FISCAL IMPACT REPORT

		LAST UPDATED	
SPONSOR	Pettigrew/Brown/Montoya	**ORIGINAL DATE**	02/26/23
SHORT TITLE	Prohibit Certain Budget Adjustment Requests	**BILL NUMBER**	House Bill 454
		ANALYST	Hitzman

ESTIMATED ADDITIONAL OPERATING BUDGET IMPACT*
(dollars in thousands)

	FY23	FY24	FY25	3 Year Total Cost	Recurring or Nonrecurring	Fund Affected
Various Agencies	Indeterminate but substantial	~$60,480.0	~$60,480.0	~$120,960.0	Recurring	General Fund
Various Agencies	Indeterminate but substantial	Indeterminate but substantial	Indeterminate but substantial	Indeterminate but substantial	Recurring	Various Funds

Parentheses ( ) indicate expenditure decreases.
*Amounts reflect most recent analysis of this legislation.

Conflicts with language in the General Appropriation Act

Sources of Information

LFC Files

<u>Responses Received From</u>
Early Childhood Education and Care Department (ECECD)
Children, Youth and Families Department (CYFD)
Department of Public Safety (DPS)
Gaming Control Board (GCB)
Department of Information Technology (DoIT)
Regulation and Licensing Department (RLD)
Aging and Long Term Services Department (ALTSD)
Human Services Department (HSD)
Administrative Office of the Courts (AOC)
New Mexico Racing Commission (NMRC)
Attorney General (AG)
Secretary of State (SOS)
Department of Finance and Administration (DFA)
Tourism Department (TOUR)
Indian Affairs Department (IAD)
Economic Development Department (EDD)
Energy, Minerals and Natural Resources Department (EMNRD)
New Mexico Corrections Department (NMCD)
Office of the State Auditor (OSA)
Office of the State Engineer (OSE)

SUMMARY

Synopsis of House Bill 454

House Bill 454 (HB454) removes the ability for state agencies to submit budget adjustment requests transferring amounts appropriated for personal services and employee benefits to other funding categories for other purposes.

This bill does not contain an effective date and, as a result, would go into effect June 16, 2023, (90 days after the Legislature adjourns) if signed into law.

FISCAL IMPLICATIONS

HB454 would prohibit state agencies from requesting budget adjustment requests (BAR) out of the personal services and employee benefits (PS&EB) category for other purposes. Historically, many agencies implement these BARs to meet their needs in other areas when their PS&EB budgets are in excess of what is needed to cover their FTE costs. In FY22, for example, agencies transferred nearly $55 million out of PS&EB into other categories, up from $27 million in FY21. In FY22, some agencies transferred funding out of PS&EB totaling just 0.3 percent of the agency's PS&EB budget while others transferred over 17 percent, including the Commission for the Blind (transferring $400 thousand of its $2.3 million PS&EB budget) and the Department of Military Affairs (transferring $1.3 million of its $7.6 million PS&EB budget). On average, though, agencies transferred around 1.5 percent of the total PS&EB budgets into other categories.

It is difficult to determine the total budgetary impact for each department individually in future years, but as one example, the Children, Youth and Families Department notes it "cannot absorb the fiscal implications of this bill. In FY22 alone, CYFD used BARs to transfer [$1.4 million] in personal services and employee benefits monies attached to vacant positions to cover other expenses."

Without the ability to BAR funds out of the PS&EB category, several agencies similarly note possible negative impacts on their budgets. For example, the New Mexico Corrections Department (NMCD) notes, "without the ability to move vacancy savings to contracts and other costs to 'shore up' the budget, NMCD anticipates in future years the need to request substantial Supplemental Appropriations every year to meet the financial obligations of the Department."

Further, the Tourism Department echoes this concern, noting "it is not currently known what the fiscal implications for NMTD would be with House Bill 454, however they have the potential to be significant [and] might otherwise cause significant fiscal impacts to the department."

For FY24, general fund appropriations for the state budget are expected to grow by around 12 percent. As such, in FY22 (FY23 numbers are not currently available), the state's PS&EB operating budgets for agencies totaled $3.6 billion. If that is expected to grow roughly 12 percent, that would total a PS&EB budget of over $4 billion. If agencies transfer out of PS&EB at similar rates as in FY22, the state could expect BARs totaling $60.5 million. Therefore, under HB454, the state could see an operating budget impact of $60.5 million in possible reversions or supplemental appropriation requests since that funding would not be able to be transferred to another budget category and used in other ways. This does not include other funds that could also be impacted, such as federal funds or other state funds.

