



State of North Carolina

Department of State Treasurer

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Memorandum No. 1060A

July 7, 2006

TO: Local Government Finance Officials and Certified Public Accountants

FROM: Sharon Edmundson, Director
Fiscal Management Section

SUBJECT: Clarification of Memorandum No. 1060

On June 5, 2006, Memorandum No. 1060 was issued. Since that date we have received numerous questions and comments about a section of that memorandum entitled **Budgeting of Debt Proceeds**. That section of the memorandum was intended to apply only to units of government who have failed to maintain good debt and fiscal management practices. This includes units who have not stayed current on submission of audits or who have received unit letters expressing concerns over serious financial difficulties, such as General Fund fund balance available of less than 8% of expenditures or other issues. Some units that do not have good debt and fiscal management practices have entered into construction contracts knowing that the financing must be approved by the Local Government Commission (LGC). Because of these poor debt and fiscal management practices, the LGC is unable to make the findings required by general statutes to approve these financings. However, these units have passed project ordinances with debt proceeds as a financing source and preaudited these construction contracts based upon these ordinances. Under these circumstances, these units had no reasonable basis to anticipate LGC approval of a financing and should not have passed these project ordinances or preaudited these contracts. As a result, these units face a choice of canceling these contracts and projects or using up the limited reserves they have to complete the contracts.

Again, the guidance in this section of the memorandum was intended to apply only to a select number of units. We regret if the memorandum failed to make this clear.

We also have received questions and comments from several units with good debt and fiscal management practices about budgeting for projects and signing contracts. One question concerns contracting for preliminary work, such as engineering or architectural services, that must be done before a unit can decide if it will undertake a project or determine the scope of the project. These costs will initially be paid by the unit from resources on hand, and will ultimately be reimbursed by debt proceeds if the project is undertaken. Units have asked if it is permissible to budget these costs in a project ordinance that has debt financing as the source of funds. The LGC is aware that units have budgeted these preliminary costs this way in the past. We have no concerns about this practice as long as the unit has sufficient resources on hand to fund these costs if the project is not undertaken and have good debt and fiscal management practices in place.

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A more complex question deals with signing of contracts for the full project before obtaining LGC approval of debt to finance the project. Units have indicated that in some cases project contracts have been signed by the unit before debt has been approved because bids for construction projects cannot be maintained for a sufficient time period to wait for LGC approval of debt. Units feel that if they requested that bids remain fixed for a long enough period to permit approval of financing by the LGC, the bids will be higher to protect the bidders from price changes during this extended bid period.

We appreciate the efforts of units to construct assets at the lowest cost possible and to use their units' resources as prudently as possible. We always have worked with units to accomplish this goal while protecting the financial integrity of each unit. We encourage units to contact us to discuss the timing of their projects, bid schedule and debt approval as soon as there is sufficient information to have a meaningful discussion. After meeting and discussing the project with the unit, we will work with the unit to determine the best course of action under the circumstances in place. Units should be aware that events could occur that would prevent the issuance of debt even after receiving LGC approval.

Please contact me at (919) 807-2381 if you have any questions or concerns.