

STATE OF CONNECTICUT

**AUDITORS' REPORT
CONNECTICUT INNOVATIONS, INCORPORATED
FOR THE FISCAL YEARS ENDED
JUNE 30, 2000, 2001 and 2002**

**AUDITORS OF PUBLIC ACCOUNTS
KEVIN P. JOHNSTON ♦ ROBERT G. JAEKLE**

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April 28, 2004

**AUDITORS' REPORT
CONNECTICUT INNOVATIONS, INCORPORATED
FOR THE FISCAL YEARS ENDED JUNE 30, 2000, 2001 and 2002**

We have made an examination of the financial records of the Connecticut Innovations, Incorporated (the Corporation) for the fiscal years ended June 30, 2000, 2001 and 2002.

Financial statements pertaining to the operations and activities of the Corporation, for the fiscal years ended June 30, 2000, 2001 and 2002, are presented and audited on a Statewide Single Audit basis to include all State agencies and funds. We have relied on the financial and compliance audits conducted by the Corporation's independent public accountant covering the fiscal years mentioned above, after having satisfied ourselves as to the firm's professional reputation, qualifications and independence, and verifying that generally accepted accounting principles and auditing standards were followed in the audits and in the preparation of the reports. The Corporation Financial statements are included in the Corporation's Annual Reports for 2000, 2001 and 2002.

This report on our examination consists of the Comments and Recommendations which follow.

COMMENTS

FOREWORD:

Connecticut Innovations, Incorporated (hereafter CII or the Corporation) operates primarily under Chapter 581, Sections 32-32 through 32-47a of the General Statutes. Pursuant to Section 32-35 of those Statutes, it is a public instrumentality and political sub-division of the State. Also, pursuant to Chapter 12 of the General Statutes, it is classified as a quasi-public agency and therefore is subject to the requirements related to such agencies as may be found in Chapter 12. As a quasi-public agency, the Corporation's financial information is included as a component unit in the State of

Connecticut's Comprehensive Annual Financial Report (CAFR).

CII was established to stimulate and encourage the research and development of new technologies and new products, the development and operation of science parks and incubator facilities and, to promote science, engineering, mathematics and other disciplines essential to the development of technology.

The Corporation provides financial assistance to Connecticut businesses for the development and marketing of high-technology products, services and processes. This assistance has been made in the form of loans, royalty agreements and equity (ownership) investments. In recent years the Corporation has used equity agreements as its primary vehicle for investing in businesses. The Corporation also funds other organizations such as Connecticut universities and technology research or application centers. The Corporation includes contingent payback provisions to those funds as a means of sharing in the royalties and other earnings from successful research projects.

The Corporation targets early stage high-technology enterprises. These include: advanced materials, aerospace, biotechnology, energy and environmental systems, information technology and photonics. To address these areas the Corporation utilizes a number of limited partnerships and financial investments to achieve its objectives of assisting qualified Connecticut organizations.

The Corporation provides several financial and technical programs to assist qualifying Connecticut companies, colleges and universities. These include:

Access Connecticut Limited Partnership – This program is a limited partnership designed to generate new technology companies in Connecticut through technology transfer from universities.

BioScience Facilities Program – This program encourages the growth of Connecticut's bioscience industry by providing financing to qualified biotechnology companies for the construction of laboratory and related space.

Connecticut Emerging Enterprise Limited Partnership – This program is a partnership between the Corporation and a major commercial bank. The program invests in initial and follow-on rounds of financing for early stage, technology growth enterprises with significant proprietary innovations or other unique, sustainable competitive advantages.

Connecticut Innovations Technology Scholars Program – This program provides scholarships to encourage talented young people to choose careers in science and technology and to pursue their education and their careers in Connecticut.

Connecticut Technology Partnership (CTP) Program – This program provides funds that supplement and leverage federal research and development dollars. The CTP offers two types of awards: (1) Small Business Innovation Research/Small Business Technology Transfer (SBIR/STTR) awards of up to \$50,000, which are used by companies to help commercialize SBIR and STTR projects; and (2) federal match awards of up to \$500,000,

which are used for research and development and contribute to a company's match funding requirements under federal programs requiring a match.

Eli Whitney Investments – This is the Agency's primary investment program. The program makes risk capital investments in emerging and established companies to stimulate their development of high technology products, processes and services. Areas of focus include bioscience, information technology and photonics.

