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## Coates' Canons Blog: The Perils of Preauditing P-Cards (and Other Electronic Payment Methods)

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A county ambulance crew member calls Fiona, the county finance officer, at 9pm on Sunday night. The crew just responded to their third call of the night and he needs to refuel the ambulance. Fiona grabs a copy of the county's budget ordinance and a printout of current expenditures and encumbrances and rushes out the door to meet the ambulance crew at a gas station several miles from her home. When Fiona arrives the crew member gives her an estimate of the amount of gas needed. Fiona notes the current per-gallon price and calculates the total cost to be \$72.65. She quickly glances at the budget ordinance. It allocates \$100,000 for ambulance fuel for the fiscal year. She also checks to see that there is \$43,000 remaining in that appropriation. She gives the crew member the ok and he fills up the tank. Fiona uses a county-issued fuel card to pay the \$72.65 owed. When the receipt prints at the pump, Fiona stamps it with the following statement, "This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act." Fiona then signs her name to the receipt and hands it back to the crew member. (The crew member will later submit the receipt, through his supervisor, to the county's finance department to reconcile with the monthly fuel card bill.)

Fiona returns home. Just as she walks in the door the phone rings again. It is a Sheriff's office deputy. She is at the end of her shift and needs to refuel her vehicle. Just as Fiona grabs her coat and starts to walk out the door again she awakes with a jolt from what can only be described as a stress-induced nightmare. Or was it?

Fiona's "nightmare" scenario actually depicts one of the few ways in which a unit can comply with the preaudit requirements of **G.S. 159-28** while executing credit card, fuel card, or p-card purchases (collectively credit cards). It illustrates the practical difficulty (perhaps impossibility) of satisfying all of the statutory preaudit requirements for electronic payment transactions.

### General Preaudit Requirements

As discussed in a previous **post**, **G.S. 159-28(a)**, as interpreted by the North Carolina courts, requires that before a local government or public authority incurs an obligation that is accounted for in a budget ordinance or a project ordinance, (1) the finance officer for the unit (or a deputy finance officer approved by the unit's governing board for this purpose) must (2) ensure that there is an appropriation authorizing the obligation; and (3) 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. Furthermore, the obligation (4) must be evidenced by a "writing" and the writing (5) must include a preaudit certificate signed by the finance officer (or deputy finance officer). The preaudit certificate states that: "This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act." (A preaudit certificate is not required on agreements approved by the State's Local Government Commission.)

An obligation is incurred for purposes of the preaudit statute when a local 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.

For example, a unit incurs an obligation, thus triggering the preaudit statute, when it places an order for office supplies accounted for in the budget ordinance, but only if the office supplies are expected to be delivered and/or paid for in the fiscal year in which they were ordered. Likewise, a unit incurs an obligation that requires a preaudit if it enters into a contract with a local landscaping company in July to mow the unit's parks as needed during the fiscal year in exchange for a fixed fee, to be paid on a monthly basis.

A preaudit is not required, however, if a unit enters into a contract whereby it agrees to provide water to a commercial entity located outside its borders. That is because the contract is for specific performance; it does not commit the unit to pay money. The statute also likely is not triggered if a unit orders a fire truck in June and expects to pay for the truck upon

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its delivery the following October because the unit will not pay money in the fiscal year in which the contract was executed (unless the fire truck purchase is accounted for in a project ordinance).

### **Application of Preaudit Requirements to Electronic Payment Methods**

What about when a unit places an internet order for park equipment and pays for the equipment with a credit card? Or when a unit makes a p-card purchase from a local vendor for water treatment chemicals? Or when an ambulance crew member uses a fuel card at a local gas station? Are these transactions subject to the preaudit requirements?

The answer is yes, the preaudit requirements apply to these transactions. When the General Assembly authorized local units to make “electronic payments” (defined as payment by charge card, credit card, debit card, or by electronic funds transfer), it specified that each electronic payment “must be subject to the preaudit process.” See **S.L. 2010-99**. The legislature further provided that “[e]xecution of the electronic payment or electronic funds transfer shall indicate that the finance officer has performed the preaudit process as required by G.S. 159-28(a).” See **G.S. 159-28(d)**.

