

STATE OF CONNECTICUT

**AUDITORS' REPORT
CONNECTICUT INNOVATIONS, INCORPORATED
FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

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

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November 15, 2006

**AUDITORS' REPORT
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FOR THE FISCAL YEAR ENDED JUNE 30, 2005**

We have made an examination of the financial records of the Connecticut Innovations, Incorporated (the Corporation), as provided in Section 2-90 and Section 1-122 of the General Statutes, for the fiscal year ended June 30, 2005.

SCOPE OF AUDIT:

This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to, a determination of whether the Corporation has complied with its written operating procedures, that are required per Section 32-35 (d) of the General Statutes, concerning the following areas:

- Affirmative action
- Personnel policies
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources.

We also considered the Corporation's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on the Corporation's financial operations in order to determine our auditing procedures for the purpose of evaluating the Corporation's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objects. Our consideration of internal control included the five areas identified above.

Our audit included a review of a representative sample of the Corporation's activities during the fiscal year in the five areas identified above and a review of such other areas as we considered necessary. The financial statement audit of the Corporation for the fiscal year indicated above, was

conducted by the Corporation's independent public accountants.

This report on our examination consists of the Comments, Recommendations and Certification that follow.

COMMENTS

FOREWORD:

Connecticut Innovations, Incorporated (hereafter CI 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 subdivision of the State. The Corporation is also responsible for administering the Renewable Energy Investment Fund, commonly referred to as the Connecticut Clean Energy Fund (CCEF), as required under Section 16-245n of the General Statutes. 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).

CI 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. 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.

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. This program is run through the Connecticut Innovations Educational Foundation (CIEF). Details about the CIEF are included later in this report.

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 Corporation'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, photonics and energy, and environmental systems.

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.

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 BioSeed Program – This program was established to help accelerate the growth of early-stage biotech enterprises in Connecticut.

Connecticut Clean Energy Fund – As required under Section 16-245n, CI administers this Fund. It was created under Public Act 98-28 as the Renewable Energy Investment Fund. The Fund is intended to promote the production and utilization of clean energy, and is commonly referred to as the Connecticut Clean Energy Fund (CCEF). Although the CCEF should be considered a CI program, its financial records and activities are kept separate from CI, as its purpose is distinctly different from that of CI. A separate independent audit is done for the CCEF.

In addition, in the footnotes to its financial statements for the fiscal year ended June 30, 2005, the following organizations are identified as blended component units of the Corporation, that,

although legally separate entities, are in substance, part of the Corporation's operations:

Connecticut Technology Development Corporation (CTDC) – The CTDC is a CI wholly owned for-profit corporation, used to address the need by new biotech firms for wet laboratory space in “move-in” condition. The CTDC activities during the 2004-2005 fiscal year consisted mainly of rent, utilities, and depreciation expenses at 25 Science Park in New Haven. The total expenses of CTDC during the fiscal year ended June 30, 2005 were \$399,399. These amounts are included in the Corporation's financial statements.

Connecticut Innovations Educational Foundation (CIEF) – The CI Board approved the creation of the CIEF at its May 14, 2001 meeting. It is a non-stock corporation, exempt from federal income taxes under Internal Revenue Code Section 501(c)(3), in which CI is the sole member. At its March 22, 2004 meeting, the Board authorized several CI and CCEF programs to be run through the CIEF, including the Technology Scholar Program, the Yankee Ingenuity Technology Competition, the Clean Energy Freedom Bus, and the Connecticut Clean Energy Fund Yankee Ingenuity Technology Competition. CI presents that the Foundation was created so that it could solicit funds from external sources as a 501(c)(3) corporation, to provide additional funding for the programs. Apparently, the Foundation was not successful in its fund raising efforts, and CI plans to discontinue its operation. The total expenses of the Foundation during the fiscal year ended June 30, 2005 were \$187,720.

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 Corporation's scope and providing, where appropriate, capital for invention and innovation when financial aid is not available from normal commercial sources.
- Marketing– responsible for marketing support.
- Connecticut Clean Energy Fund Operations – responsible for the operation of the Connecticut Clean Energy Fund.

Significant State Legislation:

An Act Establishing a Connecticut New Opportunities Fund - Public Act 05-129, effective July 1, 2005, requires that CI shall establish a fund to be known as the Connecticut New Opportunities Fund, for the purpose of investing in seed stage and emerging growth companies in the State. The corporation, or a subsidiary created by the corporation for the purposes of this section, shall serve as general partner or managing member of the fund and shall determine whether the fund should be organized as a limited partnership or a limited liability company. The fund shall have a term of ten years, provided it may be extended for three one-year periods if necessary to complete liquidation of the fund's investments. The State shall provide a first loss guarantee at the end of the tenth year, if needed, of not more than twenty-five million dollars.

An Act Permitting Stem Cell Research and Banning the Cloning of Human Beings - Public Act 05-149, Section 3(f), effective June 15, 2005, requires that CI shall serve as administrative staff of the Stem Cell Research Advisory Committee and shall assist the committee in (1) developing an application for grants-in aid for a stem cell research program, (2) reviewing such applications, (3) preparing and executing any assistance agreements or other agreements in connection with the awarding of such grants-in-aid, and (4) performing such other administrative duties as the committee deems necessary.