Next Generation Ventures LLC – This program is a joint venture between the Corporation and a major commercial insurer. The program invests in start-up and young technology companies in Connecticut by the use of seed or early stage financing.

Yankee Ingenuity Technology Program – This program was developed to encourage technological innovation through partnerships between Connecticut businesses and Connecticut colleges and universities.

Connecticut Clean Energy Fund - Public Act 98-28 created a Renewable Energy Investment Fund and directed that it be administered by CII. The Fund is intended to promote the production and utilization of clean energy, and is commonly referred to as the Connecticut Clean Energy Fund.

Organizationally, the Corporation is divided into four major areas:

- Finance and Administration - responsible for accounting, administration, finance and information technology support.
- Investments – responsible for identifying opportunities that fall within the Agency's scope and providing where appropriate capital for invention and innovation when financial aid is not available from normal commercial sources.
- Marketing and Business Development – responsible for marketing support and the development of new business opportunities.
- Clean Energy Fund Operations – responsible for the operation of the Clean Energy Program.

Board of Directors and Administrative Officials:

Pursuant to Section 32-35 of the General Statutes, the Corporation is governed by a 15-member Board of Directors. Eight members are appointed by the Governor and four are appointed by various legislative leaders. In addition, the Commissioner of the Department of Economic and Community Development, the Commissioner of the Department of Higher Education and the Secretary of the Office of Policy and Management serve as ex-officio members. Subsection (c) of

Auditors of Public Accounts

Section 32-35 provides that the Chairperson of the Board shall be appointed by the Governor with the advice and consent of the Legislature.

As of June 30, 2002, the members of the Board of Directors were as follows:

Appointed by the Governor:

Arthur H. Diedrick, Chairman
John T. Booth
Anthony J. Campanelli
J. Scott Guilmartin
George Lewson
John W. Olsen
Paul R. Pescatello
Daniel Rappaport

Legislative Appointments:

Thomas J. Clark
Geraldine U. Foster
James A. Lash
E. Charles McClenachan

Ex-Officio:

Valerie F. Lewis, Commissioner of Higher Education
James F. Abromaitis, Commissioner of Economic and Community Development
Marc A. Ryan, Secretary of the Office of Policy and Management

During the audited period Katherine Vick served on the Board as a legislative appointee.

Arthur Diedrick has served as Chairperson of the Board since January 1, 1995. Victor Budnick has served as President and Executive Director of CII since October 16, 1995.

RÉSUMÉ OF OPERATIONS:

The State of Connecticut provided significant initial financing for the Corporation's programs through the proceeds of General Obligation Bonds. It is these bond proceeds and any net income from operations that are used to finance the Corporation's investments.

Bond payments are processed through the State Comptroller's centralized payment system and are recorded on both the State and the Corporation books. State bond proceeds to finance loans and investments are recorded by the State Comptroller as expenditures, and by the Corporation as investments and as contributed capital.

The Corporation also uses the centralized State payment system for processing payroll and other operating expenses. As provided for by Subdivision (b) of Section 32-41a of the General Statutes, all investment income and loan repayments are deposited into the Corporation's "operating account."

State Accounts:

State expenditures related to Connecticut Innovations, Incorporated include, as indicated above, bond fund proceeds to finance various grants and investments. They also include certain operating expenses processed through the State's centralized processing systems. These transactions are processed through two State Funds - a special revenue fund and an enterprise fund (Connecticut Innovations Incorporated Fund). The special revenue fund is used to process certain grant awards authorized by the Legislature through various authorizing special acts and the action of the State Bond Commission.

Special Revenue Fund expenditures amounted to \$2,042,210 in 1999-2000 but fell to \$293,270 in the 2000-2001 fiscal year and zero in the 2001-2002 fiscal year. This change represents decreased direct State support for these programs and a shift to an increased reliance on funds generated by the operations of the Corporation.

