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**INDEPENDENT STATE AUDITOR'S REPORT ON
CERTAIN ACTIVITIES OF THE
MASSACHUSETTS TECHNOLOGY
DEVELOPMENT CORPORATION
JULY 1, 2008 TO SEPTEMBER 30, 2009**

**OFFICIAL AUDIT
REPORT
JULY 27, 2010**

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Chapter 497 of the Acts of 1978 established the Massachusetts Technology Development Corporation (MTDC), whose goal is to provide financial and other assistance to technology and start-up companies that have the potential to expand and generate new jobs and tax revenue. In calendar year 1992, legislation was passed to modify MTDC's charter to enable it access to more private investment capital to better fulfill its mission of assisting the start-up and early expansion of technology companies in the Commonwealth. Although MTDC was initially funded by federal and state sources, its investments have allowed it to self-finance its operations since fiscal year 1988. MTDC is governed by an 11-member Board of Directors, eight of whom are appointed by the Governor from the private sector, and three of whom are public officials. From its inception through December 2008, MTDC has reported investing over \$73 million in 126 companies that collectively have employed over 12,000 people.

In accordance with Chapter 11, Section 12, of the Massachusetts General Laws, we conducted an audit of certain activities of MTDC for the period July 1, 2008 to September 30, 2009. Our review was conducted to determine whether MTDC's internal controls over administrative costs and expenses were adequate and whether MTDC's venture capital investments met MTDC's stated investment criteria.

Our review indicated that, except as noted in the Audit Results section of this report, MTDC had adequate internal controls over its administrative costs and investment practices and has complied with applicable laws, rules, and regulations for the areas tested.

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Due to the possibility of inaccurate and untimely job data information received from its annual questionnaire of its venture capital companies, MTDC may be overestimating the actual number of jobs that have been created as a result of its investment activities. Moreover, MTDC does not verify the employment information received from respondents on this questionnaire, and some companies fail to respond at all. In order to improve the accuracy of its jobs data, MTDC should obtain summary data of the quarterly employment reports submitted by each of its investment companies from the Massachusetts Department of Revenue to verify the accuracy of the employment information that is received via the annual questionnaires to more accurately measure the effectiveness of its investments in creating jobs.

INTRODUCTION

Background

Chapter 497 of the Acts of 1978 established the Massachusetts Technology Development Corporation (MTDC), whose goal is to provide financial and other assistance to technology and start-up companies that have the potential to expand and generate new jobs and tax revenue. In calendar year 1992, legislation was passed to modify MTDC's charter to enable access to more private investment capital to better fulfill its mission of assisting the start-up and early expansion of technology companies in the Commonwealth. Although MTDC was initially funded by federal and state sources, its investments have allowed it to self-finance its operations since fiscal year 1988. MTDC is governed by an 11-member Board of Directors, eight of whom are appointed by the Governor from the private sector, and three of whom are public officials. From its inception in 1978 through December 2008, MTDC has reported investing over \$73 million in 126 companies that collectively have employed over 12,000 people.

MTDC's initial capital came from the Economic Development Administration of the United States Department of Commerce, net of start-up costs (\$2,972,000), and from the Commonwealth of Massachusetts (\$5,200,000). The Commonwealth appropriated \$5,000,000 to MTDC in fiscal year 2004 and an additional \$2,500,000 to MTDC's investment fund (\$2,250,000 for fiscal year 2007 and \$250,000 for fiscal year 2008), bringing the cumulative amount of its appropriations to \$12,700,000 at June 30, 2008. MTDC, however, uses gains realized from past investments as the primary source of funds for further investments. The following summarizes MTDC's cumulative capital sources as of June 30, 2008.

Economic Development Administration of the US Department of Commerce, Net of Start-up Costs	\$ 2,972,000
Commonwealth of Massachusetts	12,700,000
Realized Gains on Sales of Equity Securities Allocated to General Support Fund	\$ 60,846,138
Portion of Gains Used for General Support Activities	<u>(24,147,514)</u>
Transfers to the Restricted for Investment Programs Funds	<u>36,698,624</u>
Total Funds Available for Investment	\$52,370,624
Realized Losses of Investments	(28,254,323)
Distributions to U.S. Department of Commerce	(407,839)
Unrealized Gains/Loss on Investments	<u>(1,631,477)</u>
Restricted for Investment Programs Fund Balance	<u>\$22,076,985</u>

In addition to the amounts available for investment as shown in the above schedule, MTDC manages two investment pools composed of funds from MTDC and private co-investors. The investment vehicle, known as the Commonwealth Fund, has two components: Program I and Program II. By law, the investment criteria for capital managed under the Commonwealth Fund is less restrictive than those of MTDC's traditional programs. For example, the investment criteria for capital managed under the Commonwealth Fund would allow MTDC to participate in additional investments in companies that may have adequate private capital, rather than justifying the investment based upon the company's need for capital. As of June 30, 2008, each program had two co-investors who contributed a total of \$2 million to Program I and \$3 million to Program II. MTDC's cumulative capital contributions to the two programs total \$12,700,000, and the balance of the two programs is included in the "Restricted for Investment Programs Fund Balance" of \$22,076,985.

Through December 31, 2008, MTDC has exited or begun to exit its investments in 102 of its 126 portfolio companies. After MTDC exits its investments from a portfolio company, it may then use the net investment proceeds to invest in new companies.

Audit Scope, Objectives, and Methodology

Our audit, which covered the period July 1, 2007 to September 30, 2009, was conducted in accordance with applicable generally accepted government auditing standards for performance audits as issued by the Comptroller General of the United States, and included such procedures and tests as we considered necessary to meet those standards. Our audit objectives were to:

- Review and analyze the adequacy of MTDC's internal controls over administrative costs and expenses.
- Examine MTDC's costs and expenses in the areas of travel, conferences, employee use of credit cards, salaries and benefits, consultant payments, and equipment purchases and rentals to determine whether such costs are reasonable, allowable, and in compliance with applicable laws, rules, and regulations.
- Review all venture capital investments made during the audit period to determine whether they were in compliance with MTDC's stated investment criteria and examine the estimated and actual jobs created as a result of MTDC's investments and the monitoring and verification procedures utilized by MTDC to ensure the accuracy of the stated jobs created.

Our methodology included reviewing cash disbursements and related documentation, such as paid invoices, expense reports, board minutes, and payroll and consultant charges. In addition, we reviewed all current MTDC venture capital investment reports and MTDC business and employment questionnaires received from investment companies, and interviewed responsible MTDC officials.

Our review indicated that, except as noted in the Audit Results section of this report, MTDC had adequate internal controls over its administrative costs and investment practices and has complied with applicable laws, rules, and regulations for the areas tested.

AUDIT RESULTS

MTDC NEEDS TO IMPROVE ITS COLLECTION AND VERIFICATION OF MASSACHUSETTS EMPLOYMENT DATA FROM VENTURE CAPITAL INVESTMENT COMPANIES

The principal objective of the Massachusetts Technology Development Corporation (MTDC) Investment Program, including the Commonwealth Fund programs, has been to assist early-stage companies start up or expand in the state by commercializing technology developed in local corporations and research institutions. In order to determine the overall effectiveness of its investments in creating new jobs in the Commonwealth, MTDC sends an annual questionnaire to each of its active and former portfolio companies still operating in Massachusetts. This questionnaire requests that each firm provide the most recent calendar year employment figures for full-time and part-time employment for both in-state and out-of-state workers. These firms are also asked to provide MTDC with their gross payroll W-2 earnings for in-state and out-of-state workers, the taxes withheld for each worker, and Massachusetts unemployment taxes paid for the current year. MTDC then collects, analyzes, and summarizes this data and uses it to measure total employment and job creation from its investments. However, in reviewing the most recent questionnaire results (September 2008) available during our audit, we determined that MTDC needs to improve its data collection and verification process to more accurately determine the actual jobs created in Massachusetts from its investing activities. Specifically, our review of the completed questionnaires revealed that not all companies contacted responded in a timely manner and that some companies did not respond at all. Moreover, MTDC accepted the accuracy of the data provided without verifying this information through other sources such as the Commonwealth's Department of Revenue (DOR).

In calendar year 2008, MTDC mailed questionnaires to 33 of its current and former companies still operating in Massachusetts. As of September 2009, 10 companies, or 30%, have not yet responded to this jobs and earnings questionnaire. If a company fails to respond in a timely manner, MTDC initiates a series of follow-up telephone calls and e-mails to obtain the data; however, if MTDC is still unsuccessful, it takes no further actions.

Moreover, our reviewed noted that MTDC's computation of total jobs created included total employment figures for in-state as well as out-of-state employment reported by these firms. For example, the 18 active companies tracked by MTDC reported total employment of 575 jobs (451 in-state and 124 out-of-state); however, in reporting the jobs created by its investment, MTDC

included all new jobs created by these companies, regardless of the job location. We feel that a more accurate figure to report would be only those jobs created in Massachusetts.

MTDC officials indicated that they recognized the need for improvements to the present system to collect accurate and timely employment data and attributed both delays in the receipt of data and the inability to verify data received with a third party as the principal obstacles to improving its jobs data. Ultimately, these weaknesses in its system of collecting and verifying jobs creation data hinders MTDC's ability to accurately measure its overall effectiveness in creating jobs for Massachusetts residents.

Recommendation

In order to more accurately measure jobs and employment data from its investment companies, MTDC should implement the following corrective actions:

- Each year every company doing business in Massachusetts, on a quarterly basis, is required to provide DOR with a report that records the employer's quarterly wages paid to each of its employees on Form WR-1. We recommend that MTDC establish a link with DOR and request, on a semi-annual basis, a summary report for each of its investment companies' Employer's Quarterly Report of Wages Paid - Form WR-1. This data should be edited by DOR to show only total information for the period (i.e., total employee count, total wages paid, and total withholdings made). This information can then be verified with each company along with other pertinent information that MTDC deems necessary with its annual jobs questionnaire.
- For those companies that fail to cooperate with MTDC requests for annual questionnaire data, MTDC should remind these firms that future applications for investments may be in jeopardy for reporting noncompliance.
- Finally, we recommend that MTDC report on only those jobs created in Massachusetts as the basis for measuring its investment effectiveness.

Auditee's Response

In the second paragraph of page 4, reference is made to the companies that didn't respond to the report. It should be noted that very few, if any, of delinquent responses are from current portfolio companies and that we have no leverage to compel former portfolio companies to respond to the request.

In the last paragraph of page 4, it states that "...in reporting jobs created by its investment, MTDC included all new jobs created by these companies." We feel that a more accurate figure to report would only be those jobs created in Massachusetts. We agree. Most of the data we collect is for our own internal purposes, however, when we do state our economic impact statistics we typically report all information including total

employment, MA employment, MA payroll data and MA state payroll taxes. All of this information is included on our database and is useful in determining the economic impact of our investments. While we agree that the statistics on MA jobs and payroll data are the most relevant to our public purpose, we are unsure what more we can do since we already track and report this data.

Auditor's Reply

We appreciate MTDC's comments regarding the need to more accurately measure jobs created for Massachusetts residents. Ultimately, MTDC's ability to work cooperatively with DOR to obtain the necessary employment data from its current and former portfolio companies will create a more accurate measurement of total in-state jobs that have been created as a result of its investment activities.