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

		ORIGINAL DATE	2/3/15		
SPONSOR	Neville	**LAST UPDATED**		**HB**	
SHORT TITLE	Double Required Audit Threshold			**SB**	246
				ANALYST	Malone

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

	FY15	FY16	FY17	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Total	$80.0	$0.0	$0.0	$80.0	Nonrecurring	OSA operating

(Parenthesis ( ) Indicate Expenditure Decreases)

SOURCES OF INFORMATION
LFC Files

Responses Received From
Office of the State Auditor (OSA)
Attorney General's Office (AGO)
New Mexico Municipal League (NMML)

SUMMARY

Synopsis of Bill

This bill amends the tiered system of financial reporting under the Audit Act to double the operating budget revenue thresholds for tiered financial reporting for incorporated municipalities, mutual domestic water associations, land grants and special districts (local public bodies). Special districts are enumerated in Chapter 73 NMSA 1978 and include drainage districts, irrigation districts, conservancy districts, soil and water conservation districts, watershed districts and acequias.

FISCAL IMPLICATIONS

The bill establishes the following adjusted tier thresholds for financial reporting:

1) if the annual operating budget revenue of a local public body is less than $20,000 and the local public body does not directly expend at least fifty percent of, or the remainder of, a single capital outlay award, that local body is exempt from submitting and filing quarterly reports and final budgets for approval to the Local Government Division of the Department of Finance and Administration (LGD of DFA) and from any financial reporting to the state auditor.

2) If the annual operating budget revenue of the local public body is at least $20,000 but less than $100,000, the local public body is required to comply only with the applicable provisions of Section 6-6-3 NMSA 1978, which include the budget certification requirements of LGD of DFA.

3) If the annual operating budget of the local public body is less than $100,000 and the entity directly expends at least fifty percent of, or the remainder of, a single capital outlay award, the local public body is required to submit a financial reported according to a specific set of agreed-upon procedures that are:

- Focused solely on the capital outlay funds directly expended;
- Economically feasible for the affected local public body; and
- Determined by the State Auditor after consultation with the affected local public body;

4) If the annual operating budget revenue of the local public body is at least $100,000 but not more than $500,000, it shall submit to the State Auditor a financial report that includes a schedule of cash basis comparison and that is consistent with agreed-upon procedures for financial reporting that are:

- Narrowly tailored to the affected local public body;
- Economically feasible for the affected local public body; and
- Determined by the State Auditor after consultation with the affected local public body;

5) If the annual operating budget revenue of the local public body is at least $100,000 but not more than $500,000 and the entity expends any capital outlay funds, it shall submit to the state auditor, at a minimum, a financial report that includes a schedule of cash basis comparison and a rest sample of expended capital outlay funds and that is consistent with agreed-upon procedures for financial reporting that are:

- Narrowly tailored to the affected local public body;
- Economically feasible for the affected local public body; and
- Determined by the State Auditor after consultation with the affected local public body;

6) If the annual operating budget revenue of the local public body is at least $500,000 but not more than $1,000,000, it shall submit a compilation of the entity's financial statements and a report that is consistent with agreed-upon procedures for financial reporting that are:

- Economically feasible for the affected local public body; and
- Determined by the State Auditor after consultation with the affected local body;

7) If the annual operating budget revenue of the local public body is $1,000,000 or more, it is required to submit a financial and compliance audit.

The bill would have an impact on the operating budgets of incorporated municipalities, mutual domestic water associations, land grants and special districts that would shift from tier 7 to tier 6 as a consequence of changed thresholds. An annual audit of the smallest government entity can cost between $5,000 and $20,000. OSA reports that in FY14 compliance with tiered reporting cost about $1,150 for tier 3 reporting, $3,400 for tier 4 reporting, $3,400 for tier 5 reporting, and $6,600 for tier 6 reporting.

SIGNIFICANT ISSUES

The bill would relieve the financial burden of financial reporting imposed on the entities with the smallest revenues (up to $20,000) by eliminating all reporting requirements. However, these entities are required to provide a financial report if they directly receive or expend capital outlay appropriations.

Both AGO and OSA note that if enacted, the bill would result in less financial accountability for local public bodies. The bill would increase the number of small local public bodies that are not subject to any financial reporting to the Local Government Division of the Department of Finance and Administration (LGD of DFA). It would also decrease the number of larger local public bodies that are subject to a full audit; instead they would be subject to tier 6 financial reporting which includes a compilation of the entity's financial statements and an agreed-upon procedures report.

The Municipal League estimates that this legislation will allow about 18 small, rural communities to avoid having an annual audit performed while requiring them to continue to report financial information to the Local Government Division of the Department of Finance and Administration and to the State Auditor.

PERFORMANCE IMPLICATIONS

Increasing the operating budget revenue thresholds for tiered financial reporting could increase financial reporting compliance.

ADMINISTRATIVE IMPLICATIONS

Increasing the lowest tier threshold to $20,000 would lessen the administrative burden on LGD of DFA of tracking financial reporting from local public bodies. The current statute only exempts local public bodies with less than $10,000 in revenue. Entities receiving capital outlay must still meet financial reporting requirements.

OSA notes that if the bill is effective as of July 1, 2015, OSA would need to restart the contract process for all affected entities since OSA would have already promulgated the Audit Rule by that date. The OSA would also need to develop and implement amendments to the Audit Rule and agreed-upon procedures. The office estimates that it would require at least one FTE (estimated $80,000 in FY15) to handle the workload associated with this change. Additionally, the bill would also result in governmental entities having to incur expenses to make these contractual adjustments and possible restart the procurement process.

TECHNICAL ISSUES

OSA has concerns that this legislation could complicate existing requirements if entities would still have to report under the old requirements for prior fiscal years and the new requirements as they come into compliance with the current fiscal years.

Because the State Auditor has authority to determine the procedures included in the agreed-upon procedures for each tier, increasing the thresholds could lead to more strict requirements to limit the decrease in financial accountability.

OTHER SUBSTANTIVE ISSUES

The introduction of Executive Order 2013-006 has given greater importance to financial reporting for public bodies of all sizes. The order prevents entities without up-to-date and sound financial reports from receiving capital outlay funds. As of the June 2014 bond sale, 38 projects totaling $2.7 million were ineligible for funding as a result of EO 2013-06.

OSA notes that Furthermore, the legislation may not lessen the impact of Executive Order 2013-006 because the Executive Order establishes alternative measures that an entity must take if it falls below certain audit requirements.

Although OSA does not know how many of these reports/investigations resulted in findings of fraud or abuse, the agency reports that, since 2008, there have been 312 reports/investigations regarding local public bodies.

ALTERNATIVES

OSA suggests that changing the implementation year to align with FY16 financial reporting would prevent the administrative implication noted above.

CEM/je