

Audit Report

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**Department of Transportation  
Secretary's Office**

September 2009

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**OFFICE OF LEGISLATIVE AUDITS**  
DEPARTMENT OF LEGISLATIVE SERVICES  
MARYLAND GENERAL ASSEMBLY

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**DEPARTMENT OF LEGISLATIVE SERVICES**  
**OFFICE OF LEGISLATIVE AUDITS**  
**MARYLAND GENERAL ASSEMBLY**

**Karl S. Aro**  
Executive Director

September 21, 2009

**Bruce A. Myers, CPA**  
Legislative Auditor

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

Ladies and Gentlemen:

We have audited the Maryland Department of Transportation—Secretary's Office, including the Debt Service Requirements Unit (MDOT), for the period beginning January 1, 2006 and ending January 8, 2009. MDOT provides overall direction and support to six transportation modal agencies and administers the bond issuance and debt service activities associated with the Department's transportation bonds. MDOT also provides operating and capital grants for transit services in the Washington, D.C. metropolitan area as well as grants to other governmental agencies for transportation-related purposes.

Our audit disclosed that MDOT did not timely review the calculation of the State subsidies paid to the Washington Metropolitan Area Transit Authority, which during fiscal years 2007 and 2008, totaled \$171 million and \$193 million, respectively. In addition, MDOT did not ensure that sales of surplus real estate were supported by adequate property appraisals. Furthermore, supporting documentation was not always obtained for contractual payments. Finally, documentation to support certain required employee information was not obtained by MDOT during the Minority Business Enterprise recertification process to ensure employer MBE status.

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

Respectfully submitted,

Bruce A. Myers, CPA  
Legislative Auditor



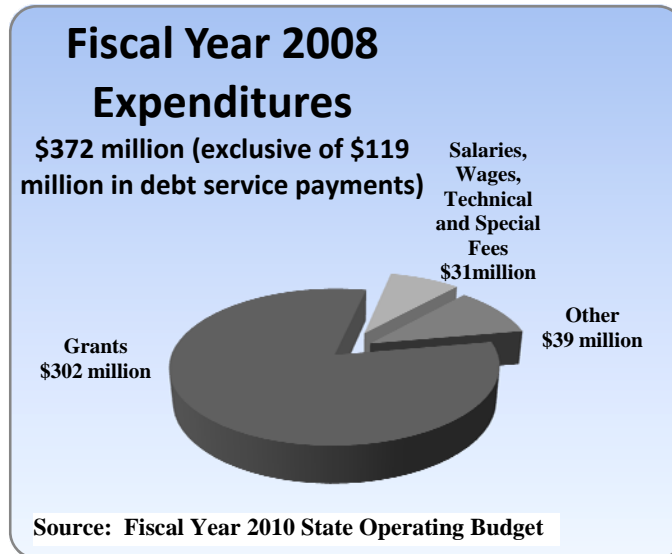
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## Background Information

### Agency Responsibilities

The Maryland Department of Transportation – Secretary’s Office (MDOT) provides overall direction and guidance to the Department and administers the bond issuance and debt service activities associated with the Department’s transportation bonds. MDOT also provides operating and capital grants for transit services in the Washington, D.C. metropolitan area, as well as grants to other governmental agencies (such as local transportation planning agencies) for transportation-related purposes. In addition, MDOT receives an appropriation for all debt service requirements of the Department.



MDOT is also responsible for the operation of the Office of Transportation Technology Services, which provides computing resources to the various units of the Department of Transportation and operates as a computer service bureau for these units. The computer operations of the Office are addressed in a separate audit of the data center and, as such, were not included in the scope of this audit.

According to the State’s records, during fiscal year 2008, MDOT’s operating expenditures totaled approximately \$372 million, the majority of which related to operating and capital grants to the Washington Metropolitan Area Transit Authority and other governmental entities. In addition, debt service payments totaled approximately \$119 million.

