STATE OF CONNECTICUT

AUDITORS' REPORT
CONNECTICUT INNOVATIONS, INCORPORATED
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

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

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October 17, 2007

AUDITORS' REPORT
CONNECTICUT INNOVATIONS, INCORPORATED
FOR THE FISCAL YEAR ENDED JUNE 30, 2006

We have made an examination of the financial records of the Connecticut Innovations, Incorporated (the Corporation), as provided in Section 2-90 and Section 1-122 of the General Statutes, for the fiscal year ended June 30, 2006.

SCOPE OF AUDIT:

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

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

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

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

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

COMMENTS

FOREWORD:

Connecticut Innovations, Incorporated (hereafter CI or the Corporation) operates primarily under Chapter 581, Sections 32-32 through 32-47a of the General Statutes. Pursuant to Section 32-35 of those Statutes, it is a public instrumentality and political subdivision of the State. The Corporation is also responsible for administering the Renewable Energy Investment Fund, commonly referred to as the Connecticut Clean Energy Fund (CCEF), as required under Section 16-245n of the General Statutes. Pursuant to Chapter 12 of the General Statutes, it is classified as a quasi-public agency and therefore is subject to the requirements related to such agencies as may be found in Chapter 12. As a quasi-public agency, the Corporation's financial information is included as a component unit in the State of Connecticut's Comprehensive Annual Financial Report (CAFR).

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

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

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

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

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

> **Connecticut Emerging Enterprise Limited Partnership –** This program is a partnership between the Corporation and a major commercial bank. The program invests in initial and

follow-on rounds of financing for early stage, technology growth enterprises with significant proprietary innovations or other unique, sustainable competitive advantages.

Connecticut Innovations Technology Scholars Program – This program provides scholarships to encourage talented young people to choose careers in science and technology and to pursue their education and their careers in Connecticut. During the audit period this program was run through the Connecticut Innovations Educational Foundation (CIEF). Details about the CIEF are included later in this report.

Eli Whitney Investments – This is the Corporation's primary investment program. The program makes risk capital investments in emerging and established companies to stimulate their development of high technology products, processes and services. Areas of focus include bioscience, energy and environmental systems, information technology, photonics/applied optics, advanced materials and engineering.

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

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

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

Connecticut BioSeed Program – This program was established to help accelerate the growth of early-stage biotech enterprises in Connecticut. The program typically invests up to $500,000 in companies working to solve unmet medical needs.

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

In addition, in the footnotes to its financial statements for the fiscal year ended June 30, 2006, the following organizations are identified as blended component units of the Corporation, that, although legally separate entities, are in substance, part of the Corporation's operations:

Connecticut Technology Development Corporation (CTDC) – The CTDC is a CI wholly owned for-profit corporation, used to address the need by new biotech firms for wet laboratory space in "move-in" condition. The CTDC activities during the 2005-2006 fiscal year consisted mainly of rent, utilities, and depreciation expenses at 25 Science Park in New Haven. The total expenses of CTDC during the fiscal year ended June 30, 2006, were $416,926. These amounts are included in the Corporation's financial statements.

Connecticut Innovations Educational Foundation (CIEF) – The CI Board approved the creation of the CIEF at its May 14, 2001 meeting. It is a non-stock corporation, exempt from federal income taxes under Internal Revenue Code Section 501(c)(3), in which CI is the sole member. At its March 22, 2004 meeting, the Board authorized several CI and CCEF programs to be run through the CIEF, including the Technology Scholar Program, the Yankee Ingenuity Technology Competition, the Clean Energy Freedom Bus, and the Connecticut Clean Energy Fund Yankee Ingenuity Technology Competition. CI presents that the Foundation was created so that it could solicit funds from external sources as a 501(c)(3) corporation, to provide additional funding for the programs. Apparently, the Foundation was not successful in its fund raising efforts, and the CI Board approved the dissolution of the Foundation at its July 28, 2006 meeting. CI assumed responsibility over the conduct and ongoing programs of the Foundation. The total expenses of the Foundation during the fiscal year ended June 30, 2006, were $22,900.

Organizationally, the Corporation is divided into five major areas:

- Finance and Administration - responsible for accounting, administration, finance, and information technology support.

