

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
CONNECTICUT INNOVATIONS, INCORPORATED  
FOR THE FISCAL YEARS ENDED JUNE 30, 2013 and 2014*

**AUDITORS OF PUBLIC ACCOUNTS**  
JOHN C. GERAGOSIAN ❖ ROBERT M. WARD

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# STATE OF CONNECTICUT



## AUDITORS OF PUBLIC ACCOUNTS

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November 20, 2015

### **AUDITORS' REPORT CONNECTICUT INNOVATIONS, INCORPORATED FOR THE FISCAL YEAR ENDED JUNE 30, 2013 and 2014**

We have audited certain operations of Connecticut Innovations, Incorporated (CI) in fulfillment of our duties under Sections 1-122, 2-90, and 32-42 of the Connecticut General Statutes. The scope of our audit included, but was not necessarily limited to, the years ended June 30, 2013 and 2014. The objectives of our audit were to:

1. Evaluate the corporation's internal controls over significant management and financial functions;
2. Evaluate the corporation's compliance with policies and procedures internal to the authority or promulgated by other state agencies, as well as certain legal provisions, including but not limited to whether Connecticut Innovations, Incorporated 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 assistance, as applicable; and
3. Evaluate the economy and efficiency of certain management practices and operations, including certain financial transactions.

Our methodology included reviewing written policies and procedures, financial records, minutes of meetings, and other pertinent documents; interviewing various personnel of the corporation, as well as certain external parties; and testing selected transactions. We obtained an understanding of internal controls that we deemed significant within the context of the audit objectives and assessed whether such controls have been properly designed and placed in operation. We tested certain of those controls to obtain evidence regarding the effectiveness of their design and operation. We also obtained an understanding of legal provisions that are significant within the context of the audit objectives, and we assessed the risk that illegal acts, including fraud, and violations of contracts, grant agreements, or other legal provisions could occur. Based on that risk assessment, we designed and performed procedures to provide reasonable assurance of detecting instances of noncompliance significant to those provisions.

We conducted our audit in accordance with the standards applicable to performance audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform our audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides such a basis.

The accompanying *Résumé of Operations* is presented for informational purposes. This information was obtained from the corporation's management and was not subjected to the procedures applied in our audit of the corporation. For the areas audited, we identified:

1. Deficiencies in internal controls;
2. Apparent noncompliance with legal provisions; and
3. No need for improvement in management practices and procedures that we deemed to be reportable.

The State Auditors' Findings and Recommendations in the accompanying report presents any findings arising from our audit of Connecticut Innovations, Incorporated.

## COMMENTS

### FOREWORD

Connecticut Innovations, Incorporated operates primarily under Chapter 581, Sections 32-32 through 32-47a of the General Statutes. Pursuant to Section 32-35, it is a public instrumentality and political subdivision of the state. Pursuant to Chapter 12 of the General Statutes, CI is classified as a quasi-public corporation subject to the requirements related to such agencies found in Chapter 12. As a quasi-public corporation, CI'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, businesses and products; to encourage the creation and transfer of new technologies; to assist existing businesses in adopting current and innovative technological processes; to stimulate and provide services to industry that will advance the adoption and utilization of technology; to achieve improvements in the quality of products and services; to stimulate and encourage the development and operation of new and existing science parks and incubator facilities; and to promote science, engineering, mathematics and other disciplines that are essential to the development and application of technology within Connecticut by the infusion of financial aid for research, invention and innovation in situations in which such financial aid would not otherwise be reasonably available from commercial or other sources.

CI 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. CI also funds other

organizations such as Connecticut universities and technology research and application centers. CI includes contingent payback provisions to those funds as a means of sharing in the royalties and other earnings from successful research projects.

CI targets early-stage high-technology enterprises. These include: advanced materials, aerospace, bioscience, energy and environmental systems, information technology, applied optics, and microelectronics. CI utilizes a number of limited partnerships and financial investments to achieve its objectives of assisting qualified organizations.

### **Agency Merger**

Public Act 12-1, Section 147, enacted in the June Special Session of the General Assembly, merged the Connecticut Development Authority (CDA) with Connecticut Innovations, Incorporated, effective July 1, 2012. All of CDA's programs and activities, which were created to stimulate industrial and commercial development within the state, continue as a part of CI.

