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## FISCAL IMPACT REPORT

SPONSOR Sapien ORIGINAL DATE 02/10/14 HB \_\_\_\_\_  
 LAST UPDATED

SHORT TITLE State Inspectors General Act SB 207

ANALYST Cerny

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY14	FY15		
	\$1839.0	Recurring	General Fund
	\$ 345.0	Recurring	Other State Funds
	\$ 342.6	Recurring	State Road Fund
	\$ 859.3	Recurring	Federal Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

Companion to SJR 1. Related to SB 13.

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

New Mexico Department of Transportation (NMDOT)  
 Children, Youth and Families Department (CYFD)  
 Office of the Attorney General (AGO)  
 Department of Health (DOH)  
 State Personnel Office (SPO)  
 New Mexico Corrections Department (NMCD)  
 Office of the State Auditor (OSA)

### SUMMARY

#### Synopsis of Bill

Senate Bill 207 would create independent Offices of Inspectors General (OIG) for eight cabinet departments. The inspectors general would be appointed by the department secretary, according to stipulated criteria, and, along with their employees, would be classified employees.

The OIGs would report directly to the secretary and would be operationally separate from other divisions of the department. Departments would be prohibited from preventing, impairing or prohibiting OIGs from initiating, carrying out or completing an audit, including an internal audit or a compliance audit, or an investigation.

The departments where such offices would be created are Children, Youth and Families (CYFD); Corrections (NM DOC); Health (DOH); Higher Education (NMHED); Human Services (HSD); Public Education (PED); Finance and Administration (DFA) ; and Transportation (NMDOT).

The Act would also create a Government Accountability Coordinating Council (GACC), consisting of the state auditor, attorney general, OIGs of the departments and the director of the LFC. The council would select a chair and vice chair for a term of two years. The council would review the reports, results of investigations, and work plans of the inspectors general.

The OIGs would conduct activities relating to the programs and operations of the departments and other state-funded entities, including school districts, charter schools, public post-secondary educational institutions, and persons who receive grants from, or who contract with, a department.

The offices would conduct and supervise audits, provide coordination and recommendations to promote economy, efficiency and effectiveness, and to prevent and detect fraud and abuse, and would keep the cabinet secretaries and governor, state auditor and legislature informed about problems and deficiencies relating to the administration of departments and state-funded entities.

On the effective date of the Act, all specified departments would transfer functions, assets and resources pertaining to the departments' audit and compliance to the newly-created OIG. (This would include state and federal funds appropriated to those agencies that are re-allocated to the funding of each respective agency's OIG.)

SB 207 establishes the authority of each office of the OIG to:

- conduct internal and compliance audits and investigate its department and related state-funded entities for efficiency, proper use of public funding, and to prevent fraud, waste and abuse;
- have unrestricted access to records, data, reports, contracts, memoranda, correspondence and any other information necessary to carry out the duties of its office;
- coordinate with state auditor, the Legislative Finance Committee, and the Medicaid fraud and elder abuse divisions of the Attorney General's Office;
- recommend changes or corrective action and provide progress reports on improvements and the recovery of misspent public funding;
- refer potential criminal matters to the attorney general or to a district attorney and report violations to the state auditor;
- gather, analyze, and validate department and state-funded entity information as requested by the governor or interim legislative committee;
- validate performance measures and provide post financial audit progress reports;
- contract for professional services;
- accept federal funds for performance of its duties; and
- adopt professional standards.

Further, SB 207 requires each OIG to abide by the following reporting requirements:

- Submit an annual work plan on planned reports and reports in progress to its department secretary, the GACC and LFC.
- Issue reports on the results of audits and investigations the same parties and to the public; provided that information in reports containing information made confidential by law or exempt from the Inspection of Public Records Act shall not be disclosed by the OIG, the department, the GACC or LFC.
- Issue an annual report not later than September 1 summarizing the work of the office during the preceding fiscal year, including reports issued; findings and cost savings identified and recommendations made to the department and its related state-funded entities; and the progress of the department and state-funded entities to resolve findings, save or recover public money or implement recommendations.

The bill restricts the OIG from performing audits of departments' financial statements or publicly disclosing information or records made confidential by law or exempt from the Inspection of Public Records Act.

SB 207 also provides definitions for the terms “department” and “state-funded entity.”

### **FISCAL IMPLICATIONS**

SB 207 appropriates funds specifically to establish offices of inspector general for expenditure in fiscal year 2015 as follows:

- \$118,245 from the general fund and \$14,614 from federal funds to CYFD;
- \$ 982,516 from the general fund to NMCD;
- \$210,460 from the general fund to DOH;
- \$ 84,714 from the general fund to NMHED;
- \$191,699 from the general fund, \$345,058 from other state funds and \$741,237 from federal funds to HSD;
- \$ 84,621 from the general fund and \$103,425 from federal funds to PED;
- \$166,675 from the general fund to DFA;
- \$342,625 from the state road fund to NMDOT.

