

Audit Report

Department of Business and Economic Development

November 2008



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

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Karl S. Aro
Executive Director

DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Bruce A. Myers, CPA
Legislative Auditor

November 10, 2008

Senator Verna L. Jones, Co-Chair, Joint Audit Committee
Delegate Steven J. DeBoy, Sr., Co-Chair, Joint Audit Committee
Members of Joint Audit Committee
Annapolis, Maryland

Ladies and Gentlemen:

We have audited the Department of Business and Economic Development (DBED) for the period beginning August 1, 2004 and ending September 30, 2007. DBED's mission is to stimulate and strengthen the Maryland economy by developing policies and implementing programs that will generate new jobs and investment in Maryland, such as by attracting businesses to the State.

Our audit disclosed DBED not obtain certain documentation to verify that individuals or entities it approved to receive income tax credits had actually met the eligibility criteria, such as creating a specified number of new jobs. In one case, a \$50,000 tax credit was approved for a corporation that did not meet the applicable eligibility criteria. During fiscal years 2005 through 2007, 215 applicants were certified for tax credits under various programs.

Our audit also disclosed that employment data reported by loan recipients (such as the number of jobs created), which often serve as the basis for forgiving loan amounts due, were not effectively verified. In addition, DBED did not enforce certain contract requirements pertaining to the administration of economic development activities nor ensure that grantees complied with reporting requirements.

Proper internal controls were not established over certain purchases and disbursements for operating expenditures. Furthermore, the effectiveness of certain promotional activities and marketing events held by DBED was not adequately evaluated or documented. Finally, DBED made payments to certain terminated employees by allowing them to remain on the payroll for specified periods with no assigned responsibilities.

An Executive Summary of our findings can be found on page 5. 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,

Bruce A. Myers, CPA
Legislative Auditor

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Executive Summary

Legislative Audit Report on the Department of Business and Economic Development November 2008

- **DBED did not always obtain adequate documentation to verify eligibility for income tax credits it approved, such as to businesses for creating a specified number of new jobs in Maryland. In one case, a \$50,000 credit was approved for a corporation that did not meet the applicable eligibility criteria. In addition, controls over the issuance of sales tax exemption certificates to film production companies were not sufficient. During fiscal years 2005 through 2007, 215 applicants were certified for tax credits under various programs and 273 sales tax exemption certificates were issued.**

DBED should obtain sufficient documentation to verify that all eligibility requirements have been met prior to approving individuals or entities for income tax credits. In addition, controls over sales tax exemption certificates should be improved as recommended.

- **DBED did not effectively verify employment data reported by loan recipients. The accuracy of these data are critical since loan agreements often provide for forgiveness of all or a portion of the loan if a certain number of jobs are retained and/or created. Loan amounts totaling approximately \$27.6 million were forgiven during fiscal years 2005 through 2007.**

DBED should take steps to effectively verify employment data reported by loan recipients.

- **DBED did not always enforce contract and grant reporting requirements related to certain financing programs, its international offices, and the development of tourism and economic development in Maryland. For example, activity reports and audited financial statements were not always obtained. Without such reports, DBED is not in the best position to evaluate and monitor contractor effectiveness and grant expenditures.**

DBED should enforce contract and grant reporting requirements.

- **Certain expenditures tested were not adequately supported or made in accordance with contract terms. In addition, controls over State checks received directly by DBED for distribution to payees need to be improved.**

DBED should obtain adequate supporting documentation for all vendor payments, ensure that payments are made only in accordance with contractual agreements, and obtain all required approvals. In addition, DBED should establish an independent verification procedure for checks received and distributed.

- **The effectiveness of certain promotional and marketing events we reviewed, costing approximately \$184,000, was not adequately evaluated or documented. In general, these events, which included poker tournaments and chartered cruises, were meant to provide networking opportunities to help promote economic stimulus in the State.**

DBED should require that the effectiveness of all promotional and marketing events held be formally evaluated and documented.

- **DBED made payment to certain employees by allowing them to remain on the payroll for extended periods after their termination dates with no specific assigned responsibilities. The Department of Budget and Management advised us that, generally, these types of payments are not permitted unless provided for in an employment contract.**

DBED should not make these types of payments to employees unless specifically provided for as noted by the Department of Budget and Management.

Background Information

Agency Responsibilities

The Department of Business and Economic Development (DBED) is a principal department of State government and operates in accordance with Article 83A 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 with family-supporting wages. It also develops policies and implements programs to help generate investment by attracting businesses to the State, by facilitating the expansion and retention of existing companies, and by promoting Maryland's strategic assets. According to the State's records, during fiscal year 2007, DBED's operating expenditures totaled \$135.8 million, which included \$67.2 million for grants and \$28.5 million for loans.

Referral to Attorney General

In January 2008, DBED referred an allegation of potential criminal activity to the Office of the Attorney General – Criminal Division. The referral alleged that the owners of a company, which received a \$1 million line of credit in October 2005 from the Department's Maryland Small Business Development Financing Authority, improperly used company funds for personal purchases. Based, in part, on its investigation, DBED alleged in the referral that the owners diverted approximately \$100,000 in funds from the company for their personal use, such as for the acquisition of a new house and for their children's school tuition.

In October 2006, DBED notified the company that it was in default on the line of credit agreement. In March 2007, the company owners filed for bankruptcy and, in May 2007, DBED submitted a bankruptcy claim totaling \$167,221 for the unpaid portion of the line of credit. As of May 30, 2008, the bankruptcy claim remained outstanding and the referral was under investigation by the Criminal Division.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the eight findings contained in our preceding audit report dated August 23, 2005. We determined that DBED satisfactorily resolved seven findings; the remaining finding is repeated in this report.

Findings and Recommendations

Tax Incentive Programs

Background

State law provides that individuals or entities may receive certain tax incentives, such as income tax credits, for meeting specified eligibility criteria relating to economic development in the State. These credits include (1) the One Maryland and Job Creation tax credit programs that provide income tax credits to qualified companies based primarily on the creation of a specified number of new jobs; (2) the Biotechnology Investment tax credit program that provides income tax credits for individuals, corporations, and qualified Maryland venture capital firms that invest in qualified Maryland biotechnology companies; and (3) sales tax exemption certificates issued to film production companies to increase film production activity within Maryland.

According to the Department of Business and Economic Development's (DBED) records, during fiscal years 2005 through 2007, DBED certified 10 applicants, which claimed to have created approximately 630 jobs for the One Maryland tax credit, and 39 applicants, which claimed to have created approximately 3,700 jobs for the Job Creation tax credit. Those records also indicate that, during fiscal year 2007, DBED certified 166 applicants for Biotechnology Investment tax credits totaling approximately \$6 million; this program was initiated in fiscal year 2007. Finally, DBED records indicate that during fiscal years 2005 through 2007, DBED approved 273 applications for sales tax exemption certificates and the applicants estimated spending \$62.9 million in eligible tax exempt expenditures, which, without the exemption, would have generated \$3.14 million in sales tax revenue.