### **Financial and Technical Programs**

CI provides several financial and technical programs and corresponding funds to assist qualifying Connecticut companies, colleges, and universities. These include:

- **Eli Whitney Fund** – This program may be used for risk capital investments in emerging and established companies to stimulate their development of high technology products, processes and services. The program also provides working capital to assist companies in marketing and launching technology products, processes, and services.
- **BioScience Facilities Fund** – This program was developed to enable the development of laboratory space in Connecticut in order to encourage the growth of biotechnology research and development companies.
- **Seed and BioSeed Funds** – These programs were developed to address the needs of entrepreneurs by promoting and investing in early stage Connecticut based emerging technology and biotechnology companies.
- **PreSeed Fund** – This program was developed to provide support and assistance to prepare high technology companies for future investments. Investments consist of two-year promissory notes ranging from \$25,000 to \$200,000.
- **Clean Tech Fund** – This program was developed to support the demand for alternative energy technologies which focus on energy conservation, environmental protection, or the elimination of harmful waste.
- **Mezzanine Fund** – This loan program is designed to address the needs of Connecticut companies as they endeavor to grow sales and revenues and thus their job base and market share. The loans will be used for working capital purposes.

- **Small Business Innovation Research (SBIR) Office** – The Connecticut SBIR Office seeks to support Connecticut based innovators, entrepreneurs, and small businesses to commercialize new products. The program also provides matching grants to manufacturers to design and develop innovative technologies to diversify their portfolio of products thereby retaining/increasing sales and employment in the state. The SBIR program also assists companies to obtain federal grants through the federal SBIR program.
- **Self-Sustaining Bond Program** – Under the self-sustaining bond program, CI accommodates the financing for specific industrial and certain recreational and utility projects through the issuance of special obligation industrial revenue bonds. These bonds are available for financing projects such as the acquisition of land or the construction of buildings, and the purchase and installation of machinery, equipment and pollution control facilities.
- **Insurance Program** – Under the Insurance Program, CI may insure loans made by other lending institutions to companies for acquisition of industrial land, buildings, machinery, and equipment located within the state.
- **Growth Fund** – Under the Growth Fund, CI is authorized to issue individual loans up to a maximum of \$4,000,000. This program provides financial assistance for any purpose CI determines will materially contribute to the economic base of the state by creating or retaining jobs, promoting the export of products and services, encouraging innovation in products or services, or supporting existing activities that are important to the state's economy. Financing may be used to purchase real property, machinery and equipment, or for working capital.
- **Connecticut Works Fund and Connecticut Works Guarantee Fund** – The Connecticut Works Fund includes direct loans and a loan guarantee program with participating lenders to encourage them to provide more credit on more favorable terms. Eligible projects include most manufacturing related projects and any project that materially supports the economic base of the state through jobs, defense diversification, exporting, and the development of innovative products or services. Loan types and amounts include revolving credit lines, fixed asset loans, and refinancing in some cases.
- **Connecticut Capital Access Fund** – The Connecticut Capital Access Fund provides portfolio insurance to participating financial institutions to assist them in making loans that are somewhat riskier than conventional loans. This assistance is funded by the two branches of the Connecticut Capital Access Fund, the Urbank Program and the Entrepreneurial Loan Program. Eligible projects are usually determined by the financial institution making the loan as long as the projects meet the requirements specified in the participation agreements.
- **Business Environmental Clean-up Revolving Loan Fund** – The Business Environmental Clean-up Revolving Loan Fund provides direct fixed-rate loans to

business property owners unable to obtain clean-up financing from conventional sources. As of June 30, 2013, there was no additional funding available for this program.

- **The Environmental Assistance Revolving Loan Fund** – The Environmental Assistance Revolving Loan Fund provides direct loans to businesses unable to obtain financing from conventional sources. Assistance relates to the prevention of future environmental hazards. As of June 30, 2013, there were no active loans remaining in this program. It is anticipated that no future funding will be available for this program.

### **Component Units**

In addition, the following organizations are identified as blended component units of CI that, although legally separate entities, are in substance, part of CI operations:

- **Connecticut Technology Development Corporation (CTDC)** – CTDC was established to address the need by new biotech firms for wet laboratory space in “move-in” condition. CTDC also established a business incubator program which leases office space to startup firms focusing on information technologies. The wet laboratory activities were discontinued on June 30, 2013. Activities after June 30, 2013 will consist only for those in relation to the business incubator program.
- **Connecticut Brownfields Redevelopment Authority (CBRA)** – CBRA is a quasi-public corporation created by the former Connecticut Development Authority in May 1999 to carry out the remediation, development, and financing of contaminated property within the state, in accordance with Section 32-11a subsection (1) of the General Statutes. CBRA is now a wholly owned subsidiary of CI. CBRA provides loans, grants, or guarantees from CI assets and the proceeds of its bonds, notes, and other obligations. Any net gain from the subsidiary flows back to CI as an addition or in the case of a loss, a reduction in earnings.

