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## FISCAL IMPACT REPORT

SPONSOR Munoz ORIGINAL DATE 2/3/17  
 LAST UPDATED 2/7/17 HB \_\_\_\_\_

SHORT TITLE Revenue Shortfall & Appropriations SB 242

ANALYST Lucero

### APPROPRIATION (dollars in thousands)

Appropriation		Recurring or Nonrecurring	Fund Affected
FY17	FY18		
Indeterminate	Indeterminate		All Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

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

	FY17	FY18	FY19	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
<b>Total</b>	Indeterminate	Indeterminate	Indeterminate	Indeterminate		All Agency Operating Funds

(Parenthesis ( ) Indicate Expenditure Decreases)

Duplicates House Bill 294 and conflicts with HB 293.

### SOURCES OF INFORMATION

LFC Files

#### Responses Received From

Office of the Attorney General (OAG)

Office of the State Auditor (OSA)

New Mexico State Treasurer

#### No Responses Received From

Department of Finance and Administration

### SUMMARY

#### Synopsis of Bill

Senate Bill 242 would establish a process to temporarily reduce general fund allotments during a revenue shortfall. The bill adds a new section to Chapter 6, Article 3 NMSA 1978 to require the LFC director to notify the Department of Finance and Administration (DFA) cabinet secretary

that actual general fund revenues are less than the revenue estimates used as the basis for building the budget and cash balances in the operating reserve and appropriation contingency fund are insufficient to fully fund the shortfall.

Upon notification of the shortfall, the bill would require the State Budget Division of DFA to adjust general fund allotments to agencies and institutions for up to sixty days or the remainder of the fiscal year, whichever period is shorter, in a total amount that does not exceed the amount necessary to satisfy a revenue shortfall. The bill calls for the allotment adjustment to each agency and institution in an amount equal to the proportion of the total that represents the agency's or institution's share of the general fund appropriations and the total amount would not exceed the shortfall amount certified by the LFC director.

An agency or institution that does not receive general fund appropriations by periodic allotment would be required to remit to DFA the portion of the agency's or institution's general fund distributions according to the same terms of adjustment that the division applies to agencies and institutions that receive general fund allotments.

## **FISCAL IMPLICATIONS**

This bill would allow DFA to adjust allotments to agencies and institutions when revenues are expected to fall short of amounts estimated during the consensus revenue estimating process and possibly avoid or delay the need for a special legislative session. The ability to adjust allotments would allow DFA to keep cash in treasury instead of allocating it to agencies and institutions, thereby reducing the possibility it will be spent or needlessly held by agencies until reversion.

The Office of the State Auditor (OSA) notes, the proposed legislation would put in place a structure to prevent the state from spending money it does not have in accordance with the limits on deficit spending imposed by Article IX, Section 7 of New Mexico Constitution. However, the proposed process may trigger temporary reductions in funds available to agencies if there is a revenue shortfall. Such temporary reductions may have significant impacts on the operations of the affected agencies.

As described in OSA's letter dated January 26, 2017 (attachment A) to the State Treasurer, DFA secretary, and LFC director, during the FY16 annual audit process, the OSA requested that the contracted auditors assess compliance with Section 8-6-7 NMSA 1978, which is aimed at preventing DFA from drawing warrants, and STO from paying warrants, when sufficient funding is not available to support the expenditure. The OSA also requested that the auditors evaluate the adequacy of each agency's internal controls with respect to identifying revenue deficiencies and preventing deficit spending by the State during the fiscal year.

Despite constitutional prohibitions on the state engaging in deficit spending, the recent audits noted that the state does not currently have sufficient controls in place to identify and address revenue shortfall issues and prevent deficit spending. Further detail is provided in OSA's January 26, 2017 letter.

