



HARFORD COUNTY, MARYLAND

Office of the County Auditor

07/31/2014

Report Highlights

Why We Did This Audit

This audit was conducted as part of the County Auditor's risk-based Annual Audit Plan, approved by the County Council, for FY2015.

What We Found

Income Tax revenue received from the State was correct and complete.

What We Recommend

Management should periodically request and review supporting details for income tax revenue.

AUDIT OF INCOME TAX REVENUE

Council Members and County Executive Craig:

In accordance with Section 213 of the Harford County Charter, we have performed an audit of Harford County's Income Tax revenue. 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 income tax collected and distributed by the Maryland Comptroller was correctly calculated and complete. Estimated distributions to Harford County were correctly and consistently calculated in accordance with State law.

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. Kathryn Hewitt, County Treasurer
Mr. James Pasko and Mr. Jason Brohawn, Maryland Revenue Administration Division

~ Preserving Harford's past; promoting Harford's future ~

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HARFORD COUNTY, MARYLAND

Office of the County Auditor

AUDIT OF INCOME TAX REVENUE

Report Number:
2014-A-10

Period Covered:
01/02/2012 through 06/30/2014

Date Issued:
07/31/2014

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BACKGROUND INFORMATION

INTRODUCTION

A county's local income tax rate is the percentage that is applied to the Maryland Taxable Income of all county residents and is collected in addition to any State and Federal taxes a resident pays; it is sometimes called a piggyback tax because it is collected and administered along with the State Income Tax. State law allows a minimum local tax rate of 1.25% and a maximum of 3.20%. Six jurisdictions currently use the maximum rate. The current Harford County income tax rate, 3.06%, was approved by the County Council via resolution 06-03.

Harford County's income tax revenue is administered by the State of Maryland's Comptroller's Office, in accordance with the General Tax Article of the Code of Public General Laws (Statutes) of Maryland. Within the Comptroller's Office, the Revenue Administration Division (RAD) processes income tax withholding payments and tax returns for all jurisdictions. Throughout the year quarterly estimated distributions are sent to the Counties and municipalities. Distributions are estimated based upon 1.) the gross amount collected by RAD and 2.) the proportion of statewide collections distributed to the each County in the last completely processed tax year. After the tax year ends, RAD prepares 5 reconciliations over the next 13 months to agree revenue to actual receipts. A schedule of the revenue cycle follows on page 6 of this report.

RAD maintains an "unallocated" and "reserve" fund to accumulate collections for which tax returns have not yet been filed and to pay anticipated refunds. Semi-annually, revenue from delinquent tax filers is distributed to the County. Over time, the reserve amounts are paid out; the Comptroller's Office estimates that 99.41% of all taxes owed are collected. RAD maintains a small administrative fee. A flowchart of the derivation of local income tax follows on page 5 of this report.

When distributions are made, the County receives a report of the revenue being provided by RAD, but does not receive any supporting information. The amount received (via wire transfer) is recorded in the County's financial system when received. Harford County estimates its future tax revenue based on projections received from the State. Given the limited information provided by RAD to the Counties, we performed this audit to confirm that each distribution agreed to the summary reports, was correctly calculated and was supported by information maintained by RAD.

KEY STATISTICS

Income taxes are the County's second largest revenue stream. The annual revenue generated from income tax for the County is approximately:

<u>Fiscal Year</u>	<i>In Millions</i>	
2012	\$ 179.2	Actual
2013	183.3	Actual
2014	190.6	Budgeted
2015	198.7	Budgeted

Income taxes are processed on a calendar year basis, so each County fiscal year includes revenue from the current calendar year as well as reconciliations of prior years. The above amounts include both current and prior year taxes that were received from RAD.

The amounts collected are allocated in the approximate percentages below (based on tax year 2012).

Revenue Administration - The County's share of the statewide local tax administration costs	0.38 %
Municipal Share to Bel Air, Aberdeen and Havre de Grace - This amount represents 17% of the local income tax derived from County residents who live within the municipalities	12.84%
Harford County Government	86.78%

REVIEW OBJECTIVE, SCOPE AND METHODOLOGY

The objective of this audit was to confirm that the County's Income Tax revenue, as administered by the State of Maryland, is substantially correct. The scope of this was limited to reviewing the calculations for the County's income tax revenue, confirming that revenue was received, and determining the overall reasonableness of the revenue received. Due to the narrow scope of this review, we relied on the internal controls testing performed by other auditors by confirming that the State received an unmodified (unqualified) audit opinion on its Fiscal Years (FY) 2012 and 2013 Comprehensive Annual Financial Reports (CAFR) and reviewing the results of Maryland's Legislative Auditors. This lack of a complete review of internal control did not affect the objective of the review.