Any unexpended or unencumbered balance remaining from the appropriations in Subsection A of this section at the end of fiscal year 2015 shall revert to the funds from which appropriated.

Importantly, SB 207 anticipates utilization of existing staff to carry out its purposes. The \$3.386 million in funds appropriated are equivalent to the estimated costs, in each of the departments affected, of FTEs whose duties are already within the purview of the OIG, as determined by LFC staff analysis.

### **SIGNIFICANT ISSUES**

The State Inspectors General Act in SB 207 seeks to improve the executive branch's effectiveness to evaluate its programs and to investigate potential waste, fraud and abuse within state agencies and other entities. Though not in statute, many executive cabinet departments carry out various government accountability functions, including internal and compliance audits

and investigations, through inspector general, internal audit and quality assurance offices. However, these government accountability functions often are not independent, have misdirected or insufficient effort and their work is often not coordinated or reported to the Legislature, according to past LFC staff analysis.

SB 207 would create a consistent set of responsibilities for these internal auditing units including collaboration with the state accountability function. This coordination is important to maximize the use of the state's accountability functions including the LFC, which performs in-depth program evaluations, Office of State Auditor, which performs financial statement audits, and the Office of Attorney General, which performs civil/criminal investigations and prosecution, including for Medicaid.

Analysis of the AGO notes that Section 4(b)(2) bill grants authority to OIGs “unrestricted access to records, data, reports, contracts, memoranda, correspondence and any other information necessary to carry out the duties of the office.” Therefore, according to AGO analysis this section does not seem to limit the access of the OIG to its own department. OSA analysis reaches the same conclusion, suggesting that this provision may provide access to any department or branch of government and therefore require disclosure of executive privilege information or confidential law enforcement information. The OSA analysis concludes, “Given these issues, Section 4(B)(2) may result in the unlawful encroachment and violate principles of separation of powers. As a result, it may result in costly and lengthy litigation.” See Amendments section for AGO recommendation to limit the authority granted to OIGs that may resolve this issue.

The bill clearly states that the OIGs may not publicly disclose information or records made confidential by law or exempt from the Inspection of Public Records Act. Nonetheless, analyses from several agencies express concern about Section 4 (b)(2) and the ability to retain confidentiality of records under the proposed structure. This is consistent with most other states. According to a 2007 report by the National Conference of State Legislatures, “nearly every state legislative program evaluation office has generally unrestricted access to state and local records, including records deemed confidential by state and federal laws,” *Establishing a Program Evaluation Office – Recommendations to the North Carolina General Assembly, 2007*.

CYFD analysis raises concern about confidentiality of information provided to the GACC, “Providing confidential information to such a large diverse group of recipients takes the responsibility and control of confidential information away from CYFD. Though the bill states certain information provided to the entities in GACC shall not be disclosed by the counsel or its members; if confidential information is ever released, it will be extremely difficult to determine who released the information.”

SPO analysis states that the breadth of provision Section 4 (B)(2) “could seriously impede the ability of the departments to protect confidential and privileged information” noting that [in Section 4(b)(8)] “it allows the offices of the inspectors general to contract for professional services, compounding the issue of keeping confidential and privileged information from being disclosed.”

While the SB 207 indicates that the OIGs shall not publicly disclose information or records made confidential by law or exempt from disclosure under the Inspection of Public Records Act, the bill provide no sanctions or penalties for such disclosures.

DOH expresses concern about the integrity of the materials to be provided to the GACC in their analysis stating that “This section appears to require DOH and the other seven cabinet-level departments subject to the bill to provide to the Council, and therefore to the Attorney General, the State Auditor, and the LFC Director virtually any and all internal information, reports, and investigative material whether or not it has been verified, validated, concluded, or in any way been found to indicate or conclude that criminal activity or financial improprieties have occurred.”

## **PERFORMANCE IMPLICATIONS**

NMCD’s analysis expresses concern with potential duplication of effort stating that the bill seems to assume that the offices of inspector general are needed to help provide better oversight over the covered agencies. However, existing law already provides for substantial fiscal oversight of state agencies including NMCD. The LFC already has the authority to review the operations and programs of state agencies, and the State Auditor has the authority to audit all state agencies once per year or at other times as necessary. Further, the State Auditor could by Rule require all state agencies to submit internal audits to it.