OSA notes, Section 8-6-7 NMSA 1978 imposes theoretical criminal penalties on the Treasurer and the DFA Secretary for drawing and paying warrants when insufficient funds are available to pay the warrants; however, in practice it is not effective. It is critical the state address this serious deficiency in internal control by putting in place a process, such as the one proposed in SB242,

to ensure the state not spend money it does not have.

## SIGNIFICANT ISSUES

SB 242 may raise a separation of powers question under Article 3, Section 1 of the New Mexico Constitution, which bars one department or branch of government from exercising powers of another. By requiring the LFC director to notify the DFA cabinet secretary of a shortfall in revenues and cash reserves upon which DFA must then adjust allotments, the LFC director, an employee of the legislative branch, may be exercising executive powers in violation of that constitutional prohibition. Directing the DFA cabinet secretary to adjust allotments based on the secretary's determination of a shortfall requiring allotment adjustments would avoid this issue.

SB 242 also raises a question of erosion of the power to appropriate by the Legislature. Adjusting allotments would mean spending levels would need to be adjusted. The bill directs the allotment adjustment be proportional to total statewide appropriations and for not more than sixty days; however, the bill is silent on the methodology beyond that. Typically, the Legislature exempts appropriation reductions in programs which impact vulnerable populations, health concerns, education, or where there is a public safety issue. The bill doesn't allow for prioritizing funding reductions.

The State Treasurer's Office noted the following concerns with the proposed bill:

- An unintended consequence would be the conflict with Section 50-4-2 NMSA 1978 (payment of wages to persons who worked for those wages). If automatic across the board allotment reductions were implemented, it could result in employees not being paid for their work as is demanded by this statute. This would potentially run afoul of federal law requirements for payment of wages.
- The state also has obligations to pay on contracts, purchase orders, etc. for work performed and cannot just arbitrarily decide not to pay on those obligations without consequence, such as a lawsuit for being in a breach of contractual obligations.
- The proposed sixty day period during which allotments would be adjusted is so short and could result in abrupt significant budget cuts and a disorderly disruption in operations.
- This proposal leaves no room for negotiation or alternatives in a changing environment and does not take into consideration the severe economic impact to the citizens of New Mexico. For example, road repairs could be put off for a future date. However, such programs that feed children or care for the elderly could not be put off for a future date without a severe social economic impact to the individual and to the state.
- STO believes there may be a separation of powers issue in that the legislative branch appropriates the monies and the executive branch runs the government. It would be a separation of powers issue to allow the director of the legislative finance committee, ie a director associated with the legislature, to dictate how to spend the money, ie run government, during a budget shortfall.
- Section 8-6-7 provides for legal consequences to both DFA and the State Treasurer's Office for spending and paying on unfunded warrants

## **ADMINISTRATIVE IMPLICATIONS**

SB242's proposed process by which the State Budget Division of DFA would temporarily adjust allotments could have administrative implications for DFA, agencies, and institutions as DFA would have to develop a process to apportion the total amount of the shortfall and adjust allotments and budgets to all agencies and institutions. Agencies and institutions would have to be able to adjust spending levels downward.

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

SB 242 is companion legislation to HB293 WRONGFUL DRAWING OF STATE WARRANTS which proposes adding clarifying language to 8-6-7 NMSA 1978 explicitly establishing that the requirements of 8-6-7 take precedent over other legislation (i.e. if the DFA secretary or the Treasurer must choose between complying with an appropriation bill or 8-6-7, they must first comply with 8-6-7). SB242 duplicates HB294

## **TECHNICAL ISSUES**

The bill requires the LFC director to certify “that actual revenues to the general fund are less than the estimates;” however, it could take several months to determine with certainty what actual revenue amounts are. The bill should require certification “that projected revenue amounts by the staff of the Legislative Finance Committee to the general fund are less than amounts estimated by the consensus revenue estimating group.”

The bill could also require the State Treasurer to develop a plan or a timeline upon the same certification from the LFC director to halt warrant redemptions until allotments have been adjusted.