### **Organizational Structure**

Organizationally, CI was divided into nine major areas during the audited period:

- **Accounting & Finance** – Responsible for financial reporting, budgeting, strategic planning, debt management, and treasury functions.
- **Operations** – Responsible for the efficiency and effectiveness of CI operations, including information technology, human resources, planning and analysis, compliance, and facilities.
- **External Relations** – Responsible for coordinating, planning and managing legislative program activities; acts as liaison between CI and the executive and legislative branches; and works with other economic development agencies to evaluate existing statewide policies and assess needs for new policy formulation.

- **Venture Team** – Responsible for evaluating investment opportunities, structuring investments, and monitoring portfolio companies at CI.
- **Loan Team** – Responsible for underwriting and structuring commercial loan transactions for Connecticut businesses in conjunction with bank and non-bank lenders.
- **Marketing & Communications** – Responsible for helping to connect entrepreneurs, established businesses, investors, and other stakeholders with the information they need to reach their goals.
- **Small Business Innovation** – Responsible for overseeing vital programs that support the state’s small technology businesses and encourage innovation, collaboration, and commercialization.
- **Strategic Investments** – Responsible for strategic projects and investments, and the coordination of projects with other governmental stakeholders at CI.
- **Bioscience Initiatives** – Supports the initiation and management of the Connecticut Bioscience Innovation Fund and other bioscience initiatives at CI.

#### **Relevant State Legislation**

- **Public Act 12-1**, enacted in the June Special Session of the General Assembly, merged the Connecticut Development Authority (CDA) with CI as of July 1, 2012, transferring CDA’s statutory mission, powers, obligations, and assets to CI.
- **Public Act 13-115**, effective July 1, 2013, set conditions allowing the CI governing board to delegate the duty to approve or deny applications for loan, loan guarantees, equity investments, and other forms of economic development assistance to CI staff.
- **Public Act 13-239**, effective July 1, 2013, established the Connecticut Bioscience Innovation Fund to finance a wide range of commercially viable bioscience projects and required CI to act as administrator.
- **Public Act 13-246**, effective October 1, 2013, established a tax increment financing program in which businesses and municipalities may obtain financing for large-scale development projects and required CI to act as administrator.
- **Public Act 13-247**, effective July 1, 2013, removed the Commissioner of Economic and Community Development as chairperson of the CI board of directors and required the Governor to appoint a chairperson from among the board members.
- **Public Act 14-94**, effective June 2014, renamed the Clean Energy Finance and Investment Authority as the Connecticut Green Bank, which shall be within Connecticut Innovations, Incorporated, for administrative purposes only.

**Board of Directors and Administrative Officials**

Section 151 of Public Act 12-1, enacted in the June Special Session of the General Assembly, changed the composition of the board of directors. Effective July 1, 2012, CI is governed by a board of 17 directors. Nine members shall be appointed by the Governor, six of whom shall be knowledgeable in the development of innovative start-up businesses and three of whom shall be knowledgeable in the field of financial lending or the development of commerce, trade, and business. Four members shall be the Commissioner of Economic and Community Development, the President of the Board of Regents for Higher Education, the Treasurer, and the Secretary of the Office of Policy and Management, who shall serve ex-officio. Ex-officio members may designate their deputy or any member of their staff to represent them at meetings of the corporation with full power to act and vote on their behalf. Four members shall be appointed as follows: one by the president pro tempore of the Senate, one by the minority leader of the Senate, one by the speaker of the House of Representatives, and one by the minority leader of the House of Representatives. The Governor shall appoint a chairperson from among the board members.

The 17 members of the board of directors as of June 30, 2014 were as follows:

***Appointed by the Governor:***

Michael A. Cantor, Chair  
Joseph J. Kaliko  
John Olsen  
Alexander D. Pencu, Esq.  
Paul R. Pescatello, J.D., Ph.D.  
Jonathan Roth  
Rafael A. Santiago  
David M. Siegel  
Christopher Swift

***Legislative Appointments:***

Christopher D. Bandecchi  
Mun Y. Choi, Ph.D.  
Alan Greene  
Richard Mulready

***Ex-Officio Members:***

Denise Nappier, State Treasurer  
*Designee: Christine Shaw, Chief Compliance Officer*

Benjamin Barnes, Secretary, Office of Policy and Management  
*Designee: Karen Buffkin, former Deputy Secretary, Office of Policy and Management (transferred to the Governor's Office effective January 7, 2015)*

Gregory W. Gray, President, Board of Regents of Higher Education  
*Designee: Gail Coppage, Director of Innovation and Outreach (retired effective July 1, 2015)*

