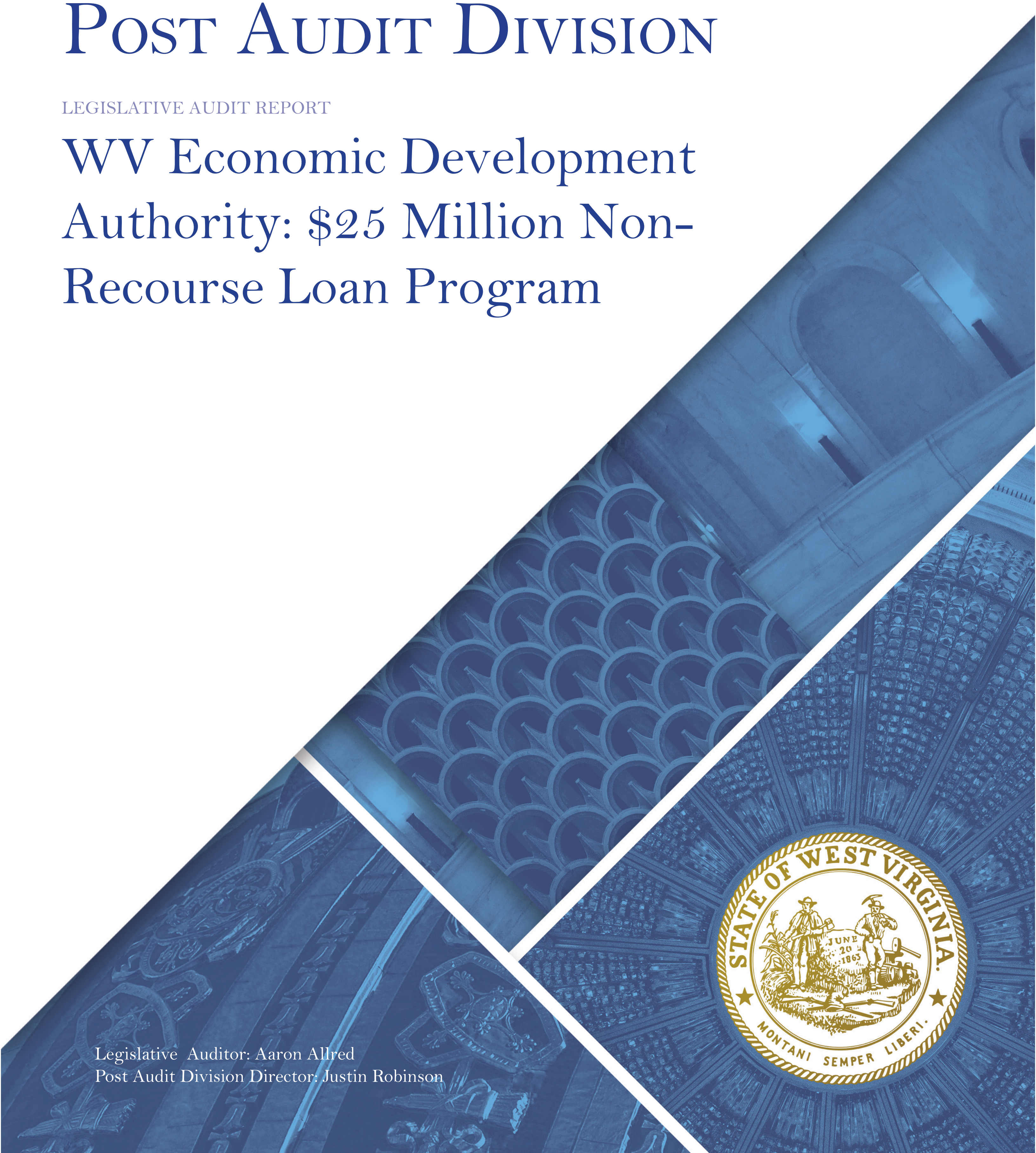
JOINT COMMITTEE ON GOVERNMENT AND FINANCE
WEST VIRGINIA OFFICE OF THE LEGISLATIVE AUDITOR

Post Audit Division

LEGISLATIVE AUDIT REPORT

WV Economic Development Authority: $25 Million Non-Recourse Loan Program



Legislative Auditor: Aaron Allred
Post Audit Division Director: Justin Robinson

GENERALLY ACCEPTED GOVERNMENT AUDITING STANDARDS STATEMENT

We conducted this performance audit in accordance with Generally Accepted Government Auditing Standards **(GAGAS)**. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

POST AUDIT DIVISION
Justin Robinson, Director

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WV Economic Development Authority: $25 Million Non-Recourse Loan Program

January 26 , 2021

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Executive Summary

The Legislative Auditor conducted this audit of the $25 million loan program (Loan Program) established by W.Va. Code §12-6-9e(f) pursuant to W.Va. Code §4-2-5.

Foreword

In 2002, subsection (f) of W.Va. Code §12-6-9e was codified, authorizing a $25 million nonrecourse loan to be issued from the Investment Management Board (IMB) to the Economic Development Authority (EDA) with the intention to spur industrial and economic growth in the state. The loan would be funded from the state's consolidated fund, which is primarily comprised of operating cash of the state and short-term investments of state agencies and local governments. The EDA received the first drawdown of $15 million from the IMB in April 2002; however, upon creation of the Board of Treasury Investments (BTI) in 2005, all loans made from the consolidated fund were transferred from the IMB to the BTI. As a result, the BTI would assume all responsibilities previously held by the IMB pertaining to the $25 million Loan Program for the remainder of the program.

Since the inception of the program in 2002, the EDA has invested $24,514,201 with seven venture capital companies. Due to limited return on the investments, the EDA has only repaid $674,222 of principal, leaving an unpaid principal balance of $24,325,778 outstanding. Further, it was identified that two of the venture capital companies selected for the program, which received a total of $8 million of funding from the EDA, did not invest any funds within the state and four of the companies selected entered into receivership before the conclusion of the program.

In Fall of 2019, the Legislative Auditor received a letter from John Perdue, State Treasurer and BTI Chairman, where he expressed concerns regarding the $25 million nonrecourse Loan Program. The letter stated the BTI attempted to perform a close out review of the Loan Program in June 2019 but, the BTI was unable to complete the review due to missing and incomplete records. The EDA disagrees with the assertions made by the BTI and states that, "BTI accepted audited financial statements and quarterly reports throughout the life of the program and did not request supporting source documents at any time."

As a result of the concerns expressed in the letter, and further detailed by the Treasurer and the BTI during a meeting with Post Audit staff, the Legislative Auditor proposed to conduct an audit of the $25 million Loan Program.

Frequently Used Acronyms in This Report

IMB: Investment Management Board

EDA: Economic Development Authority

WVEAC: West Virginia Enterprise Advancement Corporation

WVECF: West Virginia Enterprise Capital Fund

BTI: Board of Treasury Investments

Report Highlights:

Issue 1: The Economic Development Authority Did Not Maintain Adequate Records nor Did It Utilize an Accounting System Sufficient for Documenting Transactions of the $25 Million Loan Program as Required by W.Va. Code §5A-8-9.

- The EDA did not utilize an accounting system capable of adequately and efficiently documenting the transactions for the $25 million Loan Program, nor did the EDA effectively generate and maintain hardcopy source records.
- The EDA was unable to locate two years of supporting source documents and general records for Loan Program transactions.
- The EDA paid various audit and accounting fees for the Loan Program with non-program funds and then booked the expenses as accounts payable for the WVEAC. However, the EDA allowed the account to accrue from 2002 to 2015 before the $59,713 balance was eventually settled in 2020.

Issue 2: Due to the Limited Return on Investments, the EDA was Unable to Repay the BTI $24,325,778 in Loan Principal According to the Provisions Established by W. Va. Code §12-6-9e(f). Additionally, the EDA Did Not Maintain Adequate Data Regarding Industry and Job Development the Loan Program was Intended to Bolster, Making the Outcomes of the $25 Million Loan Program Unclear.

