HARFORD COUNTY, MARYLAND
Office of the County Auditor

AUDIT OF ECONOMIC DEVELOPMENT PROGRAMS

Report Number: 2016-A-04
Date Issued: 05/06/2016

Council Members and County Executive Glassman:

In accordance with Section 213 of the Harford County Charter, we have performed an audit of Harford County's Economic Development Programs. The results of that audit, our findings and recommendations for improvement are detailed in the attached report. We would like to thank the members of management for their cooperation during the audit.

The audit found the Economic Development programs have a significant impact on the capital investments and taxable real property assessments in targeted areas. We found, however, that some programs can improve their oversight to ensure that the program guidelines are met. For example, Workforce Technical Training grants were awarded without adequate support and in excess of the program limits. Additionally, some tax credits for Enterprise Zone credits are awarded in tiers extending the duration of the credit period.

The audit team is available to respond to any questions you have regarding the attached report.

Sincerely,

Chrystal Brooks, CPA

Chrystal Brooks
County Auditor

cc: Ms. Karen Holt, Director of Economic Development
Mr. Tucker McNulty, Coordinator, WFTTG and EDOL
Ms. Bridgette Johnson, Coordinator, Enterprise Zone

Report Highlights

Why We Did This Audit

This performance audit was conducted at the request of the County Council in accordance with Resolution 029-15.

What We Found

We noted that controls can be improved to ensure that grants are provided within each program's guidelines.

What We Recommend

Management should ensure that grants are reviewed further prior to approval and tax credits are reaffirmed prior to being extended.

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REVIEW RESULTS

We have audited Harford County's Economic Development programs for the period of 1/1/2006 through 12/31/2015. The audit approach focused on testing the key controls that address management's objectives for the process. Specifically, the Office of Economic Development's (OED/ED) Mission Statement is to "Facilitate business investment, entrepreneurial development and job creation to expand local tax base, foster diverse/sustainable economy as well as improving the economic and quality of life of Harford County via a robust business development services spectrum".

Our opinion, based on the evidence obtained, is Economic Development Programs help create jobs and increase the tax base in Harford County and generate more tax revenue than they cost; however, controls are not adequate to ensure compliance with each program's guidelines. Descriptions of each program reviewed can be found in the 'Background Information', later in this report. We evaluated the fiscal impact of the programs reviewed in terms of Business Investment, Entrepreneurial Development (Technical Training), Job Creation and Expanded Tax Base/ Capital Investment, as summarized below.

Economic Development Opportunity Loans stimulate business investment by providing low cost loans or grants to local companies. Recipients are required to maintain their Harford County operations for a specified period of time and must create a number of new jobs.

Harford County has issued 9 loans since 2009 totaling $1,075,000 in Business Investment funds and generating $47,409 in interest as of December 31, 2015. These loans have resulted in 77 new positions being created; those positions should generate approximately $24,500 in Income Tax Revenue annually.

In some cases, the companies awarded loans do not own real property. For those that do, the real property tax base has expanded by approximately $5.0 million (16.8%). As estimated by OED staff notes, Capital Investments total approximately $9.5 million.

As of December 2015, 7 loans remain open; their unpaid balances total $611,108. Approximately twenty (20.5%) percent of that amount, $125,000, represents a conditional loan that will not require repayment if all loan terms are met. We found that all outstanding loans are in good standing with regard to timeliness of payments, job creation and capital investment.

Workforce Technical Training Grants are awarded to companies on a reimbursement basis for technical training provided to employees.

Since fiscal year 2013, Harford County has awarded approximately $440,500 in grants to 37 companies. Based upon the information reported by the companies, we estimate those grants resulted in increased salaries of approximately $195,000 per year. This income should generate approximately $3,600 in Income Tax Revenue annually.

Enterprise Zone Tax Credits are awarded for 10 years to applying property owners, after approval by the County Council.

