

Oklahoma Capital Investment Board

Financial Statements

June 30, 2017 and 2016
(With Independent Auditors' Report Thereon)



OKLAHOMA CAPITAL INVESTMENT BOARD

FINANCIAL STATEMENTS

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Oklahoma Capital Investment Board

Report on the Financial Statements

We have audited the accompanying statements of net position of the Oklahoma Capital Investment Board (OCIB), which is a component unit of the State of Oklahoma financial reporting entity, as of June 30, 2017 and 2016, and the related statements of changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise OCIB's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

(Continued)

INDEPENDENT AUDITORS' REPORT, CONTINUED

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of OCIB as of June 30, 2017 and 2016, and the changes in net position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States.

Emphasis of Matter

Investment Interests at Fair Value

As discussed in Notes 1 and 4, the investment interests included in the financial statements are reported at fair value. As the fair values of the investment interests are not readily determinable, estimates have been used to determine the fair value. There exists an inherent uncertainty that the estimated values may differ significantly from the values that would have been used had a market for the investment interests existed, and the differences could be material. Our opinion is not modified with respect to this matter.

Other Matter

Required Supplementary Information

Accounting principles generally accepted in the United States require that the management's discussion and analysis on pages I-1 through I-4 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audits of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

(Continued)

INDEPENDENT AUDITORS' REPORT, CONTINUED

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 5, 2017, on our consideration of OCIB's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering OCIB's internal control over financial reporting and compliance.

Finley + Cook, PLLC

Shawnee, Oklahoma
September 5, 2017

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Oklahoma Capital Investment Board (OCIB), our discussion and analysis of its financial performance provides an overview of OCIB's activities for the fiscal years ended June 30, 2017 and 2016. Please read it in conjunction with OCIB's financial statements which begin on page 4. The financial statements of OCIB include the operations of the Oklahoma Capital Formation Company, LLC (OCFC).

FINANCIAL HIGHLIGHTS

- In FY-2017, OCIB (OCFC) made \$86,089 in aggregate contributions to its Venture Investment Program to fund commitments;
- In FY-2017, OCIB (OCFC) received \$1,779,567 in distributions from its Venture Investment Program (proceeds were applied to the OCFC line of credit); and
- In FY-2017, the funds supported by the OCIB Venture Investment Program provided more than \$3,150,000 of equity funding for Oklahoma companies.

OVERVIEW OF THE FINANCIAL STATEMENTS

This annual financial report consists of two parts: Management's Discussion and Analysis (this section) and the basic financial statements. OCIB is a public trust of the State of Oklahoma and follows enterprise fund reporting; accordingly, the financial statements are presented using the economic measurement focus and the accrual basis of accounting. Enterprise fund statements offer short-term and long-term financial information about the activities and operations of OCIB. These statements are presented in a manner similar to those of a private business.

LEGISLATIVE AMENDMENT—SENATE BILL NO. 1159

During the FY-2012 legislative session, Senate Bill No. 1159 (SB 1159) was signed into law. The language within SB 1159 affects OCIB in the following areas:

- SB 1159 extended OCIB's tax credit authorization from June 30, 2015, to June 30, 2020;
- SB 1159 provides an unlimited tax credit carryover period for OCIB's tax credit consortium members; and
- SB 1159 ended OCIB's ability to enroll new or extend existing loans within the Oklahoma Capital Access Program (OCAP).

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

FINANCIAL ANALYSIS OF OCIB

Net Position

The following table summarizes the net position at June 30:

	<u>2017</u>	<u>2016</u>
Current assets	\$ 20,011,280	20,008,997
Noncurrent assets	<u>52,024,089</u>	<u>61,658,457</u>
Total assets	<u>72,035,369</u>	<u>81,667,454</u>
Liabilities	<u>14,896,518</u>	<u>15,710,811</u>
Net position	<u>\$ 57,138,851</u>	<u>65,956,643</u>

Assets at June 30, 2017 and 2016, principally consisted of \$60,000,000 and \$69,085,000, respectively, of tax credits net of an expiration provision of \$9,085,000 and \$0, respectively. As of June 30, 2017 and 2016, \$20,000,000 was current and \$40,000,000 and \$49,085,000, respectively, was noncurrent (see Note 3 to the financial statements). Assets also included investment interests of \$12,024,089 and \$12,573,457 as of June 30, 2017 and 2016, respectively.

Operating Activities

The operations of OCIB are dependent upon the results of the investments made. During 2017 and 2016, no new investment interests were established. A summary of operating results for 2017 and 2016 is as follows:

	<u>2017</u>	<u>2016</u>
Operating expenses:		
Management fees	\$ (360,000)	(360,000)
Accounting, legal, and consultants	(58,175)	(51,806)
Other	<u>(1,545)</u>	<u>(5,517)</u>
Total operating expenses	<u>(419,720)</u>	<u>(417,323)</u>
Other expenses:		
Interest expense	(457,182)	(398,389)
Other	<u>-</u>	<u>(6,516)</u>
Total other expenses	<u>(457,182)</u>	<u>(404,905)</u>
Net changes in fair value of investment interests	<u>1,144,110</u>	<u>697,206</u>
Tax credit expiration provision	<u>(9,085,000)</u>	<u>-</u>
Change in net position	<u>\$ (8,817,792)</u>	<u>(125,022)</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

