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FISCAL IMPACT REPORT

ORIGINAL DATE 03/11/11

SPONSOR HJC LAST UPDATED _____ HB 596/HJCS

SHORT TITLE State Auditor Public Fund Recovery Counsel SB _____

ANALYST Archuleta

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	*Indeterminate/Possibly Significant	*See Fiscal Impact	*See Fiscal Impact	Recurring	Newly Created "State Auditor Suspense Fund"

(Parenthesis () Indicate Expenditure Decreases)

SOURCES OF INFORMATION

LFC Files

Responses Received From

State Auditor's Office (SAO)
 Public Schools Insurance Authority (PSIA)
 State Treasurer's Office (STO)

SUMMARY

Synopsis of Bill

House Bill 596 the Audit Act authorizing the State Auditor to contract outside counsel to pursue the legal proceedings in certain circumstances. The bill provides for the following:

- Section 12-6-7 NMSA 1978 provides that the State Auditor may institute legal proceedings against sureties upon official bonds of officers and employees. The bill authorizes the State Auditor to contract with outside counsel to pursue the legal proceedings authorized by Section 12-6-7 NMSA 1978.
- Second, Section 12-6-8 NMSA 1978 of the Audit Act provides that if restitution has not been made in thirty days from receipt by an agency of a report of an audit reflecting a shortage of funds for which the agency is accountable under the law, the State Auditor may bring suit to enforce repayment of refund to the agency. HJC Substitute for House Bill 596 explicitly authorizes the State Auditor to contract with outside counsel to bring or assist in the enforcement action authorized by Section 12-6-8 NMSA 1978. The bill also adds language clarifying that the action may also be for the purpose of recovering damages or seeking other relief to redress the shortage.

- Lastly, HJC Substitute for House Bill 596 creates the “state auditor suspense fund” at the state treasury. When pursuing legal action by or with the assistance of outside counsel, all proceeds of the action received in satisfaction of the claim shall be transferred to the state auditor and deposited into the state auditor suspense fund. Attorney fees and costs of litigation paid by the state auditor shall be disbursed from the suspense fund to reimburse the state auditor and the balance of the proceeds shall go to the appropriate fund or funds from which the shortage occurred. The disbursements shall be made from the fund upon warrants drawn by the DFA secretary pursuant to the vouchers being signed by the state auditor or the state auditor’s designated representative.

FISCAL IMPLICATIONS

*The bill explicitly authorizes the State Auditor to contract with outside counsel to pursue certain legal proceedings to recover shortages of the funds identified by an audit. To the extent that the State Auditor chooses to contract with outside counsel to pursue recovery, the costs of legal fees and expenses could vary and would impact the SAO’s budget. However, HJC substitute for HB 596 creates the “state auditor suspense fund” which would provided a funding source to support attorney fees and litigation expenses.

This bill creates a new fund and provides for continuing appropriations. The LFC has concerns with including continuing appropriation language in the statutory provisions for newly created funds, as earmarking reduces the ability of the legislature to establish spending priorities.

SIGNIFICANT ISSUES

In situations as described below, the General Services Department (GSD) and Public Schools Insurance Authority (PSIA) have the authority to seek recovery on behalf of state agencies and public schools. For example, PSIA has hired a law firm to pursue recovery from all parties involved in the Jemez Mountain embezzlement case. More often than not, PSIA engages in a legal contract when pursuing recoveries on a contingency basis. Therefore, contracted counsel is only compensated if funds are recovered and are only compensated a portion/percentage of funds recovered.

The State Auditor’s Office offers the following:

Financial audits, special audits and other audit engagements conducted by the State Auditor may result in identifying shortages of funds for which an agency is accountable. For example, in 2009, the OSA conducted a special audit of the Jemez Mountain School District to determine the amount of funds embezzled from the District by the former business manager Kathy Borrego. Based on the procedures performed, the OSA determined there was sufficient and competent evidence to conclude that Kathy Borrego embezzled \$3,378,701.27 from the District’s bank accounts from January 8, 2002 through June 4, 2009. The Audit Act already allows the State Auditor to bring suit to enforce repayment or refund to the agency, but House Bill 596 would explicitly authorize the State Auditor to contract with outside counsel for the purposes of recovery. Currently, the Office of the State Auditor only employs a General Counsel, so this bill would provide additional protection of taxpayer resources by explicitly allowing the State Auditor to seek outside expertise to pursue recovery of public funds.

Permitting an agency to enter into contingency fee contracts for litigation services also presents the risk of abuse through law firm selection or case selection (or non-selection) involving “pay to play” schemes involving favorable settlement terms. There would also be opportunities for frivolous lawsuits against political targets.

There is a clear need for both transparency and strong oversight to avoid the above and other possible risks from having this method of litigation available. Including language in the bill to specify that procurement of services in this way be subject to SIC review and approval, along with concurrent approval by an outside entity such as the Department of Finance and Administration’s Contracts Review Bureau or the State Purchasing Agent might help insure that this procurement method only be used for appropriate cases and maximizing possible returns to the state.

DA/svb:bym