Board of Directors and Administrative Officials:

Pursuant to Section 32-35 of the General Statutes, a 15-member Board of Directors governs the Corporation. 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 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, 2005, the members of the Board of Directors were as follows:

Appointed by the Governor:

Elaine A. Pullen, Chairperson
R. Carol Muradian
John W. Olsen
Paul R. Pescatello
Daniel Rappaport
Rafael A. Santiago
George W. Schiele

Legislative Appointments:

Thomas J. Clark
Barbara Gay Nicholson
E. Charles McClenachan

Ex-Officio:

Valerie F. Lewis, Commissioner of Higher Education
James F. Abromaitis, Commissioner of Economic and Community Development
John A. Mengacci, Undersecretary of the Office of Policy and Management

The Board experienced a significant number of changes during the fiscal year ended June 30, 2005. The following also served on the board during the audit period:

Arthur H. Diedrick
John T. Booth
Anthony J. Campanelli
Geraldine U. Foster
J. Scott Guilmartin
George Lewson
Fred Maryanski
Theresa Yerkes

Arthur Diedrick served as Chairperson of the Board until his resignation in July 2004. Elaine Pullen was appointed as Chairperson on February 23, 2005.

In addition, the Board has set up several Committees and Sub-committees to expedite certain business activities of the Corporation as well as to maintain controls over its transactions. These committees include an Audit, Compliance and Governance Committee, a Finance, Operations and Compensation Committee, an Eli Whitney Investment Committee, and a Clean Energy Investment Committee.

Victor Budnick served as President and Executive Director of CI from October 16, 1995, until his resignation on March 31, 2005. Arnold B. Brandyberry served as the Acting President and Executive Director, effective April 1, 2005, until the CI Board appointed Chandler J. Howard as President and Executive Director, effective September 1, 2005. Chandler Howard served as President until his resignation on April 27, 2006. On April 28, 2006, the Board appointed Peter Longo to the position of Deputy Executive Director. The Board appointed Frank A. Dinucci to the position of President and Executive Director, effective October 2, 2006.

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. The State Comptroller records State bond proceeds to finance loans and investments as expenditures, while the Corporation records them 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 subsection (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:

As indicated above, State expenditures related to Connecticut Innovations, Incorporated include 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 zero in the 2004-2005 fiscal year, compared to \$4,995,395 in the 2003-2004 fiscal years.

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 CI, and also for the repayment of State bonds when required by the State Bond Commission. Total bond fund monies authorized by Sections 32-41, 32-41b, and 31-41o, amounted to \$114,801,000 as of June 30, 2005. Expenditures charged to the Fund during the audited period consisted entirely of payroll costs for CI and the CCEF, which were funded by cash transfers from CI to the Fund. A summary of Fund expenditures for the audited period follows:

	<u>Fiscal Year Ended</u>	
	<u>June 30, 2005</u>	<u>June 30, 2004</u>
	\$	\$
Personal Services	2,693,368	2,625,001
Fringe Benefits	<u>1,264,931</u>	<u>1,130,067</u>
Totals	<u>\$ 3,958,299</u>	<u>\$ 3,755,068</u>

The increase in Personal Services and fringe benefits is due to an increase in the payment of accrued leave at separation and due to an increase in the fringe benefit rates. There were no State expenditures made from the Enterprise Fund for investment purposes.

Connecticut Innovations, Incorporated Accounts:

As previously indicated, pursuant to subsection (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 short-term investments and marketable securities, including 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, 2005, the Bond Commission had not requested repayment of any principal or interest.

Auditors of Public Accounts

The financial position of the Corporation as of June 30, 2004 and 2005, per its audited financial statements, is presented below. These amounts do not include the Connecticut Clean Energy Fund.

Assets	As of June 30,	
	2005	2004
Current Assets:		
Unrestricted assets:	\$	\$
Cash and cash equivalents:		
Cash	997,931	991,008
Short-term investments	<u>21,392,923</u>	<u>19,125,586</u>
Total cash and cash equivalents	<u>22,390,854</u>	<u>20,116,594</u>
Marketable securities	156,100	150,000
Current portion of investments	1,612,910	1,489,418
Due from related parties	264,759	314,635
Other assets	<u>326,073</u>	<u>1,113,359</u>
Total unrestricted current assets	<u>2,359,842</u>	<u>3,067,412</u>
Restricted assets:		
Short-term investments	<u>0</u>	<u>5,000,000</u>
Total current assets	<u>24,750,696</u>	<u>28,184,006</u>
Non-Current Assets		
Unrestricted assets:		
Investments in programs	45,593,700	59,497,413
Less current portion	<u>(1,612,910)</u>	<u>(1,489,418)</u>
Investments - non-current	43,980,790	58,007,995
Capital assets, net of depreciation	<u>1,447,909</u>	<u>1,460,252</u>
Total unrestricted non-current assets	45,428,699	59,468,247
Restricted assets:		
Short-term investments	<u>13,346,417</u>	<u>10,000,000</u>
Total non-current assets	<u>58,775,116</u>	<u>69,468,247</u>
Total Assets	<u>\$ 83,525,812</u>	<u>\$ 97,652,253</u>
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	\$ 573,298	\$ 613,239
Due to related parties	<u>14,375</u>	<u>13,766</u>
Total liabilities	<u>587,673</u>	<u>627,005</u>
Net Assets		
Invested in capital assets	1,447,909	1,460,252
Unrestricted	68,143,813	80,564,996
Restricted	<u>13,346,417</u>	<u>15,000,000</u>
Total net assets	<u>82,938,139</u>	<u>97,025,248</u>
Total Liabilities and Net Assets	<u>\$ 83,525,812</u>	<u>\$ 97,652,253</u>

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 approximately 68 percent of its investments in equity securities.

