

CONNECTICUT BIOSCIENCE INNOVATION FUND
(A Fund of the State of Connecticut)

Financial Statements

Fiscal Years Ended June 30, 2018 And 2017

CONNECTICUT BIOSCIENCE INNOVATION FUND

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JUNE 30, 2018 AND 2017

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors
Connecticut Bioscience Innovation Fund

Report on the Financial Statements

We have audited the accompanying financial statements of the Connecticut Bioscience Innovation Fund (CBIF) (a fund of the State of Connecticut), as of June 30, 2018 and 2017 and for the years then ended, and the related notes to the financial statements, which collectively comprise CBIF's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United State of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the CBIF's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of CBIF's internal control.

Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of CBIF, as of June 30, 2018 and 2017, and the respective changes in financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Management has omitted Management's Discussion and Analysis that accounting principles generally accepted in the United States of America requires to be presented to supplement the basic financial statements. Such missing information, although not a required part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. Our opinion on the basic financial statements is not affected by this missing information.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated February 4, 2019 on our consideration of the CBIF's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering CBIF's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Whittlesey PC". The signature is written in a cursive, flowing style.

Hartford, Connecticut
February 4, 2019

CONNECTICUT BIOSCIENCE INNOVATION FUND

Statements Of Net Position

JUNE 30, 2018 AND 2017

| | 2018 | 2017 |
|--|----------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Due from Connecticut Innovations, Incorporated | \$ - | \$ 9,682,324 |
| Total Current Assets | <u>-</u> | <u>9,682,324</u> |
| Noncurrent Assets | | |
| Portfolio investments | 24,053,185 | 8,645,072 |
| Total Noncurrent Assets | <u>24,053,185</u> | <u>8,645,072</u> |
| Total Assets | <u>\$ 24,053,185</u> | <u>\$ 18,327,396</u> |
| Liabilities | | |
| Due to Connecticut Innovations, Incorporated | \$ 613,189 | \$ - |
| Deferred interest income | 229,980 | 124,072 |
| Total Liabilities | <u>843,169</u> | <u>124,072</u> |
| Net Position | | |
| Restricted for Bioscience Programs | 23,210,016 | 18,203,324 |
| Total Net Position | <u>23,210,016</u> | <u>18,203,324</u> |
| Total Liabilities and Net Position | <u>\$ 24,053,185</u> | <u>\$ 18,327,396</u> |

The accompanying notes are an integral part of these financial statements.

CONNECTICUT BIOSCIENCE INNOVATION FUND

Statements Of Revenues, Expenses And Changes In Net Position

For The Years Ended June 30, 2018 And 2017

| | 2018 | 2017 |
|--|----------------------|----------------------|
| Operating Revenue | | |
| Connecticut Public Act 13-239 | \$ 14,500,000 | \$ 15,000,000 |
| Realized and unrealized loss on investments, net | (2,404,699) | (2,155,093) |
| Interest income | 16,865 | 58,127 |
| Total Operating Revenue | <u>12,112,166</u> | <u>12,903,034</u> |
| Operating Expenses | | |
| Grants | 6,380,474 | 5,007,048 |
| Administrative fee | 725,000 | 750,000 |
| Other expense | - | 38,918 |
| Total Operating Expenses | <u>7,105,474</u> | <u>5,795,966</u> |
| Change in Net Position | 5,006,692 | 7,107,068 |
| Net Position - Beginning of period | <u>18,203,324</u> | <u>11,096,256</u> |
| Net Position - End of period | <u>\$ 23,210,016</u> | <u>\$ 18,203,324</u> |

The accompanying notes are an integral part of these financial statements.