Finding 1

DBED did not always obtain adequate documentation to verify initial and continued eligibility for income tax credits approved and, in one case, approved an ineligible \$50,000 credit.

Analysis

DBED's process for verifying applicant eligibility for certain tax incentives was not comprehensive and our review noted that DBED awarded one \$50,000 tax credit even though the corporation did not meet the applicable eligibility criteria. State law provides that individuals or entities may receive certain tax credits on their State income tax returns in exchange for meeting established criteria, such as

investing in certain industries or creating a specified number of new jobs. We noted the following deficiencies regarding DBED's various applicant eligibility certification processes:

- DBED did not obtain documentation to support the number of jobs applicants claimed to have created in order to qualify for the One Maryland and the Job Creation tax credit programs. Under both programs, once a business has created and filled the required number of qualified positions during the specified period, DBED issues a tax credit certificate. DBED does not obtain any documentation (such as employment records) to support these positions reported nor does it otherwise verify that the jobs were actually created and filled. DBED advised us that the accuracy of an applicant's assertion of eligibility is subject to verification by the State Comptroller of the Treasury which is vested with the authority to verify compliance with State tax laws; however, we were advised by the Office of the Comptroller that verification of eligibility—in this case, the number of jobs created—is beyond the scope of the Office's duties. Furthermore, the State law establishing the tax credit programs assigns the responsibility for program eligibility determinations to DBED. Verification could be facilitated by requiring applicants to obtain a certification by a certified public accounting firm as to the number of new jobs created.
- DBED did not always obtain required monitoring reports regarding a recipient's continued eligibility for credits received in the One Maryland and Job Creation tax credit programs; both programs require annual monitoring reports for specified periods. These reports would include information such as the number of new jobs created and retained at the end of the year. Furthermore, for the Job Creation program, three years after the issuance of DBED's tax credit certificate, each recipient must provide DBED with a statement from an independent certified public accountant (CPA) stipulating the extent to which the company has retained sufficient positions and, if the number of positions has fallen below the required level, recipients must specify the amount to be refunded to the State. Our test of the 51 tax credits issued in fiscal years 2002 through 2004, for which CPA statements were due during our audit period, disclosed 36 instances in which these statements were overdue by as much as three years, and DBED had not taken sufficient action to obtain them (for example, send formal follow-up notices). For 7 of the 15 CPA statements that were received, tax credits totaling \$424,752 were due the State and were recaptured.

- Our test of 20 approved Biotechnology Investment tax credits issued in fiscal years 2007 and 2008, totaling approximately \$1.6 million, disclosed that DBED approved one corporation for a \$50,000 tax credit even though it had not met the eligibility criteria to receive the tax credit. Specifically, the corporation had invested only \$100,000 in a qualified company rather than the minimum of \$250,000 required to be invested by a corporation; the \$100,000 investment requirement is applicable only to individuals. We brought this matter to DBED's attention, and were subsequently advised that it is attempting to rescind the certification of the tax credit.

Recommendation 1

We recommend that DBED enhance its process for certifying individuals or entities as eligible for income tax credits by obtaining adequate supporting documentation and by ensuring that all eligibility requirements have been met and continue to be met. For example, DBED could require certification of each loan applicant's reported employment data by a certified public accounting firm. Finally, we recommend that DBED obtain and review all overdue CPA statements and ensure the State recovers all credit amounts due, including the Biotechnology Investment credit noted above.

Finding 2

DBED did not have adequate controls over the issuance of sales tax exemption certificates.

Analysis

DBED lacked adequate controls over the issuance of sales tax exemption certificates issued by its Film Office. Based on the submission of a proper application, the Office would approve a qualified applicant (such as a film production company) for an exemption from paying sales tax on certain purchases relating to film production activity. However, neither the completed application submitted by the film company nor the corresponding certificate issued by DBED contained evidence of supervisory approval. According to its records, during fiscal years 2005 through 2007, DBED issued 273 tax exempt certificates to film production companies.

According to Article 83A, Section 4-501 of the Annotated Code of Maryland, the legislative intent of issuing sale tax exemption certificates for filming was to increase film production activity within Maryland, to bring economic benefits to the citizens of the State, and to generate employment opportunities in the State. Related State regulations call for the resultant production to be subject to nationwide distribution. However, our test of 14 film productions during our

audit period disclosed that, according to the related applications, 4 certificates were issued for productions with primary filming locations outside of Maryland, calling into question the economic benefit derived by Maryland from the productions. Furthermore, two of the four productions were solely intended for distribution in Pennsylvania. According to their applications, these four production entities estimated that their Maryland expenditures eligible for tax exemption would approximate \$647,000, which, without the exemption, would have generated about \$32,400 in sales tax revenue.

Recommendation 2

We recommend that appropriate supervisory personnel document their approval of both the sales tax exemption applications and related certificates. In addition, we recommend that DBED ensure that approved productions meet all applicable requirements, such as location.

Verification of Employment Data

Finding 3

DBED's process for verifying employment data reported by loan recipients prior to forgiveness of loans was not effective.

Analysis

DBED's process for verifying employment data submitted by recipients of loans from the Economic Development Opportunities Program Fund and the Maryland Economic Development Assistance Authority and Fund was not effective. The accuracy of this data is critical since the related loan agreements frequently provide for forgiveness of all or a portion of the loan if certain performance requirements are met, including the creation and retention of a specific number of jobs, generally, at a certain location. Consequently, inaccurate data reported by loan recipients could inappropriately result in loans being forgiven. According to DBED's records, during fiscal years 2005 through 2007, loan amounts totaling approximately \$27.6 million relating to 27 loans were forgiven from the two Funds; during fiscal year 2007, the State's records indicate that loans made from these two Funds totaled approximately \$14 million.

To help verify data reported by loan recipients, DBED contracted with a State university to provide independent statistical reports of employment information relating to loan recipients. To accomplish this task, the university used employment data provided by the State's Department of Labor, Licensing and Regulation. However, our review of 21 of the aforementioned 27 forgiven loans disclosed that employment totals reported by the university often differed from

the corresponding totals reported by loan recipients, including 7 loans in which the employment totals reported by the university exceeded those reported by the loan recipients by more than 100 employees, 4 of which differed by more than 1,000 employees. Although no formal reconciliations of these data had been completed by DBED, it advised us that the totals usually will not reconcile because of inherent differences, such as the fact that data reported by the university may include multiple locations for the loan recipient.

This condition was commented upon in our two preceding audit reports. In response to our preceding report, DBED indicated that reporting hurdles still existed, but it would continue to work with the university to improve the statistical and employment reporting, and that action would be taken to better document efforts to reconcile discrepancies in employment reporting. However, because of the aforementioned inherent differences in the data, DBED should consider other methods, such as requiring loan recipients to obtain certifications of the employment data by a certified public accounting firm.

