OFFICE OF THE
STATE AUDITOR

NEW MEXICO STATE AGENCY FINANCIAL AUDIT REFORMS STUDY & BUDGETARY CONTROLS REPORT

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LEGISLATIVE FINANCE COMMITTEE
JANUARY 20, 2025

NM State Agency Financial Audit Reforms Study

- Ultimate goal is to transition to a singular audit.
- Immediate focus on Federal Single Audit that is detailed on the next few slides.
- FY ‘24 $100k special appropriation for singular audit study.
  - Outcome
- Used agency budget for UNM Bureau of Business & Economic Research (BBER) Study of State Agency Financial Audit Reforms.
- Proposed FY ‘26 Appropriation to develop transition plan.

BUREAU OF BUSINESS & ECONOMIC RESEARCH

STUDY OF NEW MEXICO STATE AGENCY FINANCIAL AUDIT REFORMS

JANUARY 2025

SUMMARY

PREPARED BY UNM BUREAU OF BUSINESS AND ECONOMIC RESEARCH

FOR THE STATE OF NEW MEXICO OFFICE OF THE STATE AUDITOR

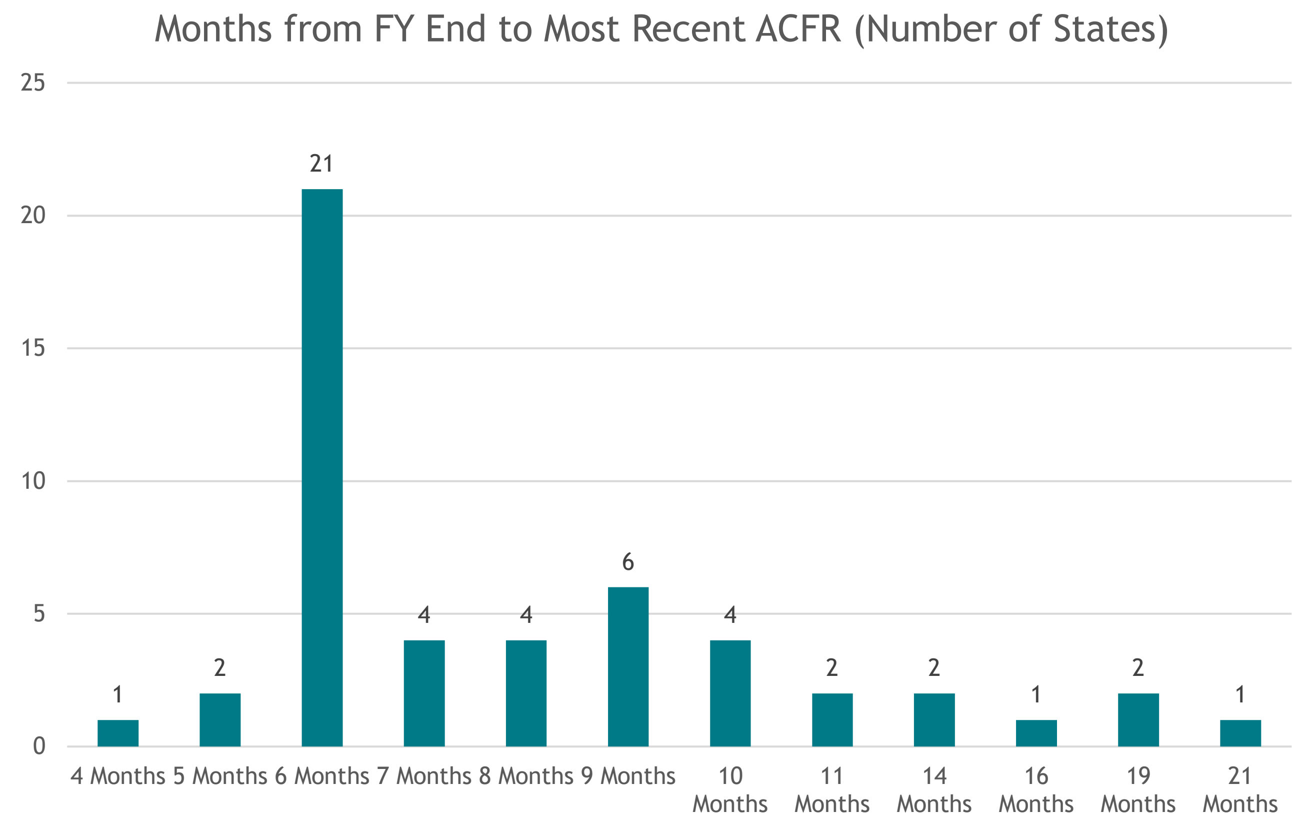
CHARIS AILES, M.A.

