Report on the Fiscal Sustainability and Financial Condition of the County of Maui

Report No. 20-02
May 2021

Office of the County Auditor
County of Maui

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Office of the County Auditor

The mission of the Office of the County Auditor is to:

- Serve as a catalyst for positive change in County government through focused independent audits and examination.
- Advocate for the efficient and appropriate use of public resources.
- Increase government transparency for the purpose of bringing a higher quality of life to the citizens of Maui County.

The Office of the County Auditor consists of a County Auditor and necessary staff, and is responsible for promoting economy, efficiency, and improved service in the transaction of the public business in both the legislative and executive branches.

To ensure the objectivity of the Office of the County Auditor, the Revised Charter of the County of Maui (1983), as amended, requires that the County Auditor be independent of the Mayor and the County Council. As such, the County Auditor is appointed to a six-year term.

We adhere to very rigorous and demanding professional auditing requirements described in Generally Accepted Government Auditing Standards, or more commonly referred to as *GAGAS* or the Yellow Book. These standards include requirements for planning our work, ensuring that our staff is properly trained and supervised; determining our rationale for the objectives, scope, and methodology; selecting the criteria we use to evaluate the audit subject; and ensuring that our evidence is sufficient, relevant, and competent.

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Preface

The difficulties presented by the coronavirus pandemic are unprecedented in modern times. Both the private and public sectors have been struggling to address current issues while pivoting operations to add value under the "new normal". As such, the Office of the County Auditor has pivoted by working on this financial condition report. This report contains figures from three prior fiscal years, FY 2018 through FY 2020, and serves as an independent assessment of the County of Maui's finances. We will annually update this report after newly audited financial statements or other applicable figures become available.

This is not an audit, but we feel now, more than ever, the County must be mindful of its resources and aware of financial trends which represent opportunities that must be capitalized on or problems that need to be addressed.

This initial report will:

1. Establish financial indicators which could help policymakers and the public to more easily determine whether the financial health of the County is improving or worsening; and

2. Identify current policies that may, in the future, present uncertainty to the County's finances and its stakeholders.

Disclaimer

This report contains "forward-looking statements" or projections. These forward-looking statements and projections may have utilized figures from unaudited sections of the County of Maui's Comprehensive Annual Financial Reports as well as the County of Maui's fiscal year budget documents. As with any projection, past performance does not guarantee future results. Any expression of opinion in this report are not intended to guide prospective investors in securities issued by the County of Maui.

Lance T. Taguchi, CPA
County Auditor

Financial Indicator Results

The County of Maui is currently in a strong financial position. Its revenues are robust and are largely generated within the County, making it less reliant on Federal and State government subsidies to meet operational needs. Further, the County has more than adequate cash to pay for unexpected short-term expenses with minimal impact to its existing operations. Overall, the County's Net Position--generally, the difference between what the County owns versus what it owes--continues to increase.

The County also has sizable financial reserves. These reserves can be used to pay for a variety of unexpected expenses but, historically, have been used to supplement future County budgets. While these reserves give the County increased flexibility, too much reserves could be a sign of problems--that services are not being delivered, budget objectives are not being met, or taxpayers are simply being overtaxed. Policymakers should be mindful that the budget not include projects or programs that are not ready or not adequately planned because doing so would make those problems worse.

The repayment of debt and employee retirement benefits remain one of the largest expenses facing the County. When combined, these expenses consume approximately 25% of the County's revenue. To say it another way, 25 cents of every dollar the County earns is already spoken before the fiscal year begins. These costs are more or less fixed. Therefore, while the County has been experiencing relatively robust revenues, any expansion of the budget in general would require cuts to services, raising taxes, or taking on more debt.

On-going monitoring of the County's financial health is good financial management and ensures that current policy decisions do not overburden future taxpayers. The financial indicators/trends we reviewed are summarized below:

	Indicator	**Overall three-year trend**	**What it means**
1	Net Position		
2	Revenues	above average	
3	Reserves		
4	Liquidity	above average	
5	Debt Service to Expenses		
6	Debt Service to Revenues		
7	Retirement Expense to Revenues	Large % but stable	
8	Debt Service + Retirement Expense to Revenues	Large % but stable	

Individual descriptions of what each indicator means, why they are important, and what to lookout for, are detailed on the pages that follow.

