

Audit Report

Maryland Department of Planning

July 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

July 2, 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 Maryland Department of Planning (MDP) for the period beginning March 28, 2005 and ending October 31, 2007.

Our audit disclosed that tax credit certification procedures under the Heritage Structure Rehabilitation Tax Credit Program were inadequate. Specifically, MDP did not require project applicants to substantiate reported project expenditures claimed for the approved rehabilitation projects. Consequently, there was a lack of assurance that only eligible expenditures were certified for tax credits.

Our audit also disclosed that MDP did not adequately monitor State grants awarded by the Division of Historical and Cultural Programs to ensure that grantees spent awarded funds and submitted related project progress reports as required. We also identified other deficiencies related to MDP's practices concerning equipment inventory and disbursements.

Respectfully submitted,

Bruce A. Myers, CPA
Legislative Auditor

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* Denotes item repeated from preceding audit report on the Department of Housing and Community Development, dated April 12, 2006

Background Information

Agency Responsibilities

The Maryland Department of Planning (MDP) provides information and services that improve the ability of State and local governments as well as community, development, and environmental organizations to support growth that fosters vibrant, livable communities. In addition, MDP is responsible for preserving and protecting the environment and for the efficient use of State resources. MDP is authorized to charge fees to recover the related costs for providing products and services, such as planning and urban design services, computer application development services, and technical studies. According to the State's records, MDP's operating expenditures totaled approximately \$51.5 million in FY 2007.

Transfer of Budgetary Program

In accordance with Chapter 440, Laws of Maryland 2005, effective October 1, 2005, the Division of Historical and Cultural Programs, which includes the Maryland Historical Trust, was transferred from the Department of Housing and Community Development (DHCD) to the Maryland Department of Planning. Although currently staffed by MDP employees, the Division continues to operate out of the DHCD offices located in Crownsville, Maryland. Primarily as a result of this budgetary transfer, MDP's annual operating expenditures increased from \$9.5 million during fiscal year 2005 to \$51.5 million during fiscal year 2007.

Status of Findings From Preceding Audit Report

There were no findings in our preceding audit report on MDP dated August 17, 2005. Our audit did include a review to determine the status of the one finding contained in our most recent audit report on DHCD, dated April 12, 2006, that was applicable to the Division of Historical and Cultural Programs, which was transferred from DHCD to MDP. We determined that MDP did not address this finding and, therefore, it is repeated in this report.

Findings and Recommendations

Heritage Structure Rehabilitation Tax Credit Program

Background

The State Finance and Procurement Article, Section 5A-303 of the Annotated Code of Maryland, provides that, for the tax year in which a certified rehabilitation of a heritage structure is completed, an individual or business entity may claim a tax credit in an amount equal to 20 percent of the qualified expenditures incurred for a rehabilitation project. For commercial rehabilitation projects, the State tax credit allowed may not exceed \$3 million. For non-commercial rehabilitation projects, the State tax credit allowed may not exceed \$50,000. The Maryland Department of Planning's (MDP) Maryland Historical Trust initially approves all rehabilitation projects for which an applicant applies for a tax credit. Upon completion of a project, the grantee submits a final application, which includes photographs of the completed project and its total cost. After review of this application and related photographs, MDP may certify the project as eligible for a tax credit. On a quarterly basis, MDP notifies the State Comptroller of all tax credit amounts which it has certified. Accordingly, the Comptroller is advised of potential tax credits that could be claimed on State income tax returns.

During calendar years 2005 and 2006, MDP certified Program tax credits totaling approximately \$25 million and \$28.3 million, respectively.

Finding 1

MDP had not established adequate procedures for certifying Heritage Structure Rehabilitation Tax Credits.

Analysis

MDP lacked adequate procedures to ensure that tax credits certified under the Heritage Structure Rehabilitation Tax Credit Program were proper. Specifically, MDP did not require, and Program applicants generally did not provide, documentation (such as contractor billings) to support that reported expenditures were actually incurred for the related rehabilitation projects.

Our test of 25 tax credits totaling \$21.8 million that were certified by MDP during our audit period disclosed that, for 20 of these tax credits totaling \$18.8 million, MDP lacked documentation to support the propriety of the applicable reported expenditures. In addition, based on the dates recorded on the applications submitted to MDP, 2 of the these 20 projects, for which MDP certified tax credits totaling approximately \$4.7 million, were not completed within the 24 month time

frame required by State law. This is significant since the portion of project expenditures that was not incurred within this time frame would not qualify for a tax credit; however, without the detailed documentation, MDP cannot identify any ineligible expenditures.

