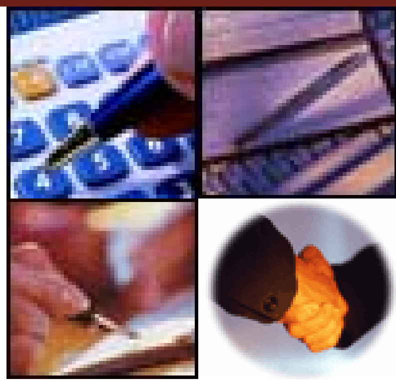
Report Highlights

Department of Economic Development - Financial Assistance Programs

October 2004

Louisiana Legislative Auditor



The Financial Assistance programs are incentive programs designed to encourage businesses to retain, expand or start operations in Louisiana. The primary purpose of the programs is to stimulate the flow of private capital, long-term loans, and other financial assistance for the sound financing of the development, expansion, and retention of small business concerns in Louisiana. Within the Department of Economic Development (DED), the Financial Assistance programs are overseen by the Louisiana Economic Development Corporation (LEDC).

Audit Results

Management Controls

- Consistent collection and verification of required information would help ensure program eligibility and compliance.
- Three sets of rules exist for the Matching Grant program.

Repayment of Loans

- LEDC small business loans are generally repaid according to contract provisions.

Benefit to the State

- LEDC investments in some venture capital programs appear to have contributed a direct benefit to the state by creating or retaining jobs. No evidence was available to show that investments in venture capital programs have indirectly benefited the state through investment returns.

Development of Venture Capital Infrastructure

- LEDC's five investments in the Venture Capital Match program for fiscal years 2002 and 2003 have not contributed to creating a venture capital infrastructure within the state because the venture capital funds LEDC invested in are investing in companies located outside of the state.
- LEDC's eight investments in the Venture Capital Co-Investment program for fiscal years 2002 and 2003 have contributed to creating a venture capital infrastructure within the state by having venture capital funds invest in firms with headquarters or production offices in Louisiana.

Reliability of Reported Data

- Two of the six (33%) Louisiana Performance and Accountability System indicators reported for fiscal year 2003 and the first two quarters of fiscal year 2004 are not reliable.
- Data reported in the DED Annual Report for fiscal year 2002 are not reliable.
- DED aggregates data for the multiple programs within Financial Assistance.

Steve J. Theriot, CPA

Legislative Auditor

Are LEDC's management controls adequate to ensure that administration of the Financial Assistance programs is in accordance with state law and do loans and investments meet applicable program guidelines?

What We Found

- LEDC staff does not always collect and verify all required information from financial assistance applicants before approving loans or investments. Some required information was not collected for 12 (26%) of the 46 contracts approved in fiscal years 2002 and 2003.
- A sufficient background check was not evident for one of 17 (6%) loans in fiscal year 2002 and for one of 14 (7%) loans in fiscal year 2003.
- A completed program application was not available for one of three (33%) investments in fiscal year 2002 and for five of 10 (50%) investments in fiscal year 2003.
- Four of 10 (40%) investments in fiscal year 2003 did not show any evidence that the venture capital fund met LEDC's experience and capital requirements.
- For one of 10 (10%) investments in fiscal year 2003, LEDC invested an amount greater than allowable per program rules.
- Quarterly or annual progress reports were not available for two of three (67%) investments in fiscal year 2002 and for five of 10 (50%) investments in fiscal year 2003.
- In some cases, even though LEDC received all quarterly or annual progress reports, the fair market value of the investment was reported inaccurately.
- One of 10 (10%) investments did not have any activity within fiscal year 2003.
- LEDC staff does not follow promulgated rules for the Matching Grant program to ensure that only qualified applicants will receive benefits.

Recommendations

- ✓ LEDC should ensure that it receives all required documentation before a project is approved and/or funds are disbursed. Before approving an application, the LEDC Board should require a statement from the program administrator or his/her supervisor that the project meets all program requirements.
- ✓ LEDC should ensure that it receives all required documentation for the life of an approved project so that management can effectively monitor program compliance and progress and can accurately value investments.
- ✓ LEDC should ensure that the Matching Grant program rules are formally promulgated in accordance with the Louisiana Administrative Procedures Act.
- ✓ LEDC should ensure that all grants issued under the Matching Grant program are issued in accordance with formally promulgated rules. The rules should clearly identify intended program beneficiaries.

Were small business loans and similar types of assistance repaid according to contract provisions?

What We Found

- LEDC small business loans are generally repaid according to contract provisions. Although it is not stated in the program rules, LEDC's goal is to write off no more than 5% of the outstanding loan amounts at the end of each fiscal year. The 5% goal was adopted from banking industry standards.

Recommendation

- ✓ LEDC should consider adopting the 5% benchmark as part of its documented program rules for the Small Business Loan program. LEDC should continue using its current procedures to ensure that loans and similar types of assistance are repaid according to contract provisions.

Have investments directly or indirectly benefited state economic development by creating or retaining jobs or by funding projects that create a benefit?

What We found

- Less than half of the LEDC investments, six of 13 (46%), through the Venture Capital Match and Co-Investment programs indicate that jobs have been created or retained. Also, there is no clear evidence that these programs have indirectly benefited state economic development.

Recommendations

- ✓ LEDC should consider adopting program rules for the Venture Capital programs that mirror state law to ensure it provides high levels of employment and income growth to the state.
- ✓ LEDC should require, as a condition of its investment, venture capital funds to invest its funds in Louisiana companies.
- ✓ LEDC should maintain its current interest in the venture capital funds until the investments mature, in year six, and at that time evaluate whether or not it should hold or sell its interest in the venture capital funds.

Have venture capital investments created an infrastructure of venture capital in the state?

What We found

- LEDC's five investments from the Venture Capital Match program in fiscal years 2002 and 2003 have not created a venture capital infrastructure within the state (see following table). All of these venture capital funds have invested in companies located outside the state. However, the eight investments from the Venture Capital Co-Investment program in fiscal years 2002 and 2003 have created a venture capital infrastructure in Louisiana. These venture capital funds have invested in companies with headquarters or production offices in Louisiana.

Fiscal Year	Investment	Investment Amount
2002	1	$5,000,000
2003	2	$5,000,000
2003	3	$5,000,000
2003	4	$1,000,000
2003	5	$100,000
Total		**$16,100,000**

Recommendations

- ✓ LEDC should only invest in venture capital funds that will actively invest in Louisiana and/or open actual production offices that will help create a venture capital infrastructure and will benefit Louisiana economic development.
- ✓ LEDC should continue co-investments with venture capital funds to hedge the amount of funds used by the state to stimulate economic development while fostering a venture capital infrastructure.

Are the performance data reported externally for the Financial Assistance programs by DED for fiscal years 2002, 2003 and the first two quarters of 2004 reliable?

What We found

- Two of the six (33%) LaPAS indicators reported in fiscal year 2003 and the first two quarters of fiscal year 2004 are not reliable.
- The data reported in the DED Annual Report for fiscal year 2002 are not reliable.
- DED reports aggregate data for multiple Financial Assistance programs.

