



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

**Department of Business and
Economic Development
(renamed the Department of
Commerce)**

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Presentation to the Joint Audit Committee

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Audit Overview

- DBED's (recently renamed the Department of Commerce) 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.
 - DBED uses various financing programs and incentives, such as loans, grants, tax credits, and other financial investments to accomplish its purpose. During FY 2014, DBED's operating expenditures totaled \$140.8 million, including \$43 million for grants and \$59.9 million for loans and other investments.
 - Report includes 11 findings; 1 was repeated from the preceding audit report (current Finding 6).
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Key Audit Issues

- DBED did not ensure that comprehensive procedures had been developed and adopted to govern the Premium Tax Credit auction established under the Invest Maryland Program.
 - The methodology used by DBED's Maryland Venture Fund Authority to select venture firms to invest in qualified Maryland companies, as well as the determination of how much capital to provide each firm, was not adequately documented.
 - DBED lacked adequate processes to ensure that requirements had been met before forgiving certain conditional loans and grants, and granting certain tax credits.
 - DBED had not properly established and maintained certain records pertaining to its financing programs.
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Premium Tax Credit Auction

Effective oversight of the Premium Tax Credit auction was not established, since DBED did not ensure comprehensive written procedures were developed and adopted to govern the auction process (**Finding 1**). The auction raised \$84 million in capital by the sale of \$100 million in premium tax credits to 11 insurance companies.

- DBED had little specific knowledge of how critical auction functions, such as the evaluations of participant applications and bids, were conducted by the auction vendor.
- DBED lacked documentation as to why the bidding methodology used for the auction was preferable to another available option.
- DBED accepted applications to participate in the auction after the deadline established in the law, and premium tax certificates issued to winning bidders included incorrect identifying information.



Premium Tax Credit Auction (continued)

DBED did not adequately document the selection process and allocation of capital raised to venture firms, and the monitoring efforts over the firms' investment activity were not sufficient (**Finding 2**). Of the \$84 million capital raised by the auction, \$56 million was designated for investment by venture firms in Maryland innovative technology companies.

- DBED could not adequately document how it selected 7 firms from the 37 deemed eligible to receive funds and how it allocated capital to these firms, which ranged from \$3 million to \$12 million.
 - DBED lacked procedures for ensuring that required quarterly investment reports were received from venture firms for its review. We found that 18 of 24 reports required from 5 firms in CYs 2013 and 2014 were not submitted or were incomplete.
 - DBED did not monitor management fees charged by the firms. For CY 2013, DBED had not questioned or investigated \$309,000 in fees that appeared to exceed the amounts allowed by law.
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Financing Programs

Maryland Economic Development Assistance Authority and Fund (MEDAAF)

DBED's process for verifying employment data submitted by recipients of conditional loans and grants provided by MEDAAF was not effective. DBED forgave loans and grant repayments based on recipient reported information, including the creation of a specified number of jobs, without adequately verifying its accuracy. Between December 2010 and January 2015, DBED forgave 22 loans and grants totaling \$6.8 million (**Finding 4**).

- OLA tests of 5 forgiven loans and grants disclosed that required recipient employment reports were incomplete for 2, totaling \$1.5 million. Missing data included wage and salary information.
 - DBED staff performed employment data verifications for only 2 of the 22 loans and grants, totaling \$700,000, including none after February 2012. DBED also received certain independent data compiled by a State university from State sources to aid in the verification process, but it often did not reconcile to recipient submitted employment data.
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Financing Programs (continued)

Maryland Small Business Development Financing Authority (MSBDFA)

DBED had not developed formal written procedures and criteria for the use of forbearance agreements when MSBDFA loan recipients defaulted on those obligations and did not have a mechanism to track and monitor the use of these agreements **(Finding 5)**.

