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# Transparency Report 2025-001
# State Agency Deficiency Appropriation Requests

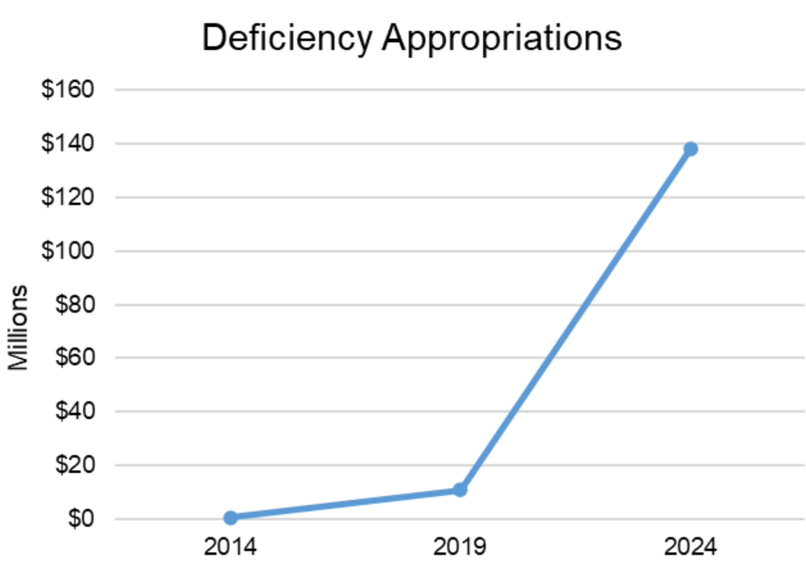
August 19, 2024

*Executive Summary*

State agency deficiency appropriations have increased over the last decade, from approximately $500,000 in 2014 to just under $138 million in 2024. In recent years alone, there has been a 59% increase from 2022 to the present. Often, the reasons stated in the General Appropriations Act for the deficiency appropriations lack specificity to understand the root causes. Some agencies requiring deficiency appropriations may not have exercised proper adherence to budget authority or financial management and oversight. However, agencies may also have extenuating circumstances impacting their financial operations requiring the need for a deficiency appropriation. The Office of the State Auditor's (OSA's) Government Accountability Office (GAO) recommends increasing transparency on the need for, and use of, deficiency appropriations in the appropriations process. OSA recommends separating supplemental and deficiency requests, increasing reviews of agencies requesting deficiency appropriations during the financial audit, and increasing state requirements for budgetary adherence. The OSA also recommends a determination on whether current deficiency appropriations should continue.

