



**Department of Legislative Services
Office of Legislative Audits**

Department of Commerce (DOC)

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Presentation to Joint Audit and Evaluation Committee

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Department of Legislative Services

Office of Legislative Audits

Audit Overview

- DOC develops policies and implements programs to help generate new jobs and retain existing jobs in Maryland, and to attract business investment to the State, including the expansion and retention of existing companies. DOC uses financing programs and incentives—such as loans, grants, tax credits, and other financial investments—to accomplish its purpose. DOC also administers the Small, Minority, and Women-Owned Businesses Account (SMWOBA), which is funded from a portion of video lottery terminal proceeds.
 - DOC spent \$125.6 million during fiscal year 2018 on operating expenses and grants, loans, and other investments.
 - Our audit focused primarily on DOC's procedures and controls for fulfilling its responsibilities with regard to monitoring compliance with program requirements established in State laws and regulations, or by written agreement.
 - Our report included 9 findings, 2 of which (Findings 1 and 9) were repeated from our preceding audit report on DOC (then the Department of Business and Economic Development).
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Audit Overview (continued)

The following two tables reflect fiscal year 2018 activity for loans, grants, loan guarantees, and tax credits.

DOC Financing Programs and Related Activity – Fiscal Year 2018		
Financing Programs	Loans and Grants	Loan Guarantees
Economic Development Assistance Authority and Fund	\$13,350,000	Not Applicable
Industrial Development Financing Authority	\$10,770,000	\$1,350,300
Video Lottery Terminal Fund	\$9,632,225	Not Applicable
E-Nnovation Initiative	\$7,020,000	Not Applicable
Small Business Development Financing Authority	\$6,032,050	\$203,600
Sunny Day	\$5,000,000	Not Applicable
Other Programs	\$1,632,652	Not Applicable



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Audit Overview (continued)

DOC Tax Credit Programs and Related Activity Fiscal Year 2018	
Tax Credit Programs	Certificates Issued
One Maryland	\$22,947,031
Biotechnology Investment	12,379,430
Research and Development	12,000,000
Aerospace, Electronic, and Defense	7,500,000
Film Production	7,047,304
Job Creation	4,344,464
Employer Security	2,000,000
Other Programs	671,497



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Key Findings

- DOC lacked adequate procedures and processes for verifying compliance with certain requirements established for participation in several of its financing programs and incentives that we examined.
 - These requirements included, for example,
 - creating and maintaining a specified number of jobs,
 - providing for matching funds,
 - using State funds for acceptable purposes, and
 - verifying lender claims for payment.
 - We examined the following programs and incentives:
 - One Maryland Tax Credit Program
 - Biotechnology Investment Tax Credit
 - Loans – Conditional and Guaranteed
 - Maryland E-Innovation Initiative Fund
 - Maryland State Arts Council Grants
 - With respect to its Small, Minority, and Women-Owned Businesses Account (SMWOBA), DOC did not have an effective process for ensuring that
 - Fund manager agreements included details regarding certain critical loan processing procedures,
 - Fund manager compensation was proper, and
 - Data reported by fund managers regarding efforts to meet program goals were accurate.
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Tax Credit Programs - Findings 1 and 2

DOC did not have adequate procedures for verifying certain critical requirements for the receipt of tax credits totaling approximately \$116 million during our audit period.

Finding 1 - One Maryland Tax Credit Program (\$69.8 million)

- DOC lacked effective procedures for verifying the accuracy of new positions claimed by applicants, as well as the duration for which those positions were filled. An eligible business may receive a credit for costs incurred for expanding or establishing a new facility in the State if at least 25 new positions are created for at least 12 months.
 - DOC reviewed applicant payroll records for only 3 (\$15 million) of the 15 credits (\$69.8 million) certified during our audit period, and our review of 2 of the 3 disclosed that the department did not verify the date the positions were created or filled or that the 12 month employment requirement was met. The 12 credits with no review were issued based on applicant supplied data and representations.
 - Our test of 6 credits found one credit for \$5.5 million (maximum allowed) that was issued for costs that were ineligible according to State regulations because they were incurred through a sale and purchase transaction between related parties. DOC advised that the regulation is antiquated and needs to be amended.
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Tax Credit Programs - Findings 1 and 2 (continued)

