

Audit Report

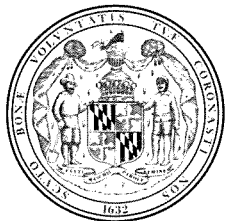
Maryland Economic Development Corporation

December 2012



OFFICE OF LEGISLATIVE AUDITS
DEPARTMENT OF LEGISLATIVE SERVICES
MARYLAND GENERAL ASSEMBLY

-
- This report and any related follow-up correspondence are available to the public through the Office of Legislative Audits at 301 West Preston Street, Room 1202, Baltimore, Maryland 21201. The Office may be contacted by telephone at 410-946-5900, 301-970-5900, or 1-877-486-9964.
 - Electronic copies of our audit reports can be viewed or downloaded from our website at <http://www.ola.state.md.us>.
 - Alternate formats may be requested through the Maryland Relay Service at 1-800-735-2258.
 - The Department of Legislative Services – Office of the Executive Director, 90 State Circle, Annapolis, Maryland 21401 can also assist you in obtaining copies of our reports and related correspondence. The Department may be contacted by telephone at 410-946-5400 or 301-970-5400.
-



DEPARTMENT OF LEGISLATIVE SERVICES
OFFICE OF LEGISLATIVE AUDITS
MARYLAND GENERAL ASSEMBLY

Karl S. Aro
Executive Director

December 3, 2012

Thomas J. Barnickel III, CPA
Acting Legislative Auditor

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

Ladies and Gentlemen:

We have audited the Maryland Economic Development Corporation (MEDCO) for the period beginning September 16, 2009 and ending May 17, 2012. MEDCO's purpose is to assist in the expansion, modernization, and retention of existing Maryland businesses and to attract new business to the State.

Our audit disclosed internal control deficiencies related to cash receipts processed electronically through remote deposit.

MEDCO's response to this audit is included as an appendix to this report. We wish to acknowledge MEDCO's cooperation extended us during the course of this audit.

Respectfully submitted,

Thomas J. Barnickel III, CPA
Acting Legislative Auditor

Background Information

Agency Responsibilities and Financial Activity

The Maryland Economic Development Corporation (MEDCO), which functions under the provisions of Title 10, Subtitle 1 of the Economic Development Article of the Annotated Code of Maryland, is constituted as a public instrumentality of the State of Maryland.

MEDCO's goal is to assist in the expansion, modernization, and retention of existing Maryland businesses and to attract new businesses to the State. MEDCO also owns and manages certain properties and, upon request, assists local jurisdiction projects, and borrows money and issues bonds for financing this assistance. MEDCO is managed by a 12-member Board of Directors appointed by the Governor. The administrative affairs and technical activities of MEDCO are directed and supervised by an executive director who is appointed by the Board, subject to the approval of the Governor.

The Corporation was created in 1984 and, as of December 2011, had undertaken 226 projects. At the end of fiscal years 2011 and 2012, MEDCO's non-recourse debt, according to its audited financial statements, totaled \$760 million and \$745 million, respectively. The debt that is recorded in the financial statements represents obligations related to the operating facilities of MEDCO, and such debt is to be retired solely from the operating revenues of the respective facilities. As of June 30, 2012, MEDCO owned and managed 14 operating facilities. MEDCO is not liable to bondholders and lenders in the event of project/borrower default. The debt consists primarily of revenue bonds issued by MEDCO (which are not obligations of the State of Maryland) and loans from government agencies (for example, the State Department of Business and Economic Development).

Based on a review of MEDCO's annual activities reports for its 14 operating facilities and discussions with management personnel, we noted the following four financially troubled projects:

- One student residential building project, one conference center project, and one innovation center, characterized as watch projects, have not met all of their financial covenants. These three projects had outstanding bond debt as of June 30, 2012 of approximately \$31.2 million, \$173.3 million, and \$2.4 million, respectively. As a result, MEDCO engaged management consultants and lenders for these projects who recommended various improvement strategies that are in the process of being implemented.

- One golf course and hotel project, characterized as non-performing, was sold to a private company on August 3, 2012 for \$6.8 million, resulting in a loss of \$67.6 million to bondholders, MEDCO, two State agencies, and a local county government. This transaction was approved by the Board of Public Works.

Financial Statement Audits

MEDCO engaged an independent accounting firm to conduct annual audits of its financial statements. In the related audit reports for fiscal years ended June 30, 2010, 2011 and 2012, the firm stated that MEDCO's financial statements presented fairly, in all material respects, the financial position of MEDCO as of June 30, 2010, 2011, and 2012, and the respective changes in financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

Status of Findings From Preceding Audit Report

Our audit included a review to determine the status of the two findings contained in our preceding audit report dated March 31, 2010. We determined that MEDCO satisfactorily addressed these findings.

Findings and Recommendations

Cash Receipts

Finding 1

Controls over processing cash receipts using remote deposit were not adequate.