Overview of Study

- Assessed general norms in financial reporting for the Annual Comprehensive Financial Report (ACFR) and federal single audit reports across all 50 states
  - Collected data from state ACFRs and single audit reports
  - Reviewed relevant National Association of State Auditors, Comptrollers and Treasurers (NASACT) data
- Conducted interviews with state auditor's offices, state controller's offices, and/or contracted CPA firms for 9 different states
  - Included six states with populations relatively close to New Mexico's: Hawaii, Kansas, Maine, Montana, Nebraska, and Nevada
  - Two states that border New Mexico: Texas and Utah
  - Alaska
- Gathered detailed qualitative information from these states about their financial reporting practices, noting those with the potential to streamline and/or speed up the ACFR's compilation and related audit

Results of Research: ACFRs across States

- ACFR time to completion is measured from the fiscal year-end
- 46 states use a fiscal year ending June 30th; the others use March, August, or September
- The average time to completion is less when the primary auditor is private*
- NM's ACFR is usually completed within 8 to 10 months after the fiscal year end



Who Conducts the Financial (ACFR) Audit?**	Number of States
State audit agency conducts audit (100%)	6
State audit agency is primary auditor	34
CPA firm(s) conducts audit (100%) Currently NM's ACFR audit is conducted by a CPA firm. In prior years OSA has also participated.	10

- 40 state audit agencies either conduct or oversee their state's ACFR audit
- Only six state audit agencies conduct 100% of the ACFR audit themselves
- In most cases, the state auditor audits some of the state agencies while a CPA firm or firms audit others
- Often, the component units have their own separate financial audits while the majority of state agencies are audited as part of a singular ACFR audit
- Sometimes large agencies with particular needs also continue to have separate financial audits

*From https://www.nasact.org/cafr_completion. **Data in table from NASACT's "Auditing in the States" (2024 Edition); the rest is from interviews and state ACFRs.