- Due to the EDA not collecting the proper data specific to the $25 million Loan Program, the Legislative Auditor was unable to quantify the jobs and businesses created or retained within the state resulting from the Loan Program.
- All investments made by the EDA in venture capital companies as a part of the $25 million Loan Program have been written down to $0 and four of the seven venture capital companies entered receivership before the conclusion of the program.
- Two companies that were selected for the $25 million Loan Program, Anthem Capital II and Toucan Capital Corporation, received a total of $8 million of funding from the EDA and did not invest any funds within the state.

- According to the BTI, the EDA repaid a total of $674,222 in principal and $3,092,301 in interest, leaving $24,325,778 in unpaid loan principal borrowed from the state's consolidated fund.

Recommendations

1.1. The Legislative Auditor recommends the EDA comply with W. Va. Code §5A-8–9, by maintaining adequate and proper documentation of the organization, functions, policies, decisions, procedures, and essential transactions of the agency. Further, when warranted, the Legislative Auditor recommends the EDA utilize an accounting system that is adequate to account for the financial activities of programs it operates, such as the Loan Program discussed in this report. Should additional funding be needed to do so, the EDA should communicate such needs to the Legislature and request the necessary funding.

1.2. The Legislative Auditor recommends the EDA comply with best business practice and pay expenses within a reasonable timeframe from when they are incurred.

2.1. The Legislative Auditor recommends the Legislature provide clear and concise statutory guidance to agencies regarding the expected outcomes of a program and guidelines to administer and monitor investments made with state funds for all programs similar to the one authorized by WV Code §12-6-9e(f) that may be established in the future.

Notation of Agency Response to Report

The West Virginia Economic Development Authority was provided a copy of this report in advance of its release. The EDA provided its responses to this report on January 22, 2021, which can be found in **Appendix F** in its entirety.

Background

During the 2002 Regular Session of the West Virginia Legislature, House Bill 4005 was enacted. This bill was created at the request of the Executive and set forth numerous provisions, one involving a $25 million nonrecourse loan program (Loan Program) to bolster industry and job development in the state. This was codified as subsection (f) of W.Va. Code §12-6-9e (Appendix C).

Specifically, subsection (f) authorizes a nonrecourse loan program, which according to subsection (a) of W.Va. Code §12-6-9e, intended to aid in "*creating jobs and businesses within the State and providing the needed risk capital to assist business and industrial development*…." A nonrecourse loan is a type of debt secured by collateral, which is usually property. If the borrower defaults, the issuer can seize the collateral but cannot seek out the borrower for any further compensation, even if the collateral does not cover the full value of the defaulted amount[1]. In respect to the loan authorized by W.Va. Code §12-6-9e(f), the only "collateral" provided would be the loan proceeds themselves and the earnings derived from use of the loan proceeds, *"…whether in the form of interest, dividends, realized capital gains, return of capital or otherwise…."*

Further, subsection (f) specifies the West Virginia Investment Management Board (IMB) "…*shall make available to the West Virginia Economic Development Authority* [EDA] *from the consolidated fund a nonrecourse loan in an amount up to twenty-five million dollars*…." Essentially, the IMB would serve as the lender of funds from the consolidated fund to the EDA as well as collect repayments from the EDA. The consolidated fund consists of operating cash of the state and short-term investments of state agencies and local governments.

Additionally, subsection (f) states the EDA is to make loans with this money from time to time to the West Virginia Enterprise Advancement Corporation (WVEAC) for investment in the West Virginia Enterprise Capital Fund, LLC (WVECF). The WVEAC is set up as a nonprofit corporation and the WVECF as a for-profit limited liability company. However, both the WVEAC and WVECF are wholly affiliated subsidiaries under the administration of the EDA and neither entity has a dedicated staff as all operating functions are performed by employees of the EDA. In essence, these entities are three BB&T bank accounts that are used to administer the proceeds of the Loan Program.

<u>Drawdowns of Loan Program Funds</u>

Over the life of the Loan Program, a total of $25 million in drawdowns from the state's consolidated fund were requested and received by the EDA beginning with the first drawdown of $15 million from the IMB in April 2002. In 2005, three years after the inception of the $25 million Loan Program, the Legislature established the Board of Treasury Investments (BTI) as a public corporation of the State of West Virginia, to make short-term operating funds of the state more accessible to state government (W.Va. Code §12-6C). As a result, any loans made from the state's consolidated fund, including the $25 million loan authorized by W.Va. Code §12-6-9e(f), were

[1] *(Source: Investopedia.com).*

transferred from the IMB to the BTI. Therefore, the BTI assumed full responsibility for the Loan Program, including the initial $15 million the IMB transferred to the EDA in April 2002 and the remaining $10 million of funds to be transferred thereafter.

There were five subsequent Loan Program fund transfers from BTI to the EDA of $2 million each beginning in April 2006 and concluding in April 2010. All Loan Program drawdowns are detailed in the following table:

Table 1
Drawdown Schedule for $25 Million Loan Program

Date	Transmitter	Receiver	Amount
4/15/2002	IMB	EDA	$15,000,000
4/6/2006	BTI	EDA	$2,000,000
8/2/2006	BTI	EDA	$2,000,000
2/5/2008	BTI	EDA	$2,000,000
2/5/2009	BTI	EDA	$2,000,000
4/2/2010	BTI	EDA	$2,000,000
TOTAL DRAWDOWNS			**$25,000,000**

Information obtained from EDA Reconciliation Spreadsheet

Selection Process of Venture Capital Companies

It is important to note that the program authorized by W.Va. Code §12-6-9e(f) provided for $25 million to be **loaned** to the EDA from the consolidated fund. According to subsection (a) of W.Va. Code §12-6-9e, these monies are to be used for **investments** that would aid in "*creating jobs and businesses within the State…"* and provide *"…the needed risk capital to assist business and industrial development….*" In effect, loan program funds drawn down from the BTI were loaned by the EDA to the WVEAC, then loaned from the WVEAC to the WVECF, and then used by the WVECF to make risk capital[2] investments. These investments were intended to support businesses and create jobs in the state and conceivably provide returns that could be used to repay the BTI's consolidated fund.

Upon creation of the $25 million Loan Program, the EDA had little experience with risk capital investments. As a result, the EDA created an "investment review committee" to assist the agency with choosing the venture capital companies in which to invest program funds. The committee included the EDA Executive and Associate Directors at the time[3], an EDA Loan Officer, one member of the EDA's Board of Directors, one state Senator, and three other individuals from the private sector with investment experience in the state. As part of the selection process, applicants seeking investments from Loan Program funds were required to attend a

[2] Risk capital refers to funds allocated to speculative activity and used for high-risk, high-reward investments. In the context of venture capital, risk capital may also refer to funds invested in a promising, but unproven, startup.

[3] The former EDA Executive Director and Associate Director at the time of the formation of the "investment review committee" are no longer in the employ of the EDA.

meeting at EDA's offices and respond to a standardized list of questions *(*Appendix D*)* posed by the committee and the EDA. The committee and the EDA subsequently evaluated each applicant's response for the purpose of selecting those venture capitalists that would receive investments of program funds. The questions asked of applicants included, but were not limited to:

- The number of physical offices located within the state;
- The value of the applicant's existing capital base;
- The applicant's knowledge of the state's business environment; and
- The minimum level of investment sought by the applicant.

The EDA provided the audit team several documents regarding the selection process of the venture capital companies. One of the documents provided was the *Respondent Presentation Schedule* that outlined the dates and times of presentations for prospective venture capital companies seeking investment of Loan Program funds. Upon review of this document, it was identified presentations took place in September 2002; however, three of the venture capital companies selected for investment were not listed on the schedule for presentation. As a result, the audit team inquired with the EDA as to why these three companies were not scheduled.

The EDA Associate Director responded by stating these companies *"...participated in a selection process in 2001. The board qualified Adena, Mountaineer and Walker as Fund Managers October 18, 2001."* Further, the Associate Director stated *"[t]he board authorized a $4,000,000 investment with Adena on August 16, 2001, a $4,000,000 investment with Mountaineer on June 19, 2002 and a $4,000,000 investment with Walker on June 19, 2002."* The Legislative Auditor questions how the EDA was able to select these companies for the Loan Program when the date of the selection process in 2001 precedes the inception of the $25 million Loan Program.

