

# Audit Report

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## Department of Business and Economic Development

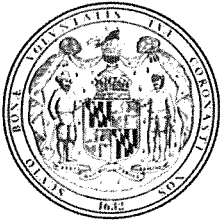
February 2012

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**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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DEPARTMENT OF LEGISLATIVE SERVICES  
OFFICE OF LEGISLATIVE AUDITS  
MARYLAND GENERAL ASSEMBLY

February 7, 2012

Karl S. Aro  
Executive Director

Bruce A. Myers, CPA  
Legislative Auditor

Senator James C. Rosapepe, Co-Chair, Joint Audit Committee  
Delegate Guy J. Guzzone, Co-Chair, Joint Audit Committee  
Members of Joint Audit Committee  
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Department of Business and Economic Development (DBED) for the period beginning October 1, 2007 and ending November 2, 2010. DBED's primary purpose is to stimulate and strengthen the Maryland economy by developing policies and implementing programs to help generate new jobs or retain existing jobs. DBED also develops policies and implements programs to help generate investments by attracting businesses to the State, by facilitating the expansion and retention of existing companies, and by promoting Maryland's strategic assets.

Our audit disclosed that DBED did not require applicants of the One Maryland Tax Credit program to submit documentation to support reported project and start-up costs on which the credit was based. Our test of 10 tax credit applicants disclosed that 8 applicants certified for \$34 million in credits did not provide any documentation of the costs. In addition, we identified deficiencies with respect to DBED's financing programs and the related automated monitoring system. For example, DBED did not take action to recover its \$250,000 investment in an international company after the company moved its principal place of business out of Maryland. Furthermore, DBED did not ensure that grantees complied with certain grant requirements.

DBED's response to our findings and recommendations is included as an appendix to this report. We wish to acknowledge the cooperation extended to us by DBED during the course of this audit.

Respectfully submitted,

A handwritten signature in black ink that reads "Bruce A. Myers".

Bruce A. Myers, CPA  
Legislative Auditor



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**\* Denotes item repeated in full or part from preceding audit report**

## **Background Information**

### **Agency Responsibilities**

The Department of Business and Economic Development (DBED) is a principal department of State government and operates in accordance with the Economic Development Article of the Annotated Code of Maryland. DBED's mission is to stimulate and strengthen the Maryland economy by developing policies and implementing programs to help generate new jobs and retain existing jobs. It also develops policies and implements programs to help generate investment by attracting businesses to the State, by facilitating the expansion and retention of existing companies, and by promoting Maryland's strategic assets. According to the State's records, during fiscal year 2011, DBED's operating expenditures totaled \$85.7 million, which included \$30.7 million for grants and \$21.8 million for loans.

### **Status of Findings From Preceding Audit Report**

Our audit included a review to determine the status of the 11 findings contained in our preceding audit report dated November 10, 2008. We determined that DBED satisfactorily addressed 10 of the findings. The remaining finding is repeated in this report.

## Findings and Recommendations

### One Maryland Tax Credit

#### **Finding 1**

**The Department of Business and Economic Development (DBED) did not require applicants of the One Maryland Tax Credit program to submit supporting documentation for all project and start-up costs.**

#### **Analysis**

DBED did not require applicants for the One Maryland Tax Credit to document all of the related project costs, which serve as the basis for the tax credit amounts. According to State law, a qualified business entity may receive the One Maryland Tax Credit after creating a specified number of new jobs. Specifically, DBED issues a tax credit certificate after it verifies a qualified business has created and filled the required number of positions during the specified period. The amount of the tax credit is based, dollar-for dollar, on the project and start-up costs incurred by the qualified business entity to expand or establish a new facility in the State (that is, costs to acquire, construct, rehabilitate, install, and equip an eligible project). A tax credit cannot exceed \$5 million for project costs and \$500,000 for start-up costs. Certified businesses are allowed by State law to carry over project and start-up tax credits for up to 14 years after the applicable project was placed in service if the amount of the tax credit exceeds the amount of State tax on the applicant's income.