Recommendations

- ✓ Although the creation and/or retention of jobs is not a requirement of any Financial Assistance program, DED should include the word "Estimated" or "Anticipated" when reporting on the number of jobs as a performance indicator.
- ✓ DED staff should verify that all performance indicators are accurate and reliable. DED management should review and approve all performance indicators before reporting them to ensure accuracy and reliability.
- ✓ DED should disaggregate its performance data by program to more clearly show the effectiveness and use of its various economic development programs.

Matter for Legislative Consideration

The legislature should consider directing legislative staff to work with DED to develop performance indicators that will report only actual performance (e.g., actual jobs created) and not allow any performance indicators that will require estimates.

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LEGISLATIVE AUDITOR

STATE OF LOUISIANA

DEPARTMENT OF ECONOMIC DEVELOPMENT
FINANCIAL ASSISTANCE PROGRAMS

PERFORMANCE AUDIT
ISSUED OCTOBER 13, 2004

LEGISLATIVE AUDITOR
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October 13, 2004

The Honorable Donald E. Hines,
President of the Senate
The Honorable Joe R. Salter,
Speaker of the House of Representatives

Dear Senator Hines and Representative Salter:

This report provides the results of our performance audit of the Financial Assistance Programs administered by the Department of Economic Development and the Louisiana Economic Development Corporation. This audit was conducted under the provisions of Louisiana Revised Statute 51:935.1, as amended.

This report contains our findings, conclusions, and recommendations. Appendix D contains management's response. I hope this report will benefit you in your legislative decision-making process.

Sincerely,

Steve J. Theriot, CPA
Legislative Auditor

SJT/ss

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EXECUTIVE SUMMARY

The Louisiana Economic Development Corporation (LEDC) and the Department of Economic Development (DED) administer seven Financial Assistance programs. During fiscal years 2002 and 2003, only four of these programs had activity--Small Business Loan, Venture Capital Co-Investment, Venture Capital Match, and Matching Grant. We reviewed all contracts for these programs for both fiscal years. Our findings are summarized below.

Performance Audit Findings

Management Controls

- Consistent collection and verification of required information would help ensure program eligibility and compliance. *See pages 9-11.*
- Three sets of rules exist for the Matching Grant program. *See pages 11-12.*

Repayment of Loans

- LEDC small business loans are generally repaid according to contract provisions. *See page 13.*

Benefit to the State

- LEDC investments in some venture capital programs appear to have contributed a direct benefit to the state by creating or retaining jobs. No evidence was available to show that investments in venture capital programs have indirectly benefited the state through investment returns. *See pages 15-18.*

Development of Venture Capital Infrastructure

- LEDC's five investments in the Venture Capital Match program for fiscal years 2002 and 2003 have not contributed to creating a venture capital infrastructure within the state because the venture capital funds LEDC invested in are investing in companies located outside of the state. *See pages 19-20.*
- LEDC's eight investments in the Venture Capital Co-Investment program for fiscal years 2002 and 2003 have contributed to creating a venture capital infrastructure within the state by having venture capital funds invest in firms with headquarters or production offices in Louisiana. *See page 21.*

Reliability of Reported Data

- Two of the six (33%) Louisiana Performance and Accountability System indicators reported for fiscal year 2003 and the first two quarters of fiscal year 2004 are not reliable. *See page 23.*
- Data reported in the DED Annual Report for fiscal year 2002 are not reliable. *See page 24.*
- DED aggregates data for the multiple programs within Financial Assistance. *See page 25.*

Legislative Auditor
339-3800

AUDIT INITIATION AND INTRODUCTION

Audit Initiation and Objectives

Louisiana Revised Statute (R.S.) 51:935.1 requires the Office of Legislative Auditor (OLA) annually to conduct performance audits designed to evaluate the management controls, accuracy, and reliability of the reported information on at least three economic development programs. These audits commenced in fiscal year 2004 and will continue in subsequent years. According to R.S. 51:935.1, OLA selects the programs for review; the Financial Assistance programs have been selected for the 2004 review period. At its July 30, 2003, meeting, the Legislative Audit Advisory Council approved economic development program audits as part of our plan for fiscal year 2004.

Our audit objectives were as follows:

1. Are the management controls for the Financial Assistance programs adequate to ensure that LEDC's administration of the programs is in accordance with state law? Specifically, do LEDC's management controls ensure that loans and other investments meet the applicable program guidelines?

2. Were small business loans and similar types of assistance repaid according to contract provisions?

3. Have investments directly or indirectly benefited state economic development by creating or retaining jobs or by funding projects that create a benefit?

4. Have venture capital investments created an infrastructure of venture capital in the state?

5. Are the performance data reported externally by DED for the Financial Assistance programs for fiscal years 2002, 2003, and the first two quarters of 2004 reliable?

Overview of the Financial Assistance Programs

The Louisiana Economic Development Corporation (LEDC) oversees many Financial Assistance programs. R.S. 51:2312 created LEDC within the Department of Economic Development (DED) in 1988. LEDC is the one reviewer and administrator for all Financial Assistance programs. The Financial Assistance programs are incentive programs designed to encourage businesses to retain, expand or start operations in the state. The primary purpose of the programs is to stimulate the flow of private capital, long-term loans, and other financial assistance for the sound financing of the development, expansion, and retention of small business concerns in the state.

The legislature appropriated $29,624,509 to DED's Resource Services Program and authorized 20 positions for fiscal year 2004. Of the $29.6 million, more than $18.7 million is for LEDC's Financial Assistance programs, as shown in Exhibit 1. See Appendix C for a brief description of each program.

Exhibit 1 Resource Services Budget - Fiscal Year 2004	
Financial Assistance Programs	**Budget**
Small Business Loan Assistance	$7,000,000
Small Business Investment Assistance	0
Venture Capital Programs	9,212,192
Project Equity Fund	450,000
Matching Grant Program	1,544,808
Rural Economic Development Account	500,000
Monroe and Northeast Incubator Center	0
Total	**$18,707,000**
Source: DED Annual Budget.	

All of LEDC's funds are held in the Louisiana Economic Development Fund, which includes funds for program operations as well as economic development assistance. The fund receives funding from several sources, including the state general fund, capital outlay, and interest on investment balances held in the fund.

The LEDC Board of Directors meets and determines how the appropriated funds will be distributed among the financial assistance programs. As of March 31, 2004, the current value of LEDC's financial assistance contracts totaled over $46.6 million.

Exhibit 2 Current Value of Financial Assistance Program Contracts	
Financial Assistance Program	**March 31, 2004**
Small Business Loan Assistance	$16,225,445
Small Business Investment Assistance	5,472,097
Venture Capital Programs	22,882,527
Project Equity Fund	389,398
Matching Grant Program	1,650,495
Rural Economic Development Account	0
Monroe and Northeast Incubator Center	0
Total	**$46,619,962**
Source: Prepared by legislative auditor's staff using information provided by LEDC. **Note:** Loan and investment values can fluctuate up or down between valuation dates; therefore, current value is not the amount of actual assistance provided by LEDC.	

The Small Business Investment Assistance program, Project Equity Fund, Rural Economic Development Account, and Monroe and Northeast Incubator Center were not used by LEDC during fiscal years 2002 and 2003; therefore, we only audited the four active programs listed in Exhibit 3. Exhibit 3 summarizes the number of contracts approved and financial assistance awarded for fiscal years 2002 and 2003.