DOH analysis states that “Making the agency compliance resources subject to the office (OIG) eliminates the agencies’ ability to comply with regulatory requirements and address audit findings resulting from the inspector general office investigation function.

NMCD analysis notes that it “already has an Office of Internal Audit charged with the same functions as those outlined in the bill. NMCD also already has an Office of Professional Standards which conducts required investigations into allegations of staff misconduct. For NMCD, creating an office of inspector general is not necessary, as those functions are already being performed.”

CYFD also has an Office of the Inspector General. The CYFD Inspector General already performs many of the duties described in the bill, and has the authorities granted by the bill. The new duties described by the bill which are not yet performed by the OIG for CYFD include: submission to the GACC of an annual work plan and reports, quarterly updates on planned and completed investigations and audits.

OSA analysis states the agency does currently communicate with established OIGs and internal auditors of certain departments, and presumably that communication and information exchange would increase under the provisions of this bill. Furthermore, the State Auditor is a member of the Government Accountability Coordinating Council. This coordination may lead to the increase of certain audit duties and activities by the State Auditor, but that operational and related fiscal impact is indeterminate at this point.

The AGO and several district attorneys’ offices may see a slight increase in the number of cases referred to them for prosecution.

## **ADMINISTRATIVE IMPLICATIONS**

DOH states that this bill transfers audit and compliance functions currently existing with DOH to the newly created office of inspector general.

CYFD analysis states: “Though the current IG and OIG report directly to the CYFD Secretary, the bill requires the CYFD OIG to supply annual reports and quarterly updates to the GACC for review. The resources necessary to support these expanded duties will be absorbed by existing resources if the appropriation contained within this bill cannot be used for same.”

NMCD analysis notes that if the bill passes, the division would have to merge its Office of Internal Audit and Office of Professional Standards into one unit called the office of inspector general. This office would then have to report directly to the Secretary of Corrections.

The OIGs would also have “unrestricted access” to records and data of these private contractors. If this bill were to pass, state contracts for these departments would have to be revised to include a provision that subjects each and every contractor to the prospect that they may be subject to investigation and audit by the applicable OIG, and that the OIG is entitled to unrestricted access to the contractor’s records. OSA analysis contends that it is “likely that this provision of the bill would be litigated by private contractors, and may even limit the pool of businesses that seek to do business with the state.”

### **OTHER SUBSTANTIVE ISSUES**

Section 3(B) defines a state-funded entity as a school district; charter school; public post-secondary educational institution; and any person who receives grants from or who contracts with a department. Section 4(B)(1) states this position will have the authority to investigate its department and related state-funded entities. Thus, it is unclear if it is the intent of this bill includes having OIGs investigate and audit school-related matters.

Section 4(B)(6) of the bill provides that the OIGs shall “gather department and state-funded entity information and analyze and validate the information” when requested to do so by an interim legislative committee. By definition, internal auditors work for the management of the audited entities, not the management of entities external to the organization. In accordance with the Institute of Internal Auditors’ Standards for the Professional Practice of Internal Auditing (which internal auditors are required to use in conjunction with Generally Accepted Government Auditing Standards (GAGAS)), it is vital that offices of inspector general be free from organizational impairments to their independence. GAGAS 3.19 provides that the “internal audit organization should document the conditions that allow it to be considered free of organizational impairments to independence for internal reporting and provide the documentation to those performing quality control monitoring and to the external peer reviewers to determine whether all the necessary safeguards have been met.” Under GAGAS 3.16, a governmental internal audit function can be presumed to be free from organizational impairments to independence for reporting internally if the head of the audit organization meets certain criteria. Those criteria include that the head of the audit organization “is accountable to the head or deputy head of the government entity or to those charged with governance” and “reports the audit results both to the head or deputy head of the government entity and to those charged with governance.” GAGAS 3.17 also specifies that “the internal audit organization should report regularly to those charged with governance.” Therefore, because Section 4(B)(6) of the bill subjects OIGs to the direction and authority of an entity outside of the department’s governance structure, namely interim legislative committees, it may create independence problems for OIGs.

Section 4(B)(3) requires the office of inspector general to recover “misspent” public funding; however, SB207 does not define what is meant by “misspent” public funding.

**RELATIONSHIP, CONFLICT**

SJR 1 Create Offices of Inspectors General is related to this bill and calls for a constitutional amendment.

SB 13 State Inspectors General Act is similar to this bill, but would have the offices of inspectors general report to the State Auditor, rather than to the department secretaries, therefore it conflicts with this bill.

**AMENDMENTS**

Analysis from the AGO suggests that an amendment should be considered to Section 4(B)(2) clarifying whether the unrestricted access of the OIG to materials is limited to its department and related state-funded entities.

CAC/ds:jl