Audit Report

Department of Business and Economic Development

October 2015

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

Warren G. Deschenaux
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Legislative Auditor

October 9, 2015

Senator Guy J. Guzzone, Co-Chair, Joint Audit Committee
Delegate Craig J. Zucker, Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have conducted a fiscal compliance audit of the Department of Business and Economic Development (DBED) for the period beginning November 3, 2010 and ending June 30, 2014. 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. DBED uses various financing programs and incentives, such as loans, grants, tax credits, and other financial investments to accomplish its purpose.

Our audit disclosed that comprehensive procedures had not been developed for administering the March 2012 Premium Tax Credit auction, which was an initiative to infuse funds received from the auction into qualified start-up and early-stage Maryland companies. Proceeds from the auction totaled $84 million in exchange for $100 million in insurance premium tax credits to the winning bidders (insurance companies). There was minimal documented guidance regarding the auction process, including the bidding methodology. The bidding methodology used by DBED, which was one of two pricing options according to the auction vendor used by DBED, resulted in all of the companies that submitted the 15 winning bids paying the same bid amount even though the final bids from most of these bidders were higher. DBED lacked documentation as to why this methodology was determined to be the most advantageous to the State. For comparison purposes, assuming that the same bids would have been received under both methods, we calculated that the cumulative value of bids received under a "multi-price award" method was greater than the cumulative value of bid amounts accepted under the "single price award" method by approximately $1.1 million.

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In addition, there was a lack of documentation regarding the methodology used by DBED's Maryland Venture Fund Authority to select the seven independent venture firms used to invest auction proceeds of $56 million into Maryland companies. We noted that some lower ranked firms among the 37 venture firms eligible to participate were selected over higher ranked firms.

DBED lacked adequate processes to ensure that requirements had been met before forgiving certain conditional loans and grants, and granting certain tax credits. Prior to forgiving conditional loans and grants issued by the Maryland Economic Development Assistance Authority and Fund, DBED did not ensure all documentation was submitted by recipients nor did it verify that certain performance requirements, such as achieving stipulated employment levels, were met. Similarly, DBED did not sufficiently verify that the 15 businesses awarded tax credits under the One Maryland Tax Credit Program totaling $54.7 million had met job creation requirements and provided accurate project costs data upon which the credits were based. We noted that many positions created by nine of these businesses, for which the credits were awarded, were not created within the time parameters established in State regulations. DBED believes the applicable regulations are poorly written and do not provide the flexibility intended by State law.

Our audit also disclosed that DBED had not properly established and maintained certain records pertaining to its financing programs. For example, records for the Maryland Small Business Development Financing Authority did not separately track the use of forbearance agreements for recipients who defaulted on loan obligations. Finally, DBED had not established proper controls to ensure the propriety of Maryland State Arts Council grant awards and disbursements as well as user access to certain computer systems.

An executive summary of our findings can be found on page 5 of this report. DBED's response to this audit is included as an appendix to this report. We wish to acknowledge the cooperation extended to us during the course of this audit by DBED.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Legislative Auditor

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

Executive Summary

Legislative Audit Report on the
Department of Business and Economic Development (DBED)
October 2015

- **DBED did not establish effective oversight over the Premium Tax Credit auction, established under the Invest Maryland Program, since it did not ensure that comprehensive procedures had been developed and adopted to govern the auction process. Proceeds from the auction totaled $84 million in exchange for $100 million in tax credits to be provided to winning bidders (insurance companies). For example, procedures did not adequately explain how the final bid rate to be paid by the winning bidders was to be determined. In addition, the bidding methodology used by DBED resulted in all of the winning bidders paying the same lowest accepted bid rate even though most winning bids exceeded that rate. DBED lacked documentation as to why this methodology was determined to be the most advantageous to the State. For comparison purposes, assuming that the same bids would have been received under both methods, we calculated that the cumulative value of bids received under a "multi-price award" method was greater than the cumulative value of bid amounts accepted under the "single price award" method by approximately $1.1 million (Finding 1).**

  DBED should ensure that formal procedures are prepared for significant programs and related processes, such as the Premium Tax Credit auction.

- **The methodology used by the 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 to each firm, was not adequately documented. In addition, periodic investment reports meant to help monitor these firms were often not received or were incomplete. Finally, management fees paid to the firms, which totaled $1.2 million during calendar year 2013, were not monitored for propriety (Finding 2).**

  DBED should adequately document the selection of venture firms and the determination of capital commitments. In addition, complete activity reports relating to the firms should be received and reviewed, and management fees should be monitored for propriety.

- **Procedures used by DBED to verify employment data provided by recipients of financing from the Maryland Economic Development Assistance Authority and Fund (MEDAAF) were not effective. These data are often used in determining whether conditional loans and grants will be forgiven. Between December 2010 and January 2015, DBED forgave 22 loans and grants totaling $6.8 million (Finding 4). DBED lacked formal procedures for its use of forbearance**

agreements for loans issued by its Maryland Small Business Development Financing Authority (MSBDFA) which become delinquent. Such loans were often modified multiple times and its loan records did not preserve the historical record of this activity (Finding 5).

DBED should establish an effective process to verify employment data for MEDAAF loans and grants to be forgiven. DBED should also establish procedures for the use of forbearance agreements issued by MSBDFA and maintain appropriate records.

- **Employee capabilities to record critical transactions on DBED's financing programs monitoring system were not adequately restricted, and cash balances recorded on the system were not adequately reconciled with the State's records (Findings 6 and 7).**

  DBED should ensure that critical system access is adequately restricted and that cash balances are reconciled with the State's records.

- **Procedures used to ensure the propriety of tax credits provided through the One Maryland and Film Production Activity Tax Credit Programs need to be improved. For example, DBED did not sufficiently verify applicants' compliance with job creation requirements of the One Maryland Tax Credit program, for which credits totaling $54.7 million were issued during our audit period (Finding 8). In addition, DBED had not established program regulations governing the Film Production Activity Tax Credit program as required (Finding 9).**

  DBED should take the recommended steps to ensure the propriety of One Maryland and Film Production Activity tax credits issued.

- **Controls over DBED's Maryland State Arts Council Grants were not sufficient since adequate documentation of grant award decisions was not maintained, one employee had complete control over the grant record keeping and payment processes, and grant payments were not adequately reconciled to the State's accounting system (Finding 10).**

  DBED should take the recommended steps to improve controls over the Maryland State Arts Council Grants.

- **Controls over certain purchasing transactions and monitoring of user access to the State's Financial Management Information System (FMIS) were not sufficient (Finding 11).**

  Appropriate online approval requirements should be established in all departments, purchasing transactions should be verified to supporting documentation, and appropriate supervisory personnel should monitor security profiles in FMIS.

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, facilitating the expansion and retention of existing companies, and promoting Maryland's strategic assets. According to the State's records, during fiscal year 2014, DBED's operating expenditures totaled approximately $140.8 million, which included $43 million for grants and $59.9 million for loans and other investments.

DBED uses various financing programs and incentives, such as loans, grants, tax credits, and other financial investments to accomplish its purpose. The following table reflects the fiscal year 2014 activity of loans, grants, and loan guarantees for which DBED's financing programs were responsible.

DBED Financing Programs and Related Activity – Fiscal Year 2014

Financing Programs	Loans and Grants	Loan Guarantees
Maryland Venture Fund	$32,049,997	Not Applicable
Maryland Industrial Development Financing Authority	$30,293,500*	$6,336,238
Maryland Economic Development Assistance Authority and Fund	$16,864,861	Not Applicable
Maryland Small Business Development Financing Authority	$6,335,000*	$1,059,500
Various Other Programs	$1,765,000	Not Applicable

*Includes bond issuances and private sector loans.

Source: DBED Fiscal Year 2014 Annual Report

According to DBED's records, as of June 30, 2014, its portfolio consists of financial instruments totaling approximately $592.5 million that were being tracked on DBED's automated financing programs monitoring system.

In addition to these financing programs, DBED's Maryland State Arts Council issued grants to arts organizations during fiscal year 2014 totaling $10.3 million. DBED also issued certain tax credits to accomplish its purpose of attracting and expanding business in Maryland. For example, during fiscal years 2012 through 2014, DBED issued tax credits to film production companies totaling $36.4 million for costs incurred in Maryland for film production activities.

Organizational Change

Effective October 1, 2015, in accordance with Chapter 141, Laws of Maryland 2015, the principal economic development entities in the State will be restructured. The law renames DBED as the Department of Economic Competitiveness and Commerce (DECC) and creates a Secretary of Commerce within the Governor's Office to be the head of economic development policy and implementation efforts in the State, and to be responsible for the operations of DECC. The Governor's Executive Order, effective October 1, 2015, provides that DECC will be known as the Department of Commerce. The Secretary of Commerce will also be responsible for monitoring the operations of the Maryland Economic Development Corporation, the Maryland Technology Development Corporation (TEDCO), and the newly created Maryland Public-Private Partnership Marketing Corporation (MPPPMC). MPPPMC was created under the law, in part, to foster public-private partnerships that encourage location and development of new businesses in the State. The law also moves the BioMaryland Center, the Maryland Venture Fund, and the Maryland Venture Fund Authority from DBED to TEDCO.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the four findings contained in our preceding audit report on DBED dated February 7, 2012. We determined that DBED satisfactorily addressed three of the findings. The remaining finding is repeated in this report.

Findings and Recommendations

Premium Tax Credit Auction

Background
The Department of Business and Economic Development's (DBED) Invest Maryland Program was established in Maryland law in 2011 as an initiative to infuse funds into qualified start-up and early-stage Maryland companies by selling $100 million in Premium Tax Credits to insurance companies through a competitive online auction. The credits are used by the insurance companies to offset the annual tax imposed on them by the State's Maryland Insurance Administration (MIA) for premiums derived from insurance business transacted in the State. The Premium Tax Credit auction was the vehicle through which qualified insurance companies bid on these tax credits. The individual bids were required by law to meet the thresholds of at least $1 million and not less than 70 cents for every one dollar in tax credits requested. Purchasers may claim the premium tax credit beginning in 2015 (for their 2014 tax year).