Exhibit 3
Financial Assistance Program Data

Financial Assistance Program	Fiscal Year 2002 New Contracts	Fiscal Year 2002 Actual Assistance Amount	Fiscal Year 2003 New Contracts	Fiscal Year 2003 Actual Assistance Amount	Total Contracts
Small Business Loan	17	$5,585,628	14	$5,062,851	31
Venture Capital Co-Investment	2	750,000	6	3,455,000	8
Venture Capital Match	1	5,000,000	4	11,895,924	5
Matching Grant	0	0	2	265,000	2
Total	**20**	**$11,335,628**	**26**	**$20,678,775**	**46**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

ARE LEDC'S MANAGEMENT CONTROLS ADEQUATE TO ENSURE THAT ADMINISTRATION OF THE FINANCIAL ASSISTANCE PROGRAMS IS IN ACCORDANCE WITH STATE LAW AND DO LOANS AND INVESTMENTS MEET APPLICABLE PROGRAM GUIDELINES?

For the four financial assistance programs active during fiscal years 2002 and 2003, the following control deficiencies were noted:

- LEDC did not consistently collect and verify all required information for program enrollment and monitoring for the Financial Assistance programs.
- Three different sets of rules exist for the Matching Grant program.

Active Financial Assistance programs during this period include:

Small Business Loan

Venture Capital Match

Venture Capital Co-Investment

Matching Grant

Consistent Collection and Verification of Required Information Would Help Ensure Program Eligibility and Compliance

LEDC staff does not always collect and verify all required information from financial assistance applicants before approving loans or investments. Some required information was not collected for 12 (26%) of the 46 contracts approved in fiscal years 2002 and 2003. The collection and thorough review of all required data by LEDC will help ensure that loans and investments are awarded and administered appropriately.

Enrollment

LEDC's program rules require all companies seeking loans or investments to meet certain qualifications to enroll in a Financial Assistance program. For initial enrollment, companies must submit an application and all supporting documentation necessary to meet specific program qualifications. For the Matching Grant program, LEDC collected and verified all required enrollment documentation according to program rules. However, the Small Business Loan, Venture Capital Match, and Venture Capital Co-Investment programs had some deficiencies.

Small Business Loans

In most instances, LEDC staff adhered to the management controls that were in place to ensure that small business loans were properly administered, except for the following:

- In fiscal year 2002, a sufficient background check was not evident for one of 17 (6%) loans. Background checks are required to ensure that companies seeking a small business loan do not have any pending or outstanding claims or criminal record. In fiscal year 2003, a sufficient background check was not evident for one of 14 (7%) loans.

Venture Capital Co-Investment and Venture Capital Match Programs

The following deficiencies were noted:

- In fiscal year 2002, a completed program application package was not available for one of three (33%) investments. In fiscal year 2003, a completed program application package was not available for five of 10 (50%) investments.

- Four of 10 (40%) investments in fiscal year 2003 did not show any evidence that the venture capital fund met LEDC's experience and capital requirements. LEDC established rules to ensure that it only invests in venture capital funds with proven management experience and sufficient capital to reduce its portfolio risk. If LEDC invests in venture capital funds that do not meet the program requirements, it increases the likelihood of seeing a negative return on its investment.

- For one of 10 (10%) investments in fiscal year 2003, LEDC invested an amount greater than allowable per program rules. LEDC established maximum investment amounts to limit its risk exposure on each individual investment and its portfolio of investments. LEDC increases its exposure on each investment when it exceeds program limits.

Recommendation 1: LEDC should ensure that it receives all required documentation before a project is approved and/or funds are disbursed. Before approving an application, the LEDC board should require a statement from the program administrator or his/her supervisor that the project meets all program requirements.

LEDC's Response: Management does receive all required documentation before a project is presented to the board. Management agrees to enclose a formal checklist to go with each application upon presentation to the board.

Monitoring

According to each program's rules, program participants must provide specific information periodically to LEDC throughout the life of the contract. LEDC collected and verified all required documentation per program rules for the Small Business Loan and Matching Grant programs. However, for the Venture Capital Match and Venture Capital Co-Investment programs, we found some deficiencies. As a result, LEDC may not be able to effectively monitor program compliance and progress and to accurately value investments.

Venture Capital Match and Venture Capital Co-Investment Programs

- In fiscal year 2002, quarterly or annual progress reports were not available for two of three (67%) investments. In fiscal year 2003, quarterly or annual progress reports were not available for five of 10 (50%) investments. As a result, LEDC cannot determine the fair market value of its investments and must continue to record investments at book value.

Furthermore, LEDC cannot determine if an investment is generating a positive return on its investment.

- In some cases, even though LEDC received all quarterly or annual progress reports, the fair market value of the investment was reported inaccurately. For example, one investment in fiscal year 2003 for $1.25 million was in a company that has yet to begin operations. However, LEDC is still recording the fair market value of the investment at $1.25 million. As a result, the current value of the investment is overstated.

- One of 10 (10%) investments did not have any activity within fiscal year 2003. According to program rules, if no activity has occurred in the Venture Capital fund for a period of one year, the fund shall be reviewed by the LEDC Board and it may revoke its investment.

Recommendation 2: LEDC should ensure that it receives all required documentation for the life of an approved project so that management can effectively monitor program compliance and progress and can accurately value investments.

LEDC's Response: Management agrees. LEDC will continue to assure that all reports are collected and evaluated in order to accurately value investments. LEDC is in the process of contracting with an outside Investment Banking firm to give a third party valuation of the investment portfolio.

Three Sets of Rules for the Matching Grant Program

LEDC staff does not follow promulgated rules for the Matching Grant program to ensure that only qualified applicants will receive benefits. Under this program, LEDC issued two grants within our audit period--one for $165,000 and another for $100,000. However, multiple policies and procedures exist for the program. As a result, problems exist with the grants and program rules.

First, Matching Grant program rules are available from three different sources: (1) LEDC staff, (2) the Louisiana Administrative Code, and (3) the DED Web site. Each set of rules lists different criteria/requirements for enrollment and continuing participation in the program. In addition, each set of rules lists a different purpose for the program. LEDC staff stated that they no longer use the rules listed in the Administrative Code or on its Web site. The rules that LEDC staff provided to us are the rules currently being used to administer the program. However, we found no evidence to suggest that the Matching Grant rules currently being used by LEDC staff have been promulgated according to requirements of the Administrative Procedures Act (APA). R.S. 51:2312(C) states that all programs of LEDC shall be administered pursuant to rules promulgated and adopted in accordance with the APA. R.S. 49:954(A) states, in part, that no rule adopted on or after January 1, 1975, is valid unless adopted in substantial compliance with the APA.

Second, the officially promulgated set of rules support grants for private sector research and development activities. However, both of the grants were awarded to public or quasi-public entities for the expansion of their operations.

Third, the $165,000-grant recipient was DED, which administers all of the financial assistance programs that LEDC reviews and approves. Because of the relationships that exist between DED and LEDC, this grant could violate the spirit or intent of the program. R.S. 51:2311(A) (2) (a) designates DED's secretary as a member of LEDC's Board of Directors. In addition, DED is a public entity, which may not qualify for the Matching Grant program as defined in the officially promulgated rules.