In the absence of readily determined market values, investments are carried at fair value as estimated by the valuation committee of the Corporation, using United States Private Equity Valuation Guidelines promulgated by the Private Equity Investment Guidelines Group. As is commonplace with investments such as those held by CI, and as disclosed in the CI's audited financial statements, due to the inherent uncertainty of valuation, those estimated values may differ significantly from the amounts ultimately realized from the investments, and the differences could be material.

CI also provides loans that are generally convertible into equity to Connecticut companies to bring new high technology products to market. Loans may be used for any business-related purpose such as hiring, marketing, research and development, inventory buildup and capital expenditures. A loan must be repaid within six years according to an arranged payment schedule.

A schedule of revenues, expenses and change in net assets for the fiscal years ended June 30, 2004 and 2005, follows. The information was obtained from the Corporation's audited financial statements, and does not include the Connecticut Clean Energy Fund.

	<u>Fiscal Year Ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
Operating Revenues:		
Interest on short-term investments and cash deposits	\$ 631,220	\$ 265,332
Interest on investments	1,262,580	1,514,635
Other income	<u>668,326</u>	<u>1,269,241</u>
Total Revenue	<u>2,562,126</u>	<u>3,049,208</u>
Operating Expenses:		
Compensation and benefits	1,912,384	1,949,097
General and administrative expenses	<u>2,292,516</u>	<u>1,821,717</u>
Total operating expenses	<u>4,204,900</u>	<u>3,770,814</u>
Net Operating Loss	<u>(1,642,774)</u>	<u>(721,606)</u>
Non-Operating Revenues (Expenses):		
Unrealized loss on investments	(1,888,213)	(12,587,255)
Realized gain (loss) on sale of investments	(5,135,005)	6,485,220
Grants and Programs	<u>(421,117)</u>	<u>(929,217)</u>
Total non-operating expenses	<u>(7,444,335)</u>	<u>(7,031,252)</u>
Change in Net Assets Before Capital Contributions and Statutory Transfers	(9,087,109)	(7,752,858)
Statutory Transfers to the State of Connecticut	(5,000,000)	(5,000,000)
Capital Contributions [from the State of Connecticut]	<u>0</u>	<u>4,995,395</u>
Change in Net Assets	<u>\$ (14,087,109)</u>	<u>\$ (7,757,463)</u>

Total revenues decreased by \$487,082 during the 2004-2005 fiscal year. Interest on short-term investments and cash deposits increased by \$365,888 in 2004-2005 due to higher average cash on hand and interest rate increases for the fiscal year. Interest on investments decreased by \$252,055 in 2004-2005 as a result of pay-offs and pay-downs of loans. Other income decreased by \$600,915 due

to the receipt of nonrecurring dividends in 2004.

General and administrative expenses increased by \$470,799 during the 2004-2005 fiscal year due primarily to higher legal and other professional fees.

Net realized losses on investments for the year were \$5,135,005, as compared to realized gains of \$6,485,220 in the 2003-2004 fiscal year. In 2004-2005 the Corporation recorded write-offs totaling \$7.5 million of investments in several portfolio companies. These losses were partially offset by \$2.4 million in realized gains from the sale of public securities. The \$6.5 million in realized gains in 2004 was from the sale of public securities.

The CI Board approved \$2,731,400 for investments during the fiscal years ended June 30, 2005, and funded \$4,060,492. The Eli Whitney Fund comprised the majority of the approved and funded amounts. In addition, CI provided funding of \$525,000 for grants and scholarships during the audited period.

Connecticut Clean Energy Fund:

The Renewable Energy Investment Fund (commonly referred to as the Connecticut Clean Energy Fund) was established in July 1998 under Title 16, Section 16-245n of the General Statutes. Said Section requires that Connecticut Innovations administer the Connecticut 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 that provides the financing for the Fund. Unlike the majority of Connecticut Innovations' investments, the Connecticut Clean Energy Fund is not limited to Connecticut businesses. CI is authorized to use any amount in the Fund for expenditures that promote investment in renewable energy sources in accordance with a comprehensive plan developed by it to foster the growth, development and commercialization of renewable energy sources and related enterprises and stimulate demand for renewable energy and deployment of renewable energy sources which serve end use customers in this state. Such expenditures may include, but not be limited to, grants, direct or equity investments, contracts or other actions which support research, development, manufacture, commercialization, deployment and installation of renewable energy technologies, and actions which expand the expertise of individuals, businesses and lending institutions with regard to renewable energy technologies.

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.).

Section 16-245n, subsection (d), establishes a Renewable Energy Investments Advisory Committee to assist CI in matters related to the Connecticut Clean Energy Fund. The committee shall consist of not more than 12 individuals with knowledge and experience in matters related to the purpose and activities of the Fund. Three of the 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-Tempore 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. This Advisory Committee is known as the Clean Energy Advisory Board of the Connecticut Clean Energy Fund. There is also a Clean Energy Committee of the CI Board of Directors currently made up of six CI Board members. Before any investment or grant proposal, etc., is funded, it must be approved by the Clean Energy Committee, which generally acts on the recommendations made by the Advisory Board.

The members of the Connecticut Clean Energy Fund Advisory Board as of June 30, 2005, were as follows:

Timothy Bowles, Chairman
Peter L. Cashman
Marian Chertow
Donald W. Downes
Richard C. Lichter
John Mengacci
Norman Richards, Ph.D.
William T. Sellay
Margery C. Winters

Appointed by the Board of Directors of Connecticut Innovations Inc:

Jerome P. Peters, Jr.
John W. Olsen

There was one vacancy as of June 30, 2005. Arthur H. Diedrick served as Chairman until his resignation in July 2004. Timothy Bowles was appointed Chairman on October 25, 2004.

