



**EASTERN VIRGINIA MEDICAL SCHOOL
AND AFFILIATED ORGANIZATION**

Consolidated Financial Statements

June 30, 2017

(With Independent Auditors' Reports Thereon)

**EASTERN VIRGINIA MEDICAL SCHOOL
AND AFFILIATED ORGANIZATION**

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KPMG LLP
Suite 1900
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Norfolk, VA 23510

Independent Auditors' Report

The Board of Visitors
Eastern Virginia Medical School:

Report on the Financial Statements

We have audited the accompanying consolidated financial statements of Eastern Virginia Medical School and Affiliated Organization (EVMS), which comprise the consolidated balance sheet as of June 30, 2017, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with U.S. generally accepted accounting principles; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' 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 of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from 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 auditors' 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 EVMS' 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 EVMS' 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 Eastern Virginia Medical School and Affiliated Organization as of June 30, 2017, and the changes in their net assets and their cash flows for the year then ended in accordance with U.S. generally accepted accounting principles.



Report on Summarized Comparative Information

We have previously audited EVMS' 2016 consolidated financial statements, and we expressed an unmodified audit opinion on those audited consolidated financial statements in our report dated October 28, 2016. In our opinion, the summarized comparative information presented herein as of and for the year ended June 30, 2016 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated November 6, 2017 on our consideration of EVMS' 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 EVMS' 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 EVMS' internal control over financial reporting and compliance.

KPMG LLP

Norfolk, Virginia
November 6, 2017

**EASTERN VIRGINIA MEDICAL SCHOOL
AND AFFILIATED ORGANIZATION**

Consolidated Balance Sheet

June 30, 2017

(With summarized financial information as of June 30, 2016)

Assets	2017	2016
Current assets:		
Cash and cash equivalents (notes 3 and 7)	\$ 29,090,910	25,723,178
Restricted cash and investments (notes 4 and 7)	5,508,453	4,909,848
Operating investments (notes 4 and 7)	23,172,252	16,294,865
Accounts receivable, net (notes 5 and 9)	24,602,458	24,742,032
Accounts receivable from affiliate (note 6)	1,634,597	338,766
Current portion of notes receivable from students	774,900	856,917
Prepaid expenses and other current assets	2,085,164	3,065,911
Total current assets	<u>86,868,734</u>	<u>75,931,517</u>
Property, plant, and equipment, net (note 8)	121,614,397	125,789,843
Other long-term assets:		
Operating investments (notes 4 and 7)	18,332,216	19,098,464
Notes receivable from students	5,448,703	5,854,999
Interest in net assets of affiliate (note 1)	68,704,398	61,804,379
Other long-term assets	3,664,605	3,549,835
Total other long-term assets	<u>96,149,922</u>	<u>90,307,677</u>
Total assets	<u>\$ 304,633,053</u>	<u>292,029,037</u>
Liabilities and Net Assets		
Liabilities:		
Current liabilities:		
Current portion of long-term debt (note 10)	\$ 4,010,000	3,820,000
Accounts payable – trade	7,713,577	5,318,404
Accrued compensation	7,203,795	9,040,159
Deferred income	4,836,653	5,531,715
Accrued expenses and other current liabilities	9,214,469	15,436,282
Total current liabilities	<u>32,978,494</u>	<u>39,146,560</u>
Long-term debt, excluding current portion and net of bond issuance costs (note 10)	39,246,542	45,518,991
Other long-term liabilities:		
Grant deposits (note 12)	3,359,522	2,853,944
Refundable federal student loans	5,599,771	5,733,042
Assets held for affiliate (note 13)	891,406	872,705
Other long-term liabilities	2,210,245	1,469,011
Total other long-term liabilities	<u>12,060,944</u>	<u>10,928,702</u>
Total liabilities	<u>84,285,980</u>	<u>95,594,253</u>
Net assets:		
Unrestricted:		
Operating	7,763,126	7,399,627
EVMS reserves	28,715,901	26,532,629
Department reserves	46,964,261	34,680,765
Net investment in plant	17,401,248	12,358,401
Parking facility reserves	75,493	78,927
Total unrestricted net assets	<u>100,920,029</u>	<u>81,050,349</u>
Temporarily restricted:		
Revolving student loans	1,722,041	1,740,662
Program restricted	2,370,442	2,443,606
Net investment in plant	46,630,163	49,395,788
Interest in net assets of affiliate (note 1)	68,704,398	61,804,379
Total temporarily restricted net assets	<u>119,427,044</u>	<u>115,384,435</u>
Total net assets	<u>220,347,073</u>	<u>196,434,784</u>
Commitments and contingencies (notes 9, 11 and 18)		
Total liabilities and net assets	<u>\$ 304,633,053</u>	<u>292,029,037</u>

See accompanying notes to consolidated financial statements.

**EASTERN VIRGINIA MEDICAL SCHOOL
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Consolidated Statement of Activities

Year ended June 30, 2017

(With summarized financial information for the year ended June 30, 2016)

	Unrestricted net assets	Temporarily restricted net assets	Total	2016 total
Operating revenues and support:				
Tuition and fees, net	\$ 41,511,122	—	41,511,122	39,302,680
State appropriations (note 14)	24,976,933	—	24,976,933	24,281,243
Municipal subsidies	1,372,944	—	1,372,944	1,371,280
Federal grants and contracts	24,772,208	—	24,772,208	25,480,756
State grants and contracts	990,446	—	990,446	987,015
Private grants, contracts and gifts	3,887,336	—	3,887,336	5,781,247
EVMS Foundation endowment income and gifts	5,753,144	—	5,753,144	5,931,555
Patient care services, net	57,059,568	—	57,059,568	58,085,079
Contractual services of graduate school residents	34,903,901	—	34,903,901	32,775,599
Contractual services	22,938,074	—	22,938,074	22,708,227
Sales and services of auxiliary enterprises	6,303,650	—	6,303,650	6,278,061
Other sources (note 15)	22,001,553	563,145	22,564,698	11,450,904
Interest and investment income	820,078	14,326	834,404	476,086
Released from restriction	3,434,881	(3,434,881)	—	—
Total operating revenues and support	250,725,838	(2,857,410)	247,868,428	234,909,732
Operating expenses (notes 11, 16, and 17):				
Program services:				
Undergraduate instruction	47,116,813	—	47,116,813	45,952,547
Graduate instruction	27,987,948	—	27,987,948	26,649,432
Research	32,826,399	—	32,826,399	29,482,831
Patient services	69,575,025	—	69,575,025	71,663,149
Total program services	177,506,185	—	177,506,185	173,747,959
Management and general:				
Academic support	7,486,028	—	7,486,028	8,059,235
Institutional support	18,660,201	—	18,660,201	16,921,247
Auxiliary services	22,857,049	—	22,857,049	22,824,704
Patient services support	7,097,082	—	7,097,082	6,616,122
Total management and general	56,100,360	—	56,100,360	54,421,308
Total operating expenses	233,606,545	—	233,606,545	228,169,267
Changes in net assets from operations	17,119,293	(2,857,410)	14,261,883	6,740,465
Nonoperating items:				
Unrealized gains from investments, net	771,561	—	771,561	69,864
Change in interest of net assets of affiliate (note 1)	—	6,900,019	6,900,019	6,887,017
Change in fair value of interest rate swaps (note 10)	1,978,826	—	1,978,826	(1,216,279)
Changes in net assets	19,869,680	4,042,609	23,912,289	12,481,067
Net assets at beginning of year	81,050,349	115,384,435	196,434,784	183,953,717
Net assets at end of year	\$ 100,920,029	119,427,044	220,347,073	196,434,784

See accompanying notes to consolidated financial statements.