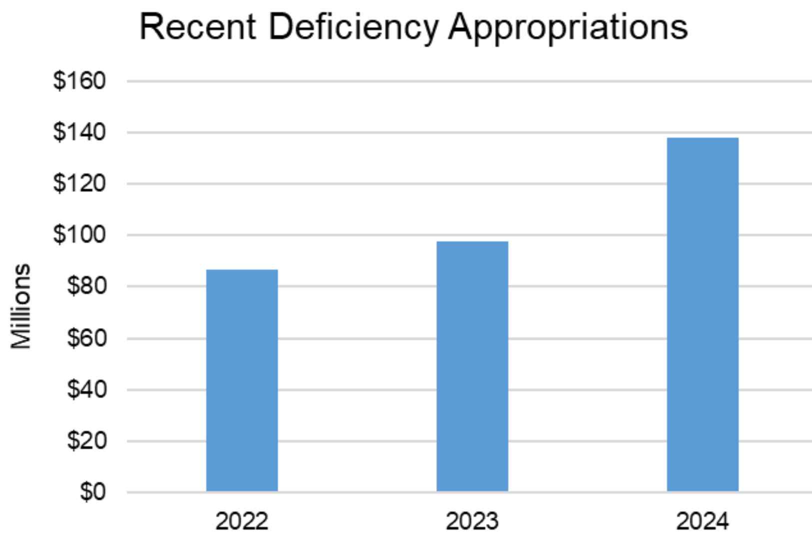
*Determining the Deficiency Cause*

It is difficult for the public to determine the need for a deficiency appropriation because the language describing the need in the General Appropriation Act (GAA) lacks detail. Common GAA purpose statements say the deficiency appropriation is for a shortfall in operating expenses in a budget category or an agency's program. These types of purpose statements lack specificity, requiring one to either research the underlying cause directly with the agency in question or the Department of Finance and Administration (DFA). When agencies receive mid-year deficiency appropriations, they often do not have negative financial operational impacts at the fiscal year-end, and the financial audit may not present information and findings on deficiency appropriations. Financial audit do not routinely include deficiency appropriation data and the lack of this information further limits public stakeholder's understanding of the need for the increased funding. To better determine the need for deficiency appropriations, the OSA GAO collaborated with the Legislative Finance Committee (LFC) staff and DFA's State Budget Division for information on fiscal year 2024 agency deficiency appropriation requests. Notably, not all agencies receiving deficiency appropriations were required to provide explanations to DFA for the need in the same manner as those discussed in this report. This underscores a lack of uniformity in deficiency appropriation approval criteria. If the state is to continue funding deficiencies, the public needs more transparency on the causes for deficiencies at state agencies.




Source: OSA Analysis of GAA

*Linking Deficiency Requests to Independent Public Audits*




Source: OSA Analysis of GAA

Most state agencies requesting deficiency appropriations did not have audit report financial statements or findings that could be easily linked to their request. After a review of audits of the agencies requesting these appropriations, audit findings (including those that indicate agencies are lacking in open and closing of the fiscal year and budgetary compliance) do not specifically discuss the deficiencies appropriations process. The request for a deficiency appropriation is not identified in the financial statements due to the appropriation process in January preceding the close of the fiscal year in June in any year when a deficiency appropriation is awarded. In some instances, mid-year deficiency appropriations may aggregate to reflect positive year end fiscal pictures. When coupled with minimal information in deficiency appropriation language in the GAA, any conclusions that can be made are limited to inference or conjecture as they do not have access to agency requests sent to DFA as supporting documentation. An inability to link deficiency requests to financial audits is an issue and will be addressed by the OSA, potentially during audit reviews and in future Audit Rule updates.

*Case Study*

As part of our review of how deficiency appropriations are treated in financial audits, the OSA examined the fiscal year 2022 (FY22) audit report for the General Services Department (GSD). GSD is the only agency to request deficiencies in each of the 2022-2024 budget bills. GSD had a deficit fund balance in its FY22 audit, and the management explanation for the deficit balance is a rare example of discussing the deficiency process within a financial audit. In 2022, GSD received $10,000,000 from the health care affordability fund "for shortfalls in the other category for health benefits claims in the employee group health benefits program". In 2023, the General Appropriation Act (GAA) provided a deficiency appropriation that was "for prior-year shortfalls in the employee group health benefits fund, contingent on implementing a plan for a one-time, employer-only assessment, with matching funds from local governments and higher education institutions of twenty-two million one hundred six thousand dollars ($22,106,000)". To better link the deficiency appropriations to deficit balance, the OSA compared language in the FY22 and FY23 GAA to the 2022 and 2023 financial audits for GSD.

Upon doing so, the multivariate reasons for the need for a deficiency appropriation request, and why they may or may not be discussed in an audit, are highlighted. In FY22 and FY23 the true deficit position of the fund was unknown as both the audit and language in the GAA did not demonstrate the actual fund balance deficit. The lack of account reconciliation in FY22 and FY23 due to GSD staff turnover created a serious under calculation of the deficit, $10 million rather than the actual $119.1 million. This is in violation of NMSA 1978, Section 10-7B-7E. When coupled with the need to restate 2022 financial statements, GSD was not able to finalize 2022 deficit amounts for the fund until January of 2023, thereby violating deadlines for audit submission in the audit rule (2.2.2.9 NMAC 1978) and preventing accurate amounts being calculated in time for the deficiency appropriations process in 2022. Since the issue remained unresolved after fiscal year 2023, GSD's audit findings for both fiscal years result in negative fund positions due to repeated internal control challenges.