FINANCIAL ANALYSIS OF OCIB, CONTINUED

Operating Activities, Continued

Cash flows from investment interests for 2017 and 2016 were as follows:

	<u>2017</u>	<u>2016</u>
Cash payments for investment interests	\$ (86,089)	(249,000)
Cash distributions from investment interests	<u>1,779,567</u>	<u>504,324</u>
Net cash flows provided by investment interests	<u>\$ 1,693,478</u>	<u>255,324</u>

A significant part of the overall operations of OCIB is its transferable tax credits. At June 30, 2017 and 2016, OCIB had \$60,000,000 and \$69,085,000, respectively, of transferable tax credits recorded as assets in its financial statements; for both 2017 and 2016, \$20,000,000 of the tax credits were recognized as current and the remainder as noncurrent. During 2012, the expiration date of the tax credits was extended to June 30, 2020. No tax credits were sold in 2017 or 2016. OCIB has agreements with four corporations to purchase up to an aggregate of \$8,000,000 per year of tax credits in conjunction with a legitimate call on an OCIB guarantee. The agreements to purchase the tax credits have been assigned as collateral for the \$20,000,000 revolving line of credit which OCIB has guaranteed for OCFC as of June 30, 2017 (see Note 3 to the financial statements)..

As of June 30, 2017, management recorded an allowance for expiring tax credits of \$9,085,000. If the legislature extends the tax credits at a future date, management will record an amount to recapture the allowance.

As more fully explained in the notes to the financial statements, OCIB has conducted a program entitled OCAP. Under OCAP, Oklahoma depository institutions pay a fee, or premium, to OCIB to enroll qualified loans in OCAP. OCIB, in return for the premium paid, establishes a reserve account equal to the amount of the fee plus an obligation by OCIB for a predetermined portion of the loan. Cash, up to the amount of the reserve account, may then be paid to the institution if the institution suffers a loss on a loan in the OCAP portfolio and submits a claim to OCIB. OCIB is not guaranteeing the entire loan portfolio, but only an amount in the established reserve account. In no event is OCIB's exposure more than the balance in the reserve account as defined in the OCAP agreement. As of June 30, 2017 and 2016, the maximum amount of exposure for OCIB was approximately \$612,000. Total loans covered by the program were approximately \$34,172,000 at both June 30, 2017 and 2016.

As of June 30, 2017 and 2016, OCIB's commitment for unfunded investment interests was approximately \$3,648,000 and \$3,735,000, respectively. It is anticipated that at least \$2,000,000 of the outstanding commitments will not be drawn (see Note 4 to the financial statements).

MANAGEMENT'S DISCUSSION AND ANALYSIS, CONTINUED

FINANCIAL ANALYSIS OF OCIB, CONTINUED

Debt Payable

To fund investment interests, OCIB had a \$23,000,000 line of credit with a local financial institution during 2016. The line of credit was renewed with a \$20,000,000 line of credit during August 2017. Activity of the debt for 2017 and 2016 was as follows:

	<u>Beginning Balance</u>	<u>Advances</u>	<u>Repayments</u>	<u>Ending Balance</u>
<u>2017</u>				
Line of credit	\$ 15,625,026	982,533	(1,793,090)	14,814,469
<u>2016</u>				
Line of credit	\$ 15,070,168	1,060,785	(505,927)	15,625,026

As further discussed in the notes to the financial statements, the debt is secured by the specific assignment of agreements with four corporations to purchase tax credits from OCIB. The revolving line of credit is presently due August 25, 2018.

REQUEST FOR INFORMATION

This financial report is designed to provide a general overview of OCIB's finances for all those with an interest. Questions concerning any of the information provided in this report or requests for additional financial information should be addressed to the Oklahoma Capital Investment Board, 13905 Quail Pointe Drive, Suite A, Oklahoma City, Oklahoma 73134.

OKLAHOMA CAPITAL INVESTMENT BOARD

STATEMENTS OF NET POSITION

<i>June 30,</i>	<i>2017</i>	<i>2016</i>
Assets		
Current assets:		
Cash	\$ 11,280	8,997
Transferable tax credits, current (Note 3)	20,000,000	20,000,000
Total current assets	20,011,280	20,008,997
Investment interests at fair value (Note 4):		
Acorn Growth Capital Fund III, L.L.C.	2,795,000	2,453,000
Blue Sage Capital, L.P.	815,702	640,089
Davis, Tuttle Venture Partners, L.P.	51,564	52,583
Mesa Oklahoma Growth Fund I, L.P.	273,714	286,824
Oklahoma Equity Partners, LLC	897,750	853,929
Oklahoma Life Sciences Fund II, L.L.C.	1,892,524	1,023,846
Oklahoma Seed Capital Fund, L.L.C.	-	1,125,010
Prolog Capital II, L.P.	1,350,064	1,685,204
SSM Venture Partners III, L.P.	1,664,625	1,812,975
Tullis-Dickerson Capital Focus III, L.P.	2,283,146	2,639,997
Total investment interests	12,024,089	12,573,457
Transferable tax credits, less current portion and net of expiration provision of \$9,085,000 and \$0 in 2017 and 2016, respectively (Note 3)	40,000,000	49,085,000
Total assets	\$ 72,035,369	81,667,454

(Continued)

See Independent Auditors' Report.
See accompanying notes to financial statements.