DBED's Maryland Venture Fund Authority (MVFA), which was established under the Invest Maryland Program, was required by law to obtain the services of an independent third party to establish procedures to administer the auction and to conduct the bidding process. The auction vendor was paid approximately $270,000 for administering the auction, which took place on March 15, 2012. Through the auction, DBED raised $84 million in designated capital and solicited 189 bids from 24 companies, 11 of which submitted 15 winning bids and were awarded $100 million in tax credits.[1]

Designated capital raised through the auction was to be paid by winning bidders in three equal annual installments beginning June 2012, and was deposited in DBED's Maryland Venture Fund (MVF). The MVF is a State-supported fund that invests in qualified Maryland companies either directly or indirectly through limited partnerships (venture firms). The MVF invests in innovative technology companies across a full range of industry sectors including software, communications, cyber security, and life sciences. By law, 67 percent of the proceeds from the auction (approximately $56 million) was allocated to one or more venture firms selected by the MVFA for the purpose of making qualified investments in accordance with criteria established in the law. The remaining 33 percent (approximately $28 million) was allocated primarily to other DBED initiatives designated in the law. According to DBED's records, approximately

[1]Three insurance companies had more than one winning bid. These bids were submitted separately for separate portions of the $100 million credit amount available.

$18.4 million in auction proceeds was disbursed from the MVF during fiscal year 2014, including investments with venture firms totaling approximately $9.6 million.

As mentioned under the Background Section of this report, effective October 1, 2015 the principal economic development entities in the State will be restructured. As part of that restructuring, the MVF and the MVFA will move from DBED to the Maryland Technology Development Corporation.

Finding 1
Comprehensive written procedures were not prepared to ensure consistency and compliance with the law in administering the auction, and tax credit certificates issued to winning bidders included incorrect identifying information.

Analysis
DBED did not establish effective oversight of the Premium Tax Credit auction established under the Invest Maryland Program. DBED did not ensure that the auction vendor and the MVFA developed and adopted comprehensive written procedures to govern the auction process, including the acceptance and evaluation of participant applications, compliance with criteria established in the law for participating in the auction, and the evaluation of bids. In this regard, DBED had little specific knowledge regarding how the vendor conducted critical functions of the auction. Consequently, DBED had to forward our questions about certain aspects of the auction to the vendor. In addition, we noted errors in identifying information included on tax credit certificates issued to insurance companies for winning bids. Comprehensive written procedures would have helped to clarify and promote consistency, accuracy, and transparency in the application of the auction process and to ensure compliance with all provisions of the law.

- The *Maryland Premium Tax Credits – General Auction Rules* and auction demos, both of which were developed by the auction vendor and the MVFA, provided only minimal guidance to govern the Premium Tax Credit auction process and did not address bidding parameters and methodologies. For example, these *Rules* did not adequately explain how the final bid rate to be paid by the winning bidders was to be determined and, therefore, as directed by DBED, we obtained such information regarding the bidding process from the vendor. According to the auction vendor, a “single price award” method was used in which a “single clearing” price was used for all winning bids.

  DBED could not provide documentation as to why the “single price award” method was selected as the most advantageous to the State as compared to the "multi-price award" method, which was the other pricing option available to DBED. The "multi-price award" method allowed for awards to be made at the actual rate bid. According to data received from the vendor, the companies that submitted the 15 winning bids paid the same accepted bid rate of 84 cents per credit dollar even though 13 of the winning bids were at higher rates. For example, one insurance company submitted a bid of 87.2 cents, but paid 84 cents per dollar, a difference which would have increased the company's payment for the $10 million in credits awarded by $320,000. For comparison purposes, assuming that the same bids would have been received under both methods, we calculated that the cumulative value of bids received under a "multi-price award" method was greater than the cumulative value of bid amounts accepted under the "single price award" method by approximately $1.1 million. According to DBED's records, of the 189 bids received, 32 were rejected and 142 were outbid, leaving the 15 winning bids.

- DBED accepted applications to participate in the auction after the February 1, 2012 deadline established in the law. The application was to be used to help determine if the entity was authorized to conduct business in the State and if it had insurance premium taxes due as of October 1, 2011, which were two requirements for participating in the auction. Our review of applications submitted by the winning bidders disclosed that DBED accepted eight applications 21 to 34 days after the aforementioned deadline. DBED advised us that these entities, which were eventually awarded tax credits totaling $52.5 million, had submitted letters of intent to participate in the auction prior to the deadline and this was deemed sufficient by DBED. However, there was no documentation explaining why or when such letters would be considered sufficient in meeting the application deadline established in the law. We also noted that DBED did not verify that entities approved to participate in the auction had a premium tax liability as of October 1, 2011 as required, but instead, verified each company's liability during fiscal year 2010 when the auction was being marketed. Our review disclosed that these entities did qualify to participate in the auction.

- Premium Tax Credit certificates issued by DBED to winning companies included incorrect identifying information. Each winning bidder received a tax credit certificate after paying each annual installment over a three-year period. The certificates, which are to be submitted by insurance companies when filing their premium tax returns with MIA, did not include the correct unique identifying number which is assigned by the National Association of Insurance Commissioners to each licensed and affiliated insurance company in the United States. Instead, another numbering system was used which did not uniquely identify the company receiving the certificate. MIA advised us that this discrepancy could potentially cause a problem for MIA when applying and recording the tax credits in its records because the tax credits could be applied to the wrong insurance company.

We recognize that the Premium Tax Credit auction was a unique event which the State may or may not use in the future. However, it is incumbent upon DBED to ensure that comprehensive written procedures are developed and implemented in such circumstances to help ensure consistency, accuracy, transparency, and compliance with all provisions of the law.

Recommendation 1
We recommend that DBED

a. ensure that comprehensive written procedures are developed and followed for significant programs and related processes, such as the aforementioned Premium Tax Credit auction;
b. comply with all provisions of State law when implementing such programs and processes; and
c. correct and reissue the aforementioned Premium Tax Credit certificates.

Finding 2
DBED did not adequately document the selection process and allocation of capital to venture firms, and monitoring efforts over the firms' investment activity were not sufficient.

Analysis
The methodology used by MVFA to select venture firms and to allocate capital to those firms was not adequately documented, and certain investment monitoring efforts were not sufficient. As previously mentioned, through the Premium Tax Credit auction, DBED raised $84 million in capital, of which $56 million was designated for the MVF.

- DBED did not adequately document the methodology used to select 7 of the 37 venture firms deemed eligible to receive funds and how it allocated capital to those firms; capital allocated to these 7 firms ranged from $3 million to $12 million. In accordance with State law, 37 firms were initially certified as eligible for investment after an evaluation of specified attributes, including management experience, investment strategy, and the firm's commitment to the State. A third-party vendor, which assisted MVFA with the eligibility, evaluation, and selection process, ranked the eligible firms into four tiers and MVFA made its selections from those rankings.

Although MVFA selected the 7 firms from the top two tiers, there was no documentation explaining why some lower ranked firms were selected over higher ranked firms. We were advised by the third-party vendor that generally not all of the highest ranking firms were available for investment because the venture firms had closed to new investors during the consideration period or were no longer interested in receiving the investment; however, there was no documentation at DBED to support the vendor's representations.

While we were advised that MVFA made its determinations during a meeting, meeting minutes or other documentation of the process did not indicate the factors considered when selecting the 7 firms and allocating the capital among them.

- DBED lacked procedures to ensure that required quarterly investment reports were received from venture firms for its review. Our test of compliance with reporting requirements disclosed that, for five of the seven venture firms, these reports were frequently not submitted or did not include all required information and data. The reports are meant to help DBED monitor the investment activity of the venture firms by disclosing, for example, the amount of funds available for investment, investments made during the period, and information specific to the businesses in which investments were made. DBED advised us that an employee had not been specifically assigned to ensure the receipt and review of these reports, but DBED believes that, even without such a review, it is fully aware of the investment activity of the venture firms through frequent contact with them.

  Of the 24 reports required to be submitted by the five venture firms during calendar years 2013 and 2014, we noted that 18 of the required reports either were not submitted or were not complete. Specifically, 9 reports had not been submitted and 9 were incomplete since they did not include certain required data relating to the qualified businesses in which investments had been made. For example, the location of the businesses, number of employees, and average annual employee compensation were not always included. DBED had committed capital totaling $26 million to these five venture firms, of which $7.7 million had been disbursed to the firms at the time of our review.

- DBED did not monitor management fees it was charged by the venture firms to ensure their accuracy and compliance with State law. Consequently, DBED had not identified apparent discrepancies in the fees charged. Our review of management fees paid by DBED to all seven venture firms, totaling approximately $1.2 million during calendar year 2013, disclosed that three firms charged 3.6 percent to 5.9 percent of allocated capital—a total of $309,000 above the 2.5 percent limit allowed by law. Because DBED did not routinely ensure the propriety of fees charged, it had not identified and investigated these differences. After our inquiries, DBED contacted one of the three firms and was advised that the additional fee represented a one-time charge required to put the total fee amount paid by DBED on an equivalent basis with amounts already paid by partners who had joined the partnership prior to DBED. However, DBED had not investigated the fee charged and its apparent inconsistency with the aforementioned law.

Recommendation 2
We recommend that, in the future, DBED

a. **adequately document the methodology used to select venture firms and allocate the designated capital;**
b. **implement a procedure to ensure that all required reports of investment activity are received and reviewed; and**
c. **monitor management fees charged to ensure that they are accurate and in compliance with the law, and recover any overcharges identified.**

Finding 3
DBED did not obtain required approval from the Office of the State Treasurer in advance of opening certain investment bank accounts.

Analysis
DBED did not obtain required approval from the Office of the State Treasurer (STO) in advance of opening certain investment bank accounts. During fiscal year 2014, DBED opened four bank accounts to facilitate the processing of equity investments made through the MVF. Our review disclosed that each of the accounts had been opened between 5 and 14 months prior to obtaining STO's approval. During this time, deposits into the accounts totaled approximately $34.5 million and disbursements from the accounts totaled $18.1 million. The Comptroller of Maryland's *Accounting Procedures Manual* requires that State agencies seek STO's approval for special bank accounts in advance of opening the accounts.

