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## FISCAL IMPACT REPORT

SPONSOR: Varela DATE TYPED: 03/14/01 HB 87/aHAFC/aSFC /aSFI #1

SHORT TITLE: State Financial Control and Audits SB \_\_\_\_\_

ANALYST: Patel

### APPROPRIATION

Appropriation Contained		Estimated Additional Impact		Recurring or Non-Rec	Fund Affected
FY01	FY02	FY01	FY02		
		\$250.0*	\$250.0*	Recurring	General Fund

\*The General Appropriation Act of 2001 contains \$200.0 for DFA to prepare a comprehensive annual financial report.

(Parentheses ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files  
 Office of the State Auditor  
 New Mexico Mortgage Finance Authority (MFA)  
 Public Defender Department (PDD)  
 Criminal and Juvenile Justice Coordinating Council  
 Department of Finance and Administration (DFA)

### SUMMARY

#### Synopsis of SFI #1 Amendment

The Senate Floor No. 1 amendment strikes HAFC amendments 1, 2, 9 and 18 and adds requirement for the financial control division of the department of finance and administration to consult with the state auditor to:

- coordinate all procedures for financial administration and financial control and integrate them into an adequate and unified system, including the devising, prescribing and installing of processing documents, records and procedures for state agencies;
- prescribe, develop, operate and maintain a uniform statewide accounting system network;
- prescribe and approve the installation of any changes in the state accounting system network; and
- prescribe the uniform classification of accounts to be used by state agencies.

The financial control division also be required to get approval of the attorney general in establishing procedure for electronic signatures.

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Finally, the Senate floor amendment by striking HAFC amendment 18 would give authority to the state auditor to select the auditor for an agency that has not submitted a recommendation within sixty days of notification to contract for the year being audited.

### Synopsis of SFC Amendment

The Senate Finance Committee amendment strikes HAFC amendments 11, 12 and 13 and strikes lines 1 through 6 on page 18 in their entirety which results in the New Mexico lottery commission, New Mexico finance authority, New Mexico mortgage finance authority, New Mexico educational assistance foundation and New Mexico student loan guarantee corporation not being subject to an annual financial audit requirement of the state audit act. These entities audit requirements are stated in their enabling acts.

### Synopsis of HAFC Amendments

The House Appropriations and Finance Committee amended this bill as followings:

- Deleted the requirement for the Financial Control Division of DFA to consult with the State Auditor (Section 6-5-2 A and B). (Pages 3 and 4).
- Changed the requirement to revert all unreserved undesignated fund balances by September 30 ( Section 6-5-10 A ). (Page 8).
- Revised the definition of an agency for audit purposes to include the New Mexico Finance Authority, New Mexico Mortgage Finance Authority and New Mexico Lottery Commission. The amendment deleted reference to any organization and the New Mexico Educational Assistance Foundation and New Mexico Student Loan Guarantee Corporation from HB87 (Section 12-6-2). (Page 18).
- Amended new section 12-6-3 C to require submission of the completed audit report to the State Auditor within sixty days after the State Auditor receives notification from the Financial Control Division of DFA that the agency's books and records are ready and available for audit. (Page 19).
- Amended section 12-6-14 A to require that the oversight agency procure an audit for the an agency that has not submitted a recommendation within sixty days of notification by the State Auditor to contract for the year being audited. The agency being audited shall pay the cost of the audit. (Page 20).

### Synopsis of Original Bill

This bill amends and adds language to certain sections of existing laws relating to the Department of Finance (DFA), Financial Control Division (FCD), public money and certain oversight agencies in order to:

- Establish statewide model accounting practices developed and maintained by the FCD.
- Centralize responsibility for the statewide accounting system and procedures.
- Establish a procurement card pilot project.
- Establish responsibility for state agencies, in addition to FCD, for determining legality and authority for expenditures, as well as determination of budgetary sufficiency.
- Grant authority to the FCD to request documentation and other information necessary to justify an agency's determination of a proposed expenditure and allow FCD to disapprove the

proposed expenditure if it is determined that the agency's justification is inadequate or not substantiated by law.

- Strengthen statewide financial oversight.
- Require state agencies to implement internal accounting controls.

The FCD would be responsible for determining compliance on a sample basis. Additional duties are added to strengthen FCD's role in coordinating activities, collecting data, enforcing statutory requirements and maintaining the central accounting system to enhance the accuracy and integrity of statewide accounting and finance.

This bill amends sections 6-10-2 and 6-10-4 related to keeping daily cash records and charges FCD to consider uncollected earned revenue when certifying that sufficient funds exist in an agency's budget to pay prior years' obligations.