Recommendation 3

We again recommend that DBED establish adequate procedures to ensure that employment totals reported by loan recipients are effectively verified prior to forgiving any related loan repayments. Because of inherent difficulties in reconciling the recipient and university-reported data, DBED should consider requiring certification of the loan recipient's reported employment data by a certified public accounting firm.

Contract and Grant Reporting Requirements

Finding 4

Reporting requirements included in DBED's contracts for the operation of its international offices were not consistent and were not always enforced.

Analysis

Reporting requirements included in DBED's contracts for the operation of its international offices were not consistent and were not always enforced. During our audit period, DBED maintained offices in 11 major cities around the world to promote economic development in Maryland; these offices were operated by contractors. However, 7 of the 11 contracts did not require the submission of an annual report to DBED that contained a self-evaluation of the contractor's effectiveness and that documented the contractor's overall activities and achievements. In addition, 9 of the 11 contracts did not require the contractor to submit audited financial statements and, for the two that did require such

statements, one contractor did not submit the statements for fiscal years 2005, 2006, and 2007. Furthermore, only these same two contracts included provisions to assess penalties for the late submission of monthly progress reports. According to DBED records, during the period from August 2004 through June 30, 2007, payments to these 11 contractors totaled approximately \$2.5 million.

Recommendation 4

We recommend that DBED include, in all of its international office operating contracts, requirements for the submission of annual audited financial statements and annual activity reports, and a provision to assess penalties when required reports are not submitted timely. We also recommend that DBED ensure that these requirements are met.

Finding 5

Required activity and financial reports were not always received from certain grantees.

Analysis

DBED did not ensure that grant recipients always met established reporting requirements. Specifically, our test of 20 grants, totaling \$5.2 million, issued during our audit period from the Divisions of Business Development, Small Business Development, and Regional Development, and from the Office of Tourism Development disclosed that DBED did not obtain required activity and/or financial reports for 7 grants totaling \$673,000. For example, although one grantee, that was awarded \$155,000 for fiscal year 2007, was required to submit quarterly reports describing the companies it assisted, the nature of that assistance, the results, and future prospects, no such reports were received by DBED. Without such reports, DBED is not in the best position to monitor the use of grant funds.

The aforementioned units of DBED disbursed grant funds to organizations and companies for various purposes, such as to stimulate the development of tourism in Maryland and to promote Maryland business and job opportunities. According to the State's accounting records, during fiscal year 2007, grant payments from these units totaled approximately \$4.8 million.

Recommendation 5

We recommend that DBED ensure that all grant reporting requirements are met by grant recipients.

Finding 6

DBED did not obtain adequate documentation to verify compliance with certain requirements relating to the administration of the Maryland Small Business Development Financing Authority's financing programs.

Analysis

DBED did not obtain adequate documentation to verify compliance with certain contractual requirements relating to the administration of the Maryland Small Business Development Financing Authority's (MSBDFDA) financing programs. MSBDFDA was created to promote business growth in the State by providing various types of financing assistance (for example, direct loans, loan guarantees) to businesses owned by socially or economically disadvantaged persons.

DBED contracted with a private entity for the purpose of administering certain aspects of MSBDFDA's programs, such as marketing and public relations. The current contract, which is effective through June 30, 2012, includes three performance benchmarks and other requirements designed to monitor the contractor's effectiveness in helping to meet MSBDFDA's business growth objectives. The three benchmarks require the contractor to (1) have substantive contact with at least 600 businesses or prospective applicants each year, (2) annually present a minimum of 30 new applicants to DBED and close transactions with at least 20 new applicants, and (3) increase by at least 10 percent per year the amount of financing in the program at fiscal year-end. According to the State's accounting records, during fiscal year 2007, the contractor was paid approximately \$1.3 million in management and monitoring fees. Our review of these requirements disclosed the following conditions:

- The contractor did not meet one of the three performance benchmarks included in the related contract. Specifically, as noted above, the contractor is annually required to have "substantive contact" with at least 600 businesses or prospective applicants who may participate in the MSBDFDA programs, and to provide DBED with sufficient information to identify each prospect including name, address, phone number, and the contact person. These contacts allow DBED to determine whether the contractor is sufficiently marketing these financing programs. However, monthly activity reports provided by the contractor during fiscal year 2006 generally did not include sufficient detail to ensure compliance with contractual terms regarding "substantive contacts." For example, no identifying information was included for 251 of the 687 contacts classified in the reports as "leads." Furthermore, the description of 39 of the contacts (for example, meetings with Maryland legislators to discuss

legislation and budgets) did not clearly identify them as a substantive contact with a business or prospective applicant, as required.

- DBED did not obtain an annual marketing and promotional budget from the contractor for fiscal years 2005 through 2007, as required. According to the State's accounting records, during these fiscal years, DBED paid the contractor approximately \$158,000 for marketing and promotional expenses.

Recommendation 6

We recommend that DBED ensure compliance with all significant contract terms. Specifically, we recommend that DBED obtain the required identifying data regarding prospects deemed to be substantive contacts by the contractor, and obtain the required annual marketing and promotional budgets.

Purchases and Disbursements

Finding 7

Proper internal controls were not established over the processing of purchasing transactions.

Analysis

DBED did not fully utilize available security features of the State's Financial Management Information System (FMIS) to establish proper internal control over the processing of certain critical purchasing transactions. Specifically, two employees could both initiate and approve purchase orders. Consequently, unauthorized purchasing transactions could be processed which may not be readily detected. According to the State's accounting records, during fiscal year 2007, DBED processed disbursements on FMIS totaling approximately \$65.7 million, of which approximately \$54.3 million had a related purchase order.

Recommendation 7

We recommend that DBED fully utilize available FMIS security features by establishing independent online approval requirements for all critical purchasing transactions.

Finding 8**Expenditures were not always adequately supported or made in accordance with contract terms.****Analysis**

Certain expenditures we examined were not adequately supported or made in accordance with contract terms. Our test of invoices totaling approximately \$1.9 million, related to nine contracts, disclosed that DBED could not provide support for expenditures totaling approximately \$126,000, which related to two contracts. For example, for three invoices relating to a mailing services contract, DBED did not obtain supporting documentation to substantiate detailed charges totaling \$92,000; DBED paid approximately \$975,000 for these mailing services during our audit period. With respect to this mailing services contract, our test also disclosed that DBED did not obtain time records to support certain invoiced labor charges, did not obtain inventory reports to support warehouse storage charges and usage, and did not retain work orders supporting charges for special mailings. Regarding the other contract, DBED lacked supporting documentation for payments totaling \$34,000 made to the contractor who operated one of DBED's international offices. The payments were for unanticipated labor hours and certain administrative and travel costs, such as hotels and meals.