In the 2024 deficiency appropriation request documentation submitted to DFA, GSD attributes unanticipated costs to the COVID-19 pandemic, and specifically to more usage, higher costs, and more illness. GSD also indicates it will need to collaborate with providers, use cash reserves, and leverage data to stem the higher tide of increased health care costs. However, the focus solely on cost management remains a matter of policy debate. Past LFC policy reports raise issues with GSD's practice of a multi-year premium holiday for employees and the change in the participant profile away from younger healthier individuals. A recent LFC performance measures report also indicates that cost-containment strategies will not solely address the deficit and GSD should look to rate increases.

Of additional concern is that although GSD has received over $165.8 million in deficiency appropriations for the employee group health benefits program and fund between 2022 and 2024, some policy makers still question if the health benefits fund will transfer to the new health care authority with a positive balance – though GSD has provided feedback in its FY23 audit that the fund will transfer in a positive position.  How much of the deficit is attributable to the pandemic versus normal health care cost inflation and a failure to maintain costs at GSD is unknown from any deficiency appropriation document OSA reviewed.

GSD is just one of many agencies with these types of issues. The process for funding a deficiency needs additional rigor and review to discuss scenarios like this case study to determine whether the elements leading to the deficiency appropriation request is more attributable to unanticipated events like the pandemic or whether it is primarily due to agency management challenges.

*Other Agency Deficiency Causes*

To better determine causality for other agency deficiency requests without discussion of a deficiency appropriation in their financial audit, OSA reviewed deficiency appropriation requests submitted to the DFA as part of the 2024 Executive budget request process. Many of the agency requests appear to show agencies exceeding budget authority, available appropriations or actual revenues received. Supporting information shows entities requesting funds for selected reasons that include:

- not having the other state funds portion of its appropriation defined by the agency before spending funds;
- over-expending salaries and benefits, including by expending a special appropriation too quickly and failing to finalize an inter-agency transfer;
- identifying improper capital outlay reversions from more than three years prior;
- stale program fund deficits prior to programs being transferred to other agencies;
- transferring staff between programs without transferring the budget for salaries; and
- unpaid invoices to another agency dating to five years prior to the current fiscal year.

It is important to note that not all entities that received deficiency appropriations in 2024 were included in the information DFA provided as support. In these instances, OSA received no documentation to support the cause for the deficiency and DFA cannot oversee the appropriateness of agency deficiency requests. State agencies should not circumvent DFA to achieve deficiency awards directly with the Legislature, if this is occurring.  Similarly, DFA should require all entities submitting a deficiency appropriation request to work through their budget process.

*Is running an operating deficiency illegal?*

Requesting a deficiency appropriation is not inherently illegal. However, some activities related to deficiency requests may be illegal, including exceeding budget authority, available appropriations, or actual revenues received. Among these are constitutional provisions in Article IV, Section 30 that say "except interest or other payments on the public debt, money shall be paid out of the treasury only upon appropriations made by the legislature," and "every law making an appropriation shall distinctly specify the sum appropriated and the object to which it is to be applied."

In state statute and specifically in the Public Monies Act there are penalties for state public officials who violate budgeted expenditures and expenditure allotment amounts established by the Department of Finance and Administration (DFA) (Sections 6-3-7 to 8 NMSA 1978). Similarly, there are requirements for agency financial officers and DFA to:

- follow proper budget adjustment procedures (Section 6-3-25 B NMSA 1978);
- obtain information on any agency financial problems (Section 6-3-15 NMSA 1978); and
- prohibit payment of expenses or obligations of state government from any fund or account unless it may reasonably be expected that at the end of the fiscal year the balances in that fund or account will be fully restored (Section 6-4-6 NMSA 1978).