Recommendation 1

We recommend that MDP establish procedures (such as requiring grantees to submit copies of paid invoices and/or cancelled checks) to verify the propriety of expenditures claimed for approved Heritage Structure Rehabilitation projects prior to certifying such expenditures for tax credits. We also recommend that MDP only certify, for tax credits, documented project expenditures that are incurred within the time frame specified in State law. In addition, we recommend that MDP determine the extent to which the expenditures applicable to the aforementioned two projects did not qualify for the \$4.7 million in tax credits that MDP authorized and, in conjunction with the State Comptroller, pursue recovery of any applicable amounts.

Grant Funds

Finding 2
MDP did not ensure that reporting requirements applicable to State grant awards were complied with and that funds were spent in accordance with the related grant provisions.

Analysis

MDP did not ensure that recipients of State grants awarded by its Division of Historical and Cultural Programs complied with applicable grant reporting requirements, and that grantees spent awarded funds as required. Our test of 8 fiscal year 2006 and 2007 grants with awards totaling \$672,814 disclosed that, for 6 grants with awards totaling \$570,314, MDP had not received, and generally did not make follow-up requests for, numerous required progress reports from the grantees. Furthermore, for 4 of these 6 grants, MDP improperly disbursed funds totaling \$185,598 since, at the time the payments were made, the applicable grantees had not submitted complete documentation to MDP to support the project expenditures. In addition, for those reports that were submitted by these 6 grantees, such reports did not always properly disclose project expenditures (that is, reports did not include any expenditure data or expenditures were not itemized by budget category), and there was a lack of documentation that MDP had reviewed the reports. Division records indicate that State grants totaling

approximately \$6 million were awarded during fiscal year 2007. The lack of support for grant expenditures was commented upon in our most recent audit of the Department of Housing and Community Development (DHCD).

MDP's grant agreements required that grantees spend awarded funds in accordance with the applicable grant budgets and provide MDP with documentation (for example, vendor invoices, cancelled checks) to support all reported expenditures. The agreements further required grantees to submit periodic progress reports of work status and final project reports. In addition, the agreements, and MDP's written grant policies, stipulated that MDP would not disburse additional funds to grantees until MDP received documentation to support all reported project expenditures.

Recommendation 2

We recommend that, in the future, MDP obtain from grantees all required reports and documentation to support reported grant expenditures, and that MDP review this information to verify that State grant funds were spent as intended. We further recommend that these verifications be performed by MDP prior to disbursing additional funds to grantees. Finally, we recommend that MDP review completed grant projects, at least on a test basis, to determine the extent of reported expenditures that were not adequately supported and/or were not made in accordance with the applicable grant agreements, and obtain reimbursements from grantees for all unsupported expenditures.

Equipment

Finding 3

MDP could not locate equipment items totaling \$537,000, and did not record certain other items that were transferred from DHCD in October 2005. In addition, MDP did not conduct physical inventories of sensitive equipment, and did not maintain certain records, as required.

Analysis

MDP did not properly account for and control its equipment inventory, including equipment transferred from DHCD in conjunction with the budgetary transfer in October 2005. Specifically, we noted the following conditions:

- MDP did not properly record and account for equipment transferred from DHCD. At the time of the transfer, records maintained by DHCD showed such equipment totaled approximately \$1.4 million and, as of June 2006,

MDP had sighted and recorded items totaling approximately \$170,000 in its equipment records. During a physical inventory of the remaining transferred equipment items conducted in October 2007, MDP was unable to locate 486 equipment items (such as photographic equipment, computers and furniture) totaling approximately \$537,000. Furthermore, although MDP had located equipment items totaling approximately \$740,000 during this inventory, as of December 2007, MDP had not recorded these items in its detail records.

- Other than for equipment items transferred from DHCD, as of December 2007, MDP had not conducted a physical inventory of its sensitive equipment items (such as computers) since June 2005.
- MDP had not reconciled the balance in its equipment control account to the related detail records since August 2006 and, as of October 31, 2007, the balance of the equipment control account exceeded the aggregate balance of the related detail records by \$31,425.

The Department of General Services' (DGS) *Inventory Control Manual* specifies the procedures for investigating, reporting to DGS, and removing records for missing items. The *Manual* also requires that all capital equipment items be recorded in the detail equipment records, that physical inventories of sensitive equipment items be completed at least annually, and that the control account balance be reconciled to the aggregate sum of the related detail records on a quarterly basis. According to its records, as of October 31, 2007, MDP's equipment (including certain items transferred from DHCD) totaled approximately \$2.6 million, including sensitive equipment items totaling approximately \$2 million.

Recommendation 3

We recommend that MDP, in conjunction with DHCD, investigate the equipment items totaling \$537,000 that could not be located, and request write-off approval from DGS, as warranted. Should MDP conclude that any missing items may have been misappropriated, we recommend that MDP refer the matter to the Office of the Attorney General – Criminal Division. We also recommend that MDP record the equipment items totaling \$740,000, as well as other equipment items that are subsequently located, in its equipment records. Finally, we recommend that MDP annually complete physical inventories of its sensitive equipment items and periodically reconcile its equipment control account balance to the aggregate sum of the related detail records.