The Connecticut Innovations Incorporated Fund is an enterprise fund authorized by Section 32-41a of the General Statutes. That Statute provides that this fund be used to carry out the purposes of CII, and also for the repayment of State bonds when required by the State Bond Commission. Total bond fund moneys authorized by Sections 32-41 and 32-41b amounted to \$114,801,000 as of June 30, 2002. Expenditures charged to the Fund include the Eli Whitney Investments, various technology loans, and payroll costs. A summary of Fund expenditures for the audited period follows:

	<u>Fiscal Year Ended June 30,</u>		
	<u>2000</u>	<u>2001</u>	<u>2002</u>
	\$	\$	\$
Personal Services	2,058,185	2,925,051	3,425,893
Fringe Benefits	849,619	1,148,338	1,447,776
Investment in Biofacilities	2,086,152	12,337,095	5,750,625
All other	<u>4,393</u>	<u>-2,524</u>	<u>5,177</u>
Totals	\$ <u>4,998,349</u>	\$ <u>16,407,960</u>	\$ <u>10,629,471</u>

The increase in Personal Services and fringe benefits is due in large part to staffing increases required to manage the Clean Energy Fund. Expenditures for personal services and fringe benefits are reimbursed in whole by CII. The category "Investment in Biofacilities" includes funding to enable biotechnology and other technology companies to make leasehold improvements to production, testing, research, development, manufacturing, laboratory, and other related facilities.

Auditors of Public Accounts

The increase in funding during the 2001 fiscal year resulted from \$15,000,000 of bond allocations during that period.

Connecticut Innovations, Incorporated Accounts:

As indicated above, pursuant to Subdivision (b) of Section 32-41a of the General Statutes, all investment income, loan repayments, and grants with payback provisions are deposited into a Corporation account (i.e. "operating account"). The operating account is used to pay administrative expenses including the transfers to the enterprise fund for reimbursements of personal services, fringe benefits and other administrative costs charged to the fund.

Any excess funds in the operating account are transferred to the State Treasurer's Short Term Investment Fund (STIF) to earn investment income. It should be noted that the Corporation may be required by the Bond Commission to repay the moneys advanced by the Bond Commission, including interest, under terms the Commission might find desirable and consistent with the purposes of the Corporation. As of June 30, 2002, the Bond Commission had not requested repayment of any principal or interest.

The financial position of the Corporation as of June 30, 2000, 2001 and 2002, is presented below:

ASSETS			
CURRENT ASSETS:	As of June 30,		
Unrestricted assets:	2002	2001	2000
Cash and cash equivalents:			
Cash	\$ 357,461	\$ 342,954	62,111
Short-term investments	27,008,415	25,402,787	25,229,501
Marketable securities	<u>5,150,000</u>	<u>10,272,600</u>	<u>31,013,430</u>
Total cash and cash equivalents	<u>32,515,876</u>	<u>36,018,341</u>	<u>56,305,042</u>
Investments in programs	86,551,541	135,682,021	114,630,424
Other assets	<u>1,002,317</u>	<u>1,206,616</u>	<u>841,792</u>
Total unrestricted assets	<u>120,069,734</u>	<u>172,906,978</u>	<u>171,777,258</u>
Restricted assets:			
Short-term investments	<u>4,818,953</u>	<u>9,864,399</u>	—
FIXED ASSETS	<u>124,641</u>	<u>205,213</u>	<u>175,831</u>
Total Assets	<u>\$ 125,013,328</u>	<u>\$ 182,976,590</u>	<u>\$ 171,953,089</u>
LIABILITIES AND NET ASSETS			
CURRENT LIABILITIES			
Accounts payable and accrued expenses	<u>1,658,199</u>	<u>7,318,155</u>	<u>8,715,124</u>
NET ASSETS			
Invested in capital assets	124,641	205,213	175,831
Unrestricted	118,411,535	165,588,823	163,237,965
Restricted	<u>4,818,593</u>	<u>9,864,399</u>	
Total net assets	<u>123,355,129</u>	<u>175,658,435</u>	<u>163,413,796</u>

Total Liabilities and Net Assets \$ 125,013,328 \$ 182,976,590 \$ 171,953,089

The Corporation makes risk capital investments of no more than six million dollars, with the approval of the Finance Committee of the Board of Directors, in high technology applicant companies. Investments greater than six million dollars are possible, with approval of the full Board of Directors. The Corporation primarily makes investments in equity securities of emerging high-tech companies. It has substantially eliminated the use of royalty financing arrangements but continues to recover the cost and revenues of past royalty arrangements. The Corporation has over 75 percent of its investments in equity securities.

