A Review of Colorado's Certified Capital Company Program

October 2003
LEGISLATIVE AUDIT COMMITTEE
2003 MEMBERS

Senator Ron Tupa
Chairman

Representative Tambor Williams
Vice-Chairman

Senator Norma Anderson
Representative Fran Coleman
Representative Pamela Rhodes
Senator Stephanie Takis
Senator Jack Taylor
Representative Val Vigil

Office of the State Auditor Staff

Joanne Hill
State Auditor

Sally Symanski
Deputy State Auditor

Becky Richardson
Nicole Javernick
Jonathan Trull
Legislative Auditors
# TABLE OF CONTENTS

<table>
<thead>
<tr>
<th>Page</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>CERTIFIED CAPITAL COMPANY PROGRAM</td>
</tr>
<tr>
<td>1</td>
<td>Scope of Report</td>
</tr>
<tr>
<td>2</td>
<td>Background</td>
</tr>
<tr>
<td>5</td>
<td>The Major Stakeholders</td>
</tr>
<tr>
<td>8</td>
<td>The First $100 Million of Certified Capital</td>
</tr>
<tr>
<td>11</td>
<td>2002 Allocation of Tax Credits</td>
</tr>
<tr>
<td>13</td>
<td>Statutory Investment Thresholds</td>
</tr>
<tr>
<td>14</td>
<td>CAPCO- Invested Businesses</td>
</tr>
<tr>
<td>20</td>
<td>Cost of the Program to the State</td>
</tr>
<tr>
<td>22</td>
<td>Responsibility for Oversight of the Tax Credits</td>
</tr>
<tr>
<td>22</td>
<td>Policy Options</td>
</tr>
<tr>
<td>A-1</td>
<td>Appendix A - Letter from the Office of Economic Development</td>
</tr>
<tr>
<td>B-1</td>
<td>Appendix B - Description of Businesses Receiving Investments</td>
</tr>
<tr>
<td>C-1</td>
<td>Appendix C - Other States’ Programs</td>
</tr>
</tbody>
</table>
Members of the Legislative Audit Committee:

This report contains the results of a review of the Colorado Certified Capital Company Program. The review was conducted pursuant to Section 2-3-103, C.R.S., which authorizes the State Auditor to conduct audits of all departments, institutions, and agencies of state government and Senate Joint Resolution 03-050 which authorized the Legislative Audit Committee (LAC) to evaluate the implementation of the Certified Capital Company Act and also gave the LAC the power to subpoena records and to take testimony under oath to complete the evaluation. The review presents a description of the CAPCO Program, the status of the 2002 Premium Tax Credit Allocations, and policy options. Also included in Appendix A are comments from the Director of the Office of Economic Development and International Trade.
Certified Capital Company Program

Introduction

The Colorado General Assembly passed the Certified Capital Company Act during the 2001 Legislative Session. According to Section 10-3.5-102, C.R.S., the primary purpose of the Act is to:

... provide assistance in the formation of new businesses and the expansion of existing businesses that create jobs in the state by providing an incentive for insurance companies to invest in certified capital companies.

Certified capital companies are often referred to as CAPCOs. When Colorado enacted its CAPCO legislation, it became the sixth state in the nation to adopt such a program.

To address concerns about the cost-effectiveness of the Program, during the 2003 Legislative Session, the General Assembly authorized the Legislative Audit Committee’s use of subpoena power to gather information. Senate Joint Resolution 03-050 authorized the Legislative Audit Committee (LAC) to evaluate the implementation of the Certified Capital Company Act and also gave the LAC “the power to subpoena records, to take testimony under oath, and to assemble records, documents and other evidence. . .” necessary to complete the evaluation.

Scope of Report

This report includes a brief description of the Program, a summary of the most up-to-date information about the Program, and policy options. As part of our review, we interviewed staff from the Governor’s Office of Economic Development and International Trade (the Office of Economic Development or the Office) and the Colorado Division of Insurance. We also interviewed representatives from the six certified capital companies currently in operation and representatives from some of the insurance companies and qualified businesses participating in the program. In addition, we contacted other states and national researchers. We reviewed and analyzed documentation collected and maintained by the Office of Economic Development and the Division of Insurance, and conducted a survey of Colorado’s
six CAPCOs. Finally, we requested an opinion from the Office of Legislative Legal Services (OLLS) on whether potential legislation to limit or eliminate the premium tax credit authorized by the Act would have implications related to Article X, Section 20, of the Colorado Constitution (The Taxpayer’s Bill of Rights or “TABOR”). Staff from the Office of Legislative Legal Services presented OLLS's opinion at the September meeting of the Legislative Audit Committee. We present a summary later in this report.

**Background**

**Venture Capital and Certified Capital Company Programs**

A Certified Capital Company program is a state economic development tool designed to encourage the growth of local small businesses and the formation and support of a local venture capital infrastructure. Venture capital refers to money for start-up, early stage, or expansion-stage companies and small businesses with significant growth potential. Using investors' money, venture capitalists create pools of capital that they invest in start-up companies in exchange for a desired return. A traditional venture capital company is capitalized or funded with investments from large institutions or wealthy individuals. These investments are fully at risk and all investors bear the risk. By contrast, CAPCOs are funded almost entirely with debt made possible by a state’s tax credit support. Nationally, insurance companies lend 99 percent to 100 percent of the total capitalization of most CAPCOs and these loans are usually fully guaranteed.

Under a CAPCO program, insurance companies are encouraged to invest in certified capital companies. In exchange, the state allows the insurance companies to claim tax credits for qualified investments in CAPCO funds. That is, in return for investments made, the insurance companies earn tax credits in lieu of the premium taxes they would have paid to the state. In a typical CAPCO, the insurance companies bear little equity risk and low credit risk. The equity risk in the CAPCO structure is borne almost entirely by the state. According to one national study, "the state provides the tax credits, and, as a result, sacrifices future revenue."

**Colorado's CAPCO Program**

When Colorado established its CAPCO Program, it became the sixth state, after Louisiana, Missouri, Wisconsin, Florida, and New York, to do so. According to Colorado Office of Economic Development staff, Alabama, Georgia, and Texas have
also since adopted CAPCO programs but have not yet implemented them for various reasons. (See Appendix C). At least 17 other states have considered, but, chosen not to adopt the CAPCO model.

Basically, Colorado's Program works in the following way. Insurance companies pay taxes to the State on policy holder premiums, instead of paying taxes on corporate profits. Under the CAPCO Program, state-certified capital companies seek insurance company investors to loan funds (certified capital) for the CAPCOs to then invest in qualified businesses. In exchange for the investments, insurance companies take an equivalent amount in tax credits against their insurance premium tax liabilities over a ten-year period. In addition, as detailed later in this report, the CAPCOs set aside some of the cash received to ensure the insurance companies ultimately receive their full investment back, plus a 5-10 percent guaranteed return regardless of the investment performance of the CAPCOs. Statutes allow for, but do not require, the State to receive any specified benefits. Indirect or noncash benefits are intended through the creation of jobs and associated tax revenues.

In total, the State of Colorado made $200 million in premium tax credits available. The first $100 million was issued in April 2002. The second $100 million is scheduled to be allocated in April 2004. For each $100 million in tax credits, $25 million is set up for a rural pool, to be used for investments in businesses located in designated rural counties, and $75 million is set up for a statewide pool to be used for eligible businesses located anywhere in the State.

The following two exhibits illustrate how the Program works: Figure 1 - Prior to the CAPCO Program and Figure 2 - After implementation of the CAPCO Program. In Figure 1, Prior to the CAPCO Program, all insurance premium taxes are paid primarily to the State's General Fund.
Insurance Companies Collect Insurance
Premiums from Colorado Citizens

Insurance Companies Remit Premium
Taxes to the Colorado Division of
Insurance Based on Gross Tax Liability

Colorado Division of Insurance Deposits
Premium Taxes in the
State General Fund

State Appropriates Monies from the
General Fund

Source: Office of the State Auditor analysis.

In Figure 2, the CAPCO Program has been implemented and the premium tax credits are issued to insurance companies in exchange for an equal amount of certified capital they loan to the CAPCOs. The CAPCOs then invest in qualified businesses with the anticipation that the businesses will grow and create more jobs. Although the tax credits diminish state revenues, the investments in qualified businesses hopefully yield enough economic growth to augment the State General Fund through job creation, increased income and sales, and the taxes thereon.
Insurance Companies Collect Insurance Premiums from Colorado Citizens

Insurance Companies Invest in Colorado Certified Capital Companies (CAPCOs) in Exchange for State Premium Tax Credits and Other Guaranteed Cash Payments From the CAPCOs

CAPCOs Invest in Qualified Colorado Businesses

CAPCO Investments Generate New Business Activity

New Business Activity Creates Jobs and Increases Gross Receipts of Qualified Businesses

New Business Activity Generates Sales, Income, and Other Taxes

Insurance Companies Use Tax Credits to Reduce Premium Tax Liability

Tax Credits Reduce State General Fund Revenues

Increased Tax Revenues Augment State General Fund

Source: Office of the State Auditor analysis of various data including CAPCO statutes.