**EASTERN VIRGINIA MEDICAL SCHOOL
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Consolidated Statement of Cash Flows

Year ended June 30, 2017

(With summarized financial information for the year ended June 30, 2016)

	<u>2017</u>	<u>2016</u>
Cash flows from operating activities:		
Changes in net assets	\$ 23,912,289	12,481,067
Adjustments to reconcile changes in net assets to net cash provided by operating activities:		
Depreciation and amortization	10,336,371	10,503,342
Change in fair value of interest rate swaps (note 10)	(1,978,826)	1,216,279
Unrealized gains on investments, net	(771,561)	(69,864)
Gain on patent licensing agreement	(4,891,023)	—
Change in interest of net assets of affiliate (note 1)	(6,900,019)	(6,887,017)
Loss on disposal of property and equipment	41,262	1,943
Provision for bad debts	12,178,164	12,149,629
Amortization of bond costs	26,377	26,372
State appropriation for property, plant and equipment (note 14)	(729,607)	(787,718)
Changes in:		
Accounts receivable	(11,935,790)	(10,861,065)
Accounts receivable from affiliate	(1,295,831)	723,376
Prepaid expenses and other current assets	980,747	(1,189,621)
Other long-term assets	(2,404)	(2,399)
Accounts payable – trade	1,794,756	(999,986)
Accrued compensation	(1,836,364)	2,016,481
Deferred income	(695,062)	141,582
Accrued expenses and other current liabilities	(6,221,813)	734,189
Grant deposits	505,578	(1,380,663)
Assets held for affiliate	18,701	25,581
Other long-term liabilities	741,234	57,603
Net cash provided by operating activities	<u>13,277,179</u>	<u>17,899,111</u>
Cash flows from investing activities:		
Purchases of restricted cash and investments	(9,719,671)	(9,290,875)
Proceeds from restricted cash and investments	9,121,066	9,388,383
Purchases of operating investments	(552,559)	(25,435,028)
Proceeds from sales and maturities of operating investments	104,004	22,065,690
Purchases of property, plant, and equipment, including interest capitalized	(5,601,770)	(6,086,450)
Disbursements for notes receivable from students	(698,111)	(1,086,202)
Collections of notes receivable from students	1,083,624	1,137,712
Change in cash surrender value of life insurance	(112,366)	(147,360)
Net cash used in investing activities	<u>(6,375,783)</u>	<u>(9,454,130)</u>
Cash flows from financing activities:		
State appropriation for property, plant and equipment (note 14)	729,607	787,718
Payments on bonds and notes payable	(4,130,000)	(4,460,000)
Refundable federal student loans	(133,271)	(362,588)
Net cash used in financing activities	<u>(3,533,664)</u>	<u>(4,034,870)</u>
Net increase in cash and cash equivalents	3,367,732	4,410,111
Cash and cash equivalents at beginning of year	<u>25,723,178</u>	<u>21,313,067</u>
Cash and cash equivalents at end of year	<u>\$ 29,090,910</u>	<u>25,723,178</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest, net of amounts capitalized	\$ 1,528,810	1,733,088
Purchases of property, plant and equipment included in accounts payable – trade	600,417	117,438

See accompanying notes to consolidated financial statements.

EASTERN VIRGINIA MEDICAL SCHOOL AND AFFILIATED ORGANIZATION

Notes to Consolidated Financial Statements

June 30, 2017

(With summarized financial information as of June 30, 2016)

(1) EVMS and Affiliated Organization

The Eastern Virginia Medical School (EVMS or the School) was created in 1964 by enabling legislation of the General Assembly of Virginia to identify, document and evaluate needs, problems, and resources relating to health and medical care within its service area and to plan, develop, and implement programs to meet such needs on both an immediate and long-range basis. EVMS may plan, design, construct, remove, enlarge, equip, maintain, and operate medical educational institutions and medical and paramedical facilities, together with related and supporting facilities, and do all things necessary and convenient to carry out any of its purposes. EVMS' powers also include the right of eminent domain within the City of Norfolk and the authorization to borrow funds and issue bonds. EVMS has been classified as an organization described in Section 501(c)(3) of the Internal Revenue Code (IRC). As such, EVMS is exempt from federal and state income taxation, and contributions to it are tax deductible.

EVMS Medical Group (EVMS MG), formerly EVMS Health Services, is a nonmember organization incorporated under the Virginia Non Stock Corporation Act. Prior to July 1, 1989, EVMS MG was an operating division of EVMS. Effective July 1, 1989, EVMS MG began operations as a not-for-profit foundation through the approval of EVMS MG's Articles of Incorporation and Bylaws by the EVMS Board of Visitors. EVMS MG bylaws cannot be altered or amended without the approval of the EVMS Board of Visitors. EVMS MG has been classified as an organization described in Section 501(c)(3) of the IRC and is exempt from federal and state income taxation. The accounts of EVMS MG are included in the accompanying consolidated financial statements.

The Eastern Virginia Medical School Foundation (EVMS Foundation) is a nonprofit organization established to provide financial support to EVMS. The EVMS Foundation qualifies as a charitable foundation and is exempt from federal and state income taxation under Section 501(c)(3) of the IRC. As such, contributions to it are tax deductible. The accounts of EVMS Foundation are not included in the consolidated financial statements of EVMS. Amounts received from the EVMS Foundation are reported as endowment income in EVMS' consolidated financial statements. EVMS' beneficial interest in the net assets of EVMS Foundation related to estimated future distributions totaling \$68,704,398 and \$61,804,379 as of June 30, 2017 and 2016, respectively, is presented as interest in net assets of affiliate and temporarily restricted net assets. Changes in the interest of the net assets of EVMS Foundation are included in nonoperating items on the accompanying consolidated statement of activities. During the years ended December 31, 2017 and 2016, income from the EVMS Foundation of \$5,753,144 and \$5,931,555, respectively, is presented in operating revenues and support on the accompanying consolidated statement of activities.