OKLAHOMA CAPITAL INVESTMENT BOARD

STATEMENTS OF NET POSITION, CONTINUED

<i>June 30,</i>	<i>2017</i>	<i>2016</i>
Liabilities and Net Position		
Current liabilities:		
Accrued interest payable	\$ 82,049	85,785
Total current liabilities	<u>82,049</u>	<u>85,785</u>
Long-term debt payable	<u>14,814,469</u>	<u>15,625,026</u>
Total liabilities	<u>14,896,518</u>	<u>15,710,811</u>
Unrestricted net position	<u>57,138,851</u>	<u>65,956,643</u>
Total liabilities and net position	<u>\$ 72,035,369</u>	<u>81,667,454</u>

See Independent Auditors' Report.
See accompanying notes to financial statements.

OKLAHOMA CAPITAL INVESTMENT BOARD

STATEMENTS OF CHANGES IN NET POSITION

<i>Years Ended June 30,</i>	<i>2017</i>	<i>2016</i>
Operating (expenses) income:		
Management fees	\$ (360,000)	(360,000)
Accounting, legal, and consultants	(58,175)	(51,806)
Venture investing	(1,292)	(2,365)
Other	(253)	(3,152)
Total operating expenses	<u>(419,720)</u>	<u>(417,323)</u>
Other expenses:		
Interest expense	(457,182)	(398,389)
OCAP claims paid in excess of cumulative premiums collected	-	(6,516)
Total other expenses	<u>(457,182)</u>	<u>(404,905)</u>
Operating loss before changes in fair value of investment interests	<u>(876,902)</u>	<u>(822,228)</u>
Changes in fair value of investment interests (Note 4):		
Acorn Growth Capital Fund III, L.L.C.	342,000	700,000
Blue Sage Capital, L.P.	211,342	(264,663)
Davis, Tuttle Venture Partners, L.P.	(1,020)	125
Mesa Oklahoma Growth Fund I, L.P.	(13,110)	8,994
Oklahoma Equity Partners, LLC	43,821	38,867
Oklahoma Life Sciences Fund II, L.L.C.	1,330,376	(13,166)
Oklahoma Seed Capital Fund, L.L.C.	30,529	29,424
Pacesetter Growth Fund, L.P.	1,220	-
Prolog Capital II, L.P.	(355,140)	517,432
Rocky Mountain Mezzanine Fund II, L.P.	3,043	1,604
SSM Venture Partners III, L.P.	(92,100)	(187,875)
Tullis-Dickerson Capital Focus III, L.P.	<u>(356,851)</u>	<u>(133,536)</u>
Net changes in fair value of investment interests	<u>1,144,110</u>	<u>697,206</u>
Tax credit expiration provision (Note 3)	<u>(9,085,000)</u>	<u>-</u>
Decrease in net position	(8,817,792)	(125,022)
Net position, beginning of year	<u>65,956,643</u>	<u>66,081,665</u>
Net position, end of year	<u>\$ 57,138,851</u>	<u>65,956,643</u>

See Independent Auditors' Report.

See accompanying notes to financial statements.

OKLAHOMA CAPITAL INVESTMENT BOARD

STATEMENTS OF CASH FLOWS

Increase (Decrease) in Cash and Cash Equivalents

<i>Years Ended June 30,</i>	<i>2017</i>	<i>2016</i>
Cash flows from operating activities:		
Cash paid to suppliers	\$ (58,175)	(51,806)
Management fees paid	(360,000)	(360,000)
General and administrative expenses paid	(1,545)	(5,517)
Cash paid for interest expense	(460,918)	(388,662)
OCAP expenses paid	-	(6,516)
Net cash used in operating activities	<u>(880,638)</u>	<u>(812,501)</u>
Cash flows from noncapital and related financing activities:		
Advances from debt	982,533	1,060,785
Repayments of debt	<u>(1,793,090)</u>	<u>(505,927)</u>
Net cash (used in) provided by noncapital and related financing activities	<u>(810,557)</u>	<u>554,858</u>
Cash flows from investing activities:		
Cash payments for investment interests	(86,089)	(249,000)
Cash distributions from investment interests	<u>1,779,567</u>	<u>504,324</u>
Net cash provided by investing activities	<u>1,693,478</u>	<u>255,324</u>
Net increase (decrease) in cash and cash equivalents	2,283	(2,319)
Cash and cash equivalents at beginning of year	<u>8,997</u>	<u>11,316</u>
Cash and cash equivalents at end of year	<u>\$ 11,280</u>	<u>8,997</u>
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	\$ (876,902)	(822,228)
Adjustments to reconcile operating loss to net cash used in operating activities:		
(Decrease) increase in accrued interest payable	<u>(3,736)</u>	<u>9,727</u>
Net cash used in operating activities	<u>\$ (880,638)</u>	<u>(812,501)</u>

See Independent Auditors' Report.
See accompanying notes to financial statements.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS

June 30, 2017 and 2016

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Nature of Operations

The Oklahoma Capital Investment Board (OCIB) is a public trust of the State of Oklahoma (the "State") pursuant to the Oklahoma Public Trust Act. OCIB was created to serve as the State's tool to mobilize sources of equity and near equity capital (as defined in the Trust Indenture) for Oklahoma businesses. The program is designed to catalyze investment in Oklahoma projects by experienced investment professionals. Specific initiatives utilized by OCIB include the Oklahoma Capital Access Program (OCAP) (Note 6) and the Venture Investment Program (Note 4).

OCIB is a component unit of the State and is included in the State's annual financial report.

Reporting Entity

The financial statements also include the operations of the Oklahoma Capital Formation Company, LLC (OCFC), formerly the Oklahoma Capital Formation Corporation. During the year ended June 30, 2006, OCIB purchased 100% of the ownership of OCFC. OCFC invests funds in qualified risk capital pools approved by OCIB.

Financial Statement Presentation and Basis of Accounting

OCIB complies with accounting principles generally accepted in the United States. Accounting principles generally accepted in the United States include all relevant Governmental Accounting Standards Board (GASB) pronouncements. The accounting and reporting framework and the more significant accounting policies are discussed in subsequent sections of this note.

The accompanying financial statements are presented on the enterprise fund basis using the economic measurement focus and the accrual basis of accounting, whereby revenues are recorded in the period earned and expenses are recorded in the period incurred.

All transactions between OCIB and OCFC have been eliminated in the preparation of these financial statements.

Cash Balances

All cash balances are maintained in financial institutions insured by the Federal Deposit Insurance Corporation up to \$250,000. As of June 30, 2017 and 2016, there were no balances exceeding the \$250,000 insured amount.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

Equipment

Capitalized equipment is depreciated using the straight-line method of depreciation over its estimated useful life. OCIB had fully depreciated all of its fixed assets as of June 30, 2017 and 2016. All equipment is currently provided by the managing entity.

Income Taxes

As a public trust, OCIB is exempt from federal and state income taxes.

Advertising Costs

All costs associated with advertising are expensed as incurred. Most advertising costs, including website creation and maintenance, are paid by the managing entity.

Cash and Cash Equivalents

For purposes of the statements of cash flows, cash and cash equivalents consist of the caption on the statements of net position described as "Cash."

Investment Interests

Investment interests represent investments made by OCFC in limited partnerships, limited liability companies, and other types of entities. Investment interests are recorded at fair value. Any material amounts of known impairment have been considered in the amounts reflected.

Use of Estimates in Preparing Financial Statements

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Material estimates that are significant to the financial statements relate to the value of the investment interests.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

New Accounting Pronouncements

In January 2016, GASB issued Statement No. 80, *Blending Requirements for Certain Component Units* (GASB 80). GASB 80 amends blending requirements for the financial statements of component units to include criteria requiring blending of a component unit organized as a not-for-profit corporation in which the primary government is the sole corporate member. OCIB adopted GASB 80 effective July 1, 2016. The adoption of GASB 80 did not have a significant impact on the financial statements.

In March 2016, GASB issued Statement No. 81, *Irrevocable Split-Interest Agreements* (GASB 81). GASB 81 provides recognition and measurement guidance for situations in which a government is one of the beneficiaries of an irrevocable split-interest agreement. Irrevocable split-interest agreements are a type of giving by a donor to provide resources to two or more beneficiaries, including governments. GASB 81 provides the recognition and reporting requirements applicable when a government is one of the parties to such an agreement. OCIB will adopt GASB 81 effective July, 1 2017, for the June 30, 2018, reporting year. OCIB does not expect GASB 81 to have a significant impact on the financial statements.

In November 2016, GASB issued Statement No. 83, *Certain Asset Retirement Obligations* (GASB 83). An asset retirement obligation (ARO) is a legally enforceable liability associated with the retirement of a tangible capital asset. GASB 83 establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs. This Statement requires that recognition occur when the liability is both incurred and reasonably estimable. GASB 83 also requires disclosure of information about the nature of a government's AROs, the methods and assumptions used for the estimates of the liabilities, and the estimated remaining useful life of the associated tangible capital assets. The requirements of this Statement are effective for reporting periods beginning after June 15, 2018. Earlier application is permitted. OCIB does not expect GASB 83 to have a significant impact on the financial statements.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

New Accounting Pronouncements, Continued

In January 2017, GASB issued Statement No. 84, *Fiduciary Activities* (GASB 84). GASB 84 establishes criteria for identifying fiduciary activities of all state and local governments. The focus of the criteria generally is on (1) whether a government is controlling the assets of the fiduciary activity and (2) the beneficiaries with whom a fiduciary relationship exists. Separate criteria are included to identify fiduciary component units and postemployment benefit arrangements that are fiduciary activities. GASB 84 describes four fiduciary funds that should be reported, if applicable: (1) pension (and other employee benefit) trust funds, (2) investment trust funds, (3) private-purpose trust funds, and (4) custodial funds. Custodial funds generally should report fiduciary activities that are not held in a trust or equivalent arrangement that meets specific criteria. GASB 84 also provides for recognition of a liability to the beneficiaries in a fiduciary fund when an event has occurred that compels the government to disburse fiduciary resources. Events that compel a government to disburse fiduciary resources occur when a demand for the resources has been made or when no further action, approval, or condition is required to be taken or met by the beneficiary to release the assets. The requirements of GASB 84 are effective for reporting periods beginning after December 15, 2018. Earlier application is permitted. OCIB does not expect GASB 84 to have a significant impact on the financial statements.

In March 2017, GASB issued Statement No. 85, *Omnibus 2017* (GASB 85). GASB 85 addresses practice issues that have been identified during implementation and application of certain GASB Statements. This Statement addresses a variety of topics including issues related to blending component units, goodwill, fair value measurement and application, and postemployment benefits (pensions and other postemployment benefits (OPEB)). Specifically, this Statement addresses the following topics:

- Blending a component unit in circumstances in which the primary government is a business-type activity that reports in a single column for financial statement presentation
- Reporting amounts previously reported as goodwill and “negative” goodwill
- Classifying real estate held by insurance entities
- Measuring certain money market investments and participating interest-earning investment contracts at amortized cost
- Timing of the measurement of pension or OPEB liabilities and expenditures recognized in financial statements prepared using the current financial resources measurement focus
- Recognizing on-behalf payments for pensions or OPEB in employer financial statements
- Presenting payroll-related measures in required supplementary information for purposes of reporting by OPEB plans and employers that provide OPEB
- Classifying employer-paid member contributions for OPEB

See Independent Auditors’ Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, CONTINUED

New Accounting Pronouncements, Continued

- Simplifying certain aspects of the alternative measurement method for OPEB
- Accounting and financial reporting for OPEB provided through certain multiple-employer defined benefit OPEB plans.

The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged. OCIB does not expect GASB 85 to have a significant impact on the financial statements.

In June 2017, GASB issued Statement No. 86, *Certain Debt Extinguishment Issues* (GASB 86). GASB 86 improves consistency in accounting and financial reporting for in-substance defeasance of debt by providing guidance for transactions in which cash and other monetary assets acquired with only existing resources—resources other than the proceeds of refunding debt—are placed in an irrevocable trust for the sole purpose of extinguishing debt. This Statement also improves accounting and financial reporting for prepaid insurance on debt that is extinguished and notes to financial statements for debt that is defeased in substance. The requirements of this Statement are effective for reporting periods beginning after June 15, 2017. Earlier application is encouraged. OCIB does not expect GASB 86 to have a significant impact on the financial statements.

In June 2017, GASB issued Statement No. 87, *Leases* (GASB 87). GASB 87 defines a lease as a contract that conveys control of the right to use another entity's nonfinancial asset (the underlying asset) as specified in the contract for a period of time in an exchange or exchange-like transaction. GASB 87 improves accounting and financial reporting for leases by governments by requiring recognition of certain lease assets and liabilities for leases that previously were classified as operating leases and recognized as inflows of resources or outflows of resources based on the payment provisions of the contract. It establishes a single model for lease accounting based on the foundational principle that leases are financings of the right to use an underlying asset. Under GASB 87, a lessee is required to recognize a lease liability and an intangible right-to-use lease asset, and a lessor is required to recognize a lease receivable and a deferred inflow of resources, thereby enhancing the relevance and consistency of information about governments' leasing activities. The requirements of this Statement are effective for reporting periods beginning after December 15, 2019. Earlier application is encouraged. OCIB has not determined the impact of GASB 87 on the financial statements.

Date of Management's Review of Subsequent Events

Management has evaluated subsequent events through September 5, 2017, the date which the financial statements were available to be issued. See Note 10 for a discussion of significant subsequent events.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(2) INVESTMENT OPERATIONS

OCIB, in order to mobilize investment in business ventures, guarantees the funds borrowed by OCFC for such investments. Prior to 2006, OCFC was considered a third-party corporation which contracted with OCIB to invest OCIB-guaranteed funds in qualified risk capital pools. As noted previously, OCFC was purchased by OCIB during 2006. All intercompany activity between OCIB and OCFC has been eliminated in preparing these financial statements.

(3) TRANSFERABLE TAX CREDITS

As a trust, part of the estate of OCIB was State of Oklahoma tax credits in an original amount of \$100,000,000. The credits may be sold by OCIB at its sole discretion. Presently, OCIB's rights to sell the tax credits expire if not utilized by June 30, 2020. Credits which have been sold may be exercised until fully utilized.

As of June 30, 2017, \$30,915,000 of the credits had been sold for face value and the cash proceeds were used to reduce debt. The credits were sold during the following years ended June 30:

2007	\$ 8,000,000
2008	4,700,000
2010	6,815,000
2011	8,000,000
2012	3,400,000
2013	-
2014	-
2015	-
2016	-
2017	-
	<hr/>
	\$ 30,915,000

Four corporations have signed agreements to purchase up to an aggregate of \$8,000,000 per year of the tax credits, in conjunction with a legitimate call on an OCIB guarantee. Up to \$20,000,000 of the tax credits may be sold by OCIB in a year. The remaining \$69,085,000 of tax credits at 2016 were not considered impaired at 2016, as there was sufficient time remaining for the remaining tax credits to be sold by OCIB before they expire on June 30, 2020. As of June 30, 2017, OCIB recorded an allowance of \$9,085,000 for expiring tax credits. If the legislature extends the tax credits at a future date, management will record an amount to recapture the allowance.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(3) **TRANSFERABLE TAX CREDITS, CONTINUED**

As noted previously, OCIB is considered a component unit of the State of Oklahoma and is included in the State's Annual Comprehensive Financial Report (CAFR). For consolidation purposes, the State does not recognize the tax credits as an asset. Because the State does not recognize the tax credits as an asset, as the credits expire and are reflected as an expiration loss in OCIB's statement of changes in net position, as required by generally accepted accounting principles, the expiration loss has no impact on the State's CAFR.

The \$69,085,000 of transferable tax credits, net of an allowance of \$9,085,000 at June 30, 2017, are included in OCIB's net position.

(4) **FAIR VALUE OF INVESTMENT INTERESTS**

In accordance with GAAP authoritative guidance on fair value measurements and disclosures, OCIB's investment interests measured and reported at fair value are classified according to the following hierarchical input levels:

- Level 1—inputs are unadjusted, quoted prices in active markets for identical investments that the reporting entity has the ability to access at the measurement date.
- Level 2—inputs are directly or indirectly observable inputs for the investment (other than quoted prices included in Level 1). These include quoted prices for similar investments in active markets, quoted prices for identical or similar investments in markets that are not active, inputs other than quoted prices that are observable for the investment, or inputs that are derived principally from observable market data by correlation or other means.
- Level 3—inputs are unobservable inputs for the investment. These inputs reflect management's best estimates of what market participants would use in pricing the investment in an orderly transaction at the measurement date. The inputs into the determination of fair value require significant management judgment or estimation. Unobservable inputs are used to measure fair value to the extent that observable inputs are not readily available.

In certain cases, the inputs used to measure fair value may fall into different levels of the hierarchy. In such cases, the level has been determined based on the lowest level of significant input to the fair value measurement.

As noted previously, OCIB (OCFC) invests in limited partnerships, limited liability companies, and other types of entities. The investment entities in turn invest in portfolio companies. The underlying assets of the investment entities are the various portfolio companies.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(4) FAIR VALUE OF INVESTMENT INTERESTS, CONTINUED

The following summarizes OCIB's (OCFC's) investments according to the fair value hierarchy levels at June 30:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
<u>2017</u>				
Investment interests	\$ <u>12,024,089</u>	<u>-</u>	<u>-</u>	<u>12,024,089</u>
<u>2016</u>				
Investment interests	\$ <u>12,573,457</u>	<u>-</u>	<u>-</u>	<u>12,573,457</u>

OCIB receives and evaluates information received from the investment managers on a regular basis. Fair values of Level 3 hierarchy investment interests are determined by the investment managers using a combination of the market, income, and cost approaches. Investments are initially recorded at transaction value (i.e., cost). Due to the illiquid, non-publicly traded, startup nature of some of the portfolio companies, many of the companies are either pre-revenue or lack sufficient operating history to be effectively valued using typical quantitative valuation methodologies. As such, techniques used to value the portfolio companies by the investment managers include, but are not limited to:

- Actual performance to budgeted or expected performance
- Recent round of financing
- Discounted cash flows
- Liquidation analysis
- Sales of similar companies

In addition, some of the investment managers review the overall portfolio for known impairments and make such adjustments when determined. If there are no known impairments, the carrying amount is considered fair value, as there is no substantive evidence of a change in value. Due to the nature of the investments, there are significant unobservable inputs, such as discounts for lack of marketability, price per share, and established time frame for liquidation.

These investments can never be redeemed. Instead, the nature of the investments is that distributions are received through the liquidation of the portfolio companies. Eventually, the portfolio companies are liquidated and the investment interest is closed.

Since the investments do not have a readily determinable fair value, there exists an inherent uncertainty that the estimated values may differ significantly from the values that would have been used had a market for the investments existed, and the differences could be material.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD**NOTES TO FINANCIAL STATEMENTS, CONTINUED**

(4) FAIR VALUE OF INVESTMENT INTERESTS, CONTINUED

A summary of the changes in investment interests for the years ended June 30 is as follows:

Balance at June 30, <u>2016</u>	Advances Made	Changes in Fair Value <u>Recognized</u>	Distributions <u>Received</u>	Balance at June 30, <u>2017</u>
<u>\$ 12,573,457</u>	<u>86,089</u>	<u>1,144,110</u>	<u>(1,779,567)</u>	<u>12,024,089</u>
Balance at June 30, <u>2015</u>	Advances Made	Changes in Fair Value <u>Recognized</u>	Distributions <u>Received</u>	Balance at June 30, <u>2016</u>
<u>\$ 12,131,575</u>	<u>249,000</u>	<u>697,206</u>	<u>(504,324)</u>	<u>12,573,457</u>

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(4) FAIR VALUE OF INVESTMENT INTERESTS, CONTINUED

OCIB (OCFC) had committed to making the following investments as of June 30, 2017:

<u>Entity</u>	<u>Amount of Commitment</u>	<u>Commitment Funded as of June 30, 2017</u>	<u>Unfunded Commitment</u>
Acorn Growth Capital Fund III, L.L.C.	\$ 1,000,000	1,000,000	-
Blue Sage Capital, L.P.	2,000,000	1,527,055	472,945 ⁽¹⁾
Chisholm Private Capital Partners, L.P.	3,385,700	3,385,700	-
Davis, Tuttle Venture Partners, L.P.	5,000,000	5,000,000	-
Dolphin Communications Fund II, L.P.	6,000,000	6,000,000	- ⁽⁴⁾
Emergent Technologies Oklahoma, L.P.	1,380,435	1,380,435	-
Intersouth Partners III, L.P.	4,000,000	4,000,000	-
Mesa Oklahoma Growth Fund I, L.P.	3,000,000	2,745,000	255,000
Oklahoma Equity Partners, LLC	7,500,000	6,015,387	1,484,613 ⁽²⁾
Oklahoma Life Sciences Fund II, L.L.C.	1,750,000	1,658,589	91,411
Oklahoma Seed Capital Fund, L.L.C.	1,000,000	922,000	78,000
Pacesetter Growth Fund, L.P.	3,500,000	3,500,000	-
Prolog Capital II, L.P.	5,000,000	4,979,467	20,533
Richland Ventures, L.P.	4,000,000	3,680,000	320,000 ⁽¹⁾
Richland Ventures II, L.P.	1,000,000	974,040	25,960 ⁽¹⁾
Rocky Mountain Mezzanine Fund II, L.P.	3,000,000	3,000,000	-
SSM Venture Partners III, L.P.	7,500,000	6,600,000	900,000 ⁽³⁾
Tullis-Dickerson Capital Focus III, L.P.	7,500,000	7,500,000	-
Ventures Medical II, L.P.	2,000,000	2,000,000	-
	<u>\$ 69,516,135</u>	<u>65,867,673</u>	<u>3,648,462</u>

⁽¹⁾ The unfunded commitment will not be used.

⁽²⁾ A large majority of this commitment is not expected to be used.

⁽³⁾ 5%, or \$375,000, of the original commitment will not be used.

⁽⁴⁾ While the commitment was \$6,000,000, Dolphin Communications Fund II, L.P. ("Dolphin") had the right to recall amounts that had been distributed to OCIB; prior to 2012, \$1,855,306 had been recalled by Dolphin and paid by OCIB.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(5) MANAGEMENT SERVICES AGREEMENT

OCIB entered into a management services agreement with Institutional Equity Associates, LLC (IEA) effective January 1, 2001. Per the agreement, IEA is to perform all of the management functions for OCIB, as well as provide the personnel, office space, equipment, and supplies needed to operate OCIB's program. As such, effective February 1, 2001, OCIB has no employees. The agreement was to last for a period of 15 years. The original agreement required an annual fee of \$443,500 to be paid to IEA, as well as a variable annual fee equal to 0.35% of the amount of each commitment by OCFC to a new venture capital fund. The variable fee would be phased out over a period of time as specified in the agreement.

On July 1, 2010, OCIB and IEA elected to amend the management services agreement in order to reduce the annual fee. During 2017 and 2016, fees of \$360,000 were paid each year to IEA in accordance with the amended management agreement.

On July 15, 2015, OCIB's Board of Trustees approved the extension of the agreement with IEA to perform the management services until September 30, 2020.

IEA also performs management oversight for Oklahoma Equity Partners, LLC, a partnership in which OCFC has invested. No additional compensation has been paid to IEA for this service.

(6) OKLAHOMA CAPITAL ACCESS PROGRAM (OCAP)

As part of its overall purpose, OCIB initiated OCAP during fiscal year 1992. Under OCAP, Oklahoma depository institutions pay a fee or premium to OCIB to enroll qualified loans in OCAP. OCIB, in return for the premium paid, establishes a reserve account equal to the amount of fee paid plus an obligation by OCIB for a predetermined portion of the loan. Cash, up to the amount of the reserve account, may then be paid to an institution if that institution suffers a loss on a loan in the OCAP portfolio and submits a claim to OCIB. OCIB is not guaranteeing the entire loan portfolio but only an amount equal to the reserve account. In no event is OCIB's exposure more than the balance in the reserve account as defined in the OCAP agreement.

As further discussed in Note 8, OCIB presently cannot enroll any new loan or make an amendment to any existing loans currently enrolled in OCAP. Loans currently enrolled in the program will remain covered until the maturity dates of the loans. The total reserve account balance should gradually decrease, as no fee or premium will be collected and claims, if any, will be paid. Reserve accounts will remain in place until such time as the active banks have no more enrolled loans in the program.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD**NOTES TO FINANCIAL STATEMENTS, CONTINUED**

(6) OKLAHOMA CAPITAL ACCESS PROGRAM (OCAP), CONTINUED

Fees paid to OCIB in excess of claims paid and recoveries received are not recognized as income, but reflected on the statements of net position as “OCAP premiums collected in excess of claims paid.” As of June 30, 2017 and 2016, cumulative claims paid exceeded cumulative fees received. During 2017, no new loans were enrolled and no claims were paid in the OCAP program. During 2016, no new loans were enrolled and one claim was paid. A summary of OCAP’s activities as of June 30, 2017 and 2016, is as follows:

	<u>Cumulative Fees Received</u>	<u>Cumulative OCIB Allocation</u>	<u>Cumulative Claims Paid, Net</u>	<u>Total Reserve Account</u>	<u>Total Loans by Institutions</u>	<u>Loans Covered by OCAP</u>
June 30, 2017	<u>\$ 1,305,510</u>	<u>1,576,425</u>	<u>2,269,993</u>	<u>611,942</u>	<u>48,670,231</u>	<u>34,171,984</u>
June 30, 2016	<u>\$ 1,305,510</u>	<u>1,576,425</u>	<u>2,269,993</u>	<u>611,942</u>	<u>48,670,231</u>	<u>34,171,984</u>

During 2017, OCIB did not pay any claims to institutions in the OCAP program. During 2016, OCIB paid \$6,516 of claims to institutions in the OCAP program. These claims were paid in cash from OCIB resources. OCIB has the right to sell tax credits in the future, subject to annual and program caps, to reimburse itself for the cash paid out.