The Major Stakeholders

The following section describes the major stakeholders in Colorado's CAPCO Program:

Certified Capital Companies - According to Section 10-3.5-103 (4), C.R.S., a Certified Capital Company means:

. . . a partnership, corporation, trust, or limited liability company, organized on a for-profit basis, that has its principal office located or
is headquartered in Colorado, that has as its primary business activity the investment of cash in qualified businesses or qualified rural businesses, and is certified by the Office as meeting the criteria of this article.

The CAPCO regulations, promulgated by the Office of Economic Development, required that all applicants provide a completed Certified Capital Company Application, along with a nonrefundable fee of $7,500 to the Office no earlier than October 31, 2001 to be eligible for the first round of premium tax credit allocations. The Office reports that it received initial applications from nine companies. Of these nine companies, eight were certified as CAPCOs. Office staff explained that one company was not certified because it failed to respond to requests for additional information. The eight companies certified to participate in the 2002 allocation were: Advantage Capital Colorado Partners, I, L.P., Enhanced Colorado Issuer, L.L.C., Murphree Colorado CAPCO, L.P., Red Rock Capital, L.L.C., Stifel Colorado Ventures, L.L.C., Stonehenge Capital Fund Colorado, L.L.C., Waveland Colorado Ventures, L.L.C., and Wilshire Colorado Partners, L.L.C. Two of the eight companies originally certified for the 2002 Allocation ultimately did not participate—Stifel Colorado Ventures, L.L.C., and Red Rock Capital, L.L.C. Therefore, of the eight companies originally certified, six are currently operating as CAPCOs in Colorado.

According to one national study released in 2001, three organizations had received the majority of all CAPCO tax credits awarded by states at that time. These three companies all have CAPCO operations in Colorado: Advantage Capital of New Orleans and St. Louis; Stonehenge Capital of Baton Rouge and Columbus, Ohio; and Newtek, a publicly-traded New York firm, also known as The Wilshire Group.

**Insurance Companies** - After the CAPCO receives its premium tax credit allocation, it issues the tax credits to the investing insurance companies. In addition, the insurance companies are guaranteed cash repayments from the CAPCOs. According to the Division of Insurance, there are about 1,400 insurance companies operating in Colorado that could have participated in the CAPCO Program. We found that 77 different insurance companies received premium tax credits from the six certified CAPCOs for the first allocation of $100 million. In four cases, the same insurance company received premium tax credits from two different CAPCOs. The number of different insurance companies making commitments for certified capital to a single CAPCO ranged from a high of 24 to a low of 2. As will be discussed in detail later in this report, the initial requests from insurance companies for credits far exceeded the first allocation of $100 million. Initially, the six CAPCOs submitted $454 million in requests to the Office of Economic Development from insurance companies for the first $100 million in premium tax credits to be taken over ten years.
Qualified Businesses - According to statute, a qualified business must meet all of the following conditions at the time of the CAPCO's first investment: (1) the business must be headquartered and its principal business operations must be located in Colorado; (2) it is a small business concern as defined by the United States Small Business Administration; and (3) it is not a business predominately engaged in professional services provided by accountants or lawyers. In addition, CAPCO regulations require that CAPCOs must make investments in businesses that are unable to obtain conventional funding or financing from the Office of Economic Development's federal Revolving Loan Funds operating in the State.

As we describe later in the report, the CAPCOs reported that they reviewed a total of about 1,150 applications from Colorado businesses requesting investments of certified capital. As of July 31, 2003, a total of 13 qualified businesses had received $9.2 million in CAPCO investments. Overall, the $9.2 million in investments represented 16 separate capital contributions to 13 different companies located in 9 different Colorado counties.

Colorado Office of Economic Development and International Trade - By statute, the Office of Economic Development has primary responsibility for oversight of the CAPCO Program. In accordance with statutes, the Director of the Office has promulgated rules to implement the provisions of the Certified Capital Company Act. In addition, some of the Office's specific statutory responsibilities include: allocating each pool of tax credits to participating CAPCOs; conducting an annual review of each CAPCO to determine whether it is abiding by the requirements of certification; advising CAPCOs as to the eligibility status of their qualified investments; and ensuring that no investment has been made in violation of statutory requirements. The Office is also authorized to decertify a CAPCO for any material violation of the requirements for continuance of certification contained in the statutes. Office staff report that they have not decertified any CAPCO for a material violation of the provisions.

Colorado Division of Insurance - As part of its responsibilities for ensuring that taxes are paid and collected, the Division of Insurance must verify whether the amount of premium tax credits allocated by the Office of Economic Development reconciles with the amount of premium tax credits claimed by the participating insurance company investors. The first series of tax credits can be claimed by insurance companies beginning with the 2003 tax year.
The First $100 Million of Certified Capital

In April 2002, the CAPCOs received $100 million of certified capital from the participating insurance companies after receiving notice of the $100 million allocation in premium tax credits from the Office of Economic Development. Thus far, according to the Office, the CAPCOs have committed more than $59 million of certified capital for purposes other than investments in qualified Colorado businesses. About $9.2 million had been invested in qualified businesses as of July 31, 2003, as the following exhibit shows. It should be noted that subsequent to our review time frame of July 2003, the CAPCOs report making another $4.9 million in investments in qualified businesses as of the middle of August, 2003.
As the exhibit shows, the first $100 million has been distributed as follows:

C Guaranteed Cash Repayments - In addition to the tax credits, the insurance company investors received guaranteed cash repayments from the CAPCOs. Because the insurance companies are loaning the CAPCOs $100 million dollars today, but can only use the associated tax credits at a rate of
$10 million per year, the entire $100 million will not be reimbursed through the tax credits for at least 10 years. One dollar in premium tax credits today does not have the same value as one dollar in premium tax credits 10 years from today. Therefore, the CAPCOs have set aside about $44 million in investments, or 44 percent, of the $100 million total. This “set aside,” is to finance future cash repayments to the insurance companies to compensate them for the loss in value of the credits in future years and to meet the guaranteed rates of return negotiated between the CAPCOs and the insurance companies. The CAPCOs will finance the repayment to the insurance companies through the purchase of U.S. Government bonds or other debt instruments. We reviewed bank records and other financial documents verifying that the CAPCOs received loans from insurance companies equaling the amount of premium tax credits allocated. We determined that the CAPCOs' receipt of investment capital (loans) reconciled to the amount of premium tax credits allocated.

C Start-up and Related Costs - Statute allows the CAPCOs to make certain distributions from certified capital on an as-needed basis. Such distributions include payment for costs related to the formation of the CAPCO and the financing and insuring of the CAPCOs’ obligations. Specifically, Section 10-3.5-103(13)(a), C.R.S., states that a qualified distribution may include, "Reasonable costs and expenses of forming, syndicating, and organizing the certified capital company, including reasonable and necessary fees paid for professional services, including, but not limited to, legal and accounting services, related to the formation of the certified capital company, and the cost of financing and insuring the obligations of the certified capital company." We estimate that $11.3 million has either been expended or incurred by the CAPCOs for the purposes of forming their companies and financing/insuring their obligations to repay their insurance company investors.

C Available for Initial Investment - After accounting for the costs of the guaranteed cash repayments and for the costs related to financing and insuring the repayments as described above, approximately $44.4 million of the original $100 million remained for the CAPCOs to invest in qualified businesses.

C Management Fees and Other Expenses - According to Section 10-3.5-103 (13), C.R.S., in addition to start-up and financing costs, the CAPCOs may make additional, qualified distributions and reimburse themselves annually for the reasonable costs and expenses of managing and operating the CAPCO. By statute, a qualified distribution means any distribution out of certified capital in connection with, “(b) reasonable costs and expenses of
managing and operating the certified capital company, including an annual management fee in an amount that does not exceed two and one-half percent of certified capital; except that no such costs or expense shall be paid to a certified investor or affiliate of a certified investor and that such costs and expenses in the aggregate shall not exceed five percent of certified capital in any one year; (c) reasonable and necessary fees in accordance with industry custom for professional services, including, but not limited to, legal and accounting services, related to the operation of the certified capital company; and (d) any projected increase in federal or state taxes, including penalties and interest related to state and federal income taxes. . . ” As of December 31, 2002, the CAPCOs reported that they had recouped a total of $3.9 million in management and other fees.

According to the Colorado Office of the Secretary of State, the CAPCOs spent $471,503 on lobbyists since Calendar Year 2000. According to self-reported data from the CAPCOs, about $85,000 of this total was financed with certified capital from the Colorado CAPCO Program. The remainder of the lobbying expenditures were financed through other sources, including funds from the CAPCOs’ parent companies.

C Invested in Colorado Businesses - Investments in 13 qualified businesses as of July 31, 2003, totaled about $9.2 million. At the point of investment, this money is no longer available to the CAPCOs for additional investments or distributions until it is repaid.

C Available for Investment in Colorado Businesses or for Qualified Distributions as of July 31, 2003 - After deducting the costs associated with guaranteed cash repayments, operational expenses, and the initial investments of $9.2 million, a total of $31.3 million of the original $100 million remained available for additional investments in Colorado businesses and other qualified expenses as of July 31, 2003. It should be noted that this amount will be reduced due to ongoing management and other expenses incurred by the CAPCOs after December 31, 2002. To meet the investment thresholds required by statute, discussed later in this report, the CAPCOs will be required to continually re-invest their returns from previous qualified investments or obtain or borrow cash from other sources.