<u>EDA Investment of $25 Million Loan Program Funds</u>

According to a valuation report created by the BTI, as well as an analysis performed by the audit team, the EDA used the $25 million in Loan Program funds to make investments totaling $24,514,201 with seven venture capital companies. The remaining $485,799 was not invested by the EDA because: (1) only $24,750,000 was committed to the seven venture capital companies, leaving $250,000 of uncommitted funds and (2) three venture capital companies did not request the full amount subscribed to them, resulting in an unfunded amount of $235,799. These total the $485,799 in uninvested funds. The seven venture capital companies that received investment of Loan Program funds, and the amount of funds invested in each, are shown in Table 2 as follows:

Table 2 Summary of EDA Investments	
Company	**Amount**
Adena Ventures, LP	$4,000,000
Anthem Capital II, LP	$4,000,000
INNOVA – WV High Tech	$744,201
Mountaineer Capital	$3,800,000
Novitas Capital	$3,970,000
Toucan Capital Corp	$4,000,000
Walker Ventures	$4,000,000
TOTAL INVESTMENT	**$24,514,201**

Information obtained from BTI Valuation Report and auditor analysis

The EDA intermittently funded the investments to the seven venture capital companies upon request with the first investment dispersed on May 16, 2002 and the last investment dispersed on July 29, 2016. When a request for a capital call was received by the EDA, the agency would verify that all disbursement requirements were met and seek approval of the disbursement from the EDA Associate Director. Then, the EDA Director or Associate Director at the time would authorize the disbursement and the EDA accountant would then forward the authorized disbursement verification to BB&T.

Current Status of Repayment of the $25 Million Loan Program

As of May 2020, the EDA Loan Program bank accounts had remaining balances totaling $269,061 and all investments made by the EDA in venture capital companies as a part of the $25 million Loan Program had been written down to $0. **Further, four of the seven venture capital companies entered receivership before the conclusion of the program.**

According to the records of both the BTI and the EDA, a total of $3,766,583 was remitted by EDA to the BTI in repayment of the $25 million loan. The payments included $3,628,583 in interest and $138,000 in principal. However, in FY 2014 the BTI began applying interest payments to outstanding principal as a part of the agency's "recovery strategy." This resulted in a total of $674,222 in principal repaid and $3,092,361 in interest repaid over the life of the program. Therefore, according to the BTI's accounting for repayment, $24,325,778 in loan principal remains outstanding as of January 20, 2021.

Apart from the return to BTI of the roughly $270,000 remaining in undistributed program bank balances, no additional monies are anticipated to be repaid[4]. Regardless of how the repayment

[4] Additionally, the Associate Director of the EDA informed the audit team that the EDA received stock certificates at the end of 2016 as a part of Novitas Capital's liquidation plan. The stock certificates received were for two companies: Tetralogic Pharmaceuticals, and Cernostics Incorporated. The Associate Director informed the audit team that Tetralogic is traded on the NASDAQ stock market exchange. According to Yahoo! Finance, Tetralogic stock was valued at $0.013 per share as of December 18, 2020. Therefore, giving the 71,518 shares held by the EDA a value of $929.73 as of 12/18/2020. The Associate Director added that the current value of Cernostics is unknown; however, as of May 16, 2019, 81,874 shares of common stock received in the liquidation were valued at $9,824.88. The auditor was unable to verify this amount as Cernostics stock is not traded publicly.

amount is accounted for in terms of interest or principal repayment, only 15% of the total $25 million was recovered. **As a result of the lack of return on investments, the Loan Program resulted in almost $24 million in unpaid loan principal borrowed from the state's consolidated fund.**

Issue 1: The Economic Development Authority Did Not Maintain Adequate Records nor Did It Utilize an Accounting System Sufficient for Documenting Transactions of the $25 Million Loan Program as Required by W.Va. Code §5A-8-9.

The Legislative Auditor received a letter from John Perdue, State Treasurer and BTI Chairman, with concerns regarding the $25 million Loan Program (Appendix E). The letter stated the BTI attempted to perform a close out review of the Loan Program in August 2019; however, the BTI stated it was unable to complete the review due to missing and incomplete records. The EDA disagrees with BTI's assertion and states that, "BTI accepted audited financial statements and quarterly reports throughout the life of the program and did not request supporting source documents at any time." Specifically, the letter from the BTI identified three central concerns related to EDA's recordkeeping for the Loan Program as follows:

1. For fiscal years 2006-2011, the only records available were program financial statements as the underlying accounting records were missing or incomplete;
2. For fiscal years 2012-2017 the underlying accounting records and standalone financial statements were unavailable; and
3. According to BTI's records, undistributed cash for the Loan Program totaled $357,380, while EDA's bank account balances used for program funds totaled $324,527—**an unaccounted difference of $32,853.**

On October 30, 2019, members of the Post Audit Division met with the Treasurer and BTI staff to further discuss the issues conveyed in the letter. As a result of the concerns expressed in the letter, and further detailed by the Treasurer and the BTI during the meeting, the Legislative Auditor proposed to conduct an audit of the $25 million Loan Program's accounting records and endeavor to resolve the $32,853 discrepancy.

Subsequent to the issues reported to the Legislative Auditor by the BTI, the Post Audit Division was informed by the EDA the agency was unable to provide a contemporaneous computerized accounting record nor could it provide two years of hardcopy records that documented and supported the financial transactions of the $25 million Loan Program. **Further, the Loan Program records of financial transactions which were available did not lend themselves to the execution of an efficient audit.** These records consisted of bank statements, bank transfer documents, and financial statements maintained in three-ring binders.

Such record keeping complicated and increased the time necessary to perform an audit of Loan Program financial transactions. As these records were insufficient on their own to conduct an audit to reconcile the $32,853 discrepancy between program bank account balances and the Loan Program balance documented by BTI, the Legislative Auditor requested the EDA perform a reconciliation of the EDA Loan Program bank balances to BTI's Loan Program records to attempt to account for the discrepancy. This reconciliation and the documents used by the EDA to perform it were then audited by the Legislative Auditor to determine if the reported discrepancy was sufficiently resolved.

The reconciliation was compiled by the EDA from the source documents that were available. These included paper documents maintained in binders organized by fiscal year, as well as additional documentation obtained from BB&T Bank, where the EDA Loan Program accounts were maintained. The reconciliation largely resolved the $32,853 discrepancy reported by BTI as much of the discrepancy was attributable to Loan Program transactions of which the BTI was not aware and, therefore, did not account for in their close out procedures. Examples of such transactions not reflected in BTI's records included, but were not limited to, additions to the reconciling balance for investment revenues and interest as well as deductions for management fees and capital calls.[5] **Through this work, the EDA was able to reconcile the BTI remaining balance to within $201.74 of the EDA's combined Loan Program bank balances.**

The Legislative Auditor reviewed the EDA reconciliation and overall accounting of the Loan Program and noted the following issues:

1. The EDA was unable to locate hardcopy records documenting program transactions for Fiscal Years 2011 and 2012. As a result, unsupported transactions used by the EDA in resolving the $32,853 discrepancy include a $2,786.63 credit to the WVECF account and credits totaling $1,010 to the WVEAC account.
2. The Legislative Auditor was unable to validate $5,500 of a $59,713 disbursement of Loan Program funds to settle unpaid payables. According to the EDA, this transaction was a reimbursement for various audit, accounting and legal fees incurred during various years throughout the life of the Loan Program that the EDA initially paid from non-Loan Program EDA funds.
3. The audit team requested a copy of the EDA's record retention schedule. Upon review of the EDA's record retention schedule and correspondence with the West Virginia Department of Administration, it was determined the EDA's schedule had not been approved by the Department of Administration as required by W.Va. Code §5A-8-9(d). However, on January 6, 2021, the Department of Administration informed the audit team that the EDA record retention schedule had been approved and provided the team a copy of the approved schedule.
4. The EDA reconciliation was unable to account for $201.74. Specifically, the reconciliation showed that bank balances should have been a combined $201.74 less than actual total bank balances for the accounts.