Recommendation 3
We recommend that DBED obtain required STO approval prior to establishing special bank accounts.

Maryland Economic Development Assistance Authority and Fund

Finding 4
DBED's process for verifying that recipients met requirements for forgiveness of conditional loans and grant repayments was not effective.

Analysis
DBED's process for verifying employment data submitted by recipients of conditional loans and grants provided by the Maryland Economic Development Assistance Authority and Fund (MEDAAF) was not effective. Specifically, DBED forgave loans and grant repayments based upon information reported by recipients without ensuring that all required documentation was submitted and without verifying the accuracy of the information, including employment data.

The accuracy and completeness of requested information, including employment data reported by these loan and grant recipients, are critical. The related agreements frequently provide for the forgiveness of all or a portion of the loan or of grant repayment requirements if certain performance requirements are met, including the creation and retention of a specific number of jobs, generally at a specific location. Inaccurate or incomplete data could result in recipients inappropriately receiving loan and grant forgiveness.

Our testing disclosed that employment reports required by DBED as part of the process of forgiving a loan or grant repayments did not always include all required data. For two of the five loans and grants judgmentally selected for testing, DBED had forgiven the loan (loan balance of $500,000) and grant repayment requirements (grant totaling $1,000,000) even though the employment reports did not include required data relating to wage and salary information and a description of benefits available to full-time employees. Between December 2010 and January 2015, 22 conditional loan and grant amounts totaling approximately $6.8 million were forgiven.

Furthermore, DBED did not have an effective process for verifying employment data submitted by recipients seeking loan and grant repayment forgiveness. To help verify employment data reported, DBED contracted with a State university to provide independent statistical reports of employment information relating to conditional loan and grant recipients. To accomplish this task, the university used employment data provided by the State's Department of Labor, Licensing and Regulation (DLLR). However, DBED has acknowledged, and our testing confirmed, that data included in reports provided by the university usually did not reconcile to employment data provided to DBED by loan and grant recipients, and was often significantly different. According to DBED, these differences were often caused by the fact that the specific employment data needs of DBED were generally for a specific business location, whereas the data reported by DLLR could include employment information for multiple locations of a particular business.

In addition, DBED's Office of Internal Audits (OIA) was directed to verify selected employment data to ensure that there was adequate oversight for the process of forgiving loans or grant repayment requirements. However, our review disclosed that as of July 2014 OIA had performed verification reviews for only 2 of the aforementioned 22 loans and grants totaling $700,000, and had not reviewed any loans or grants forgiven after February 2, 2012. In addition, OIA had not finalized formal written procedures for conducting these reviews.

MEDAAF provides grants, loans, and investments to support economic development initiatives, including business attraction and retention, infrastructure support, and local strategic planning. According to DBED's records, during fiscal year 2014, MEDAAF disbursed conditional loans totaling approximately $10.7 million and conditional grants totaling approximately $604,000.

Recommendation 4
We recommend that DBED establish effective procedures for verifying employment data reported by conditional loan and grant recipients as part of the loan and grant forgiveness process. Specifically, we recommend that DBED

a. **ensure that complete employment reports are submitted by loan and grant recipients and are reviewed prior to initiating action on conditional loans and grants;**
b. **increase the number of employment data verifications conducted by the DBED's OIA, with consideration given to the value of the loans and grants; and**
c. **develop formal written procedures for conducting such reviews.**

Maryland Small Business Development Financing Authority

Finding 5
DBED had not established formal forbearance agreement procedures for its Maryland Small Business Development Financing Authority (MSBDFA) program, and did not have an effective mechanism to track and monitor forbearance agreement activity.

Analysis
DBED had not developed formal written procedures and criteria for the appropriate use of forbearance agreements when recipients of MSBDFA loans defaulted on those obligations. In a forbearance agreement, DBED agrees not to pursue its legal remedies, such as liquidation of collateral, if the delinquent borrower agrees to a modified payment plan based on its current capacity to repay over a defined period. Furthermore, DBED did not have an effective mechanism to track and monitor these agreements.

Our review disclosed that DBED had no formal procedures or guidelines for when the initial use and continued modification of forbearance agreements is appropriate. Forbearance agreements were often modified multiple times because the loan recipients could not meet each modified repayment agreement. DBED advised us that it incorporates judgment and discretion into its collection efforts, and that multiple agreement modifications may be integral to its collection strategy for a specific borrower. While we recognize that forbearance agreements are a tool in the collection process, formal guidance should be established for their initial and continued use and to stipulate the documentation necessary to support the decision to use a forbearance agreement rather than other collection methods, such as the liquidation of borrower collateral or forwarding delinquent accounts to the State's Central Collection Unit. Delaying the use of other collection methods may reduce the likelihood of collecting any amounts due.

In addition, the automated system DBED used to monitor loans and other financing program activity did not adequately track the use of forbearance agreements and did not preserve the historical record of this loan activity. Specifically, existing loan schedules were modified and delinquency designations for amounts due were removed with each new agreement. Also, the system did not track the number of times a forbearance agreement had been modified.

Because of inadequacies in the loan records, DBED was unable to readily determine the extent to which forbearance agreements were used; however, our limited review identified four loans totaling approximately $434,000 that had forbearance agreements that were modified multiple times. For example, one loan we examined, with a balance of approximately $19,000 as of June 30, 2014, had a forbearance agreement modified six times over a six-year period.

MSBDFA assists small businesses unable to obtain adequate business financing (such as loans, loan guarantees, and equity investments) on reasonable terms through normal financing channels. According to DBED's records, during fiscal year 2014, MSBDFA executed and disbursed loans totaling approximately $4.2 million and one equity investment totaling $81,000. Those records also indicate that as of October 31, 2014, MSBDFA had 14 outstanding loans totaling approximately $2.5 million for which an undeterminable portion was delinquent.

Recommendation 5
We recommend that DBED

a. **establish formal procedures and criteria for the appropriate use of forbearance agreements and subsequent modifications, and**
b. **maintain adequate loan records that track and monitor forbearance agreement activity.**

Financing Programs Monitoring System

Finding 6
The capabilities of system users on DBED's automated financing programs monitoring system were not adequately restricted.

Background
The capabilities of system users on DBED's automated financing programs monitoring system were not adequately restricted. 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 DBED's records, as of June 30, 2014, more than 500 active financial instruments (such as, loans, grants, guarantees, investments) totaling approximately $592.5 million were being tracked.

Our review of all 47 active system users disclosed that 11 users were assigned the capability to perform critical financial activities, such as initiating bills, posting payments, and writing off amounts as uncollectable, without supervisory review and approval. Specifically, an online approval function was not available in DBED's monitoring system and DBED did not generate output reports to help verify the propriety of transactions processed. In addition, certain users did not require the system access that had been granted to them. For example, 7 users who could post critical transactions did not require that access to perform their normal job duties, and 2 of those individuals had unnecessary access to modify security settings (access) for all users. Unnecessary critical system access granted to certain employees was also commented upon in our preceding audit report. Furthermore, the employee responsible for periodically monitoring employee security settings was not independent since this employee was also capable of posting critical transactions to the system.

The Department of Information Technology's *Information Security Policy* states that agencies must ensure that the most restrictive access capabilities required for specified tasks are assigned.

Recommendation 6
We recommend that DBED

a. **ensure that critical transactions processed are subject to supervisory review and approval by, for example, using system output reports to verify the propriety of recorded transactions;**
b. **ensure that employees have only the system access necessary to perform their job duties (repeat); and**
c. **designate a supervisory employee, who is not capable of recording critical transactions, to periodically monitor employee access for propriety.**

Finding 7
Cash balances for financing programs were not adequately reconciled with the State's records.

Analysis
DBED did not adequately reconcile the cash balances for MVF and MSBDFA activity reflected in its financing programs monitoring system with the corresponding balances on the State's accounting records. In addition, there was a lack of separation of duties in that the employees responsible for performing the reconciliations could also record critical transactions in the system without independent supervisory review and approval.

Our review disclosed that the monthly MVF and MSBDFA program reconciliations were not performed in a timely manner and certain differences were not resolved. As of January 2015, the most recent reconciliations performed for both programs were for the month of September 2014. Furthermore, the September 2014 reconciliations contained unresolved differences for both programs. For example, the MSBDFA reconciliation performed for September 2014 disclosed that the cash balance on the monitoring system ($18.6 million) exceeded the cash balance on the State's records ($17 million) by approximately

$1.6 million and, at the time of our review in January 2015, there was no documentation that this difference had been investigated and resolved. Finally, the employees responsible for performing the reconciliations for these programs could also record critical transactions in the monitoring system, and the completed reconciliations were not reviewed and approved by supervisory personnel.

Recommendation 7
We recommend that DBED

a. **ensure that the monthly reconciliations are completed in a timely manner;**
b. **investigate and resolve differences identified as a result of the cash balance reconciliations; and**
c. **ensure that completed reconciliations are adequately reviewed and approved by independent supervisory personnel, and that the reviews are documented.**

One Maryland Tax Credit Program

Background

Qualified businesses that invest in economic development projects in qualified distressed counties and that create at least 25 new full-time jobs may be eligible for up to $5.5 million in State income tax credits. State law and regulations provide that a qualified business entity may receive the One Maryland Tax Credit after creating at least 25 new jobs within a specified period. The amount of the tax credit is based dollar-for-dollar on the project costs (up to $5 million) and start-up costs (up to $500,000) incurred by the business to expand or establish a new facility in the State. Project costs include the acquisition, construction, rehabilitation, and installation of a project, and start-up costs include the cost to furnish and equip a new location.

Finding 8
DBED did not sufficiently verify applicants' compliance with job creation and associated cost requirements and did not administer the program in accordance with State regulations.

Analysis

New employee positions claimed by applicants for the One Maryland Tax Credit Program were not adequately verified by DBED and credit was given to certain applicants for new positions established outside of the period required by State regulations. In addition, DBED's review of project and start-up costs reported by applicants was not sufficient since it did not require adequate supporting documentation from applicants. During our audit period, DBED certified 15 applicants for tax credits totaling approximately $54.7 million.