2002 Allocation of Tax Credits

The demand, on the part of insurance companies, to participate in the CAPCO Program far exceeded the $100 million in tax credits available in the 2002
Allocation. In fact, the requests for premium tax credits were greater than the aggregate amount of credits available under both the 2002 and the 2004 Allocations. As noted earlier, on the first day the Office recognized requests for the 2002 Allocation, the six CAPCOs submitted requests from potential insurance company investors totaling $454 million. This total was split into a statewide pool of $347.8 million and a rural pool of $106.2 million.

Section 10-3.5-106 (3), C.R.S., and the CAPCO Regulations stipulate that when requests or claims exceed available credits, the Office will allocate the premium tax credits on a pro rata basis for each specific pool (i.e., Rural and Statewide). In accordance with this allocation methodology, each certified investor (insurance company) received premium tax credits equal to approximately 24 percent of the requests it submitted for the 2002 Rural Pool and approximately 22 percent of the requests submitted for the 2002 Statewide Pool. The following chart shows the amount of requests submitted by each CAPCO on behalf of their insurance company investors and the amount of premium tax credits allocated to each by the Office of Economic Development.

<table>
<thead>
<tr>
<th>CAPCO</th>
<th>Rural Requests</th>
<th>Rural Pool</th>
<th>Statewide Requests</th>
<th>Statewide Pool</th>
<th>Total Requests</th>
<th>Total Allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantage Capital Colorado Partners I, L.P.</td>
<td>25.0</td>
<td>5.9</td>
<td>75.0</td>
<td>16.2</td>
<td>100</td>
<td>22.1</td>
</tr>
<tr>
<td>Enhanced Colorado Issuer, L.L.C.</td>
<td>25.0</td>
<td>5.9</td>
<td>75.0</td>
<td>16.2</td>
<td>100</td>
<td>22.1</td>
</tr>
<tr>
<td>Murphree Colorado Capital, L.P.</td>
<td>0</td>
<td>0</td>
<td>29.0</td>
<td>6.2</td>
<td>29</td>
<td>6.2</td>
</tr>
<tr>
<td>Stonehenge Capital Fund Colorado, L.L.C.</td>
<td>25.0</td>
<td>5.9</td>
<td>75.0</td>
<td>16.2</td>
<td>100</td>
<td>22.1</td>
</tr>
<tr>
<td>Waveland Colorado Ventures, L.L.C.</td>
<td>6.2</td>
<td>1.4</td>
<td>18.8</td>
<td>4.0</td>
<td>25</td>
<td>5.4</td>
</tr>
<tr>
<td>Wilshire Colorado Partners, L.L.C.</td>
<td>25.0</td>
<td>5.9</td>
<td>75.0</td>
<td>16.2</td>
<td>100</td>
<td>22.1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$106.2</strong></td>
<td><strong>$25.0</strong></td>
<td><strong>$347.8</strong></td>
<td><strong>$75.0</strong></td>
<td><strong>$454</strong></td>
<td><strong>$100.0</strong></td>
</tr>
</tbody>
</table>

Source: Office of the State Auditor analysis of the Office of Economic Development’s Premium Tax Credit Allocation award letters.
As the demand for premium tax credits indicates, the CAPCO Program is a highly desirable investment vehicle for insurance companies. The CAPCOs submitted requests for 2002 premium tax credits on behalf of their investors that were approximately 4.5 times the amount available under the Program. In fact, four of the six CAPCOs submitted requests for the maximum amount of premium tax credits available under the Program for each specific pool.

**Statutory Investment Thresholds**

According to Section 10-3.5-107 (1), C.R.S., CAPCOs must invest certain portions of their certified capital into qualified investments within designated time frames to remain certified. By statute, if a CAPCO does not remain certified, its investors may have to repay tax credits taken and/or forfeit future tax credits. After CAPCOs have raised certified capital and been allocated premium tax credits by the State, they must make qualified investments in Colorado businesses according to the following schedule:

- **C** Within three years of the April 15, 2002 allocation date, at least 30 percent, or $30 million, of the monies received by the CAPCO must be invested in qualified investments.

- **C** Within five years of the April 15, 2002 allocation date, at least 50 percent, or $50 million, of the monies received by the CAPCO must be invested in qualified investments.

These investment schedules apply to the statewide and rural pools separately. At no time, however, is a CAPCO required to invest 100 percent of its certified capital in qualified investments to remain certified. We found that as of July 31, 2003, the CAPCOs were at 55 percent of reaching the three-year threshold for the Statewide Pool and were at only 20 percent of the three-year threshold for the Rural Pool. In fact, only one CAPCO had deployed any capital from its Rural Pool. Four of the five CAPCOs that received an allocation from the Rural Pool had not made any investments with their rural funds at the time of our analysis.

Section 10-3.5-107 (2), C.R.S., also provides an incentive for CAPCOs to invest in designated rural counties, as defined in statute, and in distressed urban communities, as defined by the Office of Economic Development. A CAPCO that invests funds from the 2002 Statewide Pool ($75 million) in either a designated rural county or distressed urban community will receive two dollars credit for every one dollar invested. If all of the Statewide Pool was invested in a designated rural county or distressed urban community, the CAPCOs would only be required to invest
$31.25 million in qualified Colorado businesses to remain certified. The investments already made by the CAPCOs, however, indicate that much of the 2002 Statewide Pool will be used in non-designated areas of the State. As of July 31, 2003, the six CAPCOs have invested approximately 17 percent of the Statewide Pool and about 6 percent of the Rural Pool. One CAPCO, Wilshire Colorado Partners, L.L.C., has reached the 30 percent investment schedule for its share of the 2002 Statewide Pool.

**CAPCO-Invested Businesses**

As previously stated, the six CAPCOs reported that they made investments in Colorado businesses totaling about $9.2 million as of July 31, 2003. In addition, three of the CAPCOs reported investments made after July 2003 of $4.9 million. Thus, the CAPCOs reported that they have invested a total of about $14.1 million in Colorado businesses since the start of the Program through mid August 2003. As such, the CAPCOs have invested about 14 percent of the $100 million allocated during the past 16 months. Because the $4.9 million in investments was made after the time period identified in our review, they will not be included in the remainder of our analysis.

The CAPCOs had invested in 13 Colorado businesses through July 31, 2003. Overall, the $9.2 million in investments represents 16 separate contributions to 13 different companies located in 9 different Colorado counties. According to the CAPCOs, the 13 businesses receiving the $9.2 million of certified capital also received an additional $37 million from other investors. Four of the 13 businesses receiving investments are located in a designated rural county; these investments totaled about $4.5 million. One business, located in Clear Creek County, received about 73 percent of the total designated rural investments. Two of the 13 businesses receiving investments are located in distressed urban communities. Investments in these businesses totaled more than $1.6 million.

The following exhibit shows the number of businesses in which each CAPCO invested and the total amount of investments made by each. The exhibit shows that 14 businesses in which investments were made because, in one case, two CAPCOs invested in the same business.
## Number of Businesses Receiving CAPCO Investments

### As of July 31, 2003

<table>
<thead>
<tr>
<th>CAPCO</th>
<th>Number of Businesses</th>
<th>Total Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advantage Capital Colorado Partners, I, L.P.</td>
<td>5</td>
<td>$1,702,000</td>
</tr>
<tr>
<td>Enhanced Colorado Issuer, L.L.C.</td>
<td>1</td>
<td>750,000</td>
</tr>
<tr>
<td>Murphree Colorado CAPCO, L.P.</td>
<td>3</td>
<td>851,000</td>
</tr>
<tr>
<td>Stonehenge Capital Fund Colorado, L.L.C.</td>
<td>1</td>
<td>1,240,000</td>
</tr>
<tr>
<td>Waveland Colorado Ventures, L.L.C.</td>
<td>2</td>
<td>750,000</td>
</tr>
<tr>
<td>Wilshire Colorado Partners, L.L.C.</td>
<td>2</td>
<td>3,909,000</td>
</tr>
<tr>
<td><strong>All CAPCOs</strong></td>
<td><strong>14</strong></td>
<td><strong>$9,202,000</strong></td>
</tr>
</tbody>
</table>

**Source:** Office of the State Auditor analysis of self-reported investment data provided by the CAPCOs.

## Location of Business Investments

The map on the next page shows Colorado's 64 counties. Highlighted areas are either designated rural counties (light blue), per statute or distressed urban communities (dark blue), as defined by the CAPCO regulations. The map also indicates the total number of businesses and the total invested in each county that received certified capital as of July 31, 2003. Section 10-3.5-103 (6), C.R.S., defines a designated rural county as:

> . . . any county, but not any city and county, in this state that, as of June 9, 2001, has a population of not more than one hundred fifty thousand people and, if the county's population exceeds twenty thousand people, that has a growth rate that does not exceed the statewide average for the period 1990-2000 by more than twenty-five percent as defined in the two most recent decennial censuses.