During our audit, we also noted improper payments to a contractual employee working out of State. Specifically, this employee was paid an office space subsidy of \$300 per month, with payments totaling \$10,800 during fiscal years 2005 to 2007, even though DBED was aware that the employee had chosen to work from home and such payments were not provided for in the related contract. Finally, required DBM approval was not obtained for upgrades, costing an additional \$13,000, from coach to first class, for two airline tickets related to an international trip taken by DBED employees in 2006.

Recommendation 8**We recommend that, in the future, DBED obtain adequate supporting documentation for all vendor payments and ensure that payments are properly approved and made in accordance with contractual agreements.**

Checks Received for Distribution

Finding 9

Controls over State checks received by DBED for subsequent distribution to applicable payees were not sufficient.

Analysis

State checks received by DBED for subsequent distribution to applicable payees were not adequately controlled. During fiscal year 2007, 156 checks, totaling approximately \$16.6 million, were picked up from the Comptroller of the Treasury's General Accounting Division (GAD). We were advised that this procedure allowed DBED to more closely control these disbursements since, for example, GAD sends no correspondence with checks that it mails. Although these checks were recorded when received, this initial recording was not subsequently verified to proof of distribution, such as a receipt acknowledgement signed by the payee. Consequently, DBED lacked assurance that all recorded checks were properly distributed.

In addition, although DBED received authority from GAD to receive certain types of State checks (such as loan proceeds) for distribution, we noted that other types of checks, such as grant and contractor payments, were also periodically requested for distribution. These 69 checks (which are included in the aforementioned 156 checks) totaled approximately \$4.6 million during fiscal year 2007.

Recommendation 9

We recommend that an employee independent of the check distribution process verify the initial recording of checks received for distribution to documentation of receipt by the payee. We also recommend that DBED only request checks for distribution that are related to categories approved by GAD.

Promotional Activities

Finding 10

DBED did not have formal procedures requiring a documented evaluation of the effectiveness of significant promotional and marketing events.

Analysis

The effectiveness of certain promotional and marketing events, totaling approximately \$184,000, was not adequately evaluated and documented. Specifically, DBED did not have formal written procedures requiring such reports for promotional events to assess the success of each event in terms of economic development. We reviewed the following eight promotional and marketing events and noted that their effectiveness was not adequately evaluated and documented.

- DBED spent approximately \$32,000 in October 2005 to host two poker tournaments as entertainment for business prospects and to provide networking opportunities between DBED employees and individuals potentially looking to bring or expand their companies in Maryland. However, a final marketing event report was only prepared for one of the events, and this report did not clearly quantify or evaluate the effectiveness and results of that event.
- The Film Office spent approximately \$122,000 during our audit period to host four annual networking receptions at a bowling alley and bar in Hollywood, California for the purpose of promoting Maryland's film industry. DBED did not prepare a written report on the effectiveness of any of the four events.
- We also noted that DBED paid approximately \$30,000 in fiscal years 2006 and 2007 to charter a yacht and cater two cruises on the Chesapeake Bay, to provide opportunities for DBED and other State employees to network with leaders in the Maryland business community. Both cruises were held even though, according to DBED's records, only 10 out of 58 invitees for one cruise and 10 out of 75 for the other attended, and most attendees were State employees. DBED did not prepare a written report on the effectiveness of either of these two events.

Although DBED has budgeted authority to organize promotional and marketing events, there should be a process to periodically assess or review the value and/or benefit realized from such events. This would include formal follow-up with

participants of networking events. According to the State's accounting records, during our audit period, DBED spent approximately \$250,000 on promotional activities.

Recommendation 10

We recommend that DBED establish procedures requiring the preparation of comprehensive reports to document the effectiveness and results of all promotional events, such as networking opportunities obtained from these events.

Payroll

Finding 11

DBED entered into separation agreements with certain employees, allowing them to remain on the payroll for extended periods beyond their effective termination dates.

Analysis

During the period from November 2004 to December 2006, DBED entered into written separation agreements with 12 employees that allowed them to remain on the payroll for extended periods after their effective termination dates. These agreements, which were approved by the former DBED Secretary and its legal counsel, established a separation period in which the individuals remained on the payroll through a combination of being stationed at home and taking earned annual, personal, or compensatory leave. DBED advised that these agreements were made to foster amicable separations terms with these 12 employees who held various administrative and management positions. DBED confirmed to us that these individuals effectively had no assigned responsibilities during their separation periods and were not accountable for performing or completing any DBED-related duties. The periods covered by these agreements ranged from 20 to 116 days. Based on our calculations, we estimated that these 12 employees improperly earned approximately \$150,000, representing payment for days they did not work and payment for an estimated 51 additional days of annual and personal leave improperly accrued during their separation periods.

We were advised by the Department of Budget and Management that, generally, these types of separation agreements are not allowed unless the employee had an employment contract which provided for such payments upon termination. We noted that this was not the case for any of the 12 employees.

Finally, after the separation agreement was established for one employee, DBED approved and paid tuition reimbursements totaling approximately \$3,300 for courses taken by this employee during the separation period; these payments were not specifically provided for in the agreement.

Recommendation 11

We recommend that DBED not enter into similar agreements in the future, unless provided for in related employment contracts.

Audit Scope, Objectives, and Methodology

We have audited Department of Business and Economic Development (DBED) for the period beginning August 1, 2004 and ending September 30, 2007. 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. We also determined the status of the findings contained in our preceding audit report.

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

Our audit scope was limited with respect to DBED's cash transactions because the Office of the State Treasurer was unable to reconcile the State's main bank accounts during a portion of the audit period. Due to this condition, we were unable to determine, with reasonable assurance, that all DBED cash transactions prior to July 1, 2005 were accounted for and properly recorded on the related State accounting records as well as the banks' records.

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

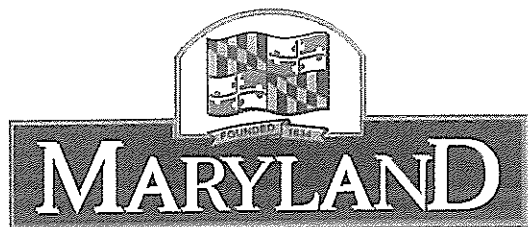
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

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

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

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

APPENDIX



DEPARTMENT OF BUSINESS &
ECONOMIC DEVELOPMENT

Martin O'Malley
Governor

Anthony G. Brown
Lt. Governor

David W. Edgerley
Secretary

Clarence T. Bishop
Deputy Secretary

November 6, 2008

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

Dear Mr. Myers:

This is the Department of Business and Economic Development's Response to the Legislative Auditor's Draft Report on their Fiscal/Compliance Audit of the Department dated October, 2008.

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

We also included updated information on the item titled, "Referral to Attorney General," on page 7 of your Draft Report in the "Background Information" section. That information is included as the last response on Attachment A.

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

Sincerely,

A handwritten signature in black ink that reads "Clarence T. Bishop". The signature is written in a cursive style with a large, prominent initial "C".