Catherine Smith, Commissioner, Department of Economic and Community Development  
*Designee: No designee; member attends all meetings.*

In addition, the board has set up several committees and sub-committees to expedite certain business activities of CI and to maintain controls over its transactions. During the audit period, CI had the following four standing committees:

- Audit, Compliance and Governance Committee
- Finance, Operations and Compensation Committee
- Eli Whitney Investment Committee
- Loan Committee

CI also has two advisory committees which met throughout the audited period including:

- Eli Whitney Advisory Committee
- Valuation Committee

Claire Leonardi served as chief executive officer and executive director from March 1, 2012 through January 8, 2015. Philip Siuta served as acting chief executive officer until Matthew McCooe was appointed as chief executive officer on July 13, 2015.

## **RÉSUMÉ OF OPERATIONS**

### **State Funding**

The State of Connecticut provides significant funding for CI programs through the issuance of general obligation bonds. The bond proceeds and any net income from operations are used to finance CI investments.

State expenditures related to CI include bond fund proceeds to finance various grants and investments. They also include certain operating expenses processed through Core-CT, the state's accounting system. These transactions are processed through five special revenue funds; Grants to Local Governments and Others, Connecticut Bioscience Collaboration Fund, Economic Development Fund (previously the CDA Guarantee Loan Fund), Connecticut Works Fund (also from CDA), Bioscience Innovation Fund, and an enterprise fund Connecticut Innovations, Incorporated Fund.

The Grants to Local Governments and Others Fund is a special revenue fund used to process certain grant awards authorized by the state legislature through various authorizing special acts and the action of the State Bond Commission. Bond payments are processed through Core-CT and are recorded on both the state's and CI's books. The State Comptroller records state bond proceeds to finance loans and investments as expenditures, while CI records them as investments and as contributed capital. During the 2012-2013 fiscal year, \$20,000,000 of special revenue funds were used to recapitalize various portfolio investment programs and \$1,670,000 was used for pre-seed programs. In the 2013-2014 fiscal year, \$225,000 of special revenue funds was used for pre-seed programs.

The Connecticut Bioscience Collaboration Fund is a special revenue fund established in accordance with Public Act 11-2. The purpose of the fund is to support the establishment of a bioscience cluster anchored by a research laboratory housed at the University of Connecticut Health Center. The state authorized the issuance of \$179,003,000 in bonds of which \$129,039,000 was issued as of June 30, 2014. During the 2012-2013 and 2013-2014 fiscal years, \$30,043,743 and \$89,065,293 respectively, was used for grants, facility loans, and equipment.

The Connecticut Bioscience Innovation Fund (CBIF) was established pursuant to Public Act 13-239, effective July 1, 2013. The fund's purpose is to finance a wide range of commercially viable bioscience projects that will create jobs while lowering health care costs and improving the delivery of health care services. It capitalizes the fund by authorizing up to \$200 million in general obligation bonds over ten years and allows the proceeds to be used for grants or loans to, or investments in, projects proposed by start-up or early stage businesses, colleges and universities, and nonprofit organizations. Fund expenditures were \$20,000,000 for the 2013-2014 fiscal year.

The Connecticut Works Fund and the Economic Development Funds are special revenue funds previously administered by CDA prior to its merger with CI. The Connecticut Works Fund was established in accordance with Section 32-23ii of the General Statutes and provides financial assistance for economic development projects for creating or retaining jobs, promoting the export of products or services, encouraging innovation in products or services, or otherwise contributing to, supporting or enhancing existing activities that are important to the economic base of the state. The state authorized the issuance of up to \$95,000,000 in state bonds of which \$86,462,706 was issued as of June 30, 2014. Expenditures related to the fund for the 2013-2014 fiscal year were \$12,515,000.

The Economic Development Fund is the previous Connecticut Works Guarantee Fund established in accordance with Section 32-261 of the General Statutes and provides commitments to guarantee loans made by participating financial institutions. Eligible projects are determined by the due diligence principles set forth in the loan presentation guidelines and underwriting considerations for the Loan Guarantee Program of the Connecticut Works Fund. The state authorized the issuance of up to \$132,430,000 in state bonds of which \$109,430,000 was issued as of June 30, 2014. Expenditures for the 2013-2014 fiscal year were \$11,100,000.

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 for the repayment of state bonds when required by the State Bond Commission. Total bond funds authorized by Sections 32-41, 32-41b, and 32-41o amounted to \$114,800,500 of which \$114,300,319 was issued as of June 30, 2014. Core-CT is used by CI for the processing of enterprise fund payroll and other operating expenses. Expenditures charged to the enterprise fund during the audited period consisted entirely of the payroll costs of CI and the Connecticut Green Bank (CGB) (formerly known as the Clean Energy Finance and Investment Authority), which were funded by cash transfers by CI and CGB to the Connecticut Innovations, Incorporated Fund. There were no state expenditures made from the enterprise fund for investment purposes.