Section 8-6-7 exempts the Secretary of Finance and Administration and the State Treasurer from wrongful drawing or payment of warrant if the warrant is for federal funds that will be received based on established warrant-clearing patterns.

In addition, this bill strengthens financial oversight by:

- Requiring FCD to compile a comprehensive annual financial report (CAFR) with state agencies assisting by compiling their own financial statements in accordance with generally accepted accounting principles (GAAP) on a schedule established by FCD.
- Requiring the Commission on Higher Education to consult with the State Auditor regarding a uniform system of classification, budgeting and reporting that must include submission of at least quarterly financial reports compiled in accordance with GAAP.
- Requiring the State Department of Education to consult with the State Auditor and to establish rules and procedures for a uniform system of accounting and budgeting.

The bill amends the Audit Act as follows:

§ 12-6-2:

- Expands the definition of "agency" to include quasi-governmental agencies such as the New Mexico Educational Assistance Foundation, New Mexico Finance Authority, New Mexico Mortgage Finance Authority, New Mexico Lottery Commission and the New Mexico Student Loan Guarantee Corporation.
- Establishes due dates and certification procedures for audits of agencies under the control of FCD.

§ 12-6-3:

- Requires an audit of the statewide CAFR.
- Allows the State Auditor to jointly conduct audits with contract auditors.
- Requires audits to be conducted according to rules issued by the State Auditor.

§ 12-6-6:

- c Requires agencies to report known or suspected loss of public funds or other illegal activity immediately to the State Auditor.

§ 12-6-14:

- Requires agencies subject to oversight by the Local Government Division, the State Department of Public Education and the Commission on Higher Education to request approval from the oversight agency prior to submitting a recommendation for an independent auditor.
- Allows the State Auditor to select an auditor for any agency that has not submitted a recommendation to the State Auditor within the specified time line.

Significant Issues

The amendments and additions contained in this bill resulted from recommendations made by the Legislative Finance Committee, consultations with the State Auditor and Director of the Financial Control Division, staff research and other states' practices. However, the Department of Finance and Administration indicated that "the provisions in this bill related to the State Auditor could be amended out of the bill and allowed to stand on their own merit."

A survey of nine other states' practices indicates that a centralized accounting system and centralized responsibility for statewide accounting is the predominant model to maximize return on investment, economies of scale and efficient reporting. This bill specifies additional FCD duties to consolidate responsibility within the division for a centralized statewide accounting system, practices, procedures and reporting. FCD is also authorized to implement a procurement card pilot project. According to the Public Purchaser Magazine, "...e-purchasing arguably holds out the most potential for big, upfront, in-your-pocket savings—in cash and in staff time." Implementation of a procurement card has the potential to reduce the number of payment transactions processed by agencies and by FCD central accounting. It will also help in reducing the volume of warrants at the fiscal agent bank and the State Treasurer's office.

Under the current law, if a transaction is processed by DFA, state agencies consider the transaction to have complied with all laws, rules and regulations and many therefore take no responsibility for noncompliance identified through the course of an audit or other type of review. This bill also places the responsibility for ensuring compliance at the agency level where the transaction originated and the expenditure was incurred. It authorizes the FCD to establish documentation requirements. An itemized voucher form approved by the Secretary of DFA would include provisions for certification requirements either in writing or electronically.

The FCD is also authorized to store and maintain records electronically which will require implementation of a document imaging system. The document imaging capability will result in elimination of the need to microfilm and store documents in a paper format. The change from paper-only format to accommodation of electronic submission of vouchers and supporting documentation will streamline state document processing and will greatly enhance efficiency through elimination of redundancy and reduction of key entry errors. The state of New Mexico must move in this direction to achieve an integrated and seamless statewide accounting system, now possible because of continuing advances in data processing and communication technology. The shift to new technologies will ultimately result in substantial cost savings to the state.

Current statute requires DFA to audit every voucher processed. According to DFA, rather than pre-auditing each and every voucher, a stratified sample could be selected for compliance testing. This is consistent with current industry practice and would provide greater coverage of high dollar transactions, freeing up staff resources to monitor and test compliance.

With regard financial oversight, the bill establishes the requirement for FCD to compile and the State Auditor to audit a comprehensive annual financial report (CAFR). A CAFR is essential to provide information that is used by investment companies to determine the state's fiscal integrity and to set bond rates. The Commission on Higher Education and the State Department of Education are required to consult with the State Auditor regarding accounting, budgeting and financial reporting systems in order to take a more proactive approach toward identifying potential problem areas. Quasi-governmental agencies are brought under the oversight of the State Auditor, and all audits must be conducted in accordance with generally accepted auditing standards and the State Auditor rule.