EVMS has defined its mission as a community-based academic institution dedicated to medical and health education, research, and patient care.

(a) Education

Undergraduate Education – Opened in 1973, EVMS offers a Doctor of Medicine (M.D.) degree. In 2004, the Association of American Medical Colleges' Liaison Committee on Medical Education awarded EVMS continued full accreditation of the educational program leading to the M.D. degree.

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In 2009, the Southern Association of Colleges and Schools awarded EVMS a continuation of accreditation for a 10-year period.

EVMS also offers several health professions programs including master's degrees in art therapy, public health, physician assistant, clinical embryology, surgical assistant, biotechnology and biomedical sciences and doctoral degrees in clinical psychology and biomedical sciences in conjunction with other local universities.

Graduate Medical Education (GME) – Founded in 1974, GME offers residency and fellowship programs at numerous healthcare facilities in EVMS' service area. Programs are accredited by the Accreditation Council of Graduate Medical Education or the American Psychological Association or are approved by specialty boards.

(b) Research

EVMS conducts numerous research projects in various areas including proteomics, cancer, reproductive medicine, systemic diseases and infectious diseases. EVMS-sponsored research is supported by various federal and state agencies, pharmaceutical companies and private foundations.

(c) Patient Care

Clinical care is provided through the following affiliates:

EVMS MG – EVMS MG was formed exclusively for charitable, scientific and educational purposes and to further the mission and goals of EVMS. EVMS MG is organized and shall at all times operate to fulfill its corporate purpose by supporting clinical practice and research in conjunction with providing faculty the opportunity to teach in a physician group practice setting within the academic environment of EVMS. EVMS MG also provides education and training to EVMS students and residents. EVMS MG incorporates the professional practice units of the EVMS faculty in all departments except pediatrics. The practice units are staffed solely by faculty members of EVMS who provide professional patient care at EVMS facilities or through agreements with other area hospitals.

EVMS Pediatrics, formerly Pediatric Faculty Associates, Inc. (PFA) – PFA was established through an affiliation agreement between EVMS, Children's Hospital of the King's Daughters (CHKD), and Children's Health System, Inc. During fiscal year 1998, PFA underwent significant organizational and structural changes. A majority of the full-time faculty members in the pediatric specialties established a for-profit professional limited liability company, Children's Specialty Group, PLLC (CSG). On June 30, 2008, the PFA corporate status was dissolved. All assets and liabilities were transferred to EVMS and reported as EVMS Pediatrics.

EVMS Pediatrics, along with CSG, incorporates the professional practice units of the EVMS faculty in the pediatric specialties. They provide professional patient care at EVMS or CHKD facilities or through agreements with other area hospitals.

**EASTERN VIRGINIA MEDICAL SCHOOL
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Notes to Consolidated Financial Statements

June 30, 2017

(With summarized financial information as of June 30, 2016)

(2) Summary of Significant Accounting Policies

(a) Basis of Presentation and Consolidation

EVMS' consolidated financial statements have been prepared on the accrual basis of accounting. All significant intercompany balances and transactions have been eliminated in consolidation. These consolidated financial statements have been prepared to focus on EVMS as a whole and to present balances and transactions according to the existence or absence of donor-imposed restrictions. Net assets, revenues, gains and losses are classified based on the existence or absence of donor-imposed restrictions and are segregated into three net asset groups as follows:

Unrestricted net assets – Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets – Net assets subject to donor-imposed stipulations that may or will be met by actions of EVMS and/or the passage of time.

Permanently restricted net assets – Net assets subject to donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or otherwise removed by actions of EVMS. There were no permanently restricted net assets at EVMS as of June 30, 2017 or 2016.

Revenues are reported as increases in unrestricted net assets unless use of the related assets is limited by donor-imposed restrictions. Expenses are reported as decreases in unrestricted net assets. Gains and losses on investments and other assets or liabilities are generally reported as increases or decreases in unrestricted or temporarily restricted net assets. Expirations of temporary restrictions on net assets (i.e., the donor-stipulated purpose has been fulfilled and/or the stipulated time period has elapsed) are reported as reclassifications from temporarily restricted net assets to unrestricted net assets.

EVMS considers the following items to be nonoperating items: unrealized gains and losses from investments, changes in the interest in net assets of affiliate and changes in fair value of interest rate swap agreements.

The consolidated financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with U.S. generally accepted accounting principles (GAAP). Accordingly, such information should be read in conjunction with EVMS' consolidated financial statements as of and for the year ended June 30, 2016, from which the summarized information was derived. In addition, certain reclassifications have been made to the prior year amounts in order to conform to the current year presentation.

**EASTERN VIRGINIA MEDICAL SCHOOL
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Notes to Consolidated Financial Statements

June 30, 2017

(With summarized financial information as of June 30, 2016)

(b) Cash Equivalents

EVMS considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents for consolidated financial statement presentation, except for those short-term investments managed by EVMS' investment managers as part of their long-term investment portfolio. Cash equivalents consist primarily of temporary investments in bank repurchase agreements, money market funds and cash reserve funds. Cash equivalents make up substantially all of the balance in cash and cash equivalents on the consolidated balance sheet as of June 30, 2017 and 2016.

(c) Restricted Cash and Investments

Restricted cash and investments represents funds that have been externally restricted or internally designated by management for a specific purpose and are reported on the consolidated balance sheet at fair value.

(d) Investments

Investments are stated at fair value. Net realized gains and losses on investments are reflected in operating revenues and support in the accompanying consolidated statement of activities. Net unrealized gains and losses on investments are reflected in nonoperating items in the accompanying consolidated statement of activities. The current year gains and losses on investments have been recognized in the accompanying consolidated statement of activities as increases or decreases in unrestricted net assets, unless their use is restricted by explicit donor stipulations.

(e) Patient Accounts Receivable

Patient receivables are recorded net of allowances for contractual adjustments and uncollectible receivables. The allowance for doubtful accounts is EVMS MG's best estimate of the amount of probable credit losses in its existing receivables. EVMS MG determines the allowance based on historical write-off experience. Account balances are charged off against the allowance after all means of collection have been exhausted and the potential for recovery is considered remote. EVMS MG does not have any off-balance-sheet credit exposure related to its customers. Patient service revenue is presented net of contractual allowances and discounts and the provision for bad debts.

(f) Property, Plant, and Equipment

Property, plant, and equipment are stated at cost or at estimated fair value at date of gift if acquired by gift. Depreciation is computed by the straight-line method over the estimated useful lives of the property, plant, and equipment.

The estimated useful lives are as follows:

Land improvements	5–20 years
Buildings and improvements	5–40 years
Equipment	3–20 years

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(g) Other Long-Term Assets

Other long-term assets in the accompanying consolidated balance sheet are primarily comprised of cash surrender value of life insurance policies held by EVMS MG.

