Louisiana Legislative Auditor

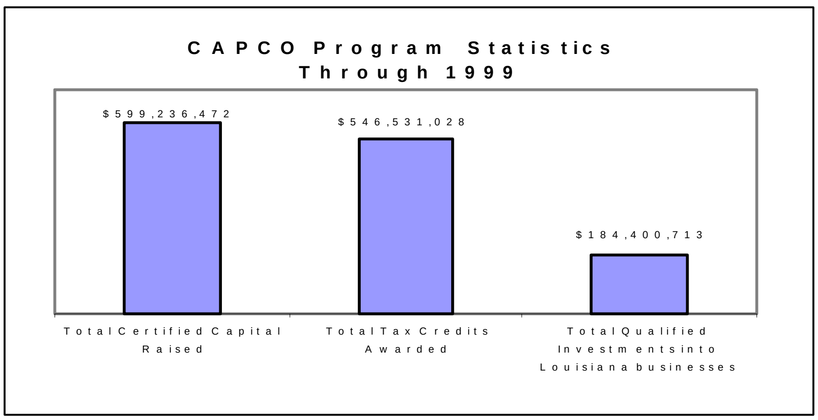
Report Highlights

A Review of the Louisiana Capital Companies (CAPCO) Program

January 2001

The CAPCO program was created in 1983 to provide assistance in the formation and expansion of new businesses that create jobs in the state. The program provides this assistance through venture capital financing to entrepreneurs, managers, inventors, and other individuals for the development and operation of qualified Louisiana businesses.

The CAPCO program has raised nearly $600 million in certified capital from investors through 1999. Investors' certified capital is eligible for state income and insurance premium tax credits. Through 1999, over $546 million of income and insurance premium tax credits has been awarded to investors. As of December 31, 1999, about $205 million of these credits was eligible to have been claimed by investors. From the certified capital raised, CAPCOs invested over $184 million in 112 qualified Louisiana businesses through 1999.



Audit Results

- ➡ The 112 businesses that have received qualified investments from CAPCOs have created or retained an estimated 3,503 full-time jobs. Of these 3,503 jobs:

- ➡ 2,725 (77.8%) are for 64 businesses that are still in existence.
- ➡ 541 (15.4%) are for 31 businesses that went out of existence after receiving the CAPCO funding.
- ➡ 237 (6.8%) are for eight businesses that may or may not still be in existence.

- ➡ The Office of Financial Institutions and the Department of Economic Development have accurately reported the dollar amounts of certified capital invested into CAPCOs and income and premium tax credits awarded to investors, with two minor exceptions.

Approximately 2,725 full-time and 543 part-time people are currently employed by businesses that received CAPCO financing.

- State law provides that the primary purpose of the CAPCO program is to provide assistance in the formation and expansion of new businesses that create jobs in the state.

What We Found

- CAPCO financing has assisted 112 qualified Louisiana businesses. Of these businesses:
  - 64 are still in operation and created and/or retained approximately 2,725 full-time and 543 part-time employees after receiving CAPCO assistance.
  - 31 are no longer in existence but employed approximately 541 full-time and 26 part-time people during their existence.
  - 8 employed approximately 237 full-time and 1 part-time people, but we could not determine whether they were still operating.
  - 9 received financing to acquire other businesses, but the CAPCO funding did not appear to impact jobs in the acquired businesses.
- Twenty-six of the 112 businesses (23.2%) were start-up businesses that created 475 full-time and 337 part-time jobs. These jobs are included in the figures above.
- Twelve of the 112 businesses had approximately 84 contract employees and also helped employ 331 construction workers.

Recommendations

- ✓ If the Legislature wishes to track job creation and retention, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs submit supporting documentation of these jobs.
- ✓ If the Legislature wishes to have more detail on jobs impacted by the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect various statistical data from the businesses in which they have made qualified investments.
- ✓ If the Legislature thinks that contract employees have sufficient economic impact to merit counting the number of such jobs, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs submit appropriate supporting documentation.
- ✓ The Office of Financial Institutions and the Department of Economic Development should establish other methods to determine whether acquisitions will further economic development in Louisiana.

Matter for Legislative Consideration

Business and Industrial Development Corporations (BIDCOs) provide financing assistance to businesses in Louisiana through loans or other credit extended or by purchasing securities issued by a business. Many CAPCOs are also licensed as BIDCOs and can use BIDCO financing to meet qualified investment requirements. In one instance, one such CAPCO/BIDCO purchased $500,000 in tax-exempt bonds from a Louisiana entity, and the purchase was counted as a qualified investment.

- ✓ The Legislature may wish to amend R.S. 51:1923(5)(b) to prevent BIDCO purchases of publicly offered tax-exempt bonds issued by Louisiana entities from counting toward the requirements necessary to retain tax credits.

For the most part, the Office of Financial Institutions and the Department of Economic Development have accurately reported the dollar amounts of certified capital invested into CAPCOs and tax credits awarded to investors.

- The Department of Economic Development reported CAPCO statistics until 1993 when the Office of Financial Institutions took over.

What We Found

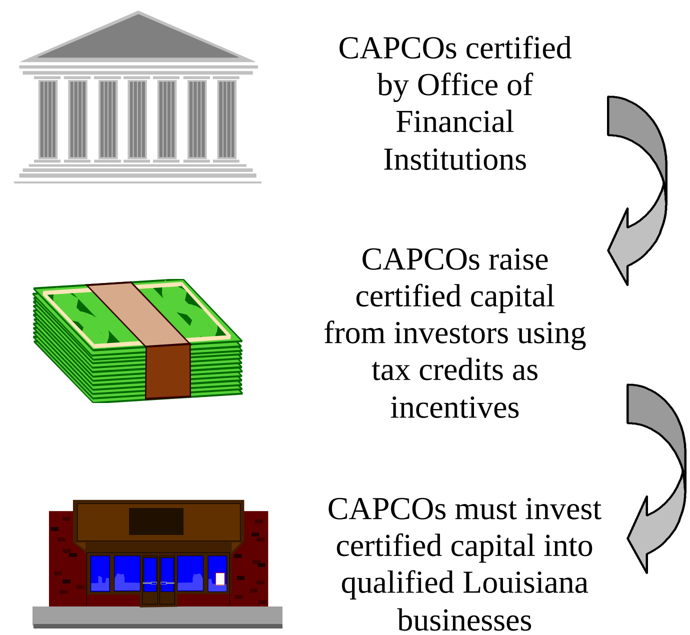
→ The Office of Financial Institutions and the Department of Economic Development have accurately reported the dollar amounts of certified capital invested into CAPCOs ($599.2 million) and income and premium tax credits awarded to investors ($546.5 million) for the years 1988 through 1999, with two minor exceptions.

How the CAPCO Program Operates

- The Office of Financial Institutions must certify all CAPCOs. Once certified, CAPCOs raise money (called certified capital) from investors. Investors receive tax credits from the state as an incentive to invest. Insurance companies receive insurance premium tax credits of 110% of their investments. Also, any person or entity can earn an income tax credit of 35% of their CAPCO investment.

- To remain certified, CAPCOs must invest certain percentages of these proceeds into qualified Louisiana businesses within certain time frames.

- CAPCOs can be voluntarily or involuntarily decertified.



Matters for Legislative Consideration

✓ The Legislature may wish to amend R.S. 51:1927(C) to provide rules regarding the recapture and forfeiture of income tax credits for investments pools that have met the three-year (30%) but not the five-year (50%) investment rules.

✓ The Legislature may wish to amend R.S. 51:1927(C) to provide rules regarding the recapture and forfeiture of premium and income tax credits for investment pools where the five-year investment rule has been met but the CAPCO subsequently fails to meet the rules for continuing certification.

Recommendation

- ✓ If the Legislature does not provide statutory rules for the recapture and forfeiture of tax credits, the Office of Financial Institutions and the Department of Economic Development should promulgate rules to address these situations.

Issues for Future Legislative Consideration

- Current law provides that new CAPCOs could not be certified after December 31, 1999, and that certified capital could not be raised after December 31, 2000. We present the following issues for consideration in case the Legislature decides to renew these aspects of the program in the future.

The Legislature may wish to consider:

- ✓ Increasing the $200,000 capitalization requirement for CAPCOs
- ✓ Lowering the insurance premium tax credit rate and/or lowering or eliminating the income tax credit rate
- ✓ Lowering the total amounts of premium and income tax credits that can be earned each year
- ✓ Removing the "once qualified/always qualified" provision from the definition of "qualified Louisiana business"
- ✓ Narrowing the parameters for what constitutes a qualified Louisiana business
- ✓ Clarifying the primary purposes of the program
- ✓ Adopting a different method for allowing the state to share in CAPCO profits
- ✓ Amending the laws that define the types of BIDCO financing that count as qualified investments
- ✓ Reviewing the Office of Financial Institutions' staffing needs because of the complexities of regulating CAPCOs
- ✓ Increasing fees that the Office of Financial Institutions can charge CAPCOs to cover the office's CAPCO-related expenses

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225-339-3800

STATE OF LOUISIANA
LEGISLATIVE AUDITOR

Department of Economic Development
Office of Financial Institutions
A Review of the Louisiana CAPCO Program

January 2001

Performance Audit

Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

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Department of Economic Development
Office of Financial Institutions
A Review of the Louisiana CAPCO Program

January 2001

Performance Audit
Office of the Legislative Auditor
State of Louisiana

Daniel G. Kyle, Ph.D., CPA, CFE
Legislative Auditor

Table of Contents

Verification of Investment and Tax Credit Amounts (Cont.)

How the CAPCO Program Operates

Issues for Future Legislative Consideration

Exhibits

Appendices

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DANIEL G. KYLE, PH.D., CPA, CFE
LEGISLATIVE AUDITOR

January 10, 2001

The Honorable John J. Hainkel, Jr.,
President of the Senate
The Honorable Charles W. DeWitt, Jr.,
Speaker of the House of Representatives

Dear Senator Hainkel and Representative DeWitt:

This performance audit report gives the results of our performance audit of the Office of Financial Institutions' CAPCO Program. This audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended.

This report contains our findings, conclusions, and recommendations. Appendix F contains the Office of Financial Institutions' response. Appendix G contains the Department of Economic Development's response. The report also identifies matters for legislative consideration. I hope this report will benefit you in your legislative decision-making process.

Sincerely,

Daniel G. Kyle, CPA, CFE
Legislative Auditor

DGK/ss

[CAPCO]

Office of Legislative Auditor

Performance Audit
Department of Economic Development
A Review of the Louisiana CAPCO Program
Executive Summary

The use of investment capital in the Louisiana Capital Companies (CAPCO) Tax Credit Program is consistent with the purposes provided by Louisiana statutes. The primary purpose of the program is to provide assistance in the formation and expansion of new businesses that create jobs in the state [Louisiana Revised Statute (R.S.) 51:1922]. CAPCOs also provide financing assistance to qualified Louisiana businesses that need capital to survive, expand, or develop new products [R.S. 51:1923(2)]. As of December 31, 1999, the state had granted more than $546 million of income and insurance premium tax credits to CAPCO investors. The results of this performance audit are:

Job Information (*See pages 7 through 20 of the report.*)

- We estimated that 3,503 full-time jobs were created or retained by 112 businesses that have received qualified investments from CAPCOs since inception of the CAPCO program. Of these 3,503 jobs:
  - 2,725 (77.8%) are for 64 businesses that are still in existence.
  - 541 (15.4%) are for 31 businesses that went out of existence after receiving CAPCO funding.
  - 237 (6.8%) are for eight businesses for which we could not determine whether they are still in existence.
- For the 64 businesses still in existence, we also identified an estimated 543 part-time jobs, 84 contract employees, and 331 temporary construction jobs in addition to the 2,725 full-time jobs.
- We also identified nine businesses that received qualified investments from CAPCOs to acquire other businesses. In these cases, the CAPCO funding did not appear to have any impact on job creation or retention for the acquired businesses.

Verification of Investment and Tax Credit Amounts (*See pages 21 through 24 of the report.*)

- The Office of Financial Institutions has accurately reported the dollar amounts of certified capital invested into CAPCOs ($599.2 million) and the amounts of income and premium tax credits granted ($546.5 million) for the years 1988 through 1999, with two minor exceptions.

How the CAPCO Program Operates (*See pages 25 through 34 of the report.*)

- This section of the report describes how the CAPCO program operates.

Daniel G. Kyle, Ph.D., CPA, CFE, Legislative Auditor
Phone No. (225) 339-3800

How many Louisiana jobs were created or retained by qualified businesses after receiving financing assistance from CAPCOs?

We estimated that 3,503 full-time jobs were created or retained by 112 businesses that have received qualified investments from CAPCOs since inception of the CAPCO program. Of these 3,503 jobs:

- 2,725 (77.8%) are for 64 businesses that are still in existence.
- 541 (15.4%) are for 31 businesses that went out of existence after receiving the CAPCO funding.
- 237 (6.8%) are for eight businesses for which we could not determine whether they are still in existence.

We also identified nine businesses that received qualified investments from CAPCOs to acquire other businesses. In these cases, the CAPCO funding did not appear to have any impact on job creation or retention for the acquired businesses.

We were unable to obtain complete and current job information for all of the 112 businesses that have received qualified investments from CAPCOs. However, for the 64 businesses still in existence, we did identify an estimated 543 part-time jobs, 84 contract employees, and 331 temporary construction jobs, in addition to the full-time jobs mentioned above.

Also, for one of the 112 businesses, we did not count the jobs that were created or retained after receiving CAPCO funding. Although this investment by a CAPCO met the legal requirements of the program, we did not feel that it fulfilled the purpose of the program. In this case, the CAPCO purchased $500,000 in tax-exempt bonds, which represented only about 1% of the total bond-offering amount of $47.4 million. Because the business apparently has the financial capability to service $47.4 million in publicly traded bonds, it is our opinion that the CAPCO's investment in this business should not have counted toward meeting the program's requirements that entitle the CAPCOs' investors to state tax benefits.

Recommendation 1: If the Legislature wishes to track the number of jobs created and retained through the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit documentation of the jobs created or retained in the businesses in which they have made qualified investments. Such documentation could include, for instance, quarterly Louisiana wage statements or affidavits executed by the businesses periodically.

Summary of the Office of Financial Institutions' Response:
Agree. If desired by the Legislature, the Office of Financial Institutions will promulgate a rule to address this situation, which will only apply to businesses receiving

investments after the enactment of the revised rule. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Partially agree. Tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program. However, such a rule can probably not be implemented with respect to capital pools already certified. This recommendation should be considered if the program is extended in any form.