DBED did not require all applicants to document these project costs. Our test of 10 applicants, certified by DBED as eligible for One Maryland Tax Credits totaling \$42 million during fiscal years 2008 through 2010, disclosed that 8 applicants, which were certified for project and start-up tax credits totaling \$34 million, did not provide any documentation to support these reported project and start-up costs. The remaining 2 applicants submitted documentation to support these costs. Our review of Comptroller of Maryland (COM) records disclosed that four of the eight applicants had taken One Maryland Tax Credits totaling \$11.7 million from calendar years 2006 to 2009.

DBED is responsible for certifying applicants as eligible for the credit and the COM is responsible for verifying that only DBED-certified applicants subsequently take the credit. According to DBED's records, during fiscal years 2008 through 2010, DBED certified 17 applicants for the One Maryland Tax Credit, which reportedly created approximately 1,400 jobs and had certified costs totaling approximately \$65.8 million, representing the maximum amount of credits these applicants may be able to claim.

### **Recommendation 1**

**We recommend that DBED obtain adequate supporting documentation for project and start-up costs prior to certifying applicants for the One Maryland Tax Credit.**

## **Financing Programs**

### **Finding 2**

**DBED did not take action to recover its \$250,000 investment in an international company after the company moved its principal place of business out of Maryland.**

### **Analysis**

Our review of three Maryland Venture Fund (MVF) investments made during fiscal years 2008 through 2010, totaling \$450,000, disclosed that DBED did not take action to recover its investment in one company that moved its principal place of business out of Maryland. Specifically, in June 2008, DBED invested \$250,000 from the MVF's Enterprise Investment Fund (EIF) in an international technology company. In accordance with State regulations, DBED's investment agreement with the company contained a mandatory repurchase provision allowing DBED to recover its original investment, plus interest at 10 percent per year, in the event the company were to move its principal place of business out of Maryland within five years from the date of the investment's closing. In March 2009—less than one year after the investment—the company closed its Maryland operations and, as of June 6, 2011, DBED had not taken action to collect its original investment plus interest, which we estimated to total \$325,000. Recovery of this investment would allow these funds to be used for future investments in Maryland technology firms.

We were advised by DBED management that no action was taken to recover the investment because the company's website still listed Maryland as its address and because the company's president has indicated to DBED that the company intends to return to Maryland once economic conditions improve. After we provided our findings to DBED, it issued a demand letter to the company's president for repayment of the investment plus interest.

The EIF is a State-sponsored venture capital fund that makes direct equity investments in emerging technology companies that agree to maintain their principal place of business in Maryland for five years. According to DBED's records, the EIF made nine investments totaling \$921,000 during fiscal year 2010.



## **Recommendation 2**

**We recommend that DBED continue its efforts to recover its investment with the aforementioned company, and in the future, take timely action to recover its investments when companies fail to comply with requirements of the investment agreements.**

### **Finding 3**

**The capabilities of system users on DBED's financing programs monitoring system were not adequately restricted.**

### **Analysis**

The capabilities of system users on DBED's automated financing programs monitoring system were not adequately restricted, and assigned user capabilities were not always timely removed once access was no longer needed. DBED uses the system to track approval and settlement processes and critical financial activities, including account billings and payments, for all of DBED's financing programs. According to system records, as of June 30, 2011, more than 560 active financial instruments (such as, loans, grants, guarantees, investments) totaling approximately \$686.3 million were being tracked.

Our review of all 41 active system users disclosed that 3 system users did not need certain assigned system capabilities to perform their duties. For example, two of these users had the capability to initiate bills and post payments even though such capabilities were not required for these employees to perform their normal job duties. In addition, as of May 6, 2011, five other users had system capabilities that were no longer needed. Specifically, these employees either had transferred to another division within DBED or had terminated employment with DBED 11 to 20 months earlier.

The Department of Information Technology's (DoIT) *Information Security Policy* requires each agency to use access rules that use a "least privilege" security strategy that gives users only the access needed to perform assigned tasks. The *Policy* also requires agencies to immediately disable access upon a change in employment status, where appropriate.

