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Maryland Technology Development Corporation (TEDCO)

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Presentation to Joint Audit and Evaluation Committee

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Background

- Fiscal compliance audit period was from January 7, 2015 to April 10, 2018.
- TEDCO is a public instrumentality of the State that seeks to create and sustain businesses in Maryland, and create jobs in technology-related industries throughout all regions of the State.
- In 2015, State law restructured the principal economic development entities in the State. This restructuring included the October 1, 2015 transfer of the Maryland Venture Fund (MVF) and the Maryland Venture Fund Authority (MVFA) from the Department of Commerce (DOC) to TEDCO. Our audit included a review of this transfer and TEDCO's investment practices since then.
- The MVF (which is also known as the Enterprise Fund) is primarily a State-supported fund that invests in qualified Maryland companies either directly or indirectly through venture firms.
- In 2011, State law established the Invest Maryland Program and the MVFA under the MVF.

Overview of Findings

- The MVF represents TEDCO's most significant program. As of 6/30/18, $102 million of TEDCO's $114.7 million net position related to the MVF.
- The audit report consisted of 3 findings and 10 specific recommendations related to the MVF; along with one informational comment on the MVFA's status.
- The MVFA is a 9 member body established under State law. The MVFA was created to select the venture firms that would receive commitments under the Invest Maryland Program and ensure that those firms made equal investments in Maryland businesses. In addition, the MVFA is to provide advice and consultation to TEDCO. According to the Governor's Appointments Office, the MVFA has been inactive and all of its members' appointments have expired. According to TEDCO, the MVFA has not met since the MVF's transfer from DOC to TEDCO in October 2015, and its responsibilities have been assumed by TEDCO.

Key Findings

- TEDCO had not adopted regulations for direct equity investments made through the MVF, as required by State law, and did not adequately document its investment decisions or rationale as to how certain investments promoted economic development in the State of Maryland.
- TEDCO created an advisory committee for the MVF to provide investment advice, without establishing adequate policies or procedures. For example, committee members were not required to file financial disclosure statements and TEDCO had not created a conflict of interest policy. We noted that 2 of the 3 committee members were associated with venture firms that had previously received $21 million in commitments under the Invest Maryland Program (prior to their appointment).
- TEDCO had not established adequate procedures over the monitoring of third-party venture firms that had received funding commitments through the Invest Maryland Program.

Direct Equity Regulations (Finding 1)

TEDCO had not adopted regulations for direct equity investments made through the MVF, as required by State law. Further, the documentation prepared by TEDCO to support its investment decisions was not adequate to indicate how certain investments promoted economic development in Maryland.

State law requires TEDCO to adopt regulations to include certain key elements, such as the types of business enterprises in which an investment may be made and the criteria it uses to make investment decisions. The law also requires TEDCO to make such investments in qualified businesses that have their principal business operations located in Maryland and intend to maintain that operation in Maryland after receiving an investment.

Direct Equity Regulation (Finding 1 cont.)

- Our review of 10 investments from May 2016 to January 2018 identified 6 investments related to 4 companies, totaling $4.7 million, where each company's principal place of business was not located in Maryland at the time of investment or following the investment.
- For example, TEDCO made 2 investments of $1.5 million each in a company between May 2016 and January 2018. These investments were made despite the company's disclosure of its intention to move its principal business operations outside of Maryland within four months of the first investment. The second investment was made less than a month after the company's relocation outside of Maryland and the closing of its Maryland facility.
- For each of the 6 investments, TEDCO did not document the reason(s) why these companies were considered qualified for investments or what potential economic impact to the State of Maryland would result from these investments.

Conflict of Interest Policy (Finding 2)

TEDCO had not established adequate policies governing its 3 member MVF investment advisory committee or its formal relationship to TEDCO. In addition, TEDCO had not established a formal conflict of interest policy for the majority of MVF's investment initiatives and programs and had no procedure to review financial disclosure statements that were filed by its own investment employees.

TEDCO established a 3 member advisory committee for the MVF comprised of industry experts selected by TEDCO's Chief Investment Officer to provide advice on investments currently held in TEDCO's portfolio and on companies considered for future investments.

Our review found that 2 of the 3 committee members were associated with two of the venture firms that had previously received commitments, totaling $21 million, through the Invest Maryland Program (prior to the transfer of the MVF to TEDCO).

Venture Firm Monitoring (Finding 3)

- TEDCO did not monitor management fees charged by the venture firms that received funding through the Invest Maryland Program (IMP) to ensure that fees were charged in accordance with State law and its agreements with the firms.
- TEDCO did not ensure that 6 of the 8 firms, that had received funding under the IMP, reported required investment specific information on a quarterly basis. This information should be used to monitor qualified Maryland investments made by the venture firms and assess the impact of those investments on the Maryland economy.
- TEDCO had not established a process to address potential investment shortfalls and the exercising of a "clawback" provision when firms receiving commitments under the IMP did not make required investments in qualified Maryland businesses. We noted one of the 8 firms had received $6 million of a $10 million commitment during 12/2013 to 6/2018, but had not made any investments in Maryland companies as of 6/2018.

Conclusions

TEDCO should

- adopt regulations, as required, for the MVF governing the provision of direct equity investments;
- comply with State law in regards to making investments in companies whose principal business operations are in Maryland;
- establish a mechanism to evaluate and document each investment's potential economic impact on Maryland;
- develop a formal conflict of interest policy over all MVF programs, require all investment advisors and decision makers to file financial disclosure statements, and monitor those statements for potential conflicts; and
- monitor the appropriateness of management fees, ensure the required program information is reported and used to assess program performance, and monitor and resolve any potential investment shortfalls, documenting such efforts.