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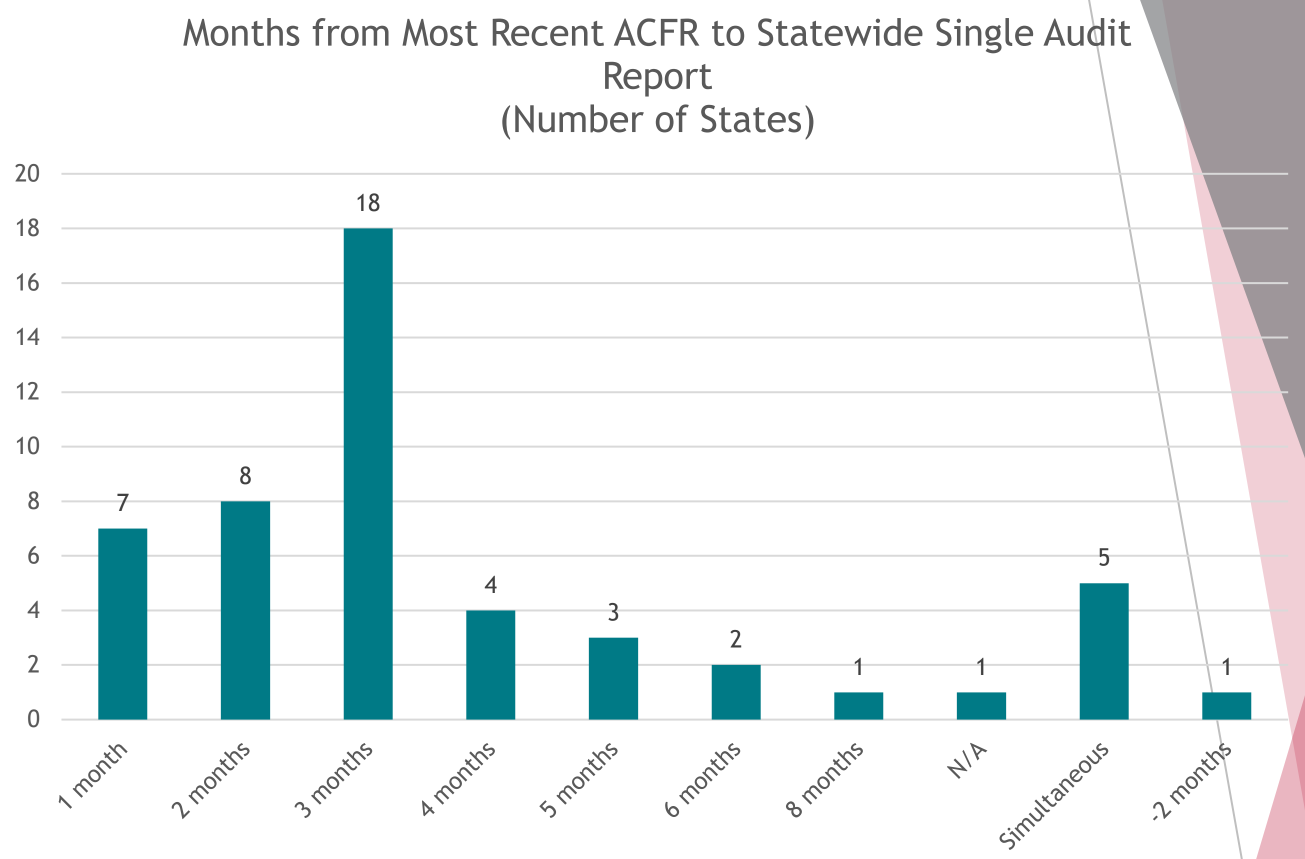
Results of Research: Statewide Single Audit Reports

- Most other states do a statewide federal single audit in addition to their ACFR audit(s)
- The statewide federal single audit is typically done by program rather than by agency
- Some state agencies and/or component units have their own separate federal single audits if needed
- States have a wide variety in who conducts the federal single audit or audits: state, CPA firm(s), or both

Federal Single Audit: Statewide vs. Department/Agency*	Number of States**
Only statewide	33
Both statewide and department/agency single audits	11
Only department/agency - (this includes NM)	3

Who Conducts the Federal Single Audit?*	Number of States
State audit agency conducts audit (100%)	17
State audit agency conducts part/ CPA firm conducts part (NM is included here because federal single audits are conducted the agency level)	19
CPA firm(s) conducts audit (100%)	14



- Federal single audits are due 9 months after the fiscal year ends
- In line with this, most states (18) completed theirs 3 months after the ACFR (often done w/in 6 mos.)
- Separating federal single audit work from the financial audits (where possible) would move it from prerequisite to the ACFR to concurrent/successive, likely decreasing the ACFR's time to completion

*Data in table from NASACT's "Auditing in the States" (2024 Edition); the chart data is from state ACFRs and Single Audit Reports; the rest is from interviews.
**The original data did not contain an answer to this question for Maryland, Massachusetts, and New Jersey.

