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

SPONSOR Varela **ORIGINAL DATE** 02/18/11 **LAST UPDATED** **HB** 411

SHORT TITLE State Agency Submission of Timely Audits **SB**

ANALYST Archuleta

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
Total	NFI	NFI	NFI			

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Attorney General's Office (AGO)
State Auditor's Office (SAO)
New Mexico Corrections Department (NMCD)
New Mexico Municipal League (NMML)

No Response Received From
Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

House Bill 411 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.

The bill 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, state institution, 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 411 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

During the 2010 Legislative session an identical version of HB411 (HB228 last year) passed the House of Representatives with 60 votes for and only 5 votes against.

According to the analysis provided by the Office of the Attorney General for the same bill last year, this bill would grant the Secretary of DFA 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 noted 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 411 should give the state agency, county, and municipal officials some incentive to submit audits and quarterly financial reports on time.

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 DFA that that required audit report has not submitted within 90 days of the due date.

TECHNICAL ISSUES

According to the AG section 5 of House Bill 411 provides new language that gives the secretary of finance and administration the authority to order that a state agency, municipality or county submit monthly financial reports until all past-due audit reports have been submitted. The new language states that the entity shall submit the reports until “the secretary is satisfied” that the there is compliance. This is an ambiguous, subjective standard that may need to be clarified or explicitly defined.

There is a similar concern within the entirety of House Bill 411 which repeatedly states that a state agency or state institution’s submissions must be “satisfactory to the state auditor.” This is also an ambiguous, subjective standard that may need to be clarified or explicitly defined.

OTHER SUBSTANTIVE ISSUES

HB 411 applies to state agencies, state institutions, counties and municipalities. According to analysis provided by DFA for the same bill last year, 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 noted 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.

The Municipal League also notes that audits of New Mexico municipalities are expensive. The expense is driven by the rural nature of the state and necessity for the audit to be conducted onsite. In some cases municipalities are unable to get an independent CPA to propose to conduct a municipal audit or the cost of the audit is prohibitive based on the total budget of the municipality. Perhaps a better solution would be to revisit the level of revenues at which a full blown audit is required or to allow audits to be conducted off site.

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.

DA/svb