Clarence Bishop,
Deputy Secretary

Enclosure

Department of Business and Economic Development's

Response to the

Legislative Auditor's Draft Report

*(For the Period Beginning August 1, 2004
And ending September 30, 2007)*

November 6, 2008

Attachment A

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

TAX INCENTIVES PROGRAM

Finding #1

DBED did not always obtain adequate documentation to verify initial and continued eligibility for income tax credits approved and, in one case, approved an ineligible \$50,000 credit.

RESPONSE TO #1

1) We disagree with the finding that DBED did not always obtain adequate documentation to verify initial and continued eligibility for income tax credits approved. DBED requires that a business entity submit a final application for the One Maryland and Job Creation Tax Credits. The business is required to provide the following information, as required by statute: the effective date of the start-up or expansion; number of full-time employees prior to the start-up or expansion and the payroll of those employees; and the number of the qualified positions created and payroll of those positions. The business submits this information on the final application and signs the application affirming under the penalty of perjury that the information it submitted is true and correct. DBED does not certify any business for the Job Creation or One Maryland Tax Credit unless the business submits a Final Application. The audit report specifically states that DBED did not obtain specific documentation, such as employment records, to support the number of jobs the applicants claimed to have created. However, we believe that requiring applicants to submit employment records would impose a significant burden on the applicants that is not required by the program's governing statute. DBED requires a qualified employee count and salary affidavit of all applicants for the initial tax credit certificates. Each year the applicants are required to verify the number of qualified employees. For the Job Creation Tax Credit, in the third year following the initial tax credit year, a CPA certification is required that the qualified positions remain or that the tax credit recapture is due to the State.

In light of your recommendation, however, we'll also take the following action. DBED will direct our Office of Internal Audits to audit the employment data for a percentage, which they determine to be appropriate, of the tax credit applicants.¹

2) Not all businesses that receive final certification claim the income tax credits. A business may not have claimed the credit for a number of reasons including that they have no tax liability, positions have fallen below the required number, or the business has closed. DBED cannot verify if a business has claimed the credit because we do not have access to a business's tax returns. In order to obtain monitoring reports, we have sent letters to all businesses reminding them of their reporting obligation and shared the results with the Comptroller showing the names of the businesses that have complied, those that stated that recapture is due and those businesses beyond the job retention period that have been non-responsive. The Comptroller has notified DBED that the information has been given to its Compliance Division for follow-up action. We agree with your recommendation and we will institute the following corrective actions to better obtain the monitoring reports: 1) send letters to all businesses in January each year reminding them of their reporting obligation by April 1, 2) follow-up with businesses that do not comply by April 1. By June 1 of each year we will share with the Comptroller's office the names of the businesses that are non-compliant or are subject to recapture of the credit.

3) We agree with the finding that DBED issued a Biotechnology Investment Incentive Tax Credit, in calendar year 2006, to a corporation in error in the amount of \$100,000 during the first year of the program. Upon notification of this error, DBED notified both the applicant and the Comptroller that the credit was issued in error. We agree with the recommendation and will institute the following corrective actions: we will convene a formal review committee to review applications. The review committee will consist of one representative from each of the following units: DBED's Tax Incentives Group, DBED's Division of Finance, DBED's Division of Business Development (with an expertise in Biotechnology) and the Attorney General's Office. The committee will review applications on a weekly basis throughout the application period to ensure applicants meet all the eligibility requirements. This is different than in the past because each committee member will review the application instead of having a single reviewer, thus reducing the potential for errors.

¹ **Auditor's Comment:** Our finding does not dispute that the employment data specifically required by statute was obtained by DBED from business applicants, or that the data was affirmed as true and correct by those businesses. Rather, we concluded, and continue to believe, that this affirmation does not provide an independent verification that the required jobs were actually created and filled by the businesses. We believe that the action specified in the response, whereby DBED's Office of Internal Audits will audit the employment data, will serve as an effective means of verification.

Finding #2

DBED did not have adequate controls over the issuance of sales tax exemption certificates.

RESPONSE TO #2

After the Sales & Use Tax Exemption was enacted, the Maryland Film Office (MFO) did establish an internal process that required supervisory approval of applications by either the Director or Deputy Director before a certificate is issued. MFO staff failed to obtain the appropriate written supervisory approval before issuing the certificates.

While the primary intent of the legislation is “to increase film production activity within Maryland,” the statute itself, as mentioned in the auditor’s analysis, speaks to “bringing economic benefits to the citizens of the State and generating increased employment opportunities in the State.” Part of the MFO’s mission is to promote the sale, rental, use, purchase and/or hiring of Maryland’s goods, services and citizens by the entertainment industry (i.e. renting camera equipment, buying lumber, hiring electricians, etc.). The MFO believed that providing companies filming outside of MD with a Sales Tax Exemption that encouraged them to purchase goods, rent equipment and hire crews in Maryland served the mission of our office, the Department and the program. After discussion with the Attorney General’s Office, the MFO understands that this is not the specific intent stated in the statute.

And, regarding distribution, the regulations of the program define "nationwide commercial distribution" as specified in the statute as “intended for commercial distribution extending primarily beyond Maryland's local or regional (Maryland, Virginia and the District of Columbia) market.”

Therefore, the certificates issued to projects that were distributed outside that area were acceptable under the regulations as defined. The MFO disagrees with the finding that these certificates were issued erroneously. However, the MFO agrees that in the instance of the distribution area as Pennsylvania was not in keeping with the intent of the statute. In the future, as a matter of policy, the MFO will seek to ensure that the intended distribution area is broader than just one state outside Maryland’s local or regional market.

RECOMMENDATION: The MFO agrees with the recommendation that appropriate supervisory personnel document their approval of both the sales tax exemption applications and related certificates and the recommendation that DBED ensure that approved productions meet all applicable requirements, such as location.

ACTION PLAN: New procedures put in place immediately following the audit require the MFO Deputy Director or MFO Director to review each sales tax exemption application and initial indicating supervisory approval of the application and the issuing of the certificates. In addition, the MFO ceased issuing Sales Tax Exemptions to productions without primary filming locations in Maryland. The MFO also began using a broader distribution area than just one state outside of Maryland's local or regional market to qualify exemptions.

VERIFICATION OF EMPLOYMENT DATA

Finding #3

DBED's process for verifying employment data reported by loan recipients prior to forgiveness of loans was not effective.