Recommendation 2: If the Legislature wishes to have more detail on jobs impacted by the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should further amend their regulations to require that CAPCOs collect from the businesses in which they have made qualified investments and submit to the Office of Financial Institutions the following information:

- The types of jobs created and retained after receiving qualified investments
- How long the jobs have been in existence
- Whether any of the businesses failed after receiving the qualified investments and the dates these businesses ceased operations

Summary of the Office of Financial Institutions' Response: Agree. If desired by the Legislature, the Office of Financial Institutions will promulgate a rule to address this situation, which will only apply to investments made after the effective date of a rule revision. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Partially agree. Tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program. However, such a rule can probably not be implemented with respect to capital pools already certified. This recommendation should be considered if the program is extended in any form.

Recommendation 3: If the Legislature thinks that contract employees have sufficient economic impact to merit tracking the number of these jobs created or retained in businesses that receive qualified investments from CAPCOs, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit supporting documentation on the number of such jobs. This documentation could include, for instance, affidavits executed by the businesses periodically or some other credible type of documentation.

Summary of the Office of Financial Institutions' Response: Agree. If the Legislature desires to have this type of information, the Office of Financial Institutions agrees that it will amend the rules to allow this type of relationship to count toward job totals. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Partially agree. Tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program. However, such a rule can probably not be implemented with respect to capital pools already certified. This recommendation should be considered if the program is extended in any form.

Matter for Legislative Consideration 1: The Legislature may wish to consider whether it would be appropriate to amend R.S. 51:1923(5)(b) concerning qualified investments by BIDCOs to prevent situations like the one involving the tax-free bonds from counting toward the requirements necessary to retain tax credits.

Recommendation 4: To help examine acquisitions more closely, the Office of Financial Institutions and the Department of Economic Development should establish other methods to use in addition to current criteria for determining whether acquisitions will further economic development in Louisiana. These additional methods could include acquiring definitive evidence that the acquired businesses would move out of state or reduce employment if CAPCO financing does not assist in the acquisitions.

Summary of the Office of Financial Institutions' Response: Partially agree. The Office of Financial Institutions is not sure if there is a need to examine acquisitions more closely. If a CAPCO's investment into a business meets two of the criteria set forth in Appendix E, the Office of Financial Institutions believes that economic benefit has accrued to the state. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Agree. The recommended changes would help improve the effectiveness of the CAPCO program.

Are the dollar amounts of certified capital invested into CAPCOs accurately reported by the Office of Financial Institutions and the Department of Economic Development? Also, are the amounts of tax credits granted to investors accurately reported by the Office of Financial Institutions and the Department of Economic Development?

We found that the Office of Financial Institutions and the Department of Economic Development have accurately reported the dollar amounts of certified capital invested into the CAPCOs and the amounts of income and premium tax credits granted for the years 1988 through 1999, with two minor exceptions. One exception was for an amount invested into a CAPCO. The other exception was for an amount of tax credits granted to insurance company investors of a CAPCO.

For the years 1988 through 1999, investors invested $599.2 million of certified capital into CAPCOs. For the same time period, the state granted $546.5 million in tax credits.

How does the CAPCO program operate?

Any business entity that wishes to be certified as a CAPCO must submit an application to the Office of Financial Institutions and have capitalization of at least $200,000. Once certified, CAPCOs can begin to raise money from investors. They do so by offering tax credits as incentives. Insurance companies that invest into CAPCOs earn insurance premium tax credits in the amount of 110% of their investments. Also, any person or entity can earn an income tax credit of 35% of its investments into CAPCOs.

There are three ways in which CAPCOs can raise certified capital for their investment pools. The most common method involves the CAPCOs issuing notes payable to investors, typically insurance companies. In order for their investment pools to remain certified, CAPCOs must meet certain statutory requirements for investing their certified capital into qualified Louisiana businesses.

CAPCOs and/or their pools can be decertified either voluntarily or involuntarily. There are two forms of voluntary decertification. First, under R.S. 51:1928(A), a CAPCO may decide that one or more of its pools cannot meet the continuing certification requirements. Second, under R.S. 51:1928(B), if any of a CAPCO’s pools meets certain statutory requirements, those pools can be voluntarily decertified. CAPCOs and/or their investment pools may also be involuntarily decertified for violating program provisions. Appendix D describes the process of involuntary decertification of CAPCOs.

Continuing certification requirements are contained in R.S. 51:1926. R.S. 51:1926(A) requires that investment pools must have 30% of their certified capital invested in qualified investments within three years and 50% of their certified capital invested in qualified investments within five years in order to remain certified. The CAPCO statutes provide some rules regarding recapture and forfeiture of tax credits if these rules are not met. However, not every possible scenario is covered. The statutes may need to be amended to provide further clarification.

Matter for Legislative Consideration 2: The Legislature may wish to consider amending R.S. 51:1927(C) to provide rules regarding the recapture and forfeiture of income tax credits for investment pools that have met the three-year (30%) but not the five-year (50%) investment rules.

Matter for Legislative Consideration 3: The Legislature may wish to consider amending R.S. 51:1927(C) to provide rules regarding the recapture and forfeiture of premium and income tax credits for investment pools where the five-year investment rule has been met, but the CAPCO subsequently fails to meet the rules for continuing certification.

Recommendation 5: If the Legislature does not provide statutory rules for the recapture and forfeiture of tax credits as discussed in Matters for Legislative Consideration 2 and 3, the Office of Financial Institutions and the Department of Economic Development should promulgate rules to address these situations.

> **Summary of the Office of Financial Institutions' Response:** Agree. If the Legislature does not address the statutory rules for the recapture and forfeiture of tax credits as discussed in Matters for Legislative Consideration 2 and 3, the Office of Financial Institutions will discuss with the Department of Economic Development changes that can be made to the existing rules to address these deficiencies. (See Appendix F for the full text of the Office of Financial Institutions' response.)
>
> **Summary of the Department of Economic Development's Response:** Agree. The recommended changes would help improve the effectiveness of the CAPCO program.

Issues for Future Legislative Consideration

Under state law, as of December 31, 1999, the Office of Financial Institutions no longer certifies the formation of new CAPCOs. Also, as of January 1, 2001, Louisiana no longer grants new tax credits to investors in CAPCOs. However, in case the Legislature subsequently decides to renew these aspects of the program, we present several issues for future consideration in the final section of this report. Implementing some of the controls discussed in this section may allow the CAPCO program to run at a lower cost to the state while being subject to more thorough controls.

Glossary of Terms

Business and Industrial Development Corporation (BIDCO): A Louisiana corporation organized to help meet the financing assistance needs of business firms in the state of Louisiana. This financing assistance can be in the form of money loaned or credit otherwise extended, or a purchase of securities, either directly or through an underwriter. The Office of Financial Institutions licenses and examines BIDCOs.

Certified capital: An investment of cash into a CAPCO that allows the investor to be granted income or insurance premium tax credits.

Certified Louisiana Capital Company (CAPCO): Any legal entity that invests cash in order to obtain equity in, or provides financing assistance as a BIDCO to, qualified Louisiana businesses. The Office of Financial Institutions must certify that a CAPCO meets the legal requirements of the CAPCO program, and the Office also examines the CAPCOs.

Investment date: With respect to each investment pool, the date on which the investment pool transaction closes.

Investment pool: The total of all investments of certified capital into a particular CAPCO that are made as part of the same transaction.

Qualified investment: An investment that furthers economic development within Louisiana and is either an investment of cash to obtain equity in, or provide financing assistance as a BIDCO to, qualified Louisiana businesses.

Qualified Louisiana business: A business that at the time of investment meets or, as the direct result of an investment pursuant to Chapter 26 of Title 51 of the Louisiana Revised Statutes of 1950, would meet, each of the following requirements:

- Operates primarily in Louisiana or performs substantially all of its production in Louisiana
- Has, together with its affiliates, a net worth which is not in excess of $18 million
- Has, together with its affiliates, an average annual net income, after federal income taxes, excluding any carry-over losses, for the preceding two completed fiscal years which is not in excess of $6 million
- Has, together with its affiliates, no more than 500 employees

Introduction

Audit Initiation and Objectives

On March 23, 1999, the Legislative Audit Advisory Council initially approved an audit of the Department of Economic Development as part of the 7-year plan (for 1999-2000) required by R.S. 24:522. This audit remained on the 7-year plan that was approved by the Legislative Audit Advisory Council on August 26, 1999, with a notation that it would not be completed before the 2000 Regular Legislative Session. Senate Resolution No. 25 of the 2000 Regular Legislative Session directed the Legislative Auditor to review certified Louisiana capital companies (CAPCOs) and determine whether the use of investment capital is consistent with the primary purpose outlined in the statutes creating this program. We designed the audit of the Department of Economic Development to address the Senate Resolution. A copy of the resolution can be found in Appendix A.

Since the primary purpose of the CAPCO program is to provide assistance in the formation and expansion of new businesses that create jobs in the state, our work focused on trying to determine how many jobs were created and retained by businesses that have received qualified investments from CAPCOs. In addition, we verified the amounts of money invested in CAPCOs because these amounts determine the amount of tax credits granted by the state to investors in the CAPCOs. The objectives of this audit were to:

- Determine how many Louisiana jobs were created or retained by qualified businesses after receiving financing assistance from CAPCOs

- Determine the accuracy of the dollar amounts reported by the Office of Financial Institutions and the Department of Economic Development for certified capital invested into CAPCOs and tax credits granted to investors

- Determine and describe how the CAPCO program operates

Appendix B describes the scope and methodology for this audit.

Background

Act 642 of the 1983 Regular Legislative Session (R.S. 51:1921 *et seq.*) created the Louisiana Capital Companies (CAPCO) Tax Credit Program. According to R.S. 51:1922, the primary purpose of the CAPCO program is to provide assistance in the formation and expansion of new businesses which create jobs in the state by providing equity venture capital financing to entrepreneurs, managers, inventors and other individuals for the development and operation of qualified Louisiana businesses.

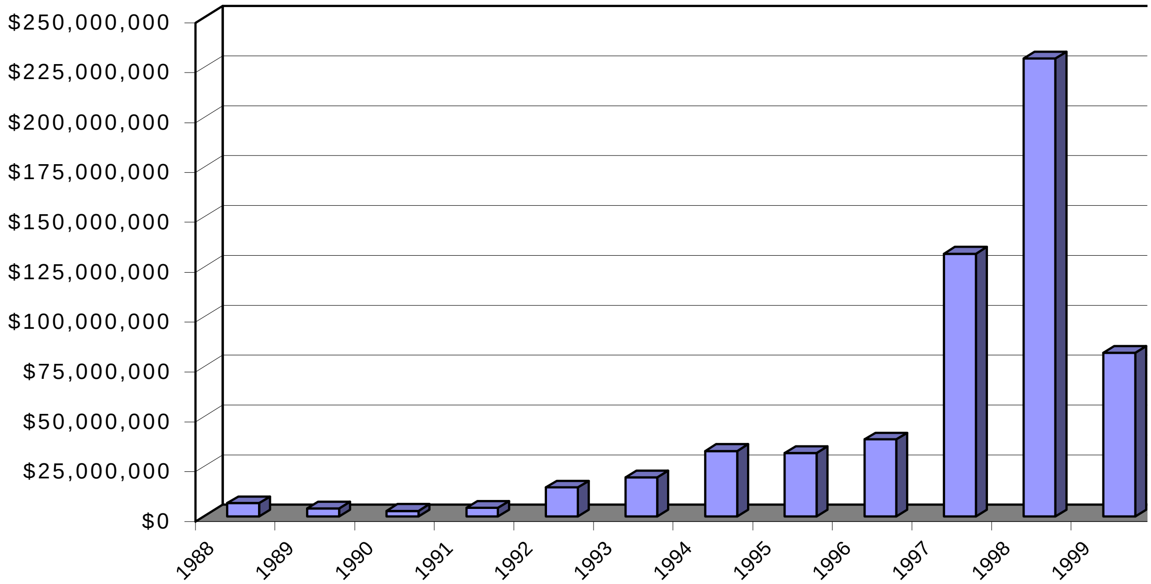
Act 506 of the 1991 Regular Legislative Session (R.S. 51:2386 *et seq*.) created BIDCOs. BIDCOs are Business and Industrial Development Corporations that typically provide loans to small businesses, although BIDCOs can also provide equity financing. The primary focus of BIDCOs is to fill the gap between conventional bank financing and venture capital financing. The Office of Financial Institutions (OFI) within the Department of Economic Development regulates CAPCOs and BIDCOs. Currently, there are 30 CAPCOs in existence. Many operate as both CAPCOs and BIDCOs. In general, CAPCOs raise capital through investments by investors. The investors receive tax credits (income tax credits and premium tax credits) from the state in return for their investments. The CAPCOs then invest the capital raised into Louisiana businesses. The section of this report titled "How the CAPCO Program Operates" contains a more detailed discussion of how the program operates.

The CAPCO program was originally scheduled to terminate on December 31, 1989, but has been extended several times by the Legislature. Act 70 of the 1998 Regular Legislative Session extended the CAPCO program through December 31, 1999. As a result, OFI could not certify the formation of new CAPCOs after December 31, 1999. Also, new income and insurance premium tax credits resulting from new certified capital investments will not be available to investors in CAPCOs after December 31, 2000. Since insurance premium tax credits are also referred to as "insurance premium tax reductions," we use the term "credits" instead of "reductions" throughout this report. Also, we use the term "tax credits" to refer to both income and insurance premium tax credits. A bill in the 2000 Regular Session would have continued the CAPCO program, but this legislation did not pass.

Almost $600 million of certified capital has been raised since the inception of the CAPCO program through December 31, 1999. If an investment into a CAPCO is made in one of several ways prescribed by law, it is considered "certified capital." Only certified capital is eligible for income or insurance premium tax credits. Exhibit 1 on page 3 shows the amount of certified capital raised each year through the CAPCO program. CAPCOs did not raise certified capital until 1988 even though the Legislature created the program in 1983.