**Connecticut Innovations, Incorporated**

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 the CI operating account. The operating account is used to pay administrative expenses, including 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 CI may be required to repay the monies advanced by the State Bond Commission, including interest, under terms the commission might find desirable and consistent with the purposes of CI. As of June 30, 2014, the State Bond Commission had not requested repayment of any principal or interest.

The financial position of CI as of June 30, 2013 and 2014, per its audited financial statements, is presented below.

	<u>June 30, 2013</u>	<u>June 30, 2014</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and Cash Equivalents	\$ 43,338,189	\$ 22,895,618
Loans, Current Portion	7,720,383	5,603,810
Portfolio Investments, Current Portion	754,649	942,917
Interest and Other Receivables	1,067,652	1,703,018
Due from State of Connecticut	7,219,774	10,041,437
Prepaid Expenses	1,019,919	216,398
<b>Total Current Assets</b>	<u>61,120,566</u>	<u>41,403,198</u>
<b>Noncurrent Assets</b>		
Restricted Assets:		
Restricted Cash and Cash Equivalents	21,708,895	45,681,652
Other Security	3,008,095	--
Total Restricted	<u>24,716,990</u>	<u>45,681,652</u>
Portfolio Investments, Net of Current Portion	64,253,204	79,175,449
Loans – Noncurrent, Net of Allowance for Loan Losses	45,305,721	58,368,220
CT Bioscience Collaboration Program Loans, Net of		
Allowance for Doubtful Accounts	--	--
Capital Assets, Net of Depreciation	414,549	413,593
Due from the State of Connecticut	--	--
Other	283,200	166,000
<b>Total Noncurrent Assets</b>	<u>134,973,664</u>	<u>183,804,914</u>
<b>Total Assets</b>	<u>\$196,094,230</u>	<u>\$225,208,112</u>

	<b>June 30, 2013</b>	<b>June 30, 2014</b>
<b>Deferred Outflows of Resources</b>	<u>\$ 200,150</u>	<u>\$ 145,266</u>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Current Portion of Bonds Payable	\$ 3,685,000	\$ 2,260,000
Accrued Expenses and Liabilities	4,946,889	7,004,950
Deferred Revenue	663,511	505,222
Due to Connecticut Bioscience Innovation Fund	--	19,000,000
Refundable Advances	4,108,607	4,072,458
Reserve for Guarantee Losses	1,050,905	1,302,237
<b>Total Current Liabilities</b>	<u>14,454,912</u>	<u>34,144,867</u>
<b>Noncurrent Liabilities</b>		
Escrow Deposits	7,843,012	9,960,743
Bonds Payable, Net of Current Portion	5,020,000	2,760,000
<b>Total Noncurrent Liabilities</b>	<u>12,863,012</u>	<u>12,720,743</u>
<b>Total Liabilities</b>	<u>27,317,924</u>	<u>46,865,610</u>
<b>Net Position</b>		
Net Investment in Capital Assets	414,549	413,593
Restricted	12,595,371	12,476,820
Unrestricted	155,966,536	165,597,355
<b>Total Net Position</b>	<u>168,976,456</u>	<u>178,487,768</u>
<b>Total Liabilities and Net Position</b>	<u>\$196,294,380</u>	<u>\$225,353,378</u>

CI makes risk capital investments in high-technology companies. CI primarily makes investments in equity securities of emerging high-tech companies. It has essentially eliminated the use of royalty financing arrangements but continues to recover the costs and revenues of past royalty arrangements. CI has almost 80 percent of its investments in equity securities.

In the absence of readily determinable market values, investments are carried at fair value as estimated by an independent valuation committee using United States Private Equity Valuation Guidelines promulgated by the Private Equity Investment Guidelines Group. As is commonplace with investments like those held by CI, and as disclosed in the CI 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 schedule of revenues, expenses, and changes in net assets for the fiscal years ended June 30, 2013 and 2014, follows. The information was obtained from the CI audited financial statements. Amounts for the 2012-2013 fiscal year are combined from CI and CDA.