CONNECTICUT BIOSCIENCE INNOVATION FUND

Statements Of Cash Flows

For The Years Ended June 30, 2018 And 2017

| | 2018 | 2017 |
|---|------------------------|-------------------|
| Cash Flows from Operating Activities | | |
| Connecticut Public Act 13-239 | \$ 14,500,000 | \$ 15,000,000 |
| Purchase of investments | (18,206,904) | (8,863,066) |
| Grants disbursed | (6,380,474) | (5,007,048) |
| Administrative fees | (725,000) | (750,000) |
| Interest income | 16,865 | 58,127 |
| Return of principal on investments | 500,000 | 1,600 |
| | <u>(10,295,513)</u> | <u>439,613</u> |
| Net Cash (used in) provided by Operating Activities | | |
| Cash Flows from Financing Activities | | |
| Funding transferred from (to) | | |
| Connecticut Innovations, Incorporated | 10,295,513 | (439,613) |
| | <u>10,295,513</u> | <u>(439,613)</u> |
| Net Cash Provided by (Used in) Financing Activities | | |
| | <u>-</u> | <u>-</u> |
| Net Change in Cash and Cash Equivalents | | |
| | <u>-</u> | <u>-</u> |
| Cash and Cash Equivalents - Beginning | <u>-</u> | <u>-</u> |
| Cash and Cash Equivalents - Ending | <u>\$ -</u> | <u>\$ -</u> |
| Reconciliation of Operating Income to Net Cash From Operating Activities | | |
| Operating income | \$ 5,006,692 | \$ 7,107,068 |
| Write-off of interest conversion | - | 38,918 |
| Unrealized loss on investments | 2,404,699 | 2,155,093 |
| Return of principal on investments | 500,000 | 1,600 |
| Purchase of investments | (18,206,904) | (8,863,066) |
| | <u>\$ (10,295,513)</u> | <u>\$ 439,613</u> |
| Net Cash (Used in) Provided by Operating Activities | | |

The accompanying notes are an integral part of these financial statements.

CONNECTICUT BIOSCIENCE INNOVATION FUND

Notes To Financial Statements

For The Years Ended June 30, 2018 And 2017

NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS

On July 1, 2013, the State of Connecticut passed Public Act 13-239 (the Act) creating the Connecticut Bioscience Innovation Fund (CBIF or the Fund). CBIF was established to finance projects to improve the delivery of health care services, lower health care costs, and directly or indirectly create bioscience jobs. The projects can involve improvements or developments in services, therapeutics, diagnostics, and devices in pharmaceuticals, bioscience, biomedical engineering, medical care, medical devices, medical diagnostics, personalized medicine, health information management, and other related disciplines.

The legislation created a thirteen-member Bioscience Innovation Advisory Committee (the Committee) to administer CBIF's affairs. The Committee is comprised of four persons appointed by the Governor of Connecticut, one appointed by the president pro tempore of the Connecticut State Senate (Senate), one appointed by the speaker of the Connecticut House of Representatives (House), one appointed by the majority leader of the Senate, one appointed by the minority leader of the Senate, one appointed by the minority leader of the House, the Commissioner of Economic and Community Development and the Commissioner of Public Health (or their designees), and the chief executive officer and executive director of Connecticut Innovations, Incorporated (CII).

Nonprofit corporations, accredited colleges and universities, and for-profit start-up or early-stage businesses can propose projects. Early stage businesses are those that have been operating for no more than three years and are developing or testing a product or service that is not yet available for commercial release or available only in a limited manner, including clinical trials or market testing of prototypes.

CBIF can provide assistance in the form of grants, equity investments, and secured convertible loans. Eligible recipients can use this assistance to pay for facilities; necessary furniture, fixtures, and equipment; materials and supplies; peer reviews; proof of concept or relevance; compensation; and other costs the advisory committee approves (see below).

Connecticut Innovations, Inc. (CII), a related party, is a separate component unit of the State of Connecticut. CII is charged with managing the Funds' assets; and, on-behalf of CBIF, provides financial assistance to eligible recipients; and prepare the Funds' annual plan, budget, and report. By law, unchanged by the act, CII will provide different types of financial assistance, including equity investments to businesses developing a wide range of technology-based products, techniques, and services.

NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

BOND AUTHORIZATIONS

The Act capitalizes the Fund by authorizing up to \$204 million in state general obligation bonds, as shown below. Any issuance costs and capitalized interest may be added to the annual authorizations. If the Committee does not use all or part of the maximum amount in a fiscal year, that amount is added to the following year’s authorization. Authorizations according to the Act are as follows:

For the year ending June 30,

| | |
|------|--------------------|
| 2013 | 10,000,000 |
| 2014 | 10,000,000 |
| 2015 | 15,000,000 |
| 2016 | 15,000,000 |
| 2017 | - |
| 2018 | 15,000,000 |
| 2019 | 15,000,000 |
| 2020 | 25,000,000 |
| 2021 | 25,000,000 |
| 2022 | 25,000,000 |
| 2023 | 25,000,000 |
| 2024 | <u>24,000,000</u> |
| | <u>204,000,000</u> |

At June 30, 2018 \$154,500,000 of bond funding remained available to be drawn by CBIF.