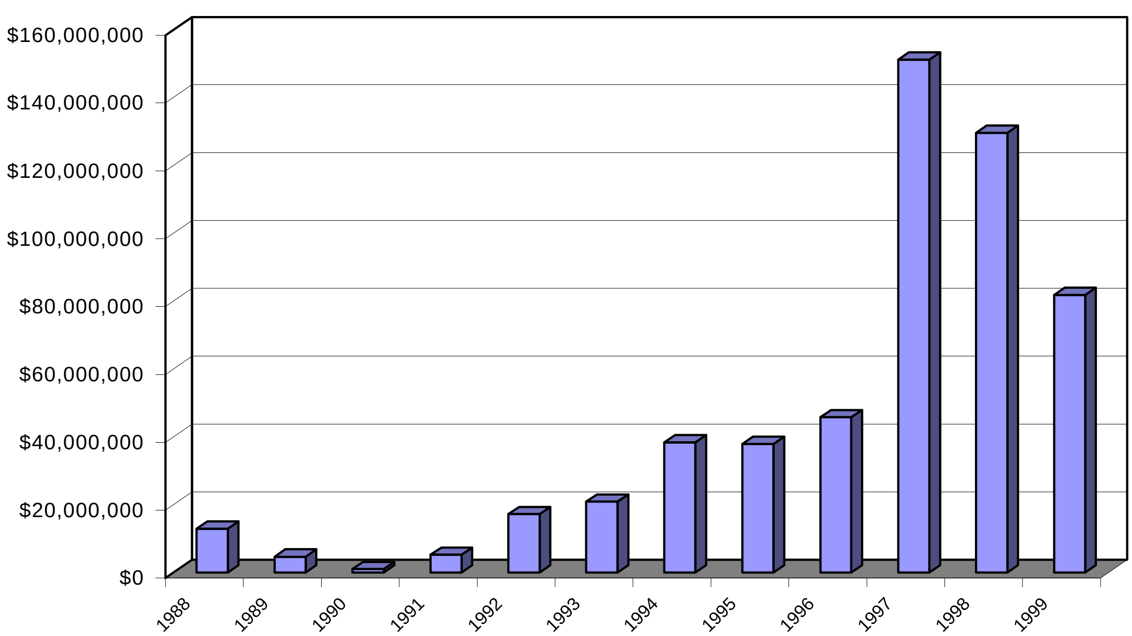
The $600 million of certified capital has generated income and insurance premium tax credits of $546 million. Of this amount, investors had almost $205 million available to be claimed as of December 31, 1999. Insurance companies must use their premium tax credits over a 10-year period; thus, there is a large amount still to be taken. Exhibit 2 on page 3 shows the total amount of tax credits granted each year since CAPCOs began raising certified capital in 1988.

Exhibit 1
Certified Capital Raised by CAPCO Program
1988 Through 1999



Source: Prepared by legislative auditor’s staff using data obtained from OFI files.

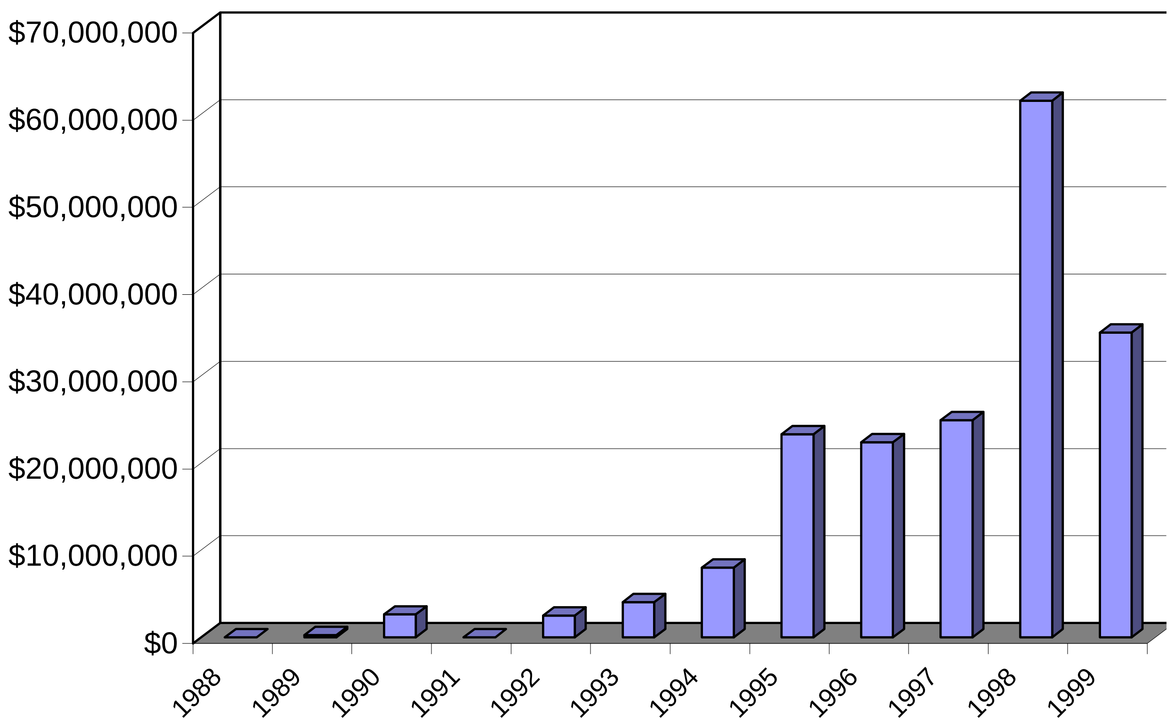
Exhibit 2
Income and Insurance Premium Tax Credits
Granted Through CAPCO Program
1988 Through 1999



Source: Prepared by legislative auditor’s staff using data obtained from OFI files.

According to OFI, CAPCOs have made $184.4 million in qualified investments to assist businesses through 1999. Exhibit 3 below shows the annual amounts of qualified investments made by the CAPCOs into businesses. Appendix C contains a list of investments made by CAPCOs sorted by type of industry. To be qualified, a business must meet several statutory guidelines, such as operating primarily or performing substantially all of its production in Louisiana. In addition, a business, together with its affiliates, must have no more than 500 employees. The definition of a qualified Louisiana business is discussed in more detail on page 31.

Exhibit 3
Qualified Business Investments Made by CAPCOs
1988 Through 1999



Source: Prepared by legislative auditor's staff using data obtained from the Department of Economic Development's 1999 Annual Report on the CAPCO program.

Issue for Further Study

OFI calculates the tax credits that investors in CAPCOs are allowed to take but does not oversee whether the proper amounts are actually taken on investors' tax returns. The Department of Revenue does this for income tax credits, and the Department of Insurance does it for premium tax credits. We did not review in detail the methods that the Departments of Revenue and Insurance use to ensure that the correct amounts of tax credits are claimed. Therefore, further study of this issue may be warranted in the future.

Report Organization

The remainder of this report is divided into the following sections and appendices:

- The section titled **Job Information** describes our audit results, recommendations, and a matter for legislative consideration regarding the first audit objective.

- The section titled **Verification of Investment and Tax Credit Amounts** describes our audit results regarding the second audit objective. This section does not contain any recommendations or matters for legislative consideration.

- The section titled **How the CAPCO Program Operates** describes our audit results, a recommendation, and matters for legislative consideration regarding the third audit objective.

- The section titled **Issues for Future Legislative Consideration** describes issues the Legislature may wish to consider if the CAPCO program is renewed in the future.

- **Appendix A** contains a copy of Senate Resolution No. 25 of the 2000 Regular Legislative Session.

- **Appendix B** contains the audit scope and methodology.

- **Appendix C** contains the amounts of CAPCO qualified investments in Louisiana businesses by type of industry from the program's inception through December 1999.

- **Appendix D** contains a description of the process of involuntary decertification of a CAPCO.

- **Appendix E** sets forth the list of criteria contained in the Louisiana Administrative Code that the Office of Financial Institutions uses to ascertain if economic development is being furthered by a CAPCO's investment in a business.

- **Appendix F** contains the Office of Financial Institutions' response to this audit report.

- **Appendix G** contains the Department of Economic Development's response to this audit report.

Job Information

How many Louisiana jobs were created or retained by qualified businesses after receiving financing assistance from CAPCOs?

We estimated that 3,503 full-time jobs were created or retained by 112 businesses that have received qualified investments from CAPCOs since inception of the CAPCO program. Of these 3,503 jobs:

- 2,725 (77.8%) are for 64 businesses that are still in existence.
- 541 (15.4%) are for 31 businesses that went out of existence after receiving the CAPCO funding.
- 237 (6.8%) are for eight businesses for which we could not determine whether they are still in existence.

We also identified nine businesses that received qualified investments from CAPCOs to acquire other businesses. In these cases, the CAPCO funding did not appear to have any impact on job creation or retention for the acquired businesses.

We were unable to obtain complete and current job information for all of the 112 businesses that have received qualified investments from CAPCOs. However, for the 64 businesses still in existence, we identified an estimated 543 part-time jobs, 84 contract employees, and 331 temporary construction jobs, in addition to the full-time jobs mentioned above.

Also, for one of the 112 businesses, we did not count the jobs that were created or retained after receiving CAPCO funding. Although this investment by a CAPCO met the legal requirements of the program, we did not feel that it fulfilled the purpose of the program. In this case, the CAPCO purchased $500,000 in tax-exempt bonds, which represented only about 1% of the total bond-offering amount of $47.4 million. Because the business apparently has the financial capability to service $47.4 million in publicly traded bonds, it is our opinion that the CAPCO's investment in this business should not have counted toward meeting the program's requirements that entitle the CAPCOs' investors to state tax benefits.

Recommendation 1: If the Legislature wishes to track the number of jobs created and retained through the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit documentation of the jobs created or retained in the businesses in which they have made qualified investments. Such documentation could include, for instance, quarterly Louisiana wage statements or affidavits executed by the businesses periodically.

Summary of the Office of Financial Institutions' Response: Agree. If desired by the Legislature, the Office of Financial Institutions will promulgate a rule to address this situation, which will only apply to businesses receiving investments after the enactment of the revised rule. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Partially agree. Tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program. However, such a rule can probably not be implemented with respect to capital pools already certified. This recommendation should be considered if the program is extended in any form.

Recommendation 2: If the Legislature wishes to have more detail on jobs impacted by the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should further amend their regulations to require that CAPCOs collect from the businesses in which they have made qualified investments and submit to the Office of Financial Institutions the following information:

- The types of jobs created and retained after receiving qualified investments
- How long the jobs have been in existence
- Whether any of the businesses failed after receiving the qualified investments and the dates these businesses ceased operations

Summary of the Office of Financial Institutions' Response: Agree. If desired by the Legislature, the Office of Financial Institutions will promulgate a rule to address this situation, which will only apply to investments made after the effective date of a rule revision. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Partially agree. Tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program. However, such a rule can probably not be implemented with respect to capital pools already certified. This recommendation should be considered if the program is extended in any form.

Recommendation 3: If the Legislature thinks that contract employees have sufficient economic impact to merit tracking the number of these jobs created or retained in businesses that receive qualified investments from CAPCOs, the Office of Financial Institutions and the

Department of Economic Development should amend their regulations to require that CAPCOs collect and submit supporting documentation on the number of such jobs. This documentation could include, for instance, affidavits executed by the businesses periodically or some other credible type of documentation.

> **Summary of Office of Financial Institutions' Response:** Agree. If the Legislature desires to have this type of information, the Office of Financial Institutions agrees that it will amend the rules to allow this type of relationship to count toward job totals. (See Appendix F for the full text of the Office of Financial Institutions' response.)
>
> **Summary of the Department of Economic Development's Response:** Partially agree. Tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program. However, such a rule can probably not be implemented with respect to capital pools already certified. This recommendation should be considered if the program is extended in any form.

Matter for Legislative Consideration 1: The Legislature may wish to consider whether it would be appropriate to amend R.S. 51:1923(5)(b) concerning qualified investments by BIDCOs to prevent situations like the one involving the tax-free bonds from counting toward the requirements necessary to retain tax credits.

Recommendation 4: To help examine acquisitions more closely, the Office of Financial Institutions and the Department of Economic Development should establish other methods to use in addition to current criteria for determining whether acquisitions will further economic development in Louisiana. These additional methods could include acquiring definitive evidence that the acquired businesses would move out of state or reduce employment if CAPCO financing does not assist in the acquisitions.

> **Summary of the Office of Financial Institutions' Response:** Partially agree. The Office of Financial Institutions is not sure if there is a need to examine acquisitions more closely. If a CAPCO's investment into a business meets two of the criteria set forth in Appendix E, the Office of Financial Institutions believes that economic benefit has accrued to the state. (See Appendix F for the full text of the Office of Financial Institutions' response.)
>
> **Summary of the Department of Economic Development's Response:** Agree. The recommended changes would help improve the effectiveness of the CAPCO program.

Overview of Businesses That Received Qualified Investments From CAPCOs

We identified 112 businesses that have received qualified investments from CAPCOs since inception of the CAPCO program. Only qualified investments count toward meeting the program requirements that ensure that investors in the CAPCOs can retain their tax credits. In our review of these 112 businesses, we found that 64 were still in existence, but that 31 had gone out of business. In addition, we could not determine whether eight other businesses were still in existence or not. We estimated the number of jobs created or retained since receiving CAPCO assistance for all of these three types of businesses. The other nine businesses used the qualified investments they received from CAPCOs to acquire other businesses. In these cases, the CAPCO funding did not appear to have any impact on job creation or retention for the acquired businesses. We labeled and refer to this category of businesses as “job neutral acquisitions” throughout this report. Exhibit 4 shows these figures.

Exhibit 4
Estimated Number of Full-time Jobs Created or Retained After Receiving Qualified Investments From CAPCOs
1988 Through 1999

Category of Business	Number of Businesses	Number of Full-time Jobs Created or Retained (Estimated)
Still in Existence	64	2,725*
No Longer in Existence	31	541*
Unknown Whether Still in Existence	8	237
Job Neutral Acquisitions	9	0
Total	**112**	**3,503**

* These figures include full-time jobs for start-up businesses.
Source: Prepared by legislative auditor's staff using data obtained from the individual businesses and file reviews conducted at OFI and the CAPCOs.

The next three sections discuss jobs in the first three categories listed in Exhibit 4. We discuss start-up businesses on pages 14 through 15. We discuss job neutral acquisitions on pages 19 through 20. See Appendix B for more information on how we defined the categories for job classifications.

The CAPCO financing assistance provided to these 112 businesses was in accordance with R.S. 51:1923(2). This statute states, in part, that CAPCOs are to provide capital assistance to qualified Louisiana businesses that need such assistance to survive, expand, or develop new products. Businesses that receive CAPCO funding must meet certain statutory guidelines in order to be considered qualified Louisiana businesses. Investments in qualified Louisiana businesses help CAPCOs meet the statutory criteria necessary to ensure that the CAPCOs' investors retain the tax credits they have been granted. We provide some examples of BIDCO loans to businesses in the discussion that follows. All BIDCOs are either licensed as CAPCOs or 100% owned by CAPCOs. Accordingly, the BIDCO loans in the following examples counted as CAPCO qualified investments.

Jobs for Businesses Still in Existence

As can be seen in Exhibit 4, 64 businesses that are still in existence have received qualified investments from CAPCOs since the inception of the CAPCO program. None of these businesses were classified as job neutral acquisitions. Our best estimate is that these 64 businesses presently employ approximately 2,725 full-time and 543 part-time employees. These jobs range from hourly workers to managers and engineers. In addition, for these 64 businesses, we identified approximately 84 contract employees and 331 construction-related jobs.

For these 64 active businesses, we have reported the most current job figures we could find. However, the number of employees can increase or decrease over time. For example, one business we reviewed received more than $12 million in CAPCO debt and equity financing over a three-year period. The company's Louisiana employee count varied from 211 to 687 during 1998 and 1999, according to information in the CAPCO's files.

