

THOMAS P. DiNAPOLI  
STATE COMPTROLLER



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ALBANY, NEW YORK 12236

STATE OF NEW YORK  
OFFICE OF THE STATE COMPTROLLER

March 20, 2007

Mr. Michael Relyea, Esq.  
President  
NYS Foundation for Science, Technology and Innovation  
30 South Pearl Street, 11<sup>th</sup> Floor  
Albany, NY 12207

Re: Small Business Technology Investment Fund  
Report 2006-S-57

Dear Mr. Relyea:

Pursuant to the State Comptroller's authority as set forth in Article V, Section 1 and Article X, Section 5 of the State Constitution, Article II, Section 8 of the State Finance Law, and Section 6278(3) of McKinney's Unconsolidated Laws of New York, we audited the Small Business Technology Investment Fund (Fund) during the period April 1, 2001 through September 30, 2006.

**A. Background**

The Fund, which was created in 1981 as part of the State's Science and Technology Foundation, provides start-up, high-tech companies throughout New York State with a source of venture capital to promote new job creation and economic growth. The Fund makes early stage equity investments in companies that have developed innovative technology products or services and that display significant competitive advantage. It was originally funded with a Federal grant and then through State appropriations. The State stopped providing investment funding to the Fund after 1995. The Science and Technology Foundation ceased its existence in 2000. At that time, the Fund was transferred to the Urban Development Corporation (UDC) doing business as the Empire State Development Corporation (ESDC). As of March 31, 2006, the Fund's investments were valued at almost \$14.4 million by UDC. The New York State Foundation for Science and Technology Innovation Act of 2005 (Act) created a new public benefit corporation, called the Foundation for Science, Technology and Innovation (Foundation). In accordance with this Act, the administration of the Fund was turned over to the Foundation as of December 31, 2006, subsequent to our audit.

At the time of our audit, the Fund's management team consisted of a manager, who was hired in 2004; a full-time investment specialist hired in 2005; and a part-time investment specialist assigned to the Fund in 2003. Since 2003, the Fund has made 17 investments totaling \$4.7 million of which 15 are active and 2 have been closed. These investments were made with the proceeds from previous investments. The Fund received no investment money from ESDC and the Fund manager stated the Fund is self-sustaining, including the staff's salaries and most direct operating expenses. Annual direct operating costs ranged from almost \$222,000 to about \$294,000 during our five year (2001-2006) audit period.

## **B. Audit Scope, Objectives and Methodology**

The objectives of our audit were to determine the status and results of the Fund's investments to date and assess if these investments were consistent with the Fund's overall investment objectives for the period April 1, 2001 through September 30, 2006. To accomplish our objectives, we reviewed the Fund's investments and investment criteria. We also spoke with officials from the Office of the State Comptroller's Investment Bureau and other states' investment bureaus to determine both best practices and industry standards for public sector venture capitalist investing.

We did our audit according to generally accepted government auditing standards. Such standards require that we plan and do our audit to adequately assess the Fund's operations included in our audit scope. An audit includes examining, on a test basis, evidence supporting transactions recorded in the accounting and operating records, and applying such other auditing procedures as we consider necessary in the circumstances. An audit also includes assessing the estimates, judgments, and decisions made by management. We believe that our audit provides a reasonable basis for our findings and conclusions.

In addition to being the State Auditor, the Comptroller performs certain other constitutionally and statutorily mandated duties as the chief fiscal officer of New York State, several of which are performed by the Division of State Services. These include operating the State's accounting system; preparing the State's financial statements; and approving State contracts, refunds, and other payments. In addition, the Comptroller appoints members to certain boards, commissions, and public authorities, some of whom have minority voting rights. These duties may be considered management functions for purposes of evaluating organizational independence under generally accepted government auditing standards. In our opinion, these management functions do not affect our ability to conduct independent audits of program performance.