The financial position of the Connecticut Clean Energy Fund as of June 30, 2004 and 2005, as presented in its audited financial statements, follows:

	<u>As of June 30,</u>	
	<u>2005</u>	<u>2004</u>
Assets	\$	\$
Cash and short-term investments	54,777,854	37,509,248
Utility Customer Assessments Receivable	1,907,965	5,616,543
Total investments and programs	774,995	2,593,770
Other assets	22,046	68,395
Short-term investments-Restricted	<u>926,581</u>	<u>1,040,875</u>
Total Assets	<u>\$ 58,409,441</u>	<u>\$ 46,828,831</u>
Liabilities and Net Assets		
Liabilities:	\$	\$
Due to Connecticut Innovations	256,688	286,008
Accrued Expenses	<u>463,232</u>	<u>258,164</u>
Total Liabilities	<u>719,920</u>	<u>544,172</u>

Net Assets:		
Restricted	926,581	1,040,875
Unrestricted	<u>56,762,940</u>	<u>45,243,784</u>
Total Net Assets	<u>57,689,521</u>	<u>46,284,659</u>
Total Liabilities and Net Assets	<u>\$ 58,409,441</u>	<u>\$ 46,828,831</u>

Connecticut Clean Energy Fund revenue, expenses and the change in net assets for the fiscal years ending June 30, 2004 and 2005, is presented below. The information was taken from the Connecticut Clean Energy Fund audited financial statements for those fiscal years.

	<u>Fiscal Year Ended June 30,</u>	
	<u>2005</u>	<u>2004</u>
Revenues:	\$	\$
Utility Customer Assessments	17,952,493	25,827,103
Interest on short-term investments	775,374	364,906
Interest on investments and cash deposits	<u>52,194</u>	<u>0</u>
Total Revenues	<u>18,780,061</u>	<u>26,192,009</u>
Expenditures/Expenses:		
General and administrative expenses	3,155,574	2,577,525
Grants and programs	<u>1,788,143</u>	<u>4,469,390</u>
Total Expenditures/Expenses	<u>4,943,717</u>	<u>7,046,915</u>
Change in Net Assets Before Changes in the Fair Value of Investments	13,836,344	19,145,094
Net realized gain (loss) on investments	151,552	0
Net decrease in the fair value of investments	<u>(2,583,034)</u>	<u>(4,760,713)</u>
Net Change in Net Assets	11,404,862	14,384,381
Net assets, beginning of year	<u>46,284,659</u>	<u>31,900,278</u>
Net assets, end of year	<u>\$ 57,689,521</u>	<u>\$ 46,284,659</u>

The decrease in revenues from utility customer assessments is due primarily to the statutory transfer of funds for debt service on the State of Connecticut Special Obligation Rate Reduction Bonds (2004 Series A) which were issued on June 23, 2004, in accordance with Public Act 03-6, Section 50, of the June 30, 2003 Special Session, effective August 20, 2003. The proceeds of these bonds were to be used in lieu of direct transfers from the CCEF to the General Fund. One-third of the one mill statutory ratepayer assessment will be used to cover the debt service portion on the bonds, resulting in a reduction in the Connecticut Clean Energy Fund revenues of an estimated \$8,600,000 per year.

Interest on short-term investments and cash deposits increased in the 2004-2005 fiscal year due to the increase in the average cash balance on hand and higher interest rates.

General and administrative expenses increased by \$578,049 in the 2004-2005 fiscal year due to an increase in operating and administrative expenses related to the increase in fund activity and higher legal and other professional fees.

Total expenditures for grants and programs in 2004-2005 were \$1.8 million. During 2004-2005, the Fund committed a total of \$35.8 million for new grants and programs

In the 2005 fiscal year, the fair value of the Fund's investments decreased by \$1,818,762. There was a decrease in valuations with respect to equities of emerging renewable energy companies in which the Fund invests. During 2004-2005, the Fund committed \$934,000 of investments in new opportunities and continued support of existing portfolio companies. Most of the Fund's investments were made in the early stages of the Fund's existence. As the Fund has evolved, it was determined that grant programs would provide more immediate results, and accordingly, CI shifted the Fund's focus from making investments to providing grants. Most of the recipients of the Fund's monies are selected based on detailed reviews of information submitted in response to the Fund's Requests for Proposals, which vary depending upon the particular program within the Fund. Investments still remain an option for the Fund.

During the 2005 fiscal year the Board approved \$44,763,224 for new grants and programs. As of June 30, 2005, the Fund had outstanding commitments totaling \$43,520,455 that are expected to be funded over the next three fiscal years.

Other Examinations:

Independent public accountants audited the Corporation's financial statements and those of the Connecticut Clean Energy Fund for the year under review. Those audits attested that the financial statements presented fairly, in all material respects, the financial position of Connecticut Innovations, Incorporated and the Connecticut Clean Energy Fund for the year under review, and the results of its operations for those years in conformity with generally accepted accounting principles.

The independent public accountants' 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. Essentially, it was concluded that the procedures the Corporation used to arrive at the estimated values of its investments were reasonable and appropriately documented; however, 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 accountants 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

Our review of the records of the Connecticut Innovations, Incorporated revealed the following areas that warrant comment.

Contract and Invoice Approvals:

Criteria: Pursuant to Section 32-35(d) of the Connecticut General Statutes, the board of directors of CI shall adopt written procedures, in accordance with the provisions of Section 1-121, for purchasing, leasing or acquiring real and personal property and personal services, and contracting for financial, legal, bond underwriting and other professional services. The Agency maintains such written procedures called CI Internal Control Procedures.