- Investments – responsible for identifying opportunities that fall within the Corporation's scope and providing, where appropriate, capital for invention and innovation when financial aid is not available from normal commercial sources.

- External Relations – responsible for communications, marketing and media relations.

- Business Development – responsible for developing and supporting business opportunities for CI and its portfolio companies.

- Connecticut Clean Energy Fund Operations – responsible for the operation of the Connecticut Clean Energy Fund.

Significant State Legislation:

An Act Concerning Jobs for the Twenty-First Century - Public Act 06-83, Section 4, effective July 1, 2006, establishes an early-stage venture capital program to be administered by CI, to provide preseed financing, seed financing, start-up financing, early or first-stage financing and expansion financing to companies in the State. CI shall establish criteria for awarding such financing and shall develop and implement a plan to market the program. The Board of CI shall review and approve each application for such financing. CI shall adopt procedures, pursuant to Section 1-121 of the General Statutes, to implement the provisions of Section 4 of the Act. Section 7 of the Act also requires that CI shall establish a development, research and economic assistance matching financial aid program for micro businesses that have received Federal funds for Phase II proposals under the small business innovation research program and the small business technology transfer program. Any micro business receiving financial aid under this subsection shall use such financial aid for the same purpose such micro business was awarded said Federal funds. A micro business must apply for the matching assistance in the same manner small businesses apply for similar assistance under the Connecticut Technology Partnership Program, which the Act renames the Connecticut Development Research and Economic Assistance Matching Grant Program.

An Act Concerning General Budget and Revenue Implementation Provisions - Public Act 06-187, Section 89, effective July 1, 2006, requires that CI shall pay to Connecticut United for Research Excellence, the State's bioscience cluster, the sum of $1,500,000, to be paid out over five years commencing July 1, 2006, for the operation of Connecticut United for Research Excellence's BioBus. Said sum shall be paid from available appropriations.

An Act Concerning the Renewable Energy Investment Fund – Public Act 07-152, Section 1, effective October 1, 2007, requires that the Renewable Energy Investment Fund shall no longer be managed by CI, but shall be within CI for administrative purposes only. It also establishes a Renewable Energy Investments Board of not more than fifteen individuals with knowledge and experience in matters related to the purpose and activities of the Renewable Energy Investment Fund. The Act requires the Board to act on matters related to the Renewable Energy Investment fund, including, but not limited to, expenditure of funds and development of a comprehensive plan that must be submitted to the Department of Public Utility Control for approval. The Board shall issue annually a report to the Department of Public Utility Control describing the programs and activities of the Renewable Energy Investment Fund and shall provide a copy of such report, to the joint standing committees of the General Assembly having cognizance of matters relating to energy and commerce and the Office of Consumer Counsel.

Board of Directors and Administrative Officials:

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

As of June 30, 2006, the members of the Board of Directors were as follows:

Appointed by the Governor:
Elaine A. Pullen, Chairperson
Louis N. George, Esq.
R. Carol Muradian
John W. Olsen
Paul R. Pescatello, Esq.
Rafael A. Santiago
George W. Schiele
vacancy

Legislative Appointments:
Thomas J. Clark
Alan K. Greene
Harris L. Marcus
E. Charles McClenachan, Ph.D.

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

In addition to the above members, Daniel Rappaport and Barbara Gay Nicholson also served on the Board during the audit period.

In addition, the Board has set up several Committees and Sub-committees to expedite certain business activities of the Corporation as well as to maintain controls over its transactions. The Corporation has the following four standing committees: Audit, Compliance and Governance Committee; Finance, Operations and Compensation Committee; Eli Whitney Investment Committee; and the Clean Energy Investment Committee. The Corporation also has several advisory committees that include: the Eli Whitney Advisory Committee, the Clean Energy Advisory Committee, the Clean Energy Investments Advisory Committee, the Valuation Committee, the Executive Advisory Committee, the BioSeed Advisory Committee, the Technology Review Committee, and the Projects Subcommittee of the Clean Energy Fund.

Arnold B. Brandyberry served as the Acting President and Executive Director, effective April 1, 2005, until the CI Board appointed Chandler J. Howard as President and Executive Director, effective September 1, 2005. Chandler Howard served as President until his resignation on April 27, 2006. On April 28, 2006, the Board appointed Peter Longo to the position of Deputy Executive Director. Frank A. Dinucci served as President and Executive Director, effective October 2, 2006, until his resignation on April 27, 2007. John Mengacci served as Acting Executive Director, effective April 13, 2007, until his resignation on April 27, 2007.