	<u>June 30, 2013</u>	<u>June 30, 2014</u>
<b>Operating Revenues</b>		
Investment Interest Income	\$ 605,618	\$ 1,399,444
Interest on Loans	2,634,562	2,751,037
Unrealized Gain (Loss) on Investments	(224,775)	2,243,357
Realized Loss on Sale of Investments	(4,119,749)	(5,819,766)
Loan Fee Income	1,431,409	1,231,942
XL Center Income	1,311,669	1,257,165
Grant and Program Income	616,057	586,330
CT Bioscience Collaboration Funding	29,427,285	85,390,633
Other Income	597,773	1,471,055
<b>Total Operating Revenues</b>	<u>32,279,849</u>	<u>90,511,197</u>
<b>Operating Expenses</b>		
Salaries	5,287,327	5,874,367
Benefits and Payroll Taxes	3,959,122	4,462,416
Grants and Programs	10,781,358	17,333,014
CT Bioscience Collaboration Loan Write-down	25,946,965	74,185,633
Provision for Loan and Guarantee Losses	3,372,500	1,950,000
XL Center Expenses	2,108,609	27,164
General Facility and Office	1,176,952	1,098,123
Professional Service Fees	813,859	1,138,124
Interest	391,558	272,681
Marketing, Conferences, Development	371,859	691,661
Depreciation and Amortization	237,211	235,215
Other	69,797	38,976
<b>Total Operating Expenses</b>	<u>54,517,117</u>	<u>107,307,374</u>
<b>Operating Loss</b>	<u>(22,237,268)</u>	<u>(16,796,177)</u>
<b>Nonoperating Revenues (Expenses)</b>		
CT Public Act 11-1	20,000,000	--
CT Pre-Seed Fund	1,570,000	225,000
Connecticut General Statutes 31-41a Funding		9,496,918
Connecticut Works (A) and Connecticut Works (B) Guarantee Fund	--	16,585,571
Loss on Disposal of Assets	(60,151)	--
<b>Total Non-operating Revenues (Expenses)</b>	<u>21,509,849</u>	<u>26,307,489</u>
<b>Change in Net Position Before Extraordinary Item</b>	(727,419)	9,511,312

	<b>June 30, 2013</b>	<b>June 30, 2014</b>
<b>Extraordinary Item</b>		
Assets Transferred in from Connecticut Development Authority	83,998,798	--
<b>Change in Net Position</b>	83,271,379	9,511,312
<b>Net Position</b> – Beginning of Year	85,705,077	168,976,456
<b>Net Position</b> – End of Year	\$168,976,456	\$178,487,768

Total operating revenues increased by \$53.8 million for the 2013-2014 fiscal year. The large increase was attributed to the additional CT Bioscience Collaboration funding from the State of Connecticut. The XL Center revenue and expenses decreased due to the expiration of the lease. Effective June 30, 2013, CI granted and transferred full and exclusive managerial, operational and financial responsibility for the facility to Northland/AEG. Other income increased primarily due to \$1,000,000 administrative fee revenue for the Connecticut Bioscience Innovation Fund administration and \$978,000 in interest earned on debt investments converted to equity in the 2013-2014 fiscal year.

Compensation, benefits, and payroll taxes increased by \$1.1 million during the 2013-2014 fiscal year. This was a result of the CI/CDA merger and increased staffing, primarily for investment managers and analysts to support the planned increase in portfolio company investments.

General and administrative expenses which include facility and office expenses, professional service fees, marketing, conferences and development, as well as depreciation, amortization, and other incidental expenses were \$3,202,099, an increase of approximately \$532,421, during the 2013-2014 fiscal year. The increase was due primarily to legal and advisory fees associated with the Innovation Ecosystem and marketing/re-branding expenses for CI and CTNext/Small Business Initiatives.

Total expenditures for grants and programs were \$17,333,014 for the 2013-2014 fiscal year. The increase can be attributed to operating grants disbursed under the Bioscience Collaborative Program, Small Business Initiatives/CTNext Programs, and Innovation Ecosystem Program.

Net realized losses on investments were \$5,819,766, for the 2013-2014 fiscal year. The losses resulted from divestitures of investments which were recorded as unrealized losses in previous years.

Net unrealized gains and losses on investments were \$2,243,357 for the 2013-2014 fiscal year. The gains resulted from net increases in valuation reserves for privately held companies in CI's investment portfolio and public holdings.

CI received other funding from the state totaling \$21,600,000 and \$26,300,000 for the 2012-2013 and 2013-2014 fiscal years respectively. In the 2012-2013 fiscal year, \$20,000,000 of the funds was used to recapitalize various portfolio investment programs and \$1,600,000 for the Pre-Seed Fund. In the 2013-2014 fiscal year, \$5,500,000 was used for CT Works (Fund A),

\$11,100,000 for CT Works (Fund B), \$225,000 for CT Pre-Seed, and \$9,500,000 in accordance with Section 32-41b of the General Statutes for (1) loans for the development and marketing of products in the high technology field within the state, (2) royalty financing for start-up costs and product development costs of high technology products and procedures in the state, and (3) financial aid for biotechnology and other high technology laboratories, facilities and equipment.