In the absence of readily determined market values, investments are carried at fair value as determined by the valuation committee of the Corporation.

CII also infrequently provides working capital loans to Connecticut companies to bring new high technology products to market. Loans may be used for any business-related purpose such as hiring, marketing, inventory buildup and capital expenditures; they may not, however, be used for product development. A loan must be repaid within six years according to an arranged payment schedule. Loan agreements can include warrants allowing the Corporation to purchase stock in the companies.

A schedule of revenues, expenses and change in net assets for the fiscal years ended June 30, 2000, 2001 and 2002 follows:

	<u>2002</u>	<u>2001</u>	<u>2000</u>
Revenues:			
Interest on short-term investments and cash deposits	\$ 1,077,969	\$ 2,901,646	\$ 3,490,350
Interest on investments	1,292,711	1,226,429	1,056,614
Other income	<u>951,756</u>	<u>1,069,310</u>	<u>2,777,695</u>
Total Revenue	<u>3,322,436</u>	<u>5,197,385</u>	<u>7,324,659</u>
Expenses:			
Compensation and benefits	2,801,104	2,355,361	4,165,711
General and administrative expenses	1,925,624	2,977,712	2,465,179
Grants and Programs	<u>2,059,247</u>	<u>820,360</u>	<u>2,237,721</u>
Total expenses	<u>6,785,975</u>	<u>6,153,433</u>	<u>8,868,611</u>
Deficiency of Revenues over Expenses	(3,463,539)	(956,048)	(1,543,952)
Net Unrealized Gain (Loss) on investments	(56,295,478)	(5,873,070)	36,335,794
Net Realized gain on investments	<u>1,705,086</u>	<u>11,261,066</u>	<u>18,132,710</u>
Net (Loss) Gain Before Capital Contributions	(58,053,931)	4,431,948	52,924,552
Capital Contributions	<u>5,750,625</u>	<u>7,210,199</u>	<u>7,213,049</u>
Change in Net Assets	<u>\$ (52,303,306)</u>	<u>\$ 11,642,147</u>	<u>\$ 60,137,601</u>

The Corporation's short-term investments consist primarily of investments in the State

Treasurer's Short Term Investment Fund.

The loss before capital contributions of \$58,053,931 compares unfavorably with the gains during the two preceding fiscal years. The wide divergence is accounted for by decreases in realized gains on the disposal of investments and a significant change in unrealized portfolio losses from a gain of \$36,335,794 in 2000 to a loss of \$56,295,478 in 2002. The Corporation's financial results were reflective of the marked decline in the private and public equity markets during the 2001-2002 fiscal year. Emerging high-tech companies, which make up a large portion of the Corporation's portfolio, were heavily impacted in both the public and the private markets.

During 2002, CII committed almost \$32,000,000 to investments in new and existing portfolio companies and spent over \$2,000,000 for grants and scholarships.

Clean Energy Fund

The Renewable Energy Investment Fund (commonly referred to as the Clean Energy Fund) was established in July 1998 under Title 16, Section 16-245n of the General Statutes. Said Section requires that Connecticut Innovations manage the Clean Energy Fund.

Section 16-245n provides that on or after January 1, 2000, the Department of Public Utility Control shall assess or cause to be assessed a charge per kilowatt-hour to each end-user of electrical service in the State. It is this assessment which provides the financing for the Fund. Unlike the majority of Connecticut Innovations' investments, the Clean Energy Fund is not limited to Connecticut businesses. The Fund may use any amount in the Fund for expenditures which:

- Foster growth, development and commercialization of renewable energy technologies and sources;
- Stimulate Connecticut consumers' demand for renewable energy;
- Promote deployment of renewable energy sources that serve Connecticut's energy customers.

The Fund's two key strategic thrusts are the support of renewable energy technologies (fuel cell, wind, solar, biomass conversion, tidal energy, ocean thermal, etc.) and infrastructure and market support (education and outreach, tradable renewable certificates, entrepreneurial stimulation, etc.).