1 Net Position

Description of indicator and what it means:

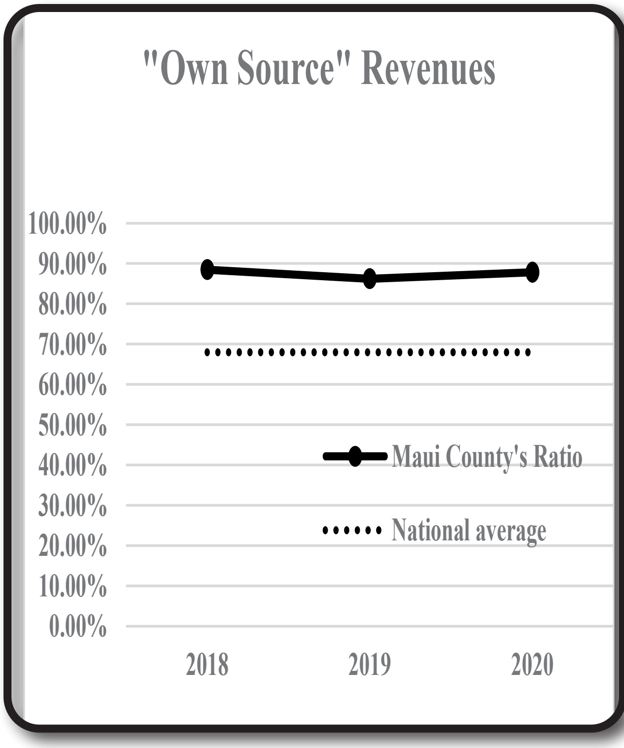
Simply put, "Net Position" is the difference between what the County owns (assets) minus what it owes (liabilities). A positive Net Position means the County owns more than it owes.

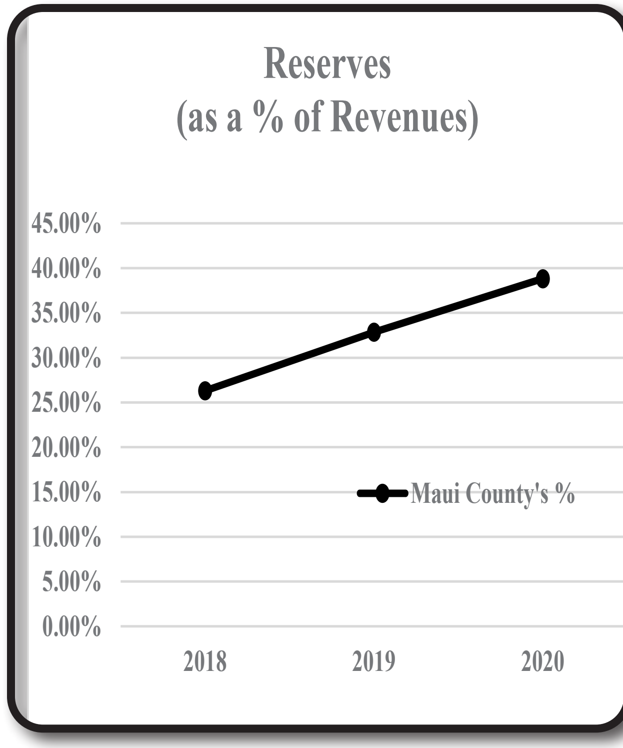
Why is it important:

It is important to understand that having a positive Net Position leaves the County room to pay for unanticipated expenses. While it's unlikely all of the County's bills will ever become due all at once, it's equally unlikely the County would ever need to sell off its roads and water systems to pay its bills.

What to look out for:

A change in Net Position may indicate that the County's financial health is improving or worsening.





2 "Own Source" Revenue

Description of indicator and what it means:

Indicates how much of the County's revenue is directly generated by the County. A higher percentage indicates a greater level of self-reliance.

Why is it important:

Being self-reliant means not worrying how to balance the County's budget when Federal and State governments cannot give money to the County. The County has no control over how much money the Federal and State governments can give.

What to look out for:

Trending toward the national average of 68% could indicate the County is becoming less self-reliant.