CI's Internal Control Procedures state that services are to be purchased by means of a contract in writing with appropriate form, content, and authorization. Contracts in excess of \$10,000 in a single fiscal year must be signed by two company officers, one of whom must be the Executive Director. In addition, a contract cannot be executed without the review and signoff by the Vice President of Finance and Administration.

CI's Internal Control Procedures also state that the approval of invoices must be obtained prior to sending such invoices to Accounts Payable for payment processing for goods and services. The level of approval and the number of approvers required is dependant on the dollar amount of the invoice.

Condition: Our review disclosed twenty contracts that lacked proper signatures and/or approvals. Of these twenty, eighteen lacked approval from the Vice President of Finance and Administration, nine lacked the signature of the Executive Director, and ten lacked the signature of a second company officer. In addition, one contract amendment was not signed by the vendor. Our review also disclosed three instances in which invoices were not properly approved for payment by authorized staff.

Effect: Internal control is weakened when established written procedures are not followed.

Cause: CI did not follow its written internal control procedures.

Recommendation: CI should strengthen its internal controls pertaining to expenditures and contract execution. (See Recommendation 1.)

Agency Response: "We agree with the audit finding and recommendation. To ensure that existing procedures for contract and invoice approvals are followed, CI has instituted the following additional measures subsequent to the audit period:

Service Contract Approvals: All personal service contracts are given a tracking number controlled by the accounting department. The VP of Finance and Administration (VP of Finance) initials all contracts, evidencing review as required. A log of all service contracts and a copy of the contract is maintained in the accounting department. On a quarterly basis a report is prepared listing all contracts by tracking number. The VP of Finance reviews all new contracts listed in the report during the quarter for compliance with established procedures.

Invoice Approvals: The accounting department processes all invoices for payment. The VP of Finance reviews all invoices submitted for payment to ensure the proper approvals have been obtained. Invoices are only released for payment after being reviewed by the VP of Finance.”

Personal Service Agreements:

Criteria: Pursuant to Section 32-35(d) of the Connecticut General Statutes, the board of directors of CI shall adopt written procedures, in accordance with the provisions of Section 1-121, for purchasing, leasing or acquiring real and personal property and personal services, and contracting for financial, legal, bond underwriting and other professional services. The Agency maintains such written procedures called CI Internal Control Procedures.

CI’s Internal Control Procedures require that, wherever possible any contract for personal services requiring an expenditure by the Corporation in excess of \$75,000 shall be awarded on the basis of a process of competitive negotiation where proposals are received from at least three qualified parties.

A system of internal control should include procedures to ensure payments are made in compliance with contract terms and provisions.

Condition: Our review disclosed the following related to expenditures for personal service agreements (PSA):

- CI entered into a contract with a stated maximum of \$75,000, that did not require competitive negotiation. However, payments made on the contract totaled \$84,770, exceeding the stated maximum and the threshold requiring competitive negotiation.
- The maximum commissions and fees payable under the terms of one performance-based contract were in excess of the \$75,000 threshold requiring competitive negotiation. There was no documentation on hand to support that the contract was negotiated competitively. Payments totaling \$19,508 were made on this contract during the audit period.
- Our review disclosed that CI entered into three contracts with one consultant, each for a six-month period from March 18, 2004,

through December 2006, to be based on the number of hours worked by the consultant plus expenses. The contracts were not awarded competitively and the total paid for each contract was \$69,675, \$70,534, and \$75,407, respectively. In addition, payments totaling \$17,734 were paid for dates of service for which there was no active PSA on file. Therefore, payments were made beyond the \$75,000 threshold requiring competitive negotiation. In addition, the contract provisions in one of the contracts required that any hours in excess of 48 per each biweekly period be pre-approved by CI. Our review disclosed eleven biweekly periods in which the consultant worked in excess of 48 hours and there was no written evidence of pre-approval on hand. Total payments without pre-approval were \$17,990.

- Although one contract had a stated maximum amount of \$2,750, payments totaling \$8,678 were processed and exceeded the contract amount by \$5,928.
- The conditions of one personal service agreement required that payments be made based on invoices submitted documenting the hours worked. Our review disclosed that the consultant was paid on CI's payroll system based on biweekly timesheets rather than through CI's accounts payable system based on invoices. By placing the consultant on the payroll, he received additional benefits totaling \$5,925 for three holidays, employer Medicare payments, and employer Social Security payments that were not part of the PSA and are not typically paid to or on behalf of vendors.

Effect: Entering into contracts over \$75,000 without a competitive negotiation reduces the opportunity to receive the best price for the services provided. The lack of an effective contract monitoring system increases the risk that over-billing could occur and not be detected.

Cause: CI did not follow its written internal control procedures and did not properly monitor for compliance with contract provisions and amounts.

Recommendation: CI should adhere to its written procedures regarding expenditures by the Corporation that are in excess of \$75,000 and should monitor for compliance with contract amounts and provisions. (See Recommendation 2.)