The audit focused on activity during the period of 01/01/2012 through 06/30/2014. The selected period allowed us to review an entire tax year through 5 reconciliations (2012), and another through its first reconciliation (2013). Our audit procedures included interviewing personnel, observation and testing. Specifically, we inquired of RAD personnel to gather an understanding of how RAD calculates each local income tax

distribution. We recalculated the various allocation rates to determine if costs and gross receipts were shared correctly. We reviewed supporting calculations for each distribution to ensure that correct formulas and allocation rates were used. Finally, using Maryland's Tax Article and annual Income Tax Summaries, we estimated Harford County's income tax revenue to determine if the total tax received for each year appeared reasonably complete.

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.

REVIEW RESULTS

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.

Our procedures disclosed that the process for calculating estimated and reconciling income tax distributions is reasonable and follows the distribution steps prescribed by the Maryland Statutes' General Tax Article, § 2-601 through 2-615.

RAD provided supporting calculations for each distribution during our review period. We noted that each spreadsheet included consistent formulas for each jurisdiction, so that each distribution is calculated in the same manner. Administrative costs and estimated revenue are distributed based on the results of prior years. Our recalculation of the allocations confirmed that the rates used by RAD for estimated payments were reasonable and that reconciling payments were based on actual results. We also confirmed that the municipal share of estimated distributions was correctly calculated based on prior year results.

Using prior year income tax summaries and projections of future revenues, we estimated the County's revenue for the review period. Based on that estimate, the County's Income Tax revenue appears complete.

We confirmed that Harford County received all of the distributions made by the State. We noted that although the County receives reports indicating the amount of each distribution; details about the basis for the distribution are not provided. Receiving this information would not impact the County's internal controls; however, the support that we received from RAD for this audit included details that the County Treasurer might find useful. We recommend the Treasurer request and consider these details as an additional source of

information when developing projections of future years' tax revenue. *(This observation does not require a response from or remediation by management.)*

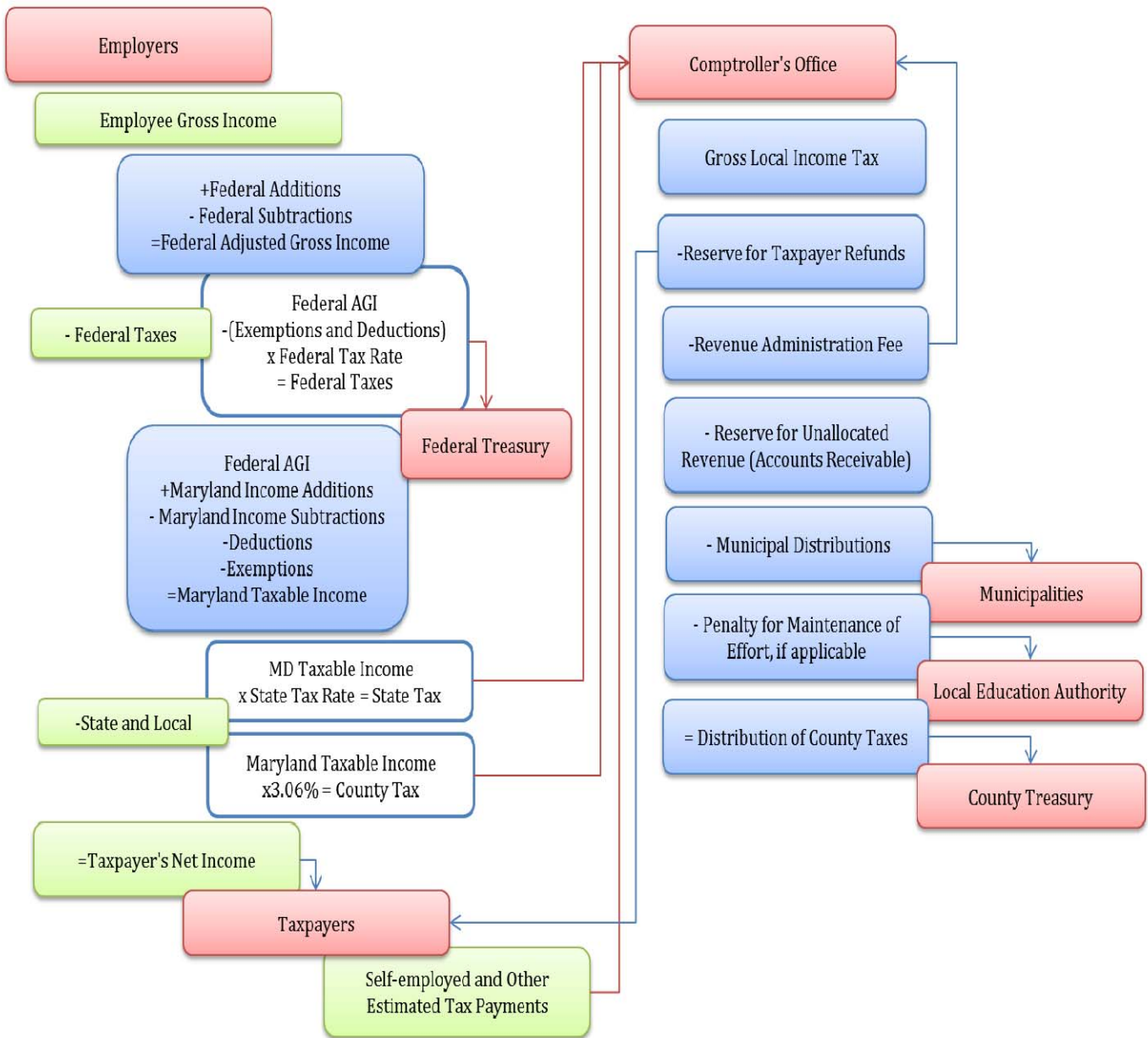
Our conclusion, based on the evidence obtained, is that Harford County's income tax revenue has been correctly calculated and distributed by the State of Maryland and received and recorded by the County Treasurer.

There were no reportable conditions, so management is not required to respond to this report. However, County and RAD officials have been provided an opportunity to respond to this report; the response provided by the County Treasurer is below.

MANAGEMENT RESPONSE

Management appreciates the effort of the Audit Office to confirm the reasonableness of the State payments to the County. In recent years, the RAD has been providing better support to the counties and municipalities to provide more information regarding their processes and calculations. We (various county finance officers and/or revenue estimators) meet with RAD on a regular basis to discuss trends and any issues regarding the collection and disbursement of the counties' share of the income tax. As stated above, income tax is the second largest revenue source to support the operations of the County government; and, therefore, is very important. The Audit Office supplied copies of the additional information they received from the RAD.

How is Local Income Tax Derived?



Note: The Reserve for Unallocated Revenue is eventually paid to the County as taxpayers file returns and more information is gathered.

Schedule of Local Income Tax Revenue

<u>Taxpayer Activity</u>			<u>Revenue Administration Distribution to Counties and Towns</u>			
Employers Withhold Taxes and Remit to Comptroller, Self-employed pay estimated taxes	Tax Year 1	Q1	Jan-01	Fiscal Year 1	Q1 Estimated Revenue	
			Feb-01			
			Mar-01			
		Q2	Apr-01			Q2 (April, May) Estimated Revenue
			May-01			
			Jun-01			
	Q3	Jul-01	Q2 Adjustment to Estimated Revenue			
		Aug-01				
		Sep-01				
	Q4	Oct-01	Q3 Estimated Revenue			
		Nov-01				
		Dec-01				
Taxpayers File Returns, Pay Tax Balances, Request Extension to File	Tax Year 2	2nd half of FY2	Jan-02	Fiscal Year 2	Q4 Estimated Revenue (TY1)	
			Feb-02			
			Mar-02			
			Apr-02			
			May-02			
			Jun-02			1st Reconciliation of TY1
Taxpayers File Extended Returns, Pay Tax Balances	Tax Year 2	1st half of FY3	Jul-02	Fiscal Year 3	2nd Reconciliation of TY1	
			Aug-02			
			Sep-02			
			Oct-02			3rd Reconciliation of TY1
			Nov-02			
			Dec-02			
Taxpayers continue to file amended or delinquent returns and make related payments to the Comptroller	Tax Year 3	2nd half of FY3	Jan-03	Fiscal Year 3	4th Reconciliation of TY1	
			Feb-03			
			Mar-03			
			Apr-03			5th Reconciliation of TY1
			May-03			
			Jun-03			
Taxpayers continue to file amended or delinquent returns and make related payments to the Comptroller	Tax Year 3	1st half of FY4	Jul-03	Fiscal Year 4	Delinquent filings in 1st half of FY3	
			Aug-03			
			Sep-03			
			Oct-03			
			Nov-03			
			Dec-03			
Taxpayers continue to file amended or delinquent returns and make related payments to the Comptroller	Future Years	2nd half of FY4	Jan-04	Fiscal Year 4	Interest and Penalties for 2nd half of FY3	
			Feb-04			
			Mar-04			
			Apr-04			
			May-04			
			Jun-04			
Future Years	Future Years	Future Years	Jul-04	Future Years	Delinquent filings in 2nd half of FY3	
			Aug-04			
			Sep-04			
			Oct-04			
			Nov-04			
			Dec-04			
Future Years	Future Years	Future Years	Jan-04	Future Years	Interest and Penalties for 1st half of FY4	
			Feb-04			
			Mar-04			
			Apr-04			
			May-04			
			Jun-04			
Future Years	Future Years	Future Years	Jul-04	Future Years	Delinquent filings in 1st half of FY4	
			Aug-04			
			Sep-04			
			Oct-04			
			Nov-04			
			Dec-04			
Future Years	Future Years	Future Years	Jul-04	Future Years	Interest and Penalties for 2nd half of FY	
			Aug-04			
			Sep-04			
			Oct-04			
			Nov-04			
			Dec-04			
Future Years	Future Years	Future Years	Jul-04	Future Years	Delinquent filings in 2nd half of FY	
			Aug-04			
			Sep-04			
			Oct-04			
			Nov-04			
			Dec-04			