
Coates' Canons Blog: New Law Modernizes the Preaudit and Disbursement Processes — Part I

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Article: <https://canons.sog.unc.edu/hb-44-and-proposed-changes-to-the-preaudit-process/>

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In recent years local governments and public authorities (collectively, local units) have struggled to comply with the statutory preaudit (**G.S. 159-28(a)**) and disbursement (**G.S. 159-28(b) & (d)**) processes, in particular when making web-based purchases, or when using credit cards, purchase cards, and fuel cards. In 2013 the North Carolina Court of Appeals made compliance even more difficult when it interpreted the provisions of **G.S. 159-28(a)** to require that all obligations subject to preaudit be in writing. See *Howard v. County of Durham*, 748 S.E.2d 1 (NC Ct. App. 2013), *disc. rev. den'd*, 367 N.C. 238 (N.C. 2013); *Executive Medical Transportation, Inc. v Jones County Department of Social Services*, 735 S.E.2d 352 (NC Ct. App. 2012), *disc. rev. den'd*, 737 S.E.2d 378 (N.C. 2013). This raised additional difficulties for units when dealing with **electronic transactions** and also when **hiring, or changing the compensation of, at-will employees**.

The legislature enacted **S.L. 2015-246** to address these issues, modernize the preaudit and disbursements processes, and (hopefully) make it easier for local governments to comply. The changes apply to local governments, public authorities, and school units. (The changes do not apply to ABC Boards, who will still be subject to the “old” preaudit and disbursement requirements in G.S. 18B-702.) The amendments go into effect on October 1, 2015, and apply to any obligations incurred on or after that date. This post summarizes the changes to the preaudit process. (Click **here** for a discussion of the changes to the disbursement process.)

Preaudit Requirements Before October 1, 2015

Before analyzing the proposed changes, it is useful to first review the previous requirements of **G.S. 159-28(a)** (applicable to local governments and public authorities) and **G.S. 115C-441** (applicable to local school units), as interpreted by the North Carolina courts. The statutes require that before a local government, public authority, or school unit incurs an obligation that is accounted for in a budget ordinance or a project ordinance, the finance officer for the unit (or a deputy finance officer approved by the unit’s governing board for this purpose) must:

- (1) ensure that there is an appropriation authorizing the obligation;
- (2) ensure that sufficient funds will remain in the appropriation to pay the amounts that are expected to come due in the fiscal year in which the obligation is incurred (or during the life of the project if accounted for in a project ordinance).
- (3) put the obligation in writing; and
- (4) affix a signed preaudit certificate to the writing. The preaudit certificate states that: “This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act.” It is signed by the finance officer or a deputy finance officer.

An obligation is incurred by a local unit, thus triggering the preaudit statute, when the unit legally commits to pay money to another entity or individual and, if the expenditure is accounted for in the budget ordinance, at least a portion of the money is expected to be paid in the fiscal year in which the agreement is executed. The form of the obligation is irrelevant. For example, a unit may incur an obligation by executing a construction contract, issuing a purchase order, paying for goods or services at the point of sale with a credit card, or committing to pay a salary to a newly hired at-will employee.

What happens if the preaudit process (or a part of the preaudit process) is not performed before the unit incurs an obligation? The obligation (contract, purchase order, credit card transaction, or agreement) is void. That means that it

cannot be legally enforced. It also means that the unit cannot disburse any monies that may come due under the contract or agreement. In fact, **G.S. 159-28(e)** and **G.S. 115C-441(e)** provide that if “an officer or employee [of a local unit] incurs an obligation or pays out or causes to be paid out any funds in violation of [the preaudit statute], he and the sureties on his official bond are liable for any sums so committed or disbursed.”