SIGNIFICANT ISSUES

Agencies already have BAR authority, including legislative agencies, to request category transfers among personal services and employee benefits, contractual services, and other. This is provided for in the General Appropriation Act (GAA) along with other specific adjustment authority for agencies. In addition, in FY22, LFC clarified language in the GAA, noting a program with internal service funds/interagency transfers appropriations in excess of those appropriated may request budget increases in an amount not to exceed 5 percent of its internal service funds/interagency transfers and, separately, a program with other state funds in excess of those appropriated may request budget increases in an amount not to exceed 5 percent of its other state funds contained in Section 4 of the GAA of that fiscal year.

As noted by the Administrative Office of the Courts (AOC), budget adjustments are typically allowed for:

- An increase or decrease in other state funds, internal service funds, or interagency transfers;
- An authorization to expend additional federal funds;
- A transfer from one program to another program within the same agency, if permitted in the General Appropriation Act (GAA); or
- A transfer between budget categories within an agency's program (usually referred to as an agency's P-code).

AOC and other agencies have noted that, currently, the State Budget Act allows the State Budget Division under the Department of Finance to review each and every one of these requests, demonstrating there is a "comprehensive process in place to justify the need to move funds out of PS&EB." To this end, DFA provides the following context regarding its administrative review process:

> The State Budget Director reviews every single submitted BAR not only for compliance with the State Budget Act and current fiscal year authority contained within the GAA but also for appropriateness of the request being submitted, including transfers out of the PSEB category. Agencies must detail how such planned transfers will be utilized in accordance with the agency's mission and objectives. If an agency does not sufficiently justify any budget adjustment request, it is within SBD's authority to either reject the BAR outright or to require revision of the request (see 6-3-24 (B) NMSA 1978, "The state budget division of the department of finance and administration may approve budget adjustments for state agencies as provided by law" (emphasis added)). SBD is not required to approve BARs as submitted by agencies.
>
> Further, every category transfer BAR except those exclusively involving federal funds are subject to a ten-day review period by LFC. During this period, LFC may raise objections to the BAR which may involve meetings with LFC staff, the director, or a public hearing with LFC member representatives and senators. Although statutes do not indicate that LFC has the power to ultimately prohibit a BAR from being processed, under such conditions agencies are incentivized to ensure that transfer requests are sufficiently justified and will be used for appropriate expenditures.

However, when agencies move funding out of their PS&EB budgets into other categories, it may be seen as a means for circumventing the legislative appropriations process. This is because agencies are appropriated funding for personnel and other employee benefit costs each year in an agency operating budget in amounts intended to, usually, support a certain number of FTE. The LFC budget recommendation process includes an analysis of an agency's filled and vacant FTE, the amount of FTE that are funded and filled versus the amount funded but vacant, and the committee uses those analyses to make determinations about an agency's need for PS&EB funding increases or capacity to hire. When an agency is allocated funding intended for FTE and employee benefits and that funding is later transferred to another budget category to support an information technology contract, for example, it is not supporting the purposes initially intended by the Legislature. LFC reports on these transfers monthly as a way to better understand how agencies are using their PS&EB funding and to see whether they are using those funds for other purposes.

As another example, an agency may transfer excess funds from PS&EB to the other costs category to cover miscellaneous operating expenses but then later come to the Legislature to request additional PS&EB funding, citing the need to fill vacancies, even though in the prior budget year there were adequate funds to fill vacant FTE that were instead transferred to another budget category. DFA provided the following:

> Additionally, under uncertain fiscal conditions agencies may be expected or mandated (especially those under executive control) to submit flat or reduced budgets. Therefore agencies must do their best to ensure that they have sufficient PSEB funding nearly a year in advance, always with the goal of filling as many vacant positions as possible. If an agency were to reduce its PSEB budget request in an attempt to maximize its other expenditure categories, it could run the risk of underfunding PSEB and not being able to hire needed positions to fill its mission.

NMCD reports using the excess funds in PS&EB to complete needed projects that would otherwise require supplemental funding, for example:

> NMCD moves these savings to cover shortfalls in medical and behavioral health services, utilities, and other costs in support of housing inmates (food, hygiene, clothing etc.). NMCD has also used a significant amount of vacancy savings to complete small and medium size construction projects that seem to fall through the cracks during the capital outlay process due to limited appropriations as well as IT upgrades and improvements.

In other cases, agencies have used their BAR authority to transfer funding out of PS&EB that was intended for permanent staff and instead have used that to support contract staff or other alternate employee services, which *would* maintain the initial intention of the funding. HB454 limits this flexibility. For example, the Early Childhood Education and Care Department (ECECD) notes:

> [HB454] does not allow the flexibility for state agencies to use unintended vacancy savings for alternate services like temporary staffing or other contractual services needed to complete work while positions are being recruited. State agencies need flexibility when filling vacancies, particularly with today's challenges due to shifts in the economy and workforce.

