

ALAN M. ARAKAWA
Mayor



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Director

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COUNTY OF MAUI
DEPARTMENT OF FINANCE
200 S. HIGH STREET
WAILUKU, MAUI, HAWAII 96793

March 1, 2018

Honorable Alan M. Arakawa
Mayor, County of Maui
200 South High Street
Wailuku, Hawaii 96793

For Transmittal to:

Honorable Riki Hokama, Chair
Budget and Finance Committee
200 South High Street
Wailuku, Hawaii 96793

APPROVED FOR TRANSMITTAL

Alan Arakawa 3/2/18

Dear Chair Hokama,

**SUBJECT: BF-1 PROPOSED FISCAL YEAR 2019 BUDGET FOR
THE COUNTY OF MAUI**

Enclosed please find further explanation from Matrix Consulting Group on the composite rates developed in the Full Cost and OMB Compliant Cost Allocation Plans developed for use in recovering and/or allocating indirect costs for the various programs and funds of the County of Maui.

As I mentioned in the B&F Committee meeting held on February 27, 2018, Matrix Consulting is more than willing to appear before the Committee to further explain their methodology and to answer any questions the Committee may have regarding these reports. The cost of bringing the consultant to Maui would be borne by the Department of Finance.

Honorable Riki Hokama

March 1, 2018

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Should you have any questions please feel free to contact me at Ext. 7474.

Sincerely,

A handwritten signature in black ink, appearing to read 'Mark R. Walker', written in a cursive style.

MARK R. WALKER
Director of Finance

cc: Sandy Baz, Budget Director
Marcy Sato, Deputy Director of Finance
Steve Tesoro, Accounting System Administrator



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Mountain View, CA 94040
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February 16, 2018

To: Steve Tesoro, Director of Recreation & Community Services
From: Courtney Ramos, Vice President, Matrix Consulting Group

SUBJECT: EXPLANATION OF INDIRECT RATE VARIANCE

In 2014 the Matrix Consulting Group prepared both a Full Cost and OMB Compliant Cost Allocation Plan for the County of Maui, and in 2016 both of these plans were updated. As part of these plans, indirect rates were developed at a program and fund level for use in recovering indirect costs. The following table outlines the composite rates developed for select funds for 2014 and 2016, as well as the rate change.

Fund	2014 Admin Rate	2016 Admin Rate	Rate Change
Golf	132.51%	87.64%	-44.87%
Liquor	29.77%	18.33%	-11.45%
Sewer	55.47%	71.85%	16.39%
Solid Waste	81.84%	60.99%	-20.85%
Water	46.17%	25.09%	-21.07%

As shown in the above table, the Golf, Liquor, Sewer, Solid Waste, and Water funds experienced significant shifts in rates from those developed in 2014 and those developed in 2016. The following sections outline how indirect rates are calculated, how components affect rates, and the reasons for why the above rates changed dramatically.

1 CALCULATION OF INDIRECT RATES

Indirect cost rates are a mechanism for fairly and equitably determining what proportions of organizational / administration costs each fund should bear. An indirect cost rate represents the ratio between the total indirect costs and benefiting direct costs, after excluding unallowable, extraordinary or distorting expenditures. These rates allow for each fund or program to assume its fair share of indirect costs when the rate is applied.

Indirect cost rates are calculated by dividing the total indirect costs of a program or fund by the salaries & wages of that program or fund. The table on the following page illustrates the components and formula for developing indirect cost rates.

$$\frac{\text{Indirect Cost Rate Base}}{\text{Total Indirect Cost}} = \text{Indirect Cost Rate}$$

The two components of an indirect cost rate are the Indirect Cost Rate Base and the Total Indirect Cost. The Indirect Cost Rate Base is the cost type the indirect cost rate would be applied to. Most often, the Indirect Cost Rate Base is either expenditures or salary and benefits. The Total Indirect Cost represent the costs for which you are trying to capture. These costs can relate to singular departmental services, or jurisdictional services. The County chooses to apply their indirect cost rates to salaries and benefits per fund or program, while indirect costs are associated with administrative services such as finance, HR, etc.

2 HOW COMPONENTS AFFECT RATES

An Indirect Cost Rate is affected when a fund or program's rate base total indirect costs fluctuate independently, rather than jointly. For example, if the indirect cost rate base decreases and the total indirect cost stays relatively the same, the Indirect Cost Rate will increase. Similarly, if the total indirect cost increases and the indirect cost rate base stays relatively the same, the indirect cost rate will also increase. This is illustrated by the following tables.