In addition to employment varying over time for businesses that have received qualified investments from CAPCOs, we do not know whether jobs that were created by these businesses represent net, new employment in Louisiana. In other words, some people employed by these businesses may have transferred from companies going out of existence.

Jobs for Businesses No Longer in Existence

As can also be seen in Exhibit 4, 31 of the 112 businesses that have received qualified investments from CAPCOs since program inception have failed since receiving the assistance. During their existence, our best estimate is that these businesses employed approximately 541 full-time people, 26 part-time people, and 35 seasonal workers. To calculate these figures, we averaged job counts over the time periods the businesses were in existence in cases where we were able to obtain that data. In cases where this type of data was not available, we used the most representative number we could determine from information in OFI's or the CAPCOs' files.

Exhibit 5 on the following page shows how long these businesses remained in existence after receiving CAPCO assistance. The exhibit also shows the number of full-time employees associated with each time period of existence. As can be seen in the exhibit, only one of the 31 failed businesses operated for more than five years after receiving CAPCO assistance. We estimated that this business employed 82 full-time people during this time period. This business provided environmental design and remediation services to industrial clients. Exhibit 5 also shows that seven businesses operated less than a year after receiving CAPCO assistance. These businesses collectively employed approximately 141 full-time people. In addition, five businesses employing 28 full-time people operated from 1 to 2 years after receiving assistance; eight businesses employing 150 full-time people operated from 2 to 3 years after receiving assistance; and 10 businesses employing 140 full-time people operated from 3 to 5 years after receiving CAPCO funding.

Exhibit 5
Businesses No Longer in Existence and Their Duration of Existence
Estimated Number of Full-time Jobs Created or Retained

Duration of Existence*	Number of Businesses	Number of Full-time Jobs
Less than one year	7	141
1-2 years	5	28
2-3 years	8	150
3-5 years	10	140
More than 5 years	1	82
Total	**31**	**541**

* We measured the duration of existence from the time the businesses first received CAPCO or BIDCO assistance until the time they went out of business.
Source: Prepared by legislative auditor's staff using data obtained from the individual businesses and file reviews at OFI and the CAPCOs.

An example of a failed business we reviewed was one that took photographs of people on amusement park rides. This business received a $600,000 loan from a BIDCO. The business remained in existence approximately one year after receiving the loan. We estimated that the business employed four full-time workers. Another example is a microbrewery that failed almost four years after receiving its first BIDCO loan. We estimated that this business employed an average of seven full-time employees while it was in existence.

Jobs for Businesses Whose Existence Is Unknown

Due to limited data, we were unable to determine whether eight of the 112 businesses that received qualified investments from CAPCOs were still in existence. We estimate that these businesses employed approximately 237 full-time people and one part-time worker after receiving debt and equity financing through the CAPCO program. In addition, one of these businesses employed 86 seasonal workers.

CAPCOs usually do not keep track of businesses once the businesses repay their loans or after the CAPCOs have sold their investments in the businesses. These factors made it difficult for us to determine whether these eight businesses were still operating. Since these businesses could still be in operation, we used the most recent information we could find to calculate the number of jobs created or retained after receiving CAPCO funding.

Jobs for Start-up Businesses

R.S. 51:1922 provides that the primary purpose of the CAPCO program is to give assistance in the formation and expansion of new businesses which create jobs in the state by providing for the availability of venture capital financing. We identified 26 start-up businesses that created an estimated 475 full-time jobs after receiving qualified investments from CAPCOs. In addition, these start-up businesses created 337 part-time, 44 contract, 284 construction, and 35 seasonal jobs. We classified a business as a start-up business if it received CAPCO financing within the first six months of its operations.

We included the job figures for the start-up businesses in the figures for businesses still in existence and businesses no longer in existence, which were discussed previously and depicted in Exhibit 4 on page 10. In other words, some of the 475 full-time start-up jobs are included in the 2,725 total jobs for businesses presently in existence. In addition, some of the 475 full-time start-up jobs are included in the category of businesses no longer in existence because some start-up businesses failed after receiving CAPCO financing.

Of the 112 qualified businesses, 26 (23%) were start-up businesses. Eighteen of the 26 start-up businesses are still in existence. Exhibit 6 on the following page shows the status of the 26 start-up businesses; the number of start-up businesses for each status; and for each category, the number of full-time and part-time jobs created or retained after receiving qualified investments from CAPCOs.

Exhibit 6
Start-up Businesses
Number of Jobs Created or Retained
1988 Through 1999

Status of Businesses	Number of Businesses	Number of Full-time Jobs	Number of Part-time Jobs
Still in Existence*	18	372	322
No Longer in Existence**	8	103	15
Total	**26**	**475**	**337**

***For businesses still in existence, we obtained job counts as of the time we did this portion of our fieldwork (September-October 2000).**
****** For businesses no longer in existence, we used an average job number, if sufficient data for computation was available. Otherwise, we used what, in our judgment, was the most representative number.
Source: Prepared by legislative auditor's staff using data obtained from the individual businesses and file reviews conducted at OFI and the CAPCOs.

An example of a start-up business that is still in existence and that received CAPCO assistance increased its Louisiana employment from approximately 15 in 1997 to 39 in September 2000, according to company officials. This business provides services to the oil and gas industry. Another example of a start-up business still in existence is a company that produces specialty construction-related materials. This business began operations in 1996 and presently employs 25 people full-time and 20 people part-time. An example of a start-up business no longer in existence is one that involved computer system designs. The business anticipated the creation of four jobs after receiving funding assistance, but it closed five months after receiving the assistance. In a similar example, a restaurant received $100,000 of funding to start-up. The restaurant created 15 jobs after receiving the financing assistance, but it operated for less than a year.

Lack of Accurate Job Information

We were unable to obtain complete and current job information for all of the businesses that have received qualified investments from CAPCOs. According to officials at OFI, the office does not have the statutory authority to request job information directly from businesses that would allow them to clearly determine the number of Louisiana jobs created or retained after businesses receive qualified investments from CAPCOs. OFI 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 provided to them by the CAPCOs. If OFI had access to wage reports or other employment information, it would be able to track employment data accurately.

CAPCOs obtain job information from businesses to which they have provided qualified investments, and they report this information to OFI annually. However, the CAPCOs do not determine the accuracy of this information. In addition, after CAPCOs' investments in the businesses are completed, they do not continue to obtain employment information from the businesses. Thus, the job impact of CAPCO investments in such businesses can no longer be measured. CAPCO officials agree that it is difficult for them to ascertain the number of jobs created or retained as a result of their investments.

Part-time Employees

According to records we reviewed, 25 businesses still in existence that have received qualified investments from CAPCOs created or retained approximately 543 part-time jobs. OFI's regulations that define employees (LAC 10:XV.303) provide that part-time employees and officers are to be converted to a full-time equivalent basis. However, we could not convert part-time people into full-time equivalents because of the limited job information in CAPCO and OFI files. Therefore, we reported them separately.

The following examples illustrate the impact the CAPCO program can have on part-time employment. One of the 25 businesses received a $50,000 loan from a BIDCO. This retail business expanded its operations from one to eight locations after receiving the loan in 1996. The business now employs 206 part-time and 44 full-time employees. Another company we reviewed owned three nursing homes and received $400,000 of CAPCO funding. A company official stated that the financing helped them expand and that they currently have 103 part-time and 258 full-time employees.

Contract Employees and Construction Workers

We found that 12 of the 112 businesses we reviewed had approximately 84 contract employees and had helped employ 331 construction workers after receiving qualified investments from CAPCOs. As with part-time jobs, these jobs are all in businesses that are still in existence. OFI's regulations (LAC 10:XV.303) state that Louisiana employees do not include individuals providing consulting or professional services to a qualified Louisiana business on a contract basis and employees that perform services (contractor) for a qualified Louisiana business. In accordance with this regulation, we counted contract and construction jobs separately and did not include them in the "full-time" job count discussed on page 7. However, we did report these jobs because they create economic benefit to the state, if only for a period of time.

The following examples illustrate the impact the CAPCO program can have on construction jobs. One example is a start-up partnership that received $455,000 in qualified investments from a CAPCO. The partnership converted a building into a residential facility and created 69 temporary construction jobs. In another example, a CAPCO made an equity investment into a limited partnership that rehabilitated historic buildings into apartments. This business created 95 temporary construction jobs and five permanent positions. In a third example, a CAPCO invested in a business that rehabilitated a building into a hotel. This business created 120 temporary construction jobs and 30 permanent positions.

Percentage of Business Financing Provided by CAPCOs

The jobs we identified in this report may not be solely attributable to the CAPCO financing the businesses received. For some of the businesses we reviewed, the amount of qualified investments received from the CAPCOs constituted only a small percentage of the businesses' long-term debt and equity. Postlethwaite & Netterville, a CPA firm, issued a study of the CAPCO program in 1999. One of its findings was that out of a sample of 20 businesses for one CAPCO, CAPCO financing only accounted for about 22% of the businesses' total financing.

For example, in one business we reviewed, the amount of funding provided to the business by the CAPCO was only about 1% of the business's long-term liabilities. In a second case, a business used a $500,000 loan it received from a BIDCO to refinance existing debt. This loan accounted for only about 18% of the business's long-term debt and equity. In a third business we reviewed, a BIDCO loan of $300,000 comprised only about 7% of a start-up company's long-term debt and equity.

In these cases, it is questionable whether the jobs created or retained after receiving the CAPCO financing assistance were solely attributable to that financing. One view is that when the percentage of total financing provided by CAPCO certified investments is low, the jobs created or retained by that business after receiving the financing are not totally attributable to the CAPCO financing. This view holds that the job creation and retention is also due to other sources of financing. Conversely, an official we interviewed at one of the CAPCOs stated that CAPCO financing makes businesses look more attractive to other financiers, thereby increasing the overall amount of financing the businesses receive from other sources. In this way, even though the amount of CAPCO qualified investments is a small percentage of the businesses' total long-term liabilities and equity, it attracts other sources of financing for the businesses that may not have been available otherwise. This CAPCO official estimated that for every $9 the CAPCO had invested, $70 of investments from other sources had been created.

We could not determine an equitable method to apportion jobs to a business based on the percentage of its financing that was provided by CAPCOs. Thus, we did not adjust the job figures downward for any business if the amount of CAPCO or BIDCO funding was a small percentage of the capital structure, with one exception. In this exception, a BIDCO purchased publicly offered securities (tax-exempt bonds) issued by a Louisiana entity. The $500,000 bond purchase accounted for only about 1% of the total bond-offering amount of approximately $47.4 million. The Louisiana financing entity then loaned the proceeds of the bond offering ($47.4 million) to a non-profit corporation. The non-profit corporation stated that approximately 85 jobs would be created or retained after receiving the loan. We did not count these jobs in our total for businesses still in existence for two reasons:

- The percentage of the non-profit corporation's long-term liabilities provided by the BIDCO bond purchase ($500,000) was so small that it had minimal, if any, impact on the jobs of this corporation.

- The business apparently has the financial capability to service $47 million in publicly traded bonds. Such a business could probably raise money without CAPCO or BIDCO assistance. It is our opinion that this type of arrangement is not the type of CAPCO financial assistance that should count toward meeting CAPCO program requirements that entitle CAPCO investors to state tax credits.

Although at the time of this transaction OFI counted the $500,000 as a qualified investment, an OFI official we interviewed agreed that this type of investment probably should not be considered a qualified investment. He also agreed that the 85 jobs should not be included in any estimate of jobs created or retained as a result of the CAPCO/ BIDCO program. This point is important because tax credits granted to investors in CAPCOs are retained by the investors based on the CAPCOs' investments in businesses that OFI has deemed to be qualified investments. The statute that defines qualified investments [R.S. 51:1923(5)] provides, in part, that a qualified investment "means an investment that in substance and in form furthers economic development within Louisiana as defined by rule . . ." This statute also provides more rules regarding equity investments and BIDCO financing assistance. The definition of what type of BIDCO financing assistance qualifies as a qualified investment for CAPCO purposes may need to be amended to preclude this type of transaction from recurring in the future.

Job Neutral Acquisitions

As discussed previously, we classified nine of the 112 businesses that have received qualified investments from CAPCOs as “job neutral acquisitions.” Job neutral acquisitions are cases where CAPCOs provided funding to businesses to acquire other businesses, but the acquired businesses would have continued to operate if they had not been acquired. Thus, the CAPCO funding did not have an effect on jobs in the acquired companies.

An example of one of the job neutral acquisitions we identified was a case where a CAPCO invested approximately $339,000 for the purpose of acquiring and consolidating three businesses in three different locations. The business claimed that it would retain 36 jobs after receiving the CAPCO funding. However, we found no information in OFI’s or the CAPCO’s files showing that any of the three businesses would have left the state or reduced the number of employees if the consolidation had not occurred. Another example is a case where a CAPCO invested approximately $321,000 in a business so the business could purchase 50% of another business. The acquired business had an estimated seven employees before the acquisition. However, nothing in the OFI and CAPCO files we reviewed indicated that the change in ownership would affect employment. In a third acquisition, a CAPCO provided $5.75 million of assistance to a business over two years. After completion of the CAPCO funding, the acquired business had 45 employees. However, we did not find any evidence that the company would have moved out of state or reduced the number of Louisiana employees if the acquisition had not occurred.

We did identify two acquisitions in which the CAPCO assistance did either keep a business in Louisiana or prevent a reduction in Louisiana employees. Accordingly, we did not classify these acquisitions as job neutral; rather, we included the jobs in the figure for businesses still in existence. In the first case, the owner wanted to sell his business, but the purchase offers he received would have likely resulted in the business leaving the state with a corresponding reduction in Louisiana employment. CAPCO officials confirmed that the business owner had several lucrative offers; however, the owner decided to sell the business to his management team and retain Louisiana jobs. In this case, it appears that the CAPCO financing helped prevent the business from being moved out of state. In the second case, CAPCO funding was used to purchase a business from the two owners who founded the company. Major competitors of the business were interested in acquiring it. A sale to one of the competitors would have probably eliminated the business and its Louisiana employees. However, according to the CAPCO files we reviewed, the business was sold to another Louisiana company instead, thus preserving all of the Louisiana jobs.

OFI considers a business acquisition to be a qualified investment if it meets the necessary legal criteria. According to an OFI official, when determining whether an acquisition is a qualified business, OFI considers whether the investment will further economic development. Appendix E contains a list of factors used by OFI in making these determinations. The OFI official we interviewed further stated that OFI has strengthened its examination procedures for allowing acquisitions to be considered qualified businesses. He stated that the office is now reviewing these transactions more closely and attempting to determine if the business will actually close or move out of state or if there would be a reduction in the number of Louisiana employees if the acquisitions did not take place.