The audit determined the issues noted above were due to EDA's non-compliance with W.Va. Code §5A-8-9 as the EDA did not utilize accounting methods capable of adequately

[5] An investment of Loan Program funds transferred to a venture capitalist. Funds were intermittently disbursed for investment upon the requests of the venture capitalists until the total amount disbursed to the capitalist equated to the subscribed amount as stipulated in each respective ***subscription agreement*** between the EDA and the venture capitalist company.

and efficiently documenting the transactions for the $25 million Loan Program, nor did the EDA effectively generate and maintain hardcopy source records. W.Va. Code §5A-8-9, states in part:

> *The head of each agency shall:*
>
> *(a) Establish and maintain an active, continuing program for the economical and efficient management of the records of the agency...*
>
> *(c)* ***Make and maintain records containing adequate and proper documentation of the organization, functions, policies, decisions, procedures and essential transactions of the agency*** *designed to furnish information to protect the legal and financial rights of the state and of persons directly affected by the agency's activities.*
>
> *(d)* ***Submit to the administrator, in accordance with the standards established by him or her, schedules proposing the length of time each state record series warrants retention for administrative, legal or fiscal purposes after it has been received by the agency… (emphasis added)***

The requirements of W.Va. Code §5A-8-9 are to ensure that the records of an agency are adequate to document the functions and transactions of the agency and these records are maintained for future "*administrative, legal or fiscal purposes*." Agencies are also required by §5A-8-9(d) to submit records retention schedules to the Department of Administration for approval to ensure the retention schedule is adequate. While not directly specified in W.Va. Code §5A-8-9, it is reasonable to infer that the statute would require an accounting system sufficient to record the transactions of a $25 million loan program and that such records should be maintained as long as fiscal purposes warrant them, in this case until such time that the BTI was able to complete its closeout review. According to the EDA, it is not known why management at the time did not purchase accounting software, however the EDA states, "…management at the time may have thought the cost of the software to handle a limited number of transactions was not justified. WVEDA processed a total of 770 transactions over the life of the program (approximately 45 per year or 3.75 per month)." Rather than using a common accounting software such as QuickBooks, the agency utilized Microsoft Excel to record transactions of the Loan Program.

During the audit, it was also identified that the EDA did not have a records retention schedule that had been approved by the Department of Administration; however, the EDA stated the agency does have a retention schedule that the agency follows. When the Post Audit Division asked the EDA why hardcopy source documents could not be located for Fiscal Years 2011 and 2012, the EDA stated:

> *…we have hundreds of boxes in storage and we felt [sic] could not be gone through in an efficient manner. It is possible that the binders could be in one of these boxes, or they could have been included in one of the boxes that have been destroyed according to our retention policy.*

On January 6, 2021, the Department of Administration informed the audit team that the EDA record retention schedule had been approved and provided the team a copy of the approved schedule. Through a review of the schedule, it was identified that general ledgers and financial statements are to be retained permanently. Therefore, if general ledgers and financial statements for the Loan Program were destroyed, this would have been in violation of the EDA's own stated retention policy.

Substandard accounting practices, and inadequate document retention complicated the audit of the Loan Program. Further, missing and incomplete records made it impossible for the audit team to verify several transactions of the program. Although the $32,853 discrepancy reported by the BTI was immaterial relative to the $25 million program, such a discrepancy is indicative of inadequate record-keeping. Inadequate record-keeping increases the risk of fraudulent and erroneous transactions. In the event such transactions were to occur, they would also have a high probability of remaining undetected by management.

Professional accounting software specifically designed for business accounting provides management the capability to better track financial transactions and to promptly generate various financial reports capable of presenting the financial condition of a given program or project. Accounting software helps organize financial data and provides an accurate, real-time look at program expenses and income. These functions are severely limited if program transactions are tracked on Excel spreadsheets and hardcopy files.

It is the opinion of the Legislative Auditor that the Loan Program, which required accounting for $25 million in funding from the state's consolidated fund issued to seven venture capitalists over a 20-year period, warranted an investment of program funds in some type of accounting software for administering the Loan Program. However, the Legislative Auditor also notes that the statute enacting the program did not provide specificity as to how the EDA was to account for the program transactions, nor did it provide for a specific allocation of funds to enable the EDA to purchase accounting software or hire additional staff if necessary.

Due to a Lack of Oversight and an Inadequate Accounting System for the Loan Program, the EDA Failed to Settle a Payable Totaling $59,713, Allowing it to Remain Unsettled for 18 Years.

Subsequent to the conclusion of our audit of the EDA reconciliation, the EDA settled an *"…outstanding payable of $59,713.00 to WVEDA on WV Enterprise Advancement Corps books for various audit, accounting and legal fees that WVEDA had paid over the years…."* The EDA provided a Microsoft Excel document that showed the payable was allowed to increase without payment each year from FY 2002, when the account was first credited for $22,304, until FY 2015 when the account was last credited for $3,500.

The payable remained unsettled until February 10, 2020, when a check for $59,713 from a Loan Program bank account was deposited into EDA's *Industrial Development Loans Fund* (wvOASIS #9061). Upon further questioning as to why expenses were not paid timely, the EDA stated that "*…neither the WVEAC nor the WVECF maintained enough cash reserves to pay its* *own expenses and the WVEDA did not want WVEAC/WVECF to borrower [sic] funds to pay expenses. As a result, the WVEDA Executive Director at the time ... paid WVEAC/WVECF expenses through the WVEDA and booked a payable from WVEAC/ECF to WVEDA."* Further, the current EDA Associate Director stated *"[WVEDA] staff cannot explain why the Executive Director at the time (who is now retired) did not pay the outstanding expenses in a timely manner."*

Best business practice dictates expenses should be paid timely—if possible, within a year of when they are incurred. The WVEAC payable to the EDA, which had its origins 18 years prior to being settled, is an extreme example of a late payment of an expense. Failure to pay expenses in a timely manner complicates record keeping, increases the risk for errors, and potentially obscures the cost of conducting operations.

As a result of the issues discussed above, the Legislative Auditor has the following recommendations:

Recommendations

1.1. The Legislative Auditor recommends the EDA comply with W. Va. Code §5A-8–9, by maintaining adequate and proper documentation of the organization, functions, policies, decisions, procedures, and essential transactions of the agency. Further, when warranted, the Legislative Auditor recommends the EDA utilize an accounting system that is adequate to account for the financial activities of programs it operates such as the Loan Program discussed in this report. Should additional funding be needed to do so, the EDA should communicate such needs to the Legislature and request the necessary funding.

1.2. The Legislative Auditor recommends the EDA comply with best business practice and pay expenses within a reasonable timeframe from when they are incurred.

Issue 2: Due to the Limited Return on Investments, the EDA was Unable to Repay the BTI $24,325,778 in Loan Principal According to the Provisions Established by W.Va. Code §12-6-9e(f). Additionally, the EDA Did Not Maintain Adequate Data Regarding Industry and Job Development the Loan Program was Intended to Bolster, Making the Outcomes of the $25 Million Loan Program Unclear.

As mentioned previously, the $25 million Loan Program established by W.Va. Code §12-6-9e(f) was meant to aid in industry and job development in the state. In an attempt to gauge the overall performance of the Loan Program in achieving this outcome, the audit team reviewed documentation provided by the EDA and the BTI to derive the totals of the more significant values that, in the opinion of the Legislative Auditor, readily point to overall program outcomes. These values include:

- **Jobs and Businesses Created as a Result of the $25 Million Loan Program –** The number of jobs created and retained within the state as a result of the investments made in the seven venture capital companies;
- **EDA Investments of Program Funds with Venture Capitalists –** The amount of funds from the $25 million program invested by the EDA in venture capital companies, the current value of those investments, as well as the venture capitalists' utilization of program funds received;
- **EDA Loan Repayments to BTI** – The total interest and principal payments remitted by EDA to the BTI in repayment of $25 million in loan proceeds.
- **Remaining Balance of Undistributed Program Funds** - The remaining aggregate program balance of undistributed program funds maintained in BB&T Loan Program bank accounts.