Disbursements

Finding 4

Proper internal controls were not established over the processing of certain critical disbursement transactions.

Analysis

MDP did not fully use the available security features of the State's Financial Management Information Systems (FMIS) to properly control certain disbursement transactions. Specifically, online approval paths had not been properly established for these transactions, and as a result, two employees could initiate and approve such transactions for payment without independent online approval. Furthermore, these employees could also establish new vendors on the system. Consequently, unauthorized disbursements could be processed that may not be readily detected.

During fiscal years 2006 and 2007, MDP processed disbursements totaling approximately \$8.8 million through FMIS, of which disbursements totaling approximately \$1.9 million were initiated and approved by the same employees.

Recommendation 4

We recommend that MDP utilize available FMIS security features by establishing independent online approval requirements for all critical disbursement transactions.

Audit Scope, Objectives, and Methodology

We have audited the Maryland Department of Planning (MDP) for the period beginning March 28, 2005 and ending October 31, 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 MDP'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 one applicable finding contained in our preceding audit report of the Department of Housing and Community Development.

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 MDP'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 certain of MDP'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 MDP 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.

MDP'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 MDP'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 of significant instances of noncompliance with applicable laws, rules, or regulations. Other less significant findings were communicated to MDP that did not warrant inclusion in this report.

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

APPENDIX



Maryland Department of Planning

Martin O'Malley
Governor

Richard Eberhart Hall
Secretary

Anthony Brown
Lt. Governor

Matthew J. Power
Deputy Secretary

June 30, 2008

Bruce A. Myers, CPA
Legislative Auditor
Department of Legislative Services
Office of Legislative Audits
301 West Preston Street, Room 1202
Baltimore MD 21201

Dear Mr. Myers:

Listed below are MDP Responses to the audit report comments and recommendations.

Finding 1:

MDP had not established adequate procedures for certifying Heritage Rehabilitation Tax Credits.

MDP lacked adequate procedures to ensure that tax credits under the Heritage Rehabilitation Tax Credit Program were proper. Specifically, MDP did not require, and tax credit applicants typically did not provide, documentation (such as contractor billings) to support that expenditures reported by applicants were actually incurred in conjunction with approved rehabilitation projects.

Recommendation 1:

MDP establish procedures to verify the propriety of expenditures claimed for approved Heritage Structure Rehabilitation projects prior to certifying such expenditures for tax credits. Also, MDP should determine the extent to which the expenditures applicable to the aforementioned 2 projects did not qualify for the tax credits authorized.)

MDP Response:

MDP has taken steps to establish procedures to verify the propriety of expenditures claimed for tax credits, as discussed below. This particular finding, however, does warrant some explanation of past practice.

The Maryland Heritage Structure Rehabilitation Tax Credit program (post 1996) was modeled on and largely adopted the process, procedures, and regulations established for two very similar state and federal tax incentive programs that had been in continuous operation since 1976. Neither program routinely had required tax credit applicants to submit detailed financial documentation to support the rehabilitation expenditures claimed, nor did the current authorizing statute require MHT or the Comptroller to collect or verify such documentation. Those programs required applicants to maintain auditable records of expenditures claimed, but relied on applicants' signature attesting under penalty of perjury to the accuracy of the claims submitted. When administrators of the programs noted a discrepancy, uncertainty, or lack of clarity in their review of tax credit projects, at that point additional supporting documentation was requested to resolve the issue. A number of such reviews resulted in adjustment of the final claimed expenditures, and, in a least one case, recapture of credits inappropriately claimed.

Beginning with Part 2 Heritage Structure Rehabilitation Commercial Tax Credit Applications certified after July 1, 2008 (FY 2009), applicants will be required to submit an "Accountant's Certification" prepared by a CPA licensed in Maryland as an addendum to the Part 3 Application. The Certification will document and verify actual costs incurred during the statutorily-defined 24-month project period. MDP will develop a procedures model which will stipulate expenditures and documentation to be certified by CPAs.

Beginning with Part 2 Homeowner Tax Credit Applications certified after July 1, 2008 (FY 2009), applicants will be required to submit receipts and invoices with their Part 3 Application for eligible rehabilitation costs incurred during the 24-month project period. This documentation will be reviewed by MDP tax credit staff as part of the review and final certification of tax credit projects.