It may not be appropriate to count as qualified investments those cases where a CAPCO's financing of business acquisitions has little, if any, impact on furthering Louisiana economic development. Furthermore, it may not be appropriate for CAPCOs to count such investments toward meeting the legal criteria necessary to retain tax credits granted by the state. Closer scrutiny of such cases may be warranted.

Verification of Investment and Tax Credit Amounts

Are the dollar amounts of certified capital invested into CAPCOs accurately reported by the Office of Financial Institutions and the Department of Economic Development? Are the amounts of tax credits granted to investors accurately reported by the Office of Financial Institutions and the Department of Economic Development?

We found that the Office of Financial Institutions and the Department of Economic Development have accurately reported the dollar amounts of certified capital invested into the CAPCOs and the amounts of income and premium tax credits granted for the years 1988 through 1999, with two minor exceptions. One exception was for an amount invested into a CAPCO. The other exception was for an amount of tax credits granted to insurance company investors of a CAPCO.

For the years 1988 through 1999, investors invested $599.2 million of certified capital into CAPCOs. For the same time period, the state granted $546.5 million in tax credits.

Certified Capital Invested Into CAPCOs

For 1997, we found a discrepancy in the amount an insurance company invested into a CAPCO. OFI's records show that this insurance company invested $100,000, but bank records sent to OFI by the insurance company show that the investment amount was $75,000. This resulted in a $25,000 discrepancy. However, according to an OFI official and other documentation we reviewed, the state granted the correct amount of tax credits to this investor.

As stated above, for the years 1988 through 1999, investors invested $599.2 million in CAPCOs. Of that total, non-insurance company investors invested $200.7 million, and insurance companies invested $398.5 million.

Income and Premium Tax Credits

The second discrepancy we found dealt with tax credits. In this situation, insurance companies invested $193,700 in a CAPCO in 1989. The Department of Economic Development administered the CAPCO program until 1993 and reported insurance premium tax credits granted at

200% ($387,400) for this investment. However, the insurance premium tax credit rate was reduced from 200% to 120% effective March 17, 1989, and the CAPCO was not certified as a CAPCO until December 1989. This means that the insurance companies' investments were made after the CAPCO was certified. Therefore, the investors were entitled to insurance tax credits of only 120% of their investments since they made their investments after March 17, 1989. Accordingly, the department's reported amount of premium tax credits was overstated by $154,960. However, the Department of Insurance granted the correct amount of premium tax credits, according to records that we reviewed.

As previously stated, for the years 1988 through 1999, the state granted $546.5 million of tax credits. Of that total, the state granted non-insurance company investors $70.2 million in income tax credits and insurance companies $476.3 million in premium tax credits. Exhibit 7 provides details on the investment and tax credit amounts by year. Details on the total annual amounts of investments and tax credits are also contained in Exhibits 1 and 2 on page 3.

Exhibit 7
Investments and Tax Credits
1988 Through 1999

Year	Investments by Non-Insurance Investors	Tax Credits Granted to Non-Insurance Investors	Investments by Insurance Investors	Tax Credits Granted to Insurance Investors
1988	$282,667	$98,933	$6,414,205	$12,828,410
1989	$282,541	$98,889	$3,788,700	$4,546,440
1990	$2,860,242	$1,001,085	$0	$0
1991	$38,850	$13,598	$4,340,000	$5,208,000
1992	$422,446	$147,856	$14,201,000	$17,041,200
1993	$3,178,830	$1,112,591	$16,483,000	$19,779,600
1994	$1,263,124	$442,093	$31,594,030	$37,912,836
1995	$385,850	$135,048	$31,486,000	$37,783,200
1996	$712,634	$249,422	$37,950,000	$45,540,000
1997	$8,143,593	$2,850,258	$123,615,000	$148,338,000
1998	$171,719,917	$60,101,971	$57,918,000	$69,501,600
1999	$11,428,571	$4,000,000	$70,727,272	$77,799,999
Total	**$200,719,265**	**$70,251,744**	**$398,517,207**	**$476,279,285**

Source: Prepared by legislative auditor's staff using data obtained from file reviews at OFI.

Exhibit 8 on the following page provides details on the total certified capital invested into each CAPCO and tax credits granted to the investors. The exhibit also details the number of full-time jobs for businesses that are still in existence, businesses that are no longer in existence, and businesses for which we could not determine whether they were still in existence or not. Some CAPCOs were only recently certified as CAPCOs and had not made any qualified business investments as of 1999. Also, some CAPCOs have changed their names during their existence or have affiliated CAPCOs and/or BIDCOs. In Exhibit 8, we grouped all entities affiliated with each CAPCO into single CAPCO groups. Even though there are now 30 CAPCOs in existence, after consolidating affiliated CAPCOs there have been 15 CAPCO groups in existence during this program. Two of the CAPCO groups listed in Exhibit 8 are no longer in existence.

Exhibit 8
Summary of Certified Capital Invested Into CAPCOs, Tax Credits Granted to Investors, Full-time Jobs Created or Retained, and Start-up Businesses Assisted
1988 Through 1999

CAPCO	Certified Capital Invested Into CAPCO	Tax Credits Granted to Investors	Number of Full-Time Jobs Created/Retained			Number of Start-up Businesses Assisted
			Businesses Still in Existence	Businesses No Longer in Existence	Unknown Whether Businesses Still in Existence	
1	$3,524,571	$6,894,182	0	0	0	0
2	$26,686,798	$30,424,484	1117	291	37	4
3	$264,040,000	$226,063,000	628	83	170	3
4	$266,016,828	$256,551,718	733	26	30	11
5	$250,000	$87,500	0	0	0	0
6	$2,858,990	$1,595,647	69	116	0	1
7	$75,000	$90,000	1	13	0	0
8	$13,507,143	$4,727,500	35	0	0	3
9	$16,400,000	$18,040,000	0	0	0	0
10	$800,000	$280,000	0	0	0	0
11	$600,000	$210,000	0	0	0	0
12	$1,000,000	$350,000	0	0	0	0
13	$200,000	$70,000	0	0	0	0
14	$2,207,145	$772,501	0	0	0	0
15	$1,070,000	$374,500	142	12	0	4
Total	**$599,236,475**	**$546,531,032**	**2,725**	**541**	**237**	**26**

Note: Some CAPCOs were only recently certified as CAPCOs and had not made any qualified business investments as of 1999.
Source: Prepared by legislative auditor's staff using data obtained from file review at OFI and the CAPCOs and the Department of Economic Development's 1999 Annual Report on the CAPCO program.

How the CAPCO Program Operates

How does the CAPCO program operate?

Any business entity that wishes to be certified as a CAPCO must submit an application to the Office of Financial Institutions and have capitalization of at least $200,000. Once certified, CAPCOs can begin to raise money from investors. They do so by offering tax credits as incentives. Insurance companies that invest into CAPCOs earn insurance premium tax credits in the amount of 110% of their investments. Also, any person or entity can earn an income tax credit of 35% of its investments into CAPCOs.

There are three ways in which CAPCOs can raise certified capital for their investment pools. The most common method involves the CAPCOs issuing notes payable to investors, typically insurance companies. In order for their investment pools to remain certified, CAPCOs must meet certain statutory requirements for investing their certified capital into qualified Louisiana businesses.

CAPCOs and/or their pools can be decertified either voluntarily or involuntarily. There are two forms of voluntary decertification. First, under R.S. 51:1928(A), a CAPCO may decide that one or more of its pools cannot meet the continuing certification requirements. Second, under R.S. 51:1928(B), if any of a CAPCO's pools meets certain statutory requirements, those pools can be voluntarily decertified. CAPCOs and/or their investment pools may also be involuntarily decertified for violating program provisions. Appendix D describes the process of involuntary decertification of CAPCOs.

Continuing certification requirements are contained in R.S. 51:1926. R.S. 51:1926(A) requires that investment pools must have 30% of their certified capital invested in qualified investments within three years and 50% of their certified capital invested in qualified investments within five years in order to remain certified. The CAPCO statutes provide some rules regarding recapture and forfeiture of tax credits if these rules are not met. However, not every possible scenario is covered. The statutes may need to be amended to provide further clarification.

Matter for Legislative Consideration 2: The Legislature may wish to consider amending R.S. 51:1927(C) to provide rules regarding the recapture and forfeiture of income tax credits for investment pools that have met the three-year (30%) but not the five-year (50%) investment rules.

Matter for Legislative Consideration 3: The Legislature may wish to consider amending R.S. 51:1927(C) to provide rules regarding the recapture and forfeiture of premium and income tax credits for investment pools where the five-year investment rule has been met, but the CAPCO subsequently fails to meet the rules for continuing certification.

Recommendation 5: If the Legislature does not provide statutory rules for the recapture and forfeiture of tax credits as discussed in Matters for Legislative Consideration 2 and 3, the Office of Financial Institutions and the Department of Economic Development should promulgate rules to address these situations.

Summary of the Office of Financial Institutions' Response: Agree. If the Legislature does not address the statutory rules for the recapture and forfeiture of tax credits as discussed in Matters for Legislative Consideration 2 and 3, the Office of Financial Institutions will discuss with the Department of Economic Development changes that can be made to the existing rules to address these deficiencies. (See Appendix F for the full text of the Office of Financial Institutions' response.)

Summary of the Department of Economic Development's Response: Agree. The recommended changes would help improve the effectiveness of the CAPCO program.

Current Status of CAPCO Program

As of January 1, 2000, under state law (R.S. 51:1931), new CAPCOs could no longer be certified by the Office of Financial Institutions (OFI) and thereby legally exist. Existing CAPCOs had until December 31, 2000, to raise capital for future business investments. After that date, OFI may no longer certify capital investments into CAPCOs, and such investments are no longer eligible for tax credits. Thus, the discussion in this section concerning CAPCO certification is no longer applicable. Also, the discussion on raising certified capital is not applicable after December 31, 2000. We included these topics in this report to provide an overall picture of the methods by which CAPCOs have operated up to that date. The section titled *Issues for Future Legislative Consideration* contains a summary of program issues the Legislature may wish to address if it decides to renew all aspects of the CAPCO program later.

CAPCO Certification

Before January 1, 2000, OFI regulations (LAC 10.XV:307.A) required any business entity that sought certification as a CAPCO to submit an application to OFI. Under R.S. 51:1925(B), the applicant had to have capitalization of at least $200,000. Also, to obtain certification, OFI had to determine that the applicant was well acquainted with the CAPCO program. If it approved the application, OFI issued a letter and certificate to the CAPCO notifying it of its certification.

Raising Certified Capital

Under the laws that sunsetted on December 31, 2000, after a CAPCO became certified, it raised funds to invest in businesses. The money raised through the incentive of tax credits is called certified capital. OFI regulated the process of raising capital. Pursuant to R.S. 22:1068(E) and R.S. 51:1924(A) and (B), and as defined in LAC 10:XV.303.*Investment*.a, there are three ways that CAPCOs could raise certified capital from investors:

- Investors could invest cash to obtain equity interests in CAPCOs. Insurance companies and other investors could use this method of investing.

- Investors could purchase notes or loans receivable with maturities of at least five years from CAPCOs. Through the life of the CAPCO program, this method has been the most popular form of raising capital, according to OFI. Insurance companies and other investors could use this method of investing.

- Insurance companies could give CAPCOs debt instruments, which are obligations of the insurance companies to the CAPCOs. In these cases, the CAPCOs would have loans receivable from the insurance companies. The insurance companies had to pay this debt in cash at a rate of at least 10% per year.

Tax Credits for CAPCO Investors

After becoming certified, CAPCOs could raise money from investors using state tax credits as incentives. There are two ways in which investors could earn tax credits. First, insurance companies could earn insurance premium tax credits in the amount of 110% of their investment into CAPCOs. Second, other investors could earn income tax credits at the rate of 35% of their investment into CAPCOs. These two scenarios are discussed below.

Premium Tax Credits for Insurance Company Investors

R.S. 22:1068(E) provides for a credit against premium taxes for insurance companies that invest into CAPCOs. This credit is 110% of the amount invested. The credit is applied to the insurance company's tax liability at a rate not to exceed 10% per year until the entire amount of the credit is claimed (i.e., usually over 10 years). However, the credit taken in any year cannot be greater than the company's net premium tax liability for that year. Therefore, if the credit scheduled to be taken in any year exceeds the premium tax liability for that year, the excess tax credit can be carried forward to future years until it is used up.

Under R.S. 51:1924(D)(1), insurance premium tax credits granted within a calendar year cannot exceed $8 million for the CAPCO program as a whole. This figure does not include the credits outstanding from previous years. Thus, the maximum amount of investments by insurance companies annually eligible for premium tax credits is approximately $72.7 million because 110% of $72.7 million is $80 million, to be taken at 10% ($8 million) per year.

Income Tax Credits for Investors

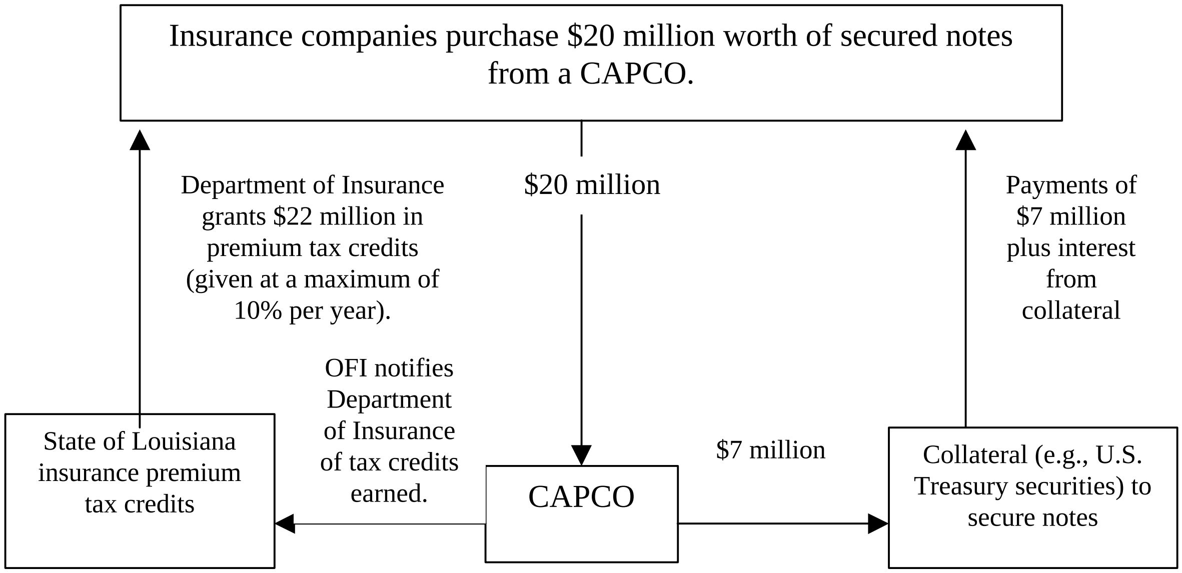
R.S. 51:1924(A) and (B) provide that any person or entity that invests in a CAPCO can take an income tax credit of 35% of the cash investment. Under R.S. 51:1924(E), if an investor's tax credit exceeds its actual tax liability for the year of investment, the excess amount is carried forward to future years until it is used up.