<u>Jobs and Businesses Created as a Result of the $25 Million Loan Program</u>

In order to determine how the agency evaluated and monitored the progress of creating jobs and businesses, Post Audit reviewed a document that summarized jobs and businesses created within the state as a result of the investments made with the seven venture capitalist companies.

In response to this request, the EDA provided a ***Summary of Venture Capital Investments Deployed in WV***—a document that outlined investments in the state and, ostensibly, the jobs created because of these investments. The audit team's analysis of this document identified that the document was not exclusive to investments provided to venture capitalists from the Loan Program funds. The document comingled data as it included investments totaling over $40 million, far exceeding the $25 million available from Loan Program funds. Additionally, the document did not include dates of the investments, which made it impossible for the audit team to determine if the investments were made as a direct result of venture capitalists receiving funding per the $25 million Loan Program. Therefore, by taking the $24,514,201 of program funds that were dispersed to the seven VCs, less the $8 million not invested in the state by Anthem and Toucan, the result would be, at most, $16,514,201 of program funds invested within the state.

Program evaluation refers to systematic efforts to collect, analyze, and interpret information about the outcomes of programs or projects. Program monitoring relies on indicators that can be tracked over time, such as in the case of the Loan Program, the number of jobs created as a result of Loan Program investments made with venture capitalists. **Because the document provided by the EDA included data not exclusive to the $25 million Loan Program, the Legislative Auditor was unable to quantify jobs and businesses created or retained within the state resulting from the Loan Program.** Moreover, this issue further exemplifies the importance of obtaining or generating records and maintaining those records for a sufficient period as stipulated in the recommendations made in Issue 1.

EDA Investments of Program Funds with Venture Capitalists

According to a valuation report created by the BTI, as well as an analysis performed by the audit team of a schedule of Loan Program bank transactions, the EDA disbursed $24,514,201 of investments to venture capital companies[6]. **It should be noted all investments made by the EDA in venture capital companies as a part of the $25 million Loan Program have been written down to $0 and four of the seven venture capital companies entered into a receivership before the conclusion of the program.** The following table provides further detail.

Table 3
Details of EDA Investments in Seven Venture Capital Companies

Company	Subscribed Amt.[1]	Disbursed Amt.[2]	Unfunded[3]
Adena Ventures, LP[a]	$4,000,000	$4,000,000	$0
Anthem Capital II, LP[a]	$4,000,000	$4,000,000	$0
INNOVA – WV High Tech	$750,000	$744,201	$5,799
Mountaineer Capital	$4,000,000	$3,800,000	$200,000
Novitas Capital	$4,000,000	$3,970,000	$30,000
Toucan Capital Corp.[a]	$4,000,000	$4,000,000	$0
Walker Ventures[a]	$4,000,000	$4,000,000	$0
TOTALS	**$24,750,000**	**$24,514,201**	**$235,799**

[a] **Placed in receivership.**

[1] Subscribed amount according to the EDA's subscription agreement with each respective company.

[2] Amount disbursed to the company according to the audit team's review of EDA's schedule of bank transactions.

[3] Subscribed amount less disbursed amount.

Information Obtained from Venture Capitalist Subscription Agreements, BTI Valuation Report, and Auditor Analysis

[6] In an email dated May 22, 2020, the EDA accountant disagreed with this number by stating he *"strongly feel[s] that the total should be $24,451,861"* because the BTI included some items as investments that were incorrect. However, no supporting documentation for this statement was provided. Although the $62,340.23 difference in the total investments between the BTI and the EDA is largely immaterial when considering the approximate $24.5 million invested, this difference exemplifies the finding identified in Objective 1 and highlights the importance of proper record keeping.

In a meeting on February 26, 2020, the EDA informed the audit team that Anthem Capital II and Toucan Capital Corporation, received $8 million of funding from the EDA, and did not invest any funds within the state. According to the EDA, when the companies were questioned about the lack of investments in West Virginia, the EDA was informed there were no companies within the state ready to receive venture capital investments. The EDA Associate Director stated the EDA was dissatisfied with the lack of return on investments, the necessary write downs in the value of the investments, and the financial instability of some of the venture capital companies; however, the EDA was informed by their legal counsel that the agency had no choice but to continue to meet their investment obligations as stipulated in the subscription agreements. The audit team requested documentation from the EDA that supported the legal advice received; but, the Associate Director stated all such advice was received verbally.

Further, when the audit team asked the EDA about the poor return on investments, the Associate Director cited the Legislature established the $25 million Loan Program with little guidance outlined within the statute regarding investments. Upon the audit team's review of W.Va. Code §12-6-9e(f), it was identified that the Code essentially only authorizes the Loan Program and establishes the repayment terms of the loan but provides no specifics on how the program should be operated or evaluated.

EDA Loan Repayments to BTI

W.Va. Code §12-6-9e(f) is explicit regarding the parameters of the repayment of the $25 million loaned to the EDA. Concerning the stipulations for repayment, subsection (f) states in part:

> *…The loan authorized by this subsection to the West Virginia Economic Development Authority must be classified by the Board as a long-term, fixed income investment, must bear interest on the outstanding principal balance thereof at the rate of three percent per annum payable annually on or before the thirtieth day of June of each year, and the principal of which must be repaid no later than the thirtieth day of June, two thousand twenty-two, in annual installments due on or before the thirtieth day of June of each year, which annual installments must commence no later than the thirtieth day of June, two thousand three…*

According to the records of both the BTI and the EDA, a total of $3,766,583 was remitted by EDA to the BTI in repayment of the $25 million loan. The payments included $3,628,583 in interest and $138,000 in principal. However, in FY 2014, the BTI began applying interest payments to outstanding principal as a part of the agency's "recovery strategy." This resulted in a total of $674,222 in principal repaid and $3,092,361 in interest repaid over the life of the program. Therefore, according to the BTI's accounting for repayment, $24,325,778 in loan principal remains outstanding as of the date of this report. Regardless of how the repayment amount is accounted for in terms of interest or principal repayment, just over 15% of the value of the amount invested was ultimately repaid. **As a result of the lack of return on investments, the Loan Program resulted in $24,325,778 in unpaid loan principal borrowed from the state's consolidated fund, by the EDA.** Apart from the return of the roughly $270,000 in undistributed program bank balances to BTI, no additional monies are anticipated to be repaid.

Remaining Balance of Undistributed Program Funds

As of May 26, 2020, the EDA stated the remaining balance of undistributed funds maintained in the Loan Program bank accounts totaled $269,061. Due to interest earnings, the balance has likely increased slightly as of the date of this report. The BTI stated the Board would request the EDA close the bank accounts and return the remaining funds to the BTI upon the release of this audit report.

Additionally, the Associate Director of the EDA informed the audit team that the EDA received stock certificates at the end of 2016 as a part of Novitas Capital's liquidation plan. The stock certificates received were for two companies: Tetralogic Pharmaceuticals, and Cernostics Incorporated. The Associate Director informed the audit team that Tetralogic is traded on the NASDAQ stock market exchange. According to Yahoo! Finance, Tetralogic stock was valued at $0.013 per share as of December 18, 2020; therefore, the 71,518 shares held by the EDA held a value of $929.73 as of that date. The Associate Director added that the current value of Cernostics is unknown; however, as of May 16, 2019*,* 81,874 shares of common stock received in the liquidation were valued at $9,824.88. The auditor was unable to verify this amount as Cernostics stock is not publicly traded. While statute is unclear, it is the Legislative Auditor's opinion these proceeds are a direct result of the Loan Program and, therefore, should be remitted to the BTI when the program bank balances are closed.

Summary of $25 Million Loan Program Outcomes

In summary, it is the Legislative Auditor's opinion that the Loan Program did not achieve the intended outcomes and what was achieved is difficult to quantify. The EDA invested approximately $24.5 million with seven venture capital companies. Four of the seven venture capital companies entered receivership before the nonrecourse Loan Program had concluded and all investments made by the EDA in these companies have been written down to $0. While the performance of these investments did not provide the returns intended, it is likely the Loan Program did create jobs within the state. However, the total number of jobs created that were attributable to the Loan Program were unable to be quantified by the audit team from the information provided by the EDA. Whether the state received a fair return on investment in terms of job creation and economic development in relation to the roughly $24.5 that remains in unpaid principal is not clear based on the information available.

