93.855			188,802	-	188,802	-
		93.855			958,900	-	958,900	420,009
		93.855			4,110,534	-	4,110,534	1,768,201
		93.855			59,256	-	59,256	-
	<i>Subtotal Allergy and Infectious Diseases Research</i>				9,574,311	2,480,169	12,054,480	2,528,369
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	-	240,048	240,048	-
	<i>Subtotal Targeting Therapeutics Development to Relieve Bottlenecks: Optimizing Lead Therapeutic Compounds against Infectious Pathogen</i>				-	240,048	240,048	-

Texas Biomedical Research Institute
Schedule of Expenditures of Federal Awards (continued)
Year Ended December 31, 2017

Cluster/Federal Agency/Major Subdivision/Federal Grantor	CFDA Name/Project Name	CFDA #	Pass-Through Entity (PTE)	PTE Subaward #	Federal Expenditures			Amounts
					Direct	Pass-Through	Total	Provided to Subrecipients
Research and Development Cluster (continued)								
U.S. Department of Health and Human Services (continued)								
National Institute of Health (continued)								
National Institute of Allergy and Infectious Diseases	Measurement of Cytokines in both Merocel Spear Eluates and Cervicovaginal Lavages	93.unknown	Quality Biological, Inc	PO#39878;PO#41112; PO#41140	\$ -	\$ 483	\$ 483	\$ -
	<i>Subtotal Measurement of Cytokines in both Merocel Spear Eluates and Cervicovaginal Lavages</i>				-	483	483	-
National Institute of General Medical Sciences	Biomedical Research and Research Training	93.859			373,568	-	373,568	82,765
	<i>Subtotal Biomedical Research and Research Training</i>				373,568	-	373,568	82,765
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	083814-00001	-	154,659	154,659	-
		93.865	The Board of Trustees University of Illinois	15966	-	21,348	21,348	-
		93.865	University of Wyoming	1002696-TBRI-Year2	-	141,930	141,930	-
		93.865	University of Wyoming	1002696-TBRI-Year3	-	186,949	186,949	-
		93.865	Wake Forest University BMC	WFUHS 440567	-	227,872	227,872	-
	<i>Subtotal Child Health and Human Development Extramural Research</i>				-	732,758	732,758	-
National Institute on Aging	Aging Research	93.866	Emory University	T360102	-	17,763	17,763	-
	<i>Subtotal Aging Research</i>				-	17,763	17,763	-
TOTAL National Institute of Health					23,070,725	4,677,104	27,747,829	3,595,291
TOTAL - U.S. Department of Health and Human Services					23,328,092	7,031,278	30,359,370	3,595,291
TOTAL RESEARCH AND DEVELOPMENT CLUSTER					24,932,649	7,420,131	32,352,780	3,595,291
TOTAL EXPENDITURES OF FEDERAL AWARDS					\$ 24,932,649	\$ 7,420,131	\$ 32,352,780	\$ 3,595,291

See accompanying notes to schedule of expenditures of federal awards.

Texas Biomedical Research Institute

Notes to Schedule of Expenditures of Federal Awards

December 31, 2017

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, 2017. 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	\$ 36,909,753
Less amounts not subject to Uniform Guidance	4,556,973
Total federal award expenditures	<u>\$ 32,352,780</u>

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs

Year Ended December 31, 2017

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)

Identification of major federal programs

<u>CFDA number(s)</u>	<u>Name of federal program or cluster</u>
12.910, 12.HDTRA1-16-C-0020, 12.UNKNOWN, 12.420, 93.UNKNOWN, 93.360, 93.113, 93.121, 93.172, 93.242, 93.310, 93.351, 93.837, 93.846, 93.847, 93.853, 93.855, 93.HHSN272201500015C, 93.859, 93.865, 93.866	Research and Development Cluster

Dollar threshold used to distinguish between Type A and Type B programs: _____ \$970,583

Auditee qualified as low-risk auditee? X yes no

Section II – Financial Statement Findings

This section identifies the significant deficiencies, material weaknesses, fraud, noncompliance with provisions of laws, regulations, contracts and grant agreements, and abuse related to the financial statements for which *Government Auditing Standards* requires reporting.

No findings were noted.

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 2017-001 – Period of Performance

Information on the federal program:

U.S. Department of Health and Human Services – National Institute of Health
Research and Development Cluster
93.310 – Trans-NIH Research Support
98.351 – Research Infrastructure Programs
93.855 – Allergy and Infectious Diseases Research

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

In accordance with 2 CFR Section 200.343(b):
Unless the Federal awarding agency or pass-through entity authorizes an extension, a non-Federal entity must liquidate all obligations incurred under the Federal award not later than 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the Federal award.