- In a forbearance agreement, DBED agrees to not pursue legal remedies, such as liquidation of collateral, if a delinquent borrower agrees to a modified payment plan.
 - Forbearance agreements could be modified multiple times due to the borrower's inability to meet the modified payment plan. A review of 4 loans totaling \$434,000 found multiple modifications; 1 loan was modified 6 times over a 6 year period.
 - DBED's automated system did not adequately track the use of forbearance agreements or the history of this loan activity.
 - MSBDFA executed and disbursed loans totaling \$4.2 million in FY 2014.
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Financing Programs (continued)

Automated Records

- Employee capabilities to record critical transactions on DBED's financing programs monitoring system were not sufficiently restricted (**Finding 6 - repeat**). Eleven of 47 system users could process critical transactions without supervisory review and approval; and 7 users had such access, but did not need it for their job duties.
 - Certain cash balances per the system were not adequately reconciled to the State's records (**Finding 7**). As of January 2015, the most recent cash balance reconciliation performed for 2 financing programs was for September 2014, and both had unresolved differences. For one program the unreconciled difference was \$1.6 million.
 - The monitoring system tracks critical financial transactions, including approvals and payments of more than 500 active financial instruments (such as loans and grants) totaling \$592.5 million as of June 30, 2014.
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Tax Credit Programs

One Maryland Tax Credit Program

DBED did not sufficiently verify applicant compliance with job creation and cost requirements (**Finding 8**). Businesses investing in a qualified development project creating at least 25 new jobs in 24 months may be eligible for up to \$5.5 million in income tax credits based on project's costs. Credits totaling \$54.7 million were issued to 15 program applicants during our audit period.

- Job creation requirements were not adequately verified as DBED did not routinely receive detailed payroll reports and DBED staff only reviewed 2 of 15 applicants issued credits during our audit period.
- DBED did not obtain adequate supporting documentation from applicants of claimed costs, such as invoices, to confirm their eligibility for the tax credit.



Tax Credit Programs (continued)

Film Production Activity Tax Credit Program

Program regulations were not established as required, and DBED lacked documentation of supervisory reviews of credits issued (**Finding 9**). State law provides that an entity may be entitled to an income tax credit for certain costs incurred to carry out film production activity in Maryland. During FYs 2012 through 2014, 9 tax credits totaling \$36.4 million were issued to 5 entities.

- DBED did not jointly adopt regulations with the Comptroller of Maryland, as required by law, to carry out the provisions of the Program, including the criteria and procedures for application, approval, and continued monitoring of eligibility.
- DBED lacked documentation that supervisory personnel had reviewed the tax credit certificates prior to their issuance to film production entities.



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Other Issues

- DBED did not obtain the required approval from the State Treasurer in advance of opening 4 investment bank accounts. DBED deposited approximately \$34.5 million and disbursed \$18.1 million prior to obtaining the Office's approval (**Finding 3**).
 - DBED had not established adequate procedures and controls over Maryland State Arts Council grant awards. For example, one employee had virtually complete control over the grant record keeping and payment processes. Approximately 250 grants were awarded during FY 2014 with related disbursements totaling approximately \$10.3 million (**Finding 10**).
 - DBED had not established proper controls over its purchasing transactions and the assignment of user access capabilities on the State's Financial Management Information System (FMIS). For example, several employees could process purchases without independent approval. Disbursements processed through FMIS totaled \$118.1 million during FY 2014 (**Finding 11**).
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Conclusions

DBED needs to

- ensure that formal procedures are prepared for significant programs and related processes, such as the Premium Tax Credit auction;
 - adequately document the selection and allocation of funds to venture firms, obtain and review complete activity reports from these firms, and monitor management fees charged;
 - establish an effective process to verify employment data for loans and grants to be forgiven, and establish procedures and appropriate records for forbearance agreements;
 - ensure that access to the financing programs monitoring system is adequately restricted and that cash balances are reconciled with State records;
 - ensure the propriety of certain tax credits issued;
 - improve controls over certain grants; and
 - implement appropriate FMIS controls.
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