FUND BALANCE BASICS
CAPITAL OUTLAY BEST PRACTICES

Standard financial operations typically require certain amounts of dollars to be held as fund balances. Typically fund balances are used to offset funding gaps between fund expenditure and fund reimbursement, similar to the way a business would utilize “working capital.” Funds are also commonly used to store dollars for purposes of future spending, contingency spending and future debt repayment. This practice is similar to how a business would use various types of savings and investment accounts. Considering these uses, there is nothing inherently wrong or right about accumulating funds balances.

However, just as with a business, agencies have a responsibility to control fund balances to keep those dollars working toward their intended purpose and into the economy. Put another way, every dollar held in a capital outlay fund is a dollar that is not circulating in the economy. Considering this basic tenet of economics, it is always prudent to consider standard best practices for the management of fund balances.

In New Mexico, capital project funds are most vulnerable to balance accumulation. Capital projects are typically fixed asset investments, including roads, bridges, water projects, schools, buildings, construction, environment projects, long-term technology or other investments designed to last at least 10 years. Capital projects are typically performed by private contractors or through state purchasing of goods and services. Because capital projects may require initial investment in planning, matching funds from other sources and complex procurement issues, and agencies often accumulate fund balances while navigating hurdles and delays.

The following recommendations are based on standard best practices of financial management as applied to New Mexico public fund management and capital investment. They include recommendations to address this challenge in three key phases:

- At the initial funding stage, to prevent unneeded fund balance accumulation.
- After funding takes place, during the expenditure process, to help agencies expend funds in a timely manner for the purpose for which they are intended.
- Throughout the project, to adjust fund management when fund balances are not optimal.

At the initial funding phase, some best practices to prevent unneeded fund balance accumulation include:

1) Fully Fund Projects Up Front

Historically, infrastructure projects have been funded on a piecemeal basis. The infrastructure funding process involves a negotiation process among the Governor, the Legislature and agency capital requests or appropriation requests. The process often results in funding projects in small, affordable chunks in the hopes that, over the course of several years, projects can be fully funded. However, project costs often escalate over time, and even project needs can change over the course of the years it takes to fund projects in this manner. To ensure funding matches actual cost estimates, projects should be fully funded within a single appropriation.

2) Require Matching Funding to Be In Place

Relatedly, many projects are partially funded as part of a project funding package that includes multiple funding sources such as dollars from federal, state and local governments. While rational, this practice can also lead to suboptimal fund balance accumulation and project underfunding. Although federal and local laws and regulations can be a barrier, securing state funding for projects after matching funds are in place can mitigate this problem to the extent possible.

FUND BALANCE BASICS
CAPITAL OUTLAY BEST PRACTICES (continued)

3) Ensure Local and State Priorities are Aligned

Another key best practice for capital funding and expenditure is to ensure that before a project is funded, the required decision makers have priorities aligned. Often state-level appropriations may come to local governments that have differing priorities. When the state and local body have different infrastructure priorities, it greatly increases the likelihood that funds languish unspent.

4) Follow existing Legislative Guidelines

Nearly a decade ago, the New Mexico Legislative Council and the Legislative Finance Committee outlined guidelines designed for the best use of capital outlay funds. These guidelines provide additional detail based on best practices. Currently these guidelines are found in each capital outlay request form and located online at http://www.nmlegis.gov:8080/Publications/Capital_Outlay/criteria_for_legislature_to_evaluate_local_projects.pdf. However, these guidelines, while strongly encouraged, are not mandatory. They include:

A. Criteria for Legislature to Evaluate Local Projects

The following criteria may be used as a guide in ranking a project's importance. Legislators can use the criteria as a tool in making funding decisions. The first set of criteria is related to the need of the project, and the second set is related to how well-planned the project is and its current status.

B. Need-Based Criteria

1. Project is on governmental entity's Infrastructure Capital Improvements Plan (ICIP).
2. Project is necessary to eliminate potential or actual health or safety hazards or other liability issues.
3. Project is required by federal, state or judicial mandate.
4. Project will prevent deterioration of asset or will correct infrastructure problems of asset.
5. Project is necessary to address population or client growth, and will provide direct services to that population or clientele.

C. Planning Criteria

1. Project has been thoroughly planned and is ready to begin.
2. Project has received prior funding and can be completed with this appropriation.
3. Matching funds or a local share has been secured for project.
4. Operational costs of project upon completion have been identified and planned for.
5. Project has had public input and buy-in.
6. Project has been designed to be energy efficient in its operation.
7. Construction of project can be successfully phased, so that each phase will be operational.

To learn more about capital outlay, visit:

Legislative Finance Committee's Finance Facts
http://www.nmlegis.gov/lcs/lfc/lfcdocs/finance%20facts%20capital%20outlay.pdf

Department of Finance Capital Outlay Bureau
http://nmdfa.state.nm.us/Capital_Outlay_Bureau.aspx

FUND BALANCE BASICS
CAPITAL OUTLAY BEST PRACTICES

After funding takes place, during the expenditure process, some best practices to prevent unneeded fund balance accumulation include:

5) Monitor Projects Centrally and Cut Red Tape

Today in New Mexico, no single entity or individual has a comprehensive list of all the state-funded infrastructure projects in progress. The information is spread across 500 plus funds and many different state and local agencies. Furthermore, many projects are tied up at the local level, into which the state has low visibility. Accordingly, the public and policy makers cannot effectively monitor the progress of already funded projects. This also makes any kind of accountability extremely difficult.

Based on research conducted at OSA, this report is the most comprehensive report of infrastructure dollar allocations in the state of New Mexico. However, OSA figures are limited to the level of detail that is provided in the annual audit. Because agencies are not required to share their project listings in their annual audits, there is currently no centralized reporting of pending construction projects. The creation of a task force or czar position to monitor and track these projects and help cut through red tape with respect to permitting and agency coordination would provide needed transparency and accountability to the process.

6) Require Project Progress Audits

Measuring progress of any given pending capital project in the state varies from agency to agency, and often such responsibility lies with a local government entity or school district. As result there is no uniform or trackable method to determine if overall progress toward completion, or lack thereof, for projects. Embedding progress audits into the appropriation, or requiring capital project audits by administrative agencies, would systematically ensure appropriate accounting and measurement of progress for capital projects.

As a project is underway, some best practices to adjust fund management when fund balances are not optimal include:

7) Include Specific Expiration Date or Reversion Dates

Unspent fund balances contain slices of appropriations from different historical years. Some funds may be decades old, although most funds are from more recent appropriation cycles. Many infrastructure funds typically have a three-year window, but there are no limits on the number of times a project can be reauthorized in order to extend this time period. Furthermore, agency requirements may vary widely. As result funds can accumulate, unchecked, for years, unless there is direct executive or legislative action to move those funds or revert them back to the general fund for future appropriation.

Best practices recognize that it is very important to establish and enforce any automatic reversion or expiration dates built into appropriations that may prevent the completion of projects. Best practices also acknowledge that at some point, for dollars allocated to a project that are not encumbered, reauthorization must cease and the funds must, at some point, revert and be used for other purposes. Having a firm “drop-dead date” to spend dollars would go a long way toward ensuring that unspent funds are recycled back into the state appropriation process.