In accordance with 2 CFR Section 200.71, Obligations are defined as follows:

When used in connection with a non-Federal entity’s utilization of funds under a Federal award, *obligations* means orders placed for property or services, contracts and subawards made, and similar transactions during a given period that require payment by the non-Federal entity during the same or a future period.

Condition:

For four Research and Development cluster expenditures, Texas Biomedical Research Institute (Texas Biomed) did not liquidate the obligations within 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the Federal award.

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

Questioned costs:

\$0

Context:

We selected and tested 25 Research and Development cluster expenditures for the period of performance compliance requirement. Of the 25 expenditures, we selected five expenditures totaling \$82,975 specifically to determine whether Texas Biomed liquidated the expenditures within 90 days after award period end. The five expenditures were selected from a population of 1,024 expenditures totaling \$2.5 million that were charged to awards after the award end date. For one of the five expenditures tested, Texas Biomed liquidated the expenditure more than 90 days after the award end date. Based on the exception noted, we judgmentally selected an additional 15 expenditures from the population of 1,024 expenditures, focusing on the largest expenditures, charged to the award more than 30 days after the award end date, for further testing of liquidation requirements. The additional 15 expenditure selections totaled \$1.4 million. For three of the additional 15 expenditures, Texas Biomed liquidated the expenditure more than 90 days after the award period end.

CFDA Number	Federal Grant Identification Number	Payment Amount	Date of Payment to Vendor	Award End Date	Days Between Award End and Payment
93.351	P51OD011133	\$81,635	November 30, 2017	April 30, 2017	214
93.310	P51OD011133	57,677	August 17, 2017	April 30, 2017	109
93.351	R24OD020347	14,913	July 20, 2017	March 31, 2017	111
93.855	P01AI048240	60,668	October 12, 2017	June 30, 2017	104

Effect

Texas Biomed did not comply with requirement to liquidate obligations within 90 calendar days after the end date of the period of performance specified in the terms and conditions of the Federal award.

Texas Biomedical Research Institute

Schedule of Findings and Questioned Costs (continued)

Cause

In all four instances, invoices from vendors or subrecipients were not received timely by Texas Biomed, 85 days after the award period end in one instance and more than 90 days after the award period end in the other three instances. Despite the untimely invoices, obligations had been incurred by Texas Biomed for each of the four expenditures through purchase orders, contracts or subawards. Texas Biomed's internal control over liquidation of obligations were ineffective during the award close-out process to ensure that payments were made in compliance with the 90-day requirement above.

Identification as a repeat finding, if applicable

N/A

Recommendation

Texas Biomed should ensure that award close-out procedures include a detailed review and follow-up of unliquidated obligations at appropriate intervals during the 90-day close-out period to ensure that all obligations are liquidated within 90 calendar days after the end date of the period of performance of the Federal award.

Views of responsible officials and planned corrective actions:

Texas Biomed is currently implementing a corrective action to ensure that internal control over liquidation of obligations is in compliance with the 90-day requirement as specified in the terms and conditions of the Federal award. The revised award close-out procedures include reviewing a detailed listing of outstanding obligations and accounts payable aging report, and following up and communicating with suppliers and subrecipients regarding outstanding invoices immediately after award ends. These procedures will be performed on a monthly basis to ensure that all obligations are liquidated and paid within 90 days after the end date of the award's period of performance. In addition, periodic staff training on the importance of the 90-day requirement and compliance will be conducted.

Responsible Officials: Keith Davis, Chief Financial Officer and Joan Dixon, Director of Finance