- DBED did not routinely obtain detailed payroll records to support new positions claimed by applicants for the credit but, instead, relied on its OIA to conduct reviews of applicant payroll data. However, the number of such reviews was very limited and the scope was not adequate since the reviews did not include an examination of payroll records for employees hired after the projects were placed in service. Our review disclosed that OIA performed reviews of only 2 of the aforementioned 15 successful applicants. Consequently, credits were issued based on applicant-supplied data and representations without a verification that these business entities had met the tax credit requirements regarding the number of positions created and, therefore, were eligible for the tax credits.

- Tax credits were issued to entities that did not meet the time requirements stipulated in State regulations for creating new positions. Those regulations require applicants to create and fill at least 25 qualified positions within 24 months after the date on which the new project was placed in service. In addition, the qualified positions have to be filled for 12 months before earning a tax credit. However, our review of the aforementioned 15 applicants disclosed 9 that were certified for tax credits totaling $30.6 million but did not meet those time requirements. The entities were given credit for creating 473 new positions, but 427 did not meet the time requirement. In most cases, the positions were added before the projects were placed in service. For example, one entity was given credit for 52 employees hired in 2012 even though the applicable project was placed in service in October 2013.

  DBED has advised us that the regulations are poorly written and that it intends to change them. Specifically, DBED does not believe the regulations provide the flexibility intended by the underlying State law as to when the new positions can be added. State law provides that, to be certified as a qualified business entity for a project tax credit or a start-up tax credit, an entity must notify DBED of its intent to seek certification before hiring any qualified employees to fill the qualified positions. DBED considered qualified positions as those created during any 24-month period beginning with the date of notification of an intent to seek the tax credit and ending 24 months after the date the facility is placed in service.

- DBED did not obtain and review adequate documentation of project and start-up costs claimed by applicants. Based on our review of the aforementioned 15 successful applicants, we noted that in 2 instances, at the time the credits were granted, the applicants had provided no documentation to support project and start-up costs of approximately $6 million. Certain documentation was obtained after the credits were granted. For 12 applicants, schedules or lists of costs being claimed were generally provided by the applicants; however, DBED did not request detailed documentation to support those costs, such as invoices paid by the applicants, to confirm their applicability to the expanded or new facility. DBED noted that the cost schedules provided were certified by the applicants' management. However, without requesting and reviewing supporting documentation there was a lack of assurance that costs being reported were accurate and valid.

Recommendation 8

We recommend that DBED

- **a. obtain documentation for and verify the number of new positions created and filled by each applicant by, for example, increasing the number of payroll reviews conducted by its OIA;**
- **b. ensure adherence to the time requirements established in State law and regulations for applicants to create and fill new positions; and**
- **c. obtain and review detailed documentation, such as paid invoices, at least on a test basis, to support project and start-up costs claimed by applicants.**

Film Production Activity Tax Credit Program

Background

State law provides that a film production entity may be entitled to a refundable tax credit against its State income tax liability for certain costs incurred that are necessary to carry out film production activity in the State. In order to qualify for the tax credit, the estimated total direct costs to be incurred in the State by a corresponding production activity must exceed $500,000. The tax credit issued to a qualified production entity is equal to 25 percent or 27 percent of the actual qualified direct costs incurred in the State based on the type of production activity. According to DBED's records, during fiscal years 2012 through 2014, DBED issued nine film production activity tax credits totaling approximately $36.4 million to five film production entities.

State law through fiscal year 2016 establishes the amount of tax credits that DBED may issue each year. Beginning in fiscal year 2017, with the establishment of the Maryland Film Production Activity Tax Credit Reserve Fund in accordance with Chapter 486, Laws of Maryland 2015, the amount of credits DBED may award is determined by the amount appropriated to the Fund by the

Governor. This law further provides that it is the intent of the Maryland General Assembly that the Governor appropriate to the Fund an amount equal to the amount that DBED reports as necessary to maintain the current level of film production activity in the State, as well as to attract new film production activity to the State.

Finding 9
Program regulations were not established as required, and DBED lacked documentation of supervisory reviews of credits issued.

Analysis
Regulations governing the Film Production Activity Tax Credit program were not adopted as required, and DBED lacked documentation that Film Production Activity Tax Credits issued were adequately reviewed.

- DBED had not adopted State regulations with the Comptroller of Maryland, as required, for the Film Production Activity Tax Credit program. According to State law, DBED and the Comptroller were to jointly adopt regulations to carry out the provisions of the program and to specify criteria and procedures for the application for, approval of, and monitoring of continuing eligibility for the tax credits. The establishment of regulations would help ensure that policies and practices used by DBED that are not specifically addressed by the enabling statute have been reviewed by the General Assembly.

- DBED lacked documentation that supervisory personnel had reviewed Film Production Activity Tax Credit certificates prior to being issued to film production entities. The tax credit determination was derived internally and the supervisory review should include an examination of critical documents, including the tax credit application and supporting expenditure reports, to ensure the certificate's accuracy and to verify that the applicant met all qualifications stipulated in the law. Although DBED advised that such reviews were conducted, there was a lack of documentation supporting this assertion.

Recommendation 9
We recommend that DBED
a. in conjunction with the Comptroller of Maryland, adopt regulations to carry out the provisions of the Film Production Activity Tax Credit program as required by State law; and
b. perform documented supervisory reviews of film production tax credit certificates and obtain supporting documentation prior to issuance.

Maryland State Arts Council Grants

Background

The Maryland State Arts Council (MSAC), a unit under DBED's Division of Tourism, Film, and the Arts, administers the Grants for Organizations program that provides annual unrestricted general operating funds to nonprofit and tax-exempt organizations and units of government that produce or present ongoing arts programming open to the public. MSAC accepts applications to the Grants for Organizations program annually and meets in June to review and select organizations for grant awards, which are forwarded to the Secretary of DBED for approval. Grant agreements are prepared and emailed after July to those that have been awarded. Seventy-five percent of the grant is disbursed to the grantee upon execution of the agreement, and the remaining grant funds are disbursed after the grantee has submitted a satisfactory interim report. According to DBED's records, approximately 250 grants were awarded during fiscal year 2014 with related disbursements totaling approximately $10.3 million.

Finding 10
Procedures and controls over the award and disbursement of program grants were not adequate.

Analysis

DBED had not established adequate procedures and controls over the award and disbursement of program grants.

- DBED did not adequately document the basis for its grant award decisions. While MSAC conducted annual meetings to select grant award recipients, the formal meeting minutes did not reflect the details of the grants awarded, including recipient names and award amounts. Rather, individual meeting participants maintained their own records of grants approved by MSAC which were then used to set up the grant records.

- One employee had complete control over the grant record keeping and payment processes. This employee was solely responsible for creating, tracking, and maintaining grant award documents and notifying grant recipients of their awards. The employee also recorded critical transactions, such as awards and payments, in the automated grants management system that were not subject to independent supervisory review and approval. Specifically, the system did not require on-line approval and was not capable of generating an output report of transactions posted for subsequent review. Furthermore, this employee created the grant disbursement invoices from the system to initiate grant payments and, although a supervisor approved the invoices, this was done without verification to independent supporting documentation.

- DBED did not adequately reconcile grant payments recorded in the grants management system with the State's accounting records. While an independent employee compared disbursements from the grants system to the State's records to ensure that individual payments were made and recorded, total grant disbursements from each system were not periodically compared and reconciled to help ensure that only valid transactions had been processed.

- Our test of 15 initial grant disbursements for fiscal year 2014 totaling $5 million disclosed that DBED disbursed grant funds totaling approximately $2.6 million to 5 recipients prior to the grant agreements being executed. In addition, 9 other disbursements totaling approximately $2.1 million were approved for payment before the related grant agreements were executed. For example, DBED executed two grant agreements 17 days after the related invoices, which totaled approximately $1.4 million, were paid. According to DBED's guidelines for the Grants for Organizations program, grant agreements must be executed before grant funds can be disbursed.

The lack of sufficient procedures and controls could result in improper awards and disbursements, which may not be readily detected.

Recommendation 10
We recommend that DBED establish adequate procedures and controls over the award and disbursement of program grants. Specifically, we recommend that DBED

a. maintain formal meeting minutes for grant awards approved by MSAC, including the recipient names and award amounts;
b. ensure that all grant award documents submitted to recipients, as well as invoices processed for payment, are verified to adequate supporting documentation by independent supervisory personnel prior to submission;
c. adequately reconcile its automated grant records with the State's accounting records by periodically comparing disbursement amounts and investigating any differences noted; and
d. ensure that grant agreements have been executed before invoices are processed and submitted for payment.

Purchases and Disbursements

Finding 11
Certain purchasing transactions and access to the State's Financial Management Information System (FMIS) were not sufficiently controlled.

Analysis
DBED had not established proper controls over its purchasing transactions and the assignment of user access capabilities for all disbursements processed through FMIS. As a result, several employees could process purchases without independent approval and improper access to FMIS could be granted without detection. According to the State's records, DBED processed disbursements totaling $118.1 million through FMIS during fiscal year 2014 pertaining to its financing programs and general operations.

- DBED had not established adequate online approval requirements in FMIS for purchases in two departments. Four employees had the capability to initiate and approve purchase orders in two departments for dollar amounts as high as $30,000 without independent approval. This differed from other departments within DBED for which the maximum threshold was generally $5,000. Furthermore, two of the four employees had the ability to add a vendor to FMIS's vendor database. Within these two departments, we noted that purchase orders totaling approximately $4.7 million were processed by the four employees without independent approval during our audit period.

- Although adequate online approval paths had been established for purchase orders processed for DBED's other departments, the two employees responsible for approving purchase orders for those departments did not always review supporting documentation, such as requisitions and bid quotes, to verify the propriety of the purchases and to ensure compliance with State procurement regulations. Specifically, one employee did not review supporting documentation for any purchase orders approved, which totaled approximately $23.5 million during our audit period. The second employee did not review supporting documentation for purchase orders that were considered a small procurement (equal to or less than $25,000). Small procurement purchase orders approved by this employee during our audit period totaled approximately $3.6 million.