The Clean Energy Fund is governed by its own 12-member advisory board consisting of individuals with knowledge and experience in matters related to the purpose and activities of the Fund. Three members are appointed by the Connecticut Innovations' Board of Directors. Of the remaining nine members, two shall be State officials appointed by the Governor, one shall be a Gubernatorial appointee with experience regarding renewable energy resources and one member each is appointed by the Speaker of the House of Representatives, the President Pro-Tem of the Senate, the majority leaders of the House of Representatives and the Senate, and the minority leaders of the House of Representatives and the Senate. The advisory board must approve investment proposals of the Clean Energy Fund before they can be funded.

The members of the Clean Energy Fund Advisory Board as of June 30, 2002 were as follows:

Arthur H. Diedrick, Chairman
Tim Bowles
Marian Chertow
Donald W. Downes
Eileen S. Kraus
John Mengacci
Jerome P. Peters, Jr.
Margery C. Winters
Robert Wright

Appointed by the Board of Directors of Connecticut Innovations Inc:

George Lewson
Thomas J. Clark
Charles McClenachan

The financial position of the Clean Energy Fund as of June 30, 2001 and 2002, as presented in its audited financial statements, is presented below:

ASSETS

	<u>As of June 30,</u>	
	<u>2002</u>	<u>2001</u>
Current Assets		
Cash and short term investments	\$ 16,406,749	\$ 14,971,762
Total investments in programs	3,988,412	2,969,726
Other assets	<u>125,000</u>	<u>125,000</u>
Total Assets	<u>\$ 20,520,161</u>	<u>\$ 18,066,488</u>

LIABILITIES AND NET ASSETS

Current Liabilities		
Due to Connecticut Innovations	\$ 475,467	\$ 863,471
Net Assets		
Unrestricted net assets	<u>20,044,694</u>	<u>17,203,017</u>
Total Liability and Net Assets	<u>\$ 20,520,161</u>	<u>\$ 18,066,488</u>

Clean Energy Fund revenue, expenses and the change in net assets for the years ending June 30, 2001 and 2002 is presented below:

Fiscal Year Ended June 30,
2002 **2001**

REVENUES:		
Interest on investments and cash deposits	\$ 427,988	\$ 589,852
EXPENSES:		
General and administrative	<u>2,874,815</u>	<u>1,705,065</u>
CHANGE IN NET ASSETS	(2,446,827)	(1,115,213)
Net unrealized loss on investments	(4,625,211)	-
Grants and programs	<u>(4,418,056)</u>	-
Net loss before capital contributions	<u>\$(11,490,094)</u>	<u>\$(1,115,213)</u>
)	
Contributed capital	\$ 14,331,771	\$ 13,969,655
Increase in net assets	2,841,677	12,854,442
Net assets, beginning of year	<u>17,203,017</u>	<u>4,348,575</u>
Net assets, end of year	<u>\$ 20,044,694</u>	<u>\$ 17,203,017</u>

Financial activity of the Clean Energy Fund for the fiscal year ended June 30, 2000 is reflected in the financial statements of Connecticut Innovations, Inc.

The loss before capital contributions of \$11,490,094 compares with a loss of \$1,111,213 for the fiscal year ended June 30, 2001, the first complete year of operations. This resulted from the marked increase in unrealized losses from zero to \$4,625,211 and the marked increase in payments for grants and programs from zero to \$4,418,056 between the two years.

During 2002, the Corporation committed a total of \$16.5 million dollars for new grants and programs. Of this amount, \$14.5 million was for fuel cell initiatives. In addition, \$5.6 million was contributed in the form of equity and debt to other fuel cell investments.

Other Examinations:

An independent public accountant audited the Corporation's financial statements and those of the Clean Energy Fund for each of the three years under review. Those audits attested that the combined financial statements presented fairly, in all material respects, the financial position of Connecticut Innovations, Incorporated and the Clean Energy Fund for the years under review, and the results of its operations and cash flows for those years in conformity with generally accepted accounting principles.

The independent public accountant's reports included an explanatory paragraph regarding the Corporation's use of estimates to determine the fair value of a significant portion of its assets in the absence of readily ascertainable market values. They concluded that the procedures used to arrive at

the estimated values of such investments were reasonable and appropriately documented. The independent public accountants noted however that "...because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material."

As an integral part of their financial statement audits, the independent public accountant also provided reports on compliance and on internal control over financial reporting. These reports disclosed no instances of noncompliance concerning these requirements. The reports on the internal control structure indicated that no material weaknesses in internal control were identified.