Agency Response: "We agree with the audit finding and recommendation. To ensure that existing procedures for Personal Service Agreements are followed, CI has instituted the following additional measures subsequent to the audit period. CI tracks all service contracts and prepares a report listing all contracts by tracking number for review by the VP of Finance. This report also contains the original amount of the contract, all payments made against the contract, and available funds under the contract. On a weekly basis accounting department staff reviews the report and when payments made against the contract reach 80% of the contract amount, the member of CI's staff

responsible for the contract is notified. Additionally and also noted in our response to Finding #1, when the VP of Finance reviews invoices for proper approvals prior to release for payment, if an invoice pertains to a service contract, the VP of Finance reviews the contract report previously mentioned to ensure that the payment will not cause the contract amount to be exceeded. We also wish to note the following:

- Total payments under the performance based contract which was completed in fiscal year 2006 were \$59,508.
- Subsequent to the commencement of his contract, the duties and responsibilities of the consultant who was paid through the state payroll system were reviewed by the CI human resource department. It was determined, based on IRS guidelines, that the consultant should have been classified as an employee and paid through the state payroll system to allow for withholding and remittance of both employee and employer payroll tax liabilities during the time services were provided to CI. The consultant substituted signed timesheets, approved by CI management, rather than invoices for payroll processing. In attempting to comply with IRS guidelines, CI inadvertently failed to modify the terms of the original contract to reflect these changes. In the future, the VP of Finance will review all potential personal service agreements prior to execution to determine if in fact the individual providing the service should be hired as an employee rather than contracted with as a vendor.”

Auditors’ Concluding Comment:

Regarding the performance based contract, regardless of the amount ultimately paid on the contract, it is clear from the contract terms that there was the potential for the total amount paid to have considerably exceeded the \$75,000 threshold that requires competitive negotiation.

Personnel Policies:

Criteria: In accordance with Sections 1-121 and 32-35(d) of the General Statutes, CI has established written procedures for most personnel matters. CI’s Employee Handbook requires that employees hired after January 1, 1998, are allowed to accumulate a maximum of thirty vacation days.

Condition: Our review of time and attendance records for seven randomly selected employees disclosed that, in one instance, an adjustment was processed to increase an employee’s vacation balance by thirty-one hours. It appears that this adjustment represents accruals for prior months that were not previously credited to the employee’s vacation balance because he was at the maximum amount allowed. By posting the adjustment, the employee was allowed to accumulate vacation days beyond the thirty-day maximum.

Auditors of Public Accounts

Effect: This represents non-compliance with CI's policies as documented in the Employee Handbook.

Cause: It appears that the adjustment was posted in order to reconcile variances between Core-CT and the Agency's separate internal tracking system. We were also informed that CI personnel misinterpreted the Employee Handbook.

Recommendation: CI should institute procedures to ensure that the vacation leave policy in the Employee Handbook is followed. (See Recommendation 3.)

Agency Response: "We agree with the audit finding and recommendation and have made the necessary changes to our internal tracking system for time and attendance to prevent any such future reoccurrences.

We would like to emphasize that this was an isolated incident which was the result of an unintentional misinterpretation of the vacation carryover provision of the CI Employee Handbook. As a result, our internal time and attendance system erroneously continued to accumulate vacation days for this employee.

Once the error was discovered, during the normal course of reconciling payroll records, the time and attendance system was corrected. Since the employee relied on this information and assumed it to be true, CI management allowed the employee to retain the thirty one hours erroneously credited to their account."

Auditors' Concluding Comment:

Although we were informed that the Human Resources Administrator approved the adjustment, there was no documentation that the adjustment was approved by the Executive Director. The Employee Handbook requires the approval of the Executive Director for exceptions to the policy.

Connecticut Clean Energy Fund Revenues:

Criteria: A system of internal control over revenues should include procedures requiring that revenues be supported by documentation substantiating the accuracy and completeness of the amounts due compared to those that are collected.

Condition: The Connecticut Clean Energy Fund receives monthly payments from two utility companies, representing charges assessed to end-users of electric services as mandated under Section 16-245n of the General Statutes, that aggregated over \$17,000,000 during the audit period. During the audit period, documentation supporting the amounts paid by one of the companies

consisted of only an assessment calculation, while the other company provided only a check. Therefore, it could not be determined from the documentation on file whether all of the required assessments were collected.

We noted that subsequent to the audit period, CI requested additional supporting documentation from the two utilities and in January 2006, CI began receiving additional documentation from one of the utilities. Documentation beyond the assessment calculation has not been received from the other utility.

Effect: There is reduced assurance that the Connecticut Clean Energy Fund received all of the revenue to which it was entitled.

Cause: During the audit period, CI had not requested the information from the utilities. Subsequent to the audit period, one of the utilities has refused to provide the requested information.

Recommendation: CI should institute procedures to ensure that it obtains adequate documentation to support the revenue collected for the Connecticut Clean Energy Fund and to enable CI to determine that the collected amounts represent all of the monies that the Connecticut Clean Energy Fund is due. Also, consideration should be given to reviewing prior years' payments to ensure that the Connecticut Clean Energy Fund received all of the revenue that it was statutorily required to receive. (See Recommendation 4.)

Agency Response: "CI will request a meeting with each electric utility company to review the procedures in place and reports available pertaining to the billing and collection of these charges. Based upon these meetings, CI will determine which reports would need to be obtained on a monthly basis to ensure that the collected amounts represent all of the monies that the Connecticut Clean Energy Fund is due. CI will then seek the assistance of the Department of Public Utility Control (DPUC) in obtaining these reports from each electric utility company."