RÉSUMÉ OF OPERATIONS:

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

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

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

State Accounts:

As indicated above, State expenditures related to Connecticut Innovations, Incorporated include bond fund proceeds to finance various grants and investments. They also include certain operating expenses processed through the State's centralized processing systems. These transactions are processed through two State Funds - a special revenue fund and an enterprise fund (Connecticut Innovations Incorporated Fund). The special revenue fund is used to process certain grant awards authorized by the Legislature through various authorizing special acts and the action of the State Bond Commission. There were no Special Revenue Fund expenditures during the audit period.

The Connecticut Innovations Incorporated Fund is an enterprise fund authorized by Section 32-41a of the General Statutes. That Statute provides that this fund be used to carry out the purposes of CI, and also for the repayment of State bonds when required by the State Bond Commission. Total bond fund monies authorized by Sections 32-41, 32-41b, and 31-41o, amounted to $114,801,000 as of June 30, 2006. Expenditures charged to the Fund during the audited period consisted entirely of payroll costs for CI and the CCEF, which were funded by cash transfers from CI to the Fund. A summary of Fund expenditures for the audited period follows:

	Fiscal Year Ended	
	June 30, 2006	**June 30, 2005**
	$	**$**
Personal Services	2,925,238	2,693,368
Fringe Benefits	1,518,782	1,264,931
Totals	$ 4,444,020	$ 3,958,299

The increase in Personal Services and fringe benefits is due to the hiring of several individuals and an increase in the fringe benefit rates. There were no State expenditures made from the Enterprise Fund for investment purposes.

Connecticut Innovations, Incorporated Accounts:

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

Any excess funds in the operating account are transferred to short-term investments and marketable securities, including the State Treasurer's Short Term Investment Fund (STIF) to earn investment income. It should be noted that the Corporation may be required by the Bond Commission to repay the moneys advanced by the Bond Commission, including interest, under terms the Commission might find desirable and consistent with the purposes of the Corporation. As of June 30, 2005, the Bond Commission had not requested repayment of any principal or interest.

The financial position of the Corporation as of June 30, 2005 and 2006, per its audited financial statements, is presented below. It should be noted that certain 2004-2005 amounts have been reclassified to be consistent with the 2005-2006 presentation. The following amounts do not include the Connecticut Clean Energy Fund.

Assets	**As of June 30,**	
Current Assets:	**2006**	**2005**
Cash and cash equivalents:	$	$
Cash	1,071,198	997,931
Short-term investments	43,735,144	34,739,340
Total cash and cash equivalents	44,806,342	35,737,271
Marketable securities	161,671	156,100
Current portion of investments	1,690,630	1,612,910
Due from related parties	1,748	264,759
Other assets	829,113	326,073
Total unrestricted current assets	2,683,162	2,359,842
Total current assets	47,489,504	38,097,113
Non-Current Assets		
Investments:		
Eli Whitney investments	19,924,662	23,284,606
Investment in BioScience Facilities	14,782,223	14,216,449
Investment in CT Emerging Enterprises	1,502,735	1,446,021
Investment in Next Generation Ventures	928,697	4,311,000
Other investments	333,015	2,335,624
Less current portion	(1,690,630)	(1,612,910)
Investments - non-current	35,780,702	43,980,790
Capital assets, net of depreciation	1,252,963	1,447,909
Total non-current assets	37,033,665	45,428,699
Total Assets	**$ 84,523,169**	**$ 83,525,812**
Liabilities and Net Assets		
Liabilities		
Accounts payable and accrued expenses	$ 605,449	$ 573,298

Due to related parties	41,498	14,375
Total liabilities	646,947	587,673
Net Assets		
Invested in capital assets	1,252,963	1,447,909
Unrestricted	82,623,259	81,490,230
Total net assets	83,876,222	82,938,139
Total Liabilities and Net Assets	**$ 84,523,169**	**$ 83,525,812**

The Corporation makes risk capital investments of no more than six million dollars, with the approval of the Finance Committee of the Board of Directors, in high technology applicant companies. Investments greater than six million dollars are possible, with approval of the full Board of Directors. The Corporation primarily makes investments in equity securities of emerging high-tech companies. It has substantially eliminated the use of royalty financing arrangements but continues to recover the cost and revenues of past royalty arrangements. The Corporation has approximately 63 percent of its investments in equity securities.

