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## FISCAL IMPACT REPORT

ORIGINAL DATE 03/03/11

SPONSOR    SEC \_\_\_\_\_ LAST UPDATED \_\_\_\_\_ HB \_\_\_\_\_

SHORT TITLE    Auditor to Perform School District Audits    SB 423/SECS \_\_\_\_\_

ANALYST Archuleta/Sallee \_\_\_\_\_

### ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY11	FY12	FY13	3 Year Total Cost	Recurring or Non-Rec	Fund Affected
*DFA	NA	\$300.0	\$300.0	\$600.0	Recurring	General Fund
**PED	NA	\$165.4	\$165.4	\$330.8	Recurring	General Fund (45%)/Federal Funds(55%)
**SAO	NA	See Fiscal Impact	See Fiscal Impact	See Fiscal Impact	Recurring	General Fund

(Parenthesis ( ) Indicate Expenditure Decreases)

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

State Auditor's Office (SAO)

Department of Finance and Administration (DFA)

Public Education Department (PED)

### SUMMARY

#### Synopsis of SEC Substitute

Senate Education Committee Substitute for Senate Bill 423 requires the State Auditor's Office (SAO) to conduct education-related reviews and audits of school districts and charter schools to deter and investigate fraud and to evaluate the effectiveness and efficiency of school district or charter school operations, reliability and integrity of financial and operational information, safeguarding of assets, compliance with contracts and state and federal laws and rules. It requires the SAO to consult with the Public Education Department (PED) when determining a school district or charter school to review or audit.

### FISCAL IMPLICATIONS

\*DFA indicates the transfer of FTE from PED to the SAO will require an appropriation for funding. The positions at the PED have remained open but unfilled for several years and thus will require an additional appropriation if sent to the SAO. The \$300 thousand estimated impact

on the general fund reflects the current specifics of this bill related to 3 FTE.

\*\*According to PED the 3 FTE referenced in the bill are currently funded through 45% general fund and 55% federal funds.

For the purpose of this analysis, the three accountant and auditor positions were assumed to be the positions that would be transferred and calculated as follows:

- Accountant and Auditor (pay band 65) at mid-point annualized would receive \$42,432.00
- Benefits at approximately 30% would add an additional \$12,730.00,
- Times the three positions would calculate to approximately \$165,486.00

However, it is unclear whether or not the State Auditor's Office would be eligible to receive federal funding to support the above mentioned FTE. Otherwise, the general fund participation would increase proportionally.

It may be necessary to expand the SAO's authority to charge for education-related reviews to SAO's to charge fees for providing audit services.

\*\*\*Though the bill does not specify how many school districts and charter schools are affected by the proposed bill, per OSA's cursory assessment, there are approximately 91 school districts and 74 charter schools which would require the internal audit as per the bill. Accomplishing internal audit functions for all school districts and charter schools would have a significant fiscal impact and may be impractical, particularly given the lack of funding for the current positions. However, the OSA could focus the full-time positions (if funded) on school districts and charter schools that are at greatest risk for fraud, waste and abuse.

## **SIGNIFICANT ISSUES**

The SAO currently has authority to conduct special audits; however the SEC substitute for SB423 would also clarify the authority to provide education-related reviews and audits of school districts and charter schools to deter and investigate fraud and to evaluate the effectiveness and efficiency of school district or charter school operations, reliability and integrity of financial and operational information.

PED indicates the Office of Inspector General is currently operating at a 50% vacancy rate and only has one Accountant and Auditor Position filled. It is not clear if the State Auditor's Office could manage to perform the task of this legislation with any of the other positions.

During the 2010 legislative interim, the Legislative Education Study Committee convened a work group on school finance. The Office of Education Accountability served as a member of this group. One of the topics addressed in the work group was the potential role that the Office of the State Auditor could serve in providing internal audit services to school districts and charter schools. The work group further discussed the current situation at PED and the Office of the Inspector General, which currently has 6 FTE assigned to it. In practice, these FTE have the responsibility of providing audit services on behalf of the PED to districts and charter schools. However, due to funding constraints, all the FTE have remained unfilled.

The State Auditor's staff reviews all annual financial audits of schools districts and higher education institutions; ensures compliance with government auditing standards, including the Statement on Auditing Standards No. 99: Consideration of Fraud in a Financial Statement Audit; works to bring school districts in compliance with the Audit Act by conducting special monitoring of those districts that have failed to submit timely audits; monitors school districts' and charter schools' corrective action on audit findings; and conducts trainings for school boards and school board members. The SAO has also identified risk areas in certain public schools which require additional audit oversight and has aggressively fought fraud in public schools, including conducting a special audit of the Jemez Mountain Public Schools which identified a multimillion dollar embezzlement scheme by the former business manager.

### **PERFORMANCE IMPLICATIONS**

Some positions in PED have been unfilled for several years, thus providing no service for a critical role of budgetary and fiscal administration of New Mexico's public schools. A critical function of the PED Inspector General is to audit components of the State Equalization Guarantee funding formula that provides about \$2.3 billion in funding for school districts and charter schools. These audits are intended to reduce the financial risk to the state and ensure the underlying data submitted to PED by public schools accurately reflects student enrollment, as well as other calculations such as those for the teacher training and experience index, bilingual program funding, related services staffing and special education. Numerous examples exist of formula chasing exist, and in some cases public schools inappropriately claiming funding by providing incorrect formula data to PED. Further reducing the staffing levels of the Inspector General could inhibit PEDs ability to ensure accurate distribution of hundreds of millions in public school funding, through the formula, as well as auditing for programmatic compliance with federal grants.

### **CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP**

SB 423 in Section 2, a Temporary Provision, would transfer three positions from the Office of Inspector General within the PED along with the associated appropriations for these positions from HB2 and allocate them to the Office of the State Auditor.

SB 423 conflicts with SB 83 that creates a State Office of Government Accountability and HB 66 which transfers duties of the PED to the Department of Finance and Administration.

SB 423 duplicates the investigative issues with school districts and charter schools in HB 383.

### **TECHNICAL ISSUES**

PED cites concern that the bill does not define which three positions from the Office of Inspector General would be subject to this action. According to PED, the Office of Inspector General currently has six positions which include General Manager I, Administrative Operations Manager 2, three Accountant and Auditor positions, and one Financial Coordinator – Operational. Of these positions, the General Manager I, Administrative Operations Manager 2, and one Accountant and Auditor position are currently filled.

**OTHER SUBSTANTIVE ISSUES**

According to the Institute of Internal Auditors (IIA) “Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.” Internal audit activity includes evaluating the effectiveness and efficiency of operations; reliability and integrity of financial and operational information; safeguarding of assets; and compliance with laws, regulations, and contracts.

IIA reports there are distinct differences between internal audit and financial statement audit: “Although they are independent of the activities they audit, internal auditors are integral to the organization and provide ongoing monitoring and assessment of all activities. On the contrary, external auditors are independent of the organization, and provide an annual opinion on the financial statements. The work of the internal and external auditors should be coordinated for optimal effectiveness and efficiency.”

The co-chairs of the LESC sent a letter to the chairs of the HAFC respectfully requesting an appropriation be made in the General Appropriations Act of 2011 to the OSA for the funding of the FTE transferred from PED. The co-chairs further requested that the positions be dedicated to education-related reviews.

**WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL**

The three positions would remain at the PED.

DA:CS/svb:mew