## **Recommendation 3**

**We recommend that DBED comply with the requirements specified in the DoIT *Information Security Policy* to ensure financing programs monitoring system access is adequately restricted and timely removed when no longer needed.**

## Grant Monitoring

### **Finding 4**

**Required expenditure and performance reports were not received from certain grantees.**

#### **Analysis**

DBED did not ensure that required expenditure and performance reports were received from certain grantees. Specifically, we tested three grants to one entity, totaling \$17.1 million, that were issued during fiscal years 2007 through 2009 from the Rural Broadband Assistance Fund (RBAF) and one \$300,000 grant from the Office of Tourism Development. Our test disclosed that DBED did not generally obtain required grant expenditure and performance reports from these grantees. For example, for the three RBAF grants, DBED did not obtain required quarterly reports detailing actual expenditures supported by appropriate documentation and performance reports specifying the grantee's accomplishments in comparison to the description of the project.

Without such reports, DBED could not adequately monitor the grantees to ensure use of the funds was consistent with the purpose of the grants. According to the State's records, during fiscal year 2009, grant payments from the RBAF and the Office of Tourism Development totaled approximately \$8.7 million. Through the RBAF, DBED provides funds to entities to provide broadband access to rural and underserved areas in the State. The Office of Tourism Development serves as the State's official travel agency, and provides grants to entities that promote Maryland attractions, accommodations, and services. Similar conditions regarding reporting requirements for grants were commented upon in our preceding audit report.

#### **Recommendation 4**

**We recommend that DBED ensure that all grant reporting requirements are met by grant recipients (repeat).**

## **Audit Scope, Objectives, and Methodology**

We have audited the Department of Business and Economic Development (DBED) for the period beginning October 1, 2007 and ending November 2, 2010. The audit was conducted in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

As prescribed by State Government Article, Section 2-1221 of the Annotated Code of Maryland, the objectives of this audit were to examine DBED's financial transactions, records, and internal controls, and to evaluate its compliance with applicable State laws, rules, and regulations. We also determined the status of the findings included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included financing programs, tax incentive programs, grant programs, contracts, disbursements, and payroll. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of DBED's operations. We also tested transactions and performed other auditing procedures that we considered necessary to achieve our objectives. Data provided in this report for background or informational purposes were deemed reasonable, but were not independently verified.

DBED's management is responsible for establishing and maintaining effective internal control. Internal control is a process designed to provide reasonable assurance that objectives pertaining to the reliability of financial records, effectiveness and efficiency of operations including safeguarding of assets, and compliance with applicable laws, rules, and regulations are achieved.

Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

Our reports are designed to assist the Maryland General Assembly in exercising its legislative oversight function and to provide constructive recommendations for improving State operations. As a result, our reports generally do not address activities we reviewed that are functioning properly.

This report includes findings relating to conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect DBED's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our report also includes findings regarding significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to DBED that did not warrant inclusion in this report.

DBED's response to our findings and recommendations is included as an appendix to this report. As prescribed in the State Government Article, Section 2-1224 of the Annotated Code of Maryland, we will advise DBED regarding the results of our review of its response.

## APPENDIX



**Martin O'Malley** Governor

**Anthony G. Brown** Lt. Governor

**Christian S. Johansson** Secretary

**Dominick E. Murray** Deputy Secretary

February 6, 2012

Bruce A. Myers, CPA  
Legislative Auditor  
Office of Legislative Audits  
301 West Preston Street  
Baltimore, MD 21202

Dear Mr. Myers:

This is the Department of Business and Economic Development's Response to the Legislative Auditor's Draft Report on the Fiscal/Compliance Audit of the Department dated January 2012.

In Attachment A, "Department of Business and Economic Development's Response to the Legislative Auditor's Draft Report," we have listed each finding. The findings are listed in the same order as they are shown in the Draft Audit Report. In the interest of brevity, we have generally utilized the brief descriptions provided at the beginning of each finding in your Draft Audit Report to summarize the findings. Each finding summary is followed by the related Departmental response. There are four responses in total.