RESPONSE TO # 3:

The Department has established well defined and rigidly adhered to procedures to verify employment data submitted by recipients of assistance from the Economic Development Opportunities Program (Sunny Day) and 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). The University of Baltimore 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 University of Baltimore 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 seven companies that are the subject of this Finding are summarized in the chart below. In each instance, the company certified that the employment level achieved was higher than the employment level required by the agreement with DBED. The Department agrees with the auditors that in each of these seven cases DLLR data show that the company's employment in Maryland is significantly higher than the employment reported by the company.

| <u>Company</u> | <u>Loan Amount</u> | <u>Forgiveness Amount</u> | <u>Date of Forgiveness</u> | <u>Job Numbers</u> | | |
|----------------|--------------------|---------------------------|----------------------------|-----------------------------|-----------------------|--------------------|
| | | | | <u>Goal for Forgiveness</u> | <u>Company Report</u> | <u>DLLR Report</u> |
| A | \$1,125,0000 | \$1,125,0000 | 12/31/2006 | 495 | 1,158 | 13,463 |
| B | \$250,000 | \$250,000 | 09/28/2005 | 313 | 418 | 1,114 |
| C | \$700,000 | \$700,000 | 12/31/2006 | 1,100 | 1,192 | 2,719 |
| D | \$100,000 | \$100,000 | 12/31/2004 | 100 | 103 | 239 |
| E | \$850,000 | \$850,000 | 06/01/2005 | 850 | 1,063 | 4,410 |
| F | \$300,000 | \$300,000 | 12/31/2006 | 1,073 | 1,121 | 2,942 |
| G | \$131,250, | \$131,250 | 12/31/2006 | 286 | 520 | 672 |

DBED understands the importance of validating employment and takes great care to ensure the process is thorough and accurate. 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.

In light of your recommendation, however, the following action is being taken. DBED will continue to require corporate officer certification under penalty of perjury and direct our Office of Internal Audits (instead of a CPA firm) to audit employment data for a percentage, that they determine to be appropriate, of those loan recipients.²

| |
|--|
| CONTRACT AND GRANT REPORTING REQUIREMENTS |
|--|

Finding #4

Reporting requirements included in DBED’s contracts for the operation of its international offices were not consistent and were not always enforced.

RESPONSE TO #4

The Department partially concurs with this finding and recommendation. Each of our offices is currently required to submit monthly reports detailing its activities and achievements by the 15th of each month. Per Recommendation 4, by October 31, 2008, the division of International Investment and Trade (DIIT) will notify its foreign offices of the need to submit an annual report within 30 days of the end of each fiscal year, which will describe the activities undertaken that year as well as a self-evaluation of efficacy. DIIT has not yet experienced any problems with the respect to the timeliness of monthly reports from foreign offices, and will consider a provision in the next round of contracts to assess penalties for late submissions if this issue should arise.

DIIT currently does not require submission of annual audited financial statements by foreign offices. The offices do, however, submit quarterly reports outlining their expenses, including copies of their receipts. If we become aware of any financial irregularities or questionable

² **Auditor’s Comment:** The “primary documentation” referred to by DBED (detailed employment reports provided by loan recipients), certified by corporate officers, is received from the very businesses to which the loans were granted. Consequently, we believe that these data should be independently verified. The “secondary source of information” noted by DBED (employment data maintained by DLLR) does not, for reasons noted in our finding and in the agency response, adequately serve to verify the reported employment information. We believe that the action specified in the response, whereby DBED’s Office of Internal Audits will audit these data, will serve as an effective means of verification.

charges, however, DIIT will take appropriate action which could include: cancelling payment of questioned costs, seeking reimbursement or requiring an audited financial statement from the foreign office in question. To this end, we will include language in the foreign office contracts that DBED can require an audited financial statement in the event of any irregularities or questionable charges that are not fully explained to our satisfaction. All such issues will be properly documented in the contract files.

Finding #5

Required activity and financial reports were not always received from certain grantees.

RESPONSE TO #5

The Department concurs with the Auditors' recommendation. And, the Department partially concurs with the auditors' finding.

Division of International Investment and Trade (Grants)

The Division of International Investment and Trade will, in the future, ensure that all our grant reporting requirements are met.

Division of Tourism, Film and the Arts – Office of Tourism Development (Grants)

We agree with the auditors' finding that three of the identified grants did not include a CPA verified financial audit of the recipient funds as required. The Office of Tourism Development (OTD) does not process grant renewals for any organization that has not submitted the requisite financial reports. OTD staff received final, un-audited reports from each organization and was unable to collect two reports as the organizations are no longer eligible: One of the recipients has dissolved and there is no organizational representative from whom to request and collect an audited report. A second recipient did not meet the criteria for OTD programmatic grant funding.

The third organization while technically eligible, has not submitted the certificated CPA reports as required by the grant guide lines. We will request that the Assistant Attorney General prepare a letter requesting the requisite reports and informing the organization that they are ineligible for future grants pending receipt.

RECOMMENDATION: We agree that OTD should monitor grant reports received to ensure that grant recipients meet reporting requirements.

ACTION PLAN: OTD will, within 45-days of the end of the fiscal year, prepare a report of current fiscal year grant recipients' submission of requisite reports. Letters will be sent from the Fiscal Officer to recipient agent requesting certified financial report if not received within 90 days of fiscal year end. Organizations not fulfilling this requirement will be referred after 90 days to the Assistant Attorney General.

Division of Regional Development (Grants)

The Division of Regional Development supports the Auditor's recommendation. The Division disagrees that the two referenced grants were out of compliance.

In the case of both grants, all required financial and programmatic reports were included in the grant file. In a search of the file after the auditor's initial findings were made available, the questioned reports were found misfiled in the file and this information was communicated prior to the Exit Conference. The Department will make every effort to ensure files are in compliance with requirements in the future.

Finding #6

DBED did not obtain adequate documentation to verify compliance with certain requirements relating to the administration of the Maryland Small Business Development Financing Authority's (MSBDFA) financing programs.

RESPONSE TO # 6

The Department agrees with the Auditor's Finding that a certain contract performance benchmark was not adequately documented or verified by the method recommended by the Auditor. The Contractor is required to provide a name, address, and telephone number for 600 MSBDFA prospects per year. Historically, the Contractor has provided a name and phone number, but not an address. The omission of an address is not an indication of disregard by the Contractor or the Department for the requirements of the contract. The minimal need and value of a prospect's address has been a topic of discussion between the Contractor, the Department, and the Auditor since a prior audit cycle. In addition, it is important for the Auditor to understand that it is often impractical to obtain this type of information, particularly during seminars, workshops or other group presentation venues, which are a regular source of prospects for the program. After careful consideration, and to avoid misunderstanding in the future concerning this issue, the Department has decided to exclude the requirement of a prospect's address from the Management Services Contract, which commenced July 1, 2007. In the future, the Department will ensure that the Contractor provides the required identifying information for all appropriate prospective applicants, including those that may be qualified as leads. The contacts described as meetings between the Contractor and State officials regarding the MSBDFA program, budgets and legislation are not to be counted as part of the 600

substantive contacts. However, these meetings are reported to demonstrate the Contractor's advocacy and efforts to facilitate resource availability in the program. The Department will ensure that the Contractor clearly distinguishes this category of activity from the required 600 substantive contacts.