By statutory definition, 49 of Colorado's 64 counties, or 77 percent, are considered designated rural counties. Furthermore, CAPCO Regulations define distressed urban communities as any area that is not within a designated rural county that has been designated as an Enterprise Zone by the Colorado Economic Development Commission. Investments from the Statewide Pool in any of the highlighted areas on the map provide the CAPCOs with a two dollar for one dollar incentive, meaning the CAPCOs can meet the investment thresholds required by statute without investing the full 30 or 50 percent of certified capital within 3 or 5 years, respectively.
Designated Rural Counties  $ - Total CAPCO Investments
Distressed Urban Communities (#) - Qualified Businesses

FREMONT

Garfield
Adams
Arapahoe
Boulder
Clear Creek
Denver
Jefferson
La Plata
Clear Creek
Denver
Jefferson
El Paso
La Plata
$703,256 (1)
$1,890,000 (3)
$150,000 (1)
$3,908,665 (2)
$750,000 (1)
$850,000 (2)
$400,000 (1)
$400,000 (1)
$500,000 (1)
$150,000 (1)

CAPCO Investments
As of July 31, 2003

$ - Total CAPCO Investments
(#) - Qualified Businesses
Approximately 88 percent, or $3.9 million, of the investments made in designated rural counties have been in two businesses located in Clear Creek County. In total, Clear Creek County has received about 43 percent of all investments made by CAPCOs. The county receiving the second greatest amount of investments was Arapahoe County with approximately 21 percent, or about $1.9 million, of total investments. The CAPCOs reported they reviewed about 1,150 applications from Colorado businesses requesting investments, including about 240 applications from businesses located in designated rural counties and 125 applications from businesses located in distressed urban communities. This indicates that the CAPCOs, on average, evaluated 82 applications for every investment selected. The CAPCOs reviewed 61 rural applications for every rural investment chosen and about 63 distressed urban community applications for each of these investments chosen.

Types of Businesses and Employment

We were unable to obtain independent information about the jobs created as a result of the CAPCO Program from the Office of Economic Development, because, according to staff, the statutes do not require documentation of economic benefits. Therefore, the Office lacks the authority to request job information directly from businesses. As a result, the Office is unable to determine the number and types of Colorado jobs created or retained after businesses receive certified capital from CAPCOs. The Office also does not have the authority to inspect the records or operations of the businesses that receive this funding; therefore, the Office has to rely on information self-reported by the CAPCOs. If the Office had access to wage reports or other employment information, it would be able to determine or verify employment data.

Because of the importance of job creation to the ultimate success of the Program, we provide data reported by the CAPCOs. However, these data should be viewed with caution as they are self-reported, and because, as described later in this section, we noted some inconsistencies. The following exhibit shows the 13 different businesses in which the CAPCOs invested and the number of jobs reportedly created. As the exhibit shows, we estimate from data reported by the CAPCOs on our survey questionnaire, that the number of employees of these 13 businesses increased from 245 positions at the time of investment to approximately 402 positions as of July 31, 2003, for a net increase of 157 positions. One company experienced a net decrease during the period, and two companies had no net change in jobs. The exhibit also shows that CAPCO investments were made in 7 of the 20 (35 percent) industry sectors identified in the North American Industrial Classification System (NAICS). Investments in the category of Finance and Insurance and Professional, Scientific, and Technical Services represented about 53 percent of the total investments made by the CAPCOs.
## Qualified Businesses Receiving CAPCO Investments
### 2002 Allocation
#### As of July 31, 2002

<table>
<thead>
<tr>
<th>Business</th>
<th>County</th>
<th>Sector</th>
<th>Amount of Investment</th>
<th>Percent of Total Investment</th>
<th>Change in FTE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Next Action Corporation</td>
<td>Jefferson</td>
<td>Professional/Scientific/Technical</td>
<td>$400,000</td>
<td>6</td>
<td>30</td>
</tr>
<tr>
<td>Connexx Technologies</td>
<td>Jefferson</td>
<td>Professional/Scientific/Technical</td>
<td>450,000</td>
<td>4</td>
<td>38</td>
</tr>
<tr>
<td>Federation, Inc.</td>
<td>Arapahoe</td>
<td>Professional/Scientific/Technical</td>
<td>300,000</td>
<td>5</td>
<td>4</td>
</tr>
<tr>
<td>Ischemia Technologies</td>
<td>Adams</td>
<td>Manufacturing</td>
<td>703,256</td>
<td>9</td>
<td>0</td>
</tr>
<tr>
<td>Anark Corporation</td>
<td>Boulder</td>
<td>Wholesale Trade</td>
<td>150,000</td>
<td>4</td>
<td>11</td>
</tr>
<tr>
<td>StorePerform</td>
<td>Denver</td>
<td>Information</td>
<td>750,000</td>
<td>60</td>
<td>0</td>
</tr>
<tr>
<td>Spin Maps, Inc.</td>
<td>La Plata</td>
<td>Information</td>
<td>150,000</td>
<td>100</td>
<td>0.5</td>
</tr>
<tr>
<td>Altia, Inc.</td>
<td>El Paso</td>
<td>Professional/Scientific/Technical</td>
<td>400,000</td>
<td>100</td>
<td>0.5</td>
</tr>
<tr>
<td>Classic Events, L.L.C.</td>
<td>Arapahoe</td>
<td>Real Estate/Rental/Leasing</td>
<td>1,240,000</td>
<td>59</td>
<td>64</td>
</tr>
<tr>
<td>BOA Technology, Inc.</td>
<td>Routt</td>
<td>Manufacturing</td>
<td>400,000</td>
<td>39</td>
<td>2</td>
</tr>
<tr>
<td>Parker Medical, L.P.</td>
<td>Arapahoe</td>
<td>Manufacturing</td>
<td>350,000</td>
<td>100</td>
<td>0</td>
</tr>
<tr>
<td>Universal Processing</td>
<td>Clear Creek</td>
<td>Finance &amp; Insurance</td>
<td>3,308,665</td>
<td>100</td>
<td>6</td>
</tr>
<tr>
<td>New Technologies</td>
<td>Clear Creek</td>
<td>Administrative &amp; Support</td>
<td>600,000</td>
<td>100</td>
<td>1</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td></td>
<td><strong>$9,201,921</strong></td>
<td>NA</td>
<td>157</td>
</tr>
</tbody>
</table>

**Source:** Office of the State Auditor analysis of information provided by Certified Capital Companies.

**Note:** Percent of Total Investment is calculated by dividing a CAPCO's investment in a qualified business by the total investment received by the business on the same day. (See Appendix B for a description of the businesses).

As indicated earlier, we noted inconsistencies in the job data provided by the CAPCOs. For instance, two CAPCOs provided funding to the same company on the same date but reported different employment data for this company. One CAPCO reported that the company experienced a net decrease in employment, while the other reported no net gain in FTE positions over the same time period.

Another concern relates to the tracking and reporting of seasonal or part-time employees. A full-time position will have a much greater impact on Colorado's economy and provide for greater returns to the state in terms of income and sales taxes than will part-time and seasonal positions. No provisions for these differences are accounted for in these job creation data. Finally, the net gain in jobs identified...
may not solely be attributable to CAPCO financing. As the preceding exhibit shows, for some of the businesses, the amount of qualified investments received from the CAPCOs constituted only a fraction of the investments received. In several instances, the CAPCOs' investments represented 5 percent or less of all investments received. In these cases, it is questionable whether the jobs created after receiving the CAPCO financing were attributable solely to that financing. Proponents of the CAPCO Program argue that although the investments from CAPCOs may be small, they act as the linchpin in attracting larger and more cautious venture capital investors.

**Development Stage of Businesses Receiving CAPCO Investments**

We asked the CAPCOs to identify the stage of development of each business in which they invested certified capital. The four stages of development included:

C **Seed/Start-up** - The initial stage. The company has a concept or product under development, but is probably not fully operational, usually having been in existence less than 18 months.

C **Early Stage** - The testing or pilot production stage. In some cases, the product may be commercially available and may or may not be generating revenues. Usually in business fewer than three years.

C **Expansion Stage** - Product or service is in production and commercially available. The company demonstrates significant revenue growth, but may or may not be showing a profit. Usually in business more than three years.

C **Later Stage** - Product or service is widely available. Company is generating on-going revenue; probably positive cash flow. More likely to be, but not necessarily, profitable. May include spin-outs of operating divisions of existing private companies and established private companies.

The CAPCOs reported that $3.9 million of their investments were in start-up businesses, about $3.4 million were in early-stage businesses, $1.5 million were in expanding businesses, and $400,000 were in later-stage businesses. Overall, approximately 79 percent of the CAPCOs' investments were made in seed or early-stage businesses. We found inconsistencies in the stage of development data provided by the CAPCOs. Specifically, two CAPCOs which invested in the same business on the same day reported different stages of development. One CAPCO reported that the investment was made in an expanding business, the other CAPCO indicated that the investment was in an early-stage business.
Type of Investments

Approximately 65 percent of the CAPCOs' investments, or about $6 million, have been equity transactions. The remaining 35 percent, or almost $3.2 million, in investments made by the CAPCOs were debt transactions including lines of credit and loans. Equity transactions mean that the CAPCOs purchased an ownership stake in the business. The equity investments resulted in the CAPCOs owning from a low of 1.4 percent of a business to a high of 95 percent of a business. Statutes do not place any limitation on the percentage of a business that a CAPCO may own. However, statutes do limit the percentage of total certified capital a CAPCO may invest in any one business. Specifically, Section 10-3.5-107 (4), C.R.S., states that a certified capital company shall not invest more than 15 percent of its total certified capital in any one qualified business or qualified rural business.

Cost of the Program to the State

Section 10-3.5-106 (1), C.R.S., provides that the $100 million in premium tax credits for the 2002 Allocation will be taken, in the aggregate, at a rate of $10 million per year beginning in tax year 2003. The first opportunity for insurance companies to use the credits from the 2002 Allocation to offset their tax liability for 2003 will be on tax returns filed in early 2004. Statute also provides that the $100 million in premium tax credits for the 2004 Allocation will be taken, in the aggregate, at a rate of $10 million per year beginning in tax year 2005. Thus, insurance companies investing in both the 2002 and 2004 Allocations will be allowed to use premium tax credits for a period of not less than 12 years. In addition, an insurance company may not have sufficient liability in a single year to claim all of the credit due. Therefore, the remaining value of the credits may be rolled forward and taken in up to 10 subsequent years. Consequently, it is possible that some investors could be claiming credits until 2024.

The following chart shows the maximum amount of tax credits that can be claimed per tax year and the resulting effect on the Division of Insurance's collections of insurance premium taxes. We project that the $200 million in premium tax credits available under the CAPCO Program will potentially reduce the total premium taxes collected by an average of 5 percent, per year, over the next 12 years, having a direct impact on the State's General Fund.
<table>
<thead>
<tr>
<th>Calendar Tax Year</th>
<th>2002 Tax Credits</th>
<th>2004 Tax Credits</th>
<th>Total Tax Credits</th>
<th>Projected Tax Collections</th>
<th>Collections Net of Tax Credits</th>
<th>Percent Decrease</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>$10</td>
<td>$0</td>
<td>$10</td>
<td>$180.3</td>
<td>$170.3</td>
<td>5.55%</td>
</tr>
<tr>
<td>2004</td>
<td>10</td>
<td>0</td>
<td>10</td>
<td>199.0</td>
<td>189.0</td>
<td>5.03</td>
</tr>
<tr>
<td>2005</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>219.6</td>
<td>199.6</td>
<td>9.11</td>
</tr>
<tr>
<td>2006</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>242.3</td>
<td>222.3</td>
<td>8.25</td>
</tr>
<tr>
<td>2007</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>267.4</td>
<td>247.4</td>
<td>7.48</td>
</tr>
<tr>
<td>2008</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>295.1</td>
<td>275.1</td>
<td>6.78</td>
</tr>
<tr>
<td>2009</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>325.6</td>
<td>305.6</td>
<td>6.14</td>
</tr>
<tr>
<td>2010</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>359.3</td>
<td>339.3</td>
<td>5.57</td>
</tr>
<tr>
<td>2011</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>396.5</td>
<td>376.5</td>
<td>5.04</td>
</tr>
<tr>
<td>2012</td>
<td>10</td>
<td>10</td>
<td>20</td>
<td>437.6</td>
<td>417.6</td>
<td>4.57</td>
</tr>
<tr>
<td>2013</td>
<td>0</td>
<td>10</td>
<td>10</td>
<td>482.8</td>
<td>472.8</td>
<td>2.07</td>
</tr>
<tr>
<td>2014</td>
<td>0</td>
<td>10</td>
<td>10</td>
<td>532.8</td>
<td>522.8</td>
<td>1.88</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$100</strong></td>
<td><strong>$100</strong></td>
<td><strong>$200</strong></td>
<td><strong>$3,938.3</strong></td>
<td><strong>$3,738.3</strong></td>
<td><strong>5.08%</strong></td>
</tr>
</tbody>
</table>

**Source:** Office of the State Auditor analysis of information provided by the Division of Insurance and the Office of Economic Development.

**Note:** The amount of the projected tax collections was based on a straight line projection to arrive at the annual amount of insurance premium taxes. We used the average, annual increase in insurance premium taxes collected between tax years 1998 and 2002 or 10.35 percent and projected forward. Credits are assumed to be taken in full in the first year they can be claimed.
Responsibility for Oversight of the Tax Credits

The Division of Insurance, with assistance from the Office of Economic Development, will be required to monitor and track the amount of premium tax credits taken by insurance companies. The Division of Insurance will need to certify that all insurance companies claiming the credits were: (1) allocated tax credits by the Office of Economic Development; (2) that such credits do not exceed 10 percent of each insurance company's total allocation; and, (3) that the tax credits taken do not exceed the state premium tax liability of each company for each tax year.

As previously stated, statutes allow an insurance company to carry forward all unused credits for up to ten years from the date upon which the credit may first be used. Statutes also permit premium tax credits to be transferred and sold by the insurance companies. The Office of Economic Development has promulgated rules governing this process. Regulations require all owners of premium tax credits to submit an annual report to the Office no later than January 31st of each year providing details of the sale and transfer of tax credits. A copy of the annual reports must also be provided to the Division of Insurance. To effectively monitor this process, the Office of Economic Development and the Division of Insurance will need to work closely together.

Policy Options

During and after the 2003 Legislative Session, concerns about the cost-effectiveness of the CAPCO Program surfaced. In the Summer of 2003, the Colorado State Treasurer convened a working group to provide a forum for broader discussion about the Program. At an August 2003 public meeting of the working group, both the State Treasurer and the Governor, through his Director of the Office of Economic Development and International Trade, announced their support for restructuring or reforming the Program.

Questions about the cost-effectiveness of the CAPCO system are not unique to Colorado. Other states, like Florida, are currently considering significant changes to their programs, including eliminating future pools of premium tax credit allocations. In addition, extensive research has been conducted on the costs and benefits to state governments from this form of venture capital. Research indicates that CAPCO Programs are the most inefficient means for a state to raise venture capital. According to one CAPCO researcher, "the principal problem with the CAPCO Program is the large share of funds (40-60 percent) raised that are not available for
investing in qualified businesses because they are held in government securities to guarantee the insurance companies’ initial investments." We found this to be true of the Colorado CAPCO Program. As previously stated, of the original $100 million in premium tax credits, only about $44.4 million was available to invest in Colorado businesses, and the remaining 55.6 percent was used by the CAPCOs to guarantee the insurance companies repayment of their initial investments and to pay for start-up and other related costs. Further, CAPCOs can be reimbursed for management and certain other fees from certified capital on an annual basis.

Fundamental statutory changes to the CAPCO Program necessitate careful thought as to the purpose of the Program and its intended benefit(s). In the following sections we discuss changes to the Program which merit consideration as part of the ongoing discussions. We provide some possible options for changing the current Program structure and the statutes governing it. The issues and options we present are based on our analysis of the Program, discussions with staff from the Office of Economic Development and Division of Insurance, representatives from the six CAPCOs, and some of the participating businesses and insurance companies. We also assessed the responses to our survey questionnaire of the CAPCOs, the experiences of other states, and the findings of national research studies. Our discussion is organized into two main areas: (1) fundamental reform - addressing a complete overhaul of the Program; and (2) improvements to the current system.

**Fundamental Reform**

Critics of the CAPCO Program argue that tax monies could be put to more effective and appropriate use elsewhere and that the Program’s structure is flawed by not providing sufficient, direct benefits to the State and to taxpayers. Consequently, discussions at the policy level have involved making fundamental changes to the Program. Some of the proposals for change include: eliminating the 2004 Allocation; replacing the 2004 Allocation with a more typical venture capital structure (a RFP process for selecting venture capital companies); restructuring the Program by redirecting tax credits toward health insurance or some other state program, and establishing a state agency with authority for investing in economic development venture capital and, thereby, eliminating additional management overhead.

Because of concerns that statutory amendments to the Program could have implications under Article X, Section 20, of the Colorado Constitution (The Taxpayer’s Bill of Rights or “TABOR”), we requested an opinion from the General Assembly’s Office of Legislative Legal Services. Specifically, we asked whether potential legislation to limit or eliminate the premium tax credit authorized by the Certified Capital Company Act would be a tax policy change directly causing a net
revenue gain to any district that would have to be referred to the voters of the State under "TABOR". In summary, the Office of Legislative Legal Services concluded that, yes, legislation to limit or eliminate the premium tax credit would be a tax policy change requiring referral to the voters of Colorado unless:

. . . the legislation also includes one or more related tax credits or reductions that would offset any net revenue gain resulting from that limitation or elimination.

To date there has been no court guidance on what would qualify as an offsetting tax credit. In addition to the legal opinion we received from the Office of Legislative Legal Services, dated September 8, 2003, the Office of Economic Development requested legal guidance from the Colorado Attorney General's Office regarding possible changes to the Program. (At the time of this report, the informal Attorney General's Opinion had not been released). In an August 25, 2003, letter to legislators, the Governor stated that the Program “must be restructured in order to ensure that Colorado receives the maximum benefit from the second $100 million investment.” Further, the Governor stated that he is suggesting the Program be significantly reformed and that “While a balance must be reached, our restructured program should place investment emphasis on new and growing Colorado companies.”

**Improvements to the Current System**

In addition to evaluating a complete overhaul, substantial changes to the current system should be considered. In the following sections we discuss a number of areas in which changes could be made to the current system to strengthen Program oversight and enhance achievement of the Program’s intent. The areas we discuss are:

- C The use of monies from the statewide pool in rural counties
- C Controls over qualified businesses
- C Direct cash benefits to the State
- C The types of businesses in which investments are made
- C The costs associated with organizing, managing, and operating the certified capital companies
- C Authority for Program oversight.
Statewide Monies in Designated Rural Counties

Section 10-3.5-107 (2), C.R.S., allows the CAPCOs to use monies from their Statewide Pools to invest in distressed urban communities or qualified rural businesses and receive a $2 for $1 incentive for doing so. This means that every $1 invested by a CAPCO from its Statewide Pool into a qualified rural business, will count as $2 toward achieving the 30 and 50 percent threshold requirements. A CAPCO may use monies from its statewide pool to invest in a business located in a designated rural county and receive the $2 for $1 incentive even if monies from its rural pool are available at the time of investment. A CAPCO does not receive this incentive if it uses funds from its rural pool to invest in designated rural counties. While this provision could increase investment in rural counties, it could also reduce the amount that is required to be invested overall from the 30 and 50 percent thresholds, to 15 and 25 percent, respectively.

During our review of the investments made by CAPCOs in qualified businesses through July 31, 2003, we identified two instances in which CAPCOs used monies from their 2002 statewide pools to invest in designated rural counties when monies from their 2002 rural pools were available. In total, the two CAPCOs invested more than $2.8 million in statewide monies, but will receive credit for investing double that figure, or $5.6 million. If the two CAPCOs had used monies from their rural pools, the investments would have been counted on a dollar-for-dollar basis. Neither the rural incentive nor the two-for-one provision are common in other states. Statutes could be amended to eliminate this provision or to allow the $2-for-$1 incentive only after all monies from a CAPCO’s rural pool has been exhausted.

Controls Over Qualified Businesses

There are no statutory requirements that a business remain headquartered in Colorado for a specific time, that a business create a specific number of jobs, that CAPCOs own only a specified amount of the businesses in which they invest, or that an investment of certified capital be used by a business within the State. Statute specifies that all investments of certified capital must be made in qualified businesses. As described earlier in this report, Section 10-3.5-103 (11), C.R.S., defines a qualified business as one that as of the time of the initial investment is headquartered in this State, has its principal business operations located in this State, is a small business concern, and, is not a business predominantly engaged in professional services provided by accountants or lawyers.

As such, statutes do not require a business to remain in the same location after the initial investment. For example, it is currently possible for a business headquartered in Colorado to receive an investment from a CAPCO and then use those monies to
construct a new manufacturing facility in another state or even in another country. Other states with CAPCO programs require businesses to remain within the state for specific periods. Florida law requires that a business keep its headquarters and/or the facility financed with CAPCO money in the state for 10 years. Louisiana requires that the business's operations financed with CAPCO investments continue within the state for at least one year.

In addition, Section 10-3.5-107 (3), C.R.S., states that:

\[
\ldots \text{Any business that is classified as a qualified business or qualified rural business at the time of first investment in said business by a certified capital company shall remain classified as a qualified business} \ldots \text{and may receive continuing investments from any certified capital company or any of its affiliates. Such continuing investments shall be qualified investments even though such business may not meet the definition of a qualified business or qualified rural business, as applicable, at the time of such continuing investments.}
\]

This provision specifically states that continuing or follow-on investments are permitted even though a business no longer meets the definition upon which it originally qualified. This would include a subsequent change in the business’s location. Changes could be made to require businesses to retain operations in Colorado and/or provide that any follow-on investments be approved by the Office of Economic Development or some other authority.

**State Cash Benefits**

A good deal of the discourse on the CAPCO Program has focused on the extent to which the State receives or will receive direct cash benefits. Currently, statutes allow the State to receive direct cash benefits “after the aggregate total of distributions from such certified capital, not including qualified distributions, cumulatively exceeds the certified capital allocated to the certified investors....have resulted in an annual internal rate of return exceeding ten percent on the certified capital allocated to the certified investors of the certified capital company on such allocation date plus any additional capital contributions to the certified capital company....” (The internal rate of return is the discount rate that results in a net present value of zero for a series of future cash flows). When the internal rate of return exceeds 10 percent, then 30 percent of further distributions go to the Division of Housing in the Department of Local Affairs for “transfer to one or more local housing authorities, public nonprofit corporations, or private nonprofit corporations” for low or moderate income housing initiatives.
Critics argue that the current statutes providing cash benefits to the State are such that any benefits will be difficult, if not impossible, to achieve. It is unlikely that cash flow to the State will be realized for at least ten years, even under optimistic scenarios. In addition, overseeing and enforcing remittance of proceeds could be difficult.

Other states have taken various approaches to direct cash benefits. Two of the five other states (New York and Wisconsin) with operating CAPCO programs do not require any direct cash benefits. Of the remaining three states, two (Louisiana and Missouri) provide for direct cash benefits through mechanisms similar to Colorado’s current internal rate of return formula. For example, Missouri requires 25 percent of distributions exceeding a 15 percent adjusted internal rate of return on certified capital be remitted to the state. Louisiana statutes provide that the state receive 25 percent of the appreciation in excess of a 10 percent adjusted internal rate of return on certified capital. The Colorado General Assembly should consider simplifying and enhancing the direct cash benefits flowing from the program. The statutes could provide for a simple split of earnings, triggered after qualified investments total a determined amount. As an example, Florida law stipulates that the state receive 10 percent of distributions exceeding the original investment of certified capital until the total amount of credits is recaptured.

Types of Businesses in Which Investments Are Made

Compared to other states with CAPCO programs, Colorado is the most permissive in terms of the types of businesses in which CAPCOs may invest. As stated previously, Colorado statutes prohibit the investment of certified capital in businesses predominantly engaged in professional services provided by accountants or lawyers. As shown in Appendix C, the other states with operating CAPCOs—Florida, Louisiana, Missouri, New York, and Wisconsin—exclude businesses engaged in accounting and legal services, but, in addition, prohibit investments in businesses engaged in real estate development, banking, insurance, lending, gaming, and services provided by physicians. It appears that these states restrict businesses because they do not believe their state governments should be directly involved in certain industries or because of the tenuous relationship between many of these industries and job creation. Colorado’s statutes could be amended to further limit the types of businesses in which investments can be made to better ensure the creation of jobs or the development of certain industry sectors within the State’s economy.

In addition, if the intent is for Colorado’s CAPCO Program to operate much like a traditional venture capital fund—to provide seed and early stage funding to Colorado businesses—then changes to the current statutes are needed. Some critics of the Program argue that the CAPCOs have, thus far, primarily invested in businesses that
already have positive cash flow and an established product and customer base. Other states such as Florida, require that 50 percent of qualified investments be in early stage businesses. Colorado has no such requirements. We believe that statute could be amended to require a certain amount of certified capital to be invested in seed and/or early stage businesses as defined by the Office of Economic Development or some other authority.

**Costs and Cost Recoveries**

Statutes permit distributions out of certified capital to be used for reasonable costs and expenses of forming, syndicating, and organizing the certified capital company. In addition, as stated previously, Section 10-3.5-103 (13) C.R.S., also allows certified capital to be used to cover “reasonable costs and expenses of managing and operating the certified capital company, including an annual management fee in an amount that does not exceed two and one-half percent of certified capital, except that no such costs or expense shall be paid to a certified investor or affiliate of a certified investor and that such costs and expenses in the aggregate shall not exceed five percent of certified capital in any one year; reasonable and necessary fees in accordance with industry custom for professional services, including, but not limited to, legal and accounting services, related to the operation of the certified capital company; and any projected increase in federal or state taxes, including penalties and interest related to state and federal income taxes. . . .”

As stated previously, the CAPCOs had paid more than $15 million in start-up, management, financing and other costs as of December 31, 2002. Changes could be made to exclude or limit the use of certified capital for some, or all, of these expenses including management fees and the costs associated with lobbying and/or government relations. Prohibitions could be placed on the use of such monies for the costs associated with lawsuits against the State. Currently there are no requirements restricting the use of qualified distributions for lobbying or governmental relations costs. Several options could be evaluated: (1) eliminating the use of or capping the amount of certified capital that can be used for these purposes; (2) tying qualified distributions to the amount invested by the CAPCOs; and (3) changing the Program’s structure to reduce management overhead.

**Program Oversight**

Currently statutes provide the Office of Economic Development with limited oversight authority, including authority for enforcement, of the CAPCO Program. The Director of the Office has authority to promulgate rules necessary to carry out provisions of the statutes related to accepting applications for certification. However, he does not have statutory authority to inspect the records or operations of the
businesses receiving investments or to impose penalties other than those associated with material violations related to the requirements for continuing certification. Therefore, Office staff rely on self-reported information from the CAPCOs. If the Office had access to wage reports or other employment information, it would be able to better track and verify employment data and other data. In addition, Office of Economic Development staff told us that they have encountered several issues related to the release of information about the CAPCO Program. According to Office staff, the CAPCOs contend that much of the information related to their investments is proprietary and would cause them injury should it be released publically. The Office could seek legislation clarifying which information is protected and which is applicable to the Colorado Open Records Act as well as enhanced authority for oversight and enforcement.
Appendices
October 15, 2003

The Honorable Ron Tupa
Chairman, Legislative Audit Committee
Legislative Services Building
200 East 14th Avenue
Denver, CO 80203-2211

Dear Senator Tupa:

On behalf of the Colorado Office of Economic Development and International Trade (OED/IT), I want to thank the Legislative Audit Committee and the State Auditor’s Office for the opportunity to provide comment on the Certified Capital Company (CAPCO) Program. We appreciate the professionalism and thoroughness demonstrated by the audit staff throughout this process.

As you know, OED/IT is responsible for implementing and overseeing the CAPCO Program. During the implementation process, our staff identified a number of significant concerns. In fact, the majority of states administering the CAPCO Program have experienced and reported similar issues.

The first $100 million in premium tax credits was allocated in April 2002, and, per statute, the second $100 million may be allocated no earlier than January 1, 2004. Prior to allocating the second $100 million, we recommend that the Certified Capital Company Program be abolished and replaced with a redesigned program that more closely resembles a true venture capital fund. Access to seed and early stage financing should be the focus of this redesigned program.

We believe that the current CAPCO structure is far too expensive. Upon completion of the first phase, this program will cost the General Fund and the taxpayers of this state $100 million. Yet, of that amount, only about $40 million will initially be available for investment in Colorado businesses. The CAPCOs have argued that the defeasance structure and guaranty insurance are necessary in order to attract investment from insurance companies. We respectfully disagree. These are monies that the participating insurance companies owe the State of Colorado. There is no reason to guarantee their investments. They should not profit at the expense of small businesses; these taxes would have been owed anyway.
In January 2002, OED received requests for premium tax credits in the amount of $454 million. Yet only $100 million in credits was available for distribution. Given the excess demand for the tax credits and a sample survey of insurance companies, it is likely that an auction format will yield greater returns and provide additional capital for job generating investments.

Although as previously stated, about $40 million is initially available for investment, the CAPCOs are permitted to charge management fees and operating expenses equal to 5% per annum on the full $100 million. They are also allowed to charge unlimited amounts for organizational expenses. This fee structure is significantly higher than that typically found in the venture capital industry. We believe that these fees can be dramatically reduced by seeking fund managers through a competitive request for proposal process. Fees will be lower and more money will available for Colorado businesses.

Venture capital funds typically provide a return to investors equal to 100% of principal and 70% to 80% of all profits. Under Colorado’s program, the CAPCOs and insurance companies keep all principal and profits. Because it is theirs to keep, there is little incentive to take risk. The current statute does have a profit sharing formula, but it is our contention that it is unenforceable and no investment return will inure to the State of Colorado. It is important to point out that, as of this date, no state has yet received a distribution of cash proceeds from a CAPCO program.

It is our understanding that the Legislature intended for the CAPCO Program to provide seed and early stage funding to Colorado businesses. However, the CAPCOs have not generally provided seed funding. Rather, they have consistently stated their desire to invest in businesses that have revenue streams and a customer base, are at or near profitability, have positive cash flow and have high growth potential. Colorado has consistently ranked among the top 10 states for venture capital investment. There is, however, a significant need for seed and early stage funding. It is assistance at this level that will benefit entrepreneurs and growing Colorado companies. It is here that we will create a sound economic future for our state.

Finally, the General Assembly intended that this program create jobs, yet there are no specific requirements contained in the legislation to do so. Other states have indicated that the CAPCO Program does not appear to be meeting the job creation goal. In fact, Florida’s annual report indicates that since program inception, companies in which CAPCOs have made an investment have seen a net decrease of 153 jobs. New York reports a net increase of 38 jobs since 1998.

With the exception of the CAPCOs, most agree that this program is seriously flawed. TABOR prevents eliminating the tax credits, but it does allow the Legislature to use them in a more beneficial way. The first tranche of tax credits, $100 million, has been issued. That phase of the CAPCO program will continue. We will have an opportunity over the next ten years to measure the results and to see if the jobs and the investment return predicted by the Certified Capital Companies do indeed materialize. The second $100 million in tax credits will likely be issued in April of 2004. We have an opportunity to create a better program, one that will place more dollars in the hands of entrepreneurs and growing companies and that will provide an ongoing return to the state in the form of both jobs and returned principal.
The Governor has asked that I work with the Legislature to develop a model program that provides stimulus to Colorado’s economy and truly benefits small businesses throughout the state. To that end, we are working on finalizing a proposal that addresses many of the identified concerns.

We look forward to working with you on this important issue. Please feel free to call me if you have questions.

Sincerely,

F. Robert Lee
Director
Appendix B

Description of Businesses Receiving CAPCO Investments
2002 Pool
As of July 31, 2003

Altia, Inc. - Custom Computer Programming Services. Based in Colorado Springs, Colorado, with sales offices in China, France, Germany, India, Italy, Japan, Singapore, South Korea, Taiwan, and the United Kingdom, Altia provides graphics tools designed to simplify a company's embedded development process. Altia's software allows developers to build virtual prototypes, simulation graphics and deployable GUI code for embedded displays. Altia is a privately held company that was founded in 1991.

Anark Corporation - Software Wholesaler. Based in Boulder, Colorado, Anark developed and now provides an interactive multimedia platform for digital media applications that allows artists to author and re-purpose content into broadcast-quality presentations in a unique layered media environment. The Anark Media Platform allows an individual to create content for CBT/eLearning, kiosks, interactive advertising, Web sites and other interactive applications. Anark was founded in 1994.

BOA Technology, Inc. - Sporting and Athletic Goods Manufacturing. Based in Steamboat Springs, Colorado, Boa Technology is the developer of the Boa Lacing System and manufacturer of Boa lace reels, laces, and lace guides. The Boa Lacing System is sold to footwear manufacturers who incorporate them into their own boot designs. The Boa Lacing System was developed on snowboard boots and has been expanded to bicycle shoes. Boa Technology was founded in 1997.

Classic Events, L.L.C. - Consumer Goods Rental. Based in Englewood, Colorado, with offices in Carbondale, Colorado Springs, Eagle, and Fort Collins, Classic Events provides party equipment rental services to customers throughout Colorado. Rentals include such items as tables, chairs, grills, heaters, lights, flatware, dance floors, linens, and tents. Classic Events also delivers and sets-up rental equipment upon request. Classic Events was founded in 1996 and recently acquired Alpine Party Rentals, the largest provider of party rental equipment in the Colorado mountains.

Connexn Technologies, Inc. - Computer Related Services. Based in Westminster, Colorado, with offices in the U.K. and Singapore, Connexn Technologies provides more than 65 global communication service providers in the wireline, wireless, Internet, broadband, data and cable markets with cost and revenue assurance solutions. In 1999 an established software consulting and development firm called The Hutton Company was purchased to become Connexn Technologies.

Federation, Inc. - Computer Related Technologies. Based in Centennial, Colorado, Federation provides a product data synchronization solution designed for the special requirements of aerospace, automotive and complex manufacturing environments. Federation software works with Product Data Management and Enterprise Application Integration systems in the unique and specific area of delivering real-time data across disparate sites, systems and architectures. Federation, Inc. was founded in 1998.

Ischemia Technologies, Inc. - In-Vitro Diagnostic Substance Manufacturing. Based in Arvada, Colorado, and with offices in Europe, Ischemia Technologies develops, manufactures and markets new
in vitro diagnostic products with a focus on cardiovascular and acute care medicine. The Company's first product detects Ischemia Modified Albumin (IMA), a biochemical marker of Ischemia, which is used as an aid to rule out Acute Coronary Syndrome (ACS) in patients presenting to the emergency department with chest pain suggestive of cardiac origin. The privately held company was originally incorporated in 1993.


**NextAction Corporation - Direct Mail Advertising.** Based in Westminster, Colorado, NextAction uses statistical modeling and database technology to provide lists of prospective customers for the retail catalog industry. NextAction is focused on delivering prospect names and activating non-buyer name sources through the cooperative participation of its Network members. Started in July 2002 and launched in January 2003, the Network is comprised of hundreds of catalog titles who, when combined, provide insights into actual buying transactions across most buying households.

**Parker Medical, L.P. - Surgical and Medical Instrument Manufacturing.** Parker Medical's research and development operation is located in Cincinnati, Ohio, with production, marketing and distribution facilities in Englewood, Colorado. Parker Medical develops and improves technology for tracheal intubation in the hospital and pre-hospital setting. Using its patented airway management technologies, Parker Medical seeks to increase the accuracy, speed, ease and safety of intubation. Parker Medical was founded in 1994.

**Spin Maps, Inc. - Consumer Goods Publisher.** Based in Durango, Colorado, Spin Maps created the Passenger Flight Maps product. Passenger Flight Maps cover the flight corridors for several different western locations, showing geographic and historical landmarks, towns and rivers, as well as topography. The maps also contain games, quizzes, and interesting aviation facts. The Passenger Flight Maps allow airline passengers to identify significant landmarks while aboard commercial flights. Spin Maps also creates custom maps, such as souvenir maps, for clients upon request.

**StorePerform Technologies, Inc. - Software Publisher.** Based in Denver, Colorado, StorePerform offers a workforce productivity and store performance management solution in the retail market. StorePerform is an Intranet-based software solution that combines store-level execution with process-driven analytics to improve retail store performance. StorePerform was founded in 2002.

**Universal Processing Services of Colorado, L.L.C. (d.b.a., Newtek Merchant Solutions of Colorado) - Financial Transactions Processing Services.** Based in Evergreen, Colorado. Newtek Merchant Solutions Colorado provides services that allow merchants, including retail, restaurant, mail-order and Internet merchants, to accept all major credit cards as well as debit and ATM cards for payment. Newtek Merchant Solutions Colorado also implements personalized gift card programs, ATMs and check guarantee services to help businesses maximize revenues and reduce costs. Newtek Merchant Solutions Colorado was founded in 2002.
## Appendix C

### Comparison of State CAPCO Programs

<table>
<thead>
<tr>
<th>Program Feature</th>
<th>Colorado</th>
<th>Florida</th>
<th>Louisiana</th>
<th>Missouri</th>
<th>New York</th>
<th>Wisconsin</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Effective Start Date</strong></td>
<td>April 15, 2002 (First Pool)</td>
<td>December 1, 1998</td>
<td>July 1, 1984</td>
<td>January 1, 1997</td>
<td>March 2, 1998</td>
<td>July 1, 1999</td>
</tr>
<tr>
<td><strong>Total Credits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Premium Tax</strong></td>
<td>$200 million</td>
<td>$150 million</td>
<td>$636.5 million&lt;sup&gt;1&lt;/sup&gt;</td>
<td>$140 million</td>
<td>$130 million</td>
<td>$50 million</td>
</tr>
<tr>
<td><strong>Income Tax</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>$78 million&lt;sup&gt;2&lt;/sup&gt;</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Maximum Annual Credits</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Premium Tax</strong></td>
<td>$10 million</td>
<td>$15 million</td>
<td>$53.9 million&lt;sup&gt;3&lt;/sup&gt;</td>
<td>$14 million</td>
<td>$13 million</td>
<td>$5 million</td>
</tr>
<tr>
<td><strong>Income Tax</strong></td>
<td>N/A</td>
<td>N/A</td>
<td>$15.4 million&lt;sup&gt;4&lt;/sup&gt;</td>
<td>N/A</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Time Restrictions</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Premium Tax</strong></td>
<td>Max of 10 percent/year, for 10 years unless insufficient tax liability</td>
<td>Max of 10 percent/year, until exhausted, with 2017 deadline</td>
<td>Max 12.5 percent/year, until exhausted</td>
<td>Max of 10 percent/year, until exhausted</td>
<td>Max of 10 percent/year, until exhausted</td>
<td>Max of 10 percent/year, until exhausted</td>
</tr>
<tr>
<td><strong>Income Tax</strong></td>
<td>N/A</td>
<td>None</td>
<td>N/A</td>
<td>None</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>Who is Eligible for Credits</strong></td>
<td>Insurance Companies N/A</td>
<td>Insurance Companies N/A</td>
<td>Insurance Companies Anyone</td>
<td>Insurance Companies N/A</td>
<td>Insurance Companies N/A</td>
<td>Insurance Companies N/A</td>
</tr>
<tr>
<td><strong>Premium Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Income Tax</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Qualified Businesses</strong></td>
<td>25 percent set aside for designated rural counties. Investments in rural areas are encouraged through a $2 for $1 incentive</td>
<td>50 percent in early stage</td>
<td>Not Addressed</td>
<td>$40 million for distressed areas</td>
<td>50 percent in early stage</td>
<td>Not Addressed</td>
</tr>
<tr>
<td><strong>Parameters or set asides</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Headquarters</strong></td>
<td>Colorado</td>
<td>Florida</td>
<td>Not addressed</td>
<td>Missouri</td>
<td>New York</td>
<td>Wisconsin</td>
</tr>
<tr>
<td><strong>Capital to be Used For</strong></td>
<td>Principal business operations in Colorado</td>
<td>Principal business operations in Florida</td>
<td>Not Addressed</td>
<td>Expansion, retention of current operations, modernization</td>
<td>Business operations excluding advertising and sales. Must be in New York</td>
<td>Not Addressed</td>
</tr>
<tr>
<td>Program Feature</td>
<td>Colorado</td>
<td>Florida</td>
<td>Louisiana</td>
<td>Missouri</td>
<td>New York</td>
<td>Wisconsin</td>
</tr>
<tr>
<td>-----------------</td>
<td>----------</td>
<td>---------</td>
<td>-----------</td>
<td>----------</td>
<td>----------</td>
<td>-----------</td>
</tr>
<tr>
<td><strong>Employee Location</strong></td>
<td>More than 75 percent of the business; total salaries, wages, and/or other compensation are paid to Colorado employees</td>
<td>75 percent employed in Florida</td>
<td>80 percent wages paid in Louisiana</td>
<td>80 percent employed in Missouri</td>
<td>80 percent employed in New York</td>
<td>75 percent employed in Wisconsin</td>
</tr>
<tr>
<td><strong>Business Size</strong></td>
<td>SBA size standards for a small business</td>
<td>SBA definition of small business</td>
<td>(including affiliates) Employees ≤ 500 Net worth ≤ $18 million Net income ≤ $6 million</td>
<td>Employees ≤ 200 Sales ≤ $4 million (age ≤ 3 years) Sales ≤ $3 million (age &gt; 3 years)</td>
<td>Employees ≤ 100 or Employees ≤ 200 and gross revenue (consolidated) ≤ $5 million</td>
<td>Employees ≤ 100 Net income ≤ $2 million Net worth ≤ $5 million</td>
</tr>
<tr>
<td><strong>Restrictions in Nature of Business</strong></td>
<td>Excludes services provided by accountants or lawyers</td>
<td>Excludes retail sales, banking, lending, real estate development, insurance, oil and gas exploration, and professional services by lawyers, accountants, doctors, and businesses whose business plan is the acquisition of businesses</td>
<td>Excludes real estate development for resale, banking, lending, gaming, oil and gas exploration and development, insurance, professional services provided by accountants, lawyers, or physicians. Excludes CAPCO associates</td>
<td>Excludes retail, real estate development, real estate, insurance, and professional services by lawyers, accountants, and doctors Excludes CAPCO associates</td>
<td>Excludes real estate development, real estate, insurance, and professional services by lawyers, accountants, and doctors</td>
<td>Excludes real estate development, banking, lending, and professional services by lawyers, accountants, and doctors</td>
</tr>
<tr>
<td>Program Feature</td>
<td>Colorado</td>
<td>Florida</td>
<td>Louisiana</td>
<td>Missouri</td>
<td>New York</td>
<td>Wisconsin</td>
</tr>
<tr>
<td>---------------------</td>
<td>----------</td>
<td>---------</td>
<td>-----------</td>
<td>----------</td>
<td>----------</td>
<td>-----------</td>
</tr>
<tr>
<td>Other Criteria</td>
<td>None</td>
<td>Principal business operations must be in Florida. Must agree to keep headquarters and facility financed with CAPCO money in Florida for 10 years.</td>
<td>Operates primarily in LA (gross receipts ≥ 50 percent or value added ≥ 50 percent in LA) or performs substantially all production in LA (i.e., total assets in LA &gt; 50 percent or wages paid in LA &gt; 80). Will continue in LA ≥ 1 year.</td>
<td>Primary business operation in MO. Cannot relocate business more than 30 miles from current location without prior approval of DED.</td>
<td>None</td>
<td>None</td>
</tr>
<tr>
<td>Follow-on investments</td>
<td>Unlimited</td>
<td>Not addressed</td>
<td>Allowed to gain control under normal circumstances</td>
<td>7 years after first investment</td>
<td>OK if staying in New York</td>
<td>Not addressed</td>
</tr>
<tr>
<td>State Profit Participation</td>
<td>30 percent of distribution exceeding 10 percent IRR on certified capital</td>
<td>10 percent of distributions exceeding original investment of certified capital, until credits are recaptured</td>
<td>25 percent of appreciation in excess of 15 percent AIRR on capital for which premium tax credits were granted after Jan. 1, 1999. After Jan. 1, 2002 25 percent of appreciation in excess of 10 percent AIRR.</td>
<td>25 percent of distribution exceeding 15 percent AIRR on certified capital</td>
<td>None</td>
<td>None</td>
</tr>
</tbody>
</table>

Source: Office of the State Auditor's analysis of a 1999 CAPCO Study prepared for the Louisiana Department of Economic Development.

Note: We contacted all states included in the chart to obtain current information. We received updated year 2003 information from Florida Louisiana, and Missouri. We did not receive complete updated information from New York or Wisconsin.

1. Allocations to date, plus authorized allocation in the year 2003.
2. Allocations to date, plus authorized allocation in the year 2003.
3. Estimated annual credits available for use in Year 2000, the highest estimated amount available in any one year.
4. Estimated annual credits available for use in fiscal years ending June 30, 2000 and 2001, pursuant to current statute and agreements between the State and two CAPCOs.
The electronic version of this report is available on the Web site of the Office of the State Auditor

www.state.co.us/auditor

A bound report may be obtained by calling the Office of the State Auditor

303.869.2800

Please refer to the Report Control Number below when requesting the report.