LAC 10:XV.305.C.1 provides that income tax credits taken within a calendar year cannot exceed $4 million for the CAPCO program as a whole. This figure does not include the credits outstanding from previous years. Thus, the maximum amount of investments annually eligible for income tax credits is approximately $11.4 million because 35% of $11.4 million is approximately $4 million.

Illustration

To illustrate the most popular method of raising capital and earning tax credits, Exhibit 9 on the following page depicts a pool of insurance companies investing $20 million in a CAPCO in exchange for notes receivable. CAPCOs typically provide insurance companies with assurance (collateral) that the CAPCOs' notes will be repaid. The CAPCOs usually provide this assurance by purchasing collateral instruments to use in repaying its investors. For example, a CAPCO may purchase zero coupon Treasury bonds, which increase in value over time. The CAPCO matches the maturity dates of the zero coupon bonds with the dates that it must make repayments to its investors. The amount of money that the CAPCO places in these bonds to repay its investors is a function of the interest rate negotiated between the CAPCO and its insurance company investors. Typically, the CAPCO repays the investors about 25% to 40% of the amount of money invested. Premium tax credits granted by the state repay the balance due to the investors.

Exhibit 9
Common Method for Insurance Companies to Invest Into CAPCOs



What returns do the insurance companies receive from investing into the CAPCO?

In our hypothetical example, a pool of insurance companies invested $20 million into a CAPCO. Over a period of at least ten years, the investors will receive $22 million in tax credits from the state plus over $7 million in payments from the CAPCO.

The CAPCO's notes are typically structured so that the insurance companies' return equals the rate of return on a U.S. Treasury note of equal maturity plus an additional percentage amount. This additional percentage return is usually about 3%. Therefore, if the rate of return on a Treasury note with a maturity comparable to the CAPCO's note is 6%, then the insurance companies would receive a return of approximately 9%.

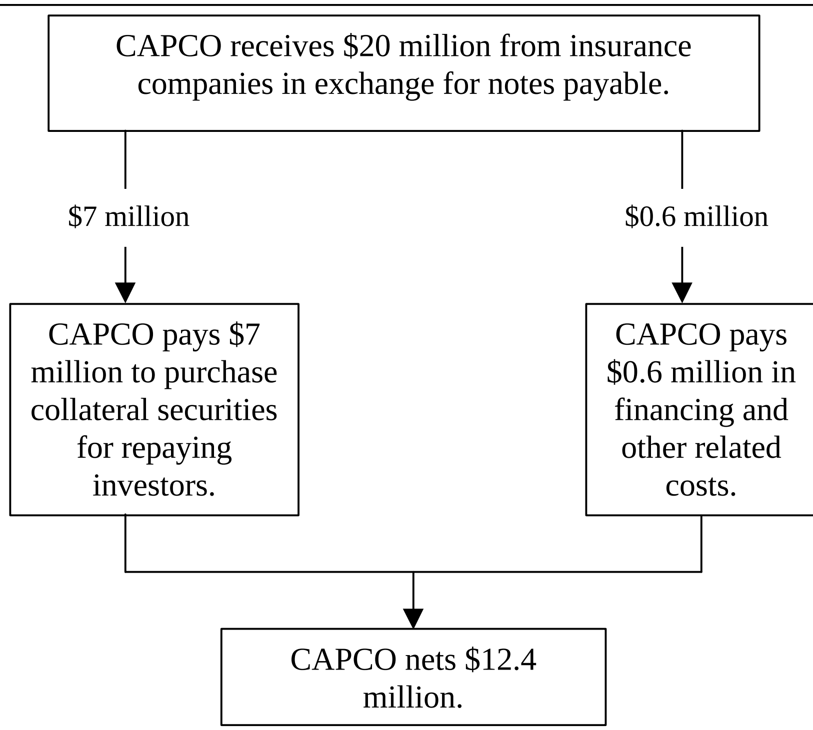
The CAPCO's notes are secured by Treasury notes, bond insurance, or other means. Accordingly, the degree of risk typically taken by insurance companies for investing into the CAPCO is very similar to the degree of risk inherent in a U.S. Treasury security of comparable maturity. Yet, insurance companies typically receive approximately 3% more return on their investments into CAPCOs than they would earn from a comparable U.S. Treasury security.

What does the CAPCO initially receive from the investment of $20 million by the insurance companies?

As depicted in Exhibit 9, the CAPCO has received $20 million from a pool of insurance companies. The CAPCO invests a portion of this money ($7 million in this example) in securities to collateralize its notes payable. As they mature, these securities will also help the CAPCO repay the investors.

The CAPCO incurs financing and other related costs for raising this money. These costs are usually 3% of the amount raised, which in this example would be $600,000 ($20 million x 3%). Thus, the CAPCO would net $12.4 million ($20 million - $7 million - $0.6 million) from this round of insurance company investments. This $12.4 million is then available for the CAPCO to make investments into qualified Louisiana businesses. Exhibit 10 depicts this process.

Exhibit 10
CAPCO's Net Proceeds From $20 Million Investment by Insurance Companies



CAPCO Investments Into Businesses

According to R.S. 51:1926(A), CAPCOs must invest certain portions of their certified capital into qualified investments in order to remain certified. If a CAPCO does not remain certified, its investors may have to repay tax credits taken and/or forfeit future tax credits.

R.S. 51:1923(5) defines *qualified investments* as investments in qualified Louisiana businesses that further economic development in the state. OFI's program regulations discuss how investments can further economic development within Louisiana. For a list of the ways that investment proceeds can be used to promote economic development, see Appendix D.

A *qualified Louisiana business* is a business that at the time of investment meets or, as the direct result of an investment pursuant to Chapter 26 of Title 51 of the Louisiana Revised Statutes of 1950, would meet, each of the following requirements:

- Operates primarily in Louisiana or performs substantially all of its production in Louisiana
- Has, together with its affiliates, a net worth which is not in excess of $18 million
- Has, together with its affiliates, an average annual net income, after federal income taxes, excluding any carry-over losses, for the preceding two completed fiscal years which is not in excess of $6 million
- Has, together with its affiliates, no more than 500 employees

In addition, if a business is considered qualified when first invested in by a CAPCO, it remains qualified for the purpose of later qualified investments by that CAPCO as long as the future investments meet all other rules for furthering economic development in Louisiana.

Investments can be made in a qualified Louisiana business in one of two ways. First, R.S. 51:1923(5)(a) provides that the investment can consist of cash to acquire equity in the business. Included in the statutory definition of equity [R.S. 51:1923(4)] are (1) stock or equivalent ownership interest, or (2) a loan with a maturity date of at least five years that is convertible into equity or has equity features. The second form of investment is provided for in R.S. 51:1923(5)(b). This type of investment consists of cash financing provided by a BIDCO in the form of a loan. OFI officials informed us that BIDCO loans must have a minimum five-year maturity to be considered qualified investments. As of 1999, Louisiana had seven BIDCOs that were also CAPCOs.

After CAPCOs have raised certified capital through investment pools, R.S. 51:1926(A) requires, in part, that they invest their certified capital in the following manner in order for the investment pools to remain certified and keep their investors' tax credits intact:

- Within three years of each pool's investment date[1], at least 30% of the money raised by the pool must be invested in qualified investments.

- Within five years of each pool's investment date[1], at least 50% of the money raised by the pool must be invested in qualified investments.

According to R.S. 51:1927(B), any violation of these statutory rules will be grounds for decertification of the non-complying investment pool.

Exhibit 11 shows how these rules work as applied to the $20 million raised in our hypothetical example.

Exhibit 11
CAPCO's Investment Into Qualified Louisiana Businesses

From an initial investment of $20 million, the CAPCO nets about $12.4 million, as shown in Exhibit 10. For the CAPCO's investment pool to remain certified, the money raised must be invested as follows:

Within **3 years**, the CAPCO must have **$6 million** invested in qualified Louisiana businesses.

Within **5 years**, the CAPCO must have **$10 million** invested in qualified Louisiana businesses.

[1] According to R.S. 51:1923(9), the *investment date* is the date on which the investment pool transaction closes.

Recapture of Income Tax Credits

The requirements for continued certification are listed in R.S. 51:1926. R.S. 51:1927(C)(1) provides that if a CAPCO's investment pool does not comply with all requirements for continued certification within three years and is thus decertified, all tax credits taken by the investors are subject to recapture. R.S. 51:1927(C)(2) provides that if the investment pool meets the three-year but not the five-year investment rule, the first three years of premium tax credits that have been taken are not subject to recapture. That is, any insurance premium tax credits taken after the first three years are subject to recapture. However, the law does not address what would happen to income tax credits in the same situation. R.S. 51:1927(C)(5) provides that the OFI may promulgate rules regarding the recapture or forfeiture of income tax credits associated with pools certified on or after January 1, 1999, that fail to meet continuing certification requirements. An amendment to the statutes or rules could clarify this situation.

Voluntary Decertification of CAPCOs' Investment Pools

There are two ways that a CAPCO can voluntarily decertify its investment pools. First, according to OFI officials, a CAPCO may acknowledge that its pool cannot meet the continuing certification requirements discussed previously. In this instance, the CAPCO may request that OFI voluntarily decertify the pool. When a CAPCO's pool is granted voluntary decertification in this manner, it must remit to the Department of Revenue and/or Department of Insurance some or all of the tax credits granted to the investors. The CAPCO is granted statutory authority to collect these credits from its investors by R.S. 51:1928(A).

The second type of voluntary decertification is provided for by R.S. 51:1928(B). This type of voluntary decertification is far more common. In this instance, when an investment pool meets certain statutory requirements, that pool can be voluntarily decertified. The requirements that must be met to achieve this type of voluntary decertification are as follows:

- For investment pools of certified capital raised on or before December 31, 1998: When the pool has been continually certified for 10 years or once the CAPCO has invested 60% of the pool into qualified investments, the CAPCO may request an OFI review and decertification of that pool.

- For investment pools of certified capital raised after December 31, 1998: When the CAPCO has invested 100% of an investment pool into qualified investments, the CAPCO may request an OFI review and decertification of that pool.

Once OFI approves this type of voluntary decertification, any tax credits associated with that pool that have been claimed or are to be claimed are guaranteed (i.e., are no longer subject to repayment, recapture, or forfeiture). This method of decertification also ends OFI oversight over how that pool can invest its funds.

As discussed in the section titled *Recapture of Income Tax Credits* on page 33, CAPCOs must meet the three-year and five-year investment requirements for their investment pools pursuant to R.S. 51:1926 in order to remain certified. Under 51:1927(C), any insurance premium tax credits taken after the first three years are subject to recapture if the five-year investment rule is not met. When reading these two statutes together with R.S. 51:1928(B), it is unclear what happens to investors' tax credits when a CAPCO has met the five-year investment rule [provided for in R.S. 51:1926(A)] but subsequently fails to meet other continuing certification requirements provided for in R.S. 51:1926. For example, if a CAPCO meets the five-year investment rule but becomes decertified, for instance, in the seventh year before it has invested 100% of its certified capital, what happens to the investors' tax credits? Should the insurance premium tax credits be guaranteed to insurance company investors at the rate of 10% per year or should they be guaranteed in total because the five-year rule has been met? State law may need to be amended to provide further clarification on this issue.

Involuntary Decertification of CAPCOs

Under R.S. 51:1927, CAPCOs can also lose their certification involuntarily. If a CAPCO is involuntarily decertified, it can no longer raise certified capital. Decertification of a CAPCO and any affected investment pools may cause the forfeiture of the remaining and unclaimed tax credits. In addition, all credits taken by the investors may also be subject to recapture. For a description of how CAPCOs may become involuntarily decertified and the implications for investors, see Appendix D.

Issues for Future Legislative Consideration

Under state law, as of December 31, 1999, the Office of Financial Institutions no longer certifies the formation of new CAPCOs. Also, as of January 1, 2001, Louisiana no longer grants new tax credits to investors in CAPCOs. However, in case the Legislature subsequently decides to renew these aspects of the program, we present the following issues for future consideration. Implementing some of the controls discussed in this section may allow the CAPCO program to operate at a lower cost to the state while being subjected to more thorough controls.

Initial Capitalization of CAPCOs

Any company seeking to become a CAPCO must have at least $200,000 in initial capitalization, according to R.S. 51:1925(B). As of 1999, there were four other states with CAPCO programs actively operating. These states all require a minimum capitalization of $500,000. The Legislature may wish to consider increasing the current capitalization requirements.

Tax Credits Granted to Investors

As discussed in the section on tax credits (see pages 27 through 28), the state grants insurance companies a premium tax credit of 110% of the investment amount to be taken at a rate not to exceed 10% per year until 100% of the premium tax credit has been claimed. This is in accordance with R.S. 22:1068 (E)(1)(a). As also discussed in the section describing how the CAPCO program operates, one method of raising capital is where insurance companies purchase notes or loans receivable from the CAPCOs. This method has been the most popular method of raising capital. Under this method, the CAPCOs typically repay the investors about 25% to 40% of the amounts invested into the CAPCOs (see pages 28 through 30). The CAPCOs use the funds invested by the investors to make these repayments. The premium tax credits granted by the state repay the balance due to the investors. Under this method of raising capital, the CAPCOs make money off the financing packages they put together before they make any investments into Louisiana businesses.

In addition, as of 1999, four other states offered tax credits of 100% of the investment amount over 10 years, which is 10% less than the rate in Louisiana. Furthermore, Louisiana is the only state that offers income tax credits to CAPCO investors. Based on these factors, the Legislature may wish to consider lowering the insurance premium tax credit rate and/or lowering or eliminating the income tax credit rate. In doing so, the Legislature may want to study other states with CAPCO programs to see how well their CAPCOs have raised capital.

Total Tax Credits Granted Each Year

As also discussed in the tax credits section (see pages 27 through 28), state law and the administrative code limit the amount of tax credits that can be granted to investors each year. Insurance company investors can annually receive a total of no greater than $8 million of new premium tax credits in one year. Other investors are limited to a total of $4 million in new income tax credits in one year. The Legislature may wish to consider lowering the amount of premium and income tax credits that can be earned each year. This could be done through an amendment to R.S. 26:1924(D)(1) for the insurance premium tax credits and to LAC 10:XV.305.C.1 for the income tax credits.