Conflicting Statutory Reporting Provisions:

Criteria: Section 32-47a of the General Statutes requires CI to prepare an annual report which shall include the following information with respect to new and outstanding financial assistance provided by CI during the twelve-month period ending on June thirtieth for each financial assistance program administered by the corporation: (1) a list of the names, addresses and locations of all recipients of such assistance; (2) for each such recipient; (A) the business activities, (B) the Standard Industrial Classification Manual codes, (C) the gross revenues during the recipient's most recent fiscal year, (D) the number of employees at the time of application, (E) whether the recipient is a minority or woman-owned business, (F) a summary of the terms and conditions for the assistance, including the type and amount of state financial assistance, job creation or retention requirements, and anticipated wage rates, and (G) the amount of investments from private and other nonstate sources that have been leveraged by the assistance; (3) the economic benefit criteria used in determining which applications have been approved or disapproved; and (4) for each recipient of assistance on or after July 1, 1991, a comparison between the number of jobs to be created, the number of jobs to be retained and the average wage rates for each such category of jobs, as projected in the recipient's application, versus the actual number of jobs created, the actual number of jobs retained and the average wage rates for each such category. The report shall also indicate the actual number of full-time jobs and the actual number of part-time jobs in each such category and the benefit levels for each such subcategory. The report shall also include a summary of the activities of the corporation, including all activities to assist small businesses and minority business enterprises, as defined in Section 4a-60g, a complete operating and financial statement and recommendations for legislation to promote the purposes of the corporation. The corporation shall furnish such additional information upon the written request of any such committee at such times as the committee may request.

Section 32-40, subsection (c), of the General Statutes provides that all financial information obtained by CI concerning any applicant or project shall not be regarded as public records.

Condition: Our review of CI's annual financial assistance report for the fiscal year ended June 30, 2005, revealed that CI did not report revenue, wage rate and benefit level data separately for each recipient of assistance. Consistent with its reporting in the past, CI did, however, report the required data in the aggregate.

Effect: The Corporation did not disclose all of the information required under Section 32-47a of the General Statutes.

Cause: Although the information was collected, CI did not report it separately for each recipient because it has taken the position that such information is confidential in accordance with Section 32-40, subsection (c).

Recommendation: CI should seek legislative clarification to resolve the apparent statutory conflict between Section 32-47a and 32-40, subsection (c), to ensure that all information is reported consistent with the legislative intent. (See Recommendation 5.)

Agency Response: “CI will seek legislative clarification during the 2007 Legislative Session. We will request that the Commerce committee, CI’s committee of cognizance, adopt legislation amending our reporting requirements so that they are consistent with the requirements of C.G.S. Section 32-40(c).”

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.

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 is earmarked for the Renewable Energy Investment Fund (Connecticut Clean Energy Fund), which, under 16-245n, subsection (c), shall be administered by CI. There is currently no reference to the Connecticut Clean Energy Fund in Chapter 581 of the General Statutes, which is devoted to CI matters.

Effect: Chapter 581 of the General Statutes does not include all of CI’s statutory responsibilities.

Cause: The current statutory structure reflects the original legislation.

Recommendation: CI should consider seeking changes to the relevant General Statutes to reflect its responsibilities for managing the Connecticut Clean Energy Fund as specified in Section 16-245n of the General Statutes. (See Recommendation 6.)

Agency Response: “CI will seek a legislative change during the 2007 Legislative Session. CI will ask the Commerce committee, its committee of cognizance, to update CI’s powers and purposes Statute by adding a new subsection granting CI the authority to administer the Renewable Energy Investment Fund created by C.G.S. Section 16-245n(c).”

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- CI should refrain from allowing its employees to benefit from employment with any portfolio company that it has created. CI's policy is to no longer make or sponsor any such post-state employment arrangements. Therefore, this finding is not repeated.
- CI should pursue only investment opportunities that are clearly within its statutory authority. Our review did not disclose any investment opportunities outside CI's statutory authority. Therefore, this finding is not repeated.
- CI should adhere to its written procedures regarding expenditures by the Corporation that are in excess of \$75,000. This recommendation is repeated. (See Recommendation 2.)
- CI should implement procedures to ensure that its written procedures pertaining to contract execution are followed. This recommendation is repeated. (See Recommendation 1.)
- CI should institute procedures to ensure that it obtains adequate documentation supporting the revenue collected for the Connecticut Clean Energy Fund, and to enable CI to determine that the collected amounts represent all of the monies that the Connecticut Clean Energy Fund is due. Also, consideration should be given to reviewing prior years' collections to ensure that the Connecticut Clean Energy Fund received all of the revenue that it was statutorily required to receive. This recommendation is repeated. (See Recommendation 4.)
- CI should seek legislative clarification to resolve the apparent statutory conflict between Section 32-47a and 32-40, subsection (c), to ensure that all information is reported consistent with the legislative intent. This recommendation is repeated. (See Recommendation 5.)
- CI should consider seeking changes to the relevant General Statutes to reflect its responsibilities for managing the Connecticut Clean Energy Fund, as specified in Section 16-245n of the General Statutes. This recommendation is repeated. (See Recommendation 6.)

Current Audit Recommendations:

1. CI should strengthen its internal controls pertaining to expenditures and contract execution.

Comment:

Our review disclosed twenty contracts that lacked proper signatures and/or approvals. Of these twenty, eighteen lacked approval from the Vice President of Finance and Administration, nine lacked the signature of the Executive Director, and ten lacked the signature of a second company officer. In addition, one contract amendment was not signed by the vendor. Our review also disclosed three instances in which invoices were not properly approved for payment by authorized staff.

- 2. CI should adhere to its written procedures regarding expenditures by the Corporation that are in excess of \$75,000 and should monitor for compliance with contract amounts and provisions.**

Comment:

Our review disclosed contracts that were not negotiated competitively, instances in which expenditures exceeded the contract amounts, and instances of non-compliance with contract provisions.