### Audit of the Department’s General Purpose Financial Statements

An independent accounting firm was engaged to audit the State of Maryland’s financial statements for the fiscal years ended June 30, 2006, 2007, and 2008. In conjunction with these audits, the firm was engaged to prepare separate audit

reports on the Department of Transportation's financial statements. In the related audit reports, the firm stated that the Department's financial statements presented fairly, in all material respects, the respective financial position of the governmental activities, the major fund, and the aggregate remaining fund information of the Department of Transportation, and respective changes in financial position, for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

### **Ground Rent for MDOT Headquarters Building**

In January 2003, MDOT completed the construction of its headquarters building. MDOT's construction and related project costs, totaling approximately \$54 million, were financed using Maryland Economic Development Corporation (MEDCO) bonds and grants. Rather than purchasing the land for the headquarters building outright, MDOT and MEDCO agreed to a land exchange with the developer (also the owner of the property) for property that was comparably valued. According to the land exchange agreement, if the land exchange was not completed by December 31, 2004, MDOT and MEDCO agreed to pay annual ground rent of \$195,000 to the developer until June 26, 2022 or until the land exchange occurs. As of May 1, 2009, the land exchange had not occurred. Consequently, MDOT had paid ground rent totaling \$780,000 during the period from January 1, 2005 through December 31, 2008.

Various issues have caused the delay in completing the land exchange. Specifically, in fiscal year 2002, MDOT originally offered State-owned property to the developer for the land exchange. However, due to various environmental concerns, the property was not deemed acceptable. In March 2006, MDOT granted \$3.6 million to MEDCO to purchase an acceptable piece of property for the land exchange. The property was purchased; however, the land exchange has yet to take place because certain requirements of the land exchange agreement (such as, acquiring certain land use permits) have not been met. MDOT anticipates completing the land exchange by December 2009.

### **Status of Finding From Preceding Audit Report**

Our audit included a review to determine the status of the eight findings contained in our preceding audit report dated July 7, 2006. We determined that MDOT had satisfactorily resolved these findings.

## Findings and Recommendations

### Washington Metropolitan Area Transit Authority (WMATA)

#### **Finding 1**

**MDOT did not timely review the State operating subsidies paid to the Washington Metropolitan Area Transit Authority (WMATA).**

#### **Analysis**

MDOT did not review the annual Washington Metropolitan Area Transit Authority (WMATA) operating subsidy calculations on a timely basis. As of May 2009, MDOT had not reviewed, for propriety, the calculations of the WMATA fiscal year 2007 and 2008 State of Maryland operating subsidies, for which the related payments totaled \$171 million and \$193 million, respectively. In accordance with the Washington Metropolitan Area Transit Authority Compact, WMATA provides transit services in Montgomery and Prince George's Counties, the District of Columbia, and several cities and counties in Northern Virginia. The Compact, between the State of Maryland, the Commonwealth of Virginia, and the District of Columbia, created WMATA and provided for the three jurisdictions to annually subsidize WMATA's operating and capital costs.

Operating subsidy payments made each year are based initially on WMATA's projected operating deficit for the year. Each jurisdiction's share of the deficit is determined using established criteria, such as population and transit ridership. The actual operating deficit is subsequently used by WMATA to make the appropriate adjustments to the previously paid subsidies. We were advised that MDOT conducts WMATA operating subsidy reviews as time and resources permit. The reviews are performed to determine whether the Maryland subsidies were properly calculated and reasonably accurate. The last review conducted, which covered the fiscal year 2006 subsidy, concluded that the State's subsidy was excessive, and resulted in a repayment totaling approximately \$738,000. We were advised by MDOT management that it intends to review future subsidy calculations triennially. In our opinion, based on the significance of the subsidy paid annually to WMATA and the potential for overpayments due to an inaccurate calculation, we believe these reviews should be conducted annually.

#### **Recommendation 1**

**We recommend that MDOT**

- a. annually verify the accuracy of the subsidy payment to WMATA, including any subsequent adjustments; and**
- b. take immediate action to verify the 2007 and 2008 subsidy calculations and settle any overpayments or underpayments identified.**

## Real Estate Sales

### **Finding 2**

**MDOT did not ensure that real estate sales were supported with adequate property appraisals.**

### **Analysis**

MDOT approved sales of surplus real estate owned by MDOT without obtaining adequate documentation of property appraisals. MDOT is responsible for reviewing real estate sales initiated by the various MDOT modal agencies (such as, State Highway Administration and Maryland Port Administration) and recommending approval of the sales to the Board of Public Works (BPW). Our test of nine real estate sales totaling approximately \$6.3 million, for which MDOT recommended approval during fiscal years 2006 through 2009, disclosed the following conditions for seven of the real estate sales tested:

- MDOT approved seven real estate sales, totaling approximately \$4.3 million, without obtaining copies of the property appraisals. Instead, MDOT relied on the modal agencies' reported values of the appraisals. Subsequently, we obtained the appraisals and confirmed the reported values. Since MDOT is approving the sales and recommending them for final approval by the BPW, we believe that MDOT should be verifying these critical documents.
- MDOT approved four real estate sales, totaling approximately \$988,000, even though the property appraisals were more than six months old. Specifically, these appraisals were completed 8 to 20 months before MDOT approved the real estate sales. Although MDOT does not require appraisals to be performed within six months of the approval for sale, due to the current volatility in the real estate market we were advised by the Principal Counsel for the BPW that the age of appraisals has recently been questioned. Furthermore, management personnel who handle real estate sales for the State Highway Administration advised us that appraisals should generally only be considered reliable if they are less than six months old.
- MDOT approved five real estate sales, totaling approximately \$4 million, without ensuring that two independent appraisals were obtained within a timely manner of each other to ensure comparability. Specifically, two real estate sales, totaling approximately \$3.1 million, were only supported with one appraisal each although the BPW requires two independent appraisals when the value of the property to be sold is anticipated to be more than \$100,000. For the other three real estate sales, totaling approximately \$878,000, although two property appraisals had been obtained for each, the appraisals were performed between 7 and 22 months apart. For example, for

one land sale of \$392,000, the appraisals were performed seven months apart. The first appraisal valued the land at \$392,000 and the second (more recent) appraisal valued the land at \$424,000. However, we were advised that the second appraisal was not considered as it was received too close to the time of sale and MDOT recommended the land be sold based on the value of the first appraisal.

According to MDOT records, during the period from January 1, 2006 to January 8, 2009, 142 real estate sales, totaling \$16 million, were recommended to BPW for approval.

## **Recommendation 2**

**We recommend that MDOT**

- a. obtain copies of the property appraisals for confirmation of appraisal amounts and document retention;**
- b. in consultation with BPW, develop procedures to ensure that property appraisals are obtained within a timely manner (such as, within six months of the recommended approval date); and**
- c. obtain at least two independent appraisals for each real estate sale, valued at more than \$100,000, and ensure that these appraisals are obtained within a timely manner of each other.**

## **Contractual Payments**

### **Finding 3**

**Supporting documentation was not always obtained for contractual payments.**

### **Analysis**

Our review of three contracts valued at \$11.6 million disclosed the following conditions:

- For two consulting service contracts, totaling approximately \$2 million, MDOT did not obtain sufficient documentation (such as, employee timesheets) to support labor hours billed, as required under the contracts. For example, our test of four payments totaling approximately \$82,900, related to one of these consulting service contracts, disclosed that MDOT did not obtain time records to support payments for labor hours totaling approximately \$82,000. The contract required the contractor to provide time records or other documentation to substantiate all hours billed.

- For another contract for transportation planning services, MDOT paid for the contractor's labor rate increases, which were not based upon the methodology provided for in the governing contract. As a result, the contractor received an overpayment of approximately \$87,100 during calendar years 2007 and 2008. For example, the contract stated that the permissible adjustment mechanism should be tied to the change in the consumer price index; instead, the labor rate adjustment for fiscal year 2008 was based upon a flat rate increase of 5 percent. After we brought this overpayment to MDOT's attention, it received the full repayment from the contractor in May 2009. As of January 2009, MDOT had paid the consultant approximately \$7.9 million related to this \$9.6 million contract.

### **Recommendation 3**

**We recommend that MDOT**

- a. obtain and review, at least on a test basis, sufficient time records to verify the propriety of labor hours billed; and**
- b. verify increases to vendor labor rates under future contracts prior to paying the increased rates.**

## **Minority Business Enterprise (MBE) Certifications**

### **Finding 4**

**MDOT did not obtain documentation during the Minority Business Enterprise recertification process to support the number of individuals employed by the applicants.**

### **Analysis**

Documented support for the number of individuals employed by a Minority Business Enterprise (MBE) was not obtained for recertification. Depending on the MBE's industry, an MBE may not be recertified if it employs more than a certain number of individuals. For example, wholesale trade agents and brokers may employ up to 100 employees. Our test of 10 MBE recertifications disclosed that MDOT did not obtain support for the number of employees reported by 4 of the 4 MBEs tested that had maximum employee requirements. Consequently, there is a lack of assurance that MBEs were properly certified.