In addition, the audit questioned whether 2 commercial projects which had been certified were completed within the 24-month time frame required by the authorizing statute. On April 3, 2008, MDP sent letters to the applicants for the 2 projects requesting clarification and documentation of project expenses, and the time frame within which they were made. For the Radcliffe Mill project in Kent County (MHT 2005-143) an analysis of eligible costs by vendor and by month for the relevant 24-month period was submitted. This analysis itemized and clarified that 1) the total qualifying rehabilitation costs for the project exceeded the amount claimed in the tax credit filing, and 2) the claimed qualifying expenditures were incurred within a 24-month period beginning July 1, 2005, and ending June 30, 2007. Information received to date from the other questioned applicant was not adequate to completely address the issues raised by the auditors and additional documentation has been requested.

Finding 2:

MDP did not ensure that reporting requirements applicable to State grant awards were complied with and that funds were spent in accordance with the related grant provisions.

Recommendation 2:

We recommend that, in future, MDP obtain from grantees all required reports and documentation to support related grant expenditures, and that MDP review this information to verify that State grant funds were spent as intended. We further recommend that these verifications be performed by MDP prior to disbursing additional funds to grantees. Finally, we recommend that MDP review completed grant projects, at least on a test basis, to determine the extent of reported expenditures that were not adequately supported and/or were not made in accordance with the applicable grant agreements, and obtain reimbursements from grantees for all unsupported expenditures.

MDP Response:

MHT was transferred to MDP in October of 2005. The audit of MHT's monitoring of grant awards focused on 8 FY2006 and FY2007 grant awards. Of the 6 projects found deficient, 4 remain active. While interim progress reports and financial backup documentation may be lacking for those 4 active grants, it is expected that the grantee's final product and financial reporting documentation will be reconciled at the conclusion of the project.

Grant procedures and processes in place at that time of the FY2006 and FY2007 awards were the product of DHCD's oversight of MHT grant administration. MDP began working with MHT to improve its monitoring of grant awards in late FY2007. MDP has focused particular attention on improving grantee compliance with program reporting and expenditure verification requirements and on standardizing administration of MHT's multiple grant programs. We believe that the changes that have already been implemented address the auditor's concerns.

In response to the auditor's review, the MDP Deputy Secretary has already led a counseling meeting with all MHT grant project monitors to clarify their responsibilities in reviewing and verifying grantee expenditures. For the FY2009 grant round, MDP will revise its "Grantee Responsibilities for Financial Reporting" guidance document to ensure that grantees submit required reports and financial backup documentation necessary to support grant expenditures. MDP staff will also host annual mandatory regional meetings with all FY2009 grant award recipients to ensure that they understand their financial reporting responsibilities. Finally, MDP staff will ensure that all expenditures made by grantees are appropriate and sufficiently documented. Grantees will not receive their final disbursement and funds already awarded will be subject to recapture if grantees fail to provide the required supporting documentation.

Finding 3:

MDP had not located certain equipment items assigned to the Maryland Historical Trust totaling approximately \$537,000. In addition, MDP had not recorded in its detail records additional equipment items of the Trust totaling approximately \$740,000.

Recommendation 3:

We recommend that MDP complete a physical inventory of the equipment assigned to the Maryland Historical Trust and record all items located in its detail equipment records. We also recommend that MDP, in conjunction with DHCD, investigate any equipment items assigned to the Trust that cannot be located and request write-off approval from the Department of General Services. Should MDP conclude that any missing items may have been misappropriated, we recommend that MDP refer the matter to the Office of the Attorney – Criminal Division.

MDP Response:

MDP has spent significant time and effort improving its inventory management over the past 6 years to be a leader in the State. Prior to the merger with MHT, MDP had a clean audit for inventory. MDP feels that this finding puts the agency in a true “no-win” situation. The equipment cited by OLA is equipment that is under the custodial care of DHCD. MDP conducted a physical inventory of all DHCD equipment located in MHT space. This physical inventory resulted in a full listing of DHCD equipment assigned to MHT. MDP has always been willing to accept into its inventory any DHCD equipment assigned to MHT that DHCD can physically locate. To date, MDP has only been unwilling to accept equipment into our inventory from DHCD that we can not physically locate, as it is the definition of poor inventory control.

OLA has agreed to broker a meeting of all parties to look at resolving this inventory issue. We anticipate that this will result in a satisfactory conclusion for all parties.

Finding 4:

Proper internal controls were not established over the processing of certain disbursement transactions

Recommendation 4:

We recommend that MDP utilize available FMIS security features by establishing independent online approval requirements for all critical disbursement transactions.

MDP Response:

As of November 2, 2007 all document types have an appropriate approval path associated with them.

We agree with the finding but would note that there is no evidence that any inappropriate transactions took place.

If you have any questions, please feel free to contact me at 410-767-4510.

Sincerely,

A handwritten signature in black ink, appearing to read "Richard Eberhart Hall". The signature is written in a cursive style with a large, stylized "R" and "H".

Richard Eberhart Hall

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