- 3. CI should institute procedures to ensure that the vacation leave policy in the Employee Handbook is followed.**

Comment:

Our review of time and attendance records for seven randomly selected employees disclosed that, in one instance, an adjustment was processed to increase an employee's vacation balance by thirty-one hours. It appears that this adjustment represents accruals for prior months that were not previously credited to the employee's vacation balance because he was at the maximum amount allowed. By posting the adjustment, the employee was allowed to accumulate vacation days beyond the thirty-day maximum.

- 4. CI should institute procedures to ensure that it obtains adequate documentation to support the revenue collected for the Connecticut Clean Energy Fund and to enable CI to determine that the collected amounts represent all of the monies that the Connecticut Clean Energy Fund is due. Also, consideration should be given to reviewing prior years' payments to ensure that the Connecticut Clean Energy Fund received all of the revenue that it was statutorily required to receive.**

Comment:

The Connecticut Clean Energy Fund receives monthly payments from two utility companies, representing charges assessed to end-users of electric services, as mandated under Section 16-245n of the General Statutes, that aggregated over \$17,000,000 during the audit period. During the audit period, documentation supporting the amounts paid by one of the companies consisted of only an assessment calculation, while the other company provided only a check. Therefore, it could not be determined from the documentation on file whether all of the required assessments were collected. We noted that subsequent to the audit period, CI requested additional supporting documentation from the two utilities and in January 2006, CI began receiving additional documentation from one of the utilities. Documentation beyond the assessment calculation has not been received from the other utility.

- 5. CI should seek legislative clarification to resolve the apparent statutory conflict between Section 32-47a and 32-40, subsection (c), to ensure that all information is reported consistent with the legislative intent.**

Comment:

Our review of CI's annual financial assistance report for the fiscal year ended June 30, 2005, revealed that CI did not report revenue, wage rate and benefit level data separately for each recipient of assistance. Consistent with its reporting in the past, CI did, however, report the required data in the aggregate.

- 6. CI should consider seeking changes to the relevant General Statutes to reflect its responsibilities for managing the Connecticut Clean Energy Fund as specified in Section 16-245n of the General Statutes.**

Comment:

While CI is responsible for the administration of the Connecticut Clean Energy Fund, such responsibility is not mentioned in CI's authorizing legislation.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 and Section 1-122 of the General Statutes, we have conducted an audit of Connecticut Innovations, Incorporated's activities for the fiscal year ended June 30, 2005. This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to a determination of whether the Corporation has complied with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds and the distribution of loans, grants and other financial resources, and to understanding and evaluating the effectiveness of the Corporation's internal control policies and procedures for ensuring that the provisions of certain laws, regulations, contracts and grants applicable to the Corporation are complied with. The financial statement audit of the Corporation, for the fiscal year indicated above, was conducted by the Corporation's independent public accountants.

We conducted our audit in accordance with the requirements of Section 2-90 and Section 1-122 of the General Statutes. In doing so, we planned and performed the audit to obtain reasonable assurance about whether the Corporation complied in all material respects with the provisions of certain laws, regulations, contracts and grants and to obtain a sufficient understanding of internal control to plan the audit and determine the nature, timing and extent of tests to be performed during the conduct of the audit.

Compliance

Compliance with the requirements of laws, regulations, contracts and grants applicable to Connecticut Innovations, Incorporated is the responsibility of the Corporation's management.

As part of obtaining reasonable assurance about whether the Corporation complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Authority's financial operations for the fiscal year ended June 30, 2005, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources.

Our examination included reviewing all or a representative sample of the Corporation's activities in those areas and performing such other procedures as we considered necessary in the circumstances. The results of our tests disclosed the following instances of non-compliance, which are further described in the accompanying "Condition of Records" and "Recommendations" sections of this report: the lack of appropriate contract and invoice approvals, non-compliance with procedures related to personal service agreements, non-compliance with CI's vacation policy in the Employee Handbook, and omission of data in the annual report.

Internal Control

The management of Connecticut Innovations, Incorporated is responsible for establishing and maintaining effective internal control over its financial operations and compliance with the requirements of laws, regulations, contracts and grants applicable to the Corporation. In planning and performing our audit, we considered the Corporation's internal control over its financial operations and its compliance with requirements that could have a material or significant effect on the Corporation's financial operations in order to determine our auditing procedures for the purpose of evaluating the Corporation's financial operations and compliance with certain provisions of laws, regulations, contracts and grants, and not to provide assurance on the internal control over those control objectives. Our consideration of internal control included, but was not limited to, the following areas:

- Affirmative action
- Personnel practices
- Purchase of goods and services
- Use of surplus funds
- Distribution of loans, grants and other financial resources.

Our consideration of the internal control over the Corporation's financial operations and over compliance would not necessarily disclose all matters in the internal control that might be material or significant weaknesses. A material or significant weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with certain provisions of laws, regulations, contracts, and grants that would be material in relation to the Corporation's financial operations or noncompliance which could result in significant unauthorized, illegal, irregular or unsafe transactions to the Agency being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving internal control that we consider to be material or significant weaknesses.

However, we noted certain matters involving the internal control over the Corporation's financial operations and/or compliance, which are described in the accompanying "Condition of Records" and "Recommendations" sections of this report.

This report is intended for the information of the Governor, the State Comptroller, the Appropriations Committee of the General Assembly and the Legislative Committee on Program Review and Investigations. However, this report is a matter of public record and its distribution is not limited. Users of this report should be aware that our audit does not provide a legal determination of Connecticut Innovations, Incorporated's compliance with the provisions of the laws, regulations, contracts and grants included within the scope of this audit.

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.

Lisa G. Daly
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts