



# Wicomico County, Maryland

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## Internal Auditor's Report

The County Council and County Executive of Wicomico County, Maryland:

Pursuant to Section 305(D) of the Wicomico County Code and Council Resolution No. 114-2014, the Office of the Internal Auditor (IA) has conducted an Audit of the Wicomico County Impact Fee Grants. A report is submitted herewith. The purpose of the audit was to determine the adequacy of procedures and controls along with the level of compliance with those procedures and controls for the process of maintaining and controlling the financial operation of the program. Additionally (as a consultation exercise) IA performed an evaluation of the program from the perspective of the participants and reviewed some high-level research concerning the economic impact of single-family home construction in Maryland.

IA conducted the audit with due professional care, and IA planned and performed the audit to obtain reasonable assurance about whether the impact grant accounting system practices are in compliance with applicable policies and procedures and whether those policies and procedures are adequate to obtain an acceptable level of control. The audit revealed a robust system of controls and adherence thereto. IA identifies several findings, mainly related to the evaluation phase of the exercise, in subsequent sections of this report, that warrant discussion.

IA extends our appreciation to Management and Staff of Wicomico County Planning and Zoning for their timely assistance, cooperation, and candid assessment of the grant program. Additionally, we would like to thank the developers, homeowners, and contractors who participated in our survey and subsequent interviews for their input.

Respectfully submitted,

J. Stephen Roser, CPA  
Internal Auditor

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## Audit Report

### Background

During the FY 2015 budget process, Wicomico County set aside \$387,094 to fund 74 "Employment Incentive Grants." Each of the 74 grants amounted to \$5,231, which equals the amount of the County's Education Impact Fee<sup>1</sup> charged to new single-family home construction.

### Audit Objectives

The objectives of the audit were to:

1. Assure that the Impact Fee Grant Program is in compliance with existing County management policies and related legislation
2. Evaluate the scope and effectiveness of the program

### Scope of the Audit

Original objectives and methodology were adjusted as information was gathered. The audit period examined on a test basis was FY 2015 to date. The Scope was open ended. Interviews and Inquiries with appropriate personnel were conducted. Additionally, IA examined various documents pertaining to the following:

- Legislative bill(s) related to the program
- Plan documents
- Contractor/homeowner response
- County financial records related to the program

### General Highlights and Statistics

Between July 28, 2014 and December 8, 2014, the County reserved all 74 Grants ancillary to permit applications as a conditional loan to the applicants. Once the permit holders meet all the conditions outlined in the program, the County forgives repayment of the loan. As mentioned in the Background section of this report, each loan is for \$5,231 allowing the applicant to pay the impact fee. Please refer to Appendix I of this report for a copy of the program provisions. The County allowed each applicant a limit of five pending applications at any given time and issued the 74 grants to 41 individual applicants. The total value<sup>2</sup> assigned to the properties, as part of the permit process, is \$10,917,535. Mean construction costs estimated by Planning and Zoning were \$147,534 per unit (\$80 sq. ft.).

### Conclusion

Based on evidence gathered, and interviews performed pursuant to the Impact Fee Grant Program, IA is of the opinion that internal control over the Impact Fee Grant process is at a satisfactory<sup>3</sup> level to its stated purpose and accounting requirements. We also include in this report other findings and issues related to participant feedback as a consultation exercise.

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<sup>1</sup> For more information on Impact Fees, please see Wicomico County Code §130-1 to §130-19

<sup>2</sup> Please keep in mind that these values are approximations required for permitting along with an estimation component and may not match (exactly) the final assessed value of the properties.

<sup>3</sup> For the purposes of this audit, IA uses a three-tier grading system recommended by the International Professional Practices Framework (IPPF) as expressed by the IPPF Practice Guide issued March 2009. The three tiers are Inadequate System of Internal Control, Adequate System of Internal Control, and Satisfactory System of Internal Control. Satisfactory findings

## Schedule of Findings

### Accounting

IA reviewed bookkeeping including MUNIS<sup>4</sup> postings for the accounts related to the program. Documentation reviewed complies with accounting best practices and other requirements through February 2015. Proper protections for default on the loans seem to be in place.

### Property Tax Revenue Generation

Current rate tax revenue based solely on estimated construction costs is approximately \$103,891. IA recalculated the return on investment numbers submitted by County Administration. Results were materially the same as those calculated by management. Five-year return on the grant (\$387,094) where returns = property tax revenues based on current rate applied to values assigned during the permit process (ignoring time value) is 34%. Payback period for the grant (again ignoring time value) is 3.73 years.

### Questionnaire Results

IA developed a questionnaire for participants to gain feedback on some high-level questions. We mailed questionnaires to each of the 41 participants and received 19 replies (46% participation). Results were as follows:

Survey Questions	YES	NO
Did you hire additional workers for your project(s)?	68%	32%
Did you change the timing of this project because of the grant?	63%	37%
Do you purchase materials from suppliers located in Wicomico County?	95%	5%
Are you satisfied with the time it took to process the payment?	95%	5%
Were County staff members helpful and courteous?	100%	0%
Would you be willing to make specific expenses available (anonymously) to the Internal Auditor	21%	79%
May we contact you with a few follow-up questions?	79%	21%

Two-thirds of the participants hired additional workers and changed the timing of projects because of the grants. According to participants, most of the materials were purchased within Wicomico County. Additionally, the survey solicited comments and we received several. Very few were willing to allow anonymous evaluation of expenses, and as such, we did not perform any P&L evaluations. However, we did conduct follow-up interviews. We discuss those interviews along with participant comments in the following section of this report.

### Participant Interviews and Comments

IA performed follow-up telephone interviews with nine<sup>5</sup> participants. Follow-up survey results were as follows:

	Yes	No
Would you have performed this project without the grant as incentive?	0%	100%
Did you move a project with an anticipated start date in 2015 to 2014 because of the grant?	56%	44%
Did you move the project to Wicomico County from some other anticipated location because of the grant?	11%	89%

indicate that overall controls are satisfactory, although some enhancements may be recommended. It is the highest rating on the scale.

<sup>4</sup> MUNIS is an acronym for the accounting software employed by the County

<sup>5</sup> Please note that eleven of 41 participants agreed to a follow-up interview and we were able to reach nine

The grant created all nine projects, moved over half to the first part of the current fiscal year, and interviewed participants moved only one of the projects from outside Wicomico County. Two-thirds of the interviewees were contractors and the remainder included homeowners acting as general contractors. Additionally, IA reviewed comments submitted with the surveys and during interviews. We gathered the following comments (edited for duplication and clarity):

- Economic considerations:
  - Impact Fee hurts new construction
  - Sussex/Worcester is cheaper to build
  - It is hard to build in Wicomico [economics, fees, regulations]...impact fee makes it harder
  - We rehired employees previously laid off
  - Small profit margins for contractors [are] greatly impacted [by impact fees]
  - Sprinklers and impact fees are a “double whammy”...makes it impossible to build
- Fairness:
  - Everyone uses schools why are contractors singled out?
  - Is the County trying to discourage building?
  - Contractors feel singled out [to solve the County’s financial woes]
- Timing:
  - Grants created the projects
  - We built spec homes because of the grant
  - Impact fee is preventing houses from being built
  - We have lots waiting for homes [to determine the future of impact fees]
  - We have projects in the pipeline waiting for impact fee decisions

### **Economic Impact**

IA gathered statics, on a statewide basis, concerning the economic impact related to the sale of a single-family dwelling. According to the Bureau of Economic Analysis (National Association of Realtors), the sale of a single-family dwelling generates an average of \$70,950 in the first year. The National Association of Realtors (NAR) estimates that one job is generated for every two home sales. More information from the NAR is available to Council and the Executive upon request.

### **Auditor’s Closing Remark**

The Wicomico County Office of the Internal Auditor would like to thank management and staff from Wicomico County Planning and Zoning for their timely cooperation and assistance during the audit. Additionally, special thanks go to all contractor and homeowner participants in our survey.

## Appendix I - Fiscal Year 2015 Employment Incentive Grant Program<sup>6</sup>

The County has made provisions to award up to 74 Employment Incentive Grants during fiscal year ending June 30, 2015. The grants will be used to incentivize construction of single-family detached residences. "Manufactured Homes" as defined by County Code are not eligible for this program. The grant will be in the form of a zero interest loan over a time-limited period of construction. Upon final completion of the home, the obligation to repay the loan will be forgiven. Should the recipient fail to meet the obligations of the loan, a lien will be placed upon the real property account. The lien will then be subject to interest, penalty and collection action as a normal real property tax receivable. The amount of each grant is \$5,231 which is the amount of the County's Education Impact Fee.

### Conditions

The grant will be initiated as a conditional loan. When all the conditions are met, the loan repayment will be forgiven. Loan forgiveness will require the grant recipients to meet all of the following conditions.

All standard requirements for the construction of a home in Wicomico County must be met.