According to State regulations, MDOT is the agency designated to certify, recertify, and decertify MBEs for the State as a whole. The MBE program encourages minority owned businesses to participate in the State procurement process; at least 25 percent of contracts awarded by the State are to be reserved for minority businesses. In order to be certified as a MBE, a business must be at least 51 percent owned and controlled by one or more socially and economically

disadvantaged individuals or must be a not-for-profit that promotes the interest of the physically and mentally disabled. MDOT annually recertifies businesses to assess MBE compliance with program requirements and certification thresholds. During fiscal year 2008, MDOT recertified 1,591 MBEs; of that amount, 210 firms were recertified based on number of employees.<sup>1</sup> As of May 4, 2009, there were 4,472 certified MBEs.

**Recommendation 4**

**We recommend that MDOT obtain supporting documentation (such as, payroll reports) for the number of employees reported by an MBE during the recertification process, when applicable.**

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<sup>1</sup> An MBE is certified in a certain industry code. While certain codes have company income as a standard, other codes have the number of employees as a standard. The federal government determines what the size standards are for the individual codes. To retain an MBE certification, a vendor may not employ more that the number of individuals specified in the government standard.

## **Audit Scope, Objectives, and Methodology**

We have audited the Maryland Department of Transportation – Secretary’s Office, including the Debt Service Requirements Unit (MDOT), for the period beginning January 1, 2006 and ending January 8, 2009. 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 the MDOT’s financial transactions, records and internal control, and to evaluate its compliance with applicable State laws, rules, and regulations. The areas addressed by the audit included procurements and disbursements for MDOT’s operating expenditures, as well as grants (including those to WMATA), payroll, cash receipts, MBE certifications, and equipment inventories. 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 the MDOT’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.

The State Highway Administration provides certain payroll support services to MDOT. These support services are included within the scope of our audit of the State Highway Administration. In addition, our audit did not include the computer operations of MDOT’s Office of Transportation Technology Services that are addressed in a separate audit of the data center.

Our audit did not include an evaluation of internal controls for federal financial assistance programs and an assessment of MDOT’s compliance with federal laws and regulations pertaining to those programs because the State of Maryland engages an independent accounting firm to annually audit such programs administered by State agencies, including the components of MDOT. MDOT’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.

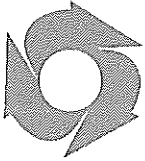
Because of inherent limitations in internal control, errors or fraud may nevertheless occur and not be detected. Also, projections of any evaluation of internal control to future periods are subject to the risk that conditions may change or compliance with policies and procedures may deteriorate.

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 the MDOT'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 MDOT that did not warrant inclusion in this report.

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

APPENDIX



**Maryland Department of Transportation**  
The Secretary's Office

**Martin O'Malley**  
Governor

**Anthony G. Brown**  
Lt. Governor

**Beverley K. Swaim-Staley**  
Secretary

**Harold M. Bartlett**  
Deputy Secretary

September 17, 2009

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

Dear Mr. Myers:

Enclosed please find the Department's follow-up responses to the Legislative Auditor's draft report dated September 2009 (for the period January 1, 2006 to January 8, 2009), for the Department of Transportation - The Secretary's Office. Additionally, an electronic version of this document has been sent to your office via e-mail (file name:TSODraftReportSeptember2009) to [response@ola.state.md.us](mailto:response@ola.state.md.us).

If you or your staff have any questions or need additional information, please do not hesitate to contact me or Mr. David L. Fleming, Chief Financial Officer. Mr. Fleming can be reached at 410-865-1035.

Sincerely,

A handwritten signature in cursive script, appearing to read "Beverley K. Swaim-Staley".