EVMS MG is the owner of two insurance policies for current and retired faculty of EVMS, where EVMS MG is the beneficiary. These policies are recorded at their net cash surrender values, as reported by the issuing insurance company, whose Standard & Poor's financial strength rating is AA+. The net cash surrender values totaled \$3,540,343 and \$3,427,977 as of June 30, 2017 and 2016, respectively.

(h) Refundable Federal Student Loans

Funds provided by the U.S. government under the Federal Perkins and Health Professions Student Loan Programs are loaned to qualified students and may be reloaned after collections. These funds are ultimately refundable to the government and are reported as liabilities in the accompanying consolidated balance sheet.

(i) Patient Care Services

EVMS MG has agreements with third-party payors that provide for payments to EVMS MG at amounts different from its established rates. Patient care services revenue is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors. Retroactive adjustments are accrued on an estimated basis in the period related services are rendered and adjusted in future periods as final settlements are determined. Reimbursements are subject to examination by agencies administering the programs for compliance with procedures and documentation standards.

(j) Charity Care

EVMS MG provides care to patients who meet certain criteria under its charity care policy without charge or at amounts less than its established rate. Because EVMS MG does not pursue collection of amounts determined to qualify as charity care, they are not reported as revenue in the accompanying consolidated statement of activities.

(k) Sponsored Grants and Contracts

Revenues under grants, contracts and similar agreements with sponsoring organizations are recognized as expenses are incurred for agreement purposes. The revenues include recoveries of indirect costs and fringe benefits, which are generally determined as a negotiated or agreed-upon percentage of direct costs with certain exclusions.

(l) Donated Services

A number of volunteers have made contributions of time to the School's program and support functions. The value of this contributed time does not meet the accounting criteria for recognition of contributed services and, accordingly, is not reflected in the accompanying consolidated financial statements.

**EASTERN VIRGINIA MEDICAL SCHOOL
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Notes to Consolidated Financial Statements

June 30, 2017

(With summarized financial information as of June 30, 2016)

(m) Functional Expenses

EVMS allocates its expenses on a functional basis among its various programs and supporting services. Expenses that can be identified with a specific program or supporting service are allocated directly. Other expenses that are common to several functions are allocated on various statistical bases.

(n) Derivative Instruments

EVMS utilizes derivative financial instruments to reduce its exposure to cash flow risks from changes in interest rates, specifically, variable interest rates. EVMS is exposed to credit losses in the event of nonperformance by the counterparty to the interest rate swap; however, the counterparty is a major financial institution, and the risk of loss due to nonperformance is considered remote. Interest rate differentials paid or received on the swap are recognized as adjustments to expense in the period earned or incurred. Interest rate swaps are recorded at fair value and reflected as assets or liabilities in the accompanying consolidated balance sheet. Changes in the fair value of interest rate swaps are reflected as nonoperating items in the accompanying consolidated statement of activities.

(o) Concentration of Credit Risk

Financial instruments, which potentially subject EVMS and its affiliated organization to concentration of credit risk, consist principally of cash, investments, patient receivables and student notes receivable.

EVMS and its affiliated organization place unrestricted cash and temporary overnight investments with high credit quality financial institutions. EVMS and the EVMS Foundation's endowment assets are allocated between several established, reputable asset management firms and, according to their investment policy, are invested in investment-grade instruments. The asset management firms are independent of the funds' trustees, who review their performance on a periodic basis.

(p) Asset Retirement Obligations

The fair value of a liability for an asset retirement obligation is recognized in the period incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the asset and amortized over its estimated useful life.

(q) Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management of EVMS to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosures of contingencies at the date of the consolidated financial statements and revenues and expenses recognized during the reporting period. Actual results could differ from those estimates.

(r) Income Taxes

EVMS is exempt from income taxes under Section 501(a) of the IRC as an organization described in Section 501(c)(3). Management has determined there are no uncertain tax positions as of June 30, 2017.

**EASTERN VIRGINIA MEDICAL SCHOOL
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Notes to Consolidated Financial Statements

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(With summarized financial information as of June 30, 2016)

(s) Release from Restriction

EVMS received temporarily restricted revenue from the Commonwealth of Virginia to fund the construction and purchase of certain real property during the years ended June 30, 2009–2016. As a part of the agreement, EVMS was required to fund a percentage of the cost of the project. EVMS' share of the cost was funded through fund-raising and the issuance of long-term debt. The restriction on the funds received from the Commonwealth of Virginia is being released over the life of the debt EVMS issued to fund the project.

(t) Recently Adopted Accounting Standards

In fiscal 2017, EVMS adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2015-03, *Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs*. The ASU requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Amortization of debt issuance costs are reported as interest expense. ASU No. 2015-03 is effective for EVMS for financial statements issued for fiscal years beginning after December 15, 2015 and is applied on a retrospective basis. Debt issuance costs of \$303,439 have been reclassified as a reduction of the term loan for the year ended June 30, 2017 in the accompanying consolidated balance sheet. Amortization of debt issuance costs of \$26,373 has been reclassified as interest expense for the year then ended in the accompanying consolidated statement of activities.

The FASB issued ASU No. 2016-01, *Recognition and Measurement of Financial Assets and Financial Liabilities* in January 2016. This ASU removes the requirement to disclose the fair value of financial instruments measured at amortized cost for entities that are not public business entities. EVMS adopted ASU No. 2016-01 in 2016 and removed the fair value disclosure for its fixed-rate debt.

(u) Recently Issued Accounting Standards

FASB issued ASU No. 2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements for Not-for-Profit Entities* in 2016. The ASU is effective for EVMS for the fiscal year beginning after December 15, 2017, and early adoption is permitted. The ASU reduces the number of net asset classes presented from three to two: with donor restrictions and without donor restrictions; requires all not for profit entities (NFPs) to present expenses by their functional and natural classifications in one location in the financial statements; and requires NFPs to provide quantitative and qualitative information about management of liquid resources and availability of financial assets to meet cash needs within one year of the balance sheet date. EVMS is currently evaluating the impact this ASU will have on the consolidated financial statements and related disclosures.

The FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*. This ASU establishes principles for reporting useful information to users of financial statements about the nature, amount, timing, and uncertainty of revenue and cash flows arising from the entity's contracts with customers; particularly, that an entity recognizes revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU No. 2014-09 is effective for fiscal year 2019.

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EVMS is currently evaluating the impact this ASU will have on the consolidated financial statements and related disclosures.

The FASB issued ASU No. 2016-02, *Leases (Topic 842)* in February 2016. This ASU requires the recognition of lease assets and lease liabilities by lessees for those leases classified as operating leases under previous GAAP, which have terms of greater than 12 months. This ASU defines a lease as a contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration. This ASU retains a distinction between finance leases and operating leases. The result of retaining a distinction between finance leases and operating leases in the statements of operations and cash flows is largely unchanged from previous GAAP. ASU No. 2016-02 is effective for fiscal year 2020. EVMS expects to record an increase in lease assets and lease liabilities presented in the consolidated balance sheet.