Original Rate Calculation

$$\frac{\$8,000,000}{\$2,000,000} = 25.00\%$$

Indirect Cost Rate Base Increase

$$\frac{\$5,000,000}{\$2,000,000} = 40.00\%$$

Total Indirect Cost Increase

$$\frac{\$8,000,000}{\$4,000,000} = 50.00\%$$

In order for Indirect Cost Rates to decrease, either the indirect cost rate base has to increase while the total indirect cost stays the same, or the total indirect cost has to decrease while the indirect cost rate stays the same. This is illustrated by the following tables.

Original Rate Calculation

$$\frac{\$8,000,000}{\$2,000,000} = 25.00\%$$

Indirect Cost Rate Base Decrease

$$\frac{\$10,000,000}{\$2,000,000} = 20.00\%$$

Total Indirect Cost Decrease

$$\frac{\$8,000,000}{\$1,000,000} = 12.50\%$$

A significant change in either or both the indirect cost rate base or total indirect cost can have a significant impact on the Indirect Cost Rate.

3 REVIEW OF CHANGES IN FUND COMPONENTS

When comparing the change in indirect cost rate bases and total indirect cost from the rates developed in 2014 and the ones developed in 2016, the funds noted above experienced significant shifts. The following sections explore each rate component.

1 Indirect Cost Rate Base Review

All funds saw an increase in their indirect cost rate bases, or rather their salaries and benefits increased from Fiscal Year 2014 to Fiscal Year 2017. The following table outlines the increase in Indirect Cost Rate Base for each Fund.

Fund	2014 Indirect Cost Rate Base	2016 Indirect Cost Rate Base	Change \$	Change %
Golf	\$745,833	\$937,313	\$191,480	26%
Liquor	\$1,038,662	\$1,509,453	\$470,791	45%
Sewer	\$5,165,304	\$7,009,968	\$1,844,664	36%
Solid Waste	\$4,078,939	\$5,416,139	\$1,337,200	33%
Water	\$8,227,206	\$10,850,349	\$2,623,143	32%

As the table above indicates, the indirect cost rate base (salaries and benefits) associated with each fund increased between 26% and 45% in the three years between Indirect Cost Rate calculations. This would indicate that staff received increased compensation associated with either direct wages, or costs associated with benefit plans increased. Overall, these increases don't appear to be out of line with comparable increases in these expenditure types with other jurisdictions across the US.

2 Total Indirect Cost Review

When reviewing the total indirect costs, all funds but Sewer saw a decrease in total indirect cost. The following table outlines the increase / decrease in Total Indirect Cost for each Fund.

Fund	2014 Total Indirect Cost	2016 Total Indirect Cost	Change \$	Change %
Golf	\$988,313	\$821,478	(\$166,835)	-17%
Liquor	\$309,245	\$276,634	(\$32,611)	-11%
Sewer	\$2,865,039	\$5,036,828	\$2,171,789	76%
Solid Waste	\$3,338,309	\$3,303,231	(\$35,078)	-1%
Water	\$3,798,297	\$2,722,757	(\$1,075,540)	-28%

The total indirect costs for each Fund decreased between 1% and 28%, with the exception of the Sewer Fund, whose total indirect costs increased by 76%. These fluctuations are a result of methodology changes incorporated into the FY 16 plan, including the following:

- **Updated Central Service Departments:** The current plan no longer includes Prosecuting Attorney as a Central Service, however, the County Auditor was added. The Prosecuting Attorney was removed as a central service, as it was no longer needed relevant to spread its costs through the plan. The County Auditor was included, as its role within the County had increased, and its services affecting all funds, departments and programs.
- **Fluctuations in Allocated Costs:** While expenditures associated with Central Service departments generally increased between the 2014 plan and the 2016 plan, expenditures associated with Fixed Assets and Countywide costs decreased significantly. Costs associated with Fixed Assets decreased by approximately \$3.8 million, while costs associated with Countywide Costs decreased by nearly \$8.7 million.
- **Changes in Allocation Metrics:** In discussions with staff during preparation of the 2016 plan, allocation metrics would revised to ensure accurate and fair reflections of services provided. One key example of this would be the adjustment made to Water related metrics used to allocate Finance related services. The Water fund is less reliant on Finance staff to provide various services, and as such, allocation metrics were reduced to ensure accuracy.

The above points highlight some significant changes between the 2014 plan and the 2016 plan. Any change to a plan can have significant impacts to the results.