- DBED did not establish controls to ensure its employees were assigned appropriate access capabilities in FMIS. One employee, who served as the security officer over all levels of access to FMIS, was also responsible for monitoring individual employee security profiles which specified the level of system access provided to employees. However, this person would not be in a position to determine what level of system access was appropriate for each employee. The Department of Information Technology's *Internal Control and Security Policy and Procedures* establishes requirements for providing appropriate controls over employee access and states that employee security profiles should be monitored and reviewed by applicable management personnel who are in a position to determine system access required by their subordinates.

Recommendation 11

We recommend that DBED

a. establish consistent independent online approval requirements so that purchase orders for all departments exceeding $5,000 are subject to such approval,

b. ensure that adequate supporting documentation is reviewed by employees responsible for approving purchase orders, and

c. ensure that appropriate supervisory personnel monitor employee security profiles in FMIS for consistency with employee job responsibilities.

Audit Scope, Objectives, and Methodology

We have conducted a fiscal compliance audit of the Department of Business and Economic Development (DBED) for the period beginning November 3, 2010 and ending June 30, 2014. 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 the 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 control, and to evaluate its compliance with applicable State laws, rules, and regulations.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of significance and risk. The areas addressed by the audit included the Premium Tax Credit auction, financing programs, tax incentive programs, grant programs, and purchases and disbursements. We also determined the status of the findings contained in our preceding audit report.

To accomplish our audit objectives, our audit procedures included inquiries of appropriate personnel, inspections of documents and records, observations of DBED's operations, and tests of transactions. Generally, transactions were selected for testing based on auditor judgment, which primarily considers risk. Unless otherwise specifically indicated, neither statistical nor non-statistical audit sampling was used to select the transactions tested. Therefore, the results of the tests cannot be used to project those results to the entire population from which the test items were selected.

We also performed various data extracts of pertinent information from the State's Financial Management Information System (such as revenue and expenditure data). The extracts are performed as part of ongoing internal processes established by the Office of Legislative Audits and were subject to various tests to determine data reliability. We determined that the data extracted from these various sources were sufficiently reliable for the purposes the data were used during this audit. We also extracted data from DBED's automated grants management system and automated financing programs monitoring system for the purpose of testing certain attributes and functions, such as grant awards, eligibility for financing, and DBED's monitoring efforts. We performed various tests of the relevant data and determined that the data were sufficiently reliable for the purposes the data were used during the audit. Finally, we performed other auditing procedures that we considered necessary to achieve our audit objectives. The reliability of data used in this report for background or informational purposes was not assessed.

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.

The response from DBED 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

MARYLAND
Department of Business & Economic Development

Larry Hogan Governor
Boyd Rutherford Lt. Governor

R. Michael Gill Secretary
Benjamin H. Wu Deputy Secretary

September 28, 2015

Mr. Thomas J. Barnickel, III, CPA
Legislative Auditor
Office of Legislative Audits
301 West Preston Street
Baltimore, MD 21201

Dear Mr. Barnickel:

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 for September 2015.

In Attachment A, "Department of Business and Economic Development's Response to the Legislative Auditor's Draft Report", the findings are listed in the order in which they appear in the draft audit report. In the interest of brevity, we have used the draft audit report's brief description of each finding to summarize the findings in our response. Each finding summary is followed by the related departmental response. There are a total of 11 responses.

Effective October 1, 2015, Maryland Venture Fund will become a part of the Maryland Technology Development Corporation (TEDCO). Findings one, two, and three in the draft report and the related response from the Maryland Venture Fund will be provided to TEDCO to comply with the recommendations.

If you have any questions, please contact Maqsood Khan at 410-767-2292 or email at maqsood.khan@maryland.gov.

Sincerely,

R. Michael Gill
Secretary

Attachment

Attachment A

Department of Business and Economic Development's

Response to the

Legislative Auditor's Draft Report

(For the Period Beginning November 3, 2010 and Ending June 30, 2014)

September 28, 2015

RESPONSE TO LEGISLATIVE AUDITOR'S
DRAFT AUDIT REPORT
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
OFFICE OF THE SECRETARY – MARYLAND VENTURE FUND

Draft Report Finding #1

ISSUE: **Comprehensive written procedures were not prepared to ensure consistency and compliance with the law in administering the auction, and tax credit certificates issued to winning bidders included incorrect identifying information.**

RESPONSE: DBED agrees with Finding #1 but disagrees with many of the specific issues, questions and conclusions presented in the finding. Many of the conclusions presented in the finding are inaccurate and could be due to the lack of understanding of how the auction was executed. Having explicit written directions might have bridged the gap on the lack of understanding of how the auction was designed and executed as demonstrated by this finding. A significant portion of the auction processes and procedures were presented, discussed and approved during a presentation titled *Maryland Venture Fund Authority / Premium Tax Credit Auction - dated January 19th, 2012* made by the auction vendor to the MVFA & DBED on January 19th, 2012. The auction vendor's 44 page presentation specifically reviewed the auction procedures and methods. The auction vendor's presentation to DBED and the Maryland Venture Fund Authority was very detailed and informed attendees of the entire auction process. The MVFA approved of all of the auction vendor's recommendations to use the auction bidding format that would be (1) simplest for "novice" bidders to use, (2) provide a format that would allow and encourage competitive bidding. The auction format approved by MVFA listed on page 19 of the presentation titled *Final Auction Methodology* provided:

(1) Open vs closed auction,

(2) Partial bidding vs All-or-none-bidding

(3) Single award vs Multi-Price award,

(4) Two-minute rule vs Fixed End Time

(5) Same day award vs multi day/round award

(6) Bid increment of $100,000 vs. $10,000 / $50,000 and

(7) Price increment of $.0001.

The auction vendor was approved by the MVFA to independently register and train the Insurance companies that expressed interested in participating in the auction. The auction was executed successfully and there were no issues raised by anyone involved in the auction or from those that observed the auction that took place on March 15th 2012.

A detailed response to all of findings, comments and suggestions are provided below:

DBED did not establish effective oversight of the Premium Tax Credit auction established under the Invest Maryland Program. DBED did not ensure that the auction vendor and the MVFA developed and adopted comprehensive written procedures to govern the auction process, including the acceptance and evaluation of participant applications, compliance with criteria established in the law for participating in the auction, and the evaluation of bids. In this regard, DBED had little specific knowledge regarding how the vendor conducted critical functions of the auction. Consequently, DBED had to forward our questions about certain aspects of the auction to the vendor. In addition, we noted errors in identifying information included on tax credit certificates issued to insurance companies for winning bids. Comprehensive written procedures would have helped to clarify and promote consistency, accuracy, and transparency in the application of the auction process and to ensure compliance with all provisions of the law.

RESPONSE: DBED disagrees with the conclusion that it did not establish effective oversight of the Premium Tax Credit auction established under the Invest Maryland Program. The auction was successfully executed by all measures. DBED executed the first online auction of Premium Tax Credits in the U.S. and at the time received the highest return for the sale of tax credits of any other state. Previous to Maryland's online auction, most states conducted closed private sales of premium tax credits which yielded 8-12% of return to the purchasers. Purchasers of Maryland Premium Tax Credits received a 5-6% return. DBED agrees that given that this was a "first" time auction that were many issues regarding the application process that could be improved upon but the most important outcome of achieving the highest bid for the tax credits was successfully achieved. Yes, DBED admits that several administrative tasks to document the auction procedures, processes and results can be improved upon so that those reviewing the activity several years later would have a clearer understanding of what transpired. DBED had significant knowledge of all of the activities and decisions that MVFA approved for the auction vendor to implement on behalf of DBED/MVFA. DBED referred auditors to the auction vendor to (1) obtain any written auction procedures and instructions which DBED did not have nor needed to execute the auction and (2) to obtain detailed bidding information that DBED did not have nor needed. Note, under the InvestMaryland statue, there is no requirement of having written instructions for the auction process and procedures and there was no requirement for the auction vendor to provide written instructions of the auction procedures and processes. DBED agrees that in future auctions, a requirement of the auction vendor will be included to provide detailed written auction procedures and instructions. DBED agrees that there was a minor error on the tax credit certificates which has already been rectified. All insurance companies have been notified of the error and the Maryland Insurance Administration has been notified of the corrections on the tax credit certificates.

- **The *Maryland Premium Tax Credits – General Auction Rules* and auction demos, both of which were developed by the auction vendor and the MVFA, provided only minimal guidance to govern the Premium Tax Credit auction process and did not address bidding parameters and methodologies. For example, these *Rules* did not adequately explain how the final bid rate to be paid by the winning bidders was to be determined and, therefore, as directed by DBED, we obtained such information regarding the bidding process from the vendor. According to the auction vendor, a "single price award" method was used in which a "single clearing" price was used for all winning bids.**

As presented above, the previously submitted presentation made by the auction vendor titled **Maryland Venture Fund Authority / Premium Tax Credit Auction - dated January 19th, 2012**, details the auction bidding parameters which were discussed and eventually approved by the MVFA. During the January 19th meeting, the auction vendor executed a few mock demos of the auction in which MVFA and DBED were shown (1) how bidders would register to login and (2) simulated bidding to demonstrate the many features that could or would be deployed for the auction site. The demo highlighted all of the bidding parameters that a bidder would need to know in order to successfully participate in the auction. The auction vendor reviewed each of the auction and bidding parameters and provided the pros and cons for each of the auction methodology and bidding parameters. As noted, the single price award and the recommendations of why the "single price award" was chosen over the multi-bid price award and why the single clearing price was chosen over the multi-price award were presented on pages 5-19 of the previously submitted presentation. Again, DBED agrees that having written procedure and instructions would clarify this misunderstanding from parties seeking knowledge of the auction after the fact.

DBED could not provide documentation as to why the "single price award" method was selected as the most advantageous to the State as compared to the "multi-price award" method, which was the other pricing option available to DBED. The "multi-price award" method allowed for awards to be made at the actual rate bid. According to data received from the vendor, the companies that submitted the 15 winning bids paid the same accepted bid rate of 84 cents per credit dollar even though 13 of the winning bids were at higher rates. For example, one insurance company submitted a bid of 87.2 cents, but paid 84 cents per dollar, a difference which would have increased the company's payment for the $10 million in credits awarded by $320,000. In total, based on our calculation, payments would have increased by approximately $1.1 million if the final amounts for the 13 bids had been used. According to DBED's records, of the 189 bids received, 32 were rejected and 142 were outbid, leaving the 15 winning bids.