An obligation is incurred for purposes of the preaudit statute in a credit card transaction when a unit uses the credit card to pay for goods or services. That is when the unit is authorizing the credit card company to pay the vendor or contracting party and thereby committing the unit to pay money (to the credit card company) to cover the costs of the expenditure.

### **Consequences of Violating Preaudit Requirements**

What happens if the preaudit process (or a part of the preaudit process) is not performed before an obligation is incurred by the unit? The obligation (contract 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)** provides 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.”

In Fiona’s “nightmare” scenario, if the ambulance crew member or sheriff deputy purchased fuel without satisfying the preaudit requirements, Fiona could be held personally liable if she pays the fuel bill when it comes due. And the ambulance crew member and deputy sheriff also could be held personally liable for obligating public funds without a proper preaudit.

### **Options Available to Local Units**

How then can a local unit preaudit a credit card, p-card, or fuel card transaction? There are not many good options under current law. One option is to follow Fiona’s example and direct a unit’s finance officer to execute all electronic payments after performing the preaudit. Another option is for a unit’s governing board to appoint each employee who will make a credit card payment as a deputy finance officer. The individual employees would then be responsible for performing the preaudit process on each electronic transaction under the direction of the unit’s finance officer. For many units, however, neither of these options is practical. Instead, the unit’s finance officer may have to develop a process for authorizing and executing credit card transactions that he or she feels complies with the spirit of the preaudit statute, if not precisely with all of its legal requirements. (Of course, there is a risk in taking any approach that does not comply with all of the preaudit requirements. Although the application of these requirements to credit card transactions has not yet been directly addressed by North Carolina courts, judges have routinely invalidated obligations because of a unit’s failure to perform all of the preaudit requirements in other contexts.)

One option that comes fairly close to complying with all of the statutory requirements is for a unit’s finance officer (or a deputy finance officer) to approve maximum spending limits per credit card (or, preferably, per transaction). The finance officer or deputy finance officer would indicate the maximum limit per card/transaction in writing (preaudit document) and would perform the preaudit process on that maximum limit. The preaudit certificate should be stamped on the preaudit document and signed by the finance officer or deputy finance officer. Then, when an electronic payment is made, the employee would affix the preaudit document to the credit card receipt executing the transaction. (Note that it is not sufficient to have an employee sign a document indicating that he or she will only use the credit card for authorized purposes or face disciplinary action. This is a recommended practice but it does not satisfy the preaudit requirements.)



Let's revisit Fiona's "nightmare" scenario. As an alternative, she could have assigned fuel cards to each vehicle or issued them to each driver. Fiona then could have created preaudit documents for each fuel card authorizing a maximum expenditure per card per day (or per card per week) and performed the preaudit on that maximum limit. The maximum limit would be based on estimated or average fuel consumption and current fuel costs. Fiona could affix and sign the preaudit certificate to each of the preaudit documents. Staff members would use the fuel cards each day, or each week, up to the maximum authorized limit. And the drivers would affix the preaudit document to each fuel card receipt to demonstrate that the transaction was preaudited.

This is not the only option. And it may not work in many units. Each unit must adopt a credit card authorization process that serves its needs and also complies with the preaudit requirements to the greatest extent possible.

## Links

- [www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter\\_159/GS\\_159-28.html](http://www.ncleg.net/EnactedLegislation/Statutes/HTML/BySection/Chapter_159/GS_159-28.html)
- [canons.sog.unc.edu/?p=7136](https://canons.sog.unc.edu/?p=7136)
- [www.ncleg.net/Sessions/2009/Bills/House/PDF/H666v4.pdf](http://www.ncleg.net/Sessions/2009/Bills/House/PDF/H666v4.pdf)