(3) Cash and Cash Equivalents

Cash and cash equivalents at June 30, 2017 and 2016 are summarized as follows:

	2017	2016
EVMS	\$ 26,525,692	21,939,858
EVMS MG	2,565,218	3,783,320
	<u>\$ 29,090,910</u>	<u>25,723,178</u>

(4) Investments and Restricted Cash and Investments

(a) Operating investments at June 30, 2017 and 2016 were comprised of the following:

	2017	2016
Money market funds	\$ 1,995,050	174,130
Common stock	1,251,920	—
Certificates of deposit	5,382,668	5,248,714
Mutual fund – fixed income	4,088,945	4,006,521
Corporate debt	7,618,367	6,259,882
Asset-backed securities	2,594,274	2,674,183
U.S. government securities	13,496,693	16,661,112
Cash reserve fund	5,076,551	368,787
Total operating investments	41,504,468	35,393,329
Less amounts available for current obligations	23,172,252	16,294,865
Long-term operating investments	<u>\$ 18,332,216</u>	<u>19,098,464</u>

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(b) Restricted cash and investments at June 30, 2017 and 2016 were comprised of the following:

	<u>2017</u>	<u>2016</u>
Restricted for parking garage operations – cash	\$ 615,881	660,172
Restricted for student loans – money market funds	2,013,525	1,694,869
Restricted for cash pension fund – mutual funds – large cap	445,640	243,723
Restricted for interest, debt retirement, and construction per trust indentures:		
General Revenue Refunding Bonds, Series 2001:		
Interest fund – money market funds	8,973	4,840
Principal fund – money market funds	1,205,288	1,090,834
Total Bonds, Series 2001	<u>1,214,261</u>	<u>1,095,674</u>
General Revenue Refunding Bonds, Series 2002:		
Interest fund – money market funds	4,325	3,531
Principal fund – money market funds	429,001	542,500
Total Bonds, Series 2002	<u>433,326</u>	<u>546,031</u>
General Revenue Bonds, Series 2006:		
Interest fund – money market funds	17,015	18,070
Principal fund – money market funds	268,490	256,667
Total Bonds, Series 2006	<u>285,505</u>	<u>274,737</u>
General Revenue Refunding Bonds, Series 2010:		
Interest fund – money market funds	25,189	16,488
Principal fund – money market funds	233,405	134,167
Total Bonds, Series 2010	<u>258,594</u>	<u>150,655</u>
General Revenue Bonds, Series 2010:		
Capitalized interest fund – money market funds	4,577	11,781
Interest fund – money market funds	14,996	12,708
Principal fund – money market funds	145,888	145,833
Total Bonds, Series 2010	<u>165,461</u>	<u>170,322</u>

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	<u>2017</u>	<u>2016</u>
General Revenue Bonds, Series 2011:		
Interest fund – money market funds	\$ 17,833	10,441
Principal fund – money market funds	58,351	58,333
Capitalized interest fund – money market funds	76	4,891
Total Bonds, Series 2011	<u>76,260</u>	<u>73,665</u>
Total restricted for interest, debt retirement and construction per trust indentures	<u>2,433,407</u>	<u>2,311,084</u>
Total restricted cash and investments	<u>\$ 5,508,453</u>	<u>4,909,848</u>

(5) Accounts Receivable

At June 30, 2017 and 2016, accounts receivable were comprised of the following:

	<u>2017</u>	<u>2016</u>
Patient receivables	\$ 14,050,837	14,146,178
Allowance for uncollectible accounts	<u>(4,827,053)</u>	<u>(4,844,368)</u>
Total net patient receivables	<u>9,223,784</u>	<u>9,301,810</u>
Sponsored programs receivables:		
Grants and contracts – federal	5,937,559	7,205,677
Grants and contracts – private	773,714	722,686
Grants and contracts – state	<u>182,700</u>	<u>137,689</u>
Total sponsored programs receivables	6,893,973	8,066,052
Local hospitals	2,729,190	2,389,850
Parking	87,147	85,263
U.S. Department of Education	4,397,022	3,532,900
Tuition receivable	520,681	618,504
Other	<u>750,661</u>	<u>747,653</u>
Total accounts receivable, net	<u>\$ 24,602,458</u>	<u>24,742,032</u>

(6) Accounts Receivable from Related Party

At June 30, 2017 and 2016, accounts receivable from affiliate were due from the EVMS Foundation in the amount of \$1,634,597 and \$338,766, respectively. This receivable is secured by the EVMS Foundation's investments.

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(7) Fair Value Measurements

Fair Value of Financial Instruments

The fair values of financial instruments are determined based on the amount 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.

Excluding the derivative instruments described in note 2(n), EVMS has a number of financial instruments, none of which are held for trading purposes. EVMS estimates that the fair values of all financial instruments do not differ materially from the aggregate carrying values of its financial instruments recorded in the accompanying consolidated balance sheet.

Fair Value Hierarchy

EVMS utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. EVMS determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date
- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability
- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at the measurement date

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The following tables present assets and liabilities that are measured at fair value on a recurring basis at June 30, 2017 and 2016:

		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	June 30, 2017			
Assets:				
Cash equivalents	\$ 40,455,995	40,455,995	—	—
Mutual funds – fixed income	4,088,945	4,088,945	—	—
Mutual funds – large cap	445,640	445,640	—	—
Common stock	1,251,920	1,251,920	—	—
U.S. government securities	13,496,693	—	13,496,693	—
Corporate debt	7,618,367	—	7,618,367	—
Asset-backed securities	2,594,274	—	2,594,274	—
Certificates of deposit	5,382,668	—	5,382,668	—
Beneficial interest in net assets of affiliate	68,704,398	—	—	68,704,398
Total	\$ 144,038,900	46,242,500	29,092,002	68,704,398
Liability:				
Interest rate swaps	\$ (1,509,981)	—	(1,509,981)	—
		Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
	June 30, 2016			
Assets:				
Cash equivalents	\$ 30,932,220	30,932,220	—	—
Mutual funds – fixed income	4,006,521	4,006,521	—	—
Mutual funds – large cap	243,723	243,723	—	—
U.S. government securities	16,661,112	—	16,661,112	—
Corporate debt	6,259,882	—	6,259,882	—
Asset-backed securities	2,674,183	—	2,674,183	—
Certificates of deposit	5,248,714	—	5,248,714	—
Beneficial interest in net assets of affiliate	61,804,379	—	—	61,804,379
Total	\$ 127,830,734	35,182,464	30,843,891	61,804,379
Liability:				
Interest rate swaps	\$ (3,488,807)	—	(3,488,807)	—

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The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- Cash equivalents: Repurchase agreements and cash reserve funds are valued at cost, which equals fair value. Money market funds are valued at fair value based on the closing price reported on the active market on which the fund is traded.
- Mutual funds: Valued at the net asset value of shares held by EVMS at year-end
- Common stock: Valued at the fair value based on the closing price reported on the active market on which the fund is traded
- U.S. government securities, corporate debt and asset-backed securities: Valued at fair value using pricing models maximizing the use of observable inputs for similar securities
- Certificates of deposit: Valued at fair value using a market approach by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer
- Beneficial interest in net assets of affiliate: Valued at the net present value of future benefits using an income approach through discounted cash flows
- Interest rate swaps (note 10): The fair value of the interest rate swaps is determined using pricing models that consider various assumptions, including time value and yield curves, as well as other relevant economic measures.