Beverley K. Swaim-Staley  
Secretary

Enclosure

cc: Mr. David L. Fleming, Chief Financial Officer, Maryland Department of Transportation  
Mr. Joseph J. Lambdin, Director, Office of Audits, Maryland Department of Transportation

**Maryland Department of Transportation  
The Secretary's Office  
Draft Audit Report Responses  
Report Period January 1, 2006 to January 8, 2009**

## **Washington Metropolitan Area Transit Authority (WMATA)**

### **Finding 1**

**MDOT did not timely review the State operating subsidies paid to the Washington Metropolitan Area Transit Authority (WMATA).**

#### **Response:**

**1a.** The Department concurs with the auditors' recommendation. The Department's WMATA Liaison Office conducts thorough reviews of WMATA's annual operating subsidy allocation calculations and any amendments to the allocation calculations on a regular basis throughout the fiscal year and before operating subsidy payments are made to WMATA. In the future, the Department will annually document its review of the WMATA subsidy allocations and retain such documentation for audit purposes.

**1b.** The Department concurs with the auditors' recommendation. The Department's Office of Audits will verify the 2007 and 2008 subsidy calculations and recover any overpayments identified. The Department's Office of Audits will complete their audit by June 30, 2010.

## **Real Estate Sales**

### **Finding 2**

**MDOT did not ensure that real estate sales were supported with adequate property appraisals.**

#### **Response:**

**2a.** The Department concurs with the auditors' recommendation. The MDOT property disposition process is divided among the MDOT Office of Real Estate (ORE) and the MDOT modal administrations. The ORE maintains copies of the property appraisals for all property sales that are managed by their office. For the modal administrations' dispositions, the modes obtain the appraisals, negotiate the terms and submit recommendations for sale based on their reviews to the ORE. The ORE's role in the modal administrations' sales is to manage the clearance process, whereby the properties are "cleared" for disposition. The ORE reviews the modal's recommended sales to confirm that the administrations comply with all the steps required by law and policy regarding their property sales. With respect to the appraisals, the ORE currently requires the modal administrations to submit information confirming that this step in the clearance process has been satisfied, but ORE does not require that a copy of the entire appraisal package be submitted due to the volume of documents. To provide more clarity and confirmation to this process, the ORE will now require the modal administrations to submit a copy of the appraisal's summary document produced by the appraiser, as part of the information package provided to the ORE.

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**2b.** The Department concurs with the auditors' recommendation. MDOT has always worked to provide the Board of Public Works (BPW) with the information necessary for the BPW to make value determinations regarding the disposition of MDOT properties. The BPW makes valuation determinations based on a compilation of information, including appraisals. This process provides the BPW the ability to ensure fair prices for State assets. MDOT will meet with the BPW staff to review and update our existing processes by November 30, 2009.

**2c.** The BPW Advisory regarding property dispositions requires two appraisals for all properties valued over \$100,000. MDOT follows this BPW guideline for its property sales, except for properties that are sold at public auction. The Annotated Code of Maryland (Transportation article 8-309) requires the Administration to appraise the land; and if the Administration believes that the land has value of more than \$100,000, "the land also shall be appraised by at least one independent, qualified real estate appraiser." The Department believes this method is adequate and cost effective since the public auction itself is a reliable indication of current market value. MDOT will consult with the BPW staff to review and update our current processes.

### **Contractual Payments**

#### **Finding 3**

**Supporting documentation was not always obtained for contractual payments.**

#### **Response:**

**3a.** The Department concurs with the auditors' recommendation. MDOT did obtain the time records from the consultant cited by the auditors for the \$82,000 in work completed by the consultant to verify the propriety of the consultant's invoiced hours worked.

**3b.** The Department concurs with the auditors' recommendation and will verify any future labor rate increases for all contracts.

### **Minority Business Enterprise (MBE) Certification**

#### **Finding 4**

**MDOT did not obtain documentation during the Minority Business Enterprise recertification process to support the number of individuals employed by the applicant.**

#### **Response:**

The Department concurs with the auditors' recommendation. Effective June 15, 2009, the Office of MBE is requiring staff to obtain payroll reports and/or other supporting documentation for the number of employees reported by the MBEs during the initial certification and recertification process. The Office of MBE will verify this information and retain it for audit purposes.

AUDIT TEAM

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