For the 22 properties that completed their 10th year in the program in FY2016, we noted they have expanded the County Property Tax Base by $40.1 million. They averaged $160,000 in capital investments per property per year, according to records maintained by OED. The real property tax credits awarded totaled $2.9 million; half of that amount is reimbursed by the State of Maryland. The related net increase in County real property tax revenue over that period is $2.9 million.

There are 63 properties remaining in the program. They have been active for an average of 5.6 years and have expanded the County Property Tax Base by $326.1 million. They average $1.5 million in capital investments per property per year, according to OED records. The real property tax credits awarded totaled $10.0 million since fiscal year 2008. The net increase in County tax revenue over that period is $7.8 million.

This program requires capital investment *or* job creation. However, we found that job creation cannot be reliably determined because tax credits are awarded to property owners who may not occupy the property and may have multiple tenants.

Assumptions used in the above estimates are detailed in the review methodology, later in this report.

In addition to the fiscal impact summarized above, the audit approach focused on testing the key controls that address management's objectives for these programs. Conclusions drawn are below.

Risk	**Expected Control**	**Conclusion**
Loans granted do not generate the employment required by authorizing legislation or loan agreements	Management regularly receives updates from loan recipients and other sources regarding job creation.	Satisfactory
Loans granted are poor investments	Liens for collateral property are properly recorded.	Satisfactory
Favoritism impacts the organizations selected to receive loans or grants	Loans are reviewed and approved by the Economic Development Advisory Board's Finance Committee	Satisfactory

Risk	Expected Control	Conclusion
Training grants are awarded inappropriately	Grant applications are reviewed to confirm eligibility criteria are met before pre-approval letters are sent	Needs Improvement
Training grants are not used appropriately	Documentation of training costs and the technical nature of training are reviewed before reimbursements are issued to companies.	Unsatisfactory
Enterprise Zone companies do not increase their property value (investment) as implied by the related legislation	Management regularly receives updates from loan recipients and other sources regarding investment and job creation	Satisfactory

Areas for improvement are described in the Findings and Recommendations section of this report. Management has been provided an opportunity to respond to this report; the responses provided follow each recommendation.

FINDINGS AND RECOMMENDATIONS

Finding Number: 2016-A-04.01 Training Grant Support

Workforce Training grants are not fully supported and appear to exceed the program guidelines.

Analysis: The workforce technical training grants program provides up to $1,000 per employee per fiscal year to applying companies as reimbursement for eligible technical training costs. The current limit for the grant is $20,000 per year per company. We tested a sample of the grants issued in fiscal years 2013 through 2016. We found that some exceeded the annual limit. In some cases, this was a matter of timing, but in total we found 5 instances, related to 4 companies, totaling $160,285 awarded in excess of the annual limit.

Companies may apply for the grant by submitting an application form to the Office of Economic Development. The form requires the applicant to describe the training to be provided, the estimated costs, and names and salaries of employees receiving the training. Grant applications are reviewed and approved, three times per year, by a subset of the Economic Development Advisory Board. The review and approval is not documented. This approval is important because the Board should serve as a secondary confirmation that the training to be (or already) provided meets the program guidelines and will occur within a reasonable time frame. In our test of grants awarded, we noted one grant application did not include a description of the type of training provided and 3 approved grants were for new employee orientation or non-technical skills that should not be eligible expenses.

After training has been completed, companies can submit a request for reimbursement, along with supporting documentation for OED to review and approve payment. Supporting documentation should include evidence of payment for the course, payroll records (if labor reimbursement is requested) and certificates of completion. We noted three grants did not have certificates of completion for the courses. For 20 of the 26 grants we tested, pay rates for reimbursement are supported by a spreadsheet prepared by the requesting company. This follows the standard procedure for the grant process and OED requires a company official to certify the accuracy of the report. However, there is not a process in place to occasionally confirm that those records are supported. Without an oversight mechanism it is not possible to identify errors or misuse of the funds.

Recommendation: We recommend, at least on a sample basis, that OED confirm that executive-certified payroll information is supported by actual payroll records. We further recommend that each grant's Board approval be documented to confirm the propriety of the grant.