3 Unrestricted/Unreserved Fund Balance to Revenues

Description of indicator and what it means:

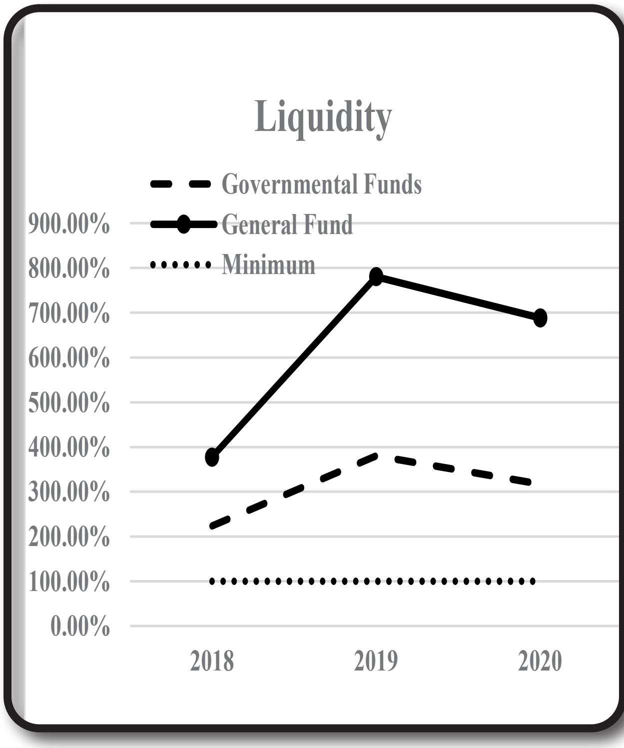
A positive balance (financial reserve) is like a safety net that can be used to pay for unexpected expenses now or in the future. Generally, a higher percentage means the County has more resources available to take care of unforeseen expenses which could include emergencies.

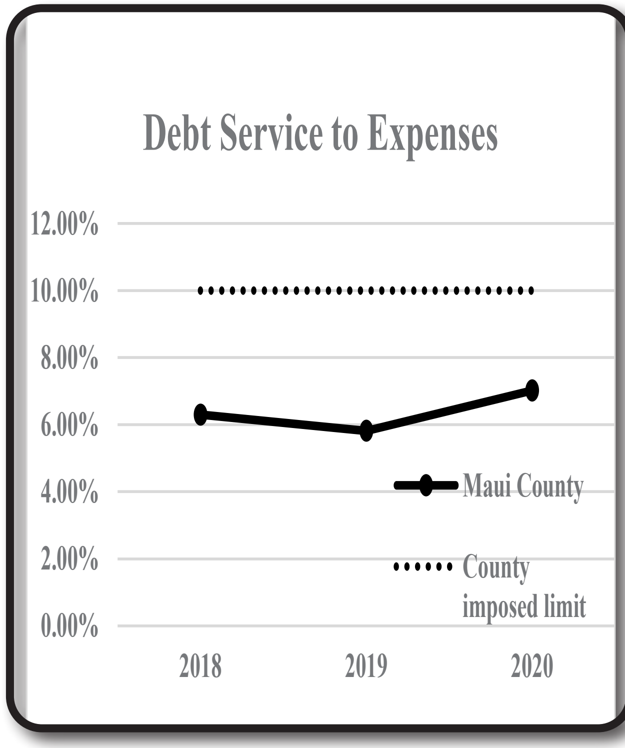
Why is it important:

Having financial reserves allows the County to respond to emergencies without raising taxes or cutting everyday services.

What to look out for:

A steady declining percentage means the County is burning through its reserves. A percentage that climbs higher than normal could be a signal that services are not being delivered, budget objectives are not being met, and/or taxpayers are simply being overtaxed.





4 Liquidity

Description of indicator and what it means:

Liquidity is the cash position of the County. Expressed as a ratio or percentage, anything below 1:1 or 100% is a bad thing.

Why is it important:

Extra/spare cash is generally a good thing. A Liquidity percentage above 100% means the County has more cash than bills—a good thing. On the other hand, a Liquidity percentage below 100% could mean the County might not be able to pay its bills.

What to look out for:

Falling below 100% is okay as long as the percentage climbs above 100% the next year. However, consistently staying below 100% is a bad thing.

5 Debt Service to Expenditures

Description of indicator and what it means:

This shows how much of the County's expenses goes towards paying for borrowed money—6 cents of every dollar spent by the County.