State agencies are responsible for establishing systems of controls to prevent accounting errors and violations of state and federal law and rules related to financial matters (6-5-2 NMSA 1978); and the Financial Control Division of DFA has responsibilities to verify and control state agency compliance with allotments (§ 6-5-2.1 NMSA 1978). Ideally, if agencies were violating these sections of the law, then DFA would respond as befits its statutory financial oversight responsibilities. The penalties would depend on the violation. These can range from having a chief financial officer removed (MAPS FIN 16.9) to, in some instances, triggering felony penalties of law related to violating DFA's expenditure allotment amounts (§ 6-3-8 NMASA 1978).[1] In budgetary control instances, like failure to adhere to approved budget authority without an appropriate budget adjustment request, state law and rule is not explicit in penalties or remediation. State law penalties and remediations are generally focused on actual revenues and expenditures. For example, penalties exist for warrants being issued by the Secretary of Finance and Administration and State Treasurer when they have information that funds are not available (§ 8-6-7 NMSA 1978).

In contrast, there are also instances where the financial problem leading to a deficiency request was not the result of ongoing financial issues and possible violations of law but because of items any prudent person would judge outside of agency control – such as global pandemics impacting enterprise activities such as New Mexico State Fair revenues. In still others, the determination of a revenue shortfall versus an over expenditure of allotment, appropriation or budget authority is subjective and cannot be determined from the supporting documentation OSA reviewed. In rare instances, state agencies may be using the deficiency appropriation process in error when they mean to use a supplemental appropriation request process to access non-recurring funding sources. In these instances, just as the state is dependent on DFA for oversight of adherence to the Public Monies Act and determining if state law has been violated, the state is also dependent on DFA to use its professional judgement in determining malfeasance when the underlying deficiency appropriation request does not specify if a law was broken. DFA and the Legislature may consider a comprehensive review of DFA's statutory financial oversight responsibilities and increasing penalties for over-expending actual allotments or violating budgeted expenditures without a budget adjustment request (BAR).

[1] A felony and upon conviction thereof shall be punished by a fine of not more than ten thousand dollars ($10,000) nor less than five hundred dollars ($500) or imprisonment for a term of not more than ten years, or both.

*Conclusion*

**DFA and the Legislative Finance Committee (LFC) should collaborate to improve transparency of the need for deficiency appropriation requests in budget hearings.** In the absence of direct links between financial statements and deficiency requests, state agencies and their oversight entities such as DFA and LFC may consider working together to provide better explanations to the public for the reason for shortfalls during the deficiency appropriation budgetary request process. DFA and LFC should expand on the current DFA process and require state agencies provide more written details and support regarding deficiency needs in their annual budget request. State agencies must collaborate with DFA on statewide deficiency requests, and if entities have not submitted to DFA the required information for both agencies to review and consider, the Legislature may consider not funding those deficiency appropriations requests.

**OSA should require additional audit procedures on entities receiving deficiency appropriations.** OSA will require independent public accountants (IPA's) to conduct additional state law compliance procedures on agencies requesting deficiencies to allow public users to examine how deficiency appropriations impact financial statements. OSA may consider amending the audit review process and Audit Rule to do so.

**The Legislature and Governor should consider whether to continue to fund deficiency requests and, if continued, provide additional rigor in the deficiency appropriation process.** If the deficiencies process is to continue, it needs additional transparency, formalization, accountability, and vetting. It may need performance metrics around budget and appropriation adherence. DFA and state agencies should be prepared for a scenario in which no deficiency appropriations are awarded by the legislature and how best to address deficit balances moving forward.

**The Legislature and DFA should separate deficiency requests from supplemental requests as part of the budget process.** To facilitate transparency, additional discussion and debate on deficiencies can be facilitated by the State separating and differentiating the processes. DFA may consider publicly providing its oversight documentation provided by state agencies and collected during operating budget development and provide clear and concise information to the public on how supplemental requests differ from deficiency requests.

**The Legislature and DFA may consider reviewing the penalties section of the Public Moneys Act for expenditure of funds, including developing penalties for violating budgetary controls.** Current law and DFA's Model of Accounting Practices (MAPS) consider penalties for violating allotments, not closing the year with positive fund balances, or other actual revenue and expenditure items. The Legislature and DFA may also consider reviewing the sections of state law regarding budget adjustment or budgetary oversight to determine if additional steps regarding budgetary controls and oversight are needed. Improved state budgetary controls and a more empowered state budget division should be viewed as an important first step to minimizing the need for deficiency requests.

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