Management Response: Agreed. As a general note, most, if not all of the deficiencies referred to by the Auditor occurred prior to FY '16, during the tenure of a prior administration. However, the current administration is actively working to strengthen the process for future Workforce Training Grants. For example, tools to review criteria scoring and documentation are currently under development and will be used in the evaluation and award of the final training grant awards for FY '16. In FY '17, only two rounds of workforce training rounds will be offered and issued to ensure compliance within the same fiscal year. Also, for FY '17, an annual, randomly-selected grant recipient review of payroll documentation will be integrated into an on-site business retention call to ensure compliance and verify payroll information. Disclosure of this new procedure has already been included in the application process going forward. Additionally, specific measures are being taken by OED to emphasize technical training, including tangible examples, to ensure all training that comes before the review committee will meet the definition of technical training either in support of technical skill enhancement and/or job position advancement, or foundations of technology in certified areas identified as 'sector critical'. Oversights for documentation of EDAB Committee approval, capped award and issuance amount have been developed and will be implemented with future grant rounds.

Expected Completion Date: Prior to June 10 round of applications

Finding Number: 2016-A-04.02 Multiple Credits

Some properties have been approved for and/or are receiving more than one Enterprise Zone credit.

Analysis: For the properties that received Enterprise Zone credits in fiscal year 2016, there were 9 that have received multiple credits. For the 16 related credits parts, all but 4 had received County Council approval.

Annually, the Treasury Department receives base year and current year property assessments from the State and uses that information to calculate the credit eligible assessment and the credit amounts. When a property is approved for a second Enterprise Zone credit, the State creates a second base value to $0 and restarts the 10 year credit schedule for the new credit part. Section 9-103 of Maryland's Tax-Property Article allows the credits to be claimed for no more than 10 consecutive years and identifies the credit percentages to be applied in each of those 10 years.

We were advised that this is done because a property owner may build up their property in phases; when there is a new phase or a new approval, a new credit is awarded. The effect of this added credit part is that some property owners will receive larger credits for a longer period of time than would have been awarded under just one credit. Most credits were associated with approved legislation. However, we found four (4) credit parts, for three (3) properties, that did not receive County Council approval for the subsequent credits. Creating the second credit parts for these properties resulted in over credit of approximately $2,400.

The additional effect of separating one assessment into two or more parts is that the original assessment part can lose value, and that lost value is not offset by a reduction to the second credit part. This was the case for Kohl's Trimble Road property. For FY2016, we calculated the total credit for this property was approximately $51,000 more than it would have been under the one original credit approval. Considering the County Council's second credit approval the over-credit was still approximately $35,700.

In total, for the 9 properties in question, we calculated that the County awarded $40,500 more in credits than it should have. If the subsequent Council approvals for these credits had not been done, the over-credit for FY2016 would have been approximately $58,400.

Recommendation: We recommend Enterprise Zone credits only be applied at the rates defined within each credit's authorizing legislation.

Management Response: Disagreed. According to the State Department of Assessments and Taxation, it has been the policy and practice statewide to provide multiple credits without subsequent resolutions. However, the Department of Treasury and the Department of Law are working with the Department of Economic Development to receive County Council approval on each credit for properties that are issued multiple credits due to phased-in construction.

Expected Completion Date: 12/31/2016

Finding Number: 2016-A-04.03 Improper Loan Fund Payments

Designated Loan Funds were spent on Contributions

Analysis: This fund is dedicated to providing financial assistance to local businesses. Appropriations to this fund were $75,000 in FY2011 and have been $28,000 in each year since. Grants and contributions to other types of agencies are not an allowed use of the fund.

We noted that each year since FY2011, the County has contributed approximately $15,000 to Maryland's Procurement Technical Assistance Program (PTAP) from the Economic Development Opportunity Fund. The total loans issued from the fund have been $975,000 over the above period. This means that the PTAP grant represents approximately 41.9% of the appropriations into the fund and approximately 8.5% of the expenditures from the loan fund.