EVMS' accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no transfers into or out of Level 1, Level 2 or Level 3 for the year ended June 30, 2017.

(8) Property, Plant, and Equipment

At June 30, 2017 and 2016, property, plant, and equipment consisted of the following:

	<u>2017</u>	<u>2016</u>
Land	\$ 2,992,315	2,992,315
Land improvements	9,260,954	9,215,801
Buildings and improvements	186,064,823	185,238,591
Equipment	70,374,132	68,338,202
Construction in progress	<u>3,109,928</u>	<u>399,013</u>
	271,802,152	266,183,922
Less accumulated depreciation and amortization	<u>(150,187,755)</u>	<u>(140,394,079)</u>
Total property, plant, and equipment, net	<u><u>\$ 121,614,397</u></u>	<u><u>125,789,843</u></u>

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Depreciation and amortization expenses related to property, plant, and equipment for the years ended June 30, 2017 and 2016 were \$10,336,371 and \$10,503,342, respectively.

(9) Lines of Credit

EVMS has a \$10,000,000 unsecured line-of-credit facility with a bank. Under the terms of the agreement, interest is payable at one-month London Interbank Offered Rate (LIBOR) plus 1.50% (2.67% at June 30, 2017). The line of credit was not utilized during the year ended June 30, 2017 and expires on January 9, 2020.

EVMS MG has a \$3,000,000 line-of-credit facility with a bank, which is subject to semi-annual review and expires on May 30, 2018. This facility is collateralized by certain accounts receivable. Interest is payable at the 30-day LIBOR plus 1.50% (2.71% at June 21, 2017). No amounts were outstanding under the line of credit at June 30, 2017 or 2016.

(10) Long-Term Debt

At June 30, 2017 and 2016, long-term debt consisted of bonds payable and related interest rate swap agreements as follows:

	<u>2017</u>	<u>2016</u>
Bonds (property and equipment fund):		
General Revenue Refunding Bonds, Series 2001	\$ 3,265,000	5,135,000
General Revenue Refunding Bonds, Series 2002	1,380,000	2,310,000
General Revenue Bonds, Series 2006	6,910,000	7,350,000
General Revenue Bonds, Series 2010	12,340,000	12,900,000
General Revenue Refunding Bonds, Series 2010	9,255,000	9,485,000
General Revenue Bonds, Series 2011	8,900,000	9,000,000
	<u>42,050,000</u>	<u>46,180,000</u>
Interest rate swaps	1,509,981	3,488,807
Less bond issuance costs	(303,439)	(329,816)
Less current portion	<u>(4,010,000)</u>	<u>(3,820,000)</u>
Noncurrent portion	<u>\$ 39,246,542</u>	<u>45,518,991</u>

- (A) On December 5, 2001, EVMS refunded \$9,735,000 of the Series 1991A Bonds by issuing the Series 2001 General Revenue Refunding Bonds. The Series 2001 Bonds are secured by a Master Indenture of Trust dated November 15, 1991 between EVMS and U.S. Bank, as trustee, as amended, and supplemented by a Sixth Supplemental Indenture of Trust dated November 15, 2001. The Series 2001 Bonds, maturing on November 18, 2018, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on November 15, 2008 and each November 15 thereafter through 2018. In addition, the bonds are also subject to optional redemption, as described in the Indentures of Trust mentioned above.

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Interest is payable semi-annually at a floating rate per annum equal to 64% of 30-day LIBOR plus 50 basis points (1.25% and 0.79% as of June 30, 2017 and 2016, respectively) on each November 15 and May 15, and the entire principal balance is due on November 15, 2018. Mandatory sinking fund payments will be due annually on November 15 as follows:

<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>
2017	\$ 2,065,000	2018	\$ 1,200,000

- (B) On January 15, 2002, EVMS refunded \$4,620,000 of the Series 1991A Bonds by issuing the Series 2002 General Revenue Refunding Bonds. The Series 2002 Bonds are secured by a Master Indenture of Trust dated November 15, 1991 between EVMS and U.S. Bank, as trustee, as amended, and supplemented by a Seventh Supplemental Indenture of Trust dated January 15, 2002. The Series 2002 Bonds, maturing on November 18, 2018, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on November 15, 2003 and each November 15 thereafter through 2018. In addition, the bonds are also subject to optional redemption, as described in the Indentures of Trust mentioned above.

Interest is payable semi-annually at a floating rate per annum equal to 64% of 30-day LIBOR plus 50 basis points (1.25% and 0.79% as of June 30, 2017 and 2016, respectively) on each November 15 and May 15, and the entire principal balance is due on November 15, 2018. Mandatory sinking fund payments will be due annually on November 15 as follows:

<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>
2017	\$ 735,000	2018	\$ 645,000

- (C) On June 15, 2006, EVMS issued the Series 2006 General Revenue Bonds. The Series 2006 Bonds are secured by a Master Indenture of Trust dated November 15, 1991 between EVMS and U.S. Bank, as trustee, as amended, and supplemented by an Eighth Supplemental Indenture of Trust dated June 1, 2006. The Series 2006 Bonds, maturing on November 15, 2028, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on November 15, 2009 and each November 15 thereafter through 2028. In addition, the bonds are also subject to optional redemption, as described in the Indentures of Trust mentioned above.

On October 17, 2011, EVMS modified the Series 2006 General Revenue Bonds, in accordance with the Twelfth Supplemental Indenture of Trust, effective November 1, 2011, to reduce the current interest rate payable from 4.00% per annum to 2.95% per annum until the rate reset date, which was also adjusted from June 15, 2021 to November 15, 2021.