Recommendation 3: LEDC should ensure that the Matching Grant program rules are formally promulgated in accordance with the Louisiana Administrative Procedures Act.

LEDC's response: LEDC has been and will continue to follow the promulgated rules for the program.

Recommendation 4: LEDC should ensure that all grants issued under the Matching Grant Program are issued in accordance with formally promulgated rules. The rules should clearly identify intended program beneficiaries.

LEDC's Response: Management agrees that all matching grants be issued according to the promulgated rules and they have been.

WERE SMALL BUSINESS LOANS AND SIMILAR TYPES OF ASSISTANCE REPAID ACCORDING TO CONTRACT PROVISIONS?

LEDC small business loans are generally repaid according to contract provisions. We reviewed all Guarantee and Participation loans approved in fiscal years 2002 (17 loans) and 2003 (14 loans).

According to LEDC staff, when borrowers default on a Guarantee Loan, LEDC works closely with the bank that made the loan to recover as much of the outstanding balance as possible. The banks exhaust every effort to avoid default, including refinancing and interest-only payments before calling in LEDC's loan guarantee. LEDC's guarantee is only requested by the banks as a last resort, at which time it is converted to a participation loan and LEDC continues collection efforts. Exhibit 5 highlights total outstanding loan amounts and default percentages during fiscal years 2002 and 2003.

Although it is not stated in the program rules, LEDC's goal is to write off no more than 5% of the total outstanding loan amounts at the end of each fiscal year. The goal of no more than 5% was adopted from banking industry standards. LEDC staff takes the total dollars defaulted on divided by the total dollars outstanding to calculate the default percentage. Total dollars outstanding includes all fiscal years since the program's inception that still have loan balances. Default percentages are calculated on the last day of each fiscal year (June 30).

Exhibit 5
Default Percentage for Small Business Loans

Fiscal Year	Outstanding Loans	Defaulted Loans	Percentage
2002	$13,190,716	$402,110	3.05%
2003	11,455,079	394,548	3.44%
Total	**$24,645,795**	**$796,658**	**3.23%**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

Recommendation 5: LEDC should consider adopting the 5% benchmark as part of its documented program rules for the Small Business Loan program. LEDC should continue using its current procedures to ensure that loans and similar types of assistance are repaid according to contract provisions.

LEDC's Response: Management does not agree with adopting a 5% benchmark. The mission of LEDC is to mitigate risk to the private sector for loans that would otherwise not be funded. LEDC has made provisions in the rules not to support some business sectors that are considered extremely high risk. We do not believe that benchmarking a loss rate in the rules is necessary. LEDC will continue to use current procedures to ensure loans are repaid by using the banks to the greatest possible extent to collect and monitor loans.

HAVE INVESTMENTS DIRECTLY OR INDIRECTLY BENEFITED STATE ECONOMIC DEVELOPMENT BY CREATING OR RETAINING JOBS OR BY FUNDING PROJECTS THAT CREATE A BENEFIT?

Less than half of the LEDC investments through the Venture Capital Match and Venture Capital Co-Investment programs indicate that jobs have been created or retained. Also, there is no clear evidence that these programs have indirectly benefited state economic development. LEDC invested through the Venture Capital Match program once in fiscal year 2002 and four times during fiscal year 2003. The Venture Capital Co-Investment program made investments twice during fiscal year 2002 and six times in fiscal year 2003.

LEDC program rules do not require jobs to be created or retained even though state law provides that financial assistance programs shall be used as a means of providing high levels of employment and income growth to the state.

Job Creation or Rentention Is Not Always Evident in Venture Capital Programs

R.S. 51:2302(11), in part, provides that financial assistance programs shall be used as a means of providing high levels of employment and income growth to the state. According to venture capital contracts, six of LEDC's 13 (46%) venture capital investments in fiscal years 2002 and 2003 have directly benefited state economic development by creating or retaining an estimated 881 jobs.

In fiscal year 2002, LEDC invested $5 million in one venture capital fund through the Venture Capital Match program, which in turn invested in ten companies located in Pennsylvania, Virginia, and Maryland. However, LEDC did require the venture capital fund to create a production office in Louisiana. LEDC's files contained no evidence that any of the $5 million was invested in a Louisiana company. LEDC also invested $750,000 in fiscal year 2002 in two companies through the Venture Capital Co-Investment program. Both companies were located in Louisiana and the investment helped create or retain an estimated 568 jobs according to contract files.

In fiscal year 2003, LEDC invested $11.1 million into four venture capital funds through the Venture Capital Match program, which in turn invested in 14 companies located in other states. One of the four venture capital funds did invest in a Louisiana company; however, the company has since filed for bankruptcy. In addition, LEDC required one venture capital fund to open a production office in the state. LEDC also invested $3.45 million in fiscal year 2003 into six companies through the Venture Capital Co-Investment program. All six companies are located in Louisiana. Two of the six investments (33%) were in companies that have yet to begin operations; as a result, no jobs have been created. However, the remaining four investments (67%) did help create or retain an estimated 313 jobs according to contract files.

Recommendation 6: LEDC should consider adopting program rules for the Venture Capital programs that mirror state law to ensure it provides high levels of employment and income growth to the state.

LEDC's Response: LEDC has adopted rules for the Venture Capital programs that follow state law. The value of making investments in venture capital funds is to develop an infrastructure with the intent of providing access to capital for Louisiana businesses. The board has exercised judgment in developing the rules that encourage investment without discouraging seasoned investors from investing millions of private sector dollars in Louisiana businesses. This process may not create direct jobs in an immediate time frame. An infrastructure of seasoned and successful venture capital fund managers has only started to grow in Louisiana. In order to attract these funds and their managers few restrictions can be levied.

Recommendation 7: LEDC should require, as a condition of its investment, venture capital funds to invest its funds in Louisiana companies.

LEDC's Response: Management does not agree. If the restriction of investing only in Louisiana were to be implemented then seasoned successful venture capital funds will not locate in Louisiana. Venture capital funds do not see geographical boundaries; they only see investment opportunities and portfolio diversification. The board has exercised judgment in developing rules that allow for an economic benefit to the state in either the creation of jobs and/or a return on investment.

No Evidence That Investments in Venture Capital Programs Have Indirectly Benefited the State

If LEDC realizes a positive return on its investments, it will be creating an indirect benefit to the state. The additional funds generated can be used to fund other economic development programs. We found no evidence that investments in venture capital programs have indirectly benefited the state. However, according to a cash flow analysis prepared by LEDC staff, LEDC expects to see an annual return on investment (ROI) between 15%-25% starting in the sixth year of each investment. Each investment has an approximate life of ten years.

During fiscal year 2002, LEDC invested $5 million in one venture capital fund through the Venture Capital Match program. As of March 31, 2004, a total of $2,630,000 had been drawn down and invested by the fund and had a market value of $1,768,106, which represents a decrease of 33% in the value of the investment. In addition, LEDC invested $750,000 in two companies through the Venture Capital Co-Investment program. As of March 31, 2004, the investments had a value of $549,216, which represents a decrease of 27% in the value of the investment.

During fiscal year 2003, LEDC invested $11,100,000 in four venture capital funds through the Venture Capital Match program. As of March 31, 2004, $6,322,576 had been drawn down and invested by the funds and had a market value of $6,096,629, which represents a decrease of 4% in the value of the investments. In addition, LEDC invested $3.45 million in six companies through the Venture Capital Co-Investment program. As of March 31, 2004, the investments had a value of $3.4 million, which represents a decrease of 2% in the value of the investments.

LEDC records its investments at estimated fair market value or at book value if a fair market value is not readily determinable by management. Fair market value is generally considered the amount that LEDC might reasonably expect to receive for its investments if negotiations for sale were entered into on the valuation date. Valuation as of any particular date, however, is not necessarily indicative of the amount which LEDC ultimately may realize as a result of a future sale or other disposition of its investments.

Exhibits 6 and 7 summarize the original investment amounts, fair market values of the investments, and the current ROI for investments in the Venture Capital Match and Co-Investment programs during fiscal years 2002 and 2003.

Exhibit 6
Value of Fiscal Year 2002 and 2003 Venture Capital Match Investments

Fiscal Year	Investment	Amount Dedicated	Amount Drawn Down	Fair Market Value as of 3/31/04	ROI
2002	1	$5,000,000	$2,630,000	$1,768,106	-33%
FY 2002 Total		**$5,000,000**	**$2,630,000**	**$1,768,106**	**-33%**
2003	2	$5,000,000	$768,031	$615,032	-20%
2003	3	5,000,000	5,000,000	5,000,000	0%
2003	4	1,000,000	454,545	381,597	-16%
2003	5	100,000	100,000	100,000	0%
FY 2003 Total		**$11,100,000**	**$6,322,576**	**$6,096,629**	**-4%**
Grand Total		**$16,100,000**	**$8,952,576**	**$7,864,735**	**-12%**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

Note: LEDC records investments at book value if fair market value is not readily determinable by LEDC staff (see *Monitoring* section on pages 10-11).

Exhibit 7
Value of Fiscal Year 2002 and 2003 Venture Capital Co-Investments

Fiscal Year	Investment	Amount Dedicated	Fair Market Value as of 3/31/04	ROI
2002	1	$500,000	$299,216	-40%
2002	2	250,000	250,000	0%
Total		**$750,000**	**$549,216**	**-27%**
2003	3	$500,000	$500,000	0%
2003	4	500,000	421,120	-16%
2003	5	630,000	630,000	0%
2003	6	1,250,000	1,250,000	0%
2003	7	68,175	$68,175	0%
2003	8	500,000	500,000	0%
Total		**$3,448,175**	**$3,369,295**	**-2%**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

Note: LEDC records investments at book value if fair market value is not readily determinable by LEDC staff (see *Monitoring* section on pages 10-11).

Recommendation 8: LEDC should maintain its current interest in the venture capital funds until the investments mature, in year six, and at that time evaluate whether or not it should hold or sell its interest in the venture capital funds.

LEDC's Response: Management partially agrees. Management agrees that LEDC should stay in the venture capital funds until maturity, which is usually in year ten to year twelve. Subscription agreements are contracts that govern the period of investment and there are significant penalties for selling early. The LEDC Board is given information on its investment portfolio and evaluates its exit strategy on a regular basis.

HAVE VENTURE CAPITAL INVESTMENTS CREATED AN INFRASTRUCTURE OF VENTURE CAPITAL IN THE STATE?

LEDC's five investments from the Venture Capital Match program in fiscal years 2002 and 2003 have not created a venture capital infrastructure within the state. All of these venture capital funds have invested in companies located outside the state. However, eight investments from the Venture Capital Co-Investment program in fiscal years 2002 and 2003 have created a venture capital infrastructure in Louisiana. These venture capital funds have invested in companies with headquarters or production offices in Louisiana.

The investment amounts for each program were as follows:

Exhibit 8
Venture Capital Match Program Investments
Fiscal Years 2002 and 2003

Fiscal Year	Investment	Amount
2002	1	$5,000,000
2003	2	5,000,000
	3	5,000,000
	4	1,000,000
	5	100,000
Total Investments		**$16,100,000**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

Exhibit 9
Venture Capital Co-Investment Program Investments
Fiscal Years 2002 and 2003

Fiscal Year	Investment	Amount
2002	1	$500,000
	2	250,000
2003	3	500,000
	4	500,000
	5	630,000
	6	1,250,000
	7	75,000
	8	500,000
Total Investments		**$4,205,000**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

Investments Through the Venture Capital Match Program Have Not Contributed to a Venture Capital Infrastructure Within the State

According to Act 888 of the 1988 Regular Legislative Session (R.S. 51:2310), the Louisiana Venture Capital Incentive programs shall have the express purpose of encouraging existing venture capital funds to invest in firms with headquarters and production offices in Louisiana and to encourage the formation of seed and venture capital funds in the state. LEDC staff defines this purpose as creating a venture capital infrastructure in the state.

LEDC's five investments through the Venture Capital Match program for fiscal years 2002 and 2003 have not helped to create a venture capital infrastructure within the state because the majority of the funds are invested outside the state.

- Investment #1 ($5,000,000) was in a venture capital fund that is headquartered in Pittsburgh, Pennsylvania. The venture capital fund has invested a total of $24.7 million into ten companies located in Pennsylvania, Virginia, and Maryland. The venture capital fund has not invested in any Louisiana companies. The venture capital fund has opened a Louisiana production office and hired one part-time employee that is shared with the venture capital fund in investment #2.

- Investment #2 ($5,000,000) was in a venture capital fund that is headquartered in Research Triangle Park, North Carolina. The venture capital fund has invested $5.3 million into six companies, all located in North Carolina. The venture capital fund has not invested in any Louisiana companies. The venture capital fund has opened a Louisiana production office and hired one part-time employee that is shared with the venture capital fund in investment #1.

- Investment #3 ($5,000,000) was in a venture capital fund that is headquartered in Hollywood, California. LEDC could not provide us with any documentation for the investments made by this fund. We cannot determine if they were in Louisiana companies or other companies outside of the state. The venture capital fund has not opened a Louisiana production office.

- Investment #4 ($1,000,000) was in a venture capital fund that is headquartered in New Orleans. The venture capital fund did invest $1.3 million in one Louisiana company that later filed backruptcy. The fund has also invested $10.6 million into seven other companies located in Texas, Florida, and Pennsylvania.

- Investment #5 ($100,000) was in a proposed venture capital fund that has not yet raised the required capital of $5 million for them to qualify for an investment by LEDC. Furthermore, the $100,000 was for the proposed fund to pay expenses it incurred while trying to meet the capital requirements. As a result, the fund has not made any investments.

Recommendation 9: LEDC should only invest in venture capital funds that will actively invest in Louisiana and/or open actual production offices that will help create a venture capital infrastructure and will benefit Louisiana economic development.

LEDC's Response: Management does not agree. As stated in the response to recommendation 7, if the restriction of investing only in Louisiana were to be implemented then seasoned successful venture capital funds will not locate in Louisiana. Venture capital funds do not see geographical boundaries, they only see investment opportunities and portfolio diversification. The board has exercised judgment in developing rules that allow for an economic benefit to the state in either jobs and/or a return on investment. LEDC has invested in venture capital funds that have headquarters out of state and they have provided for a production office within Louisiana manned by a professional investor.

Investments in the Venture Capital Co-Investment Program Have Contributed to a Venture Capital Infrastructure Within the State

LEDC's eight investments in the Venture Capital Co-Investment program for fiscal years 2002 and 2003 have contributed to creating a venture capital infrastructure within the state by having venture capital funds invest in firms with headquarters or production offices in Louisiana. The eight Louisiana companies were able to obtain $26.4 million in financial assistance with the state only having to provide $4.2 million or 16% of the funds. The remaining $22.2 million was supplied from various venture capital funds from both inside and outside the state. If these investments are successful, future Louisiana companies may also have access to funds that are managed by these and other venture capital firms. Exhibit 10 summarizes the additional funds that were obtained for Louisiana companies through the program.

Exhibit 10
Value of Venture Capital Co-Investments for Fiscal Years 2002 and 2003

	LEDC Amount	Fund Amount	Total Investment
Investment 1	$500,000	$1,500,000	$2,000,000
Investment 2	250,000	6,750,000	7,000,000
Investment 3	500,000	2,500,000	3,000,000
Investment 4	500,000	3,750,000	4,250,000
Investment 5	630,000	4,500,000	5,130,000
Investment 6	1,250,000	750,000	2,000,000
Investment 7	75,000	400,000	475,000
Investment 8	500,000	2,000,000	2,500,000
Total	**$4,205,000**	**$22,150,000**	**$26,355,000**

Source: Prepared by legislative auditor's staff using information provided by LEDC.

Recommendation 10: LEDC should continue co-investments with venture capital funds to hedge the amount of funds used by the state to stimulate economic development while fostering a venture capital infrastructure.

LEDC's Response: Management agrees and will continue encouraging co-investments with venture capital funds.

ARE THE PERFORMANCE DATA REPORTED EXTERNALLY FOR THE FINANCIAL ASSISTANCE PROGRAMS BY DED FOR FISCAL YEARS 2002, 2003 AND THE FIRST TWO QUARTERS OF 2004 RELIABLE?

Although LEDC administers and oversees all of the financial assistance programs, the performance indicators are calculated and reported by DED staff. We focused on program data reported in the Louisiana Performance and Accountability System (LaPAS) for fiscal year 2003 and the first two quarters of fiscal year 2004 and the DED Annual Report for fiscal year 2002. DED reports three performance indicators in LaPAS: (1) number of projects approved, (2) number of jobs created or retained, and (3) amount approved for financial assistance. The data in the Annual Report include (1) LEDC participation, (2) bank participation, and (3) associated jobs. DED reports the data for both LaPAS and its Annual Report in aggregate for the multiple programs within Financial Assistance.

- Two of the six (33%) LaPAS indicators reported in fiscal year 2003 and the first two quarters of fiscal year 2004 are not reliable.
- The data reported in the DED Annual Report for fiscal year 2002 are not reliable.
- DED reports aggregate data for multiple Financial Assistance programs.

Two LaPAS Indicators Reported for Fiscal Year 2003 and the First Two Quarters of Fiscal Year 2004 Are Not Reliable

The number of jobs created or retained in fiscal year 2003 and the first two quarters of fiscal year 2004 were calculated and reported accurately by DED staff; however, they are unreliable. The reported number of jobs created or retained is an anticipated value based on future assumptions of the program applicants; it is not based on actual/verifiable data. Furthermore, creating jobs is not a requirement for any of the Financial Assistance programs.

The number of projects approved in fiscal year 2003 and the first two quarters of fiscal year 2004 are reliable.

The amounts of financial assistance approved in fiscal year 2003 and the first two quarters of fiscal year 2004 are reliable.

Recommendation 11: Although the creation and/or retention of jobs is not a requirement of any Financial Assistance program, DED should include the word “Estimated” or “Anticipated” when reporting on the number of jobs as a performance indicator.

LEDC’s Response: Management agrees. LEDC will qualify reported number of jobs as “Estimated” or “Anticipated” to be created by the various businesses in the state.

Data Reported in the DED Annual Report for Fiscal Year 2002 Are Not Reliable

Financial Assistance data reported in the 2001-2002 Annual Report is divided into two parts--Venture Capital and Loan Assistance. DED reported the following information in the Annual Report for fiscal year 2002.

Exhibit 11
DED Annual Report Data for Fiscal Year 2002

Indicator	Venture Capital	Loan Assistance
LEDC Participation[1]	$7,005,000	$7,146,778
Bank Participation[2]	$56,250,000	$7,005,597
Associated Jobs	597	574

Source: DED 2001-2002 Annual Report.
[1] Total dollars invested or loaned by LEDC.
[2] Total dollars invested by venture capital funds (Venture Capital) or total dollars loaned by banks (Loan Assistance).

All of the indicator values for Venture Capital are unreliable.

- For *LEDC Participation* ($7,005,000), DED staff reported the amounts for one venture capital investment based on what LEDC initially approved, not on the amount actually invested. As a result, this indicator value was overstated by $625,000 in the Annual Report.

- For *Bank Participation* ($56,250,000), the indicator value was understated by $4.75 million in the Annual Report. The actual bank participation was $61 million according to the contracts.

- The *Associated Jobs* (597) is not reliable because the reported number of jobs created or retained is an anticipated value based on future assumptions of the program applicant; it is not based on actual/verifiable data.

All of the indicator values for Loan Assistance are unreliable.

- For *LEDC Participation* ($7,146,778), the indicator value was overstated by $635,790. In addition, the LEDC participation reported is greater than the bank participation reported. However, according to program rules, LEDC cannot commit more than 75% of the bank amount for guarantee loans and 40% for participation loans. Therefore, the maximum LEDC participation should be no greater than 75% of the bank participation amount. We verified through audit testing that the actual LEDC participation ($6,510,988) was 69.5% of the actual bank participation.

- For *Bank Participation* ($7,005,597), the indicator value was understated by $2.37 million. LEDC contract files show the actual bank participation to be $9,374,350.

- The *Associated Jobs* (574) is not reliable because the reported number of jobs created or retained is an anticipated value based on future assumptions of the program applicant; it is not based on actual/verifiable data.

Recommendation 12: DED staff should verify that all performance indicators are accurate and reliable. DED management should review and approve all performance indicators before reporting them to ensure accuracy and reliability.

LEDC's Response: Management agrees and has taken steps to assure accurate reporting through the use of a unified single database and review process.

Matter for Legislative Consideration: The legislature should consider directing legislative staff to work with DED to develop performance indicators that will report only actual performance (e.g., actual jobs created) and not allow any performance indicators that will require estimates.

DED Aggregates Data for Multiple Programs Within Financial Assistance

DED reports on four financial assistance programs in one performance indicator. The programs included are as follows:

1. Small Business Loan Program
2. Venture Capital Match Program
3. Venture Capital Co-Investment Program
4. Matching Grant Program

The Governmental Accounting Standards Board (GASB) states that reporting disaggregated data for individual indicators are likely to be much more useful than presenting only aggregate data. However, DED does not disaggregate data for its Financial Assistance programs' performance indicators reported to LaPAS. As a result of DED's aggregate reporting of financial assistance performance indicators, overall averages may conceal considerable information for individual programs that is potentially useful to government officials and the public as well as to DED and LEDC staff.

Recommendation 13: DED should disaggregate its performance data by program to more clearly show the effectiveness and use of its various economic development programs.

LEDC's Response: Management agrees and has already taken steps to separate the performance of different programs in LaPAS.

APPENDIX A: SCOPE AND METHODOLOGY

We conducted this performance audit under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. All performance audits are conducted in accordance with generally accepted governmental auditing standards as promulgated by the Comptroller General of the United States.

Scope

R.S. 51:935.1 directs the legislative auditor to conduct performance audits annually to evaluate the management controls, accuracy, and reliability of the reported information of at least three economic development programs. This audit focused on the Financial Assistance programs' management controls, repayment to the state, benefit to the state, and venture capital infrastructure beginning with fiscal year 2002 and continuing through fiscal year 2003. We also assessed the accuracy and reliability of performance data reported by DED for the program for fiscal years 2002, 2003, and the first two quarters of fiscal year 2004.

Methodology

We reviewed 100% of the 46 contracts for the four active Financial Assistance programs during fiscal years 2002 and 2003. The four programs included (1) Small Business Loan, (2) Venture Capital Match, (3) Venture Capital Co-Investment, and (4) Matching Grant.

Determining the effectiveness of LEDC's management controls for Financial Assistance programs. To gain an understanding of how these programs operate, we reviewed applicable state laws, program rules, and LEDC files and had discussions with LEDC program officials. We developed data collection instruments (DCIs) that were used to evaluate whether LEDC collected and verified all required information for enrollment and monitoring of the programs. We reviewed all active files as of March 31, 2004, which included for fiscal year 2002, 17 small business loans, two venture capital co-investments, and one venture capital match investment. For fiscal year 2003, we reviewed 14 small business loans, six venture capital co-investments, four venture capital match investments, and two matching grants. We used the data collected to determine whether an applicant met the requirements for enrollment in the programs and to determine if LEDC monitored loans/investments as required by program rules.

Determining whether loans and similar types of assistance were repaid according to contract provisions. For this objective, we reviewed 17 small business loans made during fiscal year 2002 and 14 during fiscal year 2003. We reviewed loan information provided by banks and the LEDC accounting system and consulted with staff to determine if borrowers paid loans in accordance with contract provisions. In addition, we collected a list of all small business loans written off as uncollectible/bad debt during fiscal years 2002 and 2003. From this list, we calculated the total loan amounts written off each fiscal year and divided it by the total outstanding loan amounts to determine the default percentages for each fiscal year.

Determining whether venture capital investments directly or indirectly benefited the state. For the purpose of this report, we considered creating or retaining jobs as a direct benefit and a return on the investments by LEDC as an indirect benefit to the state. This objective only applied to the Venture Capital Match and Venture Capital Co-Investment programs. We reviewed three venture capital investments made during fiscal year 2002 and 10 during 2003. To determine the estimated number of jobs created or retained, we reviewed term sheets, which are part of the contract file for each investment and list the number of jobs to be created and/or retained. From the term sheets, we calculated the total estimated number of jobs for each venture capital program. To determine the return on investments by LEDC, we obtained original and current values for each investment from the LEDC accounting database. Using these values, we then calculated the percentage change for each investment to determine its rate of return.

Determining whether venture capital investments created an infrastructure of venture capital n the state. This objective only applied to the Venture Capital Match and Venture Capital Co-Investment programs. We reviewed three venture capital investments made during fiscal year 2002 and 10 investments during 2003. We reviewed contract files to determine whether venture capital investments made by LEDC resulted in venture capital funds relocating or opening offices in the state or investing money in Louisiana companies.

Determining the reliability of performance data reported for Financial Assistance programs. We reviewed the program performance data reported in the Louisiana Performance Accountability System (LaPAS) for fiscal year 2003 and the first two quarters of fiscal year 2004. We also reviewed data reported in DED's Annual Report for fiscal year 2002. In addition, we consulted with department staff and asked for supporting documentation to determine if DED reported reliable data. We used the data found in DED's Financial Assistance database and in its files to determine whether the performance data were reliable.

APPENDIX B: GLOSSARY

Loan Participation: A loan in which LEDC participates with the bank (up to 40% of the total loan value) in lending the money to a small business owner.

Loan Guarantee: A loan in which LEDC guarantees the bank repayment on a percentage of the total loan value if the small business owner defaults on the loan.

Venture Capital: Money made available for investment in innovative enterprises or research, especially in high technology, in which both the risk of loss and the potential for profit may be considerable.

Return on Investment: The gain or loss on an investment, expressed as a percentage of the total amount invested.

Fair Market Value: The price that a buyer would be willing to pay and a seller would be willing to accept on the open market assuming a reasonable period of time for an agreement to arise.

Book Value: The value of an asset as it appears on a balance sheet, equal to cost minus accumulated depreciation. Book value often differs substantially from market price, especially in knowledge industries such as high-tech.

Valuation Date: The date on which the value of an asset is determined.

APPENDIX C: FINANCIAL ASSISTANCE PROGRAMS DESCRIPTIONS

1. **Small Business Loan Assistance** - There are five Small Business Loan Assistance programs overseen by LEDC.

    - **Small Business Loan** - the only active loan program in use at the time of our audit. The program consists of two types of loans. First, the program grants Guarantee loans in which LEDC guarantees repayment to a bank for a portion of a loan (not to exceed 75% in most cases) if the borrower defaults on the loan. The second type of loan is a Participation loan in which LEDC actually lends a portion (up to 40%, maximum is $1.5 million) of the total loan to the borrower and receives principal and interest payments equal to LEDC's participation percentage.

    - **Micro Loan** - this program is very similar to the Small Business Loan program only the lending amounts are smaller. However, this program has not been used by LEDC in several fiscal years. Currently, there are no outstanding Micro loans at LEDC.

    - **Contract Loan** - the program has never been used by LEDC.

    - **Capital Access Loan** - the program has never been used by LEDC.

    - **Linked Deposit Program** - The Department of Treasury oversees this program. However, the program has not been used in the last two to three fiscal years because of the decrease in interest rates. The program buys down interest rates on existing loans but with interest rates already so low the program has not been practical in several years.

2. **Small Business Investment Assistance** - There are two types of Small Business Investment Assistance programs as follows:

    - **Seed Capital** - an investment program to encourage the formation of seed capital funds that will be used to finance any process, technique, product, or device that may create an economic benefit to the state. The program has never been used by LEDC; however, it remains in existence (currently unfunded) in case a future opportunity for usage presents itself.

    - **BIDCO -** an investment program that provides funds to a Louisiana Business and Industrial Development Corporation (BIDCO), which in turn provides non-traditional capital and/or debt funding for qualified state businesses. The BIDCO program has not been used by LEDC since fiscal year 1998.

3. **Venture Capital** - there are three types of Venture Capital programs. The programs are as follows:

   - **Venture Capital Match Program** - an investment program in which LEDC invests in a private venture capital fund, which may provide equity through the purchase of common stock, preferred stock, partnership rights or any other equity instrument.

   - **Venture Capital Minority Match Program** - this program is similar to the Venture Capital Match program except the investment limits and percentages are considerable lower. The program has never been used by LEDC.

   - **Venture Capital Co-Investment Program** - an investment program in which LEDC along with a private investor(s) directly invest funds into a Louisiana company.

4. **Project Equity Fund** - LEDC established this loan program to bring new manufacturing products, innovation, jobs and creativity to the state. The program has only been used once (fiscal year 2004) by LEDC.

5. **Matching Grants** - This program provides matching state grants (to federal grants) to leverage state and local funding for the purpose of assisting, whether individually or collectively, qualified Louisiana businesses, minority-owned businesses, high-growth potential businesses, women-owned businesses, small business and disabled persons' business enterprises, and may also include providing matching funding for federal grants for infrastructure and basic infrastructure projects under the Louisiana Economic Development Award program.

6. **Rural Economic Development Account** - This account is established within the Louisiana Economic Development Fund to provide for economic development in rural areas of the state. LEDC has not used the program. The legislature created it in the 2003 Regular Legislative Session; however, no rules for the program have been promulgated.

7. **Monroe and Northeast Incubator Center** - This program provides a loan or loan guarantee to eligible applicants for an amount not to exceed $100,000 to establish, maintain, or expand a small business incubator located in Northeast Louisiana. The program has never been used by LEDC. It was approved in the 2003 Regular Legislative Session; however, no rules for the program have been promulgated.

APPENDIX D: MANAGEMENT'S RESPONSE

State of Louisiana

DEPARTMENT OF ECONOMIC DEVELOPMENT

Kathleen Babineaux Blanco
Governor

Michael J. Olivier
Secretary

September 10, 2004

Mr. Steve J. Theriot, CPA
Legislative Auditor
1600 North Third Street
Post Office Box 94397
Baton Rouge, Louisiana 70804

Dear Mr. Theriot:

Enclosed is our response to the revised draft of your performance audit report dated August 24, 2004 on the Financial Assistance Programs administered by LEDC within Louisiana Economic Development.

While we don't concur with a lot of the detail in the report because of some inaccuracies, we do agree with most of your recommendations. We request the opportunity to discuss the details of the report with you before it is issued. We thank you and your staff for your courtesies during the course of the audit.

Sincerely,

Michael J. Olivier
Secretary
Louisiana Economic Development

Post Office Box 94185, Baton Rouge, Louisiana 70804-9185/ (225) 342-3000
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Recommendation 1: LEDC should ensure that it receives all required documentation before a project is approved and/or funds disbursed. Before approving an application, the LEDC board should require a statement from the program administrator or his/her supervisor that the project meets all program requirements.

Management does receive all required documentation before a project is presented to the board. Management agrees to enclose a formal check list to go with each application upon presentation to the board.

Recommendation 2: LEDC should ensure that it receives all required documentation for the life of an approved project so that management can effectively monitor program compliance and progress, and can accurately value investments.

Management agrees. LEDC will continue to assure that all reports are collected and evaluated in order to accurately value investments. LEDC is in the process of contracting with an outside Investment Banking firm to give a third party valuation of the investment portfolio.

Recommendation 3: LEDC should ensure that the Matching Grant program rules are formally promulgated in accordance with the Louisiana Administrative Procedures Act.

LEDC has been and will continue to follow the promulgated rules for the program.

Recommendation 4: LEDC should ensure that all grants issued under the Matching Grant Program are issued in accordance with formally promulgated rules. The rules should clearly identify intended program beneficiaries.

Management agrees that all matching grants be issued according to the promulgated rules and they have been.

Recommendation 5: LEDC should consider adopting the 5% benchmark as part of its documented program rules for the Small Business Loan program. LEDC should continue using its current procedures to ensure that loans and similar types of assistance are repaid according to contract provisions.

Management does not agree with adopting a 5% benchmark. The mission of LEDC is to mitigate risk to the private sector for loans that would otherwise not be funded. LEDC has made provisions in the rules not to support some business sectors that are considered extremely high risk. We do not believe that benchmarking a loss rate in the rules is necessary. LEDC will continue to use current procedures to ensure loans are repaid by using the banks to the greatest possible extent to collect and monitor loans.

Recommendation 6: LEDC should consider adopting program rules for the Venture Capital programs that mirror state law to ensure it provides high levels of employment and income growth to the state.

LEDC has adopted rules for the Venture Capital programs that follow state law. The value of making investments in venture capital funds is to develop an infrastructure with the intent of providing access to capital for Louisiana businesses. The board has exercised judgment in developing the rules that encourage investment without discouraging seasoned investors from investing millions of private sector dollars in Louisiana businesses. This process may not create direct jobs in an immediate time frame. An infrastructure of seasoned and successful venture capital fund managers has only started to grow in Louisiana. In order to attract these funds and their managers few restrictions can be levied.

Recommendation 7: LEDC should require, as a condition of its investment, venture capital funds to invest their funds in Louisiana companies.

Management does not agree. If the restriction of investing only in Louisiana were to be implemented then seasoned successful venture capital funds will not locate in Louisiana. Venture capital funds do not see geographical boundaries, they only see investment opportunities and portfolio diversification. The board has exercised judgment in developing rules that allow for an economic benefit to the state in either the creation of jobs and/or a return on investment.

Recommendation 8: LEDC should maintain its current interest in the venture capital funds until the investments mature, in year six, and at that time evaluate whether or not it should hold or sell its interest in the venture capital funds.

Management partially agrees. Management agrees that LEDC should stay in the venture capital funds until maturity, which is usually in year ten to year twelve. Subscription agreements are contracts which govern the period of investment and there are significant penalties for selling early. The LEDC Board is given information on its investment portfolio and evaluates its exit strategy on a regular basis.

Recommendation 9: LEDC should only invest in venture capital funds that will actively invest in Louisiana and/or open actual production offices that will help create a venture capital infrastructure and will benefit Louisiana economic development.

Management does not agree. As stated in the response to recommendation number 7, if the restriction of investing only in Louisiana were to be implemented then seasoned successful venture capital funds will not locate in Louisiana. Venture capital funds do not see geographical boundaries, they only see investment opportunities and portfolio diversification. The board has exercised judgment in developing rules that allow for an economic benefit to the state in either jobs and/or a return on investment. LEDC has invested in venture capital funds that have headquarters out of state and they have provided for a production office within Louisiana manned by a professional investor.

Recommendation 10: LEDC should continue co-investments with venture capital funds in order to hedge the amount of funds used by the state to stimulate economic development while fostering a venture capital infrastructure.

Management agrees and will continue encouraging co-investments with venture capital funds.

Recommendation 11: Although the creation and/or retention of jobs is not a requirement of any Financial Assistance program, DED should include the word "Estimated" or "Anticipated" when reporting on the number of jobs as a performance indicator.

Management agrees. LEDC will qualify reported number of jobs as "Estimated" or "Anticipated" to be created by the various businesses in the state.

Recommendation 12: DED staff should verify that all performance indicators are accurate and reliable. DED management should review and approve all performance indicators prior to reporting them to ensure accuracy and reliability.

Management agrees and has taken steps to assure accurate reporting through the use of a unified single data base and review process.

Recommendation 13: DED should disaggregate its performance data by program to more clearly show the effectiveness and use of its various economic development programs.

Management agrees and has already taken steps to separate the performance of different programs in Louisiana Performance and Accountability System (LaPAS).