What is clear is that at least $8 million of this funding invested in Anthem Capital II and Toucan Capital Corporation was not invested in the state. Given W.Va. Code §12-6-9e(a) states the intent of the $25 million Loan Program was to create jobs and businesses within the state, the Legislative Auditor questions how this could be achieved when, at a minimum, 32% of the total proceeds of the Loan Program were not invested in businesses within West Virginia.

Further, it is the opinion of the Legislative Auditor that the award process should have required unequivocal guarantees in the subscription agreements made with the seven venture capitalist companies that legally obligated the capitalists to use program funds received from the EDA exclusively for investment with companies located within the state. Had W.Va. Code §12-6-

9e(f) required unequivocal in-state investment requirements and established parameters to review the performance of such investments, it is likely the state would have experienced more positive outcomes.

Recommendation

2.1 The Legislative Auditor recommends the Legislature provide clear and concise statutory guidance to agencies regarding the expected outcomes of a program and guidelines to administer and monitor investments made with state funds for all programs similar to the one authorized by WV Code §12-6-9e(f) that may be established in the future.

Appendix A

WEST VIRGINIA LEGISLATIVE AUDITOR'S OFFICE

Post Audit Division

1900 Kanawha Blvd. East, Room W-329
Charleston, WV 25305-0610
(304) 347-4880

Justin Robinson
Director

December 16, 2020

Caren Wilcher, Associate Director
WV Economic Development Authority
Greenway Building
Northgate Business Park
180 Association Drive
Charleston, WV 25311-1217

Dear Associate Director Wilcher:

Attached is a draft copy of the Post Audit Division's audit report on the $25 million program established by W.Va. Code §12-6-9e, Subsection (f). As a result of COVID-19, at this time there are no scheduled interim meetings of the Post Audits Subcommittee where the report would typically be presented and released. Rather, the report is planned to be released to the members of the Subcommittee and the public through our website at a date not yet specified, after the Economic Development Authority's review and comment on the draft report. Once this date is determined, we will notify you.

If you would like to schedule a meeting to discuss the report prior to its release, please contact Terri Stowers, Executive Assistant, at 304-347-4880 at your earliest convenience to schedule the meeting. In addition, if you would like to provide a response to the report to be included in the final draft, please provide your written response to us not later than Wednesday, December 30, 2020. Thank you in advance for your cooperation, and feel free to contact me with any questions or concerns.

Sincerely,

Justin Robinson

Objective, Scope, and Methodology

The Post Audit Division within the Office of the Legislative Auditor conducted this review as authorized by Chapter 4, Article 2, Section 5 of the *West Virginia Code*, as amended.

Objective

The objectives of this review were to determine if the Economic Development Authority (EDA) properly accounted for a $25 million loan program established by W. Va. Code §12-6-9e(f); and, to determine the overall performance and results of the loan program.

Scope

The scope of this audit consisted of a review of all documents pertaining to the $25 million loan program as well as all applicable W. Va. Code, Legislative Rules, and best business practices. Also included was a review of a sample of an EDA reconciliation of program bank balances to the Board of Treasury Investments (BTI) program balance. The timeframe of the review spanned from the inception of the loan program in 2002 until the program bank accounts were closed by the EDA and the balances of the accounts transferred to the BTI on January 21, 2012.

Methodology

The Post Audit Division staff gathered and analyzed several sources of information and assessed the sufficiency and appropriateness of the information used as evidence. Audit staff analyzed various Loan Program documents that were either provided to us by the EDA, the BTI, or publicly available via internet websites. Documentary evidence included, but was not limited to, Loan Program bank statements and transfer documents, EDA Board minutes, and subscription agreements between the EDA and those venture capital companies that received investments of Loan Program funds. Testimonial evidence was gathered through meetings with the EDA and from correspondence via email with EDA and BTI staff. The primary purpose for testimonial evidence was to gain a better understanding or clarification of certain issues, to confirm the existence or non-existence of a condition, or to understand the respective agency's position on an issue. Such testimonial evidence was confirmed by either written statements or the receipt of corroborating documentary or physical evidence.

Post Audit also audited a sample of Loan Program disbursement and receipt transactions documented in a Microsoft Excel document that was prepared by the EDA. The purpose of the audit was to determine if the recorded transactions recorded by the EDA were both proper and accurate. This was accomplished by verifying that the sampled transactions were supported by independent third-party source documentation, such as bank documents.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

WEST VIRGINIA CODE: §12-6-9E

§12-6-9e. Legislative findings; loans for industrial development; availability of funds and interest rates.

(a) The Legislature hereby finds and declares that the citizens of the state benefit from the creation of jobs and businesses within the state; that a business and industrial development loan program provides for economic growth and stimulation within the state; that loans from pools established in the consolidated fund will assist in providing the needed capital to assist business and industrial development; and that time constraints relating to business and industrial development projects prohibit duplicative review by both the board and the West Virginia economic development authority board. The Legislature further finds and declares that an investment in the West Virginia enterprise capital fund, LLC, of moneys in the consolidated fund as hereinafter provided will assist in creating jobs and businesses within the state and providing the needed risk capital to assist business and industrial development. This section is enacted in view of these findings.

(b) The board shall make available, subject to cash availability, in the form of a revolving loan, up to $175,000,000 from the consolidated fund to loan the West Virginia economic development authority for business or industrial development projects authorized by section seven, article fifteen, chapter thirty-one of this code and to consolidate existing loans authorized to be made to the West Virginia economic development authority pursuant to this section and pursuant to section twenty, article fifteen, chapter thirty-one of this code which authorizes a $150,000,000 revolving loan, and article eighteen-b, chapter thirty-one of this code which authorizes a $50,000,000 investment pool: Provided, That the West Virginia economic development authority may not loan more than $15,000,000 for any one business or industrial development project. The revolving loan authorized by this subsection must be secured by one note at a variable interest rate equal to the twelve-month average of the board's yield on its cash liquidity pool. The rate must be set on the first day of July and the rate must be adjusted annually on the same date. The maximum annual adjustment may not exceed one percent. Monthly payments made by the West Virginia economic development authority to the board must be calculated on a one hundred twenty-month amortization. The revolving loan must be secured by a security interest that pledges and assigns the cash proceeds of collateral from all loans under this revolving loan pool. The West Virginia economic development authority may also pledge as collateral certain revenue streams from other revolving loan pools which source of funds does not originate from federal sources or from the board.

The outstanding principal balance of the revolving loan from the board to the West Virginia economic development authority may at no time exceed one hundred three percent of the aggregate outstanding principal balance of the business and industrial loans from the West Virginia economic development authority to economic development projects funded from this revolving loan pool. This provision must be certified annually by an independent audit of the

West Virginia economic development authority financial records.

(c) The interest rates and maturity dates on the loans made by the West Virginia economic development authority for business and industrial development projects authorized by section seven, article fifteen, chapter thirty-one of this code must be at competitive rates and maturities as determined by the West Virginia economic development authority board.

(d) Any and all outstanding loans made by the board, or any predecessor entity, to the West Virginia economic development authority must be refunded by proceeds of the revolving loan contained in this section and no loans may be made hereafter by the board to the West Virginia economic development authority pursuant to section twenty, article fifteen, chapter thirty-one of this code or article eighteen-b of said chapter.

(e) The trustees of the board bear no fiduciary responsibility as provided in section eleven of this article with specific regard to the revolving loan contemplated in this section.