Definition of "Qualified Louisiana Business"

R.S. 51:1923 (6)(b) allows a business to remain a qualified Louisiana business even if it no longer meets other statutory provisions for remaining qualified. Once a business is determined to be a qualified Louisiana business by OFI, the business is always considered qualified for future investments by that same CAPCO as long as the future investments further economic development in Louisiana. However, if a qualified Louisiana business has grown to the point that it no longer meets the statutory size parameters, then the qualified investment has accomplished what it was intended to accomplish. A business of that size should be able to obtain financing outside of the CAPCO program. This scenario raises the question of whether a business that has been determined to be qualified should always thereafter be considered eligible for qualified investments.

In addition, the statutory provisions in R.S. 51:1923 (6)(a) that define what a qualified Louisiana business is may be too broad (see page 31). A private placement memorandum issued by one CAPCO in 1997 states that an estimated 100,000 Louisiana companies meet the criteria stated in the law. The private placement memorandum also states that data from DED indicates that over 98% of all businesses in the state meet these criteria. The primary purpose of the CAPCO program, as defined in statute, is to provide for the availability of venture capital financing to help form and expand new businesses that create jobs. However, if almost every business in the state can be considered qualified, it could increase the likelihood that CAPCOs will invest more in proven, profitable firms instead of new or expanding businesses in order to ensure higher returns on their investments. This type of investment is not consistent with what a venture capital program is supposed to accomplish. Therefore, the Legislature may wish to consider narrowing the parameters for qualified businesses. Doing so would help ensure that smaller businesses with less income or equity would receive a greater benefit from the program.

Clarification of Statutes

The statutes describing the purpose and intent of the CAPCO program may need to be clarified. R.S. 51:1922 says that the primary purpose of the program is "to provide assistance in the formation and expansion of *new businesses* [emphasis added] which create jobs in the state . . ." However, R.S. 51:1923(2), under the definition of "certified Louisiana capital company," says that the primary business activity of a CAPCO is to make investments "to qualified Louisiana businesses that are in need of capital for *survival, expansion, new product development, or similar business purposes* [emphasis added] . . ." As the statutes currently read, it seems that R.S. 51:1922 says that the purpose of the *program* is to help new businesses, while R.S. 51:1923(2) seems to say that the purpose of the *CAPCOs themselves* is to help businesses survive, expand, or introduce new products. The Legislature may wish to consider clarifying what the primary purposes of the program are by amending R.S. 51:1922 and/or R.S. 51:1923(2).

State Participation in CAPCO Profits

Current CAPCO law (R.S. 51:1927.1) states that during each CAPCO's annual audit, the auditor will determine whether the aggregate cumulative appreciation of any pools certified on or after January 1, 1999, has resulted in an annual rate of return of at least 15%. The auditor must then determine the amount of that appreciation (if any) that exceeds the 15% rate of return. The CAPCO must then remit 25% of the excess over 15% to the Louisiana Economic Development Fund. However, according to OFI officials, it is unlikely that the state will ever benefit from this provision. The reason is that the 15% rate of return is calculated immediately after decertification, and CAPCOs try to decertify their pools as quickly as possible. Venture capital investments typically take a while to appreciate (i.e., the businesses cannot pay them back that quickly), so that when a pool decertifies, it would not have had enough time to earn a 15% annual return. Therefore, the Legislature may wish to consider adopting a different method that would allow the state to share in CAPCO profits.

BIDCO Loans Guaranteed by Small Business Administration

BIDCO loans can be guaranteed by the U.S. Small Business Administration (SBA). Since all BIDCOs also qualify as CAPCOs, these guaranteed loans can count as qualified investments under the CAPCO program. When these loans count as qualified investments, they help CAPCOs meet the three-year and five-year investment rules that must be satisfied for the CAPCOs to maintain certification. In these situations, the BIDCOs/CAPCOs are not subject to the risk of losing the loan principal for the SBA-guaranteed portion. Therefore, it may not be appropriate for the SBA-guaranteed portion of the loan to count as a qualified investment that helps CAPCOs meet certification requirements and also helps investors retain their tax credits. As a result, the Legislature may wish to amend the laws that allow this type of BIDCO financing to count as qualified investments in the CAPCO program. The requirements for continued certification of CAPCO capital can be found in R.S. 51:1926. The BIDCO laws are contained in R.S. 51:2386 *et. seq*.

OFI Staffing and Funding

Since the CAPCO and BIDCO programs are complex and involve millions of dollars in state tax credits, it is important that OFI have sufficient, competent staff to fulfill its regulatory responsibilities. We did not review OFI's staffing during this audit. Therefore, if the CAPCO program is continued in the future, the Legislature may wish to request an assessment of OFI's staffing needs as they relate to the oversight of these programs.

OFI charges fees to CAPCOs and BIDCOs for its examinations, but these self-generated revenues do not pay for all regulation expenses that it incurs, according to OFI officials. According to one official, in the fiscal year ended June 30, 1999, expenses associated with CAPCO/BIDCO regulation exceeded self-generated revenue by more than $96,000. The Legislature may wish to allow an increase in the fees that OFI can charge CAPCOs and BIDCOs. This issue would become more important if the statutory provisions of the program that recently sunsetted are renewed in the future.

Appendices

Appendix A

Senate Resolution No. 25

ENROLLED

Regular Session, 2000

SENATE RESOLUTION NO. 25

BY SENATOR HEITMEIER

A RESOLUTION

To direct the legislative auditor to review the use of investment capital by certified Louisiana capital companies; and to issue a written report to the members of the Senate.

WHEREAS, the Louisiana Capital Companies Tax Credit Program was created by the legislature in 1983; and

WHEREAS, the primary purpose of the Louisiana Capital Companies Tax Credit Program is to provide assistance in the formation and expansion of new businesses which create jobs in the state by providing the availability of venture capital financing to entrepreneurs, managers, inventors, and other individuals for the development and operation of qualified Louisiana businesses; and

WHEREAS, there are currently thirty-two certified Louisiana capital companies in existence in Louisiana; and

WHEREAS, over the life of the program, the certified Louisiana capital companies have raised certified capital in excess of $600,000,000, of which, seventy-four percent was raised since 1997; and

WHEREAS, affidavits of investment claim the retention of 4,841 jobs as a direct result of the investments which the office of financial institutions is not able to independently verify; and

WHEREAS, the office of financial institutions has no statutory authority to either examine or audit any business in which a certified Louisiana capital company has invested.

THEREFORE, BE IT RESOLVED that the Senate of the Legislature of Louisiana hereby directs the legislative auditor to review certified Louisiana capital companies and determine whether the use of investment capital is consistent with the primary purpose outlined in the statutes creating the program.

BE IT FURTHER RESOLVED that the legislative auditor make a written report to the members of the Senate prior to the beginning of the 2001 Regular Session of the Legislature.

BE IT FURTHER RESOLVED that a copy of this Resolution be transmitted to the legislative auditor and to the commissioner of the office of financial institutions.

PRESIDENT OF THE SENATE

Appendix B

Scope and Methodology

Appendix B: Scope and Methodology

Senate Resolution No. 25 of the 2000 Regular Legislative Session directs the Legislative Auditor to review the CAPCO program and determine whether the use of investment capital is consistent with the primary purpose outlined in the statutes creating this program. This performance audit was conducted under the provisions of Title 24 of the Louisiana Revised Statutes of 1950, as amended. All performance audits are conducted in accordance with generally accepted government auditing standards as promulgated by the Comptroller General of the United States. Fieldwork on this audit began in June 2000 and ended in October 2000.

Scope

This audit focused on three major areas of the Louisiana Capital Companies (CAPCO) Tax Credit Program. First, we gathered information concerning the number of Louisiana jobs created and/or retained by businesses that received CAPCO assistance. Second, we verified the amount of money invested into CAPCOs and the corresponding tax credits since program inception. Third, we studied how the CAPCO program operates.

For job numbers, we relied on information either reported to the Office of Financial Institutions (OFI) by the CAPCOs or furnished to the CAPCOs by the businesses in which the CAPCOs invested. We obtained these numbers from OFI's Baton Rouge office and by reviewing files at selected CAPCOs in Baton Rouge and New Orleans. We also relied on written and telephone responses from businesses when we could obtain such information. Finally, we relied on OFI's management controls and did a limited assessment of the effectiveness of these controls.

The job data that we obtained imposed some limitations on our analysis and conclusions. Often times, we had to rely on anecdotal evidence, such as memos, OFI examiner notes, and phone conversations for this data. Also, it was often difficult to obtain current job information for some businesses. Thus, all job data presented in this report must be considered approximations because of the limited verifiable information available.

Methodology

In order to gain an understanding of the laws and rules that govern the CAPCO program, as well as the types of investments made into and by CAPCOs, we completed the following procedures:

- Reviewed the Louisiana Revised Statutes, Louisiana Administrative Code, and Attorney General opinions relatig to the CAPCO program

- Reviewed a study of the CAPCO program issued by the CPA firm, Postlethwaite and Netterville, in December 1999

- Reviewed the last two annual reports (for 1998 and 1999) issued by the Department of Economic Development on the CAPCO program

- Held discussions with OFI officials and reviewed CAPCO files at OFI relating to program operations and documentation retained

- Held discussions with CAPCO officials relating to their capital-raising methods

- Met with officials from the Department of Revenue and Department of Insurance to discuss the process of awarding tax credits

To verify the dollar amounts invested into CAPCOs and the corresponding tax credits awarded, we performed the following procedures:

- Obtained spreadsheets from OFI showing the name of each CAPCO, the name of each investor, the amount invested by each investor, and the amount of tax credits granted to each investor from 1988 through 1999

- Reviewed CAPCO examinations done by OFI and other OFI information about the investors, amounts invested, and tax credits granted

- Reconciled investment information from OFI files with OFI's spreadsheets for 10 of the 12 years that CAPCOs have received investments

- Reviewed a list of insurance premium tax credits granted that was prepared by the Department of Insurance

We calculated the number of jobs created or retained after investments into qualified Louisiana businesses by CAPCOs by doing the following:

- Reviewed OFI examiners' files for each CAPCO investment for job related information such as affidavits, memos, and OFI examiners' notes from the time when the investments were made

- Obtained from OFI a list of businesses that received CAPCO assistance and sent them letters requesting information on job creation and retention since receiving the CAPCO assistance

- Visited five CAPCOs; reviewed their investment files; obtained job information such as wage statements, salaries from income tax returns, and memos from those files; and obtained supplemental information by interviewing CAPCO officials

- Telephoned businesses that did not respond to our written request if we had no other reliable job information and obtained further information on jobs created or retained from those businesses that we were able to contact

We then analyzed and categorized the job data that we obtained in our fieldwork. We initially considered averaging the job numbers throughout the years for each business from the date it received assistance. This would have provided a picture of how the program has performed over time. However, we did not have enough data to perform an analysis of this sort. Therefore, we have reported the most recent job figures we could identify for full-time, part-time, contract, and construction jobs in active businesses.

It is worth noting that for the jobs that are still active, we have no way of knowing whether these jobs will increase, decrease, or remain the same in the future. The numbers could vary greatly over time. Our data presents a “snapshot” of the current job numbers for 64 active businesses. Also, in many cases, businesses received additional assistance after receiving an initial round of financing. We often could not determine how many jobs were created or retained after subsequent rounds of financing because sufficient data were not available to make these determinations. For some businesses, our only job figures were from the time of the original investment.

After taking into consideration these limiting factors, we decided to report the job figures as follows:

- We first reported a job count for businesses that are still active. For this figure, we calculated the number of current full-time jobs based on the most recent information we could find in either OFI or the CAPCO files. However, in cases where the business provided this information to us through our survey or telephone interviews, we used that information.

- We provided separate job counts for businesses that no longer exist. This data consists of jobs created or retained in businesses that went out of existence in less than one year, from 1-2 years, 2-3 years, 3-5 years, or over 5 years from the date that they received CAPCO financing. When possible, we calculated an average; otherwise, we used what, in our judgment, was the most representative number.

- We tracked the number of jobs that were created by start-up businesses that received CAPCO financing. If a start-up business was still in existence, we reported its jobs in the figure for active businesses. If the start-up business no longer existed, we reported its jobs in the figure for the businesses no longer in existence. We considered start-up businesses to be those that received CAPCO financing within the first six months of operation.

- We also included a discussion of “job neutral acquisitions.” Some businesses received CAPCO funding to acquire other businesses. In nine of the 12 such cases, we found no evidence that the acquired businesses would have gone out of existence or moved to other states without the acquisitions. In these cases, we felt that the CAPCO-funded acquisitions had no impact on employment in the acquired companies, and we reported them accordingly.

- We identified eight businesses that may or may not still be active. We could not make this determination from the information available to us. For those businesses whose current status is unknown, we reported a separate job count based on the most recent information we could find in either the CAPCO or OFI files.

- We provided separate counts for part-time, contract, and construction jobs created or retained after businesses received CAPCO assistance. According to OFI regulations, for the purposes of this program, contract employees (which would also usually include construction workers) are not considered Louisiana employees. However, we counted these jobs because they have a positive economic effect, albeit a limited impact. This same regulation also provides that part-time employees must be converted to a full-time basis to be counted as Louisiana employees for the businesses. We did not attempt to make this conversion because we could find no definitive guidelines as to how part-time employees should be converted to full-time for statistical purposes. Also, we did not have enough information (e.g., hours worked) on all of the part-time employees to convert to full-time equivalents even if we did have a methodology.

Appendix C

Qualified Investments by Type of Industry, 1988 Through 1999

Appendix C: Qualified Investments by Type of Industry, 1988 Through 1999

Type of Industry	Qualified Investments ($)	Percentage
Business Services	$40,991,485	22.23%
Communications	23,228,322	12.60%
Real Estate	23,028,393	12.49%
Wholesale Trade - Durable Goods	16,781,250	9.10%
Oil and Gas Extraction	13,691,175	7.42%
Automotive Repair, Services, and Parking	9,495,000	5.15%
Motion Pictures	9,002,450	4.88%
Chemical and Allied Products	5,975,000	3.24%
Electronic and Other Electrical Equipment and Components	5,900,000	3.20%
Construction - Special Trade Contractors	5,290,644	2.87%
Measuring, Analyzing, and Controlling Instruments	5,134,838	2.78%
Printing, Publishing and Allied Industries	3,100,000	1.68%
Wholesale Trade – Nondurable Goods	2,489,674	1.35%
Environmental Services	2,398,305	1.30%
Industrial and Commercial Machinery	2,135,000	1.16%
Mortgage Loan Brokers	2,050,000	1.11%
Hotel and Lodging Places	1,655,157	0.90%
Paper and Allied Products	1,500,000	0.81%
Motor Freight Transportation and Warehousing	1,365,750	0.74%
Eating and Drinking Places	1,095,000	0.59%
Heavy Construction Other Than Building	1,000,000	0.54%
Health Services	900,000	0.49%
Food and Kindred Products	806,967	0.44%
Engineering and Related Services	770,349	0.42%
Automotive Dealers and Service Stations	700,000	0.38%
Services Not Elsewhere Classified	596,028	0.32%
Water Transportation	538,750	0.29%
Social Services	500,000	0.27%
Miscellaneous Retail	450,000	0.24%
Transportation Equipment	400,000	0.22%
Building Materials, Hardware, Garden Supplies, etc.	400,000	0.22%
Amusement and Recreation Services	300,000	0.16%
Miscellaneous Manufacturing Industries	175,000	0.09%
Fishing, Hunting, and Trapping	160,000	0.09%
Insurance Agents, Brokers, and Services	150,000	0.08%
Petroleum Refining and Related Industries	121,676	0.07%
Home Furniture, Furnishings, and Equipment Stores	49,500	0.03%
Apparel and Accessory	25,000	0.01%
Building Construction - General Contractors	25,000	0.01%
Food Stores	25,000	0.01%
Totals	**$184,400,713**	**100.00%**

Source: Prepared by legislative auditor's staff using DED's 1999 Annual Report on the CAPCO program, as later updated by OFI officials.