The Auditors have recommended the Department directly contact a sample group of prospects to verify the Contractor's reported contact with the subject. The Department does not agree with the Auditor's recommendation. This type of business practice may cause an undesirable perception of the Contractor and send a negative signal to a prospective client, possibly resulting in loss of business relationships.³

Clearly, the most important measure of the contractor's performance is full utilization of the resources available in the program during a fiscal year. When the contractor consistently achieves this goal as it has, other benchmarks such as the 600 prospects are of secondary importance.

The Department agrees with the Auditor's Finding that we did not obtain an annual marketing budget for review and approval, and later in the fiscal year advanced funds for marketing activity rather than reimburse the Contractor for approved costs.

The Department has implemented successive budget reduction plans in response to the fiscal condition of the State. In fiscal year 2005, the Department withheld and did not authorize expenditures for marketing the program. In fiscal year 2006, the Department initially withheld funds that had been appropriated by the Legislature for marketing the program. In fiscal year 2007, the Department did not request a funds appropriation for marketing the program.

During each fiscal year noted above, the Department engaged in discussions with the Contractor concerning the fiscal condition of the State, and has advised that funds for marketing may be restricted or eliminated for the incoming new fiscal year. The omission of an annual marketing budget is not an indication of disregard by the Department for the requirements of the contract. However, in view of the Department's action to withhold funds for marketing, it would not be prudent or appropriate to require submission of a budget from the Contractor. To do so would be improper, create expectations, and possibly negatively affect the Department's relationship with the Contractor.

As noted above, in fiscal year 2006, the Department initially withheld funds that had been appropriated for marketing the program. Late in the fiscal year, the Department determined that it would have funds remaining that could be targeted to appropriate expenses. At that point, the Contractor had not incurred costs for marketing primarily because the Department had withheld

³ **Auditor's Comment:** The recommendation referred to by DBED regarding verification of a sample group of prospective contacts was not included in the audit report.

funds. Consequently, in lieu of actual reimbursable costs, and after consultation with the Department, the Contractor submitted invoices for marketing activity they desired to conduct.

The Auditors have recommended that in the future, DBED obtain an annual marketing and promotional budget from the contractor. The Department does not agree with the Auditor's recommendation for the reasons detailed above. In the future, the Department will obtain and review a proposed annual marketing budget from the Contractor, if the Department requests a budget appropriation for marketing the program. In the future, the Department will reimburse the Contractor for approved costs, rather than advance funds for marketing activity. The Department will obtain supporting documentation for costs incurred from funds previously advanced, and recover any unspent funds.

PURCHASES AND DISBURSEMENTS

Finding #7

Proper internal controls were not established over the processing of purchasing transactions.

RESPONSE TO #7

DBED agrees with this finding and recommendation that available FMIS security features be used by establishing independent online approval requirements for all critical purchasing transactions. The Office of Contracts and Procurement (OCP) staff FMIS security levels have been **changed** to ensure that no one individual can both initiate and approve a purchase order.

OCP staff who can only *initiate* a purchase order are as follows:

Alice Cook
Debi Epps
Debbie Harris
Perscilla Cothorn

OCP staff who can only *approve* a purchase order is as follows:

Debi Chronister

Finding #8

Expenditures were not always adequately supported or made in accordance with contract terms.

RESPONSE TO # 8

The Department concurs with the recommendations, and the findings.

Division of Tourism, Film and the Arts – Office of Tourism Development (Mailing Services)

The fulfillment tasks have been handled by different people over the years, due to staff changes. Unfortunately, the proper training to complete the fulfillment functions did not consistently occur. The audit issues are indeed correct and, once alerted to the documentation problems, the Office of Tourism Development (OTD) took steps to correct these items and to secure all of the back-up. Additionally, as OTD is at the juncture of proceeding with a Request for Proposal for fulfillment, OTD has been able to simplify the billing chart and put it on a per piece basis rather than a kit basis. This should allow the office to simplify and easily reconcile invoices to the work for which it is being billed. Also, the RFP will have stipulations that labor charges for additional tasks such as special surveys, kit development, etc will have to begin with a task order form issued by OTD and that time sheets will be required to support billing charges.

In the category where over billing and under billing occurred, OTD has notified the vendor of the inconsistencies and is determining the amount of money to be either refunded by the vendor or that is due the vendor. OTD staff is working on reconciling the difference. This process will be completed by June 30, 2008. The vendor will be invoiced for any difference due to the state.

RECOMMENDATION: We agree that staff should monitor vendor invoices to ensure that they have supporting documentation.

ACTION PLAN: We have instituted remedies to ensure that this type of issue does not arise moving forward. Proper training of staff has occurred, and will continue, in regard to the cost arrangement with the vendor; additionally, the approval of all invoices has been elevated to a manager level rather than a subject area expert. Additionally, we are in the process of going out to bid for the fulfillment contract and have incorporated many of the auditors' comments into the RFP process and into OTD's business practices.

Division of International Investment and Trade (Disbursements for International Office & International Travel)

As required, the Division of International Investment and trade (DIIT) will ensure that all of its Baltimore-based and foreign office staff provide complete documentation and justification for All expenditures.

The DIIT team will comply fully with the State’s international travel regulations with respect to international travel air tickets. First class travel is never authorized under any circumstances.

Division of Tourism, Film and the Arts – the Maryland Film Office (Contractual employee)

The contractual employee working out of State was a part-time contractual position for a Los Angeles resident to represent the Maryland Film Office (MFO) in California. Exhibit B of the contract stated that the workplace for this contractual employee was to be his home. There was an attachment to Exhibit B which specified an additional payment of up to \$300 a month for office space for this contract position. Comparable office space in California costs \$1,000/month for an open cubicle in a shared bullpen area to \$1,800/month for a small private office in a complex. The decision to provide a home office expense allowance was made with the approval of a previous Director of the Film Office and Director of Administration for DBED in July of 2000 to reduce operating costs of this contractual activity.

RECOMMENDATION: The MFO agrees with the recommendation that DBED obtain adequate supporting documentation for all vendor payments and ensure that payments are properly approved and made in accordance with contractual agreements.

ACTION PLAN: The contract was terminated June 30, 2007; therefore no procedural changes are required to be compliant with the auditor’s recommendations.

CHECKS RECEIVED FOR DISTRIBUTION

Finding #9

Controls over state checks received by DBED for subsequent distribution to applicable payees were not sufficient

RESPONSE TO #9

The Division understands the concern in Finding number 9 specifically regarding independent verification of check distribution by random testing; however, the Division feels that it is taking all the necessary and reasonable steps to ensure proper delivery and receipt of disbursement checks. The Division attempted to have checks directly sent from the Comptroller but encountered many problems such as checks going to the incorrect borrowing entity, checks sent to the incorrect address, and checks lost in the mail. Checks sent from the Comptroller are delivered by regular mail, do not require a return receipt, and are not sent with any correspondence to the recipient. There is no assurance using direct delivery from the Comptroller that the correct payee received the check. The Division has adopted wire transfer as the preferred method to disburse funds in order to eliminate control issues. However, in some instances it is necessary to disburse funds at a loan settlement or mail the disbursement check directly to the payee. Check disbursements taken to settlement require a written receipt from the borrower. For checks mailed directly to the payee, the Division uses FedEx delivery and keeps the FedEx receipt on file for tracking purposes. If for any reason the payee does not receive the disbursement check, the Division can easily track the package. In addition, the Division has recently implemented online tracking with FedEx, which allows for even further verification by providing an online image of the recipient's signature along with the date the disbursement package was received. This method ensures further verification that the package is delivered to the correct address and received by the appropriate recipient. All hand delivered check receipts and FedEx receipts are kept on file with a copy of the disbursement check.

