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Dale A. Rodman, Secretary

Sam Brownback, Governor

**Testimony: Overview of the Kansas Bioscience Authority
to
The Senate Commerce Committee**

**By Dale A Rodman
Secretary of Agriculture
Kansas Department of Agriculture**

January 26, 2012

Good afternoon Madame Chairman. My name is Dale Rodman. I worked for nearly 50 years in many different types of business organizations. I worked for Cargill the majority of those years. When I started in 1963, it was an \$8 billion company with 6,000 employees. When I left in 2002, it was a \$120 billion company with 130,000 employees and a global leader in agribusinesses. I have lived, worked and managed businesses in six states and two countries. In that process I have been to and done business in more than 40 countries. With this background and the experience of many organizations and challenges, the governor asked me to be the point person for the audit.

1. We would not be here today if the KBA Board had done their job properly.
2. Those of you who led and voted to create the KBA should feel outraged that a golden opportunity that you helped create was taken away from your efforts.
3. This committee's work last year led to all of us being here today. Senator Wagle, I thank you for your lead in this issue.
4. I want to say that it is my belief that National Bio and Agro-Defense Facility (or NBAF) and the University of Kansas Cancer Center would not be here today if the funding stream of the KBA had not been available. The coalition of state leaders and legislators worked hard to obtain and develop these on-going projects. The work is not finished.

At the present time, there is much information flying around about the KBA and the audit. It is important that we all step back and look at the entity and the situation from a distance.

As we know, there are many issues. Many of the issues are listed in the audit but they are deep and buried. The most important issues are:

1. Is the KBA obtaining the performance expected?
2. Are the KBA, its board and management worthy stewards of the monies given them to invest by the citizens of the state of Kansas?

You have copies of letters that were written on December 19th and December 28th. They are strictly about the performance results made by the KBA when they distributed their fall press

Senate Commerce Committee

Date: January 26, 2012

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release. I went to the KBA and with their help spent three hours verifying their numbers. We will now go over the numbers via these letters.

You will find three things

- 1- The KBA spent \$200,000 per job before Tom Thornton and \$700,000 per job after he became the CEO of the KBA.
- 2- They spent nearly 40 cents of every dollar invested on overhead expenses.
- 3- The board has to be responsible for these results.

I was totally amazed at an audit meeting when David Vranicar, acting CEO of KBA, told me that he was not there to create jobs. The results above show that the board and KBA management have not fulfilled the mission of the Kansas economic growth act.

The citizens of Kansas, many of whom would like to get a job, and not even a biotech job, would not accept the premise that I would not recuse myself on voting on my own benefits. Whether or not it is legal is not the issue. It does not pass the smell test. If it smells bad, it is bad, and you should not do it. If they wanted the money from the KBA they should have quit and followed the normal request procedures. The legislature made clear its intent on the subject.

STATUTE 74-99B04 – (J) STATES “No part of the funds of the authority shall inure to the benefit of, or be distributed to, its employees, officers or members of the board, except the authority may make reasonable payments for expense incurred on its behalf relating to any or its lawful purposes and the authority shall be authorized and empowered to pay reasonable compensation for services rendered to or for its benefit relating to any of its lawful purposes, including to pay its employees reasonable compensation.”

At a board meeting, director Sanford, who heads the ethics committee, gave a glowing report on what a fine job the ethics committee had done. Page 64 of the audit states, “KBA hired Bioenterprise of Cleveland, associated with KBA Director Bill Sanford through his position as COB of BioEnterprise, and paid \$200,000 under an Affiliation Agreement for start-up operational advice, assistance with recruitment of staff and introduction to useful contacts in the areas of technology transfer and funding.” It further states that BDK identified no evidence of purposeful partnering. Page 144 of the audit states, “Director Bill Sanford is the COB and 14% owner of NanoScale, a bioscience company that received four grants totaling \$674,996 from KBA.”

At the last board meeting, I was asked what they should do. I used the Johnson and Johnson, Tylenol example and explained how they almost lost their company and destroyed their brand because of their management and board's denial of the event.

Director Sanford looked at me and said “If you want to get something done, you have to hire someone like Thornton. If we had hired a laid-back Kansan we would not be where we are at today.” I have to agree with him. With a good Kansan in charge we would not be having this meeting.

I would urge you not give up on the issue related to Thornton's connection to Cleveland. This begins with Cleveland and has Cleveland at the end.

Governor John Carlin told me that KBA could not do business in Kansas with strict ethic rules because everyone in Kansas knows each other. In my experience, when you reduce your morale and character standards in hiring, eventually you will be sorry for your actions. It remains true in this case. The board failed.

The issue of the loss on intellectual property was discussed during yesterday's hearing. When a key employee with knowledge and intellectual property of the company leaves to go to a competitor, the board should immediately send a cease and desist order to the new company and the employee. This will inform the competitor that knowledge the employee has belongs to the former employer, and use of that information will result in legal action. Kansas has lost intellectual property.

I do not believe the KBA Board did this with Thornton. The present board did not live up to its responsibility. From the beginning, the board should have recognized that Thornton was a mistake, and if they had acted earlier we would not be here today. The board did not do their job

Please remember the base issue is as stated earlier:

- 1- The KBA spent \$200,000 per job before Thornton and \$700,000 after he became CEO. These are unacceptable figures.
- 2- They spent nearly 40 cents of every dollar invested on internal expenses. This is unacceptable performance.
- 3- The board must be responsible for these results.

As the Governor stated, and I support strongly, the bioscience industry is an extremely important industry to Kansas and I am committed to growing this key sector of the state. We have many states chasing us that are now passing similar laws. Let's get this fixed and move on. Kansas needs it.



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Sam Brownback, Governor

December 19, 2012

Dan Watkins, Chairman
Board of Directors
Kansas Bioscience Authority
10900 S. Clay Blair Blvd.
Olathe, KS 66061

Re: Investment Outcomes Summary

Dear Chairman Watkins and Board:

I am writing this prior to the release of the forensic audit and in response to the KBA's recent release of the Investment Outcomes summary to the press. During the course of a forensic audit the release of any public statements by the management of the entity being examined should be carefully vetted for accuracy. Please note that all of the following concerned areas are from your publically available documents.

The Investment Outcome summary issued by the KBA appears overinflated by errors and inconsistencies that paint a picture that does not seem borne out by the facts. In reviewing the publically obtained records of the KBA, several major inefficiencies were observed that need to be brought to your attention.

- It should be noted that the actual formalization of the existing KBA management and board structure began in 2007 and many of the claimed outcomes predate that time frame.
- Since 2007 only 347 jobs are shown in the investment outcomes as created by the KBA.
- Commitments and payments by the KBA in the statement from 2007 are \$246.1 million. The investment cost per job exceeds \$708,000 and is certainly actually higher because KTEC and Commerce made additional investments in many of these companies as well.
- The \$816.4 million cumulative equity investment claimed by the KBA also appears to be incorrect and overstated.

- Included in the press release numbers is \$86.7 million spent by Homeland Security outside of the State of Kansas and cannot be credited to the KBA.
- Research grants are included as total amounts although much of the funds are designated payments in future years.
- There are numerous instances of what appear to be double counts where KBA numbers invested in a company are added to the funds being invested by the receiving company for the same asset.
- KTEC and Commerce have also invested in some of these businesses so KBA cannot claim all the investment leverage or the outcomes.

One of the major issues raised by critics of the KBA has been unnecessary and wasteful expenditures of state money. My review of the expenses of the KBA from public documents from 2007 through 2011 included the overhead costs of not only the KBA but also of the affiliated Centers of Excellence and Heartland Bioventures.

- The KBA and its created affiliated entities have a total overhead cost of nearly 40 cents for every dollar invested when all costs are considered.
- KBA has entered into debt commitments of over \$10.0 million in regards to the Olathe industrial park and office that are due after the scheduled sunset date for KBA.
- The \$18,489,616 spent on the office in Olathe was ill advised and excessive. KBA had adequate office space prior and this was a waste of Kansas money.
- KBA was created to provide funding for private entities to create jobs but appears to have used much of its public funding for internal investments. In 2010 over \$90 million and in 2011 over \$80 million was on KBA's balance sheet as cash or securities held for investment. The use of taxpayer dollars to create investment income for KBA operations is a dubious use of citizen dollars.
- I was recently told by the acting CEO of the KBA "The KBA is not here to create jobs." The Board of Directors and the Management of the KBA have allowed excessive spending, poor investment returns with a lack of jobs, encouraged high overhead self expenditures, and allowed apparent conflicts of interest.

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This is only a cursory view and most likely did not uncover every error, inaccuracy or misstatement included in the press release. The administration is very concerned about these issues and would encourage the management and the Board of Directors of the KBA to address these issues even before the forensic audit is released.

Sincerely,

A handwritten signature in cursive script that reads "Dale A. Rodman". The signature is written in dark ink and is positioned above the printed name and title.

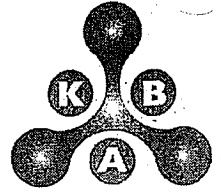
Dale A. Rodman
Secretary of Agriculture

cc: Governor Sam Brownback
Chief Counsel Caleb Stegal
Budget Director Steve Anderson

OFFICE OF THE SECRETARY

DEC 30 2011

KS DEPT OF AGRICULTURE



KANSAS BIOSCIENCE
AUTHORITY

December 28, 2011

Secretary Dale A. Rodman
Kansas Department of Agriculture
109 SW 9th Street, 4th Floor
Topeka, Kansas 66612-1280

Dear Secretary Rodman:

I am writing in response to your letter dated December 19 regarding KBA investment outcomes and other issues. I have forwarded your letter and my response to the Board and we will discuss these issues at our next meeting when the audit report is also presented.

The Kansas Bioscience Authority Board and staff are committed to the mission of growing the bioscience sector of the Kansas economy. We believe the KBA has been successful in driving toward this mission and that investment outcomes KBA has reported reflect that progress.

At our Dec. 7 meeting, you stated your displeasure that KBA had released information regarding 2011 investment outcomes. It has been the KBA's annual practice to report outcomes following the October board meeting. The Board encouraged management at the November 2011 Board meeting to do more to communicate KBA outcomes to the public. To address your concerns about outcome data, I stated at our Dec. 7 meeting the Board's and management's interest and willingness to review outcome methodology and reporting as well as involving a qualified third-party to validate a methodology to ensure the information reported is as sound, accurate and meaningful as possible.

Other views your letter expresses, after you have spent the past eight months closely monitoring the KBA and actively participating in an exhaustive forensic audit, cause me concern. The KBA has cooperated fully with you and others in the Administration, opening every aspect of KBA operations and documentation to you and those conducting the forensic audit whose broad scope you have fully and totally defined. Given your views on KBA investments and expenditures, the Venture Accelerator, conflicts of interest and other matters after your extensive involvement and the draft findings of BKD, I am unsure that explanations we provide regarding the KBA will mitigate your opinions. Nevertheless, I believe it is important to address the issues you raise with information that I believe is pertinent to a fair analysis of the KBA and its activities.

The KBA Board and management have sought to work collaboratively with other state agencies, including the Department of Commerce. We are all working toward the same end. The reporting of KBA outcomes is intended to show progress for the entire state's efforts to grow the biosciences, while specifically reporting the outcomes of companies and universities funded by the KBA. The outcomes news release distributed on Nov. 16, 2011, quotes me:

"The outcomes reported today demonstrate KBA grants and investments are succeeding in building the bioscience sector in Kansas and fueling the Kansas economy. We acknowledge

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and appreciate the efforts of the partners that helped achieve these outcomes for the state, including the Kansas Department of Commerce."

Like other aspects of KBA operations, outcomes reporting and documentation has improved as the KBA has matured and a full-time staff person has been dedicated to that effort. We believe that this process will continue to improve as we review our methodology and reporting requirements and trust that future reports will be sound and meaningful.

The extensive and exhaustive forensic audit will provide a definitive look at other matters you raise.

BKD has spent eight months engaging in an in-depth review of KBA activities at significant expense. This comprehensive audit has examined all KBA expenditures and contractual arrangements since its inception in 2004, potential conflicts of interest, analysis of specific investments, the process which approved the Venture Accelerator and KBA offices, as well as issues related to former KBA president Tom Thornton and other matters brought to BKD's attention by you and others. BKD has provided you updates contemporaneously with our own.

BKD professionals have spent over 1,900 hours conducting the investigation, which at the last draft produced a 142-page report, with an additional 600+ pages of exhibits. BKD interviewed 67 individuals during the investigation, including current and former KBA employees and Board members, current and former lawmakers with knowledge pertaining to the KBA, and persons and companies doing business with the KBA.

Your letter cites "several major inefficiencies" and your view that "the Board of Directors and the Management of the KBA have allowed excessive spending, poor investment returns with a lack of jobs, encouraged high overhead, self expenditures and allows apparent conflicts of interest."

I believe the draft forensic audit reflects the following:

- There is no pattern or practice of unauthorized or improper expenditures;
- The investment process and Investment Committee are thorough in their review of investments;
- The KBA investment process is sufficiently diligent to prevent the improper approval of investments;
- No grants or investments were deemed inappropriate or in violation of KBA's Conflict of Interest policy or the Kansas Economic Growth Act of 2004 (KEGA) which defines the parameters of the KBA;

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- The level of documentation, organization and completeness of KBA files related to contracting with third parties improved markedly over the years and most exceptions noted occurred in the early years of the KBA;
- The decision to construct the Venture Accelerator and KBA offices was made in 2007 and all aspects of following through on this decision are set out.

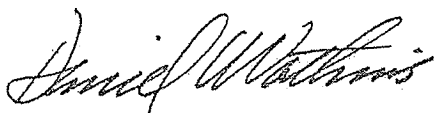
If the conclusions set out in your letter are publicly put forth as those of the Administration, I believe it will unfairly and wrongly send a dissonant message to KBA partners, clients, potential clients and others with whom KBA currently has significant credibility. I believe the audit report should speak for itself and that we should then move forward constructively in carrying out the mission in KEGA.

Attached to this letter are responses to the bulleted points in your letter.

In light of the short time frame between now and January 5th, the fact that we do not anticipate receiving a final BKD draft report until sometime in the first week of January at the earliest, the difficulty in holding a special Board of Directors meeting and briefing all board appointing authorities prior to January 5th, the fact that the CIBOR audit will not be finalized by January 5th and the importance of these issues to the Board, I believe it is a more realistic course to have both BKD and the CIBOR auditors present their findings to the KBA Board at our regularly scheduled meeting on January 23rd with a meeting to present the findings to KBA appointing authorities (Governor and legislative leadership) on January 24th with public release made quickly thereafter. I informed the Governor's Chief of Staff of these concerns and my preference for the audit reports to be made at the scheduled KBA Board meeting and public release after briefing the appointing authorities on the findings.

I am willing and available to discuss these matters should you desire it.

Very truly yours,

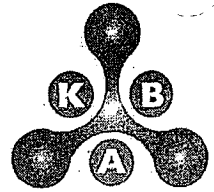


Daniel L. Watkins
Chair of the Board

Cc: Governor Sam Brownback
Steve Anderson
Caleb Stegall
David Kensinger
KBA Board

DEC 30 2011

KS DEPT OF AGRICULTURE

KANSAS BIOSCIENCE
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December 28, 2011

Bullets in Sec. Rodman's letter dated Dec. 19, 2011, in italics
followed by Watkins Responses

1. *It should be noted that the actual formalization of the existing KBA management and board structure began in 2007 and many of the claimed outcomes predate that time frame.*
2. *Since 2007 only 347 jobs are shown in the investment outcomes as created by the KBA.*

The KBA was established by the Kansas Economic Growth Act of 2004. The first board of directors was formed in August 2004 and met for the first time in September 2004. The KBA made its first investment commitment in July 2005. It is not clear why jobs created by companies which received KBA investments prior to 2007 should not be included—or should somehow be treated differently—than outcomes for investments made after 2007. Early KBA investments are as pertinent as current investments.

The Quintiles investment made in fiscal 2006 accounts for 55% of the 1,347 full-time bioscience jobs (751 jobs) created by 41 companies. Quintiles also accounts for \$45 million in reported capital expenditures. The investment in Quintiles has obviously paid significant dividends in the development of the Kansas bioscience industry and is thus included in KBA outcomes.

3. *Commitments and payments by the KBA in the statement from 2007 are \$246.1 million. The investment cost per job exceeds \$708,000 and is certainly actually higher because KTEC and Commerce made additional investments in many of these companies as well.*

The calculation assumes all commitments since 2007 have been paid and are already at work, and implies that the sole purpose of KBA investments is job creation.

As articulated in KEGA, growing the biosciences is a long-term strategy. If the KBA focused solely on short-term job creation, it would invest only in large, late-stage expansion and attraction deals, which would not necessarily result in the broad, long-term industry growth envisioned by KEGA. If the KBA's only goal were short-term job creation, it would not have invested in helping the University of Kansas Cancer Center prepare for National Cancer Institute designation, NBAF, a large number of early-stage companies with promising bioscience discoveries, or other opportunities for long-term growth of the biosciences.

\$87.5 million has been paid on all \$250.5 million in KBA investment commitments through June 30, 2011. Over time, many additional jobs will be created, spurred in part as milestones are met and these investment commitments are paid out.

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- 4. The \$816.4 million cumulative equity investment claimed by the KBA also appears to be incorrect and overstated.*

\$816.4 million is the cumulative impact of wages, external research funding, capital expenditures and equity investments reported in the November 16 news release based on information provided by KBA client companies and other entities. The total cumulative equity outcomes reported are \$78.9 million.

- 5. Included in the press release numbers is \$86.7 million spent by Homeland Security outside of the State of Kansas and cannot be credited to the KBA.*

The Department of Homeland Security has to date awarded \$86.7 million in contracts related to NBAF. These contracts are integrally related to the eventual construction of the lab in Kansas, which was the aim of the investments and efforts of KBA and others in recruiting NBAF to Kansas. Without these investments by DHS, NBAF could not be realized in Kansas.

- 6. Research grants are included as total amounts although much of the funds are designated payments in future years.*

Grants that are awarded to Kansas research institutions and companies are highly likely to be delivered by the granting entity. For that reason, the KBA does not require these institutions and companies to report on exactly when the cash arrives in the state. However, under regular reporting, the KBA does identify those rare instances when awarded funds are not received and they are then deducted from KBA outcome reports.

- 7. There are numerous instances of what appear to be double counts where KBA numbers invested in a company are added to the funds being invested by the receiving company for the same asset.*

KBA grants are not supposed to be counted as part of any KBA outcome. All client reporting forms indicate this very clearly. If there are identified specific instances where this may have occurred, they will be corrected as we are currently not aware of such instances.

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8. *KTEC and Commerce have also invested in some of these businesses so KBA cannot claim all the investment leverage or the outcomes.*

The KBA works with many partners, including KTEC and the Department of Commerce, to grow the bioscience sector in the state. The state's universities, federal agencies, philanthropies, private investors, and others often match our grants. We actively collaborate with others and annually report outcomes as a gauge of the state's success, and say so in KBA releases.

9. *One of the major issues raised by critics of the KBA has been unnecessary and wasteful expenditures of state money. My review of the expenses of the KBA from public documents from 2007 through 2011 included the overhead costs of not only the KBA but also of the affiliated Centers of Excellence and Heartland Bioventures. The KBA and its created affiliated entities have a total overhead cost of nearly 40 cents for every dollar invested when all costs are considered.*

Since its inception the KBA has incurred approximately \$17 million in administrative expense. This amount does not translate into a 40% overhead cost. As a proportion of total investment commitments, it equates to approximately 7 cents on the dollar. As a proportion of investments actually paid, it is approximately 20 percent.

The Centers of Excellence are KTEC programs that are unaffiliated with and have never received funding from the KBA. While the KBA has helped fund four Centers of Innovation, they are independent entities with independent boards and other independent investors. Including the operating costs of these centers or overhead of other entities in which KBA invests as part of KBA operating costs is not a generally accepted accounting practice.

10. *KBA has entered into debt commitments of over \$10.0 million in regards to the Olathe industrial park and office that are due after the scheduled sunset date for KBA.*

The KBA made a financial decision to finance the Kansas Bioscience Park through debt as most capital improvements are financed. This has been contemplated in financial KBA projections, and the KBA clearly has planned to cover this debt as it matures. The statute provides a mechanism for the KBA to exist in some form after sunset specifically to pay these types of longer-term commitments. In addition, the KBA could elect to pre-pay any debt amount at any time.

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11. *The \$18,489,616 spent on the office in Olathe was ill advised and excessive. KBA had adequate office space prior and this was a waste of Kansas money.*

The fundamental purpose of the Venture Accelerator is to serve as an incubator where Kansas helps jump-start early stage bioscience companies, in line with KEGA. The KBA's offices are within the incubator, making its business professionals readily accessible to tenants. The decision to construct the incubator was made by the Kansas Bioscience Authority board of directors in 2007, under the direction of then-KBA Chairman Clay Blair. The construction cost of \$285 per square foot compares favorably to comparable buildings, including the neighboring K-State Olathe Innovation Campus.

12. *KBA was created to provide funding for private entities to create jobs but appears to have used much of its public funding for internal investments. In 2010 over \$90 million and in 2011 over \$80 million was on KBA's balance sheet as cash or securities held for investment. The use of taxpayer dollars to create investment income for KBA operations is a dubious use of citizen dollars.*

The amount of cash KBA receives is defined within the funding formula outlined in KEGA, and is administered by the Kansas Departments of Labor and Revenue. KBA does not pay out commitments in a lump sum, as KBA grants and investments are earned based on the achievement of specific milestones. Funds that have been received and committed but not yet paid are maintained in interest-bearing accounts, in accordance with sound financial practices.

13. *I was recently told by the acting CEO of the KBA "The KBA is not here to create jobs."*

This supposed quote is not a view held by or expressed by Mr. Vranicar as a flat statement with no other context. Mr. Vranicar supports the purpose and mission of KEGA, "to make Kansas the most desirable state in which to conduct, facilitate, support, fund and perform bioscience research, development and commercialization, to make Kansas a national leader in bioscience, to create new jobs, foster economic growth, and advance scientific knowledge and improve the quality of life for citizens of the state of Kansas." While an important part of this mission is generating jobs today, the longer-term mission is more robust: to build a bioscience infrastructure that will generate high-paying bioscience jobs today and for future generations of Kansans. KBA investments reflect this mission and do not solely focus on near-term job creation. I believe this is the point Mr. Vranicar made in our Dec. 7 meeting to which I think you refer.

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14. The Board of Directors and the Management of the KBA have allowed excessive spending, poor investment returns with a lack of jobs, encouraged high overhead self expenditures, and allowed apparent conflicts of interest.

I do not believe the exhaustive forensic audit conducted by BKD and its findings will support those conclusions. I trust the audit report will speak for itself and that upon its conclusion we can make any needed adjustments and move forward toward achievement of KBA's mission.