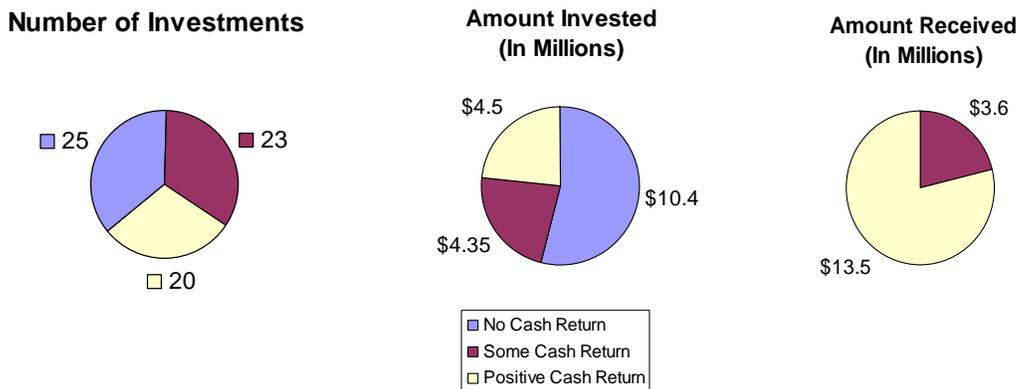
## **C. Results of Audit**

The Fund has invested \$37.8 million in 108 companies since its inception in 1981. Approximately \$14.4 million of the \$37.8 million invested was from State appropriations or Federal grants. The remaining \$23.4 million represents the Fund's reinvestment of the proceeds from certain investments since its inception in 1981. The Fund currently has active investments in 40 companies, totaling \$18.6 million invested, and inactive or closed investments in 68 companies, totaling \$19.2 million invested.

For the investments classified as active, the Fund is involved on the boards of directors of these 40 companies and is closely monitoring their financial status. The Fund has proceeds on these

investments totaling \$6.3 million and four of the 40 companies have gone public. The Fund holds stock in these four companies worth approximately \$9.5 million, as of September 30, 2006. The Fund will either divest itself slowly as it needs the funds for new investments or sell the stocks if they begin to devalue.

Fund officials stated that the inactive status means the Fund has either closed the investment completely or maintains only a passive interest in it. Fund officials stated that passive interest means their board rights have expired, but they still have either preferred or common stock in the company. These companies have neither gone public nor been sold. The chart below shows the proceeds totaling \$17.1 million on the 68 investments the Fund classifies as inactive, as well as categorizing the investments by level of success.



Fund management established several criteria that a potential recipient must meet before the Fund will invest in the company. The criteria include:

- The company must be located in New York State.
- The product the company is offering must be a new technology with a significant competitive advantage.
- The company must provide its financial information and a complete business plan.
- The company must represent a potential for creating jobs in New York State.
- There must be at least a 3:1 ratio of other investor money to the Fund's money.

Once a company has provided all of the above information, Fund officials perform due diligence, which evaluates the company's history, investors, board of directors, product and potential markets, and its business plan. If the Fund decides to invest in a company, it forwards the recommendation to the Fund's Investment Review Committee. This committee is comprised of individuals from both the public and private sectors and they either approve the investment or return it to the Fund for further work. Once the Committee approves the investment, it forwards it to ESDC's Board of Directors for approval.

From the 26 investments made during our audit period, we judgmentally selected ten investments for review; we selected the two highest dollar investments, the lowest dollar investment and seven investments that represented a cross-section of amounts in between. We found that these investments met the Fund's established investment criteria and were approved following the above

process. We also found that Fund officials monitored the investments closely by attending Board meetings, obtaining periodic progress reports and reviewing quarterly financial statements. We found that other states had similar investment criteria and approval processes. However, we found a major difference in the exit strategies. When a company was either bought out or went public, the other states cashed in their investment, while the Fund does not. The Fund's manager stated the other states could follow this policy because they receive regular annual funding, while the Fund has not received any State appropriations for investment since 1995. The Fund's manager stated that the Fund prefers to keep its investments that have gone public and monitor their progress. The manager believes these companies will continue to grow over the long term and these investments will ultimately yield a much higher return than if they were cashed out at the time the company is either bought out or its stock goes public.