Finding 2 – Biotechnology Investment Tax Credit (\$47 million)

- DOC lacked effective procedures for verifying employment and ownership information provided by biotechnology companies prior to issuing tax credits to eligible investors.
 - Our review of records for \$8 million in credits relating to 5 companies disclosed that DOC had not verified employment reports provided by any of the companies. For certification under the program, a biotechnology company must be based in Maryland and have fewer than 50 employees. DOC advised us that it obtains a self-certification of the employee count from each company, and that through its working knowledge of the companies, knows that each company employs fewer than 50 employees.
 - DOC did not adequately verify the ownership interest of investors receiving tax credits. A tax credit not exceeding \$500,000 may be issued to an investor in a certified company if the investment does not result in the investor owning more than a 25 percent equity interest in the company. DOC did not obtain and verify complete ownership information to ensure compliance with this requirement.
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Conditional Loans & Loan Guarantees - Finding 3

Conditional Loans

- DOC lacked sufficient procedures to verify employment reports received from loan recipients to support the forgiveness of loans. Generally, loan recipients must hire and maintain a minimum number of qualified employees at certain wage, hour, and benefit levels to warrant loan forgiveness. During fiscal years 2015 through 2018, DOC forgave 20 loans (\$8.3 million) under one financing program tested.
 - Employment data obtained by DOC from the State's Department of Labor for verification purposes did not provide the specificity needed to confirm employment reports received.
 - Verifications performed by DOC's Office of Internal Audits were limited. Payroll data were verified for only 4 of the 20 forgiven loans, and 2 of the verifications did not include all years of the loan as would be necessary to verify eligibility for forgiveness of the entire loan.
 - DOC advised that it also relies on loan recipients to submit accurate employment reports under penalty of perjury.
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Conditional Loans & Loan Guarantees - Finding 3 (cont.)

Loan Guarantees

- DOC paid certain lender claims on guaranteed loans without receiving and reviewing adequate supporting documentation. During fiscal years 2015 through 2018, DOC paid \$1.6 million for guarantees associated with 4 loans under one financing program. Upon default of a guaranteed loan, lenders must first exhaust recovery efforts with the borrower, including liquidating collateral, before turning to DOC for any guaranteed portion of the loan.
 - A review of claims paid totaling \$1.3 million for 3 loans disclosed that interest claimed by the applicable lenders was not properly calculated in all 3 instances, resulting in DOC overpayments.
 - For one claim of \$632,000, DOC did not obtain adequate independent documentation supporting the lender's assertion that there was no equity available for recovery in two collateralized properties.
 - Similarly, DOC did not obtain documentation, as required in the guarantee agreement, supporting one lender's claim of \$89,000 in costs incurred when liquidating collateral.



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Maryland E-Innovation Initiative Fund - Finding 4

This program provides matching funds (\$16.8 million between July 2015 and December 2017) to support research endowments at Maryland non-profit institutions of higher education, and can be used, for example, to fund new research positions and equipment.

- DOC did not have established procedures to
 - verify that recipients of State funds from this program secured and deposited qualified donations to serve as matching funds as required, and
 - require recipients to submit documentation supporting the appropriate use of State funds provided.
 - A review of 10 awards to 5 recipients disclosed that DOC did not verify that the recipients of 6 awards totaling \$6.3 million had obtained qualified donations as required. Although not requested by DOC, recipients of the other 4 awards provided such documentation.
 - As for documentation that State funds were used properly, DOC believes that annual reports accounting for these funds and signed self-certifications received from recipients are sufficient. Since these recipient reports are not independently prepared, OLA believes that documentation, such as invoices and cancelled checks, should also be obtained and examined.
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Maryland State Arts Council Grants - Finding 5