Changes to the Preaudit Statutes (After October 1, 2015)

Section 6 of S.L. 2015-246 makes several changes to the preaudit statutes:

1. It eliminates step (3) of the preaudit process. The preaudit statute, itself, does not require that a contract, purchase order, or similar agreement be in writing. And a preaudit certificate is not required unless the obligation is evidenced by a writing. The first two steps in the preaudit process still apply to all obligations subject to the preaudit (written or oral). But the preaudit certificate requirement only applies if a purchase order, contract, or agreement subject to preaudit is memorialized in writing. Effectively the amendment exempts telephone orders or other oral contracts or agreements from the preaudit certificate requirement, unless those agreements are required to be in writing by other statutes. The other steps in the process (steps (1) and (2)) will continue to apply, though. Note, also, that there are other provisions of law that require a particular contract or agreement be in writing. For example, all contracts entered into by municipalities must be in writing, although the governing board may ratify a contract that violates this provision. See **G.S. 160A-16**. All contracts involving the sale of “goods” for the price of \$500 or more must be in writing. See **G.S. 25-2-201**. Contracts for purchases and construction or repair subject to formal bidding requirements also must be in writing. See **G.S. 143-129(c)**.

To illustrate how this change will work in practice, after October 1, 2015, if a county manager enters into a verbal contract with a vendor for IT services, the preaudit statute does not require that the contract be reduced to writing. If it is not reduced to writing, no preaudit certificate is required. Before the county manager may commit the county to the contract, however, the county finance officer, or a deputy finance officer, must still ensure that there is budget appropriation authorizing the expenditure and that sufficient monies remain in the budget appropriation to pay the amounts that are expected to come due this fiscal year.

2. The new law also exempts certain transactions from the signed preaudit certificate requirement even if an order, contract, or agreements is memorialized in writing. The exemptions apply to:

- *Any obligation or document that has been approved by the Local Government Commission (LGC).* This exemption existed before the October 1, 2015 amendments. It applies to loan agreements, debt issuances, and other lease and financing transactions that are subject to LGC approval and have, in fact, been so approved.
- *Payroll expenditures, including all benefits for employees of the local government.* This exemption ensures that salary and benefit changes for current employees need not include a preaudit certificate, even if they are recorded in writing.
- *Electronic payments, defined as payments made by charge card, credit card, debit card, gas card, procurement card, or electronic funds transfer.* (An electronic funds transfer is “initiated by using an electronic terminal, a telephone, a computer, or magnetic tape to instruct or authorize a financial institution or its agent to credit or debit an account.”) These types of transactions are the most difficult to preaudit, and the purpose of this exemption is to facilitate electronic payments by local units. The exemption only applies, however, if a local unit complies with rules and procedures promulgated by the LGC for handling these types of electronic transactions. In other words, **unless and until the LGC adopts rules related to electronic payments, these transactions are not exempt from the signed preaudit certificate requirement.** Once the LGC adopts rules governing electronic payments, following the rules will be considered a safe harbor. In other words, the law presumes compliance with the statutory requirements if a finance officer or deputy finance officer follows the LGC rules.

It is worth also emphasizing that all of these exemptions only apply to the preaudit certificate requirement (step 4). A unit still must perform the other steps (steps (1) and (2)) before incurring an obligation.

3. The new law empowers the LGC to adopt rules of procedure for local units to follow when performing the preaudit

process. A finance officer or deputy finance officer must incorporate any rules adopted by the LGC into his or her own internal procedures related to the preaudit process. Although the amendments do not appear to require the LGC to adopt any rules related to these processes, as previously noted, the exemptions from the preaudit certificate requirement for electronic payments will only apply if the LGC does in fact adopt procedural rules that are followed by the local unit.

4. Finally, the new law clarifies that it is a local unit's governing board, and only the governing board, that determines whether or not to impose penalties under G.S. 159-28(e) on a finance officer or deputy finance officer for failing to follow the required preaudit process. The penalty provisions in subsection (e) apply to any employee or official who violates the preaudit provisions, or causes them to be violated. In fact, the most common violation occurs when a department head or other staff member orders goods or enters into a contract before it is properly preaudited. The proposed amendments do not address whether or not taxpayers, vendors, contractors, or others could force a local unit to hold these individuals accountable for preaudit violations under **G.S. 159-28(e)**.

Links

- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-28.html
- canons.sog.unc.edu/?p=7360
- canons.sog.unc.edu/?p=7597
- www.ncleg.net/Sessions/2015/Bills/House/PDF/H44v5.pdf
- canons.sog.unc.edu/?p=8230
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_115C/GS_115C-441.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_160A/GS_160A-16.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_25/GS_25-2-201.html
- www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_143/GS_143-129.html