During fiscal year 2012-2013, CI approved \$27 million and funded \$21.3 million for investments in new opportunities and continued support of existing portfolio companies. For fiscal year 2013-2014, CI approved \$23.6 million and funded \$22 million for investments in new opportunities and continued support of existing portfolio companies.

### **Other Examinations**

Independent public accountants audited the CI financial statements for the fiscal years under review. Those audits attest that the financial statements presented fairly, in all material respects, the financial position of Connecticut Innovations, Incorporated for the audited period, and the results of the operations and cash flows during that period in conformity with accounting principles generally accepted in the United States of America.

As an integral part of their financial statement audits, the independent public accountants also provided reports on compliance and internal control over financial reporting. The reports on internal control indicated that no material weaknesses in internal control over financial reporting were identified. However, for the 2012-2013 fiscal year, a significant deficiency was reported. It was noted that CI had not recorded or paid arbitrage during the life of a 1993 bond issue which was finalized during 2013. The lack of recording resulted in a restatement of liabilities and the net position of the CDA portion of balances transferred into CI, effective July 1, 2012.

The report on compliance and internal control over financial reporting did not include any significant deficiencies for the 2013-2014 fiscal year.

### **Other Matters**

In accordance with Section 4-33a of the General Statutes, Connecticut Innovations, Incorporated, reported to the Auditors of Public Accounts, a breakdown in internal control regarding an unauthorized checking account. An employee who transitioned to the corporation from a non-profit organization opened the account prior to joining CI. The account was used to manage national conferences that the employee's former non-profit hosted. The account was opened in an event planner's name that also had total control of the account. When the employee joined CI, they did not notify management of the checking account's existence and continued to process payments through the account.

Management discovered the checking account in late 2014 and took immediate control of the account and the remaining funds. CI hired a forensic accounting team to research and identify the sources and uses of funds and to identify any suspicious activity, including personal expenditures or cash withdrawals. The forensic accountants were also asked to identify deposited amounts and to determine how much of that money remained in the account after the last

conference. CI hopes to determine ownership for the remaining funds so they may be returned in accordance with prior agreements.

Although the review did not find any wrongdoing other than the checking account being unauthorized and opened outside of corporation protocol, we note that expenditures in the account were not subject to CI's internal purchasing procedures. Total expenditures, per the checking account register, were \$79,716 for the period of January 2, 2011 through August 6, 2014.

## STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

Our review of the records of the Connecticut Innovations, Incorporated disclosed certain matters of concern requiring corporation attention.

### Statutorily Required Reports

*Criteria:* The board of directors and executives of CI are required to comply with numerous reporting requirements set forth in various sections of the General Statutes.

*Condition:* Our review disclosed that CI did not submit the following reports for the fiscal years ended June 30, 2013 and 2014 in a timely manner:

- Annual reports, quarterly financial reports, and quarterly personnel status reports required by Section 1-123 of the General Statutes, subsections (a)(b) and (c) were not filed timely. The annual reports for fiscal years ended June 30, 2013 and 2014 were submitted approximately ten and six months after the end of the fiscal year, respectively. Seven of the eight quarterly financial reports were submitted between two and ten months after each quarter for the fiscal years ended June 30, 2013 and 2014. Seven of the eight quarterly personnel status reports were submitted between two and ten months after each quarter for the fiscal years ended June 30, 2013 and 2014.
- The business plan required by Section 32-47a of the General Statutes, due January 1<sup>st</sup>, was submitted approximately 16 months late for the fiscal year ended June 30, 2013.
- The quarterly Bioscience Collaboration Report of Program Operations and Funding required by Section 32-41y subsection (d)(2) of the General Statutes, due by April 15<sup>th</sup>, was submitted between one and 15 days late for all four quarters of the fiscal year ended June 30, 2014.
- The Bioscience Collaboration Program operating and capital budgets required by Section 32-41y subsection (d)(3) of the General Statutes, due by April 1<sup>st</sup>, were submitted four and three months late for the fiscal years ended June 30, 2013 and 2014, respectively.

- The Economic Cluster Bond Funds Report required by Section 32-4h of the General Statutes, due by August 1<sup>st</sup>, was submitted one month late for both fiscal years ended June 30, 2013 and 2014, respectively.

*Effect:* Although all required reports were submitted, CI was not in compliance with statutory reporting timeframes set forth by the General Statutes.

*Cause:* It appears that managerial oversight in addition to the merger of CI and CDA delayed the reports from being submitted in a timely manner.