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Interest is payable semi-annually on each May 15 and November 15 at a rate of 2.95% per annum until the reset date of November 15, 2021. Effective November 15, 2021, the interest rate per annum will reset based on the 10-year average of the 7-year U.S. Treasury bond plus 30 basis points. The entire principal balance is due on November 15, 2028. Mandatory sinking fund payments will be due annually on November 15 as follows:

<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>
2017	\$ 460,000	2021	\$ 540,000	2025	\$ 630,000
2018	475,000	2022	560,000	2026	650,000
2019	500,000	2023	580,000	2027	680,000
2020	520,000	2024	605,000	2028	710,000

- (D) On October 29, 2010, EVMS issued the Series 2010A and Series 2010B General Revenue Bonds. The Series 2010 Bonds are secured by a Master Indenture of Trust dated November 15, 1991 between EVMS and U.S. Bank, as trustee, as amended, and supplemented by a Tenth Supplemental Indenture of Trust dated October 1, 2010. The Series 2010A Bonds, maturing on November 15, 2027, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on May 15, 2011 and each May 15 and November 15 thereafter through 2027. The Series 2010B Bonds, maturing on November 15, 2032, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on May 15, 2011 and each May 15 and November 15 thereafter through 2032. In addition, the bonds are also subject to optional redemption, as described in the Indentures of Trust mentioned above.

Interest is payable semi-annually at a floating rate per annum equal to 67% of 30-day LIBOR plus 184 basis points (2.62% and 2.14% as of June 30, 2017 and 2016, respectively) on each November 15 and May 15, and the entire principal balance is due on November 15, 2032.

EVMS made early redemption payments of \$310,000 and \$870,000 on the Series 2010B Bonds during the years ended June 30, 2017 and 2016, respectively, reducing the total principal of the Series 2010A and 2010B Bonds to \$12,340,000 as of June 30, 2017. Mandatory sinking fund payments will be due annually on November 15 as follows:

<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>
2017	\$ 250,000	2023	\$ 1,250,000
2018	1,250,000	2024	1,250,000
2019	1,250,000	2025	1,250,000
2020	1,250,000	2026	1,250,000
2021	1,250,000	2027	840,000
2022	1,250,000		

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- (E) On November 15, 2010, EVMS refunded \$10,000,000 of the Series 2008 Bonds by issuing the Series 2010 General Revenue Refunding Bonds. The Series 2010 Bonds are secured by a Master Indenture of Trust dated November 15, 1991 between EVMS and U.S. Bank, as trustee, as amended, and supplemented by an Eleventh Supplemental Indenture of Trust dated November 1, 2010. The Series 2010 Bonds, maturing on November 15, 2032, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on May 15, 2011 and each May 15 and November 15 thereafter through 2032. In addition, the bonds are also subject to optional redemption, as described in the Indentures of Trust mentioned above.

Interest is payable semi-annually at a floating rate per annum equal to 67% of 30-day LIBOR plus 169 basis points (2.47% and 1.99% as of June 30, 2017 and 2016, respectively) on each November 15 and May 15, and the entire principal balance is due on November 15, 2032. Mandatory sinking fund payments will be due annually on November 15 as follows:

<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>
2017	\$ 400,000	2023	\$ 530,000	2029	\$ 690,000
2018	430,000	2024	555,000	2030	720,000
2019	445,000	2025	580,000	2031	755,000
2020	465,000	2026	605,000	2032	785,000
2021	490,000	2027	635,000		
2022	510,000	2028	660,000		

- (F) On November 17, 2011, EVMS issued the Series 2011 General Revenue Bonds. The Series 2011 Bonds are secured by a Master Indenture of Trust dated November 15, 1991 between EVMS and U.S. Bank, as trustee, as amended, and supplemented by a Thirteenth Supplemental Indenture of Trust dated November 1, 2011. The Series 2011 Bonds, maturing on November 15, 2032, are subject to mandatory sinking fund redemption by lot at a redemption price of 100% of the principal amount redeemed plus accrued interest on May 15, 2012 and each May 15 and November 15 thereafter through 2032.

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Interest is payable semi-annually at a floating rate per annum equal to 65% of 30-day LIBOR plus 170 basis points (2.46% and 1.99% as of June 30, 2017 and 2016, respectively) on each November 15 and May 15, and the entire principal balance is due on November 15, 2032. Mandatory sinking fund payments will be due annually on November 15 as follows:

<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>	<u>Maturity dates</u>	<u>Principal amount</u>
2017	\$ 100,000	2023	\$ 550,000	2029	\$ 650,000
2018	500,000	2024	550,000	2030	700,000
2019	500,000	2025	550,000	2031	700,000
2020	500,000	2026	600,000	2032	750,000
2021	500,000	2027	600,000		
2022	500,000	2028	650,000		

(G) The Series 2001 and 2002 General Revenue Refunding Bonds bear interest at 64% of 30-day LIBOR plus 50 basis points (1.25% and 0.79% as of June 30, 2017 and 2016, respectively). To minimize the effect of changes in LIBOR, EVMS entered into an interest swap contract with a current notional principal amount of \$4,602,100, under which it pays interest at 5.635% and receives interest at 64% of 30-day LIBOR plus 50 basis points. The swap will expire on November 15, 2018. The cumulative unrealized loss of \$159,706 and \$458,565 as of June 30, 2017 and 2016, respectively, from the changes in the swap contract's fair value is included in long-term debt.

The Series 2010 General Revenue Refunding Bonds bear interest at 67% of 30-day LIBOR plus 169 basis points (2.47% and 1.99% as of June 30, 2017 and 2016, respectively). To minimize the effect of changes in LIBOR, EVMS entered into an interest swap contract with a current notional principal amount of \$9,255,000, under which it pays interest at 3.31% and receives interest at 67% of 30-day LIBOR plus 169 basis points. The swap will expire on November 15, 2032. The cumulative unrealized loss of \$548,615 and \$1,133,431 as of June 30, 2017 and 2016, respectively, from the changes in the swap contract's fair value is included in long-term debt.

The Series 2010 General Revenue Bonds bear interest at 67% of 30-day LIBOR plus 184 basis points (2.62% and 2.14% as of June 30, 2017 and 2016, respectively). To minimize the effect of changes in LIBOR, EVMS entered into an interest swap contract with a current notional principal amount of \$12,250,000, under which it pays interest at 3.28% and receives interest at 67% of 30-day LIBOR plus 184 basis points. The swap will expire on November 15, 2027. The cumulative unrealized loss of \$483,090 and \$1,063,510 as of June 30, 2017 and 2016, respectively, from the changes in the swap contract's fair value is included in long-term debt.

The Series 2011 General Revenue Bonds bear interest at 65% of 30-day LIBOR plus 170 basis points (2.46% and 1.99% as of June 30, 2017 and 2016, respectively). To minimize the effect of changes in LIBOR, EVMS entered into an interest swap contract with a current notional principal amount of \$8,900,000, under which it pays interest at 2.94% and receives interest at 65% of 30-day LIBOR plus 170 basis points. The swap will expire on November 15, 2032. The cumulative unrealized loss of

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(With summarized financial information as of June 30, 2016)

\$318,570 and \$833,301 as of June 30, 2017 and 2016, respectively, from the changes in the swap contract's fair value are included in long-term debt.