BOND COMMISSION APPROVAL

The act requires CII to enter into a memorandum of understanding (MOU) with the Office of Policy and Management (OPM) secretary and state treasurer regarding the bond issuance, including the extent to which federal, private, and other available funds should be added to the bond proceeds. The bond commission must approve the MOU, which satisfies the standard approval requirements under the State General Obligation Bond Procedure Act. The Act deems the principal amount of the authorized bonds to be an appropriation and allocation of the bond amounts. The bonds are subject to standard statutory conditions. Funds are not recorded as operating revenue under CT Public Act 13-239 until they have been requested and approved by the State of Connecticut for disbursement.

CII’S FUND ADMINISTRATION DUTIES

Besides managing CBIF’s assets and providing financial assistance, CII also provides staff, office space, systems, and administrative support needed to do so. In administering the fund, CII may use any of its statutory powers as the state’s venture capital and technology innovation arm (e.g., enter into agreements providing financial assistance for marketing new and innovative services based on the use of specific technologies, products, techniques, services, or processes).

NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Beginning January 1, 2014, CII must prepare, on behalf of CBIF, an annual operations plan and operating and capital budgets for each fiscal year. It must submit these documents to the Committee for review and approval no later than 90 days before the fiscal year begins.

CII is allowed to recover its administrative costs from the Fund's assets (5% of each amount paid to CBIF by the State of Connecticut). In addition CII will receive all interest repayments, income, and earnings or return on investment realized in excess of original cost.

BASIS OF PRESENTATION

These financial statements are reported using the economic resources measurement focus and accrual basis of accounting. Revenues are recognized when earned, and expenses are recognized when the liability is incurred, regardless of the timing of the related cash flows.

USE OF ESTIMATES

Management uses estimates and assumptions in preparing these financial statements in accordance with accounting principles generally accepted in the United States of America. Those estimates and assumptions affect certain reported amounts and disclosures in the financial statements. Actual results could vary from the estimates that were used.

OPERATING VS. NON-OPERATING REVENUE (EXPENSE)

All entities distinguish between operating revenues and expenses from non-operating revenues and expenses. Operating revenues consist of funding received from the State of Connecticut for CBIF's intended purpose of assisting in the growth of bioscience programs. Operating expenses consist of those expenses allowed in accordance with the legislation establishing CBIF. Non-operating revenues and expenses consist of items determined by management to not directly relate to its operations.

USE OF RESTRICTED VS. NON-RESTRICTED RESOURCES

When both restricted and unrestricted amounts are available for use, the policy is to use restricted resources for their intended purposes first and then unrestricted resources.

PORTFOLIO INVESTMENTS, VALUATIONS, AND GRANTS

As set forth in the statutes, CBIF assistance can be provided through grants, equity investments, and secured convertible loans. At June 30, 2018, CBIF's portfolio investments consisted of twelve convertible loans and twenty-three equity investments. At June 30, 2017, CBIF held thirteen convertible loans and seven equity investments.

All of CBIF's investments are uninsured, unregistered and held by CBIF in CBIF's name. Investments in the form of debt instruments are secured by the underlying assets and intellectual property of the borrower and bear interest at rates ranging from 7% to 20% per annum. The debt instruments provide for a maximum borrowing amount, with funding provided in tranches, based on the borrower meeting certain milestones determined on a case-by-case basis.

For June 30, 2018, CBIF approved six debt financing investments totaling \$3,650,000 with \$1,875,000 of approved investments funded. \$2,921,612 remains to be funded based on the terms of the individual debt instruments. For June 30, 2017, CBIF approved ten debt financing investments totaling \$4,750,000 with \$4,613,065 of approved investments funded and \$1,146,612 remaining to be funded based on the terms of the individual debt instruments.

NOTE 1 – NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

For June 30, 2018, CBIF approved eighteen equity investments totaling \$18,164,838 with \$16,331,904 of approved investments funded. \$5,082,934 remains to be funded based on the terms sheets for the equity investments. For June 30, 2017, CBIF approved eight equity investments totaling \$7,500,000 with \$4,250,000 of approved investments funded. \$3,250,000 remains to be funded based on the terms sheets for the equity investments.

CBIF values all investments with readily determinable market value at fair value but never greater than original cost, any return on investment realized in excess of original cost is deemed unrestricted funds of CII as administrator. Fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Fair value, for other than publicly traded securities, is determined by an independent valuation committee for the Corporation using United States Private Equity Valuation Guidelines promulgated by the Private Equity Investment Guidelines Group (PEIGG). Consideration is given to pertinent information about the companies comprising these investments, including, but not limited to, recent sales and purchase prices of the issuer's securities, sales growth, progress toward business goals and other operating data. The CBIF has applied procedures in arriving at the estimate of the value of such securities that it believes are reasonable and appropriate.

CBIF grants provide for a maximum grant amount, with funding to be provided in tranches, based on the grantee meeting certain milestones determined on a case-by-case basis. For June 30, 2018, five grants totaling \$3,507,904 were approved by CBIF, \$6,380,474 of previously approved grants were funded and \$1,117,507 remained to be funded based on the terms of the original grant agreements. If the grantee does not meet the performance requirements, unfunded amounts will not be earned and therefore not paid by CBIF.

At June 30, 2017, no new grants were approved by CBIF, \$5,007,049 of previously approved grants were funded and \$3,990,077 remained to be funded based on the terms of the original grant agreements.

SUBSEQUENT EVENTS

Management has evaluated subsequent events through February 4, 2019, the date which the financial statements were available to be issued. No events requiring recognition or disclosure in the financial statements have been identified.

NOTE 2 – DUE TO/FROM CONNECTICUT INNOVATIONS INCORPORATED

In 2018 the State of Connecticut transferred \$14,500,000 into a CII bank account on behalf of CBIF for which CI deducted \$725,000 for administrative costs, as allowed by legislation, and then disbursed the funds to make investments and grants. Connecticut Innovations also funded \$613,189 of a Strategic Grant on behalf of CBIF in 2018 which will be reimbursed from State of Connecticut transfers in 2019. In 2017 the State of Connecticut transferred \$15,000,000 into a CII bank account on behalf of CBIF. CII deducted \$750,000 for administrative costs, as allowed by the legislation, disbursed funds to make investments and grants and held onto the balance of these funds as administrator of CBIF.

Due to Connecticut Innovations, Incorporated of \$613,189 as shown on the statements of net position on June 30, 2018, represents the amount due from CBIF to CI for the funding of a Strategic Grant which will be reimbursed by CBIF to CI in 2019. Due from Connecticut Innovations of \$9,682,324 on June 30, 2017 represents cash held for CBIF by CII as administrator. These amounts are legally held in separate bank accounts and restricted by CII, for CBIF use only. Cash activity related to the separate bank accounts are shown in the accompanying statements of cash flows.

NOTE 3 – FAIR VALUE MEASUREMENTS

The framework for measuring fair value provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. Fair value for CBIF’s investments, is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy under Financial Accounting Standards Board Accounting Standards Codification 820 are described as follows:

Level 1 Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Fund has the ability to access.

Level 2 Inputs to the valuation methodology include:

- quoted prices for similar assets and liabilities in active markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

Level 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2018.

- CBIF’s investments in public companies are valued at the closing price recorded on the active market on which the individual securities are traded and are categorized as Level 1. CBIF values all investments with readily determinable market value at fair value but never greater than original cost, any return on investment realized in excess of original cost shall be deemed unrestricted funds of CII as administrator.
- Fair value, for non-publicly traded securities, is determined by an independent valuation committee for the Fund using United States Private Equity Valuation Guidelines promulgated by the Private Equity Investment Guidelines Group (“PEIGG”) and are categorized as Level 3. The Fund has applied procedures in arriving at the estimate of the value of such securities that it believes are reasonable and appropriate. The following is a break-out of investments by level as of June 30, 2018:

| <u>Portfolio Investments Type</u> | <u>Level 1</u> | <u>Level 2</u> | <u>Level 3</u> | <u>TOTAL</u> |
|-----------------------------------|----------------|----------------|----------------------|----------------------|
| <u>Equity</u> | \$ - | \$ - | \$ 19,584,226 | \$ 19,584,226 |
| <u>Debt</u> | - | - | 4,468,959 | 4,468,959 |
| | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 24,053,185</u> | <u>\$ 24,053,185</u> |

**REPORT ON INTERNAL CONTROL OVER FINANCIAL
REPORTING AND ON COMPLIANCE AND OTHER MATTERS
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS***

To the Board of Directors
Connecticut Bioscience Innovation Fund

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Connecticut Bioscience Innovation Fund (CBIF) (a fund of the State of Connecticut) as of June 30, 2018 and for the year then ended, and the related notes to the financial statements, which collectively comprise CBIF's basic financial statements, and have issued our report thereon dated February 4, 2019

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered CBIF's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of CBIF's internal control. Accordingly, we do not express an opinion on the effectiveness CBIF's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether CBIF's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

A handwritten signature in black ink that reads "Whittlesey PC". The signature is written in a cursive, flowing style.

Hartford, Connecticut
February 4, 2019