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

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

A schedule of revenues, expenses and change in net assets for the fiscal years ended June 30, 2005 and 2006, follows. The information was obtained from the Corporation's audited financial statements, and does not include the Connecticut Clean Energy Fund.

	Fiscal Year Ended June 30,	
Operating Revenues:	**2006**	**2005**
Interest on short-term investments and cash deposits	$ 1,442,315	$ 631,220
Interest on investments	1,576,558	1,262,580
Other income	423,316	668,326
Total Revenue	3,442,189	2,562,126
Operating Expenses:		
Compensation and benefits	2,209,590	1,912,384
General and administrative expenses	2,133,308	2,292,516
Grants and programs	374,825	421,117
Total expenses	4,717,723	4,626,017

Operating Loss	(1,275,534)	(2,063,891)
Non-Operating Revenues (Expenses):		
Unrealized gain (loss) on investments	11,679,330	(1,888,213)
Realized gain (loss) on sale of investments	(9,465,713)	(5,135,005)
Total non-operating revenues (expenses)	2,213,617	(7,023,218)
Change in Net Assets Before Capital Contributions and Statutory Transfers	938,083	(9,087,109)
Statutory Transfers to the State of Connecticut	-	(5,000,000)
Change in Net Assets	$ 938,083	$ (14,087,109)

Total revenues increased by $880,063 during the 2005-2006 fiscal year. Interest on short-term investments and cash deposits increased by $811,095 in 2005-2006 due to higher average cash on hand and interest rate increases for the fiscal year. Interest on investments increased by $313,978 during the fiscal year 2005-2006 as a result of payments received on debt held in the investment portfolio. Other income decreased by $245,010 due to the receipt of nonrecurring royalties in 2005.

General and administrative expenses decreased by $159,208 during the 2005-2006 fiscal year due primarily to decreases in consulting fees and office expenses.

Total expenditures for grants and scholarship programs in 2006 were $374,825, a decrease of $46,292 over last year. The decrease was largely due to a decline in funding to the Yankee Ingenuity Technology Program in 2006.

Net realized losses on investments for the year were $9,465,713, as compared to realized losses of $5,135,005 in the 2004-2005 fiscal year. In 2005-2006 the Corporation recorded write-offs totaling $14.3 million of investments in several portfolio companies. These losses were partially offset by $4.8 million in realized gains primarily from the sale of public securities.

The CI Board approved $4,300,000 for investments during the fiscal year ended June 30, 2006, and funded $1,493,300. The Eli Whitney Fund comprised the majority of the approved and funded amounts. In addition, CI provided funding of $374,826 for grants and scholarships during the audited period.

Connecticut Clean Energy Fund:

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

Section 16-245n provides that on or after January 1, 2000, the Department of Public Utility Control shall assess or cause to be assessed a charge per kilowatt-hour to each end-user of electrical service in the State. It is this assessment that provides the financing for the Fund. Unlike the majority of Connecticut Innovations' investments, the Connecticut Clean Energy Fund is not limited to Connecticut businesses. CI is authorized to use any amount in the Fund for expenditures that promote investment in renewable energy sources in accordance with a comprehensive plan developed by it to foster the growth, development and commercialization of renewable energy sources and related enterprises and stimulate demand for renewable energy and deployment of renewable energy sources which serve end use customers in this state. Such expenditures may include, but not be limited to, grants, direct or equity investments, contracts or other actions which support research, development, manufacture, commercialization, deployment and installation of renewable energy technologies, and actions which expand the expertise of individuals, businesses and lending institutions with regard to renewable energy technologies.