Further, the Office of the State Engineer (OSE) notes:

> In some cases, agencies are forced to creatively adapt to the lack of available employees by instead transferring funds to the contractual category to employ contractors on an interim basis to achieve legislative and executive performance and service level expectations and mandates.

Agencies also reported relying on PS&EB vacancy savings to plan for unexpected expenditures and emergencies. For example, without the ability to request PE&EB BARs, the New Mexico Racing Commission (NMRC) notes "the bill can drastically impact an agency's ability to fund unexpected expenditures such as litigation settlements." Further:

> When our agency has to payout large sums of money for litigation, our agency knows that we can delay the hiring process of certain positions to obtain vacancy savings. Only so much money can be derived from cutting costs like supplies, travel, etc. However, salary savings is one major item that is in the control of the agency.

The New Mexico Tourism Department also notes the importance of PS&EB transfers in instances where hiring is difficult: "Through these last few years, it has become apparent that finding qualified applicants to fill vacancies is difficult and many agencies do not have adequate funding in the salaries and benefits category to compete with the market for qualified employees, therefore vacancies are not filled leaving an available balance."

The bill does not contain an effective date and, if signed into law, the effective date would be June 16, 2023. DPS notes "the Department of Finance and Administration's (DFA) State Budget Division (SBD) established the final deadline for year-end Budget Adjustment Requests (BARs) in early to mid-May. When agencies have a need to submit last minute emergency BARs, such as to address fires or floods, they would be unable to do so even in FY23."

Other agencies echoed these concerns around hiring and planning for unforeseen expenditures or emergencies, including:

The Department of Public Safety (DPS):

> DPS, like other agencies, is struggling to fill its vacant positions in all funding sources. Critical operations must continue, and the only solution is to transfer vacancy savings resulting from delayed/unfilled positions to Contractual Services to fund contractors to meet mandatory service needs.

The Gaming Control Board (GCB):

> The NM Gaming Control Board's only funding source is the General Fund. NMGCB's lack of alternate funding, as some other agencies have, makes it's ability to deal with critical needs that weren't anticipated in the approved Budget request (or denied via a budget reduction) could cause harm to the agency's ability to regulate an industry which brings millions of dollars in tax, fines, and fees to the general fund, which could result in harm to licensees and the integrity of gaming at large. There is not a mechanism in this proposed bill to account for small agencies which encounter expenses that are not predictable.

The Department of Information Technology (DoIT):

> When a critical position cannot be filled through the standard recruitment process, DoIT may need to contract for staff augmentation or other contractual services agreements. If there is insufficient budget the 300's category because of other contractual obligations this becomes a hiring issue for the agency for mission critical positions.

The Regulation and Licensing Department (RLD):

> When confronted with an unexpected emergency situation (and the resulting unbudgeted expenses), state agencies must have immediate flexibility to procure necessary services/equipment to respond to the situation. Being able to move available funds from one agency budget category to another category where there is an immediate need via a budget adjustment request (BAR), is a critical and effective tool to allow state agencies to respond to emergency situations in a timely and effective manner. If HB454 is adopted, the real-world result would be to erect a roadblock to the ability of state agencies to timely and effectively react to emergency situations.
>
> In October of 2022 the Regulation and Licensing Department (RLD) experienced a cyber incident that impacted the Department's information technology systems and resources. This was exactly the type of unexpected and unbudgeted for situation that emphasizes the need for state agencies to be able to utilize the BAR process.

The Aging and Long Term Services Department (ALTSD):

> In a time of a local emergency or unforeseen shortfalls this proposed legislation would prevent agencies from moving available funding from personal services and benefits categories even though those funds may become stagnate given a lengthy hiring period or an inability to find a qualified candidate resulting in potential catastrophic events.
>
> …In 2022 ALTSD used $150,000 from vacancy savings to assist seniors during a devastating power outage in Northern New Mexico. Additionally, ALTSD in 2022 budget adjusted vacancy savings to the Human Services Department for SNAP benefits in the amount of $420,000. These are just some of the examples where vacancy savings can and should be used for urgent and unforeseen circumstances.

The Human Services Department (HSD):

> At times, a department may experience a high rate of attrition, creating available budget that may be critical in the other expenditure components. This increased need is due to unanticipated program growth, unforeseen economic factors and amendments to contracts that took place after the budget was established. As a result, there will be a need in either the contractual services or other cost category.

AOC notes this is also a concern for the judicial branch; "Most judicial entities have single-line item budget appropriations, which allows the agencies the flexibility to manage their agency's budgets as they need. Under HB454, agencies will not be able to fully utilize their budgets in the case of any unforeseen situations. If budget is needed in other categories to handle a crisis, this could potentially handicap their options." DFA provides the following regarding judicial agencies:

> In recent years most judicial entities such as district courts have been appropriated budget in the GAA in a single line for "operations." When such entities submit their operating budgets on May 1 of each year, they may establish each expenditure category as they see fit. Therefore they have an extra 10 months to plan for their PSEB expenditures for the following fiscal year, a benefit afforded no other state agency. They could use this knowledge to increase their Contractual and Other Cost category budgets at this time to skirt the limitation imposed by this bill.

