


FREDERICK COUNTY GOVERNMENT

INTERAGENCY INTERNAL AUDIT AUTHORITY

Tricia Griffis, Director of Internal Audit

Memorandum

To: Frederick County Council
Rick Harcum, Director Frederick County Government Budget Office

From: Tricia A. Griffis, CPA


Date: August 28, 2018

Subject: Review of the Frederick County "County-City Tax Equity" Program and Calculation

Introduction and Summary

At the request of the County Council and as agreed by the Interagency Internal Audit Authority (IIAA), the Internal Audit Division (IAD) performed a non-attest special project reviewing and analyzing the Frederick County "County-City Tax Equity" program and calculation. This review was conducted by the IAD to evaluate the calculations prepared as a tax set off between the County and related municipalities. The procedures and work performed by the IAD constitutes a non-attest engagement and does not fall under the guidance of Government Auditing Standards (GAS).

During the special project the IAD reviewed and analyzed the following data and criteria:

- County-City Tax Equity committee report for Frederick County, dated 1981, which includes original formula calculations and determinations are presented by the committee.
- "Property Tax Set-Offs" annual report by the Maryland State Department of Legislative Services for fiscal year 2017, dated January 2018.
- FY19 Tax Equity Calculation from the Frederick County Budget Department, along with supporting documentation verifying data.
- Frederick County presentation on Property Tax Set-Offs dated August 2011.
- Maryland State Code, Title 6 -Taxable Property; Imposition of Tax; Setting Tax Rates Subtitle 3 - Setting Property Tax Rates Section 6-305 - County tax rate in certain municipal corporations.
- COG meeting minutes: July 2005
- Tax Set-Off Committee Meeting minutes: February 2011

Frederick County: Rich History, Bright Future

It is management's responsibility to design and implement an adequate system of internal control and it is the IAD's responsibility to determine if management's system of internal control is functioning properly in relation to the objectives of the special project. It is also management's responsibility to decide if action should be taken in response to any reported recommendations, taking into consideration related costs and benefits. Management, therefore, assumes the risk of making the decision not to implement any reported recommendations.

The objectives of the special project were as follows:

- To review the current property tax set off rebate and differential calculations for Frederick County and its municipalities along with corresponding laws and agreements; and
- To determine if the current calculation appears reasonable in relation to corresponding laws and agreement between the County and municipalities.

Background and Informational Summary

Frederick County began an evaluation on tax-equity (set-off) in 1981 bringing together a committee to identify and develop a potential tax equity calculation for the County and municipalities to utilize where services are duplicated between the County and municipalities. At that time, service duplication was defined as: "Those service areas of the Frederick County Government funded in whole or in part by general fund revenues which are not provided or extended to all municipal residents and the same or similar type services are provided to municipal residents by two or more municipal governments which fund said services in whole or part with municipal property tax revenues." As a result of the study four areas of service duplication were identified 1) Highway/Street Maintenance 2) Police Services 3) Bulk Waste Collection 4) Parks and Recreation Services. Since the time of the study, Bulk Waste Collection is no longer provided by municipalities like the City of Frederick and has become an Enterprise Fund activity supported by user fees rather than property tax revenues and is no longer considered a service duplication under tax equity standards. Also, planning and zoning was analyzed later to be determined as an added service duplication area. Each area of service duplication then underwent analysis to develop a formula calculating tax equalization. According to the study "The purpose of the formulas is to return tax dollars collected by the county from municipal residents for services which are not provided to those residents by the county." The formulas were also formulated to have a cap amount which limits the tax set off to the estimated municipal contribution, the study states "Through the use of the equalization formulas and the "CAP", the county attempts to insure that equalization does not exceed the municipal contribution". The cap is based on a municipality taxable income, assessable base and population. As a result of the study the formulas and caps were determined along with two recommendations, one that the study be reviewed and updated annually by a committee set up with county and municipal representatives and two, that the county and municipalities work together to utilize financial reporting standards to allow for easier formula calculation in a comparable manner.

The State of Maryland under Annotated Code mandates Frederick County under Section 6-305.1 to meet on an annual basis with County municipalities to discuss the tax set-off. If a municipality can prove that it performs services in lieu of services or programs provided by the county then the county "shall" grant a tax set-off to that municipality. The set-off calculation in this case must be agreed upon by the County and the municipality. If the County and municipality are unable to agree on a formula then the "county shall grant a tax set-off in accordance with the formula used during the preceding taxable year."

The Maryland State Department of Legislative Services performs an annual review of tax-set offs within the state. The most recent review covered fiscal year 2017. This review verifies that the County provided a tax differential to the City of Frederick and Myersville during 2017 and tax rebates to Brunswick, Burkittsville, Emmitsburg, Middletown, Mt. Airy, New Market, Rosemont, Thurmont, Walkersville and Woodsboro. Total differentials for fiscal year 2017 in Frederick County were \$9.1 million and total rebates were \$4.2 million. The set-offs covered services for highways, police protection, planning and zoning and parks and recreation.

Observations

At this time it appears that the County does meet with municipal leaders to review the formulas on an annual basis as required by state law. Letters are sent annually to each municipality as well to provide for change request opportunities and a timeline for requests to be submitted to the County Budget department which oversees the tax set off calculations. Over the past 2 years there have been no documented requests for calculation changes per the Budget department. Therefore calculations utilized and the four areas of tax set off (police, parks and recreation, planning and zoning and highways) have remained unchanged from the prior year.

Calculation Observations:

- Overall the calculations appear accurately portrayed. IAD was able to trace and agree amounts utilized to their respective County and municipality financial statements as well as other supporting documentation from the county, state and municipal governments as viewed through e-mails and other support provided by the Budget department.
- Due to a footing issue when implementing a new methodology in the calculation format for administrative costs, the costs reflected are not accurate on the supplemental schedule provided by the Parks and Recreation division to the Budget department. This schedule was put together for the first time in fiscal year 2019 due to the removal of utilizing program budgets. The Budget department is aware of the issue and will correct the values for future fiscal years.
- IAD and the Budget department discussed utilizing actual figures in the future for the parks and recreation administrative cost calculation rather than budget amounts.
- When calculating figures on the "CAP" spreadsheet within the full calculation a column heading needs to be updated to state "No Applicable Base", rather than "Applicable Base". The calculations in this column are accurate, the heading just needed correction.
- Careful consideration is needed by the Budget department when determining where base funds are derived from as this affects each areas CAP. Determination of "Net

Taxable Income", "Assessable Base" and "Population estimates" funding pockets affects the CAP percentage. During our testwork of the FY19 calculation, IAD did not note any areas of concern with incorrect funding sources.

Conclusion

It appears that the tax set off amounts as calculated by the county Budget department are reasonable. There is one numerical error found which can be easily corrected in the next fiscal year calculation. The calculations appear to be consistent with the spirit of the law and original thought process to the history of the 1981 committee set forth to determine the set off basis and calculations.

During the analysis it was a pleasure to work with county Budget personnel and the IAD sincerely appreciates their full cooperation and assistance with the support and information required to perform the necessary work. The work performed under this special project was not performed in accordance with Generally Accepted Government Auditing Standards and is considered a non-attest service.

Please let the Director of the IAD, Tricia A. Griffis, CPA, know if you have any questions or concerns as it relates to this special project. The IAD staff will be happy to assist in any way that we can.

Pc: Dawn Reed, Administrative Coordinator, Internal Audit
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