CONDITION OF RECORDS

Severance Payments to Employees:

Criteria: In accordance with Section 32-35, subsection (d), subpart (2), of the General Statutes, CII has established written policies for hiring, dismissing, promoting and compensating employees. However, CII has no written policy specifically covering severance payments.

Section 32-35, subsection (d), subpart (3) of the General Statutes states that CII's procurement policies should include approval by the Board of Directors for any nonbudgeted expenditure in excess of \$5,000.

Section 32-37, subsection (b), of the General Statutes permits the CII Board of Directors to delegate to three or more of its members such Board powers and duties as it may deem proper.

Condition: We noted one severance payment during the audited period. This expenditure was approved by the Audit and Operations Committee, and exceeded \$110,000 when considering the combination of a six-month severance period and other relocation costs incurred by the former employee.

While the CII Board has the ability to delegate the approval of such a transaction to the Audit and Operations Committee, documentation of the extent of authority actually granted to the Committee was not immediately available

Cause: The Agency had not seen a need for a severance policy because such payments were rarely made.

Effect: The lack of a written policy regarding severance payments could lead to apparent inconsistencies or the appearance of favoritism. We were unable to confirm that this expenditure was approved in conformance with CII's established procedures

Recommendation: CII should establish a policy pertaining to the payment of severance payments. (See Recommendation 1.)

Auditee Response: "The severance payment mentioned in this report was approved by the Operations and Audit Committee of the Board of Directors in conformance with CII's Board of Directors' established policies and procedures. This topic was appropriately discussed and approved by the committee. Severance payments are not normally a budgeted

expenditure. The severance payments were properly recorded as part of compensation and benefits expense.

The one instance cited was unique and in no way typical of CII's general severance guidelines. The individual had been hired to manage the Clean Energy Fund. The position required someone with unique experience. This person was hired only after an extensive nation wide search and had to relocate his family to Connecticut. When the focus of the fund changed the following year, his services were no longer required. CII felt obligated to help the employee relocate his family back to his home state.

CII concurs that it would be beneficial to document the general guidelines pertaining to the payment of severance payments. On August 25, 2003 the Board of Directors approved a severance policy. A copy of CII's Severance Policy is attached.

Also on August 25, 2003, the Board of Directors passed a resolution confirming the delegation of certain administrative and other responsibilities, including personnel responsibilities, to the Operations and Audit Committee and ratifying all actions and resolutions taken by the Committee."

Noncompliance with Statutory Reporting Provisions:

Criteria: Section 32-47a of the General Statutes details the specific contents of annual reports that CII is required to submit by November 1st annually to the Commissioner of Economic and Community Development, the Auditors of Public Accounts and the joint standing committee of the General Assembly having cognizance of such matters. Among these requirements are information concerning the gross revenues during each recipient's most recent fiscal year, and a summary of the CII's activities to assist small business and minority business enterprises.

Section 32-40, subsection (c), of the General Statutes provides that all financial information obtained by CII concerning any applicant or project shall not be regarded as public records. Such a provision appears to conflict with the reporting requirements of Section 32-47a.

Condition: CII's reports issued in conformance with Section 32-47a of the General Statutes present an overall "Analysis of Gross Revenue

Figures” but not the individual recipient data required. In addition, there was no summary of the corporation’s activities to assist small business and minority business enterprises.

Cause: With regard to the revenue figures, CII has taken the position that such information is confidential in accordance with statutory provisions. With regard to a summary of the corporation’s activities to assist small business and minority business enterprises, the omission appears to have been an oversight.

Effect: The Corporation did not fully comply with its statutory reporting requirements.

Recommendation: CII should implement procedures to comply with all of its legislated reporting requirements. Where questions exist as to the confidentiality of required information, the Corporation should seek legislative clarification to resolve the apparent statutory conflict and ensure that the legislative intent is met. (See Recommendation 2.)

Agency Response: “CII has complied with all legislated reporting requirements. Section 32-40(c) exempts from public disclosure under the Freedom of Information Act all financial information obtained by CII concerning an applicant, project, activity, technology, product or invention. Based on this specific exemption, we believe that the aggregate revenue information included in the annual report is accurate, complete and meets the legislative intent.

Information on CII’s activities to assist small business and minority business enterprises is included in the report but not summarized. CII will prepare a summary as recommended.”