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

Section 16-245n, subsection (d), establishes a Renewable Energy Investments Advisory Committee to assist CI in matters related to the Connecticut Clean Energy Fund. The committee shall consist of not more than 12 individuals with knowledge and experience in matters related to the purpose and activities of the Fund. Three of the members are appointed by the Connecticut Innovations' Board of Directors. Of the remaining nine members, two shall be State officials appointed by the Governor, one shall be a Gubernatorial appointee with experience regarding renewable energy resources and one member each is appointed by the Speaker of the House of Representatives, the President Pro-Tempore of the Senate, the majority leaders of the House of Representatives and the Senate, and the minority leaders of the House of Representatives and the Senate. This Advisory Committee is known as the Clean Energy Advisory Committee of the Connecticut Clean Energy Fund. There is also a Clean Energy Investment Committee of the CI Board of Directors currently made up of six CI Board members. Before any investment or grant proposal, etc., is funded, it must be approved by the Clean Energy Investment Committee, which generally acts on the recommendations made by the Advisory Committee.

The members of the Connecticut Clean Energy Fund Advisory Committee as of June 30, 2006, were as follows:

Timothy Bowles, Chairman
Marian Chertow
Donald W. Downes
Norma J. Glover
Richard C. Lichter
Robert Maddox
John Mengacci
William T. Sellay
Margery C. Winters

Appointed by the Board of Directors of Connecticut Innovations Inc.:
Jerome P. Peters, Jr.
John W. Olsen
E. Charles McClenachan, Ph.D.

In addition to the above members, Peter L. Cashman and Norman Richards, Ph.D., also served on the committee during the audit period. Timothy Bowles was appointed Chairman on October 25, 2004.

The financial position of the Connecticut Clean Energy Fund as of June 30, 2005 and 2006, as presented in its audited financial statements, follows:

	As of June 30,	
	2006	2005
Assets	$	$
Cash and short-term investments	69,789,779	54,777,854
Utility Customer Assessments Receivable	1,910,000	1,907,965
Investments and programs	1,168,903	774,995
Other assets	27,719	22,046
Short-term investments-Restricted	879,325	926,581
Total Assets	$ 73,775,726	$ 58,409,441
Liabilities and Net Assets		
Liabilities:	$	$
Due to Connecticut Innovations	0	256,688
Accrued Expenses	1,072,232	463,232
Total Liabilities	1,072,232	719,920
Net Assets:		
Restricted	879,325	926,581
Unrestricted	71,824,169	56,762,940
Total Net Assets	72,703,494	57,689,521
Total Liabilities and Net Assets	$ 73,775,726	$ 58,409,441

Connecticut Clean Energy Fund revenue, expenses and the change in net assets for the fiscal years ending June 30, 2005 and 2006, is presented below. The information was taken from the Connecticut Clean Energy Fund audited financial statements for those fiscal years.

	Fiscal Year Ended June 30,	
	2006	2005
Revenues:	$	$
Utility Customer Assessments	21,538,969	17,952,493
Interest on short-term investments	2,462,457	775,374
Other income	211,786	52,194
Total Revenues	24,213,212	18,780,061
Expenditures/Expenses:		
Program:		
Grants	10,216,053	1,788,143
Program expenses	1,533,547	1,481,761
Total Program Expenses	11,749,600	3,269,904
General and administrative expenses	1,732,310	1,673,813
Total Expenditures and Expenses	**13,481,910**	**4,943,717**
Change in Net Assets Before Changes		

in the Fair Value of Investments	10,731,302	13,836,344
Net realized gain (loss) on investments	(3,019,450)	151,552
Net increase (decrease) in the fair value of investments	7,302,121	(2,583,034)
Net Change in Net Assets	15,013,973	11,404,862
Net Assets, beginning of year	57,689,521	46,284,659
Net Assets, end of year	$ 72,703,494	$ 57,689,521

Revenues from utility customer assessments increased by $3,586,476 during the 2005-2006 fiscal year due to an increase in utility usage. Beginning in the 2005-2006 fiscal year, there was a statutory transfer of funds for debt service on the State of Connecticut Special Obligation Rate Reduction Bonds (2004 Series A) which were issued on June 23, 2004, in accordance with Public Act 03-6, Section 50, of the June 30, 2003, Special Session, effective August 20, 2003. The proceeds of these bonds were to be used in lieu of direct transfers from the CCEF to the General Fund. One-third of the one mill statutory ratepayer assessment will be used to cover the debt service portion on the bonds, resulting in a reduction in the Connecticut Clean Energy Fund revenues of an estimated $8,600,000 per year.

Interest on short-term investments and cash deposits increased in the 2005-2006 fiscal year due to the increase in the average cash balance on hand and higher interest rates.