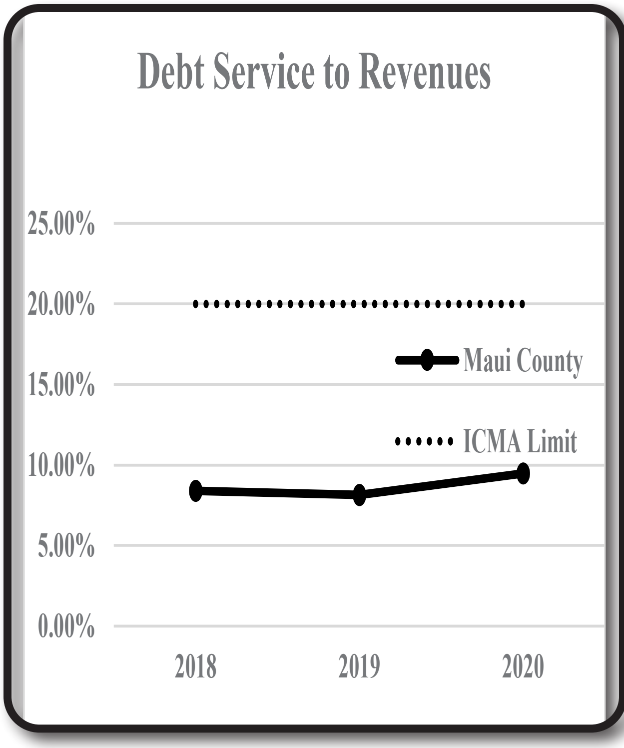
Why is it important:

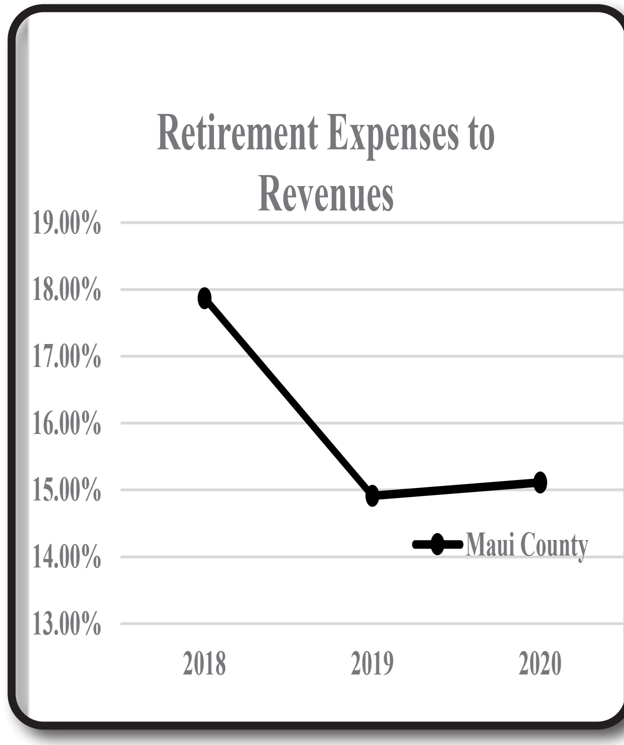
The County's debt is ultimately a financial burden of its taxpayers. If this percentage climbs, it means the County is using more of every dollar it spends to pay for borrowed money and losing its flexibility to provide for everyday services and respond to emergencies.

What to look out for:

The County has a self-imposed ceiling[1] of 10%. County services may be negatively impacted as this percentage moves closer towards that ceiling.

[1]Annual budget proposal documents





6 Debt Service to Revenues

Description of indicator and what it means:

This shows how much of the County's revenues goes towards paying for borrowed money—9 cents of every dollar the County receives.

Why is it important:

The County's debt is ultimately a financial burden of its taxpayers. If this percentage climbs, the County may be taking on too much debt and losing its flexibility to provide for everyday services and respond to emergencies.

What to look out for:

The International County Management Association ("ICMA") establishes a warning ceiling of 20%. County services may be negatively impacted as this percentage moves closer towards that ceiling.