Lack of Accountability for Clean Energy Fund Revenues:

Criteria: Sound business practice suggests the periodic preparation of an accountability report of cash receipts to enable a comparison of revenues received with an independent report of revenues that should have been received.

Condition: As of March 2003, the Clean Energy Fund was receiving in excess of \$1,000,000 a month from utility companies, representing charges assessed to end-users of electric services as mandated under Section 16-245n of the General Statutes. No supporting documentation was provided to support the amounts paid. In addition, CII had not prepared an accountability report during the period under review to reconcile receipts from the utility companies against reported sales of electric power to consumers.

- Cause:* CII apparently had not considered the need for a mechanism to verify that the correct amounts were received from the utilities.
- Effect:* There is reduced assurance that the Clean Energy Fund had received all of the revenue to which it was entitled.
- Recommendation:* CII should institute procedures to ensure that it obtains adequate documentation in a timely manner to support revenue of the Clean Energy Fund, and to enable CII to prepare regular accountability reports. (See Recommendation 3.)
- Agency Response:* “Under Section 16-245n, subsection (b) of the General Statutes, the DPUC is responsible for assessing the charge on end-users of electricity that is earmarked for the Clean Energy Fund. The statutes do not give CII the authority to audit the utilities’ calculation of ratepayer contributions. Such authority rests with the DPUC.
- CII is working with both the DPUC and the utilities to obtain documentation to support the calculation of ratepayer contributions to the Clean Energy Fund.”

Statutory Responsibilities Codified Outside of Corresponding Chapter:

- Criteria:* In order to more readily associate statutory responsibilities to the entity charged with carrying out those tasks, such duties are normally delineated in the Chapter(s) of the Statutes creating the entity.
- CII administers a number of programs as part of its operations. Generally, all of its programs are operated within CII’s financial structure and the annual CII financial audit covers these operations.
- Condition:* Section 16-245n is located in Chapter 283 of the Statutes, which is devoted to matters affecting the Department of Public Utility Control (DPUC). Under Section 16-245n, subsection (b), the DPUC is responsible for assessing a charge on end-users of electricity. That assessment is earmarked for the Clean Energy Fund.
- There is currently no reference to the Renewable Energy Investment Fund (Clean Energy Fund) in Chapter 581 of the General Statutes, which is devoted to CII matters. However, in accordance with Section 16-245n, subsection (c), of the General Statutes, CII is responsible for administering the Clean Energy Fund. Under Section

16-245n, subsection (d), the Chairperson of the Board of Directors of CII is required to convene a Renewable Energy Investments Advisory Committee to assist CII. These provisions effectively make the Clean Energy Fund a program within CII. Thus, the level of involvement by CII is much greater than that of the DPUC. While CII treats the Clean Energy Fund as its own program in most of its published documents, CII obtains separate financial audits of the Fund. The Clean Energy Fund is regarded as a related party in CII's financial statements.

Effect: Attempts to compare CII's activities to attainment of its statutory mission are made more difficult when references to the mission are not aggregated. CII is also incurring additional expenses by requiring a separate audit rather than including the Fund's operations within its own financial statements.

Cause: The current statutory structure reflects the original legislation. CII obtains separate audits because the Fund is not statutorily a program of CII.

Recommendation: Connecticut Innovations, Inc. should consider seeking changes to the relevant General Statutes to reflect its responsibilities for managing the Renewable Energy Investment Fund as specified in Section 16-245n of the General Statutes. (See Recommendation 4.)

Agency Response: "We respectfully disagree. The Clean Energy Fund (statutorily the Renewable Energy Investment Fund) is not a program within CII. CII administers the Fund as stated in the General Statutes. The Clean Energy Fund has a different mission and funding source than CII. Separate accounting records are maintained and separate financial statements and results of operations are prepared in order to properly report on the Fund's activities. Further, proceeds of the Clean Energy Fund are not co-mingled with CII operating funds, nor would it be appropriate to do so.

In fiscal year 2001, the first full year of the Fund's operation, CII had the independent auditors and legal counsel review the applicable General Statutes. Both the independent auditors and legal counsel concluded that the activities of the Clean Energy Fund were independent from CII and that separate accounting records, financial statements and results of operations were necessary in order to properly report on the Fund's activities."