Annual changes in the swap contracts' fair value are included in nonoperating items in the accompanying consolidated statement of activities.

- (H) Debt issuance costs associated with the long-term debt totaled \$303,439 at June 30, 2016. Amortization of these amounts is being recognized on a straight-line basis over the term of the loan and is included in interest expense. Annual amortization was \$26,377 for the year ended June 30, 2016.
- (I) Pursuant to the terms of the Indentures of Trust, EVMS is required to comply with certain covenants regarding payment of bonds, pledging of revenues, the operations of EVMS, insurance, accounting and financial statements, limitations on liens and the incurrence of additional indebtedness, and the sale, lease, or other disposition of assets. It is management's opinion that these requirements have been met for the fiscal years ended June 30, 2017 and 2016. The bonds are equally and ratably secured by an unconditional guaranty of EVMS Foundation and by security interest in revenue granted by EVMS.

Payment requirements on EVMS' bonds payable for the next five years ending June 30 and thereafter are as follows:

2018	\$	4,010,000
2019		4,500,000
2020		2,695,000
2021		2,735,000
2022		2,780,000
Thereafter		<u>25,330,000</u>
	\$	<u>42,050,000</u>

(11) Leases

EVMS has several noncancelable operating leases, primarily for buildings and medical and office equipment, which expire over the next six years. These leases generally contain renewal options for periods ranging from one to five years. Total rental expense for operating leases for the years ended June 30, 2017 and 2016 amounted to \$2,819,924 and \$2,526,305, respectively.

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Future minimum lease payments under noncancelable operating leases (with initial or remaining lease terms in excess of one year) as of June 30, 2017 were approximately as follows:

Year ending June 30:		
2018	\$	2,313,000
2019		1,957,000
2020		1,573,000
2021		1,592,000
2022		1,584,000
Thereafter		<u>2,469,000</u>
Total minimum operating lease payments	\$	<u><u>11,488,000</u></u>

(12) Grant Deposits

At June 30, 2017 and 2016, grant deposits for sponsored research consisted of the following:

	<u>2017</u>	<u>2016</u>
Federal grants	\$ 532,004	334,822
State and local grants	383,706	305,831
Private gifts and grants:		
Bill and Melinda Gates Foundation	1,588,082	1,127,164
Obici Healthcare Foundation	302,515	262,125
Others	<u>553,215</u>	<u>824,002</u>
Total private gifts and grants	<u>2,443,812</u>	<u>2,213,291</u>
Total grant deposits	<u><u>\$ 3,359,522</u></u>	<u><u>2,853,944</u></u>

Grant deposits represent amounts received for various grants and contracts that have not been expended at June 30, 2017 and 2016. If amounts are not expended per agreement, they will be refunded to the grantors, as required.

(13) Assets Held for Affiliate

Various donors contributed funds to the EVMS Foundation for the purpose of establishing loan funds for EVMS students. EVMS manages the award and subsequent collection of these loans from EVMS students on behalf of the EVMS Foundation. The amount of loan funds held for the EVMS Foundation at June 30, 2017 and 2016 was \$891,406 and \$872,705, respectively.

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(14) State Appropriations

EVMS receives state appropriations funds annually. A summary of the programs supported for the years ended June 30, 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Education	\$ 16,947,539	15,977,137
Indigent care	6,158,108	6,158,108
Family medicine	661,026	686,039
Medical modeling and simulation	417,507	612,252
Higher education equipment trust fund	553,387	471,042
Capital maintenance reserve	176,220	316,676
Virginia Area Health Education Center	63,146	59,989
	<u>\$ 24,976,933</u>	<u>24,281,243</u>

(15) Other Sources of Revenue

During the year ended June 30, 2017, EVMS received 369,312 shares of stock in exchange for a license of several of its patents. Shares of stock sold in fiscal 2017 generated \$10,519,493 of revenue, which is recorded as other sources of revenue in the accompanying consolidated statement of activities. This income was partially offset by distributions to the inventors (113,358 shares) and a third party (66,962 shares), in accordance with the terms of the agreements governing the intellectual property. These contractual payments are reported under contractual expense in the amount of \$5,628,470 on the accompanying consolidated statement of activities. As of June 30, 2017, the remaining balance of stock held by EVMS is carried at fair value in the amount of \$1,251,920.

(16) Expenses by Object Class

Expenses by object class for the years ended June 30, 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Salaries and wages	\$ 129,847,355	129,817,979
Contractual services	29,383,656	25,316,324
General expenses	27,174,034	26,659,589
Fringe benefits	25,343,603	23,857,774
Operating supplies and minor equipment	9,904,773	10,193,953
Depreciation and amortization	10,336,371	10,503,342
Interest expense	1,536,753	1,740,306
Indigent care – institutional component	80,000	80,000
Total expenses	<u>\$ 233,606,545</u>	<u>228,169,267</u>

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(With summarized financial information as of June 30, 2016)

(17) Retirement Plan

Substantially all of the salaried personnel of EVMS are eligible after specified periods of employment to participate in qualified tax-deferred annuity plans under Sections 403(b) and 401(a) of the IRC. EVMS' contributions to the Plans are based on percentages of qualified employee earnings. EVMS contributions to this program were \$4,869,378 and \$4,684,285 for the fiscal years ended June 30, 2017 and 2016, respectively.

(18) Commitments and Contingencies

Amounts received and expended by EVMS under various federal and state programs are subject to audit by various federal and state agencies. In the opinion of management, audit adjustments, if any, will not have a significant effect on the consolidated financial position of the School.

EVMS is subject to various legal proceedings and claims, which arise in the ordinary course of its business. In the opinion of management, appropriate provision has been made for possible losses, and the ultimate resolution of these matters will not have a significant effect on the consolidated financial position of the School.

(19) Subsequent Events

EVMS has evaluated subsequent events for potential recognition and/or disclosure in the June 30, 2017 consolidated financial statements through November 6, 2017, the date the consolidated financial statements were issued.



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

The Board of Visitors
Eastern Virginia Medical School:

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, the consolidated financial statements of Eastern Virginia Medical School and Affiliated Organization (EVMS), which comprise the consolidated balance sheet as of June 30, 2017, and the related consolidated statements of activities and cash flows for the year then ended, and the related notes to the consolidated financial statements, and have issued our report thereon dated November 6, 2017.

Internal Control over Financial Reporting

In planning and performing our audit of the consolidated financial statements, we considered EVMS' 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 consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of EVMS' internal control. Accordingly, we do not express an opinion on the effectiveness of EVMS' 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 EVMS' consolidated financial statements are free from 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 results of that testing, and not to provide an opinion on the effectiveness of EVMS' internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering EVMS' internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

KPMG LLP

Norfolk, Virginia
November 6, 2017