While Fund officials have followed the Fund's stated investment processes, we found that they have not established a long-range strategic plan, clear overall goals and objectives, or annual investment budgets for the Fund. Instead, officials indicated that the Fund's primary objectives are to remain solvent and to continue to make investments in worthy companies as the opportunities arise. As a result, management has no clear performance measures to use in determining how well the Fund is performing, other than to state the Fund invests in companies that meet its investment criteria.

### **Recommendation**

*Establish a strategic plan with measurable goals and objectives that will maximize the Fund's investment abilities and establish criteria to measure the Fund's performance.*

We provided draft copies of this report to ESDC and Foundation officials for their review and comment. Their comments were considered in preparing this report, and are included as Appendices A and B. Foundation officials indicated that the audit recommendation will be considered as new policies and plans for the Fund are implemented.

Within 90 days of the final release of this report, as required by Section 170 of the Executive Law, the President of the Foundation shall report to the Governor, the State Comptroller, and the leaders of the Legislature and fiscal committees, advising what steps were taken to implement the recommendation contained herein, and, if not implemented, the reasons therefor.

Major contributors to this report were John Buyce, Joel Biederman, Greg Petschke, Jacqueline Keeys-Holston, and David Reilly.

Very truly yours,

Frank J. Houston  
Audit Director

cc: Lisa Ng, Division of the Budget  
Patrick Foye, ESDC



Anita W. Laremont  
Senior Vice President - Legal  
and General Counsel

February 7, 2007

Frank J. Houston  
Audit Director  
Office of the State Comptroller  
123 William Street  
New York, NY 10038-3804

Re: Audit 2006-S-57 SBTIF Oversight

Dear Mr. Houston:

Enclosed is Empire State Development Corporation's response to the draft audit report on the Small Business Technology Investment Fund.

Sincerely yours,

A handwritten signature in cursive script, appearing to read "Anita W. Laremont".

cc: Patrick Foye  
Avi Schick

Empire State Development Corporation  
633 Third Avenue New York, New York 10017-6754 Tel 212 803 3750 Fax 212 803 3775

**EMPIRE STATE DEVELOPMENT RESPONSE TO DRAFT AUDIT REPORT  
REGARDING SMALL BUSINESS TECHNOLOGY INVESTMENT FUND (2006-  
S-57)**

The following constitutes ESDC's response to the Office of the State Comptroller's (OSC) draft audit of the Small Business Technology Investment Fund Report (2006-S-57) (the "Report").

In accordance with State law, ESDC turned over administration of the Small Business Technology Investment Fund to the New York State Office of Science, Technology and Academic Research (NYSTAR) last fall, with the transition fully effective as of December 31, 2006. Accordingly, ESDC has no ability to implement the recommendation contained in the draft audit, regarding the establishment of a strategic plan with measurable goals and objectives that will maximize the Fund's investment abilities and establish criteria to measure the Fund's performance. ESDC nevertheless agrees that the establishment of such a strategic plan would be an appropriate undertaking if it had retained the program.



MICHAEL J. RELYEA  
EXECUTIVE DIRECTOR

New York State Foundation for  
Science, Technology & Innovation  
(NYSTAR)

30 SOUTH PEARL STREET, 11<sup>th</sup> FLOOR  
ALBANY, NEW YORK 12207

February 20, 2007

Mr. Joel Biederman, Audit Supervisor  
Office of the State Comptroller  
State Audit Bureau  
110 State Street, 11<sup>th</sup> Floor  
Albany, New York 12236

Dear Mr. Biederman:

You requested that the New York State Foundation for Science, Technology and Innovation (the Foundation) review and comment on the Office of the State Comptroller's audit of the Small Business Technology Investment Fund (Fund).

As you are aware, the audit was conducted on the Fund for a timeframe prior to its statutory transition to the Foundation.

Your final audit and recommendations will be forwarded to Foundation Board Members on the Investment Review Committee and appropriate Foundation staff for consideration as new policies and plans for the Fund are implemented.

Thank you for the opportunity to respond to your audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Michael Relyea", is written over a horizontal line. The signature is stylized and cursive.

Michael Relyea, Esq.

CC: Foundation Board Audit Committee Members

P: 518.292.5700 • F: 518.292.5798  
[www.nystar.state.ny.us](http://www.nystar.state.ny.us)