

# STATE OF CONNECTICUT



*AUDITORS' REPORT  
CONNECTICUT INNOVATIONS, INCORPORATED*

*FISCAL YEARS ENDED  
JUNE 30, 2015 AND 2016*

**AUDITORS OF PUBLIC ACCOUNTS**  
JOHN C. GERAGOSIAN ❖ ROBERT J. KANE

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# STATE OF CONNECTICUT



## AUDITORS OF PUBLIC ACCOUNTS

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Hartford, Connecticut 06106-1559

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July 26, 2018

### **INTRODUCTION AUDITORS' REPORT CONNECTICUT INNOVATIONS, INCORPORATED FOR THE FISCAL YEARS ENDED JUNE 30, 2015 AND 2016**

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, 2015 and 2016. 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 authority, 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. The corporation's management provided this information and it was not subject to the procedures applied in our audit of the authority. 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 (CI) operates under Chapters 579 and 581 of the General Statutes. In accordance with Section 32-35 of the General Statutes, CI is a public instrumentality and political subdivision of the state. CI is a quasi-public agency of the State of Connecticut under Chapter 12 of the General Statutes and is, therefore, subject to the requirements related to such agencies. As a quasi-public agency, the CI 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 industries 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.

Additionally, Public Act 12-1 transferred the operations of Connecticut Development Authority (CDA) to CI. The operations transferred from CDA, which now continue as part of CI,

were created to stimulate industrial and commercial development within the state. The incorporation of CDA into CI is a vertical extension of the CI overall economic reach.

The mission of CI is to be a leading source of financing and ongoing support for Connecticut's innovative, growing companies. CI seeks to fulfill this mission through the provision of flexible financing, strategic guidance, and introductions to valuable partners. CI operates 3 core programs: venture, loans, and innovative programs. The CI venture portfolio includes equity and debt investments in early-stage technology companies; the CI loan program helps early-stage and later-stage companies with capital expenditures and working capital; and the CI innovative programs focus on supporting research commercialization activities at universities and other research institutions, the pipeline of start-up companies, and talent retention.

### **Financial and Technical Programs**

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

- **Eli Whitney Fund:** CI uses this program 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:** CI developed this program to enable the development of laboratory space in Connecticut to encourage the growth of biotechnology research and development companies.
- **Seed and BioSeed Funds:** CI developed these programs to address the needs of entrepreneurs by promoting and investing in early stage Connecticut-based emerging technology and biotechnology companies.
- **PreSeed Fund:** CI developed this program to provide support and assistance to prepare high technology companies for future investments. Investments consist of 2-year promissory notes ranging from \$25,000 to \$200,000.
- **Clean Tech Fund:** CI developed this program to support the demand for alternative energy technologies, which focus on energy conservation, environmental protection, or the elimination of harmful waste.
- **Mezzanine Fund:** CI designed this loan program 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 are 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 or increasing sales and employment in the state. The SBIR program also assists companies in obtaining 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 such projects as the acquisition of land or the construction of buildings and 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. In addition, CI insured all of its umbrella program loans under this program.
- **Growth Fund:** Under the Growth Fund, CI has the authority to issue individual loans up to \$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:** The Connecticut Works Fund includes direct loans and a loan guarantee program with participating lenders to encourage them to provide more credit on terms that are more favorable. 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, in some cases, refinancing.
- **Connecticut Works Guarantee Fund:** The Connecticut Works Guarantee Fund provides commitments to guarantee loans made by participating financial institutions. The fund determines eligible projects 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.
- **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 2 branches of the Connecticut Capital Access Fund, the Urbank Program and the Entrepreneurial Loan Program. Eligible projects are determined usually by the financial institution making the loan as long as the projects meet the requirements specified in the participation agreements.

## **Component Units**

In addition, the following organizations are 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 leased office space to startup firms focusing on information technologies. CTDC discontinued the wet laboratory activities on June 30, 2013 and the business incubator activities on August 31, 2015. All CTDC operations ceased on August 31, 2015 and CTDC formally dissolved on January 12, 2017.
- **Connecticut Brownfields Redevelopment Authority (CBRA):** CBRA is a quasi-public agency created by the former Connecticut Development Authority in May 1999 to carry out the remediation, development, and financing of contaminated property within the state. 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 reduction to the earnings.

## **Organizational Structure**

Organizationally, CI consisted of the following major areas during the audited period:

- **Finance, Operations, and Compliance:** The finance, operations, and compliance unit, overseen by a chief financial officer, is responsible for financial reporting, budgeting, strategic planning, debt management, and treasury functions.
- **Venture:** The venture team, overseen by a chief investment officer, is responsible for managing the investment function at CI, which includes staffing, portfolio and risk management, outreach, budget, planning, and performance measurement.
- **Marketing & Communications:** The marketing and communications unit, overseen by a director of marketing and communications, is responsible for public relations strategy and execution for CI. The team’s role is to craft key messages and convey the CI story and news to stakeholders and the public. The team also counsels CI portfolio companies on messaging, positioning, pitching, public speaking, web development, thought leadership, social media, and more.

## **Significant Legislation**

The following legislation, enacted during the audited period, significantly effects the operations and organizational structure of CI.

- **Bioscience Innovation Fund Administrative Costs:** Public Act 15-5 of the June Special Session of the General Assembly allowed CI to use Bioscience Innovation Fund money

to pay for its administrative costs, including peer review, professional fees, allocated staff, and other out-of-pocket costs related to administering and operating the fund. Under the act, CI may use no more than 5% of the total amount allotted for the year in the fund's operating budget to pay for its administrative costs, and expenditures from the fund for administrative costs do not require the fund's advisory committee approval. The act also specified that it does not require CI to risk or spend its funds to administer the Bioscience Innovation Fund.

- **CTNext:** Public Act 16-3 of the May Special Session of the General Assembly required CI to establish a subsidiary called CTNext and specified the CTNext rules of operation. The major purpose of CTNext is to assist entrepreneurs and startup and growth-stage businesses. An 11-member board of directors governs CTNext, most of whom must be serial entrepreneurs representing a diverse range of Connecticut's growth sectors. The board's chairperson is the CI chief executive officer. The chairperson, with board approval, must appoint an executive director to supervise the CTNext administrative affairs and technical activities as the board directs.

The act established the CTNext Fund as a nonlapsing fund outside the General Fund and required CI to administer it. The act earmarked \$67.25 million in previously authorized bonds for CTNext in the fiscal years 2016-2017 through 2020-2021. CI may invest the fund's money in any institution it chooses, and these institutions must invest or pay that money as CI directs. CI must deposit and hold any returns on these investments for the fund's benefit. CI must administer the fund and provide any staff, office space, office systems, and administrative support needed to operate it.

The public act went into effect on June 2, 2016, except for the provision transferring CI powers to CTNext, which went in to effect on September 1, 2016.

- **Connecticut Green Bank:** Effective June 10, 2016, Public Act 16-212 eliminated provisions that placed the Connecticut Green Bank within CI for administrative purposes only and required a member of the CI board of directors to serve on the bank's board. The act makes the Connecticut Green Bank independent of CI.

### **Board of Directors and Administrative Officials**

A 17-member board of directors governs CI. Nine members are appointed by the Governor, 6 of whom shall be knowledgeable in the development of innovative start-up businesses and 3 of whom shall be knowledgeable in the field of financial lending or the development of commerce, trade, and business. Four of the members are the Commissioner of Economic and Community Development, the president of the Connecticut State Colleges and Universities, the Treasurer, and the Secretary of the Office of Policy and Management, who 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 are 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 members of the board of directors as of June 30, 2016 were as follows:

***Appointed by the Governor:***

Michael A. Cantor, Chair  
Valarie Gelb  
John Olsen  
Alexander D. Pencu, Esq.  
Paul R. Pescatello, J.D., Ph.D.  
Rafael A. Santiago  
David M. Siegel  
2 vacancies

***Legislative Appointments:***

Mun Y. Choi, Ph.D.  
John Pavia  
Richard T. Mulready  
Christopher D. Bandecchi

***Ex-Officio Members:***

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

Mark Ojakian, President of the Connecticut State Colleges and Universities  
*Designee: Estela Lopez, Provost & Senior Vice President of Academic & Student Affairs*

Denise Nappier, Treasurer  
*Designee: Richard Gray, Deputy State Treasurer*

Benjamin Barnes, Secretary of the Office of Policy and Management  
*Designee: Susan Weisselberg, Deputy Secretary of the Office of Policy and Management*

During the audited period, Karen Buffkin, Gail Coppage, Alan Greene, Brion Johnson, Joseph Kaliko, Jonathan Roth, and Christine Shaw also served as members of the board of directors.

In addition, the board has set up several committees and subcommittees to expedite certain business activities of CI and to maintain controls over its transactions. During the audited period, CI had the following 4 standing committees:

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

CI also has 5 advisory committees which met throughout the audited period, including:

- Connecticut Bioscience Innovation Fund Advisory Committee
- Eli Whitney Advisory Committee
- Regenerative Medicine Research Fund Advisory Committee
- Regenerative Medicine Research Fund Advisory Subcommittee
- 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, and continues to serve in that capacity.

## **RÉSUMÉ OF OPERATIONS**

### **State Funding**

The State of Connecticut provides significant funding for CI programs through the issuance of general obligation bonds. CI uses the bond proceeds and any net income from operations to finance its 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 3 special revenue funds; Grants to Local Governments and Others, Federal and Other Restricted Accounts, and Connecticut Bioscience Collaboration Fund. CI also processes transactions through 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. CI processes bond payments through Core-CT and are recorded on both the state and CI 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 audited period, CI used \$2,991,500 for the bio-facilities loan program, \$25,000,000 to recapitalize various portfolio investment programs, and \$15,818,781 for the stem cell program.

CI used the Federal and Other Restricted Accounts Fund to account for the Regenerative Medicine Research Fund during the audited period. The Regenerative Medicine Research Fund, formerly the stem cell program, is governed by Sections 32-41jj to 32-41nn of the General Statutes and provides financial assistance to eligible institutions for the advancement of regenerative medicine research in the state. During the audited period, CI used \$4,057,783 for regenerative medicine research.

The Connecticut Bioscience Collaboration Fund is a special revenue fund established in accordance with Section 32-41cc of the General Statutes. The purpose of the fund is to support the establishment of a bioscience cluster anchored by a research lab at the University of Connecticut Health Center. During the audited period, CI used \$75,635,970 for grants, facility loans, and equipment.

The Connecticut Innovations, Incorporated Fund is an enterprise fund authorized by Section 32-41a of the General Statutes. That statute provides that CI use this fund to carry out its purposes 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 by CI as of June 30, 2016. CI uses Core-CT to process enterprise fund payroll and other operating expenses. Expenditures charged to the enterprise fund during the audited period consisted entirely of CI payroll costs, funded by cash transfers by CI 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, CI deposits all investment income, loan repayments, and grants with payback provisions into the CI operating account. CI uses the operating account 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.

CI transfers any excess funds in the operating account to short-term investments and marketable securities to earn investment income, including the State Treasurer's Short Term Investment Fund (STIF). It should be noted that CI may be required to repay funds 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, 2016, the State Bond Commission had not requested repayment of any principal or interest.

The financial position of CI as of June 30, 2015 and 2016, per its audited financial statements, is presented below.

	<u>June 30, 2015</u>	<u>June 30, 2016</u>
<b>Assets</b>		
<b>Current Assets</b>		
Cash and Cash Equivalents	\$57,003,386	\$46,777,245
Current Portion of Loans	5,682,543	5,865,225
Current Portion of Portfolio Investments	2,324,836	1,841,478
Interest and other Receivables	1,431,406	1,737,254
Due from State of Connecticut	1,102,428	412,980
Prepaid Expenses	217,624	1,155,936
<b>Total Current Assets</b>	<u>67,762,223</u>	<u>57,790,118</u>

	<u>June 30, 2015</u>	<u>June 30, 2016</u>
<b>Noncurrent Assets</b>		
Restricted Assets:		
Restricted Cash and Cash Equivalents	46,268,933	19,310,357
Total Restricted	46,268,933	19,310,357
Portfolio Investments, Net of Current Portion	77,047,528	82,345,674
Loans – Noncurrent, Net of Allowance for Loan Losses	50,795,637	44,696,545
CT Bioscience Collaboration Program Loans, Net of		
Allowance for Doubtful Accounts	--	--
Capital Assets, Net of Depreciation	340,986	199,948
Other	133,000	100,000
<b>Total Noncurrent Assets</b>	<u>174,586,084</u>	<u>146,652,524</u>
<b>Total Assets</b>	<u>\$242,348,307</u>	<u>\$204,442,642</u>
<b>Deferred Outflows of Resources</b>		
Deferred Bond Issuance Costs	\$87,806	\$71,900
Deferred Amount for Pensions	3,310,649	2,781,291
<b>Deferred Outflows of Resources</b>	<u>\$3,398,455</u>	<u>\$2,853,191</u>
<b>Liabilities</b>		
<b>Current Liabilities</b>		
Current Portion of Bonds Payable	\$500,000	\$525,000
Accrued Expenses and Liabilities	4,709,138	2,841,512
Deferred Revenue	141,397	91,686
Due to Connecticut Bioscience Innovation Fund	17,811,739	9,242,711
Reserve for Guarantee Losses	1,217,966	1,567,966
<b>Total Current Liabilities</b>	<u>24,380,240</u>	<u>14,268,875</u>
<b>Noncurrent Liabilities</b>		
Net Pension Liability	28,018,735	26,988,791
Escrow Deposits	8,897,397	2,920,613
Bonds Payable, Net of Current Portion	2,260,000	1,735,000
<b>Total Noncurrent Liabilities</b>	<u>39,176,132</u>	<u>31,644,404</u>
<b>Total Liabilities</b>	<u>63,556,372</u>	<u>45,913,279</u>
<b>Net Position</b>		
Net Investment in Capital Assets	340,986	199,948
Restricted	15,162,872	5,011,013
Unrestricted	165,685,862	154,579,252
<b>Total Net Position</b>	<u>181,189,720</u>	<u>159,790,213</u>

	<b>June 30, 2015</b>	<b>June 30, 2016</b>
<b>Total Liabilities and Net Position</b>	\$244,746,092	\$205,703,492

**Deferred Inflows of Resources**

<b>Deferred Amount for Pensions</b>	\$1,000,670	\$1,592,341
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The CI portfolio investments consist of shares of publicly traded securities as well as promissory notes, and equity and debt financing instruments extended to various companies to create jobs and further the economic base of Connecticut. In the absence of readily determinable market values, CI carries investments 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 audited financial statements, due to the inherent uncertainty of such valuations, those estimated values may differ significantly from the amounts ultimately realized from the investments, and those differences could be material. As of June 30, 2016, the portfolio investments of CI, measured at fair value, totaled \$70,681,232 in equity securities and \$13,505,920 in debt securities. The total value of the CI investment portfolio increased by \$4.8 million in the 2015-2016 fiscal year. This increase consisted of new investments totaling \$21.6 million offset by investment sales of \$1.5 million, principal repayments of \$5.3 million, and net \$10 million of write-offs and devaluations of portfolio investments.

CI also extends commercial loans that are generally convertible into equity to Connecticut customers to advance certain economic development objectives consistent with the CI mission and contractual obligations of the state. Companies can use loans for any business-related purpose such as hiring, marketing, research and development, inventory buildup, and capital expenditures. As of June 30, 2016, the CI direct loan portfolio was comprised of 85 loans totaling \$58,582,889. The CI direct loan portfolio decreased \$5.9 million in the 2015-2016 fiscal year due primarily to loan pay downs and charge offs.

A schedule of revenues, expenses, and changes in net assets for the fiscal years ended June 30, 2015 and 2016 follows. We obtained the information from the CI audited financial statements.

	<b>June 30, 2015</b>	<b>June 30, 2016</b>
<b>Operating Revenues</b>		
Investment Interest Income	\$1,176,602	\$1,395,680
Loan Interest Income	2,963,847	2,592,776
Unrealized Loss on Investments	(3,779,432)	(2,660,094)
Realized Loss on Sale of Investments	(3,653,234)	(3,358,915)
Loan Fee Income	788,612	601,554
Regenerative Medicine Grant Income	19,876,564	--
U.S. Treasury Grant Income	8,646,196	4,536,182
Grant and Program Income	502,024	150,808
Connecticut Bioscience Collaboration Funding	59,354,358	20,572,730
Other Income	2,083,687	1,356,508

	<u>June 30, 2015</u>	<u>June 30, 2016</u>
<b>Total Operating Revenues</b>	87,959,224	25,187,229
<b>Operating Expenses</b>		
Salaries	6,180,150	4,833,099
Benefits and Payroll Taxes	4,486,180	3,693,895
Grants and Programs	27,043,036	27,631,964
CT Bioscience Collaboration Loan Write-down	44,354,358	6,072,730
Provision for Loan and Guarantee Losses	1,200,000	500,000
General Facility and Office	1,294,332	1,070,037
Professional Service Fees	1,388,906	1,596,972
Restructuring Charge	750,000	--
Interest	162,707	126,306
Marketing, Conferences, Development	439,928	885,907
Depreciation and Amortization	297,070	152,921
Other	38,487	22,905
<b>Total Operating Expenses</b>	<u>87,635,154</u>	<u>46,586,736</u>
<b>Operating Gain (Loss)</b>	<u>324,070</u>	<u>(21,399,507)</u>
<b>Nonoperating Revenues</b>		
Connecticut Public Act 11-1	25,000,000	--
Connecticut Biofacilities	2,991,500	--
<b>Total Nonoperating Revenues</b>	<u>27,991,500</u>	<u>--</u>
<b>Change in Net Position</b>	<u>28,315,570</u>	<u>--</u>
<b>Net Position</b>	178,487,768	--
<b>Cumulative Effect of Implementing GASB 68 and 71</b>	<u>(25,613,618)</u>	<u>--</u>
<b>Net Position – Beginning of Year</b>	<u>152,874,150</u>	<u>181,189,720</u>
<b>Net Position – End of Year</b>	<u>\$181,189,720</u>	<u>\$159,790,213</u>

Total operating revenue decreased by \$62.8 million in the 2015-2016 fiscal year. This was primarily due to a \$38.8 million decrease in state funding for the Connecticut Bioscience Collaboration Program. Additionally, federal funding decreased \$4.1 million, net realized and unrealized losses decreased \$1.4 million, and interest on notes and loan fees decreased \$0.6 million during the 2015-2016 fiscal year. During the fiscal year ended June 30, 2015, CI received \$19.9 million from the state to provide financial assistance for regenerative medicine research under approved bond fund authorizations.

Compensation, benefits, and payroll taxes decreased by \$2.1 million in the 2015-2016 fiscal year due to a decrease in the number of employees. CI employees are participants in the State of Connecticut payroll and retirement system, and the corporation is charged a fringe rate that averaged 76.6% for the fiscal year ended June 30, 2016.

Interest expense on bonds payable decreased by approximately \$37,000 due to interest savings from the \$0.5 million bond pay down in the 2015-2016 fiscal year. General and administrative expenses, which include facility and offices expenses; professional service fees; restructuring charges; marketing, conferences, and development expenses; depreciation and amortization; and other incidental expenses decreased in aggregate by \$0.5 million in the 2015-2016 fiscal year due to continued efficiencies realized within the operations of CI. Additionally, CI recorded a reduction of \$0.7 million for loan loss provision due to the reduced loan closing volume.

Net realized losses on investments for the 2014-2015 and 2015-2016 fiscal years were \$3.7 million and \$3.4 million, respectively. In both the 2014-2015 and 2015-2016 fiscal years, the realized losses resulted from both divestitures of investments, which CI recoded as unrealized losses in previous years and permanent devaluation to zero of investments that occurred throughout the year.

Net unrealized losses on investments for the 2015-2016 fiscal year were \$2.7 million as compared to net unrealized losses of \$3.8 million for the 2014-2015 fiscal year. In both years, the net unrealized losses resulted from net increases in valuation reserves for privately held companies in the CI investment portfolio and valuation changes for public holdings.

Total expenditures for grants and programs in the 2015-2016 fiscal year were \$27.6 million, an increase of \$588,928 from the 2014-2015 fiscal year. This decrease was due to a reduction in expenditures pertaining to the funding of Small Business Initiatives/CTNext programs as well as operating grants disbursed under the Bioscience Collaborative Program.

Funding received from the state and recorded as operating revenue in the 2014-2015 and 2015-2016 fiscal years totaled \$44.3 million and \$6.1 million, respectively, for facility and equipment loans under the Connecticut Bioscience Collaboration program. CI reserved this funding in full in the fiscal years and recorded it as an operating expense.

Other funding from the state recorded as nonoperating revenues totaled \$27.9 million in the 2014-2015 fiscal year. CI utilized these contributions as follows: \$25 million for the Connecticut Jobs Bill, Public Act 11-1 of the October Special Session, and \$2.9 million for Connecticut Biofacilities Fund financing.

In June 2012, the Governmental Accounting Standards Board (GASB) issued Statement No. 68, *Accounting and Financial Reporting for Pensions*, to improve accounting and financial reporting by state and local governments for pensions. The implementation of this standard resulted in an adjustment to reduce the CI beginning net position by \$29,017,545, as of July 1, 2014. In November 2013, GASB issued Statement No. 71, *Pension Transition for Contributions made Subsequent to the Measurement Date, an Amendment of GASB 68*. The purpose of the standard is to address an issue regarding application of the transition provision of GASB No. 68 for amounts associated with contributions, if any, made by a state or local government employer or non-employer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. The implementation of this standard resulted in an adjustment to increase the CI beginning net position by \$3,403,927 as of July 1, 2014.

During the 2014-2015 fiscal year, CI approved \$19.5 million and funded \$20.5 million for investments. During the 2015-2016 fiscal year, CI approved \$30.8 million and funded \$21.6 million for investments. Investments were for new opportunities and continued support of existing portfolio companies. The type of investments made take time to mature and involve considerable risk. CI maintains a considerable cash reserve to meet the future funding requirements of CI's portfolio companies.

### **Financial Statement Audits**

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.

For the 2014-2015 fiscal year, the accountants reported a deficiency in internal control. They noted that a bank account used for marketing events went unrecorded until brought to management's attention by the staff who possessed and had control over the account. Receipts and disbursements into and from this account on behalf of CI had not followed CI procedures and CI did not record the financial activity in the CI general ledger and related financial reporting. In response to the discovery of this bank account, CI hired a forensic accounting team to research and identify the sources and uses of funds, and identify any suspicious activity, including personal expenditures or cash withdrawals. The review did not find any wrongdoing other than the checking account being unauthorized and opened outside of agency policy. It was determined that the remaining funds belonged to the Department of Economic and Community Development (DECD). DECD and CI agreed to use the remaining funds for joint ventures. We also reported on this matter in our prior audit report.

The report on compliance and internal control over financial reporting did not include any deficiencies in internal control for the 2015-2016 fiscal year.

## STATE AUDITORS' FINDINGS AND RECOMMENDATIONS

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

### Statutorily Required Reports

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

*Condition:* Our review of 38 reports from the audited period disclosed that 8 reports were not submitted in a timely manner, 1 report was not submitted at all, and 1 report was incomplete as follows.

- CI submitted the annual reports required by Section 1-123 (a) for the fiscal years ended June 30, 2015 and 2016 157 and 188 days after the fiscal years ended, respectively.
- CI submitted the annual operating and capital budget for the Connecticut Bioscience Collaboration Program required by Section 32-41y (d) of the General Statutes, due April 1, 2015 and 2016, 45 and 42 days late, respectively.
- CI submitted the economic cluster bonds funds reports required by Section 32-4h of the General Statutes, due August 1, 2015 and 2016, 25 and 21 days late, respectively.
- CI did not submit the report including the annual operations plan and operating and capital budgets for the Connecticut Bioscience Innovation Fund required by Section 32-41cc (i) of the General Statutes, due April 1, 2015. CI submitted the report due April 1, 2016 81 days late. The report was incomplete because the annual operations plan was not included.
- CI submitted the report of activities of the Connecticut Bioscience Innovation Fund required by Section 32-41cc (k), due to the Bioscience Innovation Advisory Committee by April 15, 2016, 67 days late. Additionally, CI submitted the report to the General Assembly prior to receiving approval from the advisory committee.

*Effect:* CI did not comply with statutory reporting requirements set forth by the General Statutes.

*Cause:* The untimely reports appear to be the result of a lack of managerial oversight due to the number of required reports, limited staffing, and the timing of board and committee meetings.

Section 32-41cc (k) requires CI to provide a report of the activities of the Connecticut Bioscience Innovation Fund on an annual basis. Such report contains available information on the status and progress of the operations and funding; types, amounts, and recipients of financial assistance awarded; and any return on investment. CI explained that the reports, including the annual operations plan and operating and capital budgets for the Connecticut Bioscience Innovation Fund required by Section 32-41cc (i), were not submitted and/or submitted incompletely for the audited period because the annual report required by Section 32-41cc (k) contains the same information.

*Recommendation:* Connecticut Innovations, Incorporated should submit all reports required by the General Statutes within the statutory timeframes or should consider seeking legislation to clarify the reporting requirements established by Sections 32-41cc (i) and (k) of the General Statutes. (See Recommendation 1.)

*Agency Response:* “Connecticut Innovations agrees with the finding. The delays were attributable to our reduced staff and the legislative requirement that some reports must be approved by their oversight board before submission. CI will strive to continually improve on the timeliness of our legislative reporting requirements.”

## **Telecommuting**

*Criteria:* In accordance with the CI Employee Handbook, telecommuting is a management option that allows an employee to work at home or an alternate worksite. All employees who telecommute, even occasionally, must have a signed and approved telecommuting agreement on file. The telecommuting agreement prescribes the following provisions.

- Telecommuting employees must have a set schedule of regular telecommuting days, with no employee telecommuting more than 1 day per week or for consecutive days (i.e. Friday of one week and Monday of the next week).
- The policy also permits telecommuting for inclement weather and on an as-needed basis if a valid business need exists for the agency. Each occurrence requires individual supervisory approval.

*Condition:* We reviewed the telecommuting arrangements for 5 employees during the audited period and found that the 5 employees telecommuted for a total of 323 days. Of those days, 221 days were in accordance with the employees' regular telecommuting schedules. The remaining 102 days were on an as-needed basis or for inclement weather. We could not confirm that the employees obtained supervisory approval or that the telecommuting was for a valid business need.

*Effect:* The lack of documentation increases the risk for abuse of the telecommuting program and the inaccurate reporting of time.

*Cause:* CI does not have a formal procedure in place to document the approval of telecommuting for an as-needed basis or inclement weather. In addition, CI does not document that this telecommuting is for a valid business need.

*Recommendation:* Connecticut Innovations, Incorporated should strengthen its internal controls to ensure compliance with its policies and procedures concerning telecommuting. (See Recommendation 2.)

*Agency Response:* "Connecticut Innovations agrees with the finding. CI has since strengthened its internal controls for telecommuting as outlined in CGS 5-248i to ensure compliance with its policies and procedures."

## RECOMMENDATIONS

Our prior report on the fiscal years ended June 30, 2013 and 2014 contained a total of 2 recommendations, of which 1 was resolved and 1 is being repeated.

### Status of Prior Audit Recommendations

- **Connecticut Innovations, Incorporated should strengthen internal controls to ensure compliance with reporting timeframes as prescribed by the General Statutes.** We continued to find similar issues with reporting; therefore, this recommendation will be modified and repeated. (See Recommendation 1.)
- **Connecticut Innovations, Incorporated should strengthen internal controls related to contracts to ensure adherence to all provisions required by the General Statutes and internal procedures.** This recommendation was resolved and is not repeated.

### Current Audit Recommendations

1. **Connecticut Innovations, Incorporated should submit all reports required by the General Statutes within the statutory timeframes and should consider seeking legislation to clarify the reporting requirements established by Sections 32-41cc (i) and (k) of the General Statutes.**

Comment:

Our review of 38 reports from the audited period disclosed that 8 reports were not submitted in a timely manner, 1 report was not submitted at all, and 1 report was incomplete.

2. **Connecticut Innovations, Incorporated should strengthen its internal controls to ensure compliance with its policies and procedures concerning telecommuting.**

Comment:

We reviewed the telecommuting arrangements for 5 employees and found that 102 days were on an as-needed basis or for inclement weather. We could not confirm that employees received supervisory approval or that the telecommuting was for a valid business need.

**ACKNOWLEDGMENT**

The Auditors of Public Accounts would like to recognize the auditors who contributed to this report:

Audrey Kelliher  
Brandon Martin

**CONCLUSION**

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



Audrey Kelliher  
Associate Auditor

Approved:



John C. Geragosian  
State Auditor



Robert J. Kane  
State Auditor