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FISCAL IMPACT REPORT

ORIGINAL DATE 01/30/14
 LAST UPDATED 01/30/14

SPONSOR Salazar HB 205

SHORT TITLE State Auditor Small Subdivision Audits SB _____

ANALYST Boerner

APPROPRIATION (dollars in thousands)

| Appropriation | | Recurring or Nonrecurring | Fund Affected |
|---------------|---------|------------------------------|------------------|
| FY14 | FY15 | | |
| | \$500.0 | Recurring | General Fund |

(Parenthesis () Indicate Expenditure Decreases)

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT (dollars in thousands)

| | FY14 | FY15 | FY16 | 3 Year Total Cost | Recurring or Nonrecurring | Fund Affected |
|--------------|------|---------|---------|----------------------|------------------------------|---|
| Total | | \$500.0 | \$500.0 | \$1,000.0 | Recurring | State Auditor Operating Budget |

(Parenthesis () Indicate Expenditure Decreases)

Duplicate with Senate Bill 4 Small Political Subdivision Audits

SOURCES OF INFORMATION

LFC Files

Responses Received From

Office of the State Auditor (OSA)

Department of Finance and Administration (DFA)

SUMMARY

Synopsis of Bill

Senate Bill 4 appropriates \$500 thousand from the general fund to the Office of the State Auditor to perform audits for small political subdivisions with annual budgets of \$100 thousand or less.

FISCAL IMPLICATIONS

The appropriation of \$500 thousand contained in this bill is a nonrecurring expense to the general fund. Any unexpended or unencumbered balance remaining at the end of fiscal year 2015 shall revert to the general fund.

The OSA notes this appropriation may assist small local public bodies in complying with the Audit Act (Sections 12-6-1 through 12-6-14 NMSA 1978) which requires government agencies that receive or expend public funds to receive an annual financial audit. However, the OSA does not (perhaps cannot) indicate exactly how many local public bodies could be assisted with this appropriation because:

- The bill does not state whether the appropriation is intended to pay for all or part of an entity's audit costs;
- The bill does not state whether the appropriation is intended to assist small political subdivisions currently behind on their audits/tiered system engagements (defined below) or small political subdivisions that are current with their audits/agreed upon procedures engagements (defined below);
- Depending on an entity's specific designation under the New Mexico Audit Act or the federal Single Audit Act, the cost of a specific entity's audit or agreed upon procedures engagement varies widely, from \$1,500 to as much as \$32,000.

SIGNIFICANT ISSUES

The OSA provided the following analysis:

The bill uses the term "audit," which technically means a financial audit or single audit performed in accordance with auditing standards generally accepted in the US and standards applicable to financial audits contained in Government Auditing Standards issued by the US Comptroller General. However, most small political subdivisions with annual budgets of \$100,000 or less are not required to have a full audit under the Audit Act. "Local public bodies," are defined under Section 12-6-2 NMSA 1978 as a "mutual domestic water consumers association, a land grant, an incorporated municipality or a special district."

Under the Audit Act, local public bodies with annual revenues of less than \$500,000 may qualify for a "tiered system" engagement pursuant to Section 12-6-3(B) NMSA 1978. A tiered system engagement is an agreed-upon procedures engagement that is intended to cost less than an audit. An agreed-upon procedures engagement is much smaller in scope and less costly than an audit, but still incorporates test work procedures geared towards significant areas.

In fiscal year 2013, 38 local public bodies contracted to have a Tier 3, 4 or 5 agreed-upon procedures performed in accordance with the tiered system. There are many more local public bodies that are currently behind in their audit requirements. On average, a private independent public accountant would charge a local public body approximately \$3,000 for a Tier 3 engagement; approximately \$3,500 for a Tier 4 engagement; approximately \$3,700 for a Tier 5 engagement; and approximately \$8,000 for a Tier 6 engagement.

The NM State Auditor's hourly rate for conducting audits or tiered system engagements is lower than the average for private independent public accountants; therefore, the cost of these engagements for local public bodies would most likely be less if performed by the OSA. For example, a Tier 3 engagement may cost approximately \$1,500. However, it should be noted that costs can increase depending on certain factors, such as the condition of the local public body's records or whether auditors identify certain fraud risks that require expanded test work.

It is important to note that some small political subdivisions with annual budgets of \$100,000 or less may spend the requisite amount of federal funding that triggers the requirement to have a “single audit” performed pursuant to the federal Single Audit Act. When a single audit is required the entity is required to have a financial audit and a federal single audit performed. These audits are more costly and more time consuming to perform. The cost of a financial audit in conjunction with a single audit for a small political subdivision charged in fiscal year 2013 ranges from approximately \$2,000 to \$32,000.

Finally, it should be noted that a number of local public bodies have been subject to Executive Order 2013-06 issued by Governor Martinez (requiring an entity to have an audit performed or be deemed ineligible to receive capital outlay appropriations) and this appropriation could assist in bringing those smaller political subdivisions into compliance.

OTHER SIGNIFICANT ISSUES

Pursuant to Section 12-6-5 NMSA 1978, the “reasonable cost of all audits shall be borne by the agency audited.” In light of this provision of state law, it is unclear whether or not the OSA is to pay for all or part of an entity’s audit costs. If the bill only assists with a portion of the audit costs, then the bill does not address how to allocate the portion of the cost for which the small political subdivision is responsible. The OSA presumes that the intention of the bill is to assist small political subdivisions that do not have funds to bear the cost of an audit or a tiered system engagement.

The bill does not specify whether the appropriation is intended to assist small political subdivisions that are currently behind on their audits/tiered system engagements or small political subdivisions that are current with their audits/agreed upon procedures engagements.

PERFORMANCE IMPLICATIONS

The OSA currently employs 12 auditors in its Financial Audit Division. On average, the OSA performs approximately 3 to 6 financial audits per year, depending on the size and complexity of the agency. Additionally, the OSA’s performance measures require it to bill at least \$430,000 per year in audit fees to help support its budget and its operations. This year, the OSA performed 5 of the 6 audits in conjunction with another independent public accounting firm due to the limited staff at OSA. In fiscal year 2014, the OSA performed 6 financial audits and 15 tiered system engagements. This required the use of all of the Financial Audit Division staff, who is also required to perform audit work paper reviews and hundreds of audit report reviews throughout the year.

Due to the lack of staff resources at the OSA, it is unlikely that the OSA would be able to use the entire appropriation to perform the audits/tiered system engagements of small political subdivisions directly (particularly since the appropriation is nonrecurring, there is no assurance that additional staff hired by the OSA using the funds would be maintained beyond fiscal year 2015). Therefore, the OSA would use some of the funds to contract with private independent public accountants to conduct the work.

TECHNICAL ISSUES AND SUGGESTED AMENDMENTS

Although the language of SB4 appropriates funds for audits “for small political subdivisions with annual budgets of \$100,000 or less,” the OSA presumes that SB4 will apply to local public bodies that have \$100,000 or less in annual revenues pursuant to Section 12-6-3(B) NMSA 1978.

WHAT WILL BE THE CONSEQUENCES OF NOT ENACTING THIS BILL

Certain small political subdivisions would continue to struggle when trying to comply with the State Audit Act. If these political subdivisions cannot afford an audit they would continue to appear on the Office of the State Auditor’s “At Risk” list. Compliance with audit requirements improves transparency, strengthens accountability and reduces fraud risks.

CB/jl:svb:jl