Recommendation: We recommend any future contributions be recorded from Economic Development's operating account.

Management Response: Agreed. It is the understanding of Management that the concern raised by the Auditor is an issue regarding internal control for recording purposes and that there were no findings of deficiencies regarding the administration of the loans. The concern raised by the Auditor has been addressed. Eff. FY '17, PTAP expenses have been reallocated to OED's operating account and will no longer impact EDOF provisions.

Expected Completion Date: 07/1/2016

BACKGROUND INFORMATION

PROGRAM DESCRIPTIONS

"The Office of Economic Development and its Economic Development Advisory Board market the County as an area for new business to relocate; strengthen expansion of resident industry and small businesses; explore programs that create job and career opportunities for County residents; and expand availability of financial resources for industry and small business." (Per the County budget)

Economic Development Opportunity Loans allow Harford County to provide low cost loans or grants to local companies. Recipients are required to maintain their Harford County operations for a specified period of time and must create a number of new jobs. Loans must be approved by the ED Advisory Board's finance committee. Generally, the County Council approves legislation authorizing the loan terms. Often, loans are approved in coordination with a Maryland Business and Economic Development financial assistance proposal. The loan program is intended to pay its own costs through interest and administrative fees and the eventual repayment of the loan principal. The fiscal impact of the loans should be able to offset the County's loss of use of those funds.

Workforce Technical Training Grants are awarded on a reimbursement basis; companies must apply for the funds and provide receipts prior to receiving the grant payment. Harford County will reimburse 50% of allowed costs up to $1,000 per employee per year, and up to $20,000 per year for each company approved.

Enterprise Zone companies receive property tax credits on the increased value of their property for ten years after council approval. Generally the schedule is an 80% credit for the first 5 years then 70, 60, 50, 40, and 30% discounts in the remaining years. Property owners must apply for the credit and related legislation must be approved by the County Council.

REVIEW OBJECTIVE, SCOPE AND METHODOLOGY

The objective of this audit was to review Harford County's Economic Development programs to determine if the terms and conditions required by the authorizing pieces of legislation and related agreements have been met. The audit additionally sought to confirm that the County's procedures ensure timely repayment of loans, tax credit rebates and the appropriateness of training grant reimbursements. We were further tasked with estimating the fiscal impact of these programs in Harford County. The scope of this project was limited to Enterprise Zone Tax Credits, Workforce Technical Training Grants, Economic Development Loan Funds and Grants, Loans and Conditional Loans issued by the State of Maryland and endorsed by the Harford County Council.

The audit focused on activity during the period of 1/1/2006 through 12/31/2015. Our audit procedures included interviewing personnel, observation and testing. Specifically, we met with the coordinators for each of these programs to determine how they review, approve and monitor participants. During the planning for this project, we determined that State loans, endorsed by the County Council, are monitored by the state to track specific job creation results. Consequently, we excluded those loans from our testing procedures. For County-issued loans, we reviewed the authorizing legislation for each loan to determine the criteria for each and compared that information to the records maintained by Economic Development and other sources. We used a similar approach to test a sample of Enterprise Zone credits. For a sample of training grants, we reviewed the documentation provided by grantees to confirm that training was acceptable and the reimbursements were correct. Using all of the information gathered, we developed estimates of the fiscal impact of each programs reviewed.

Our estimate of fiscal impact for job creation assumed that 60% of new positions are filled by Harford County residents and that those positions pay 150% of minimum wage, with employees working 35 hours per week. We assumed the conditional loan will not be repaid. Personal property tax income has not been estimated because capital investments may impact both personal and real property assessments. For all estimates, we assumed that without the program, the baseline would be maintained, so the estimates only reflect changes from the starting figures for jobs, property values and investments.

Harford County management is responsible for establishing and maintaining effective internal controls. 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.

The audit was performed in accordance with Generally Accepted Government Auditing Standards (GAGAS). Those standards require that we plan and perform the audit to obtain sufficient 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.

Audit Team:

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