Disclosure of Related Organizations and Related-Party Transactions:

<i>Criteria:</i>	<p>In the interest of full disclosure, the relationship between governmental entities and other related organizations should be recognized.</p> <p>Generally Accepted Auditing Standards require that independent auditors apply sufficient audit procedures to provide reasonable assurance that related organizations and related party transactions are adequately disclosed in the financial statements.</p>
<i>Condition:</i>	<p>During the fiscal year ended June 30, 2002, the Clean Energy Fund contributed \$500,000 to a non-profit organization established for the purpose of raising awareness of clean energy issues among businesses, community groups, and environmental organizations. The Board of Directors of the non-profit consists of four individuals, two of whom were employees of Connecticut Innovations. As discussed above, the Clean Energy Fund is essentially a program administered by CII. Despite the fact that CII represents 50 percent of the non-profit's Board of Directors and Clean Energy Fund contributed over 60 percent of the entity's available capital, the expenditure to the non-profit was not recognized as a related-party transaction.</p> <p>During the January 2002 Board meeting, the CII Board of Directors approved a guarantee of lease payments for the Connecticut Technology Development Corporation (CTDC). CII is the sole shareholder of CTDC, and all five CTDC Board members are on the CII Board of Directors. This transaction was not reflected as a related-party transaction, despite the relationship of CII and CTDC. The CTDC was not reflected as a related organization in the footnotes to CII's financial statements.</p>
<i>Effect:</i>	<p>The failure to identify all related-party organizations and transactions increases the risk that such transactions may not be carried out at arms-length and go undetected.</p>
<i>Cause:</i>	<p>CII staff informed us that reliance was placed on the independent auditor to identify the transactions through a review of the minutes of the Board meetings.</p>
<i>Recommendation:</i>	<p>In conjunction with its independent auditors, Connecticut Innovations Inc. should exercise greater care in identifying organizations that meet the criteria of related parties. (See Recommendation 5.)</p>

Agency Response: “We agree. CII will continue to work with our outside auditors to identify and disclose in the notes to the financial statements organizations that meet the criteria of related parties.

The independent auditors were provided with all documentation on the investments and related party transactions of both CII and the Clean Energy Fund. The auditors did not believe that either example cited was a related party transaction which required disclosure.

Although the CII Board of Directors approved a guarantee of lease payments for the CTDC, the lease was never executed. Hence, there was no reportable related party event. The existence of the CTDC will be disclosed in the notes to the financial statements.

RECOMMENDATIONS

Status of Prior Audit Recommendations:

There were no prior audit recommendations.

Current Audit Recommendations:

1. CII should establish a policy pertaining to the payment of severance payments.

Comment:

While only one severance payment was made during the audited period, we noted the lack of a policy relating to such payments.

2. CII should implement procedures to comply with all of its legislated reporting requirements. Where questions exist as to the confidentiality of required information, the Corporation should seek legislative clarification to ensure that the legislative intent is met.

Comment:

Annual reports did not include revenue data from individual recipients. In addition, a summary of the corporation's activities to assist small business and minority business enterprises was omitted. As of March 1, 2003, the annual report due on November 1, 2002, had not been submitted.

3. CII should institute procedures to ensure that it obtains adequate documentation in a timely manner to support revenue of the Clean Energy Fund, and to enable CII to prepare regular accountability reports.

Comment:

The Clean Energy Fund did not obtain data needed to confirm that the amounts received from utility companies were correct.

4. **Connecticut Innovations, Inc. should consider seeking changes to relevant General Statutes to reflect its responsibilities for managing the Renewable Energy Investment Fund, as specified in Section 16-245n of the General Statutes.**

Comment:

While CII was almost solely responsible for the administration of the Fund, it is not mentioned in CII's authorizing legislation.

5. **In conjunction with its independent auditors, Connecticut Innovations, Inc. should exercise greater care in identifying organizations that meet the criteria of related parties.**

Comment:

Auditing standards require footnote disclosure of transactions with related parties in financial statements. We noted two such transactions that were not disclosed during the audited period.

CONCLUSION

We wish to express our appreciation for the cooperation and courtesies extended to our representatives by the personnel of the Connecticut Innovations, Incorporated during our examination.

Kenneth Post
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts