



**REPORT OF**  
**THE**  
**STATE AUDITOR**

**Colorado Venture Capital Program  
Venture Capital Authority**

**Performance Audit  
February 2007**

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Members of the Legislative Audit Committee:

This report contains the results of a performance audit of the Colorado Venture Capital Program. The audit was conducted pursuant to Section 24-46-206, C.R.S., which requires the State Auditor to audit the implementation of the Colorado Venture Capital Program (Section 24-46-201, et seq., C.R.S.) by March 4, 2007. The report presents our findings, conclusions, and recommendations, and the responses of the Colorado Venture Capital Authority.

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SALLY SYMANSKI, CPA  
State Auditor

**Colorado Venture Capital Program  
Venture Capital Authority  
Performance Audit, February 2007**

**Authority, Purpose, and Scope**

This performance audit was conducted under the authority of Section 24-46-206, C.R.S., which requires the State Auditor to audit the implementation of the Colorado Venture Capital Program (Section 24-46-201, et seq., C.R.S.) by March 4, 2007. The audit work was conducted between December 2006 and February 2007 in accordance with generally accepted government auditing standards.

We reviewed the Venture Capital Authority's implementation of the Venture Capital Program. We also evaluated the Authority's staffing, performance reporting, and compliance with certain statutes applicable to local governments. Additionally, we evaluated the controls implemented by the Authority and the Division of Insurance to ensure that the State's \$50 million investment in the Venture Capital Program is being appropriately safeguarded. We gratefully acknowledge the assistance and cooperation extended by the Venture Capital Authority Board members and by the staff of the Office of Economic Development and International Trade, and of High Country Venture, LLC.

**Background**

Through passage of Senate Bill 04-106 the General Assembly created Colorado's state-supported Venture Capital Program (the Program) during the 2004 Legislative Session. As part of the legislation, the General Assembly created the Venture Capital Authority (the Authority) which is charged with specific duties and responsibilities related to the Program. The Program is designed to provide in excess of \$40 million in seed-, early-stage, and follow-on venture capital to Colorado businesses, and to assist in the development of businesses that should, in turn, create jobs in the State.

The creation of Colorado's Venture Capital Program followed the October 2003 release of the Office of the State Auditor's evaluation of the Certified Capital Company (CAPCO) Program. The 2003 evaluation identified problems with the CAPCO Program including limited capital available for investment in businesses, limited controls over businesses receiving investment capital, a complicated mechanism for calculating state cash benefits, high administrative costs, and limited program oversight. Following the release of our evaluation, the General Assembly redirected \$100 million in premium tax credits from the CAPCO Program to the Venture Capital Program (\$50 million) and to CoverColorado (\$50 million), which is a nonprofit entity created by the General Assembly to provide medical insurance for eligible Colorado residents who are unable to obtain coverage from private insurers because they have pre-existing medical conditions.

*For further information on this report, contact the Office of the State Auditor at 303.869.2800.*

## **SUMMARY**

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Basically, the Venture Capital Program operates in the following way. Under Colorado law, insurance companies pay taxes based on policy holder premiums rather than on corporate profits. The Venture Capital Authority solicits cash (certified capital) from insurance companies through a competitive bid process. In exchange for the cash received from the insurance companies, the State, through the Venture Capital Authority, provides insurance companies with tax credits that can be used to reduce their insurance premium tax liabilities over a 10-year period. Thus, the State in effect reduces future tax revenues in exchange for the opportunity to provide venture capital to new businesses.

The cash or certified capital received from the insurance companies is used by the Authority to establish one or more venture capital funds. The Authority then selects one or more professional fund managers to manage the venture capital funds and make investments of certified capital in qualified businesses. The Authority's investments are fully at risk. That is, the Authority will not receive any returns if the fund managers' investments fail. However, if the fund managers' investments are successful and generate returns, statute requires the fund managers to first reimburse the Authority for 100 percent of the certified capital invested. Returns on investments that exceed the original amount of certified capital invested are then divided between the fund managers and the Authority, based on negotiated agreements.

In April 2005, the Venture Capital Authority sold the \$50 million in state premium tax credits to four insurance companies. In exchange for the premium tax credits, the Authority is scheduled to receive about \$43.1 million of capital from the four insurance companies between 2005 and 2014. In June 2005, the Authority formed its first venture capital fund—Colorado Fund I. Colorado Fund I is a limited partnership formed to provide equity capital and debt financing to seed- and early-stage Colorado businesses. The Authority has committed about \$21.8 million to Colorado Fund I through 2009. Through a competitive process, the Authority selected High Country Venture, LLC, to manage Colorado Fund I as the general partner. Combined, the total commitment to Colorado Fund I by all partners is approximately \$22.8 million. As of December 31, 2006, High Country Venture, LLC, had made investments from Colorado Fund I totaling about \$5.1 million in five qualified businesses.

### **Summary of Audit Findings**

The primary focus in this audit was to determine if the Venture Capital Authority complied with the provisions of Part 2 of Article 46 of Title 24 of the Colorado Revised Statutes and met all statutorily established milestones. Overall, we found that the Authority implemented the Venture Capital Program according to statutory provisions, with one exception. Specifically, the Authority failed to provide the Office of the State Auditor with its annual report for 2004 by February 1, 2005, as required by statute (Section 24-46-206, C.R.S.). The Authority subsequently filed this report in January 2006.

During our review of the Authority's implementation of the Venture Capital Program we also found:

- **The fund manager will need to increase the pace of investments in designated rural counties if the required amount of investments in these areas is to be made by the deadline.** Specifically, by June 20, 2008, High Country Venture, LLC, is to invest about \$1.6 million in qualified businesses located in designated rural counties, \$1.6 million in qualified businesses located in distressed urban communities, and \$3.3 million in qualified businesses located statewide. We found that as of December 31, 2006, or mid-way to the June 20, 2008, deadline for investments totaling about \$1.6 million in designated rural counties, High Country Venture, LLC, has invested only about \$605,000, or 37 percent of the total required.
- **The staff-sharing arrangement between the Venture Capital Authority and the Office of Economic Development and International Trade's (OEDIT) is problematic.** The statute authorizes the Authority to "hire staff as it deems necessary and convenient to administer" the Venture Capital Program and to pay for its direct and indirect expenses in administering the Program. Additionally, statute requires the Office of Economic Development to "cooperate with the Authority and its staff" and to assist in the administration of the Venture Capital Program. To date, the Authority has not hired staff. Rather, it has relied entirely on OEDIT staff to carry out the day-to-day activities of the Authority, its Board, and the Venture Capital Program. This staff-sharing arrangement is problematic for two reasons. First, by functioning as staff for the Authority, OEDIT staff appear to be violating the conflict of interest provision in Section 24-46-207, C.R.S., of the Venture Capital Authority statute. Second, the arrangement is not consistent with the purpose for which funds were appropriated by the General Assembly to the OEDIT. That is, the OEDIT is bearing the cost of providing administrative support to the Authority, an arrangement not reflected in the legislative appropriation for the OEDIT.
- **The Venture Capital Authority's annual reports to the State Auditor do not provide sufficient information regarding the implementation status of the Program.** Section 24-46-206, C.R.S., requires the Venture Capital Authority to submit an annual report to the State Auditor beginning in 2005 "regarding the results of the implementation" of the Venture Capital Program. Although the statute does not specify the contents of the reports, we found the reports provided to our office did not include meaningful information the financial and operational performance of the Program.
- **The Venture Capital Authority has not complied with either the Local Government Budget Law or the Local Government Audit Law.** Colorado statutes include financial reporting requirements with which local governments must comply. Two of these requirements are the Local Government Budget Law (Section 29-1-101, et seq., C.R.S.) and the Local Government Audit Law (Section 29-1-601, et seq., C.R.S.). According to statute,

## **SUMMARY**

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the Venture Capital Authority meets the definition of a local government and, therefore, should be complying with both laws.

- **The Venture Capital Authority's annual review of fund managers should be strengthened.** According to Section 24-46-203(9), C.R.S., the Venture Capital Authority is required to conduct an annual review of each fund manager to determine compliance with Program statutes. We found the Authority's first annual review of High Country Venture, LLC, did not include verification of compliance with the statutory requirement that Colorado businesses receiving investments of certified capital are to expend the investments within Colorado or purchase goods and services that will be used or performed in Colorado. Additionally, the Authority's annual review did not verify the accuracy of financial and performance data reported to the Authority by High Country Venture, LLC.

Our recommendations and the responses of the Venture Capital Authority can be found in the Recommendation Locator and in the body of the report.



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## RECOMMENDATION LOCATOR

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Rec. No.	Page No.	Recommendation Summary	Agency Addressed	Agency Response	Implementation Date
1	27	Continue monitoring High Country Venture, LLC's level of investment in businesses located in designated rural counties and continue cooperating with the Office of Economic Development and International Trade to identify investment opportunities in these areas.	Venture Capital Authority	Agree	Implemented and Ongoing
2	29	Take steps to resolve problems identified with the current staffing arrangement with the Office of Economic Development and International Trade.	Venture Capital Authority	Partially Agree	January 2008
3	31	Include information on the financial and operational performance of the Venture Capital Program in the annual report to the State Auditor.	Venture Capital Authority	Agree	February 2008
4	33	Comply with the provisions of the Local Government Budget and Audit Laws by preparing and submitting the required financial reporting documents in accordance with statutorily required timelines.	Venture Capital Authority	Agree	July 2007
5	35	Improve the annual review of fund managers. At a minimum, the annual review should include determining whether qualified businesses are expending certified capital as required by statute and reviewing source documentation to verify the accuracy of performance data reported by fund managers.	Venture Capital Authority	Agree	December 2007

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# Venture Capital Program

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## Introduction

Venture capital refers to money for start-up (seed-stage), early-stage, or expansion-stage companies and small businesses with significant growth potential. Venture capitalists are individuals or companies that create pools of capital that they invest in businesses in exchange for the potential of a desired return. Traditionally, venture capitalists are funded or “capitalized” with investments from large institutions or wealthy individuals. Investments are fully at risk, and all investors bear the risk. Investments in seed- and early-stage businesses are usually riskier than later-stage investments, but the potential return on early-stage investments typically exceeds the return on investments in businesses that are more established.

According to the PricewaterhouseCoopers/National Venture Capital Association Money/Tree™ Report, Colorado businesses received about \$622 million of venture capital in Calendar Year 2006, a decrease of about 5 percent from Calendar Year 2005. Nationally, venture capital investments increased by almost 12 percent from about \$22.8 billion in Calendar Year 2005 to approximately \$25.5 billion in Calendar Year 2006. Investments in seed- and early-stage companies represented only about 20 percent of total venture capital investments nationally for Calendar Year 2006.

Recognizing the need for seed- and early-stage capital, states have launched many new venture capital programs. A recent study by the National Association of Seed and Venture Funds reported that Colorado is one of 44 states with venture capital programs. These 44 states have committed a total of about \$5.8 billion to 151 different venture capital programs. Almost 60 percent of these programs focus investments at the seed stage. States report that the main goals of their programs, in order of importance, are job creation, return on investment, and economic growth.

## Colorado’s Venture Capital Program

The General Assembly created Colorado’s state-supported Venture Capital Program (the Program) during the 2004 Legislative Session. The Program is designed to provide in excess of \$40 million in seed-, early-stage, and follow-on venture capital to Colorado businesses and to assist in the development of businesses that should, in turn, create jobs in the State.

The creation of Colorado's Venture Capital Program followed the October 2003 release of the Office of the State Auditor's evaluation of the Certified Capital Company (CAPCO) Program. Similar to the Venture Capital Program, the CAPCO Program was a state economic development tool designed to encourage the growth of local small businesses and the formation and support of a local venture capital infrastructure. Both programs used state-authorized insurance premium tax credits to raise investment capital. However, in contrast with the Venture Capital Program, the CAPCO Program was funded almost entirely with debt, which resulted in limited capital for investment. Because of the structure of the CAPCO Program, less than one-half of the \$100 million in capital derived from insurance premium tax credits was available for investment in Colorado businesses. Additionally, about 44 percent of the certified capital was set aside to guarantee cash repayments to insurance company investors.

Concerns about these and other aspects of the CAPCO Program during the 2003 Legislative Session resulted in the General Assembly, through passage of Senate Resolution 03-050, requesting the Legislative Audit Committee to evaluate the implementation of the Certified Capital Company Act. The evaluation conducted by the State Auditor identified problems with the CAPCO Program including limited controls over businesses receiving investment capital, a complicated mechanism for calculating state cash benefits, high administrative costs, and limited program oversight.

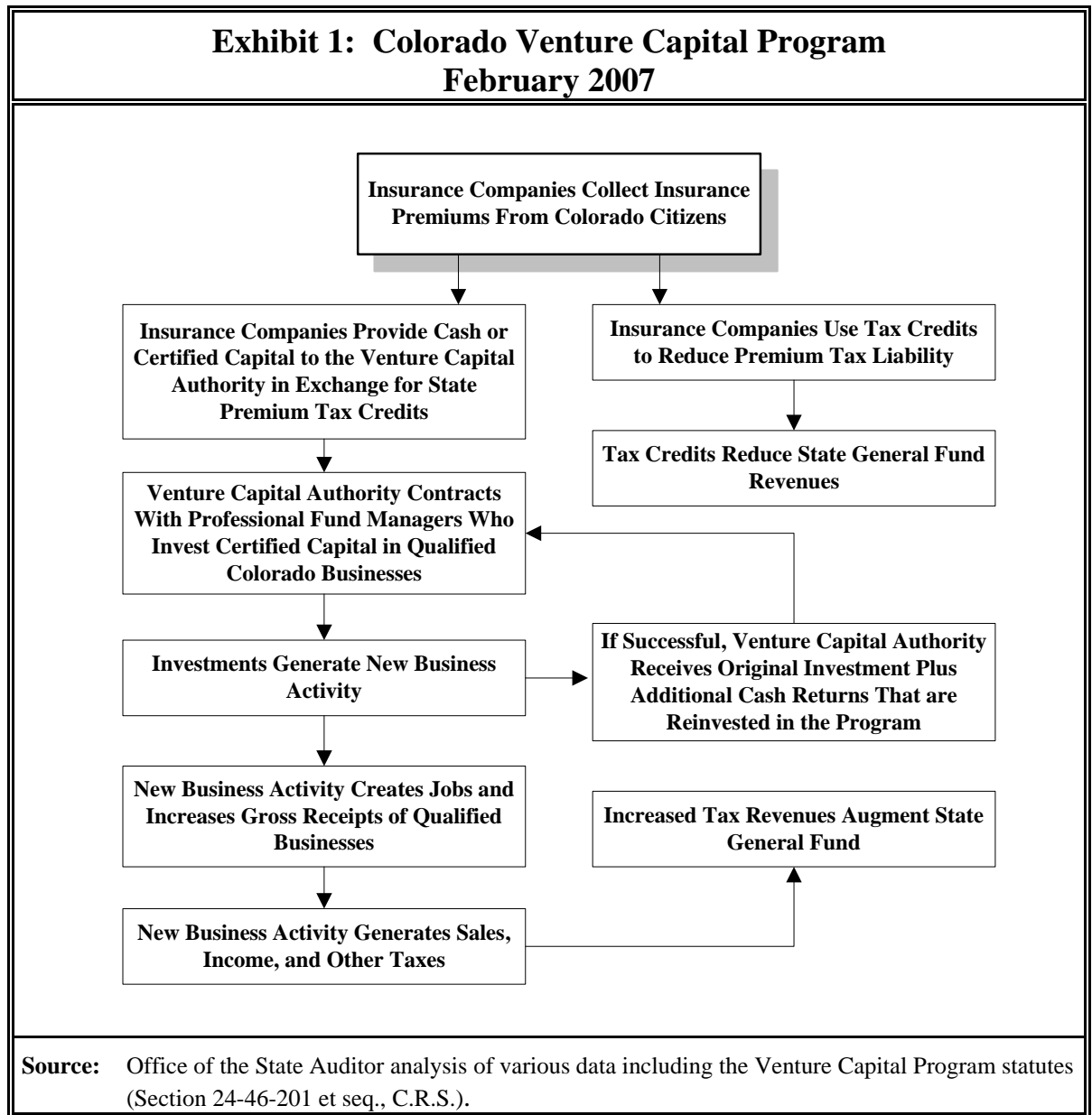
The State of Colorado originally made \$200 million in premium tax credits available through the Certified Capital Company Act. The first \$100 million was issued in April 2002. Following the release of our evaluation, the General Assembly halted the issuance of additional premium tax credits under the CAPCO Program. Specifically, Senate Bill 04-106 and House Bill 04-1206 redirected the second \$100 million from the CAPCO Program to the Venture Capital Program (\$50 million) and to CoverColorado (\$50 million). CoverColorado is a nonprofit entity created by the General Assembly to provide medical insurance for eligible Colorado residents who are unable to obtain coverage from private insurers because they have pre-existing medical conditions.

## **Venture Capital Program Basics**

Senate Bill 04-106 created the Venture Capital Program effective March 4, 2004. As part of the legislation, the General Assembly created the Venture Capital Authority (the Authority) which is charged with specific duties and responsibilities related to the Program. Basically, as shown in the exhibit on page 10, the Program works in the following way. Under Colorado law, insurance companies pay taxes based on policyholder premiums rather than on corporate profits. The Authority solicits cash (certified capital) from insurance companies through a competitive bid

process. In exchange for the cash received from the insurance companies, the State, through the Authority, provides insurance companies with tax credits that can be used to reduce their insurance premium tax liabilities over a 10-year period. Thus, the State in effect reduces future tax revenues in exchange for the opportunity to provide venture capital to new businesses.

The cash or certified capital received from the insurance companies is used by the Authority to establish one or more venture capital funds. The Authority then selects one or more professional fund managers to manage the venture capital funds and make investments of certified capital in qualified businesses. The Authority's investments are fully at risk. That is, the Authority will not receive any returns if the fund managers' investments fail. However, if the fund managers' investments are successful and generate returns, statute requires the professional fund managers to first reimburse the Authority for 100 percent of the certified capital invested. Returns on investments that exceed the original amount of certified capital invested are then divided between the fund managers and the Authority, based on negotiated agreements. The Authority is required by statute to deposit all proceeds in an enterprise fund. The enterprise fund is to be used as a revolving, evergreen fund for providing continued seed- and early-stage investment capital to qualified businesses.



## Major Stakeholders

There are several major stakeholders in Colorado’s Venture Capital Program. These are the:

**Venture Capital Authority.** Pursuant to Section 24-46-202(1)(a), C.R.S., the Authority is a special purpose authority and “a body corporate, a political subdivision of the state, and a public instrumentality. . . .” Furthermore, the Authority is not an agency of state government and shall not be subject to

administrative direction by any department, commission, board, or agency of the State. By statute, the Authority is to be governed by a nine-member Board of Directors (the Board). Five members are appointed by the Governor, two by the President of the Senate, and two by the Speaker of the House of Representatives. Board members must be residents of the State and have experience in venture capital, investment banking, institutional investment, fund management, or banking. The statute requires the Board to elect a chair and vice-chair, adopt rules of procedure, meet at least once per quarter, and maintain a record of its proceedings. Board members serve without compensation. The Board was fully appointed as of June 30, 2004.

The Authority's statutory responsibilities include establishing procedures and selection criteria for a competitive process for selecting one or more fund managers; establishing a process for receiving irrevocable offers for contributions of certified capital from insurance companies; providing contributing insurance companies with premium tax credit certificates; providing the Division of Insurance with an annual report identifying the insurance companies eligible for premium tax credits; conducting an annual review of the fund managers; advising fund managers on the eligibility status of their qualified investments; and reviewing investments for compliance with statutory and contractual requirements.

**Insurance Companies.** The Authority was charged with raising at least \$40 million of certified capital by selling premium tax credits to insurance companies operating in Colorado. Pursuant to statute (Sections 24-46-204(2) and (5), C.R.S.), the Authority established a process by which insurance companies could submit irrevocable offers of certified capital for the \$50 million of premium tax credits authorized by the General Assembly. According to the Division of Insurance, there were almost 1,500 insurance companies operating in Colorado that could have participated in the Venture Capital Program. The Authority received bids from seven insurance companies. The seven companies requested a total of \$79 million in tax credits, or \$29 million more than the \$50 million statutory limit. The Authority accepted the bids of four of the seven insurance companies.

According to the statutes, the amount of capital proposed by the insurance companies could not be less than 80 percent of the requested amount of tax credits. Basically, this means the Authority could not accept less than 80 cents in certified capital for each dollar in premium tax credits. As required by the statute (Section 24-46-204(5)(c)(II), C.R.S.), the Authority distributed the premium tax credits to the four bidders offering the highest amount of certified capital per dollar of credits until the total \$50 million in premium tax credits were allocated. In April 2005 the Authority entered into contracts with each of the four qualifying insurance companies and issued tax credit certificates totaling \$5 million. In exchange for the tax credits, the four insurance companies provided the Authority with approximately \$4.6 million.

In total, the four companies are scheduled to provide the Authority about \$43.1 million between 2005 and 2014 in exchange for \$50 million in premium tax credits.

On average, the Authority will receive cash equivalent to approximately 86.2 percent of the total value of the tax credits, or about 86 cents for each dollar in tax credits. The individual cash equivalent average for the four insurance companies ranges from a low of about 85 cents to a high of about 87.8 cents per dollar in tax credits. The insurance companies are authorized to sell or transfer all or a portion of their tax credits to other insurance companies. To date, one insurance company has transferred \$705,000 in premium tax credits to five additional insurance companies.

**Professional Fund Manager(s).** The Authority was statutorily required to competitively select one or more fund managers to manage the fund or funds created by the Program. In selecting fund managers, the Authority was to place significant emphasis on the (1) total amount of venture capital managed by the applicant in Colorado and elsewhere; (2) applicant's historical return on investment, with an emphasis on returns from seed- and early-stage investments; and (3) percentage of proceeds to be retained by the applicant in comparison with the percentage of proceeds to be distributed back to the Authority. The Authority received applications from 10 fund managers. In December 2004 the Authority selected High Country Venture, LLC, located in Boulder, Colorado, as the sole fund manager. Among its fund management responsibilities, High Country Venture, LLC, is to accept and review applications from businesses seeking investments; make investments in Colorado businesses in compliance with statutory and contractual requirements; provide the Authority with an annual operational report and audited financial statements; and make distributions from certified capital for management fees and other expenses.

**Qualified Businesses.** Section 24-46-201(8), C.R.S., requires that businesses meet a number of conditions at the time of first investment to be eligible or "qualified" for the Program. Specifically, a qualified business must be headquartered and its principal operations be located in Colorado. If the business is located outside of the State, it contractually must agree to move and headquarter or establish its principal operations in Colorado within nine months after finalization of the contract between the business and the fund manager. Qualified businesses must also be small businesses that are not predominately engaged in professional services provided by accountants, doctors, or lawyers; banking, lending, real estate development, insurance, oil and gas exploration, direct gambling activities; or making loans to or investing in a fund manager or affiliates of a fund manager. The statute also prohibits a business from receiving an investment from any venture capital fund established by the Authority and a professional fund manager that exceeds 15 percent of the fund's total certified capital. Finally, a qualified business must maintain its

business in Colorado for at least five years after first receiving an investment of certified capital and expend all certified capital within Colorado, or, purchase goods and services to be used or performed within Colorado. The Venture Capital Authority is authorized to qualify a business if the business meets some, but not all, of the above criteria and the investment is determined to further the economic development of the State.

**Office of Economic Development and International Trade.** By statute, the Office of Economic Development is to cooperate with the Authority and its staff and assist in administering the Venture Capital Program. At the time of our audit, the Authority had not hired staff, and staff from the Office of Economic Development and International Trade (OEDIT) were handling the majority of the Authority's administrative activities, as will be described later in the report. Although the OEDIT is to cooperate with and assist the Authority, the Venture Capital Authority and its governing Board are statutorily responsible for specific duties and responsibilities related to the Venture Capital Program.

**Division of Insurance.** As part of its responsibilities for ensuring that insurance premium taxes are paid and collected, the Division of Insurance (the Division) must verify whether the amount of premium tax credits allocated by the Venture Capital Authority reconciles with the amount of premium tax credits claimed by the participating insurance company investors. The Division must also track the amount of tax credits carried forward by insurance companies and the amount of tax credits sold and/or transferred to other insurance companies.

## Program Costs and Direct Cash Benefits

Section 24-46-204(1), C.R.S., provides that the \$50 million in premium tax credits allocated to the Venture Capital Program will be taken, in aggregate, at a rate of \$5 million per year beginning in Tax Year 2005. The first opportunity for the four participating insurance companies to use the credits to offset their tax liabilities began with the July 31, 2005, quarterly estimated premium tax filings. If an insurance company does not have sufficient liability in a single year to claim the full amount of its allocated credits, the remaining value of its credits may be rolled forward up to 10 subsequent years. Consequently, it is possible that one or more of the insurance companies could be claiming credits until 2024. For Tax Years 2005 and 2006, as of September 30, 2006, the insurance companies have claimed about \$8.7 million in Venture Capital Program tax credits.

The statute requires that the Authority receive direct cash benefits from the investment of the certified capital. According to Section 24-46-203(6)(b)(I) and (II), C.R.S., the fund manager shall first distribute investment proceeds (i.e., return of capital and investment earnings) to the Authority in an amount equal to 100 percent



of the certified capital allocated to the venture capital fund. Following this distribution, the fund manager must distribute all remaining certified capital and proceeds to the Authority and to the fund manager according to the provisions of the contractual arrangement and as certified capital and proceeds become available. The Authority will retain its portion of the cash benefits in the enterprise fund (discussed below) and use the money to create additional venture capital funds. No cash benefits will be paid to the State's General Fund.

## Distribution of Certified Capital

As previously discussed, the Venture Capital Authority is scheduled to receive about \$43.1 million from insurance companies between 2005 and 2014. This money has been committed and/or expended as follows:

- **Certified Capital Received.** As of December 31, 2006, the Venture Capital Authority had received approximately \$9.1 million in certified capital from the four participating insurance companies in exchange for \$10 million in premium tax credits.
- **Enterprise Fund.** Statute (Section 24-46-202(9), C.R.S.) created the enterprise fund within the Venture Capital Authority. The enterprise fund is to be a revolving fund administered by the Authority as a government-owned business. Revenues earned on the investment or deposit of moneys in the enterprise fund shall be credited to the fund. By statute, the Authority is to use the fund for two purposes. First, the enterprise fund is to be a revolving, evergreen fund for continued seed- and early-stage investment capital in qualified businesses. For this purpose, the Authority is to transfer revenues in the fund to one or more venture capital funds to enable a fund manager to make qualified investments. The second purpose of the enterprise fund is to finance the Authority's direct and indirect expenses in administering the Venture Capital Program.

Between 2005 and 2009, the Authority will receive about \$22.3 million from the four participating insurance companies. The Authority has committed about \$21.8 million through 2009 to its first venture capital fund—Colorado Fund I. The difference between the amount of certified capital received from the insurance companies and the amount committed to Colorado Fund I is about \$554,000. According to the Authority, it has reserved these monies for identified costs, unexpected administrative costs, and additional investment capital for businesses, if needed. Furthermore, the Authority will retain the about \$21.8 million committed to Colorado Fund I in the enterprise fund until specific amounts are requested or drawn down by High Country Venture,

LLC. As of December 31, 2006, the Authority had earned approximately \$235,000 in interest on the money retained in the enterprise fund.

As of December 31, 2006, the Authority had paid approximately \$133,000 from the fund, or about 1.5 percent of the approximate \$9.1 million received from insurance companies, for the direct and indirect expenses related to administering the Program. The bank balance for the enterprise fund was about \$2.8 million as of December 31, 2006.

- **Colorado Fund I.** Colorado Fund I (the Fund) is a venture capital fund formed by High Country Venture, LLC, in June 2005 to provide equity capital or debt financing to seed- and early-stage Colorado businesses. High Country Venture, LLC, is the general partner and manager of the Fund. The Venture Capital Authority and Tango VIII, LLC, are limited partners. Tango VIII, LLC, is a limited liability company formed to invest in Colorado Fund I and is affiliated with the principals/members of High Country Venture, LLC. High Country Venture, LLC, also committed a portion of its own money to the Fund. According to the Authority, the investment by High Country Venture, LLC, of its own funds serves as an incentive for it to make good investment decisions.

As the table below shows, the total commitment to the Fund by all partners is approximately \$22.8 million. The Authority has committed about \$21.8 million or 95.6 percent of the total funding commitment of approximately \$22.8 million. Tango VIII, LLC, has committed slightly more than \$772,000 or 3.4 percent of total funding commitment, and High Country Venture, LLC, has committed about \$228,000 or 1 percent of total funding commitment to the Fund. According to the limited partnership agreement and as demonstrated in the table below, each partner is required to make specific amounts of capital available to the Fund on an annual basis. As of December 31, 2006, approximately \$9.2 million was available to the Fund for investments in Colorado businesses, including approximately \$8.8 million available from the Authority, \$310,000 available from Tango VIII, LLC, and \$90,000 available from High Country Venture, LLC. Although the \$9.2 million is available to the Fund, each partner retains its committed capital until it is requested or drawn down by Colorado Fund I's general partner (High Country Venture, LLC).

<b>Colorado Venture Capital Program Capital Commitments to Colorado Fund I By Partner and Date Capital Must Be Available</b>				
<b>Date Capital Must Be Available</b>	<b>Limited Partners</b>		<b>General Partner</b>	<b>Total Commitment by Year</b>
	<b>Venture Capital Authority</b>	<b>Tango VIII, LLC</b>	<b>High Country Venture, LLC</b>	
April 20, 2005	\$4,398,000	\$156,000	\$46,000	\$4,600,000
April 20, 2006	\$4,433,000	\$157,000	\$46,000	\$4,636,000
April 20, 2007	\$4,373,000	\$155,000	\$46,000	\$4,574,000
April 20, 2008	\$4,311,000	\$153,000	\$45,000	\$4,509,000
April 20, 2009	\$4,251,000	\$151,000	\$45,000	\$4,447,000
Total Commitment by Partner	\$21,766,000	\$772,000	\$228,000	\$22,766,000
Percentage of Total Commitment by Partner	95.6%	3.4%	1.0%	100%

**Source:** Office of the State Auditor analysis of the limited partnership agreement creating Colorado Fund I.

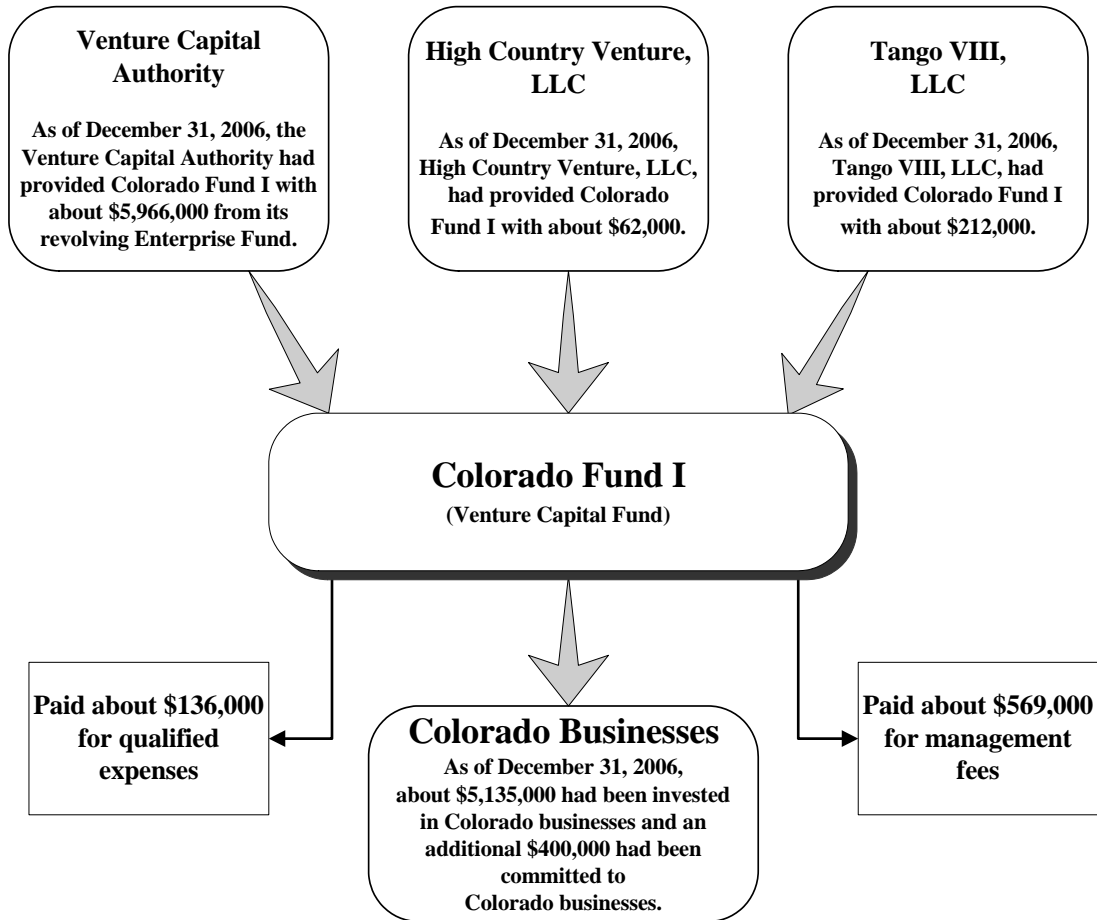
As of December 31, 2006, the general and limited partners have provided Colorado Fund I with about \$6.2 million of their capital commitments for investments in Colorado businesses, management fees, and other qualified expenses. Of this total, approximately \$5.9 million was provided by the Venture Capital Authority, \$200,000 by Tango VIII, LLC, and almost \$100,000 by High Country Venture, LLC. The exhibit on page 18 shows the amount of capital provided to Colorado Fund I by each partner and the amounts invested in Colorado businesses and expended on management fees and other expenses as of December 31, 2006.

- **Management Fees and Other Expenses.** According to statute, fund managers may make qualified distributions for expenses related to managing and operating the Fund. A qualified distribution is statutorily defined as any distribution of certified capital from a specific venture capital fund for expenses related to managing and operating that fund. Qualified distributions are not to exceed 2.5 percent annually of the total amount of certified capital committed to each venture capital fund unless authorized by the Authority. This means qualified distributions from Colorado Fund I are not to exceed about \$570,000 per year. In accordance with statute, High Country Venture,

LLC, made qualified distributions of about \$276,000 in 2005 and \$429,000 in 2006. Furthermore, the statute prohibits certified capital from being used for litigation challenging the validity, implementation, or effect of the Venture Capital Program statutes (Part 2 of Article 46 of Title 24 of the Colorado Revised Statutes); for lobbying; or for government relations purposes. As of December 31, 2006, High Country Venture, LLC, had made about \$705,000 in qualified distributions from Colorado Fund I. This figure included approximately \$569,000 in reimbursements for its fund management services and \$136,000 for operating expenses. Of the approximate \$705,000 in qualified distributions paid from Colorado Fund I, about \$674,000 was provided by the Authority, \$24,000 by Tango VIII, LLC, and \$7,000 by High Country Venture, LLC.

- **Investments in Colorado Businesses.** As of December 31, 2006, High Country Venture, LLC, had made investments from Colorado Fund I totaling about \$5.1 million in five qualified businesses. (See Appendix A for information regarding the businesses receiving qualified investments.)

**Exhibit 2: Colorado Venture Capital Program  
Colorado Fund I  
Cash Receipts and Disbursements as of December 31, 2006**



**Source:** Office of the State Auditor analysis of the Venture Capital Authority’s financial records.  
**Note:** Pursuant to the statute (Section 24-46-201(9), C.R.S.), a fund manager may make qualified distributions for expenses related to managing and operating a venture capital fund. Qualified distributions shall not exceed 2.5 percent annually of the total amount of certified capital committed to the venture capital fund. In 2006 qualified distributions were about 1.9 percent of total certified capital committed to Colorado Fund I.

## **Audit Scope**

Section 24-46-206, C.R.S., requires the State Auditor to audit the implementation of the Venture Capital Program by March 4, 2007, and submit a report to the Legislative Audit Committee. Pursuant to the statute, we reviewed the Venture Capital Authority's implementation of the Venture Capital Program. Our primary focus was to determine if the Venture Capital Authority complied with the provisions of Part 2 of Article 46 of Title 24 of the Colorado Revised Statutes and met all statutorily established milestones. We also evaluated the Venture Capital Authority's staffing, performance reporting, and compliance with certain statutes applicable to local governments. Additionally, we evaluated the controls implemented by the Authority and the Division of Insurance to ensure that the State's \$50 million investment in the Venture Capital Program is being appropriately safeguarded. We identified areas for improvement and discuss each in the following sections of the report.

## **Program Implementation**

The Venture Capital Program's enabling legislation contains specific provisions regarding the implementation of the Program and establishes date-specific milestones. Pursuant to Section 24-46-206, C.R.S., we reviewed the Venture Capital Authority's (the Authority's) implementation of the Program, including its compliance with the statutorily established milestones. Overall, we found that the Authority implemented the Venture Capital Program according to statutory provisions, with one exception, as indicated in the table on the following page.

<b>Colorado Venture Capital Program Statutory Implementation Checklist As of December 31, 2006</b>			
<b>Statutory Milestone</b>	<b>Required Completion Date</b>	<b>Actual Date Completed</b>	<b>Complied</b>
Venture Capital Authority and Program established (Senate Bill 04-106)	N/A	March 4, 2004	N/A
Fund Manager(s) Selected (Section 24-46-203(1), C.R.S.)	December 31, 2004	December 10, 2004	✓
Execution of Contract with Fund Manager (Section 24-46-203(3), C.R.S.)	As soon as practicable after selection	June 20, 2005	✓
Issuance of Tax Credits for 2005 (Section 24-46-204(2), C.R.S.)	On or between January 31, 2005, and December 1, 2005	April 30, 2005	✓
Annual Report to the Office of the State Auditor for 2004 (Section 24-46-206, C.R.S.)	February 1, 2005	January 30, 2006	✗
Initial Investment of Certified Capital (Section 24-26-203(3)(a), C.R.S.)	January 1, 2006	August 16, 2005	✓
Annual Report by Fund Manager for 2005 (Section 24-46-203(7)(a), C.R.S.)	January 31, 2006	January 31, 2006	✓
Annual Report to the Office of the State Auditor for 2005 (Section 24-46-206, C.R.S.)	February 1, 2006	January 30, 2006	✓
Fund Manager's Audited Financial Statements (Section 24-46-203(7)(b), C.R.S.)	March 31, 2006	March 22, 2006	✓
Issuance of Tax Credits for 2006 (Section 24-46-204(2), C.R.S.)	On or between January 31, 2006, and December 1, 2006	April 30, 2006	✓
Annual Review of Fund Manager for 2006 (Section 24-46-203(9), C.R.S.)	2006	December 5, 2006	✓
<b>Source:</b> Office of the State Auditor analysis of Colorado Revised Statutes and Venture Capital Authority records.			
<b>Key:</b> ✓ = met statutory milestone; ✗ = failed to meet statutory milestone.			

## Investments in Qualified Businesses

As of December 31, 2006, the Authority's fund manager (High Country Venture, LLC) had invested a total of about \$5.1 million in five Colorado businesses. The statutes (Section 24-46-201(8)(a), C.R.S.) specify the types, size, and location of businesses that can receive investments of certified capital. The statutes also establish the maximum amount of certified capital each business is authorized to receive and the types of investments that can be made by fund managers (e.g., equity, loans, convertible loans). We reviewed High Country Venture, LLC's investments through December 31, 2006, and found they were made in accordance with statute. Furthermore, as required by statute, all of the five businesses have entered into contracts with Colorado Fund I agreeing to maintain their businesses in Colorado for at least five years after first receiving an investment of certified capital (or to return the value of the investment) and to expend all certified capital in Colorado or to purchase goods and services to be used or performed in Colorado. (See Appendix A for detailed information regarding the businesses receiving investments of certified capital.)

The statutes also specify the percentages of certified capital that the Authority **shall** allocate for investment in businesses located in rural, urban distressed, and all other areas of the State. Further, the investments are to be made by established deadlines. The statute and the Authority's limited partnership agreement with High Country Venture, LLC, specify that the approximate \$21.8 million of certified capital be invested in qualified businesses as shown in the following table. As the table indicates, by June 20, 2008, High Country Venture, LLC, is to invest about \$1.6 million in qualified businesses located in designated rural counties, \$1.6 million in qualified businesses located in distressed urban communities, and \$3.3 million in qualified businesses located statewide. By June 20, 2015, or 10 years after the first allocation of certified capital, High Country Venture, LLC, is to have invested all certified capital, or about \$21.8 million, committed by the Authority.



<b>Colorado Venture Capital Program Fund Manager Investment Schedule</b>				
<b>Investment Schedule</b>	<b>Location of Investments</b>			<b>Totals All Areas</b>
	<b>Designated Rural Counties</b>	<b>Distressed Urban Communities</b>	<b>Statewide</b>	
Total by June 20, 2008	\$1,632,000	\$1,632,000	\$3,265,000	\$6,529,000
Total by June 20, 2010	\$2,721,000	\$2,721,000	\$5,442,000	\$10,884,000
Total by June 20, 2015	\$5,441,000	\$5,441,000	\$10,884,000	\$21,766,000

**Source:** Office of the State Auditor analysis of Colorado Revised Statutes and the limited partnership agreement between the Venture Capital Authority and High Country Venture, LLC.

By statutory definition, 49 of Colorado’s 64 counties, or about 77 percent, are considered designated rural counties. As of July 2005, the 49 rural counties had a total population of about 832,000, or about 18 percent of Colorado’s total population. Section 24-46-201(11)(a), C.R.S., defines a rural county as:

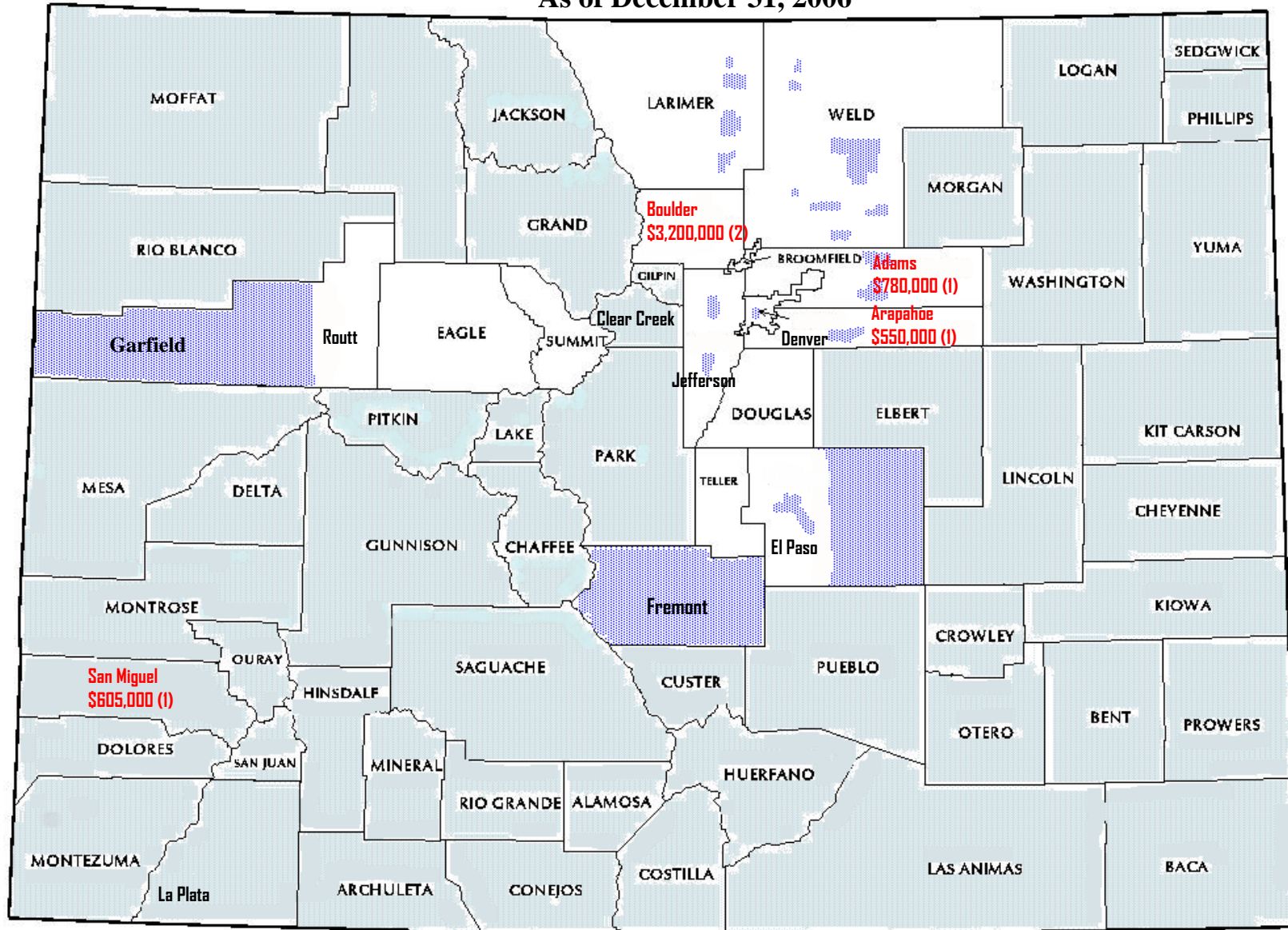
. . . any county, but not any city and county, in this state that, as of June 9, 2001, has a population of not more than one hundred and fifty thousand people and, if the county’s population exceeds twenty thousand people, that has a growth rate that does not exceed the statewide average for the period of 1990-2000 by more than twenty-five percent as defined in the two most recent decennial censuses. Additionally, a qualified rural business must be located in an area designated as an enterprise zone pursuant to article 30 of title 39, C.R.S., unless the authority waives this requirement.

A distressed urban community is defined as any area that is not within a designated rural county and that has been designated as an Enterprise Zone by the Colorado Office of Economic Development and International Trade pursuant to Article 30 of Title 39 of the Colorado Revised Statutes. Statewide investments refer to investments made in all other areas of the State (i.e., areas that are not designated as distressed urban communities or rural counties).

The map on page 24 shows Colorado’s 64 counties. Highlighted areas are either designated rural counties (light blue) or distressed urban communities (dark blue). The map shows the number of businesses and the total amount invested in businesses in each county. Specifically, as of December 31, 2006, High Country Venture, LLC,

had invested about \$605,000 in designated rural counties (within San Miguel County), \$780,000 in distressed urban communities (within Adams County), and about \$3.8 million in other statewide areas (within Arapahoe and Boulder Counties).

## Colorado Fund I Investments As of December 31, 2006



- |   |   |
|---|---|
| <ul style="list-style-type: none"> <li><span style="display: inline-block; width: 15px; height: 15px; background-color: #e0f2f1; border: 1px solid black; margin-right: 5px;"></span> Designated Rural Counties - \$605,000</li> <li><span style="display: inline-block; width: 15px; height: 15px; background-color: #4285f4; border: 1px solid black; margin-right: 5px;"></span> Distressed Urban Communities - \$780,000</li> <li><span style="display: inline-block; width: 15px; height: 15px; background-color: white; border: 1px solid black; margin-right: 5px;"></span> Other Statewide Areas - \$3,750,000</li> </ul> | <ul style="list-style-type: none"> <li>\$ - Total Investment</li> <li>(#) - Qualified Businesses</li> </ul> |
|---|---|

## **Pace and Location of Investments**

At the time of our audit, we found that High Country Venture, LLC, appeared to be on schedule to make the required amount of investments in businesses located in distressed urban communities. Additionally, investments made statewide, in areas other than distressed urban communities or rural counties, have already exceeded the June 20, 2008, schedule. However, we found that High Country Venture, LLC, will need to increase the pace of investments in designated rural counties if the required amount of investments is to be made by the deadline. Specifically, as the following table shows, by December 31, 2006, midway to the June 20, 2008, deadline for investing about \$1.6 million in designated rural counties, High Country Venture, LLC, had invested about \$605,000, or 37 percent, of the required total. The starting date for calculating the investment milestones is the date of the limited partnership agreement forming Colorado Fund I—June 20, 2005.

<b>Colorado Venture Capital Program</b> <b>Colorado Fund I Investments as of December 31, 2006</b> <b>As Compared with the June 20, 2008, Investment Milestone</b>				
Investment Milestone	Location of Investments			Totals All Areas
	Designated Rural Counties	Distressed Urban Communities <sup>1</sup>	Statewide	
Investments Required by June 20, 2008	\$1,632,000	\$1,632,000	\$3,265,000	\$6,529,000
Investments as of December 31, 2006	\$605,000	\$780,000	\$3,750,000	\$5,135,000
Actual Investments as Percentage of Investments Required by June 20, 2008	37%	48%	115%	79%
<p><b>Source:</b> Office of the State Auditor analysis of Colorado Revised Statutes, the limited partnership agreement between the Venture Capital Authority and High Country Venture, LLC, and Authority financial records.</p> <p><sup>1</sup>According to the limited partnership agreement between the Authority and High Country Venture, LLC, co-investments not to exceed an aggregate of \$5 million made by companies controlled by the owners of High Country Venture, LLC, but not included as a partner in Colorado Fund I, can be applied toward meeting the investment milestones. As of December 31, 2006, co-investments totaling about \$327,000 had been made in Taligen Therapeutics, which is a qualified business located in a distressed urban community. According to the limited partnership agreement, the about \$327,000 co-investments are to be applied to the June 20, 2008, milestone. Therefore, pursuant to the limited partnership agreement, a total of about \$1.1 million has been invested in qualified businesses located in distressed urban communities. This raises the percentage of investments in these areas of the State to about 68 percent.</p>				

Despite marketing and outreach efforts, personnel at High Country Venture, LLC, have expressed concerns regarding the availability of promising investment opportunities in designated rural counties. According to the Authority, High Country Venture, LLC, received 230 applications for investments from businesses throughout the State. Only 17 of the 230 applications were from businesses located in rural counties.

The Authority is aware of the ongoing difficulty in identifying qualified businesses in the designated rural areas. As such, the Authority reports that it has discussed the statutory requirements with High Country Venture, LLC, and has encouraged it to take steps to identify and review investment opportunities in these areas. Although it is premature to conclude that the appropriate amount of investments will not be

made in qualified rural businesses, the Venture Capital Authority should continue to monitor High Country Venture, LLC's investments in these areas of the State. As such, the Authority should continue working with High Country Venture, LLC, and the Office of Economic Development and International Trade to identify investment opportunities in rural Colorado.

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### **Recommendation No. 1:**

The Venture Capital Authority should continue to monitor High Country Venture, LLC's level of investment in businesses located in designated rural counties of the State and continue cooperative efforts with the Office of Economic Development and International Trade to identify investment opportunities in these areas.

### **Venture Capital Authority Response:**

Agree. Implementation Date: Implemented and Ongoing.

The Authority is closely monitoring High Country Venture, LLC's investments in businesses in designated rural counties and will continue to do so. If High Country Venture, LLC, had made one or more additional investment(s) totaling \$200,000, then Colorado Fund I's investment rate would be fully in line with the pace required to meet the level of total investments expected by the stated June 30, 2008, deadline. Although High Country Venture, LLC, is responsible for identifying such investment opportunities, the Authority will continue to cooperate with the Economic Development Commission and the Governor's Office of Economic Development and International Trade to identify investment opportunities in the rural areas of the State and share that information with High Country Venture, LLC.

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## **Staffing**

As previously stated, statute authorizes the Venture Capital Authority to "hire staff as it deems necessary or convenient to administer" the Venture Capital Program and to pay for its direct and indirect expenses in administering the Program. In addition, by statute (Section 24-46-202(1)(d)(I), C.R.S.), the Office of Economic Development is to "cooperate with the Authority and its staff" and to assist in the administration of the Venture Capital Program (Section 24-46-206, C.R.S.).

To date, the Authority has not hired staff. Rather, it has relied entirely on staff from the Office of Economic Development and International Trade (OEDIT) to carry out the day-to-day activities of the Authority, its Board, and the Venture Capital Program. Since the inception of the Program in 2004, OEDIT staff have been responsible for handling the majority of the Authority's and the Board's administrative and program activities. For example, OEDIT staff have been responsible for scheduling the Board's meetings, preparing the Board's meeting minutes, reviewing proposed business investments to determine eligibility under statute, establishing bank accounts, reviewing and reconciling accounting records to bank statements, preparing wire transfer requests, conducting the statutorily required annual review of the fund manager, and preparing statutorily required reports. These recurring activities are essential for the operation and success of the Program. Staff at the OEDIT estimate that, in total, they spend an average of about 100 hours per month performing tasks for the Authority.

We found that the current staff sharing arrangement between the Authority and OEDIT is problematic for two reasons. First, the conflict-of-interest provision of the Venture Capital Program statutes (Section 24-46-207, C.R.S.) prohibits any member or employee of the executive branch from becoming "an officer, director, employee, or consultant of or receiving any compensation from the authority or a fund manager either during the term of the member or employee's employment with the executive branch or for six years after such term ends." By functioning as staff for the Authority, OEDIT staff, as members of the executive branch, appear to be violating this statutory provision. Second, the staff sharing arrangement violates the purpose for which OEDIT funds were appropriated by the General Assembly. To date, the General Assembly has not appropriated funds to the OEDIT for staffing the Authority. As such, OEDIT staff who assist the Authority do so in addition to their regular responsibilities. These staff report that the work performed for the Venture Capital Authority has increased their workloads to the extent that uncompensated overtime is occasionally required. Staff also report that it has become increasingly difficult to provide the level of support required by the Authority and still meet their primary job responsibilities at the OEDIT. Furthermore, we identified one OEDIT employee whose position is funded entirely by and for another program who routinely conducts activities for the Authority.

According to the Venture Capital Authority Board, it believes that statute requires the OEDIT to provide staffing services to the Authority. The Board's position is based on statutory language that states, the OEDIT **shall** cooperate with and assist the Authority. By contrast, the Board believes the statutory language that the Authority "may hire staff as it deems necessary or convenient" is not a mandate that it hire staff. Finally, the Board reports that the Authority did not have access to funds for operations, including staff services, in 2004 and part of 2005.

We agree that the statutes require Office of Economic Development and International Trade staff to assist and cooperate with the Authority. Further, we understand that having OEDIT staff, particularly those with expertise related to venture capital programs, assist the Authority, was a reasonable expectation. However, we believe the Authority's ongoing and total reliance on the OEDIT for administrative and program support has exceeded the levels of assistance and cooperation intended by statute. In addition, the current staffing situation does not provide the requisite clarity with regard to responsibility and accountability for the actions and activities of the Authority and the Program. Finally, the Authority's permanent and continued use of staff appropriated to the OEDIT is inappropriate and should not continue. It is for these reasons that the Authority should take steps to resolve the problems identified with its current staff-sharing arrangement with the OEDIT. One solution is for the Authority to hire its own staff and pay for those staff from Venture Capital Program funds, as authorized in statute. If, however, the Authority continues to rely on OEDIT staff, then it will need to seek statutory change to the conflict-of-interest provision of the Venture Capital Program statutes and establish clear lines of authority and responsibility for its operations.

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## **Recommendation No. 2:**

The Venture Capital Authority should take steps to resolve the problems identified with the current staff sharing arrangement with the Office of Economic Development and International Trade.

### **Venture Capital Authority Response:**

Partially agree. Implementation Date: January 2008.

Although the Authority was not aware of a staffing concern until this audit, the Authority is willing to work with the OEDIT to resolve this concern and will provide updates to the Office of the State Auditor. A number of options will be explored by the Authority, including seeking legal guidance, potentially seeking legislation so that OEDIT staff can continue to provide staff support, and contracting for staff.

The Authority disagrees that the use of the OEDIT's staff is inappropriate. In addition to the rationale previously provided for not hiring staff, the Authority was informed of the OEDIT's testimony to the 2004 legislature in which the OEDIT committed to providing staffing for the Authority using the OEDIT's existing staff/resources. The Authority believes that the OEDIT is the most appropriate entity to assist the Authority with this Program. The OEDIT has provided qualified, responsive staff support to assist the



Authority in the implementation and ongoing operation of the Program. The Authority believes that strong staff support and continuity in the program, particularly with the volunteer nature of its board, are important to its success.

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## Performance Reporting

By statute (Section 24-46-206, C.R.S.), the Venture Capital Authority is required to submit a report to the State Auditor by February 1 of each year, beginning in 2005. On January 30, 2006, the Authority provided the Office of the State Auditor with its annual reports for 2004 and 2005. In reviewing the reports, we found they did not provide sufficient information regarding the implementation status of the Program. For example, the Authority's annual report for 2005 did not include information on the statutory requirements for investments made in designated rural counties, distressed urban communities, and statewide.

The only statutory requirement concerning the report's contents is that it be "regarding the implementation" of the Venture Capital Program. Statute does not specify the information to be included in the report. Therefore, the reports the Authority has submitted have complied with statute. We believe, however, for the reports to be meaningful, additional financial and performance information should be included.

Investors in typical venture capital funds regularly receive information necessary to assess the financial and operational performance of their investments. The Venture Capital Program derives its investment capital from insurance premium tax credits. In other words, in the absence of the Venture Capital Program, the \$50 million in tax credits made available to fund the Program would have been tax revenues to the State. Those revenues, in turn, could have been used to fund other public programs or to address other public needs. Consequently, we believe the following types of information on the Program's performance should be included in the Authority's annual report to the State Auditor:

- The balance of certified capital not yet invested and/or expended at the end of the immediately preceding calendar year for each venture capital fund managed by the fund manager(s).
- The number of jobs created in Colorado from qualified investments made by the fund manager(s) and the amount of proceeds, if any, received by the fund manager(s) from the investments.

- 
- The amount of qualified distributions made by the fund manager(s) from certified capital during the immediately preceding calendar year and since inception.
  - The amount of qualified investments made by the fund manager(s) from certified capital during the immediately preceding calendar year and since inception by location (i.e., designated rural county, distressed urban community, statewide).
  - An analysis of the fund manager's performance with regard to meeting all investment schedules established by statute and contract (e.g., limited partnership agreement).
  - An analysis of the Authority's performance relative to the mission and goals of the Venture Capital Program.
- 

### **Recommendation No. 3:**

The Venture Capital Authority should include information on the financial and operational performance of the Program in its annual report to the State Auditor.

#### **Venture Capital Authority Response:**

Agree. Implementation Date: February 2008.

The annual reports submitted by the Authority contained the relevant information needed to assess implementation status of the program to date as required under the statute and are in compliance with the statute as acknowledged by the Office of the State Auditor. Prior to this audit, the Authority had never received a request to include additional information in its reports. However, the Authority is certainly willing to provide the additional information now requested and will do so going forward.

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## **Local Government Laws**

Colorado statutes include financial reporting requirements with which local governments must comply. Two of these requirements are the Local Government Budget Law (Section 29-1-101 et seq., C.R.S.) and the Local Government Audit Law (Section 29-1-601 et seq., C.R.S.). These laws define a local government as:

. . . any authority, county, municipality, city and county, district, or other political subdivision of the state of Colorado; any institution, department, agency, or authority of any of the foregoing; and any other entity, organization, or corporation formed by intergovernmental agreement or other contract between or among any of the foregoing.

Pursuant to Section 24-46-202, C.R.S., the Venture Capital Authority is a special purpose authority and “a body corporate, a political subdivision of the state, and a public instrumentality. . . .” As such, the Authority meets the definition of a local government and, therefore, should be complying with the provisions of both the Local Government Budget and Audit Laws. However, the Authority has not complied with either law as follows:

**Local Government Budget Law.** Section 29-1-103(1), C.R.S., requires each local government to adopt an annual budget. Furthermore, the adopted budget must present a complete financial plan by fund and by spending agency, within each fund, for the budget year. The budget must also provide specific detailed information including all proposed expenditures for administration, operations, maintenance, debt service, and capital projects; anticipated revenues; estimated beginning and ending fund balances; actual figures for the prior fiscal year and projected figures for the current fiscal year; a written budget message; and explanatory schedules.

In February 2005 the Authority’s Board adopted a 10-year budget. We found this budget lacked the specific information cited above. Also, according to the Local Government Budget Law, prior to adopting the budget, the Authority should have published a notice containing the date and time of the hearing at which the budget would be considered and statements that the budget was available for inspection by the public and that any interested person could file an objection to the budget prior to final adoption. We found that the Board did not provide the required public notice. In addition, the Local Government Budget law requires the Authority to file a certified copy of its budget with the Department of Local Affairs’ Division of Local Government by January 31 of each year. To date, the Authority has not complied with the statutory requirement.

Staff at the Office of Economic Development and International Trade, who have been working on behalf of the Venture Capital Authority, reported that they have discussed this issue with staff at the Governor’s Office and at the Department of Local Affairs. According to OEDIT staff, staff at these two agencies indicated that they do not believe the Authority meets the aforementioned definition of a local government. Therefore, compliance with the Local Government Budget Law was not required. Based on their discussions, it was determined that the Venture Capital Authority shares similar characteristics with other entities that are expressly

exempted from the Local Government Budget Law. Specifically, staff cite other state-created authorities including the Colorado Sheep and Wool Authority, the Colorado Beef Council Authority, and the Colorado Horse Development Authority, which are all exempted from the Law.

**Local Government Audit Law.** The Venture Capital Authority's 2005 financial audit was not completed and submitted to the State Auditor in accordance with statutorily required timelines. Pursuant to the Local Government Audit Law (Section 29-1-603, C.R.S.), the Venture Capital Authority is required to undergo an annual audit of its financial statements. The statute requires the audit be completed within six months after the close of the fiscal year. The local government is then required to forward a copy of the audit report to the State Auditor within 30 days after receiving it. Until contacted by our office, the Authority was not aware of the statutory requirement to undergo an annual financial audit. The Authority subsequently took steps to comply with the provisions of the Local Government Audit Law. However, the audit for Fiscal Year ended December 31, 2005, was not submitted to the State Auditor until December 12, 2006. Thus, the audit did not meet the statutory timelines. The audit for Fiscal Year ended December 31, 2005, was submitted approximately five months after the deadline in July 2006.

Although there are entities that are exempted from these local government financial reporting laws, the Venture Capital Authority is not one of the exempted entities cited in the statutes. Therefore, in the absence of a specific statutory exemption, the Authority needs to comply by preparing and submitting the required budget and audit documents. If the Authority believes it does not meet the definition of a local government and, therefore, is not subject to the requirements of the Local Government Budget and Audit Laws, it should seek appropriate statutory change.

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#### **Recommendation No. 4:**

The Venture Capital Authority should comply with the provisions of the Local Government Budget and Audit Laws by preparing and submitting the required financial reporting documents in accordance with statutorily required timelines.

#### **Venture Capital Authority Response:**

Agree. Implementation Date: Budget Law by May 2007 and Audit Law by July 2007.

The Venture Capital Authority will explore obtaining a formal exemption from the Local Government Budget Law during the 2007 Legislative

Session. If an exemption is not provided, the Authority will begin the process needed to comply with this law.

Upon being contacted by the Office of the State Auditor and informed that the Authority would need to comply with the Local Government Audit Law, the Authority immediately began working on compliance. However, it was not possible to have the specific type of audit procured and completed within the statutory time frames. The Authority has now completed and submitted its audits and will submit the audits as required in the future.

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## Fund Manager Review

Pursuant to Section 24-46-203(9), C.R.S., the Venture Capital Authority is required to conduct an annual review of each fund manager. The purpose of the review is to determine if the fund manager is complying with the Venture Capital Program statutes (Part 2 of Article 46 of Title 24 of the Colorado Revised Statutes) and its contract with the Authority. The annual review is an important component of the Authority's internal control framework and is necessary to ensure accountability for the Program.

In December 2006 staff from the Office of Economic Development and International Trade (OEDIT), on behalf of the Authority, conducted the first annual review of High Country Venture, LLC. We evaluated OEDIT staff's review of High Country Venture, LLC, and found several areas in which the review could be strengthened. Specifically, statute requires that Colorado businesses receiving investments of certified capital expend the investment within Colorado or purchase goods and services that will be used or performed in Colorado. We found that staff did not verify that the certified capital invested in Colorado businesses at the time of the review had been expended in accordance with this requirement. The annual review should include verification of source documentation, such as the expenditure records of qualified businesses.

Additionally, the Authority's annual review did not include verification of the accuracy of performance data reported to the Authority by High Country Venture, LLC. For example, staff did not verify the accuracy of the job creation numbers reported to the Authority by High Country Venture, LLC. The creation of jobs is one of the goals of the Program and should be one factor considered by the Authority in assessing the success of the Program. Based on job creation and other factors, additional amounts of certified capital could be committed to Colorado Fund I. As such, it is important that the Authority's annual review include verifying the accuracy of the fund manager's reported job data. To conduct such verification, the

Authority should review source documentation, such as the payroll records of those businesses receiving investments of certified capital both prior to and after the fund manager's initial investment.

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### **Recommendation No. 5:**

The Venture Capital Authority should improve its annual review of fund managers. The annual review, at a minimum, should include verifying that qualified businesses are expending certified capital as required by statute and reviewing source documentation to verify the accuracy of performance data reported by fund managers.

### **Venture Capital Authority Response:**

Agree. Implementation Date: December 2007.

The Authority will review source documentation to confirm that qualified businesses are expending certified capital in compliance with statutory requirements and to verify the accuracy of the fund manager's reported job data.

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**Appendix A**

<p align="center"><b>Colorado Venture Capital Program</b>  <b>Qualified Businesses Receiving Investments of Certified Capital from Colorado Fund I</b>  <b>As of December 31, 2006</b></p>							
Name	County	Business Description	Location	Colorado Fund I Investments			
				Venture Capital Authority	Tango VIII, LLC	High Country Venture, LLC	Total Investment
Taligen Therapeutics	Adams	Research and development in the physical, engineering sciences	Distressed Urban	\$746,000	\$26,000	\$8,000	\$780,000
Progressive GaitWays/Thera Togs	San Miguel	Surgical appliance and supplies manufacturing	Rural	\$578,000	\$21,000	\$6,000	\$605,000
Surginetics	Boulder	Surgical appliance and supplies manufacturing	Statewide	\$1,052,000	\$37,000	\$11,000	\$1,100,000
SmartCare	Arapahoe	Health and personal care providers	Statewide	\$526,000	\$19,000	\$5,000	\$550,000
EnVysion	Boulder	Web-based security monitoring	Statewide	\$2,008,000	\$71,000	\$21,000	\$2,100,000
<b>Total</b>				<b>\$4,910,000</b>	<b>\$174,000</b>	<b>\$51,000</b>	<b>\$5,135,000</b>
<p><b>Source:</b> Office of the State Auditor analysis of Venture Capital Authority and fund manager financial and investment records.</p>							

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