The bill adds provisions to assist the State Auditor in carrying out the responsibility to be accountable for audits and to obtain quality audits on a timely basis by allowing joint audits, by establishing audit due dates and certification procedures for FCD-controlled agencies and by allowing State Auditor selection of Independent Public Accountants (IPA) when agencies do not meet deadlines.

According to the PDD, the department will have to evaluate the current internal controls in order to determine if they are sufficient. Additionally, the PDD is currently authorized to determine the authority for a public expenditure before obligating funds, as opposed to state agencies.

In February 1999, Governing Magazine gave New Mexico a grade C- for financial management and states, "Agency books are audited, but the statewide financial report is not. New Mexico aims to present a complete set of audited books for inspection sometime in 2001. Even the unaudited financial statements sometimes take nine months or a year before the public gets a chance to see them." This bill contains some of the structural changes required to bring cohesion and timeliness to financial management in New Mexico. February 2001, Governing Magazine gave New Mexico a grade of C+ and states that "the state's pensions are fully funded and its bond ratings are healthy, but it could use better analysis of debt capacity. Financial reporting continues to be weakness here as well. Contracting is very decentralized, leaving problems with the potential to fester unnoticed."

## FISCAL IMPLICATIONS

This bill contains no appropriation and theoretically should not result in additional costs to the agencies because agencies should already be ensuring that expenditures are legal and that sufficient funds exist prior to incurring an expenditure.

According to the State Auditor's Office "there will be some additional funding necessary for some agencies to add personnel or better train their current employees to get their accounting completed in a timely manner as required by this bill." Furthermore, the State Auditor indicated that "because the controller (DFA) will either generate or commission an accounting firm to generate the Comprehensive Annual Financial Report (CAFR) for use by bonding companies, an independent audit will be needed for the CAFR. The State Auditor will select the independent auditor for the CAFR. The CAFR cannot replace individual audits because the higher level of materiality would exclude smaller agencies being examined."

In order to attain an audited comprehensive annual financial report (CAFR) in fiscal year 2002, the Financial Control Division must preplan during fiscal year 2001. Similarly, the State Auditor will be required to plan and coordinate the audit of the CAFR with the Financial Control Division and an independent auditing firm. The annual cost for this requirement is estimated to be \$250.0 for fiscal years 2001 and 2002. (**Note- The General Appropriation Act of 2001 contains \$200.0 for DFA to prepare a CAFR; however, there is no funding for the State Auditor's office to audit a CAFR.**)

A cost estimate to implement an integrated accounting system with document imaging capabilities could not be determined at this time. However, every caution should be exercised in planning an integrated accounting system that handles accounting, payroll, procurement and other central office functions, including budget preparation and fixed asset/inventory, grant and project accounting, etc. System planning should be extremely thorough to utilize appropriate development tools, to ensure security for intranet/internet users, and to take advantage of Web-enabling software. Technology and training considerations should include common databases that utilize client/server desktop integration, including graphical user interfaces and data warehouses/business portals to avoid redundancy of data entry and capture.

According to the MFA, bringing the agency under the state Audit Act would require the hiring of an additional one to two employees to comply with state requirements. Because MFA currently receives audits from a host of qualified agencies and because the State Auditor may audit MFA at any time, this extra cost seems unnecessary.

With passage of this bill, the PDD will have to review and possibly update all fiscal procedures to ensure that they meet the requirements of the bill. The agency will also have to review and assess the current accounting system to ensure that it can adequately meet the reporting needs as set forth.

#### **ADMINISTRATIVE IMPLICATIONS**

If this bill is enacted, the FCD could be more effective in its monitoring of expenditures and in fulfilling its oversight responsibility. Centralization of the statewide accounting and finance functions will make the receipting, purchasing, disbursing and reconciliation of public funds process more efficient and effective without making significant demands for additional administrative resources.

Allowing the State Auditor's Office to engage in joint ventures with audit firms will allow the office to work with more auditing firms to accomplish more audits and more staff experience in the methods private firms use when conducting audits.

#### **OTHER SUBSTANTIVE ISSUES**

State agencies with an internal audit function could implement a process whereby expenditures would be tested internally to ensure that they comply with existing laws, rules and regulations, which should provide greater assurance of compliance.

#### **PERFORMANCE IMPACTS**

According to the State Auditor's Office "this bill assures more thorough accounting for the revenue and expenditures of all agencies...Even with a statewide system, each agency must still be audited to make sure that accounting information is looked at to substantiate to legislature, the oversight agency and taxpayers that all funds are received, accounted for and expended according to law." Also, "quarterly financial reports will encourage local governments to accomplish their accounting in a timely manner."

Items clarified and specified in this bill should increase the auditing capacity of the state, which would encourage state and public agencies to more fully comply with procedures and statutes and ultimately more efficiently fulfill their agency goals and missions.