- DOC had not established effective procedures and controls over the award and disbursement of Grants for Organizations funds provided to eligible organizations and units of government to support arts programming open to the public.
 - According to DOC records, 285 grants were awarded in fiscal year 2017 with disbursements totaling \$13.8 million.
 - DOC grant guidelines specify both allowable and non-qualified expenses under the grants.
 - Grantees are required to provide certain matching funds.
 - Our test of 10 grants totaling \$7.5 million disclosed that DOC did not obtain documentation from any of the grantees, such a bank statements and invoices, to ensure that State fund were properly matched and used in accordance with program guidelines.
 - DOC did not reconcile grant disbursements according to its records with the State's records. During fiscal year 2017, OLA noted a difference of \$700,000 between the two sets of records.
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Small, Minority, and Women-Owned Businesses Account (SMWOBA) - Finding 6

Under the SMWOBA Program, DOC has agreements with eight fund managers to provide investment capital and loans to small, minority, and women-owned businesses throughout Maryland. The Fund manager agreements provide descriptions of the services and responsibilities, including making and servicing loans or investing in targeted businesses (based on DOC established goals), and submitting certain reports and audited financial statements to DOC. During our audit period, \$25.7 million was disbursed to fund managers for this purpose.

Finding 6

DOC did not have a process to ensure that fund manager agreements included critical details relating to loan underwriting processes, such as procedures for determining borrower eligibility, minimum borrower requirements, and collateral requirements.

- Our review of 4 fund manager agreements disclosed that 3 lacked details of the underwriting process. These fund managers settled 37 loans totaling \$5.3 million in fiscal year 2017. The fourth agreement included adequate underwriting details.
- A lack of appropriate underwriting standards and practices can expose the SMWOB Program to greater risk of loss.



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Small, Minority, and Women-Owned Businesses Account (SMWOBA) - Findings 7 and 8 (cont.)

Finding 7

DOC did not establish an effective process to verify the propriety and accuracy of compensation that fund managers periodically withdrew from their accounts of funds made available to them by DOC.

- DOC did not obtain supporting documentation of fund manager compensation, and our tests disclosed certain discrepancies between actual and reported compensation.
- Fund manager compensation includes a percentage of grant awards made; loan origination and transaction fees paid by borrowers; and any interest, capital gains, and dividend earnings from investments.
- Manager compensation totaled \$2.6 million since Program inception through fiscal year 2017.

Finding 8

DOC did not verify data reported by fund managers relating to their efforts to meet certain annual program lending goals established by DOC, including, for example, making loans to at least one veteran-owned business, two women-owned businesses, and two businesses in rural targeted areas. Our review of fiscal years 2016 and 2017 loan activity for three fund managers disclosed that none had met all of the stated goals.



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Purchases and Disbursements (Finding 9)

- DOC had not established effective controls over certain purchases and disbursements, as well as user access to the State's automated financial system.
 - Adequate online approval requirements for disbursements had not been established in two departments as the same employee was able to initiate, approve, and transmit a voucher for payment.
 - Four employees in one department had the ability to initiate and approve purchase orders as high as \$25,000 without independent review and approval. Purchase orders totaling \$6.6 million were processed during our audit period without independent approval.
 - DOC lacked effective controls to ensure that employees had appropriate access capabilities in the State's financial system. All access was monitored by a single employee who was not necessarily in position to know if access granted to a particular employee was necessary.



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Conclusions

- DOC should establish adequate procedures and processes for verifying compliance with critical requirements, established in law, in regulation, and/or by written agreement, for participation in its financing programs and incentives. Critical requirements to be independently verified include requirements for creating and maintaining a specified number of jobs, providing for matching funds, using State funds for acceptable purposes, and verifying lender claims for payment.
 - With respect to its Small, Minority, and Women-Owned Businesses, DOC should establish an effective process for ensuring
 - fund manager agreements include details regarding all critical loan processing procedures,
 - fund manager compensation was proper, and
 - data reported by fund managers regarding efforts to meet program goals were accurate.
 - DOC should establish effective controls over its purchasing and disbursement transactions and the assignment of system access capabilities for disbursements processed through the State's automated accounting system.
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