(f) Subject to cash availability, the board shall make available to the West Virginia economic development authority from the consolidated fund a nonrecourse loan in an amount up to $25,000,000, for the purpose of the West Virginia economic development authority making a loan or loans from time to time to the West Virginia enterprise advancement corporation, an affiliated nonprofit corporation of the West Virginia economic development authority. The respective loans authorized by this subsection by the board to the West Virginia economic development authority and by the West Virginia economic development authority to the West Virginia enterprise advancement corporation must each be evidenced by one note and must each bear interest at the rate of three percent per annum. The proceeds of any and all loans made by the West Virginia economic development authority to the West Virginia enterprise advancement corporation pursuant to this subsection must be invested by the West Virginia enterprise advancement corporation in the West Virginia enterprise capital fund, LLC, the manager of which is the West Virginia enterprise advancement corporation. The loan to West Virginia economic development authority authorized by this subsection must be nonrevolving, and advances thereunder must be made at times and in amounts as may be requested or directed by the West Virginia economic development authority, upon reasonable notice to the board, the loan authorized by this subsection is not subject to or included in the limitations set forth in subsection (b) of this section with respect to the $15,000,000 limitation for any one business or industrial development project and limitation of one hundred three percent of outstanding loans, and may not be included in the revolving fund loan principal balance for purposes of calculating the loan amortization in subsection (b) of this section. The loan authorized by this subsection to the West Virginia economic development authority must be classified by the board as a long-term, fixed income investment, must bear interest on the outstanding principal balance thereof at the rate of three percent per annum payable annually on or before the thirtieth day of June of each year, and the principal of which must be repaid no later than June 30, 2020, in annual installments due on or before June 30 of each year, which annual installments must commence no later than June 30, 2003, in annual principal amounts as may be agreed upon between the board and the West Virginia economic development authority, and which annual installments need not be equal. The loan authorized by this subsection must be nonrecourse and must be payable by the West Virginia economic development authority solely from amounts or returns received by the West Virginia economic development authority in respect of the loan authorized by this subsection to the West Virginia enterprise advancement corporation, whether in the form of interest, dividends, realized capital gains, return of capital or otherwise, in all of which the board must have a security interest to secure repayment of the loan to the West Virginia economic development authority authorized by this subsection. Any and all loans from the West Virginia economic development authority to the West Virginia enterprise advancement corporation made pursuant to this subsection must also bear interest on the outstanding principal balance thereof at the rate of three percent per annum payable annually on or before the thirtieth day of June of each year, must be nonrecourse and must be payable by the West Virginia enterprise advancement corporation solely from amounts of returns received by the West Virginia enterprise advancement corporation in respect of its investment in the West Virginia enterprise capital fund, LLC, whether in the form of interest, dividends, realized capital gains, return of capital or otherwise, in all of which the board must have a security interest to secure repayment of the loan to the West Virginia economic development authority authorized by this subsection. In the event the amounts or returns received by the West Virginia enterprise advancement corporation in respect of its investment in the West Virginia enterprise capital fund, LLC, are not adequate to pay when due the principal or interest installments, or both, with respect to the loan from the West Virginia economic development authority and, as a result thereof, the West Virginia economic development authority is unable to pay the principal or interest installments, or both, with respect to the loan authorized by this subsection by the board to the West Virginia economic development authority, the principal or interest, or both, as the case may be due on the loan made to the West Virginia economic development authority pursuant to this subsection must be deferred, and any and all of these past-due principal and interest payments must promptly be paid to the fullest extent possible upon receipt by the West Virginia enterprise advancement corporation of moneys in respect of its investments in the West Virginia enterprise capital fund, LLC. The trustees or the board bear no fiduciary responsibility as provided in section eleven of this article with regard to the loan authorized by this subsection.

INITIAL QUESTIONS for PROSPECTIVE VC MANAGERS

- What is your existing capital base?
- When do you anticipate closing this Fund?
- How much additional capital are you attempting to raise?
- Is there a minimum acceptable level of investment, through West Virginia's venture capital initiative, that your firm would require?
- Has your firm identified an office location in West Virginia and/or the individual who will be based in that office?
- Are the members of your team familiar with business environment in West Virginia, including the State's universities/colleges, principal industries and social issues? Do any team members have ties to West Virginia?
- How would you characterize your firm's niche in the venture capital world and how might your firm be distinguished from among equally qualified applicants for our investment?
- Would you firm be receptive to membership in a proposed "Association" of venture capital companies in West Virginia? What added value would your firm bring to the Association?

WEST VIRGINIA
BOARD OF TREASURY INVESTMENTS

Investing Local, County and State Funds for West Virginia

WV Legislative Auditor's Office
Attention: Aaron Allred
1900 Kanawha Blvd. East # 329
Charleston, WV 25305

Dear Mr. Allred,

Per WV House Bill 4005 (2002 Regular Session) and WV State Code §12-6-9(e) (2005), the WV Investment Management Board and the WV Board of Treasury Investments ("BTI"; successor entity), were required to loan $25 million, in the form of a non-revolving, non-recourse loan, to the WV Economic Development Authority ("WVEDA"). The WVEDA loaned the funds to the WV Enterprise Advancement Corporation ("WVEAC") for investment in the WV Enterprise Capital Fund ("WVECF") for venture capital initiatives.

On June 6, 2019, the WVEDA notified the BTI that they would be closing out the Non-Recourse loan program resulting in a final write down of $449,153. Based on the BTI's records, this left a balance of $357,380 in undistributed cash (funds drawn down, but not distributed). Per the WVEDA bank statements, the undistributed cash balance was $324,527. This resulted in a $32,853 difference.

On August 26, 2019, BTI staff visited the WVEDA to perform a close-out review of the Non-recourse Loan program. BTI staff were unable to complete the review as the underlying accounting records and stand-alone financial statements for the WVEAC and the WVECF for fiscal years 2012 through 2017 were unavailable. Further, for fiscal years 2006 through 2011, BTI staff had to rely upon the standalone financial statements for the WVEAC and WVECF as the underlying accounting records were missing or incomplete.

This letter is to inform you of the above issues that the BTI encountered in attempting to close out the loan program and the discrepancy in the remaining balance of the Non-Recourse loan program. BTI staff will continue to exhaust all efforts to reconcile the difference. Due to the concerns regarding the discrepancy and the missing records, the Board felt it was its fiduciary duty to inform you of this matter.

Best Regards,

John Perdue

BTI Chairman, John D. Perdue

cc: Dave Hardy, Cabinet Secretary, WV Department of Revenue
Lindsay Marchio, WV State Treasurer's Office Associate General Council
Kara Hughes, Executive Director, WV Board of Treasury Investments
Karl Shanholtzer, CFO, WV Board of Treasury Investments

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180 Association Drive
Charleston, WV 25311
https://eda.wv.gov

January 22, 2021

Via Electronic Mail
(stan.lynch@wvlegislature.gov)
Justin Robinson
Director
West Virginia Legislature
Post Audit Division
Building 1, Room W-329
Charleston, West Virginia 25305

RE: Agency Response of the West Virginia Economic Development Authority $25 Million Loan Program Authorized by West Virginia Code §12-6-9e(f)

Dear Director Robinson:

On behalf of the West Virginia Economic Development Authority ("WVEDA"), thank you for the opportunity to provide an agency response to the Post Audit Division's report described above. As you know, in 2002 the West Virginia Legislature authorized WVEDA to execute a $25 million non-recourse promissory note with the West Virginia Board of Treasury Investments ("BTI") pursuant to the provisions of West Virginia Code §12-6-9e(f), as amended. At the time, the goal of this legislation, and the subsequent investment, was to stimulate venture capital financing in the State of West Virginia (the "State"). This collective effort leveraged capacity in excess of $575 million among qualified entities such as Small Business Investment Companies ("SBIC's") that draw upon matching federal dollars. WVEDA placed these investments with SBIC's, traditional venture funds and pre-seed entities in order to broaden the scope of the State's initiative and to maximize the State's overall investment (hereinafter, the "Loan Program").

WVEDA loaned the funds to the West Virginia Enterprise Advancement Corporation ("WVEAC"), a non-profit organization formed to promote economic development through the promotion and development of accessible risk capital. To further these objectives, and as required by law, WVEAC invested in and is the 100% owner of the West Virginia Enterprise Capital Fund, LLC ("WVECF"). WVEAC became the member and fund manager of WVECF in September 2002. WVECF was created pursuant to the West Virginia Venture Capital Act (the "Act"), which was a tax credit program involving the investment and placement of funds with fund managers to be selected by WVEDA based on their expertise and qualifications. As a result, WVECF invested in such venture capital entities as provided for under the Act. The investments involve risks not normally associated with investing, such as equity interests in development stage companies. The risks associated with these investments are affected by many factors such as economic outlook, company ability to raise capital, or building a customer base. Collateral values securing any of the venture capital investments were unknown to WVEDA, or anyone else, at the time because the investments were not readily marketable.