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Singular Audit – Proposed Outline and Transition Plan

Singular Financial Audit

In order to speed up the ACFR preparation time, a singular state audit is proposed that would include all or most state entities that use SHARE (the statewide accounting system)

- The singular state audit would replace annual individual financial and compliance audits for these agencies (approximately 115-130 state agencies); any individual audits would be later added to the ACFR
- Examples of agencies to continue having separate audits:
  - Large and complex agencies
  - Component units that are legally separate from the state such as the New Mexico Finance Authority and the Mortgage Finance Authority
  - Constitutional institutes of higher education and associated component units

- In addition to the singular state audit, the OSA would use a risk-based approach to come up with an audit schedule of state agencies, ensuring all state agencies are audited at least once every three years
  - These audits could take various forms, such as performance audits
- The five state universities and three other Constitutional Schools do not use the SHARE system; neither do the component units (around 100)
  - Perhaps a real-time interface capability could be added to SHARE that would allow the component units to be added to their own ledger, thus making the ACFR preparation more efficient and less time-consuming
  - If these upgrades are not possible or too costly, system replacement could also be considered

Singular Audit – Proposed Outline and Transition Plan - Continued

First Step – Study to Determine Needed Next Steps for a Successful Singular Audit

There would also be a second study to determine what changes are needed to ensure a successful separate statewide single audit balanced with other risk-based engagements

- In-depth review of the SHARE System to determine:
  - What Changes/Upgrades are Required
  - Estimated cost of upgrades
  - Timeline for completion
- Review of statutory requirements to determine suggested updates, ensuring audit risk is addressed and providing for cyclical audits of every state agency

Second Step - Statewide Federal Single Audit

There would be a separate statewide single audit that uses the ACFR as its financial portion.

- The statewide federal single audit would be program-based rather than agency-based
- Upgrades to the SHARE system could help to facilitate the creation of a statewide Schedule of Expenditure of Federal Awards (SEFA)
- Benefits include:
  - Matching
  - Maintenance of Effort
  - Efficiency/Economy
  - Possibility for fewer findings
  - Better Alignment with Federal Requirements
  - Easier to Accommodate Changes in the Federal Single Audit Act such as the New Financial Management Risk Reduction Act

Potential Effects of Moving to a Singular Audit

- State Bond Ratings*
  - Primarily based on statewide factors related to the state's economy, financial performance, institutional framework/governance, and leverage
  - More affected by the timeliness of the release of financial statements and the quality and content of financials and their audits than by whether the audits are done by agency or statewide
- Audit Cost
  - Individual agencies portion of a singular audit and/or statewide single audit can be charged to each agency according to NMSA 1978 12.6.4 and 12.6.13
  - It is also possible that a statewide federal single audit would permit charging federal awards for some or all of the costs of a federal statewide single audit**
- Statewide Singular Audit would be a "Hybrid"
  - Anticipate that large and complex agencies, material to the state as a whole, would continue to be audited annually
  - Smaller agencies and commissions anticipated to be part of the ACFR group audit

*Conclusions based on https://ratings.moodys.com/rmc-documents/425428.
**Mentioned in https://www.ecfr.gov/current/title-2/subtitle-A/chapter-II/part-200/subpart-E/subject-group-ECFRed1f39f9b3d4e72/section-200.425.

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THANK YOU!

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NM State Agency Financial Audit Reforms Study

- Never been studied.
- Modernize State agency audits to better address identified risks and comply with professional standards.
- Proposed FY ‘26 Appropriation to develop transition plan.
    - Go to statewide federal single audit by program vs agency. Join all other States.
    - Agency level Federal Single Audits can be determined on a case-by-case basis.
    - Consider separate audits for large and complex agencies.
    - Improve timeliness of state agency audits.
    - Federal government sees programs at the state level, not by agency.
- Push for SHARE integration of universities & component units.
- Implement singular audit. Consider hybrid model ensuring all agencies are audited at specified intervals.
- Remove caps on state agency audit budgets.