The bill is silent what can or should occur if others identify a likely revenue shortfall. The LFC relies in data readily available to the Taxation and Revenue Department, DFA, OSA, and the State Treasurer.

## **OTHER SUBSTANTIVE ISSUES**

The Legislature has in the past authorized the governor to adjust budgets and allotments in the General Appropriation Act; however, it has been vetoed.

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

Without the proposed legislation, the State will continue to lack a process to ensure that it does not spend money it does not have, in particular in instances where shortfalls are due to unexpectedly low revenue. The State will be unable to identify deficits when there is a shortfall in a specific fund or agency. Adequate controls will not be in place to prevent unconstitutional deficit spending.

DL/al/jle

**Timothy M. Keller**  
State Auditor



**Sanjay Bhakta, CPA, CGFM, CFE, CGMA**  
Deputy State Auditor

**State of New Mexico**  
**OFFICE OF THE STATE AUDITOR**

**VIA EMAIL AND U.S. MAIL**

January 26, 2017

The Honorable Tim Eichenberg  
State Treasurer  
Office of the State Treasurer  
P.O. Box 5135  
Santa Fe, NM 87502

Duffy Rodriguez  
Secretary Designate  
Department of Finance and Administration  
407 Galisteo Street  
Santa Fe, NM 87501

David Abbey  
Director  
Legislative Finance Committee  
325 Don Gaspar, Suite 101  
Santa Fe, NM 87501

Treasurer Eichenberg, Secretary Rodriguez, Director Abbey:

The Office of the State Auditor ("OSA") released the Fiscal Year 2016 ("FY16") financial and compliance audits for the New Mexico Department of Finance and Administration ("DFA") and the New Mexico Office of the State Treasurer ("STO"). The independent accounting firms REDW LLC ("REDW") and CliftonLarsonAllen LLP ("CLA") performed the audits respectively.

As part of the FY16 annual audit process, the OSA requested that the auditors assess compliance with Section 8-6-7 NMSA 1978, which is aimed at preventing DFA from drawing warrants, and STO from paying warrants, when sufficient funding is not available to support the expenditure. The OSA also requested that the auditors evaluate the adequacy of each agency's internal controls with respect to identifying revenue deficiencies and preventing deficit spending by the State during the fiscal year.

With regard to DFA, REDW did not note any compliance or internal control issues during FY16. However, concerning STO, CLA stated that the agency, given its current resources, is unable to identify deficits during the fiscal year. Since STO only matches payments and deposit activity to the bank activity and is not part of the State revenue forecast, STO is only able to identify the sufficiency of the total amount of money in the bank as opposed to a shortfall with respect to a specific fund or agency. Because Section 8-6-7 prohibits the State Treasurer from paying any warrant when he knows, or should reasonably know, there are insufficient funds available in the treasury "for the purpose to pay the warrant" CLA found that STO did not violate the statute.

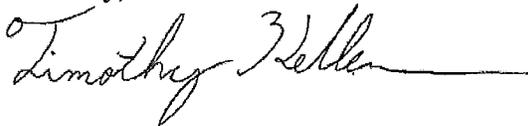
It is important to note that these conclusions are only with respect to FY16. During the current fiscal year, there was likely deficit spending prior to the effective date of the Legislature's solvency measures. Because the special session solvency measures failed to gain the required

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votes to maintain an emergency clause, it is unlikely the state was in compliance with deficit spending restrictions at that time. However, the FY17 audits will not be performed until after the end of the fiscal year.

It is clear that the State, overall, does not currently have an adequate process in place to ensure it does not spend money it does not have. This is especially true in instances where the shortfall is due to unexpectedly low revenue. The OSA has proposed legislative changes to strengthen controls and we look forward to continuing to work with you to improve these processes.

Sincerely,

A handwritten signature in cursive script that reads "Timothy Keller". The signature is written in black ink and includes a horizontal line extending to the right from the end of the name.

Timothy M. Keller  
State Auditor