BTI requested an onsite visit to WVEDA in June 2019 to facilitate the close out of the Loan Program at WVEDA's request. WVEDA had source documents for fiscal years 2016 through 2019 on site. All other source documents were maintained offsite at Iron Mountain. WVEDA was not aware that BTI was expecting all source documents over the life of the program to be available to them during the June 2019 visit. Over the life of the Loan Program, BTI was provided WVEDA, WVEAC and WVECF audited financial statements upon completion of annual year end audits for the years 2000 through 2016. BTI also had access to all source documents over the life of the Loan Program. Additionally, WVEDA staff provided BTI with quarterly activity and valuation reports. BTI accepted audited financial statements and quarterly activity and valuation reports throughout the life of the Loan Program and did not request supporting source documents at any time.

Issue 1: The Economic Development Authority Did Not Maintain Adequate Records nor Did It Utilize an Accounting System Sufficient for Documenting Transactions of the $25 Million Loan Program as Required by W.Va. Code §5A-8-9.

- **The EDA did not utilize an accounting system capable of adequately and efficiently documenting the transactions for the $25 million Loan Program, nor did the EDA effectively generate and maintain hardcopy source records.**

Current leadership and staff at WVEDA were not employed at the inception of the Program. Management and staff involved with the inception of the Loan Program have either retired from WVEDA or left state government. While we do not know management's reasoning in 2000 for not purchasing accounting software, management at the time may have thought the cost of the software to process a limited number of transactions was not justified. WVEDA processed a total of 770 transactions over the life of the program (approximately 45 transactions per year or 3.75 per month).

WVEDA has software capable of processing traditional WVEDA loan programs, expenses and revenues, but the existing accounting software did not have the capability of booking and tracking venture capital investments (which was the intended use of the loan funds). Accounting staff at the time did use Microsoft Excel to create general journal posting, adjusting journal entries and trial balances and these source documents were audited annually. The use of Microsoft Excel to account for approximately 3.75 monthly transactions for the Loan Program was considered acceptable by our external independent auditors at the time and all transactions were properly recorded and audited throughout the life of the Loan Program. It it is worth noting, however, that WVEDA purchased a new accounting software to replace GMS in fiscal year 2020.

- **The EDA was unable to locate two years of supporting source documents and general records for Loan Program transactions.**

Of the 14 years of source documents, WVEDA provided source documents for 12 years but was unable to find source documents for fiscal years 2011 and 2012. Per the WVEDA Record Retention Policy, the retention period for Accounting and Finance documents are seven (7) years. The exceptions to this policy are Annual Audit Reports and Financial Statements which the agency retains permanently. The source documents for fiscal years 2011 and 2012 that WVEDA was unable to locate were outside of the seven-year retention requirement.

- **The EDA paid various audit and accounting fees for the Loan Program with non-program funds and then booked the expenses as accounts payable for the WVEAC. However, the EDA allowed the account to accrue from 2002 to 2015 before the $59,713 balance was eventually settled in 2020.**

The current WVEDA staff cannot explain why the Executive Director at the time (who is now retired) did not pay the outstanding expenses in a timely manner. Upon his retirement and at the recommendation of WVEDA's Accountant, the agency promptly collected the expenses.

Issue 2: Due to the Limited Return on Investments, the EDA was Unable to Repay the BTI $24,325,778 in Loan Principal According to the Provisions Established by W. Va. Code §12-6-9e(f). Additionally, the EDA Did Not Maintain Adequate Data Regarding Industry and Job Development the Loan Program was Intended to Bolster, Making the Outcome of the $25 Million Loan Program Unclear.

- **Due to the EDA not collecting the proper data specific to the $25 million Loan Program the Legislative Auditor was unable to quantify the jobs and businesses created or retained within the state resulting from the Loan Program.**

The WVECF was one of many investors that subscribed to seven Venture Capital ("VC") companies. The WVECF committed $24,750,000 to the seven VC companies who raised a combined $190,397,222 in capital. Each VC company made investment decisions and requested capital calls from all investors. Capital calls were not solely funded by WVECF. WVECF was legally bound by a Subscription Agreement to fund capital calls when requested.

During the life of the Loan Program, WVECF monitored the seven VC companies' investment activity and identified investments in West Virginia companies.

Once an investment in a West Virginia company was identified, WVECF would track the investment and request job creation and/or job retention data from VC companies for each investment. Based on the data collected over the life of the program, five VC Companies invested $41 million in 25 West Virginia- based companies, resulting in the creation or retention of 409 jobs.

- **All investments made by the EDA in venture capital companies as a part of the $25 million Loan Program have been written down to $0 and four of the seven venture capital companies entered into a receivership before the conclusion of the program.**

All VC companies provided audited financial statements annually and most provided quarterly internally prepared financial statements. WVEDA staff reviewed the financial information and made recommendations to write-up or write-down the value of each VC investment based on each VC company's performance. WVEDA made consistent and timely recommendations to write-up or write-down investments as appropriate throughout the life of the Loan Program. Quarterly valuations of investments were audited annually by an external independent auditor and the information was reported to BTI on a quarterly basis.

Four of the VC companies ("Partnerships") were designated as SBICs under 301(c) of the Small Business Investment Act of 1958, 15 U. S. C. §661, as amended, which draw upon matching federal dollars. SBICs are private investment funds which are licensed and regulated by the United States Small Business Administration ("SBA") and participated in similar federal programs where the SBIC was required to make qualified investments in small businesses. As a result, SBICs are specifically listed as a type of entity which could serve as a Fund Manager under the Act's regulations. Due to their status as licensed and regulated SBICs, the Partnerships were required to comply with certain conditions and covenants imposed by the SBA. One of the conditions was that the Partnership did not have a condition defined as "capital impairment."

The SBA, under section 13 CFR Section 108.1810(g) of the SBA regulations, has the right to impose certain remedies for capital impairment including: 1) declare the entire indebtedness, including accrued interest, immediately due, 2) prohibition against future investments unless approved in advance by the SBA, 3) prohibitions on distributions to anyone other the SBA, and 4) to review and re-determine the approved management expenses. In the event a Partnership triggered "capital impairment", the SBA would place the Partnership in Restricted Operations and subsequently transfer the Partnership to SBA's Office of Liquidations. When a transfer to the SBA's Office of Liquidation occurred, staff made the recommendation to write-down the WVECF investment to zero dollars ($0).

Recommendations

1.1 The Legislative Auditor recommends the EDA comply with W. Va. Code §5A-8–9, by maintaining adequate and proper documentation of the organization,

functions, policies, decisions, procedures, and essential transactions of the agency. Further, when warranted, the Legislative Auditor recommends the EDA utilize an accounting system that is adequate to account for the financial activities of programs it operates such as the Loan Program discussed in this report. Should additional funding be needed to do so, the EDA should communicate such needs to the Legislature and request the necessary funding.

Please refer to the agency's Management Response for Report Highlights: Issue 1 above.

1.2 The Legislative Auditor recommends the EDA comply with best business practice and pay expenses within a reasonable timeframe from when they are incurred.

WVEDA agrees with this recommendation and does pay expenses on a timely basis.

2.1 The Legislative Auditor recommends the Legislature provide clear and concise statutory guidance to agencies regarding the expected outcomes of a program and guidelines to administer and monitor investments made with state funds for all programs similar to the one authorized by WV Code §12-6-9e(f) that may be established in the future.

WVEDA agrees with this recommendation.

Again, thank you for your cooperation and solicitation of the agency's input on this report. If you have any further questions or comments, please contact me at any time.

Respectfully submitted,

Caren Wilcher

Caren Wilcher
Associate Director

cc: Ed Gaunch, Cabinet Secretary, West Virginia Department of Commerce
Michael Graney, Executive Director, West Virginia Development Office

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