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TRANSPARENCY REPORT: BUDGETARY CONTORLS

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LEGISLATIVE FINANCE COMMITTEE

JANUARY 20, 2025

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PROJECT TIMELINE

Reviewing statutory provisions for budgetary controls grew out of previous interactions with the Legislature and recommendations from a previous OSA report.

January 10, 2024

Senate Finance Committee asks OSA to look into state agency deficiency requests.

April to June 2024

OSA's GAO holds scoping meetings with LFC staff and requests state agency deficiency data from DFA's Budget Division.

August 19, 2024

OSA GAO publishes Transparency Report 2025 -01: State Agency Deficiency Appropriation Requests. Recommendations include reviewing state laws regarding budget adjustment or budgetary oversight.

October 23, 2024

LFC members ask OSA to review budgetary control statutes to determine recommendations. As most budgetary oversight and approval lay with LFC and DFA, OSA responds that it may only provide recommendations for consideration of those and other stakeholders.

January 2025

OSA GAO publishes recommendations in Transparency Report 2025 -03: Budgetary Controls.

November - December 2024

OSA staff undergo an in -depth evaluation of our state statutes and budgetary controls in neighbor states, making recommendations for policy considerations.

KEY TERMS

Budget Deficiency

An agency's fund has sufficient cash balances to recognize expenditures in excess of approved budgets but does not have legislative authority to spend this excess cash.

Cash Deficiency

An agency's fund has budgetary authority to spend up to a certain amount but does not have adequate cash to support the legal expenditures, or a fund has a legal mandate to spend without budget.

Preventing Deficiencies

These two aren't mutually exclusive, but many state agency deficiency requests stem from cash deficiencies. State can help prevent deficiencies by modernizing and clarifying state agency budget making and maintenance, and related oversight via budgetary controls.

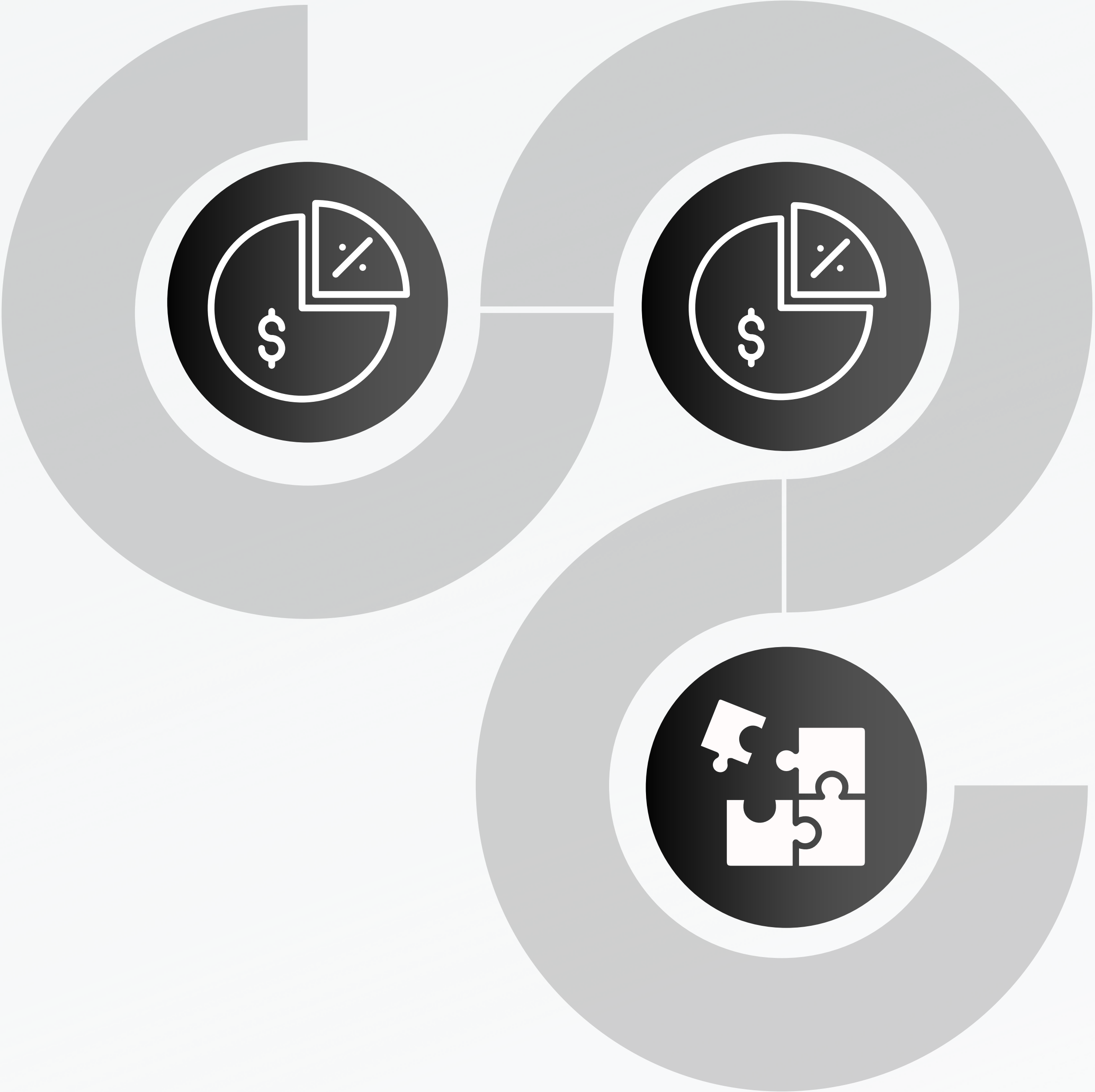
KEY TERMS: WHAT ARE BUDGETARY CONTROLS?