*Recommendation:* Connecticut Innovations, Incorporated should strengthen internal controls to ensure compliance with reporting timeframes as prescribed by the General Statutes. (See Recommendation 1.)

*Corporation Response:* “Connecticut Innovations agrees with the finding. CI did submit 100% of the reports as required by the General Statutes. However, CI agrees there were some submission delays. These delays were attributable to the merger with the Connecticut Development Authority and staffing issues. CI has now assigned personnel for each report so that it will be filed timelier going forward.”

## **Personal Service Agreements**

*Criteria:* CI operating procedures require that any solicitation of bids or proposals by the corporation, and any award of a contract by the corporation, shall be subject to all of the state procurement and contracting requirements applicable to quasi-public agencies. These statutes require various contract affidavits, verifications of non-violation of occupational safety and health acts, and disclosures regarding solicitations of campaign contributions.

*Condition:* Our review of 15 personal service agreements during the audited period revealed the following:

- Two of the six personal service agreements, with a value of \$50,000 or more, did not include affidavits regarding campaign contributions and consulting agreements.
- One personal service agreement did not include a nondiscrimination affidavit.

- One agreement did not include provisions ensuring that the contractor had not been cited for occupational safety and health act violations.

*Effect:* CI is not in compliance with contract provisions within the General Statutes and internal operating procedures.

*Cause:* The missing documentation appears to have been due to managerial oversight.

*Recommendation:* Connecticut Innovations, Incorporated should strengthen internal controls related to contracts to ensure adherence to all provisions required by the General Statutes and internal procedures. (See Recommendation 2.)

*Corporation*

*Response:* “Connecticut Innovations agrees with the finding. CI has already strengthened our internal controls by having its contracting language reviewed and updated by outside counsel on an ongoing basis to ensure compliance with the general statutes.”

## RECOMMENDATIONS

Our prior report on Connecticut Innovations, Incorporated covered the fiscal year ended June 30, 2012 and contained two recommendations, both of which will be repeated. Our prior report on the Connecticut Development Authority covered the fiscal years ended June 30, 2011 and 2012, and contained two recommendations which have been resolved.

### *Status of Prior CI Audit Recommendations:*

- Connecticut Innovations, Incorporated should strengthen internal controls to ensure compliance with reporting requirements as prescribed by the Connecticut General Statutes. We continued to find similar issues with reporting; therefore this recommendation will be repeated to reflect our current findings. (See Recommendation 1.)
- Connecticut Innovations, Incorporated should strengthen internal controls to ensure that contracts include all provisions required by the General Statutes. We continued to find missing documentation with executed contracts therefore this recommendation will be revised and repeated. (See Recommendation 2.)

### *Status of Prior CDA Audit Recommendations:*

- Connecticut Innovations, as the successor agency to the Connecticut Development Authority, should implement controls to provide compliance with public meeting requirements not previously adhered to by CDA.

Public Act 12-1, Section 147, of the June Special Session, merged the CDA with CI, effective July 1, 2012. All of CDA's programs and activities which were created to stimulate industrial and commercial development within the state continue as a part of CI. As CDA is now part of CI, the prior recommendation is resolved. During our review of CI's board meetings we did not note any exceptions in the filing of agendas with the Secretary of State.

- Connecticut Innovations, as the successor agency to the Connecticut Development Authority, should implement controls to provide compliance with reporting requirements not previously adhered to by CDA. Although anticipated wage rates for new financial assistance provided during 2011 and 2012 were included in the annual report for the same periods, CDA did not report anticipated wage rates for outstanding financial assistance.

Public Act 12-1, Section 292, repealed Connecticut General Statute 32-11a, subsection (c); therefore, the prior recommendation is resolved.

*Current Audit Recommendations:*

- 1. Connecticut Innovations, Incorporated should strengthen internal controls to ensure compliance with reporting timeframes as prescribed by the Connecticut General Statutes.**

Comment:

During our review, we found numerous reports were not submitted in accordance with the timeframes outlined in the General Statutes.

- 2. Connecticut Innovations, Incorporated should strengthen internal controls related to contracts to ensure adherence to all provisions required by the General Statutes and internal procedures.**

Comment:

Our review of 15 personal service agreements found that two agreements, exceeding \$50,000, did not have the required affidavits on file. We also noted one agreement was missing a nondiscrimination affidavit and another was missing documentation to ensure the contractor had not been cited for occupational safety and health act violations.

**CONCLUSION**

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



Rebecca M. Balkun  
Principal Auditor

Approved:



John C. Geragosian  
Auditor of Public Accounts



Robert M. Ward  
Auditor of Public Accounts