PERFORMANCE IMPLICATIONS

Several agencies noted concerns regarding their agency's ability to maintain operations without using PS&EB BARs. For example, DPS notes:

> The inability to move appropriated budget from Personal Services and Employee Benefits (PSEB) to other categories during a fiscal year would create adverse implications for the Department of Public Safety (DPS) as well as other agencies.
>
> At times, depending on the particular circumstances, DPS has had to hold positions vacant in order to meet other expenditure obligations to avoid deficit spending, the risk of receiving an audit finding for exceeding the budget and having to request a deficiency appropriation in a future fiscal year.
>
> The passing of this bill would significantly decrease the ability of DPS to make critical budget adjustments, which will directly inhibit our ability to provide funding for essential operational costs for the Department, but most specifically the New Mexico State Police.

Further, the Energy, Minerals and Natural Resources Department notes "unforeseen retirements, turnover, and market conditions may cause vacancies in critical positions which are necessary to meet performance requirements. If agencies cannot transfer personnel services and benefits budget to contractual services in order to complete required work on time while these critical positions are being filled, the agency will likely not be able to meet those specified performance measures."

The Secretary of State's Office notes "there are no exceptions provided, even if there are unused funds left in those categories at the end of the fiscal year," which could lead to an increase in agency reversions at the end of the fiscal year in the PS&EB category while simultaneously resulting in shortfalls in other areas of the budget. DFA echoes this concern, noting "because agencies would not be able to transfer funds out of the PSEB category, they would likely end the fiscal year with larger unspent budget balances due to savings accrued from employee turnover and not being able to fill all vacant positions. Such balances would either revert to the general fund or specific special agency operating funds (such as those funded by fee revenue). "

NMRC notes how this can create difficulties for agencies in subsequent fiscal years: "When the next fiscal year arises, the budgeting process will be harder to justify the need for funding vacant positions when an agency reverts large amounts of funds from the previous fiscal year."

ADMINISTRATIVE IMPLICATIONS

As indicated in the Performance Implications and Significant Issues sections above, state agencies may see an impact on their operations resulting from HB454 if they are no longer able to support other administrative and operational needs with PS&EB funding. However, as noted by DFA, "under HB454 the number of budget adjustment requests submitted by agencies and reviewed by SBD and the LFC every year would decline, possibly freeing up time and resources to be spent on other aspects of budget and financial management."

Further, NMRC notes this bill "could result in agencies overestimating other categories just to supplement their budget for the 'just in case' items that can come up throughout the fiscal year."

CONFLICT, DUPLICATION, COMPANIONSHIP, RELATIONSHIP

HB454 conflicts with the General Appropriations Act, which allows these transfers to take place.

TECHNICAL ISSUES

OSE notes that the bill includes language prohibiting transfers from the "personal services and benefits" category, when the category name as used in the GAA and other citations is "personal services and ***employee*** benefits" category.

ECECD notes "HB454 does not identify the restricted funding sources. As such, the restrictions apply to state general funds, federal funds, and other state funds."

To this end, DPS provides the following:

> As drafted, Section 1.A. does not indicate which of these four (4) categories are impacted; therefore, agencies would be prohibited from transferring PSEB budget authority included in House Bill 2 in any of these categories. DPS's operating budget in the three (3) non-General Fund categories is approximately 18% of the agency's total budget. DPS receives a variety of federal and state grants which allow it to reprogram excess grant funds to incur revised needs that benefit the grant award deliverables. As drafted, even though the grantor may authorize a transfer out of PSEB, this bill would prohibit the transfer. In addition, DPS receives a variety of Other State Funds from varying income-generating sources that have no restrictions on spending which allows DPS to budget these revenues to meet current needs which oftentimes cannot be predicted during the compilation of the Annual Request.

OTHER SUBSTANTIVE ISSUES

GCB notes:

> There are events which are hard for an agency to predict when it comes to budget requests. For example, the agency can't predict the number of incidents that may result in administrative hearings. This agency monitors the Tribal Gaming Compacts and any dispute in interpretation of the compact with any one of 15 Tribes can result in the need for arbitration, a lengthy and costly process.

AMENDMENTS

GCB proposes to add an emergency clause with exceptions for expenses related to regulatory responsibilities. RLD also proposes exceptions for emergencies:

> Page 1, line 21, after the semi-colon, strike the words "provided that" and insert "<u>except as may be necessary in the event of an emergency circumstance, as decided by the Secretary of the affected Department, the head of the affected agency, or their designee.</u>"

JH/al/ne