01 The primary purpose of a budgetary control is to ensure a government does not spend more monies than appropriated and experience a cash deficiency.

02 Budgetary controls can prevent a financial transaction from proceeding if there are not sufficient funds available to cover the cost of the transaction in the budget.

Examples include denying encumbrances, purchase orders, invoices, or requisitions or not approving budget authority if revenues are unlikely to materialize.

03 State level budget controls are intertwined with budget oversight, monitoring and maintenance by centralized oversight entities.



STATUTORY FRAMEWORK: WARRANTS AND OVERPAYMENTS

8-6-7 NMSA 1978 provides penalties for wrongful drawing or payment of warrant the Secretary of Finance and Administration or State Treasurer.

- Law tries to prevent cash deficiencies but dates from when New Mexico was a territory; it is very old.
- Last updated to consider receivables in 2003 when the Treasurer and DFA had separate fund tracking - now all tracking is in SHARE.
- No longer any difference between issuing a warrant and paying a warrant.
- The agency initiates, and DFA pays, warrants - not the State Treasurer.

Policy makers may wish to revise this section of law to remove the Treasurer from any discussion regarding warrant issuing and refocus on state agency roles in the warranting process.

STATUTORY FRAMEWORK: WARRANTS AND OVERPAYMENTS CONTINUED

6-5-6 NMSA 1978 provides for state agencies and DFA's Financial Control Division (FCD) to ensure actual expenditures do not exceed: appropriations, allotments, or unencumbered balances of funds at an agency's disposal, including receivables (like federal funds not yet received).

- Law appears to prevent DFA's FCD from issuing warrants that exceed periodic allotments or "funds at the agency disposal."
- Like most governments, state operates on a cash basis.
- Expenditures that are dependent on receivables depend on the accuracy of estimating receivables.
- Language regarding "funds at the agency's disposal" is vague and prone to subjectivity between DFA and the agency.
- The inclusion of receivables not received in the calculation of "funds at the agency's disposal" makes it hard to deny a warrant - the agency is largely responsible for that determination.