7 Retirement Benefit Expenses to Revenues

Description of indicator and what it means:

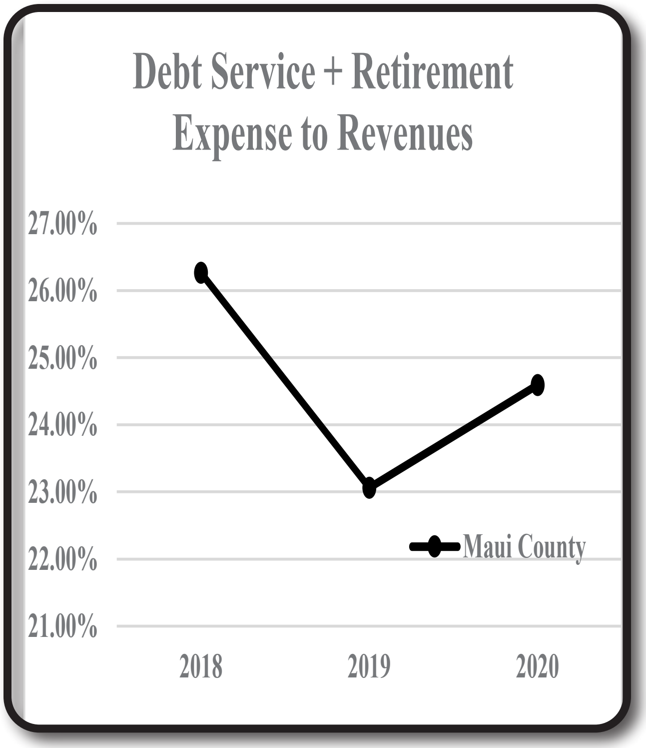
This shows how much the County pays for its employees' retirement benefits—16 cents of every dollar the County receives.

Why is it important:

County employees are entitled to retirement benefits they've earned. If this percentage climbs, the County loses its flexibility to provide for everyday services and respond to emergencies.

What to look out for:

An increasing percentage means the County will be placing a greater financial burden on *future* taxpayers to pay for those employee retirement benefits.



8 Debt Service + Retirement Expense to Revenue

Description of indicator and what it means:

This shows how much the County pays for borrowed money and its employees' retirement benefits—25 cents of every dollar the County receives.

Why is it important:

Generally, the County's debt is ultimately a financial burden of its taxpayers. County employees are entitled to retirement benefits they've earned. If this percentage climbs, the County loses its flexibility to provide for everyday services and respond to emergencies.

What to look out for:

An increasing percentage means the County will be placing a greater financial burden on *future* taxpayers for services they did not receive.

Factors that Could Create Uncertainty to the County's Financial Situation

Real Property Assessed Values Considering Income

In recent years, approximately 45% of Total Estimated Revenues recognized in the County's budget came from Real Property Tax ("RPT") revenue. RPT pays for everyday needs and services like Police, Fire, Parks, Open Space, and Affordable Housing. Simply put, a large portion of everyday needs—needs residents expect—are possible because of RPT revenue.

RPT is made up of two main parts: Tax Rate and Assessed Value. RPT is calculated by multiplying Tax Rate and Assessed Value.

Tax Rate is set by the County Council after a mandatory *legislative* public process during the County's annual budget review.

Assessed Value is determined through *administrative* processes[1] performed by the County's Real Property Tax Division of the Department of Finance. As a result, Assessed Values and, therefore, RPT revenues *are* generally described as "predictable" and "stable".

However, the coronavirus pandemic has challenged the County to make many unprecedented decisions. One such decision was to reduce the Assessed Values of Hotel and Resort properties due to the catastrophic drops in occupancy experienced by that industry. We note such a practice sets bad precedent because it:

1. Shifts RPT from being relatively predictable to a more transactional tax. This shift can create volatility and may not be suitable because the data concerning income generated by properties (e.g., occupancy rates, revenue losses, margin projections, etc.) may not be readily available to the County;

2. Presents a slippery slope whereby owners of other types of properties may also seek a reduction to their Assessed Value due to loss of income; and

3. May diminish the ability of the County Council to effectively legislate taxes.

While the County's decision to reduce the Assessed Values of the Hotel and Resort classification may make sense and may even be legal, the long-term impacts to other RPT classifications or the County's stakeholders are unknown.

[1]According to the Maui County Code, the fair market value of all taxable real property is "…determined and annually assessed by the market data and cost approaches to value using appropriate systematic methods suitable for mass valuation of properties…"

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The Office of the County Auditor is tasked with promoting economy, efficiency, and improved service in the transaction of public business in the legislative and executive branches of the County. Copies of this audit report can be obtained by contacting the Office of the County Auditor or visitng our website: https://www.mauicounty.gov/2032/Audit-Reports-Projects.