Appendix D

Involuntary Decertification

Appendix D: Involuntary Decertification

Involuntary decertification of a CAPCO or its investment pools may cause the forfeiture of the investors' remaining and unclaimed income and premium tax credits. In addition, it may cause the recapture of tax credits already taken by the investors. OFI conducts annual reviews of each CAPCO to check for certification requirements, to advise the CAPCO, and to ensure compliance with other provisions of the CAPCO laws. If a CAPCO or its investment pools is not in compliance with any provisions, OFI gives it 120 days to correct the deficiencies. If the deficiencies are not corrected, OFI involuntarily decertifies the CAPCO and any affected investment pools. The table below shows how CAPCOs and non-complying investment pools become involuntarily decertified.

Any violations of the following provisions are grounds for involuntary decertification of the CAPCO *and* any investment pools not yet decertified:
• A CAPCO cannot invest more than 15% of its total certified capital under management into any one company, unless that investment is permissible.
• All information submitted by a CAPCO to OFI must not contain any material misrepresentation. A CAPCO shall not willfully violate any provision of CAPCO laws or any rule or regulation promulgated by OFI.
• Each CAPCO must file a quarterly report with OFI if any of the following information has changed since the previous quarter. The report should contain the following information:
  • Each investor's name, tax identification number, investment amount and tax credit
  • Dates on which investments were received
  • Amount of certified capital at the end of the quarter and whether or not more than 15% of certified capital has been invested in any one company
• Each CAPCO must submit an annual report to OFI listing all of its qualified investments and the pools from which those investments were made. CAPCOs must also submit annual audited financial statements, which include the opinion of an independent CPA.
• Before investing in a business, a CAPCO must obtain a signed affidavit from the business, to be maintained in CAPCO files.
	Any violations of the following provisions are grounds for involuntary decertification of *only* the non-complying investment pools:
	• Within three years after the investment date, at least 50% of an investment pool must be invested in permissible investments (e.g., cash, certificates of deposit, etc.), with at least 30% of the pool placed in qualified investments.
	• Within five years after the investment date, at least 80% of an investment pool must be invested in permissible investments, with at least 50% of the pool placed in qualified investments.

Source: Prepared by legislative auditor's staff based on R.S. 51:1926-1927, LAC 10:XV.303 "Permissable Investments," and information obtained from OFI.

Appendix E

How CAPCO Investments Into Louisiana Businesses Can Further Economic Development

Appendix E: How CAPCO Investments Into Louisiana Businesses Can Further Economic Development

OFI's regulations [LAC 10:XV.303.*Investment*(b)] discuss how CAPCO investments into businesses further economic development within Louisiana. According to this regulation, investment by a CAPCO into a business promotes economic development if over 50% of the investment amount is used for two or more of the following purposes:

- To hire significantly more Louisiana employees
- To directly purchase or lease furniture, fixtures, land or equipment that will be used in the state operations of the business or to construct or expand production or operating facilities in Louisiana
- To purchase inventory for resale from Louisiana-based operations or outlets
- To capitalize a business so that it can secure future debt financing to support its Louisiana operations
- To increase or preserve working capital and/or cash flows for the business's Louisiana operations
- To preserve or expand Louisiana corporate headquarters' operations
- To support research and development or technological development in the state
- To fund start-up businesses that will operate primarily in the state
- To provide any other economic benefits not mentioned above*

* For any other benefit to be considered as furthering economic development, the CAPCO must request in writing a written opinion from OFI as to whether the activity will further Louisiana economic development.

Source: Prepared by legislative auditor's staff using LAC 10:XV.303 *Investment* (b).

Appendix F

Office of Financial Institutions’ Response

STATE OF LOUISIANA

OFFICE OF FINANCIAL INSTITUTIONS

BATON ROUGE, LOUISIANA

January 2, 2001

RECEIVED
LEGISLATIVE AUDITOR
01 JAN -3 AM 8:23

VIA FACSIMILE - Original to follow by mail

Daniel G. Kyle, CPA, CFE
Legislative Auditor
Post Office Box 94397
Baton Rouge, Louisiana 70804-9397

Dear Dr. Kyle:

Thank you for the opportunity to comment on the performance audit report of the Louisiana CAPCO program produced by your staff. Let me begin by acknowledging the courtesy and professionalism of the members of your audit staff. My staff informs me that at all times your employees minimized the disruption which is naturally caused by an audit, while still doing their job of gathering information. This was greatly appreciated.

Your audit report asks for this office's response to recommendations relating to job creation information, the tracking of accurate job retention information, job neutral acquisitions, and income and premium tax recapture issues. In addition to comments solicited within the body of your audit, you have attached a checklist of audit recommendations and have solicited my position. I have completed the checklist and it is included as an attachment to this correspondence.

The audit report also recommends several changes to the CAPCO statutes. These changes address current deficiencies in existing statutes and provide areas for further discussion should the program be renewed. I will be prepared to discuss these issues during the upcoming hearing or during the special session should the renewal of the CAPCO program be included in the Governor's call.

The first recommendation is for an amendment to existing CAPCO rules to require that CAPCOs collect and submit documentation of the jobs created or retained in the businesses in which they have made qualified investments. Examples of documentation given are quarterly wage statements or affidavits executed by the businesses. If desired by the Legislature, OFI will promulgate a rule to allow for the capture of this information. In applying these new requirements, we would expect that only businesses receiving investment subsequent to the enactment of the revised rule would be impacted.

The second recommendation is to require CAPCOs to collect, from the companies in which they invest, additional information on the jobs created or retained. Examples provided in this recommendation include the types of jobs created or retained subsequent to the investment by the CAPCO, how long the jobs have been in existence, and whether any of the businesses failed after receiving the CAPCO investment and the dates of failure. If the legislature wishes to have this information, I believe the procedure could be established by rule. However, we again feel that this information can only be gathered on investments made subsequent to the effective date of a rule revision.

POST OFFICE BOX 94095, BATON ROUGE, LOUISIANA 70804-9095 (225) 925-4660
DEPOSITORY & ADMINISTRATION - FAX # (225) 925-4548
LEGAL, NON-DEPOSITORY & SECURITIES - FAX # (225) 925-4524
web site: www.ofi.state.la.us email: la_ofi@mail.premier.net

The third recommendation concerns the economic impact of contract employees. The audit report poses the question as to whether this type of employment should be counted towards the total jobs attributed to the CAPCO program. It then states that if the Legislature believes that this type of employment should be counted towards job totals, OFI should amend the rule to allow this category of employment to count. If the legislature indicates that this is their wish, OFI will immediately initiate changes to the rule to allow this type of relationship to count towards job totals.

The next recommendation concerns job neutral acquisitions. The audit report suggests that acquisitions should be reviewed more closely so that job neutral acquisitions would not count towards the determination of whether the investment furthers economic development in Louisiana. We are unsure if there is a need to examine acquisitions more closely. The creation or retention of jobs is not the only criteria that goes into the analysis of whether an investment furthers economic development in Louisiana. Whether the investment is for an acquisition, a start-up venture, or an expansion of existing operations, the investment must still meet the criteria for furthering economic development in Louisiana. These criteria can be found in Appendix E of the audit report. The criteria include varied ways in which the investment can further economic development in Louisiana, beyond just preventing a business from moving out of state or reducing employment. If two of these additional tests can be met, we believe that economic benefit has accrued in Louisiana.

The last recommendation discusses what should be done if the Legislature does not, via statutory change, provide for the recapture and forfeiture of tax credits after the fifth year of an investment pool or when a income tax pool has met the three year time horizon but failed to meet the fifth year requirement. Should the Legislature not address this through statutory changes, we will discuss with DED changes that can be made to the existing rule to address these deficiencies.

Thank you for allowing me the opportunity to comment on the findings of the audit report. Based upon the findings in the audit report and discussions with your staff, I believe that your report shows what I already knew, that OFI has exercised its examining duties over the CAPCO program in a conscientious and thorough manner. I look forward to seeing you at the Legislative Audit Advisory Council meeting on January 16, 2001.

Sincerely,

John D. Travis

John D. Travis
Commissioner of
Financial Institutions

JPD:dam
Enclosure

Hand delivered

Office of the Legislative Auditor
Checklist for Audit Recommendations

Instructions to audited agency: Please check the appropriate box below for each recommendation. A summary of your response for each recommendation in the audit report will be included in the body of the report. The entire text of your response will be included as an appendix to the audit report.

Recommendation	Agree	Partially Agree	Disagree
Recommendation 1: If the Legislature wishes to track job creation and retention for the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit documentation of the jobs created or retained in the businesses in which they have made qualified investments. Such documentation could include, for instance, quarterly Louisiana wage statements or affidavits executed by the businesses periodically.	X		
Recommendation 2: If the legislature wishes to have more detail on jobs impacted by the CAPCO program, the Office of Financial Institutions and the Department of Economic Development could further amend their regulations to require that CAPCOs collect from the businesses in which they have made qualified investments and submit to the Office of Financial Institutions the following information: • the types of jobs created or retained after receiving qualified investments • how long the jobs have been in existence • whether any of the businesses failed after receiving the qualified investments and the dates the businesses ceased operations	X		
Recommendation 3: If the Legislature thinks that contract employees have sufficient economic impact to merit tracking the number of these jobs created or retained in businesses that receive qualified investments from CAPCOs, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit supporting documentation on the number of such jobs. This documentation could include, for instance, affidavits executed by the business periodically or some other credible type of documentation.	X		

Recommendation	Agree	Partially Agree	Disagree
Recommendation 4: To help examine acquisitions more closely, the Office of Financial Institutions and the Department of Economic Development should establish other methods, to use in addition to current criteria, for determining whether acquisitions will further economic development in Louisiana. These additional methods could include acquiring definitive evidence that the acquired business would move out of state or reduce employment if the CAPCO financing does not assist in the acquisition.		X	
Recommendation 5: If the Legislature does not provide statutory rules for the recapture and forfeiture of tax credits as discussed in Matters for Legislative Consideration 2 and 3, the Office of Financial Institutions and the Department of Economic Development should promulgate rules to address these situations.	X		

Appendix G

Department of Economic Development's Response

State of Louisiana

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LEGISLATIVE AUDITOR
01 JAN -5 PM 2:30

DEPARTMENT OF ECONOMIC DEVELOPMENT

M.J. "Mike" Foster, Jr.
Governor

Don J. Hutchinson
Secretary

January 5, 2001

Honorable Daniel G. Kyle, CPA
State Legislative Auditor
Post Office Box 94397
Baton Rouge, LA 70804-9397

Dear Dr. Kyle:

Thank you for allowing me the opportunity to respond to the audit report on the Louisiana CAPCO Program. I have attached the completed Checklist for Audit Recommendations in addition to the written comments contained in this letter.

Recommendations 1, 2, and 3. In general, I agree that tracking the creation and retention of jobs by businesses that receive qualified investments would be useful in analyzing the overall effectiveness of the CAPCO program and that the recommendations would help achieve that goal. However, I question whether such a rule could be implemented with respect to capital pools that have already been certified. The rules in effect when a pool of capital is certified set the guidelines under which that pool must be operated. DED may not be able to change the requirements for capital that has already been certified retroactively. These recommendations should be considered, however, if the program is extended in any form.

Recommendations 4 and 5. I agree that the recommended changes would help improve the effectiveness of the CAPCO program. DED would be happy to work with OFI and the Legislature to develop any changes needed.

I look forward to receiving the completed report, but if you have any questions regarding these comments, please contact me at 342-5388. Also, I would appreciate your keeping us advised of subsequent meetings or discussion on this matter.

Sincerely yours,

Don

Don J. Hutchinson
Secretary of Economic Development

Post Office Box 94185/Baton Rouge, Louisiana 70804-9185/(225)-342-3000
www.lded.state.la.us

Office of the Legislative Auditor
Checklist for Audit Recommendations

Instructions to audited agency: Please check the appropriate box below for each recommendation. A summary of your response for each recommendation in the audit report will be included in the body of the report. The entire text of your response will be included as an appendix to the audit report.

Recommendation	Agree	Partially Agree	Disagree
Recommendation 1: If the Legislature wishes to track job creation and retention for the CAPCO program, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit documentation of the jobs created or retained in the businesses in which they have made qualified investments. Such documentation could include, for instance, quarterly Louisiana wage statements or affidavits executed by the businesses periodically.		X	
Recommendation 2: If the legislature wishes to have more detail on jobs impacted by the CAPCO program, the Office of Financial Institutions and the Department of Economic Development could further amend their regulations to require that CAPCOs collect from the businesses in which they have made qualified investments and submit to the Office of Financial Institutions the following information: • the types of jobs created or retained after receiving qualified investments • how long the jobs have been in existence • whether any of the businesses failed after receiving the qualified investments and the dates the businesses ceased operations		X	
Recommendation 3: If the Legislature thinks that contract employees have sufficient economic impact to merit tracking the number of these jobs created or retained in businesses that receive qualified investments from CAPCOs, the Office of Financial Institutions and the Department of Economic Development should amend their regulations to require that CAPCOs collect and submit supporting documentation on the number of such jobs. This documentation could include, for instance, affidavits executed by the business periodically or some other credible type of documentation.		X	

Recommendation	Agree	Partially Agree	Disagree
Recommendation 4: To help examine acquisitions more closely, the Office of Financial Institutions and the Department of Economic Development should establish other methods, to use in addition to current criteria, for determining whether acquisitions will further economic development in Louisiana. These additional methods could include acquiring definitive evidence that the acquired business would move out of state or reduce employment if the CAPCO financing does not assist in the acquisition.	X		
Recommendation 5: If the Legislature does not provide statutory rules for the recapture and forfeiture of tax credits as discussed in Matters for Legislative Consideration 2 and 3, the Office of Financial Institutions and the Department of Economic Development should promulgate rules to address these situations.	X		