The Division agrees with the auditor's recommendation to randomly test the initial recording of disbursement checks to the documentation of receipt by the payee. The Division will have the Office of Internal Audits verify quarterly the initial recording of checks received for distribution to documentation of receipt by the payee. The Division is in the process of auditing the first quarter of 2008 disbursement check documentation by the Office of Internal Audits as recommended.

The Division believes it complies with the GAD approval dated October 22, 2001 and interpreted "loan settlements" to also include grants settled as they have a similar process and are often acceptable alternatives under the statutes. The Division did confirm with the Comptroller's Office that "loan settlements" did include grant settlements in its October 2001 approval.

However, for clarification the Division requested to have "Grants" added to the list of payments allowed to be disbursed from DBED on the GAD approval. On June 9, 2008, the Division received formal approval from the Comptroller's office for the above request to add "Grants" to the list of payments allowed to be disbursed from DBED. The Division will also ensure that third party vendor payments are distributed directly from the Comptroller.

PROMOTIONAL ACTIVITIES

Finding #10

DBED did not have formal procedures requiring a documented evaluation of the effectiveness of significant promotional and marketing events

RESPONSE TO # 10

The Department concurs with the findings and the recommendations.

Division of Business Development (Poker tournaments)

In October of 2005, DBED hosted promotional events that targeted business site location consultants and corporate real estate executives to establish strong business relationships between the Maryland sales staff and this key audience. These consultants are responsible for advising companies on good locations for future business expansions.

The poker events did not involve winning money. The format was strictly used as a means to interact with the business executives and to build good relationships with them. In sales, relationships are key because people do business with people they know. These consultants are more apt to call Maryland if they have an established contact here.

Additionally, DBED also consistently seeks sponsors to off-set the costs involved in hosting these events. The expenditures noted included catering for the event, equipment rental and a host to organize the games. In FY 2005 and FY 2006, DBED company successes that came from consultants resulted in capital expenditures of \$78 million and \$83 million respectively.

Action Plan: Final reports will be written within two weeks after the event. The report will include a final attendee list, method of follow-up with attendees, and detailed dates of follow-up.

Division of Tourism, Film and the Arts- Office of Tourism Development (Cruises)

The Division of Tourism, Film, and the Arts (TFA) agrees with auditor's finding. This issue raised concerned a one-time marketing event held in 2006 that was coordinated by a staff member who is no longer employed by DBED. There were no records submitted nor report prepared prior to his departure concerning this event.

RECOMMENDATION: We agree with the auditor's recommendation that TFA prepare comprehensive reports to document purpose, effectiveness and results of all promotional events; document follow up efforts on networking activities; and, consider cancelling or rescheduling events where there is lower than expected interest in a marketing event. However, we are not able to construct a report for this particular event in retrospect due to absence of accurate, verifiable records.

Division of Tourism, Film and the Arts – The Maryland Film Office (Networking receptions)

For over 20 years, the Maryland Film Office (MFO) has hosted an annual Maryland marketing event in Los Angeles as a vital element of MFO's promotion of Maryland as a filmmaking destination. In recent years, the MFO began holding the event at Lucky Strike, a bowling alley and restaurant (with a bar) centrally located in Hollywood. Film and television project development is a long process that can take years to realize; therefore, it is vital to maintain existing relationships, establish new contacts, and track long term progress. These events provided Film Office staff with an opportunity to connect with industry professionals and decision makers many of whom were past and/or present clients. These events afford the MFO the opportunity to nurture and sustain relationships in an industry where relationships play a vital role.

In recent years, Tom Rothman, a Maryland native, Chairman of 20th Century Fox and, according to *Premiere Magazine*, one of Hollywood's "Most Powerful" people, has been the honorary host of the MFO event. His prestige alone attracts high quality industry professionals and decision makers.

Besides helping to maintain established relationships, the following are examples of leads for projects that came about as a result of the MFO's most recent event. At the November 2007 event, the MFO's discussions with a guest directly resulted in Gallaudet that she has in development and MFO has been scouting for this production.

The MFO agrees with the auditor's findings that there was no formal written report prepared following each event. However, the MFO provided the guest list and an accurate accounting of who attended each event.

RECOMMENDATION: The MFO agrees with the recommendation that DBED establish procedures requiring the preparation of comprehensive reports to document the effectiveness and results of all promotional events, such as networking opportunities obtained from these events.

ACTION PLAN: A Final Marketing Event Report to document purpose, effectiveness and results of promotional events and monitor follow-up efforts has been developed by TFA and copies of the completed report are maintained with the event contract. The MFO prepared this report for its November 2007 event.

PAYROLL

Finding #11

DBED entered into separation agreements with certain employees, allowing them to remain on the payroll for extended periods beyond their effective termination dates.

RESPONSE TO #11

This is an appropriate finding. DBED independently reached the policy decision to abandon the historical practice of entering into employment separation agreements in December 2006 before the audit findings and recommendations were made. Nevertheless, we agree with Finding 11 and commit that DBED will not return to that practice. Also, tuition reimbursements will not be provided to resigning employees.

**BACKGROUND INFORMATION SECTION OF DRAFT AUDIT REPORT–
REFERRAL TO ATTORNEY GENERAL**

Referral To Attorney General (Page 7 of Draft Report)

In May 2007, DBED submitted a bankruptcy claim for the unpaid portion of a line of credit a company had received from DBED. And, in January 2008, DBED referred an allegation of potential criminal activity on the same company to the Office of the Attorney General – Criminal Division.

RESPONSE

The Assistant Attorney General at the Criminal Division of the Office of the Attorney General (OAG) notified DBED's OAG of the following. The Criminal Division has decided that there is insufficient basis to pursue further investigation or prosecution in this case. The matter is closed.

Regarding DBED's bankruptcy claim, the individual debtors were discharged in their Chapter 7 bankruptcy case. There were no assets of the bankruptcy estate from which to pay the claims of unsecured creditors. DBED is barred from pursuing its claim against the discharged debtors.

DBED has also asserted a claim against the United States Department of Defense, Defense Energy Support Center (DESC), under the federal Assignment of Claims Act.

AUDIT TEAM

Paul R. Denz, CPA
Audit Manager

Matthew L. Streett, CPA, CFE
Senior Auditor

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