Implementation Date: October 31, 2018

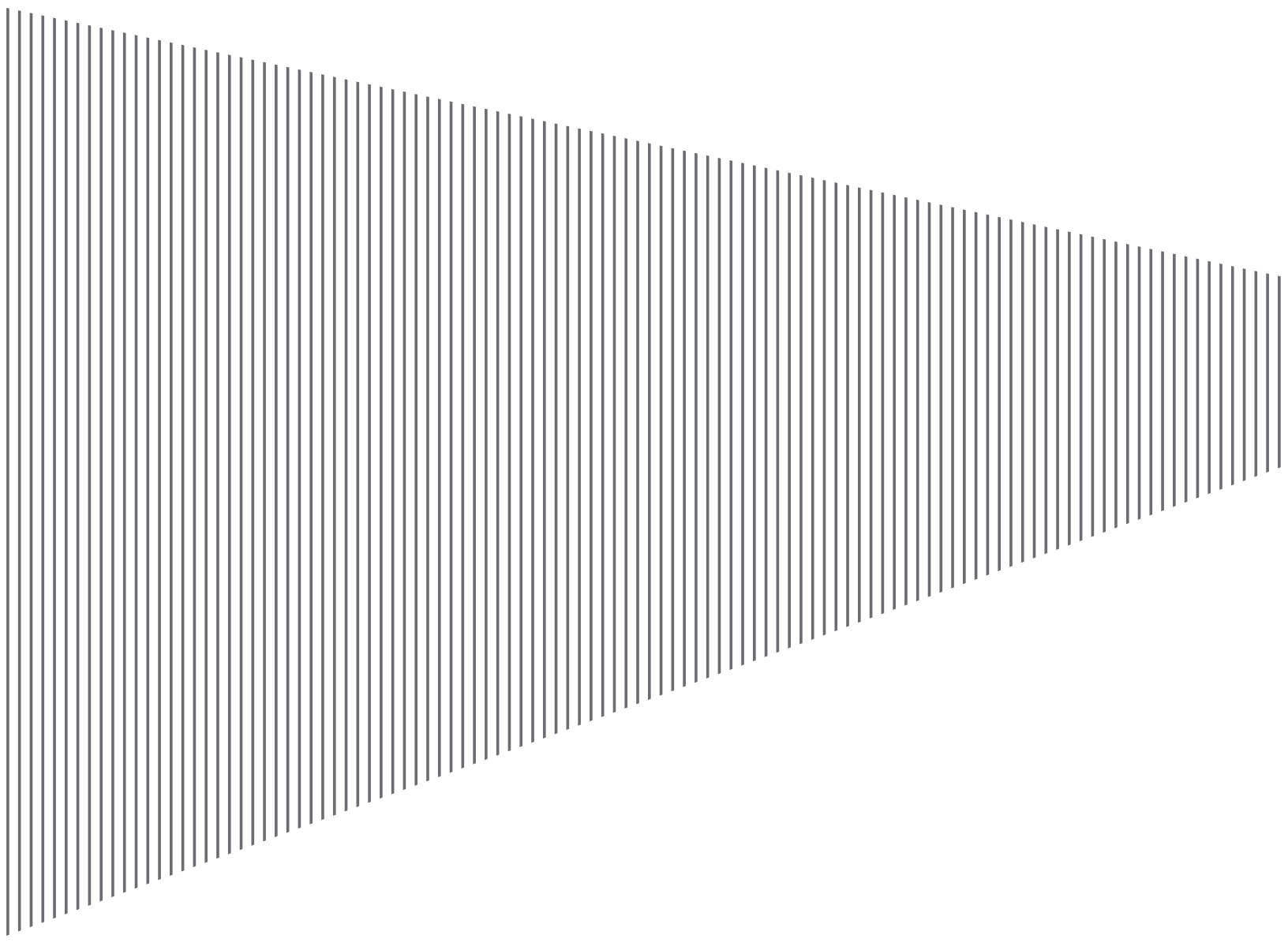
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Summary Schedule of Prior Audit Findings

Year Ended December 31, 2017

Finding 2016-001 – Equipment and Real Property Management

Status: This finding has been corrected.

There were no findings in 2015.



TEXAS BIOMEDICAL RESEARCH INSTITUTE

Corrective Action Plan

Finding 2017-001 – Period of Performance

In accordance with 2 CFR Section 200.343(b):

Unless the Federal awarding agency or pass-through entity authorizes an extension, a non-Federal entity must liquidate all obligations incurred under the Federal award not later than 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the Federal award.

In accordance with 2 CFR Section 200.71, Obligations are defined as follows:

When used in connection with a non-Federal entity's utilization of funds under a Federal award, obligations means orders placed for property or services, contracts and subawards made, and similar transactions during a given period that require payment by the non-Federal entity during the same or a future period.

For four Research and Development cluster expenditures, Texas Biomedical Research Institute (Texas Biomed) did not liquidate the obligations within 90 calendar days after the end date of the period of performance as specified in the terms and conditions of the Federal award.

Corrective Action:

Texas Biomed is currently implementing a corrective action to ensure that internal control over liquidation of obligations is in compliance with the 90-day requirement as specified in the terms and conditions of the Federal award. The revised award close-out procedures include reviewing a detailed listing of outstanding obligations and accounts payable aging report, and following up and communicating with suppliers and subrecipients regarding outstanding invoices immediately after award ends. These procedures will be performed on a monthly basis to ensure that all obligations are liquidated and paid within 90 days after the end date of the award's period of performance. In addition, periodic staff training on the importance of the 90-day requirement and compliance will be conducted.

Responsible Parties: Keith A. Davis, Chief Financial Officer

Joan Dixon, Director of Finance

Anticipated Completion Date: October 31, 2018