Total expenditures for grants and programs in 2005-2006 were $11,749,600. During 2005-2006, the Fund committed a total of $19.4 million for new grants and programs

In the 2006 fiscal year, the fair value of the Fund's investments increased due to an increase in valuations with respect to equities of emerging renewable energy companies in which the Fund invests. During 2005-2006, the Fund committed $250,000 of investments in new opportunities and continued support of existing portfolio companies. Most of the Fund's investments were made in the early stages of the Fund's existence. As the Fund has evolved, it was determined that grant programs would provide more immediate results, and accordingly, CI shifted the Fund's focus from making investments to providing grants. Most of the recipients of the Fund's monies are selected based on detailed reviews of information submitted in response to the Fund's Requests for Proposals, which vary depending upon the particular program within the Fund. Investments still remain an option for the Fund.

During the 2005-2006 fiscal year the Board approved $18,518,009 for new grants and programs. As of June 30, 2006, the Fund had outstanding commitments totaling $27,294,810 that are expected to be funded over the next two fiscal years.

Other Examinations:

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

The independent public accountants' reports included an explanatory paragraph regarding the

Corporation's use of estimates to determine the fair value of a significant portion of its assets in the absence of readily ascertainable market values. Essentially, it was concluded that the procedures the Corporation used to arrive at the estimated values of its investments were reasonable and appropriately documented; however, because of the inherent uncertainty of valuation, those estimated values may differ significantly from the values that would have been used had a ready market for the investments existed, and the differences could be material.

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

CONDITION OF RECORDS

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

Connecticut Clean Energy Fund Revenues:

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

Condition: The Connecticut Clean Energy Fund receives monthly payments from two utility companies, representing charges assessed to end-users of electric services as mandated under Section 16-245n of the General Statutes, that aggregated over $21,538,000 during the audit period.

During the prior audit we reported that documentation supporting the amounts paid by the companies was insufficient to determine whether all of the required assessments were collected. In January 2006, CI began receiving additional documentation from one of the utilities and in January 2007, CI received supporting documentation from the other utility that covered the audit period. Although CI has taken steps toward corrective action by reviewing the supporting documentation, such reviews have raised questions regarding the completeness of the amounts reported by the utilities. CI has been unable to develop a process to verify the accuracy and completeness of the supporting reports.

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

Cause: Although CI contacted the utilities, CI has been unable to develop a process to adequately confirm that all collected revenues due have been collected.

Recommendation: CI should institute procedures to ensure that the revenue collected for the Connecticut Clean Energy Fund represents all of the monies that the Connecticut Clean Energy Fund is due. Also, consideration should be given to reviewing prior years' payments to ensure that the Connecticut Clean Energy Fund received all of the revenue that it was statutorily required to receive. (See Recommendation 1.)

Agency Response: "CI will continue to work with each utility company and the Department of Public Utility Control to further develop a process to independently verify the accuracy and completeness of the supporting documentation received with each payment."

Conflicting Statutory Reporting Provisions:

Criteria:

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

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

Condition:

Our review of CI’s annual financial assistance report for the fiscal year ended June 30, 2006, revealed that CI did not report revenue, wage rate and benefit level data separately for each recipient of assistance. Consistent with its reporting in the past, CI did, however, report the required data in the aggregate.

Effect:

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

Cause:

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

Recommendation: CI should seek legislative clarification to resolve the apparent statutory conflict between Section 32-47a and 32-40, subsection (c), to ensure that all information is reported consistent with the legislative intent. (See Recommendation 2.)

Agency Response: “CI sought legislative clarification during this the 2007 legislative session. On CI’s behalf the Commerce Committee raised HB 7226 An Act Implementing the Audit Recommendations for Connecticut Innovations, Incorporated. The bill passed the Commerce Committee unanimously and was referred to the Finance, Revenue & Bonding Committee but no action on the bill was taken there before the end of the legislative session. CI intends to work with the Commerce Committee again during the 2008 legislative session to pass legislation addressing this issue.”

RECOMMENDATIONS

Status of Prior Audit Recommendations:

- CI should strengthen its internal controls pertaining to expenditures and contract execution. Corrective action has been taken by CI. Therefore, this finding is not repeated.

- CI should adhere to its written procedures regarding expenditures by the Corporation that are in excess of $75,000 and should monitor for compliance with contract amounts and provisions. Corrective action has been taken by CI. Therefore, this finding is not repeated.