Policymakers may wish to clarify how to measure the impact receivables and other accruals have on any measure of the ability to pay. Policymakers may wish to strengthen DFA FCD and Budget Division oversight of revenue projections.

STATUTORY FRAMEWORK - BUDGETARY CONTROL AND PENALTIES

6-3-6 and 6-3-8 NMSA 1978 provide the responsibilities of DFA for allotments, withholding allotments, and penalties for expending more than allotments.

- Puts in place state-level budgetary control of disbursement via allotments. Allotments can be an effective budgetary control on expenditures by periodically limiting the access to state funds that may be expended.
- Under our state law there are only allotments in place every other year and only for six months of that year.
- It is unclear if the allotment limitations apply only to an agency's general fund appropriations or whether federal and other funds are included (including unbudgeted funds).
- Penalties are significant, but it is unclear how a violation would be made enforceable because the scope is not well defined.

Policy makers may wish to revise these sections to create standardization across years in the use of allotments, increase allotment frequency, and provide clarification on funds requiring budgetary control.

STATUTORY FRAMEWORK – SELECT OTHER BUDGETARY CONTROL LAWS

6-3-15 NMSA 1978 and 6-5-2.1 NMSA 1978 requires DFA to obtain information on financial problems and creates duties for financial oversight.

6-4-6 NMSA 1978 prohibits DFA payment unless it may reasonably be expected that at the end of the fiscal year the balances in that fund or account will be fully restored.

- Language indicates that expenditures should not be paid unless fund balances are "reasonably expected" to be restored.
- Whether funds are reasonably expected to be received depends either on the accuracy of revenue forecasts federal or on the end of year reconciliation – preventing ongoing monitoring.
- Other issues regarding vague and outdated oversight exist in other sections of laws not enumerated here as well.

Policy makers may wish to: revisit the provisions for budget adjustments to require more stringent procedures (mandatory budget adjustments if revenues are not receipted by certain key dates), clarify the process by which DFA reviews agency forecasts, and reinstitute limitations on appropriations and/or allow determination of expenditure limits by DFA.

NEIGHBOR STATE COMPARISONS

Arizona

Includes requirements for individual budget units to account for receipts and expenditures (budget by program) and has an easily accessible budget stabilization fund.

Utah

Agencies must prepare a detailed budget execution plan. Revisions to an approved budget execution plan appear very low and can be triggered by revenue shortfalls at the agency level.

Texas

Allows the Legislative Budget Board or the Executive to propose changes to appropriations after enactment and prohibit or transfer appropriations. The legislature plays a significant role in budget oversight.

Colorado

Strict balanced budget amendment and agencies must provide detailed explanations of anticipated revenues and include support for expenditures including leases and any MOU's/MOA's.

Oklahoma

Has a process for the Executive branch to certify revenues and limits agency expenditures to 95 percent of certified expenditures. Has a revenue failure statute allowing the Executive to make across-the-board cuts.

Comparisons

Some of our neighbor states can guide policymakers on more detailed provisions for managing budget adjustments during revenue shortfalls and reallocations.

All states require balanced budgets, but the mechanisms and specific requirements to balance the budget vary.

States differ in their oversight mechanisms, some involving Governor and Legislative staff directly.

Some states have more detailed provisions for managing budget adjustments during revenue shortfalls and reallocations.