If you have any questions, please contact Michael McManus at 410-767-2286.

Sincerely,

A handwritten signature in black ink, appearing to be "C. Johansson".

Christian Johansson,  
Secretary

Enclosure

***Department of Business and Economic Development's***

***Response to the***

***Legislative Auditor's Draft Report***

***(For the Period Beginning October 1, 2007  
and Ending November 2, 2010)***

***February 6, 2012***

**Department of Business and Economic Development's  
Response to the Legislative Auditor's Draft Report**

**ONE MARYLAND TAX CREDIT**

**Finding #1**

*The Department of Business and Economic Development (DBED) did not require applicants of the One Maryland Tax Credit Program to submit supporting documentation for all projects and start up costs*

**RESPONSE TO 1:**

DBED agrees with the auditors' recommendation.

ACTION PLAN: DBED will immediately amend the preliminary and final tax credit applications to include an accounting of start-up and project costs.

**FINANCING PROGRAMS**

**Finding #2**

*DBED did not take action to recover its \$250,000 investment in an international company after the company moved its principal place of business out of Maryland.*

**RESPONSE TO 2:**

DBED agrees with the auditors' recommendation that DBED should take action to recover the investment as well as any other obligation when the recipient fails to comply with the requirements of an agreement. The Office of Finance Programs focuses significant attention on the collection of funds due from the portfolio of transactions and, within the constraints of staffing and prioritization, takes all reasonable actions. During the period of fiscal years 2008 through 2011, aggregate collection of funds from the portfolio exceeded \$54 million.

ACTION PLAN: DBED has sent a demand letter to the company informing them that the company is in breach of contract and that DBED is exercising its right to recover the investment under the terms of the agreement. DBED will continue to pursue all avenues to recover the investment.

### **Finding #3**

*The capabilities of system users on DBED's financing programs monitoring system were not adequately restricted.*

### **RESPONSE TO 3:**

We agree with the recommendation that DBED should comply with DoIT's Information Security Policy, which requires a "least privilege" security strategy. DBED took immediate action during the audit as soon as the discrepancy was brought to our attention and corrected the security permissions and access rules.

ACTION PLAN: DBED has coordinated with ITM and taken the following actions to ensure appropriate access: (1) reviewed all user permissions to ensure permission levels comply with policy; and (2) going forward coordinate quarterly with ITM to review user permissions and to monitor for continued compliance.

<b>GRANT MONITORING</b>
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### **Finding #4**

*Required expenditure and performance reports were not received from certain grantees.*

### **RESPONSE TO 4:**

DBED agrees with the recommendation and will ensure that all grant reporting requirements are met in the future.

### **Office of Tourism Development – Babe Ruth Birthplace /Sports Legend Museum**

The grant agreement with the Babe Ruth Birthplace Foundation, Inc. required reporting is as follows:



“ the Grantee shall provide the Board with reports and information concerning the Grant and the operations and finances of the Grantee in form and substance acceptable to the Board, as the Board may from time to time require.”

The Board did make a request for the final report and the documentation (with a cover letter dated September 29, 2011) was received and turned over to the auditors at the October 20, 2011 meeting.

We agree with the recommendation and will continue to monitor grant reports received to ensure that grant recipients meet reporting requirements. OTD will, within 45-days of the end of the fiscal year, prepare a report of current fiscal year grant recipients' submission of requisite reports. Letters will be sent from the Fiscal Officer to recipient agent requesting certified financial report if not received within 90 days of fiscal year end. Organizations not fulfilling this requirement will be referred after 90 days to the Assistant Attorney General.

**Office of Contracts and Procurement – Rural Broadband Assistance Fund**

We agree with this finding. We realize the importance of monitoring the use of grant funds to ensure use of the funds was consistent with the purpose of the grants. DBED agrees with the audit recommendation and will ensure that all grant reporting requirements are met by grant recipients in the future.”

**AUDIT TEAM**

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