Recipients must apply for and receive a Building Permit from the responsible jurisdiction within 30 days of the date of the grant award check.

Construction must be initiated within three (3) months of permit issuance. For this purposes, "initiation" is defined as an acceptably installed footer and foundation.

Construction is to be substantially complete within fifteen (15) months of permit issuance. For this purpose, "substantial" is defined as the house being roofed, acceptably framed and fully enclosed. This period may be extended by the Building Inspector for an additional three (3) months for a regularly active project or documented hardship.

### Process

**Application** - The County Department of Planning and Zoning will receive grant applications submitted under the name of both the property owner and the (MHBR) Licensed Builder as applicable, including reference to a specific lot of record and parcel identification number appearing on the county tax rolls. The Department will maintain a formal list of applications, to be processed sequentially based on a time/date stamp. At no time may an applicant have more than five (5) pending applications. Following the substantial completion of each subject home (as defined above), an applicant may submit additional grant applications to be evaluated within the noted sequence.

**Loan** - Following notification of a grant award, the applicant(s), which must include the legal owners of the property, will sign the loan paperwork. The loan documents will be held by the Finance Department until forgiven or failed. The County Tax Records will be annotated to identify the pledge of the property to obtain the loan. The property loan paperwork will include the standard Educational Impact Fee Routing Form. When the loan is approved, a check will be made payable to both the property owner(s) and Wicomico County. This check will be endorsed by the property owner(s) and returned to the Finance Department in exchange for the receipt-stamped Impact Fee Routing Form (provided by Planning & Zoning). Recipients must apply for and receive a Building Permit from the responsible jurisdiction within 30 days of the date of the award check. The Impact Fee Routing Form is to be included as part of the standard permits documentation.

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<sup>6</sup> As submitted by Wicomico Planning and Zoning July 2, 2014

**Budgeting and Accounting**

When the loan check is issued, a direct pay form will be used to create the check. The check will be paid against a loan receivable account that will be established in the grant fund #67 to offset the disbursement of cash. A copy of the loan agreement will be attached to the direct pay. The original loan will be held in the vault.

For the purposes of encumbering the fiscal year budget authority during a loan performance period that will likely cross fiscal years; a single purchase order will be created for the full value of the grant fund, \$387,094. The expense line in MUNIS, 67010013-520454, will be sited on the purchase order. The Vendor will be the Wicomico County Conditional Loan Account (the receivable account).

Planning and Zoning will provide a letter to Finance Department certifying that all conditions have been met for loan forgiveness. When a loan is forgiven, a check will be cut against the PO and deposited to the County's bank account and applied against the designated receivable account in fund 67. The payment will reduce the encumbrance against the FY15 budget appropriation, create an expense against the grant economic development line (520454) and reduce the receivable account by the grant amount. A copy of the certification and payment will be retained in a separate file by Finance for the impact fee grant program.

At the end of fiscal year 2015, the PO encumbrance will have to be reduced by the amount equal to any un-issued grants. In other words, if 50 of the 74 funded grants were issued as loans during the fiscal year, then the original encumbrance would have been too high by  $24 * \$5,231 = \$125,544$  and the encumbrance would be reduced by that amount.

If a loan recipient fails to meet the conditions of forgiveness;

Planning and Zoning will send a letter to Finance and Law Departments certifying the failure.

Finance will annotate the MUNIS real property tax record to show a tax lien for the amount of the failed loan (the receivable will remain in fund 67).

Law will file a lien with the Circuit Court for the amount of the failed loan.

When the taxes and liens due are paid either by the property owner or through tax sale, the receivable account in fund 67 will be paid the appropriate amount from the payment proceeds (liens are paid ahead of taxes).

**Loan Forgiveness** – If the described conditions are met, the loan will be converted to a grant.

Planning and Zoning will send a letter to Finance and the loan recipients certifying that the conditions of the loan have been met.

Finance will convert the loan to a grant as outlined in the budgeting and accounting section.

**Loan Failure** – Planning and Zoning will track the progress of the loan recipients towards meeting the specified conditions for loan forgiveness. Planning and Zoning will communicate with the recipients to ensure that extensions authorized under the conditions section are requested and approved as necessary. When it is clear that the conditions have not, or will not be met, Planning and Zoning will send a certified letter to all the parties to the loan giving them 30 day notice to meet grant conditions after which the County will convert the loan to a lien against the real property and become subject to interest, penalties and collection action (tax sale) in the same manner as all other real property taxes and liens.