Under the OCAP program, OCIB’s maximum amount of loss exposure at both June 30, 2017 and 2016, was \$611,942, which would come from the unrestricted net position.

(7) DEBT PAYABLE

For the years ended June 30, 2017 and 2016, OCIB had a line of credit provided by the Bank of Oklahoma of \$23,000,000 and \$25,000,000, respectively. The debt matured on August 26, 2017 and August 26, 2016, respectively. At the respective maturity dates in August 2017 and 2016, the line of credit was reduced to \$20,000,000 and \$23,000,000, respectively, and the maturity dates were extended, as noted below.

At June 30, the balance due was as follows:

	<u>Commitment</u>	<u>Balance Outstanding</u>	<u>Maturity</u>
Line of credit, as renewed in August 2017	<u>\$ 20,000,000</u>	<u>14,814,469</u>	August 25, 2018
Line of credit, as renewed in August 2016	<u>\$ 23,000,000</u>	<u>15,625,026</u>	August 26, 2017

See Independent Auditors’ Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(7) DEBT PAYABLE, CONTINUED

The debt payable is classified as either long-term or short-term based on the maturity date. Although the current debt agreement was executed after June 30, 2017, the maturity date was used to classify the debt as long-term.

The line of credit has a fluctuating interest rate equal to the 30-day LIBOR plus 2.25% per annum (3.47% at June 30, 2017), with a 364-day termination date. Interest is payable quarterly, and repayment of outstanding principal may be made without premium or penalty.

The line of credit is secured by the specific assignment of tax credit purchase obligations. As of June 30, 2017, OCIB had \$60,000,000 of available State of Oklahoma tax credits and agreements with four corporations for them to purchase up to an aggregate of \$8,000,000 per year of tax credits in conjunction with a legitimate call on an OCIB guarantee.

Changes in the debt payable during 2017 and 2016 were as follows:

	<u>Beginning Balance</u>	<u>Advances</u>	<u>Repayments</u>	<u>Ending Balance</u>
<u>2017</u>				
Line of credit	<u>\$ 15,625,026</u>	<u>982,533</u>	<u>(1,793,090)</u>	<u>14,814,469</u>
<u>2016</u>				
Line of credit	<u>\$ 15,070,168</u>	<u>1,060,785</u>	<u>(505,927)</u>	<u>15,625,026</u>

(8) COMMITMENTS AND CONTINGENCIES

Legal

From time to time, OCIB is involved in certain legal proceedings arising in the normal course of business. In the opinions of management and counsel, the ultimate disposition of such proceedings will not have a material effect on OCIB's financial statements.

Legislative/Regulatory

An amendment was made to the Oklahoma Capital Formation Act, effective June 8, 2012 (the "Amendment"). The Amendment extended the expiration date of all tax credits of OCIB to June 30, 2020, and limited OCIB's ability to make any new investments or incur any obligations subsequent to June 8, 2012. As of June 30, 2017, management believes OCIB is in compliance with all requirements of the Amendment.

See Independent Auditors' Report.

OKLAHOMA CAPITAL INVESTMENT BOARD

NOTES TO FINANCIAL STATEMENTS, CONTINUED

(9) **INVESTMENT IN EMERGENT TECHNOLOGIES**

At June 30, 2017 and 2016, OCIB (OCFC) had an investment in Emergent Technologies that was fully impaired. Though OCIB (OCFC) may receive recovery of the investment in the future, such amounts, if any, could not be reasonably estimated and therefore are not reflected in the accompanying financial statements.

(10) **SUBSEQUENT EVENT**

Subsequent to June 30, 2017, OCIB received a distribution of approximately \$1,031,000 from SSM Venture Partners, III, L.P.

See Independent Auditors' Report.



**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS**

Board of Trustees
Oklahoma Capital Investment Board

We have audited, in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Oklahoma Capital Investment Board (OCIB), which is a component unit of the State of Oklahoma financial reporting entity, as of and for the years ended June 30, 2017 and 2016, and the related notes to the financial statements, which collectively comprise OCIB's basic financial statements, and have issued our report thereon dated September 5, 2017. Our report includes an explanatory paragraph disclaiming an opinion on required supplementary information.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered OCIB's internal control over financial reporting ("internal control") to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of OCIB's internal control. Accordingly, we do not express an opinion on the effectiveness of OCIB's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

(Continued)

**INDEPENDENT AUDITORS' REPORT ON
INTERNAL CONTROL OVER FINANCIAL REPORTING AND
ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN
ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS, CONTINUED**

Compliance and Other Matters

As part of obtaining reasonable assurance about whether OCIB's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of OCIB's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering OCIB's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Finley + Cook, PLLC

Shawnee, Oklahoma
September 5, 2017