Analysis

Cash receipts processed using remote deposit were not adequately controlled. According to MEDCO records, receipts received by mail during fiscal year 2011 totaled approximately \$23.2 million, and generally related to management fees, bond fees, rental fees, and reimbursable project expenditures. The remote deposit process allows MEDCO to electronically scan the images of the checks and money orders and electronically transmit the images to the bank for deposit instead of physically taking the receipts to the bank for deposit. Specifically, we noted the following conditions:

- The deposit verifications were performed by an employee who frequently deposited checks through the bank's remote deposit system.
- The aforementioned employee and another employee shared one username and password to routinely access the bank's remote deposit system. Consequently, there is a lack of accountability for activity by these individuals.
- Checks deposited through the remote deposit system were not voided after they had been processed, and the checks were retained until MEDCO's external independent auditor had issued the annual audited financial statements. Consequently, sensitive banking information recorded on these checks was unnecessarily retained, increasing the risk of unauthorized disclosure. According to the Office of the State Treasurer's *Policy on the Use of Remote Deposit Services*, scanned and transmitted checks should be voided upon verification that the bank has accepted the scanned images and generally should be stored for no longer than thirty days. Although MEDCO is not required to comply with this *Policy*, the *Policy* reflects standard best practices to control the remote deposit process.

Recommendation 1

We recommend that MEDCO

- ensure that an employee who is independent of the cash receipts functions verifies that all collections are subsequently deposited,**
- assign unique usernames and passwords to employees with access to the bank's remote deposit system, and**
- ensure that checks are stamped as voided once processed through the bank's remote deposit system and are destroyed in a timely manner (such as, monthly) after deposits are independently verified.**

Audit Scope, Objectives, and Methodology

We have audited the Maryland Economic Development Corporation (MEDCO) for the period beginning September 16, 2009 and ending May 17, 2012. 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 MEDCO'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 included in our preceding audit report.

In planning and conducting our audit, we focused on the major financial-related areas of operations based on assessments of materiality and risk. The areas addressed by the audit included cash receipts, cash disbursements, and project monitoring. Our audit procedures included inquiries of appropriate personnel, inspections of documents and records, and observations of MEDCO'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.

MEDCO engaged an independent accounting firm to audit its financial statements annually. In the related audit reports, the firm stated that the financial statements presented fairly, in all material respects, the financial position of MEDCO as of June 30, 2010, 2011, and 2012 and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America. We have relied on the work of the independent accounting firm to provide audit coverage of certain aspects of MEDCO's operations (such as, internal controls and testing for debt financing, personnel, and payroll processing). Our audit procedures in these areas were generally limited, therefore, to obtaining a sufficient basis for that reliance.

MEDCO'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 conditions that we consider to be significant deficiencies in the design or operation of internal control that could adversely affect MEDCO's ability to maintain reliable financial records, operate effectively and efficiently, and/or comply with applicable laws, rules, and regulations. Our audit did not disclose any significant instances of noncompliance with applicable laws, rules, or regulations.

MEDCO'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 MEDCO regarding the results of our review of its response.

APPENDIX



MARYLAND ECONOMIC DEVELOPMENT CORPORATION

MEDCO

100 NORTH CHARLES STREET, SUITE 630

BALTIMORE, MD 21201

Phone: (410) 625-0051; Fax (410) 625-1848

November 26, 2012

Department of Legislative Services
Office of Legislative Audits
Thomas J. Barnickel III, CPA
301 West Preston St. Rm. 1202
Baltimore, Maryland 21201

Dear Mr. Barnickel:

We are responding to the Legislative Audits, draft audit report, on the Maryland Economic Development Corporation (the "Corporation") for the period September 16, 2009 through May 17 2012. The following are the Findings and Recommendations along with the Corporations' response:

Findings and Recommendations

Cash Receipts

Finding 1

Controls over processing cash receipts using remote deposit were not adequate.

Recommendation 1

We recommend that MEDCO

- a. ensure that an employee who is independent of the cash receipts functions verifies that all collections are subsequently deposited,**
- b. assign unique usernames and passwords to employees with access to the bank's remote deposit system, and**
- c. ensure that checks are stamped as voided once processed through the bank's remote deposit system and are destroyed in a timely manner (such as, monthly) after deposits are independently verified.**

MEDCO Response to Legislative Audits draft audit report
For the Period September 16, 2009 to May 17, 2012

We generally concur with your findings and recommendations and propose the following actions to address them:

- a. We proposed to have the Receptionist continue to prepare a daily log of checks received, stamp the checks for deposit to our account, save it as an *Excel* file on our server and give the checks to the Bookkeeper for deposit. In the absence of the Bookkeeper, the Assistant Controller will process the checks for deposit. The Controller will compare the daily log to the bank statement during the bank reconciliation process regardless of who makes the deposit. This procedure was put in place in October 2012 and is now the Corporations' procedure.
- b. We requested the bank to provide the unique usernames and passwords for our current Assistant Controller. The unique usernames and passwords were set up and were fully implemented on November 13, 2012
- c. We will stamp checks received as void upon verification that the bank has accepted the scanned image in accordance with the State Treasurer's policy. Generally, we expect this to be during the account reconciliation process once the monthly statement is received. Checks will be destroyed when they no longer constitute a reconciling item on the account. This procedure was adopted in October 2012 and is now the Corporations' procedure.

If you have any questions or further comments, please contact me.

Sincerely,



Robert C. Brennan
Executive Director

Cc: Martin Knott Jr., Chairman
Randy Shields, Controller

AUDIT TEAM

Matthew L. Streett, CPA, CFE
Audit Manager

Elaine D. Portnoy
Senior Auditor

Peter Rorick
Tu N. Vuong
Staff Auditors