F I S C A L   I M P A C T   R E P O R T

SPONSOR Varela

ORIGINAL DATE 02/04/10
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HB 228/aHJC

SHORT TITLE Timely Audits of State Agencies

SB

ANALYST Patel

APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Non-Rec	Fund Affected
FY10	**FY11**		
NFI	NFI	NFI	NFI

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION

Responses Received From
Attorney General's Office (AGO)
State Auditor's Office (SAO)
Department of Finance and Administration (DFA)
Department of Transportation (DOT)
Public Education Department (PED)
Department of Health (DOH
LFC Files

SUMMARY

Synopsis of the HJC Amendment

The House Judiciary Committee amended the HB 228 to include state institution subject to periodic allotment withholding that has failed to submit an audit report required by the Audit Act.

Synopsis of Original Bill

House Bill 228 amends NMSA Section 6-3-6 relating to distribution of periodic allotments to state agencies by the State Budget Division to provide that upon the direction of the Secretary of Finance and Administration pursuant to a new NMSA Section 9-6-5.2, also enacted by this bill, the State Budget Division shall temporarily withhold an allotment to a state agency that has failed to submit an audit report required by the Audit Act. The amount withheld and the number of periodic allotments subject to the withholding shall be as directed by the Secretary.

HB 228 also amends NMSA Section 6-6-2 relating to the powers and duties of the Local Government Division of the Department of Finance (DFA) to add a new subsection G to require the division to notify the Secretary of Finance and Administration if a municipality or county has failed to submit two consecutive financial reports which are required by the Division, at least quarterly, as provided in NMSA Section 6-6-2 F.

The bill amends NMSA Section 7-1-6.15 relating to distributions and transfers of certain tax revenues to municipalities and counties to provide that upon the direction of the Secretary of Finance and Administration pursuant to new NMSA section 9-6-5.2 the Secretary of Taxation and Revenue shall temporarily withhold a distribution to a municipality or county that has failed to submit an audit report required by the Audit Act or a financial report required by Subsection F of Section 6-6-2 NMSA 1978. The amount to be withheld, the source of the withheld distribution and the number of months that the distribution is to be withheld shall be as directed by the Secretary of Finance and Administration. A distribution withheld pursuant to that provision shall remain in the tax administration suspense fund until distributed to the municipality or county and shall not be distributed to the general fund.

The bill also enacts a new NMSA Section 9-6-5.2 within the Department of Finance and Administration Act (NMSA Sections 9-6-1 to 9-6-3; 9-6-4 and 9-6-5) which provides that upon notification by the State Auditor pursuant to Subsection G of Section 12-6-3 NMSA 1978 that a state agency, municipality or county has failed to submit an audit report as required by the Audit Act, the Secretary of Finance and Administration shall order the agency, municipality or county to submit monthly financial reports to the Department of Finance and Administration until all past-due audit reports have been submitted to the state auditor and the Secretary is satisfied that the agency, municipality or county is in compliance with all financial and audit requirements. If, ninety days after an order has been issued, the agency, municipality or county has not submitted all past-due reports or has not otherwise made progress satisfactory to the State Auditor toward compliance with the Audit Act, the Secretary may direct the State Budget Division to temporarily withhold periodic allotments to the agency pursuant to Section 6-3-6 NMSA 1978, or, in the case of a municipality or county, direct the Secretary of the Taxation and Revenue Department to withhold tax revenue distributions pursuant to NMSA Section 7-1-6.15. The amounts withheld and the period of time for which the allotments or distributions are to be withheld shall be determined by the Secretary, apparently subject to certain limitations and guidelines.

The bill enacts similar provisions in that new section which provide for the withholding of certain tax distributions and transfers if a municipality or county fails to submit financial reports to the State Budget Division by a municipality or county as required by NMSA Section 6-6-2.

The bill also amends NMSA Section 12-6-3 of the Audit Act (NMSA Section 12-16-1 et seq.) requiring the State Auditor to notify the Legislative Finance Committee (LFC), in addition to the Public Education Department as provided in current law, if a school district, charter school or regional education cooperative has failed to submit a required audit report within ninety days of the due date specified by the State Auditor.

The bill also amends Section 12-6-3 to provide that the State Auditor shall notify the Legislative Finance Committee and the Secretary of Finance and Administration if a state agency, municipality or county has failed to submit a required audit report within ninety days of the due date specified by the State Auditor; and the State Auditor has investigated the matter and attempted to negotiate with the state agency, municipality or county but the state agency, municipality or county has not made satisfactory progress toward compliance with the Audit Act.

FISCAL IMPLICATIONS

House Bill 228 does not contain an appropriation, but allows for a temporary withholding of general fund allotments to state agencies or tax distributions to counties and municipalities. The State Auditor does not see any significant fiscal impact resulting from this bill.

SIGNIFICANT ISSUES

According to the Office of the Attorney General this bill would grant the Secretary of Finance and Administration the discretion to take monetary action against a state agency or local public body by ordering the reduction of its appropriated budget allotment, or by directing the Secretary of Taxation and Revenue to withhold certain statutorily authorized tax revenues, if the agency or body fails to submit required audit reports to the State Auditor.

The Attorney General further notes that under constitutional separation-of-powers principles set forth in Article III, Section 1 of the New Mexico Constitution, the Legislature cannot delegate its power to appropriate money unless specifically authorized by the State Constitution. Gamble v. Velarde, 36 N.M. 262, 266, 13 P.2d 559, 561 (1932). Although this bill does set forth certain limitations and guidelines (a five to ten percent limit on the amounts withheld, for example), it delegates legislative authority to reduce allotments and distributions appropriated for state agencies and local public bodies to the Secretary of Finance and Administration. The bill could therefore violate those principles.

PERFORMANCE IMPLICATIONS

The sanctions provided by HB 228 should give the state agency, county, and municipal officials some incentive to submit audits and quarterly financial reports on time. However, this bill may require an amendment to include Institutions of Higher Education for timely audit reports.

ADMINISTRATIVE IMPLICATIONS

The State Auditor indicates that additional staff time may be required to investigate the matter and attempt to negotiate with the agencies and notify the LFC, DFA and PED that required audit report is not submitted within 90 days of the due date.

OTHER SUBSTANTIVE ISSUES

HB 228 applies to state agencies, counties and municipalities, <u>but it does not include Institutions of Higher Education</u> which may require an amendment to this bill.

According to DFA there are valid reasons for some state agencies, counties and municipalities who fail to submit a timely audit, examples are as follows:

- A new state, county or municipal administration may inherit a financial mess left by the previous administration;
- The location of a county or municipality may be in an isolated area, which would not be cost-effective for an audit contractor to travel, so Request for Proposals (RFPs) often fail to receive a response;
- A response to an RFP may be too expensive for the county or municipality to pay for due to insufficient funds;

- Sometimes audit contractors fail to complete an audit or adhere to the State Auditor's deadlines.

DFA notes these reasons should be considered in explaining why late audits are not always the result of the failure of state agencies, counties and municipalities to cooperate.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Some state and local governments will continue to ignore the requirements of the State Audit Act since they currently do not face any penalties or sanctions for noncompliance. Since the noncompliant agencies have not submitted audit reports to the State Auditor in accordance with the State Audit Act, there is an increased risk that fraud, waste, abuse, illegal acts, and internal control weaknesses over financial reporting, noncompliance with laws, regulations, contracts and grant agreements will go undetected and unreported.

In addition, since the annual audit reports contain the financial statements of the agency, policy makers including the Legislature and executive may not have current or accurate information with which to base budget and policy decisions upon.

MP/svb