Unfortunately, the conclusions above are flawed. First, the auction was structured to accept a single clearing price because (1) The US Treasury uses this format and it's considered to be very fair and effective (2) several interested bidders expressed that they preferred the single price award over a multi-price award. The main reason for a single price award was the sense of fairness that every bidder had a real chance to actually purchase tax credits if they were willing to offer a winning bid. Without the assurance of having a real chance of being awarded tax credits, many bidders that participated in the **single-award** auction would not participate in a **multi-price** award auction.

No conclusions can be drawn from a hypothetical "multi-price" award auction format using the bidding data from a single price award auction.
If a "multi-price" award auction was conducted, the bidders would not be the same, the bids that they would make would not be the same and the final outcome would not be the same as stipulated above. Again, the single price award format encouraged the most bidders to participate in the auction and to encourage bidders to increase their bids. The reason a multi-price award auction was not recommend by the auction vendor nor would be accepted by the MVFA was two-fold (1) multi-price award format is not generally used in the sale the of premium tax credits and the insurance companies expressed their dissatisfaction if they were to receive a tax credit price higher than someone else participating in the same auction (2) the auction vendor believed that by enabling bidders to improve their bids the actual clearing price method would yield a higher gross return than using the multi-price award auction.

Now, to review the actual bidding data from the auction, the results are clear. All bids were accepted at $0.70, and would be awarded tax credits if all $100,000,000 of the tax credits had been awarded. The clearing price ended at 84 cents. **There were only 3 bids within the one hour auction that submitted bids above the clearing price,** one bid at 87.2 cents for $10,000,000 in tax credits, a bid at 85 cents for $22,500,000 in tax credits and another bid of 85 cents for $10,000,000. The remaining bidders started in the low 70s cent range and improved their bids to eventually securing a clearing price of 84 cents. A logical conclusion is that the single price award auction conducted on March 15, 2012, would generate a minimum of $70,000,000 and final results **yielded** $84,000,000, **$14,000,000** more than the minimum expectation of 70 cents per tax credit. If a multi-price award auction was to be held we do know that there would have been fewer bidders and there would be a high probability that the State would have received a lower yield due to the smaller pool of bidders.

Recommendation 1
We recommend that DBED

a. **ensure that comprehensive written procedures are developed and followed for significant programs and related processes, such as the aforementioned Premium Tax Credit auction;**

DBED agrees and will require that **future Auction vendors** will be required to provide written procedures for a Premium Tax Credit auction.

b. **comply with all provisions of State law when implementing such programs and processes; and**

DBED agrees and will comply with all provisions of State law when implementing such programs and processes.

c. **correct and reissue the aforementioned Premium Tax Credit certificates.**

Premium Tax Credit Certificates have been updated and sent to Purchasers and the Maryland Insurance Administration has been updated with corrections to address previous errors.

> **<u>Auditor's Comment</u>: While DBED agreed that comprehensive written procedures for the tax credit auction may have enhanced understanding of how the auction was executed, DBED also stated that a significant portion of the audit process and procedures were presented, discussed, and approved during a presentation made by the auction vendor in January 2012. However, as stated in the report, during the audit, DBED had little specific knowledge of how the vendor conducted the audit, and therefore, DBED forwarded our questions and requests for documentation and information regarding the bidding methodology and parameters used to the auction vendor for resolution. At no time were we provided with comprehensive written procedures, including the referenced auction vendor presentation, nor did we receive documentation substantiating that DBED had officially made any decisions regarding the auction options presented by the vendor.**
>
> **DBED also provided an explanation in its response as to the advantages of the "single price award" bidding method. However, the finding did not conclude that the single price award method was not an appropriate method to use for the auction, but noted that there was a lack of specific documentation as to why this method was determined to be the most advantageous. The comparison of award methods provided in the report was included to**

demonstrate the need to better document why one method was chosen over another. The report has been modified to clarify this point.

Finally, the response noted that only 3 bids that exceeded the clearing price of 84 cents were submitted within the one-hour auction. According to the published auction results, the auction spanned approximately 74 minutes, and 10 bids exceeding the clearing price were accepted after the hour timeframe. Nevertheless, DBED's response acknowledged that better documentation could have improved understanding of the auction procedures and processes, and DBED has agreed to obtain such in the future, consistent with our recommendation.

RESPONSE TO LEGISLATIVE AUDITOR'S DRAFT AUDIT REPORT DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT OFFICE OF THE SECRETARY – MARYLAND VENTURE FUND

Draft Report Finding #2

ISSUE: **DBED did not adequately document the selection process and allocation of capital to venture firms, and monitoring efforts over the firms' investment activity were not sufficient.**

RESPONSE: DBED agrees with the finding that the resolutions of the Maryland Venture Fund Authority approving the selection of private venture funds for InvestMaryland investment were not adequately documented. While minutes were kept with respect to the public portion of the Authority's meetings, the actual discussion and approval of investment commitments occurred after the meetings had been closed to the public pursuant to the Public Meetings Act due to the confidential fund information discussed in connection with investment decisions. For each investment decision the Authority received a written report and recommendation from the outside consultant, retained as required under the InvestMaryland Act, and after discussion the Authority adopted resolution approving each investment and the investment amount. The investment commitments were subsequently made pursuant to those approvals. The lack of closed meeting minutes is attributed to the fact that there was not a clear directive to transfer staffing responsibilities for the Authority from DBED staff to the new Maryland Venture Fund staff, and by the time that transfer was clarified, the Authority had made almost all of its investment decisions. At that point MVF staff and the Attorney General's staff assigned to DBED began keeping minutes of closed meetings, but during the interim period there was no one charged with responsibility for maintaining minutes of the closed meetings. The Authority agrees to follow the Recommendation in the report and document a resolution ratifying all of the investments previously approved.
DBED agrees with the finding that monitoring efforts over the firms' investment activity were not sufficient.

Regarding the report's **recommendation 2**, we agree that the following measures should be implemented **by DBED/TEDCO prior to the 2016 fiscal year:**

a. In future selection activities for investing funds with potential venture capital firms, written documentation of the methodology used to select venture firms and decisions made to allocate the designated capital will be provided;
b. Review the submitted reports to ensure the venture firms are on target with making qualified investments in qualified businesses, as defined by State law; and
c. Review management fees charged by the venture firms to ensure amounts charged are within amounts permitted by State law, and if applicable, recover any amounts for which DBED was overcharged.

RESPONSE TO LEGISLATIVE AUDITOR'S
DRAFT AUDIT REPORT
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
OFFICE OF THE SECRETARY – MARYLAND VENTURE FUND

Draft Report Finding #3

ISSUE: **DBED did not obtain required approval from the Office of the State Treasurer in advance of opening certain investment bank accounts.**

RESPONSE: We agree that prior to establishing any checking accounts to obtain approval from the State Treasury's Office and that all special bank accounts have independent authorized signers. Of note, DBED did confer with Treasury prior to establishing the checking accounts. However, DBED was not knowledgeable regarding some of the mechanics of STO's approval process. **Currently, all investment accounts are approved, and registered with Treasury.**

**RESPONSE TO LEGISLATIVE AUDITOR'S
DRAFT AUDIT REPORT
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
DIVISION OF BUSINESS AND ENTERPRISE DEVELOPMENT OFFICE OF FINANCE PROGRAMS**

Draft Report Finding #4

ISSUE: **DBED's process for verifying that recipients met requirements for forgiveness of conditional loans and grant repayments was not effective.**

RESPONSE: We disagree with the auditor's conclusion that DBED's process for verifying employment was not effective. The Department has established well defined and rigidly adhered to procedures to verify employment data submitted by recipients of assistance from the Maryland Economic Development Assistance Authority and Fund. The primary documentation required to verify compliance with job requirements are detailed employment reports provided by the recipients and transmitted with a certification executed by an official of the recipient. As a secondary source of information, all recipients of assistance are required to execute consent forms enabling the Department to access employment information maintained by the Department of Labor and Licensing and Regulation (DLLR). A State university has been engaged by the Department as an intermediary that extracts information from DLLR database and then formats the information into reports that are usable by the Department. The Department's confidence in the reporting/verification process is based on: (1) a requirement that any employment data provided to the Department by a recipient have a certification under penalty of perjury, signed by an official of the recipient., (2) the recipients knowledge that the DLLR information is used as an independent system of verification, and (3) the fact that the employment data at DLLR is subject to an audit system.

The supporting information provided by the Auditors, for this Finding, shows that the comparison being made by the Auditors is between company reported data and DLLR data. The finding is not based on the pertinent comparison of employment requirements contained in transaction documents to company reported employment levels. The Department acknowledges that the reports provided by the State university as a secondary source of information usually will not reconcile to employment reports provided to the Department by recipients of assistance. This is due to inherent differences in the data needs between DLLR and DBED. The difference in the reporting needs include, among other things, DBED using a more restrictive definition of employees to be reported, more than one unemployment number for the recipient, and multiple locations for the recipient within the State covered by the same unemployment number. All that said, it does not diminish the value of the DLLR data as a secondary source of information in the validation process.

The information contained in the DLLR reports will include all of the employees at the facility or multiple facilities for unemployment insurance reporting. Data reported to DLLR by companies is subject to audit and any over reporting of employees to DLLR would have negative tax consequences for the company. In situations where the company reported a larger number of employees to DBED than what was reported to DLLR the discrepancies are researched and the company as well as DLLR are contacted to resolve the discrepancy. Any discrepancies reported are documented on the Employment Validation memo and reviewed by management before any decisions are made either to forgive or clawback funds.