CONCLUSION

Modernize

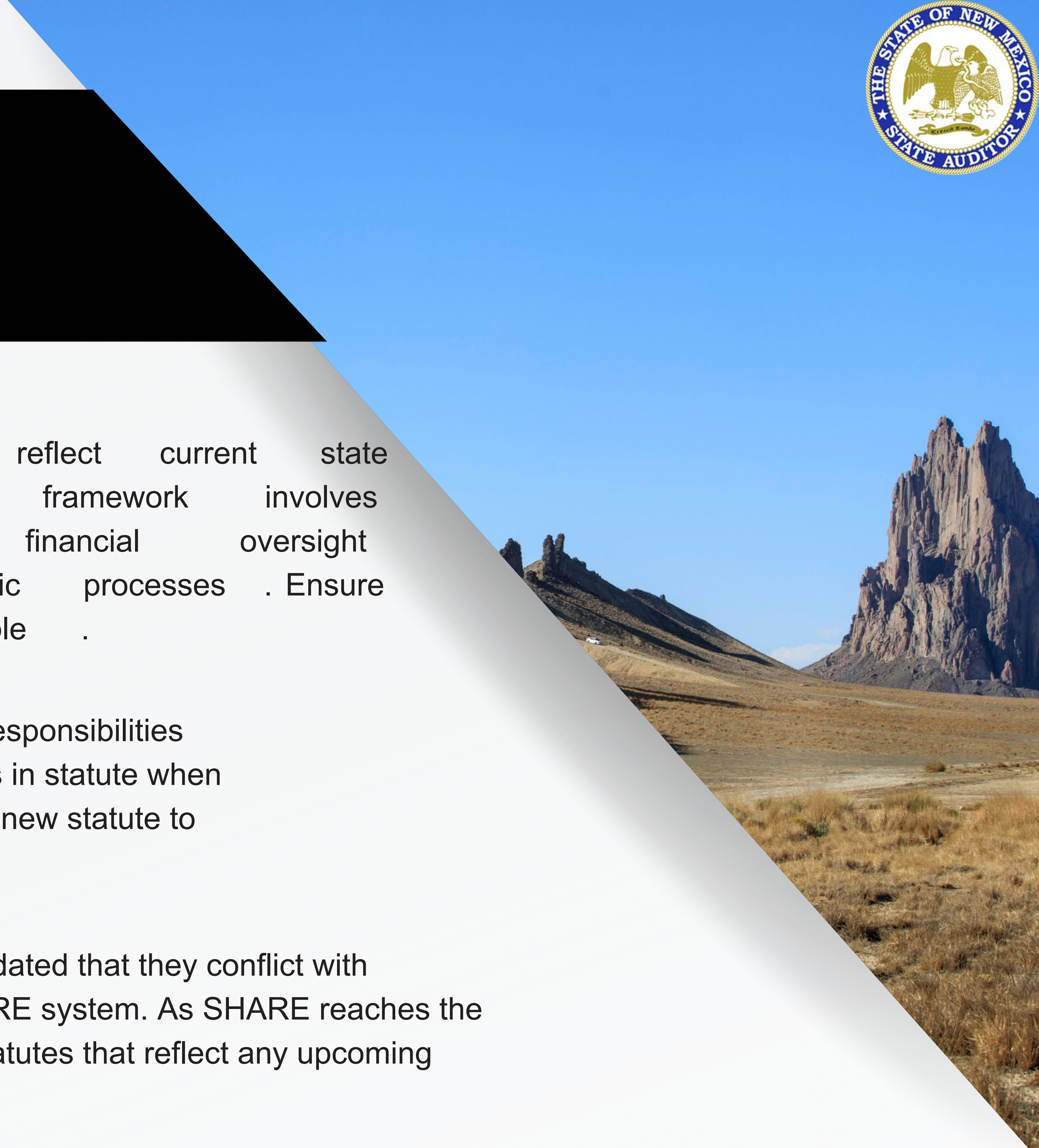
State should modify statutes to reflect current state financial operations. Ensure legal framework involves current lines of authority, financial oversight responsibilities and reflects electronic processes. Ensure penalties are effective and enforceable.

Clarify

Remove the vagueness regarding roles and responsibilities between agencies and DFA. Remove conflicts in statute when older statutes conflict with newer. Promulgate new statute to enhance controls.

Look Ahead

Many elements of our state statute are so outdated that they conflict with current practice or the current electronic SHARE system. As SHARE reaches the end of its useful life, we should also look to statutes that reflect any upcoming systems.



DISCUSSION

- Questions on Presentation?
- Next steps
- Role of OSA

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