- CI should institute procedures to ensure that the vacation leave policy in the Employee Handbook is followed. Corrective action has been taken by CI. Therefore, this finding is not repeated.

- CI should institute procedures to ensure that it obtains adequate documentation to support the revenue collected for the Connecticut Clean Energy Fund and to enable CI to determine that the collected amounts represent all of the monies that the Connecticut Clean Energy Fund is due. Also, consideration should be given to reviewing prior years' payments to ensure that the Connecticut Clean Energy Fund received all of the revenue that it was statutorily required to receive. This recommendation is repeated to reflect current conditions. (See Recommendation 1.)

- CI should seek legislative clarification to resolve the apparent statutory conflict between Section 32-47a and 32-40, subsection (c), to ensure that all information is reported consistent with the legislative intent. This recommendation is repeated. (See Recommendation 2.)

- CI should consider seeking changes to the relevant General Statutes to reflect its responsibilities for managing the Connecticut Clean Energy Fund as specified in Section 16-245n of the General Statutes. This recommendation is resolved with the passage of Public Act 07-152, which requires that the Clean Energy Fund is no longer managed by CI, but shall be within CI for administrative purposes only. In addition, Section 2 of the Act revised Section 32-39 of the General Statutes to include in CI's responsibilities administration of the Clean Energy Fund.

Current Audit Recommendations:

1. **CI should institute procedures to ensure that the revenue collected for the Connecticut Clean Energy Fund represents all of the monies that the Connecticut Clean Energy Fund is due. Also, consideration should be given to reviewing prior years' payments to ensure that the Connecticut Clean Energy Fund received all of the revenue that it was statutorily required to receive.**

   Comment:

The Connecticut Clean Energy Fund receives monthly payments from two utility companies, representing charges assessed to end-users of electric services as mandated under Section 16-245n of the General Statutes, that aggregated over $21,538,000 during the audit period. During the prior audit we reported that documentation supporting the amounts paid by the companies was insufficient to determine whether all of the required assessments were collected. In January 2006, CI began receiving additional documentation from one of the utilities and in January 2007, CI received supporting documentation from the other utility that covered the audit period. Although CI has taken steps toward corrective action by reviewing the supporting documentation, such reviews have raised questions regarding the completeness of the amounts reported by the utilities. CI has been unable to develop a process to verify the accuracy and completeness of the supporting reports.

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

   Comment:

   Our review of CI's annual financial assistance report for the fiscal year ended June 30, 2006, revealed that CI did not report revenue, wage rate and benefit level data separately for each recipient of assistance. Consistent with its reporting in the past, CI did, however, report the required data in the aggregate.

INDEPENDENT AUDITORS' CERTIFICATION

As required by Section 2-90 and Section 1-122 of the General Statutes, we have conducted an audit of Connecticut Innovations, Incorporated's activities for the fiscal year ended June 30, 2006. This audit was primarily limited to performing tests of the Corporation's compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to a determination of whether the Corporation has complied with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds and the distribution of loans, grants and other financial resources, and to understanding and evaluating the effectiveness of the Corporation's internal control policies and procedures for ensuring that the provisions of certain laws, regulations, contracts and grants applicable to the Corporation are complied with. The financial statement audit of the Corporation, for the fiscal year indicated above, was conducted by the Corporation's independent public accountants.

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

Compliance

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

As part of obtaining reasonable assurance about whether the Corporation complied with laws, regulations, contracts and grants, noncompliance with which could result in significant unauthorized, illegal, irregular or unsafe transactions or could have a direct and material effect on the results of the Authority's financial operations for the fiscal year ended June 30, 2006, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, including but not limited to the following areas:

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

Our examination included reviewing all or a representative sample of the Corporation's activities in those areas and performing such other procedures as we considered necessary in the circumstances. The results of our tests disclosed the following instance of non-compliance, which is further described in the accompanying "Condition of Records" and "Recommendations" sections of this report: omission of data in the annual report.

Internal Control

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

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

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

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

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

CONCLUSION

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

Lisa G. Daly
Principal Auditor

Approved:

Kevin P. Johnston
Auditor of Public Accounts

Robert G. Jaekle
Auditor of Public Accounts