The Department agrees with the auditors that in each of these four cases DLLR data show that the company's employment in Maryland is significantly **higher** than the employment reported by the company. The Department agrees that certain benefit and salary information was not submitted for two of the recipients; however, this information was not material in nature given that DBED had historical representations of salary and benefit information. **Nevertheless, DBED will review its procedures with staff to ensure all required documentation is received before forgiving any loans or grants. However, DBED feels strongly that the validation process in place, requiring corporate officer certification under penalty of perjury combined with the comparison to third party data from DLLR is sufficient for the Secretary to make appropriate forgiveness and claw back decisions.**

Office of Internal Audits

RESPONSE: The Office of Internal Audits (OIA) agrees with the auditor's recommendation to increase the number of employment data verifications conducted and to develop formal written procedures for performing such reviews. As of September 2015, we have developed written procedures that provide guidelines for the completion of our reviews, giving consideration to the value of the loans and grants to be selected. Procedures allow for judgmentally selecting the loans and grants to be reviewed, with those having a higher dollar value and greater inherent risk to the state given higher priority. These procedures will be updated or revised as needed. Effective immediately, the number of audits to be conducted will be based upon the number of loans and grants awarded, the availability of professional audit resources necessary to complete this task, and the existing workload, including special projects, if any, assigned to the OIA.

> **Auditor's Comment: DBED disagreed with the conclusion that its process for verifying employment data was not effective because it uses two sources of documentation to verify such data. The primary documentation used is certified employment reports from loan and grant recipients, and a secondary source of documentation is the DLLR employment data extracts from the State university. As noted in the finding, this process does not provide sufficient assurance that recipients have actually met employment requirements for forgiveness of a conditional loan or grant. Furthermore, another verification process, which was performed by its Office of Internal Audits (OIA), was not effectively used given the relatively small number of audits conducted. Nevertheless, consistent with our recommendation, DBED agreed to increase the number of employment data verifications performed by the OIA.**

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Draft Report Finding #5

ISSUE: **DBED had not established formal forbearance agreement procedures for its Maryland Small Business Development Financing Authority (MSBDFA) programs, and did not have an effective mechanism to track and monitor forbearance agreement activity.**

RESPONSE: DBED agrees that it has not prepared formal written procedures and criteria for the appropriate use of Forbearance Agreements. However, DBED disagrees with the opinion that formal written procedures and criteria are necessary based upon the reasoning used by the Auditors to support their recommendation.

The Forbearance Agreement is an established and widely used tool by Creditors to aid in the collection of a debt. In the Forbearance Agreement, DBED agrees not to pursue its legal remedies if the borrower agrees to a modified plan, based upon current capacity to repay over a defined period. Thereafter, an extension of the Agreement may be appropriate to facilitate continued repayment of the obligation. If the borrower fails to pay as agreed, DBED has discretion to declare a default or take other actions, which may help the borrower return to a compliant status.
The Agreements are intentionally structured as short-term instruments with a term of one or two years. This approach enables closer monitoring and an automatic, near-term end date wherein the repayment capability of the borrower can be re-evaluated. Because of the re-evaluation, the Agreement may be extended for an additional period or revoked, or the payment amount may be increased or decreased, or other modifications as determined by DBED. If interpreted in this context, it may be clearer to the Auditors that multiple modifications may be integral to DBED's collection strategy for a specific borrower, and not a flaw or exception.

DBED incorporates judgement and discretion into its collection efforts. Flexibility to exercise both is essential to the Department's collection strategy. Furthermore, we engage in close collaboration with the Department's legal team. We strive for the appropriate approach, anticipated to be most effective recognizing the distinct circumstances presented by different borrowers.

The Auditor's suggested that DBED consider other methods of collection, such as liquidation of collateral or sending delinquent accounts to the Department of Budget and Management's Central Collections Unit (CCU). DBED presently includes consideration of both of these alternatives in its collection strategy. However, it is important for the Auditors to understand that in most cases, liquidation of collateral is not a productive option for two important reasons. Similarly, CCU is a viable option only in a limited number of situations.

First, as the State's primary Economic Development Agency, charged with improving economic outcomes for all citizens, liquidation of collateral, particularly owner occupied residential real estate, is a sensitive issue. DBED carefully weighs the benefit to be derived and pursues the option after all other collection efforts fail. Second, in most cases, available collateral does not offer sufficient tangible market value, and DBED is typically subordinate to other creditors in the order of lien priority. As a result, it is probable that minimal recovery or none at all would be the outcome.

DBED has a history with CCU. However, we became aware that CCU does not monitor the status of collateral. This limitation jeopardizes DBED's interests as a secured creditor. As a result, DBED is able to use CCU only in limited situations, primarily when collateral does not exist or has been previously liquidated. DBED refers accounts to CCU if the borrower is unresponsive and all other collection efforts, including liquidation of collateral, have been exhausted. Historically, DBED's direct collection efforts have been more productive than results achieved through the use of CCU.

DBED's present methodology for the use of Forbearance Agreements is effective and achieves the recovery of delinquent loan proceeds in most cases. DBED encourages the Auditors to understand that an agreement that compels regular and consistent payments, and direct communication with the borrower presents the best opportunity for material recovery of loan proceeds. This is particularly valid in view of the minimal value of collateral associated with most delinquent loans.

We agree with the auditor's recommendation to maintain adequate detail records to monitor and track forbearance agreements. DBED will implement following the process to track and monitor forbearance agreements as part of its monthly reporting to the Management Team:

1. Review Loan Modification Audit Report- Monthly
2. Review Loan Modification History Report- Monthly
3. Create a Maturity Date Tickler for all Forbearance Agreements

<u>**Auditor's Comment**</u>**: DBED disagreed with the need for formal written procedures and criteria for the appropriate use and modification of forbearance agreements, and stated in its response that its present methodology for the use of these agreements is effective. The report finding does not state that the Department's methodology is ineffective. Rather, the finding emphasizes the need to develop procedures and criteria to help ensure such agreements are used in the appropriate situation and in a consistent manner. This could be accomplished if the Department formalized its "present methodology" for using the agreements.**

RESPONSE TO LEGISLATIVE AUDITOR'S
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Draft Report Finding #6

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

RESPONSE: We agree with the auditor's recommendation to review and approve critical changes made to the system. DBED has identified several key areas for review: non-cash for forgiveness of loans, non-cash for write-off of loans, and loan or transaction deletion. DBED has the appropriate approval processes in place to initiate these transactions. **Effective May 1, 2015, the Manager for the Accounting and Administrative group will review the system logger at least monthly for these transactions to ensure they are appropriate.** The Manager does not have Administrative or Accounting access to the system and is independent of the Accounting process.

We agree that some of the capabilities of system users were not adequately restricted and agree with the Auditor's recommendations. Of note, of the 47 system users, 30 are read only users, 10 are Office of Finance Administrative and Accounting staff, three are contractor staff for emergency purposes, and do not have access to DBED's network, the remaining four are DBED Information Technology Management (ITM), and Performance Management & Process Improvement (PMPI) staff. During the time of the audit, ITM was supporting the system. However, there was a transition of support for the system from of ITM to PMPI so there was overlap of ITM and PMPI users in the system. Furthermore, the three contractor users are part of the system software and are used only when technical support is needed from the contractor. The contractor does not have access to the system or DBED's network. The three contractor user accounts are now inactive but they cannot be removed from the system. Additionally, the two ITM staff user accounts are now inactive. The remaining two PMPI staff has remained as active system users with some modifications to their access however, they are the primary technical support for the system and need appropriate access. The user access for the Manager of the Accounting and Administrative group was modified to remove the Administrative and

Accounting module. The remaining user access was also examined and modified. (Users' access highlighted in yellow, which we submitted in response to this finding in OLA's Discussion Notes, has been removed.) **DBED will continue to monitor user access on a quarterly basis to ensure access is removed within 60 days of inactivity and that system access is adequately restricted to assigned tasks.**

RESPONSE TO LEGISLATIVE AUDITOR'S DRAFT AUDIT REPORT DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT DIVISION OF BUSINESS AND ENTERPRISE DEVELOPMENT OFFICE OF FINANCE PROGRAMS

Draft Report Finding #7

ISSUE: **Cash balances for financing programs were not adequately reconciled with the State's records.**

RESPONSE: DBED agrees with all of the auditor's recommendations. The reconciliation issues discussed in the analysis are the result of timing issues between disbursement of funds in the investment checking accounts, which are not tracked in FMIS and replenishment of the investment checking account, which is tracked in FMIS. As a result, DBED carries these accounts as reconciling items to the FMIS cash account. However, all balance differences are investigated, and reconciled. From July through October, finance accounting staff was managing requests from legislative as well as external auditors, which created disruptions in the day-to-day workflow. Overall, reconciliations are completed timely. Additionally, all three programs are subject to an external independent audit, which requires all cash accounts to be in order and reconciled. All three audits received an unqualified report.

Effective May 1, 2015 DBED management started reviewing all reconciliations to ensure they are performed and documented in a timely manner. DBED management also started investigating and resolving differences identified as a result of the cash balance reconciliations.

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Draft Report Finding #8

ISSUE: **DBED did not sufficiently verify applicants' compliance with job creation and associated cost requirements and did not administer the program in accordance with State regulations.**

RESPONSE: DBED disagrees that it did not require applicants to document project and start-up costs. The last audit report stated that DBED did not require applicants of the One Maryland Tax Credit program to provide supporting documentation for all project and start-up costs. DBED responded that it agreed and would require final applications to include an itemized accounting of qualifying project and start-up costs. In addition, when the business is paying for the improvements through a lease, we require the business to submit a copy of the lease agreement that we review.

The draft reports states that 2 of the 15 applicants did not provide documentation to support reported project and start-up costs at the time of certification. These applicants were certified prior to DBED implementing the policy to require an accounting of eligible project and start-up costs.

DBED disagrees with the finding that it did not require applicants to document its payroll of new employees created from the One Maryland project. DBED has its Office of Internal Audits (OIA) audit employment data for a percentage of applicants, which they determine to be appropriate. DBED agrees that OIA should increase the percentage of One Maryland applicants they review, based on available resources that OIA has available. Furthermore, after DBED approves a business as eligible for the One Maryland tax credit, DBED requires the business to submit an employment report on the qualified positions for each year that it claims the One Maryland Tax Credit. DBED agrees that it will require the business provide an employment report of the qualified positions to be attached to the final application.

DBED allows businesses to begin counting the project and start-up costs it incurs and the qualified positions it creates after the business declares its intent to qualify for the One Maryland tax credit to the Department. This is in compliance with the One Maryland Tax Credit. Section 6-402(b) of the Economic Development Article (One Maryland Economic Development Tax Credit) provides that "[t]o be eligible for a project tax credit or a start-up tax credit, a person shall: … (2) During **any** 24-month period, create at least 25qualified positions at the new or expanded business facility; …." The regulations implementing the One Maryland Tax Credit (COMAR 24.05.24), provided that "[t]he qualified business entity shall have created and filled at least 25 qualified positions at the project within 24 months after the date on which a project is place in service;…" (COMAR 24.05.24.08C). The regulations are poorly written. There are many situations when a business would need to begin hiring before the project is "placed in service". For example, in an expansion project new employees may be hired well before the expansion is placed in service; similarly, in a leasing project, a facility may require improvements but new employees might be hired prior to the leased space being fully placed in service. To restrict qualified positions to the two-year time period beginning with the date on which the facility is placed in service, would unduly restrict these types of projects—projects clearly envisioned by the statute.

On advice of DBED counsel, such an undue restriction on the language and intent of the statute is beyond the authority of the Department. Therefore, the Department could not implement COMAR 24.05.24.08C as written. In order to meet the statutory requirement, the Department has permitted positions to be created in any 24-month period beginning with the date of notification of an intent to seek the tax credit and ending 24 months after the date a facility is placed in service, despite the regulatory language. Although the regulation clearly should have been amended, the Department's actual implementation of the 24-month period was a reasonable interpretation of the statute.

DBED does agree that it will amend its regulations to reflect the intent of the statute.

DBED does agree and will immediately implement Recommendation 8. Recommendation 8 follows:

We recommend that DBED

a. obtain documentation for and verify the number of new positions created and filled by each applicant by, for example, increasing the number of payroll reviews conducted by its OIA;

b. ensure adherence to the time requirements established in State law and regulations for applicants to create and fill new positions; and

c. obtain and review detailed documentation, such as paid invoices, at least on a test basis, to support project and start-up costs claimed by applicants.

> **<u>Auditor's Comment</u>: DBED disagreed that it did not require applicants for the One Maryland tax credit to document project and start-up costs because it requires an itemized accounting of such costs from the applicants. However, the report finding, while acknowledging that schedules or lists of costs being claimed were largely provided, addressed the need for DBED to obtain assurance that the listed costs were accurate and valid. Consistent with our recommendation, DBED has agreed to obtain and review detailed documentation, such as paid invoices, to support project and start-up costs claimed by applicants.**
>
> **DBED also disagreed with the finding that it did not require applicants to document new employee positions created for the One Maryland project. Nevertheless, consistent with our recommendation, DBED has agreed to verify the number of new positions by increasing the number of payroll reviews conducted by its Office of Internal Audits.**

RESPONSE TO LEGISLATIVE AUDITOR'S
DRAFT AUDIT REPORT
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
DIVISION OF TOURISM, FILM AND THE ARTS

Draft Report Finding #9

ISSUE: **Program regulations were not established as required, and DBED lacked documentation of supervisory reviews of credits issued.**

RESPONSE: DBED agrees with the finding that DBED has not adopted regulations to carry out provisions of the Film Production Activity Tax Credit program.

As soon as the Film Production Activity Tax Credit was signed into law following the 2011 legislative session, the Maryland Film Office (MFO) held a meeting with the Comptroller of Maryland (COM) designee and DBED's AAG on April 19, 2011 to discuss the process, timing and logistics of how the tax credit program would work. Over the next two months many conferences with COM, DBED's AAG and MFO staff took place to establish the process, procedures and required documentation in order to have clear, concise and transparent information on the provisions of the tax credit program published on the MFO website by the start of the fiscal year on July 1, 2011. A copy of those policies and procedures, as published, is attached. The Film Production Activity Tax Credit process and documents can be found here - http://www.marylandfilm.org/FilmProductionEmploymentAct.html.

Those provisions were published on-line on June 24, 2011 with applications being accepted beginning at 9:00 am on July 1, 2011. All tax credits for FY2012 were committed by 9:00am that day. Once the critical, short term need was met, the MFO and DBED's AAG began the lengthy process of promulgating the regulations. During this process, however, the MFO was made aware of legislation that was going to be introduced in 2012 legislative session (SB1006) that would change the tax credit program. The MFO and DBED's AAG decided to hold on the regulations until the outcome of the legislation. SB1006 did not pass and the MFO and AAG resumed work on the regulations.

Discussions continued between the MFO, DBED's AAG and the COM regarding the policies and procedures as questions arose about the implementation and administration of the program. Any revisions were immediately published on the website. Yet again, the MFO was informed of legislation to be introduced in the 2013 session that would change the tax credit program. SB183 was proposed and passed. The MFO and AAG began the dialogue regarding regulations for a third time. And then, the MFO was made aware of new legislation that would be introduced in the 2014 session that would change the tax credit program. HB520 was introduced, but did not pass.

Action Plan: During the 2015 legislative session, new legislation was passed that revamped the program and established a Film Tax Credit Reserve Fund. Although there are legislative concepts being discussed to amend this program in the 2016 session, the **MFO has been working with the AAG to draft formal regulations to the existing statute.**

RESPONSE: DBED disagrees with the inference that DBED did not adequately perform a review of its preliminary and final Film Production Activity Tax Credit certificates prior to being issued to film production entities. The Deputy Director of the Maryland Film Office (MFO), who administers the program, closely and conscientiously reviews all of the documents when a production company applies for preliminary approval of a tax credit, as well as the independent audit and all closing documentation submitted after the production is completed to receive the final tax credit.

The Director of the MFO reviews all evaluations of preliminary tax credit applications, including supporting documentation, and final tax credit applications, including the independent audit and all supporting documentation, examined and completed by the Deputy Director. Additionally, the Director is involved in all meetings and conference calls discussing the final outcomes of the Deputy Director's review of the final application and closing documentation. He is actively involved in the determination of the qualification of the film production entity, the amount of tax credits to reserve for the preliminary tax credit certificate and the amount of final tax credits to be issued.

As mentioned above, each tax credit was reviewed by DBED's staff. No preliminary tax credit certificates or final tax credit certificates were issued by the MFO without signatory approvals from the Assistant Attorney General for DBED assigned to the MFO, the Assistant Secretary for Tourism, Film & the Arts and the Secretary.

Action Plan: The MFO has revised the approval buckslip for both the preliminary tax credit certificate and the final tax credit certificate to include the MFO Director, who will confirm in writing that the Production Company is a certified film production entity and that he has reviewed the tax credit amount and supporting documentation. The approval signature on both buckslips has been changed from simply approval to "Reviewed & Approved." **The MFO Director will attach a memorandum to file certifying that he has independently reviewed the calculation and evaluation for final tax credit certification performed by the Deputy Director.** The MFO will continue to include supporting documentation along with the tax credit certificates circulated for the Secretary's signature for supervisors' review.

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DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
DIVISION OF TOURISM, FILM AND THE ARTS

Draft Report Finding #10

ISSUE: **Procedures and controls over the award and disbursement of program grants were not adequate.**

RESPONSE: MSAC concurs with the facts of finding and is in agreement with the recommendations.

Recommendation 10

a. **maintain formal meeting minutes for grant awards approved by MSAC, including the recipient names and award amounts;**
   Action: Expand meeting minutes, including the Grants Committee and the Council's Annual Meeting where Grants for Organizations Program grant award recommendations are finalized, to fully reflect specific grants awarded by including itemized list by discipline of each applicant organization's name, county, grant type and award amount. **Completion Date: June 30, 2015**
b. **ensure that all grant award documents submitted to recipients, as well as invoices processed for payment, are verified to adequate supporting documentation by independent supervisory personnel prior to submission;**
   Action: Develop and implement procedures for additional review of supporting documentation and reconciliation against grant award transactions as they are processed within the system. **Completion Date: October 31, 2015**
c. **adequately reconcile its automated grant records with the State's accounting records by periodically comparing disbursement amounts and investigating any differences noted;**
   Action: Develop and implement procedures for Fiscal Officer to reconcile the grant transactions processed through the system with those entered into FMIS. **Completion Date: October 31, 2015**
d. **ensure that grant agreements have been executed before invoices are processed and submitted for payment.**
   Action: Revise procedures and require grant agreements to be fully executed (signed and witnessed) before initiating any grant payment process**.** **Completion Date: March 30, 2015**

RESPONSE TO LEGISLATIVE AUDITOR'S
DRAFT AUDIT REPORT
DEPARTMENT OF BUSINESS AND ECONOMIC DEVELOPMENT
DIVISION OF ADMINISTRATION AND TECHNOLOGY

Draft Report Finding #11

ISSUE: **Certain purchasing transactions and access to the State's Financial Management Information System (FMIS) were not sufficiently controlled.**

A. RESPONSE: DBED concurs with this recommendation and **effective immediately will institute a standardized FMIS procurement approval process** for all purchase orders (POs) over $5,000. These approvals will require verification that the agency's pre-approved BB4-form matches specific lines within the PO-entry in FMIS. This matching will verify correct departmental designation, purchase description, appropriate procurement method, and price designation. All prior verifications of correct budget, department, and object codes will be the responsibility of the OAT Office of Budget and Finance (OBF), which reviews and approves all POs for these items prior to procurement approvals.

This evaluation process will be performed on all FMIS POs daily. When this is not possible due to time constraints, absence of critical procurement personnel, or unplanned/unforeseen circumstances, random reviews of a representative sample of POs will be conducted by those individual(s) responsible to the extent possible within our present staffing structure.

B. RESPONSE: DBED agrees with this recommendation. For all transactions under $5,000, transaction verification is done by comprehensive review of credit-card logs by both the Director of the OBF and the Director of the Office of Contracts and Procurement (OCP) on a monthly basis. Written verification of reconciliation is then sent to the Comptroller's Office by the Director of OBF. For transactions over $5,000, **DBED has addressed this recommendation as per the response to item "a", above.**

C. RESPONSE: DBED concurs with this recommendation and **effective immediately will institute a regular bi-monthly review of security levels** by the Director of Budget and Finance to ensure consistency with employee job responsibilities.

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