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**Memorandum# 2017-04**

To: Finance Officers of Local Governments

From: Sharon Edmundson, Director of Fiscal Management Section

Subject: Proposed Rules for Electronic Transactions in Accordance with G.S. 159-28(d2) and G.S. 115C-441(d2)

Date: August 4, 2016

The 2015 legislature modified GS 159-28 (d2) (local governments) and 115C-441(d2) (local school administrative units) to allow the Local Government Commission (LGC) to adopt rules (administrative code) to address the execution of the preaudit and disbursement process related to electronic transactions for local government and local school administrative units. Execution of electronic transactions must follow the statutory provisions in GS 159-28 and 115C-441; however after the LGC adopts the proposed guidelines to the administrative code (Appendix A), a unit of government will be exempt from the preaudit certificate and disbursement certificate requirements on electronic transactions ***if they follow the adopted administrative code***. The purpose of this memorandum is to outline the proposed changes to the Administrative Code, provide examples of what units of governments are doing to meet the preaudit requirements for credit/ procurement/ fuel cards (Appendix B) and to layout the administrative code process.

**The Administrative Code Process**

We hope to begin the administrative code adoption process, which includes a 60 day comment period, around the end of August, 2016. Assuming that the rule making process goes smoothly and there are no substantive changes to the proposed rules the new administrative code should be effective as of December 1, 2016. If we make any changes to the proposed rules a second 60 day comment period is invoked.

***We are asking that you review Appendix A and let us know immediately if you would like us to consider changing any part of the proposed rule. All comments should be received in our office by August 19, 2016. We want to make sure that we have considered all appropriate facts before the end of August, 2016. Please email your comments to Melinda Canady at [melinda.canady@nctreasurer.com](mailto:melinda.canady@nctreasurer.com).***

## **Discussion of the Proposed Rules**

The Administrative Rules for Electronic Transactions are divided up into two areas: the rules governing the preaudit of the obligation and the rules governing the preaudit of the disbursement.

### ***Discussion of the Administrative Rules for Electronic Transactions for the Preaudit***

As more business transactions moved to electronic payments, units of government were seeking a more efficient way to preaudit electronic payments. In order to comply with previous legislation, each credit card, procurement card and fuel card transaction had to be “stamped” at the point of obligation. While the recent modification to G.S. 159-28 and G.S. 115C-441 did not address all the business challenges units of government face in today’s business environment, it does provide some improvements. Units whose policies and procedures comply with the LGC administrative code should now be able to develop a more efficient business process and still comply with the general statutes as they relate to electronic transactions.

### **What Steps Must a Unit of Government Take to be Exempt from Placing a Preaudit Certification on Each Electronic Obligation?**

1. The unit’s board must adopt policies and procedures for electronic transactions or delegate that authority to the Finance Officer.
2. The unit must adopt a written policy outlining basic procedures for preauditing obligations incurred by electronic transactions. The written policy and any procedures developed by the Finance Officer must provide sufficient internal controls, which must include the following:
  - a. Ensure that there is an appropriate budget ordinance or project/grant ordinance appropriation authorizing the expenditure;
  - b. ensure that sufficient monies remain within the appropriation to cover the amount that is expected to be paid out during the current fiscal year if accounted for in the budget ordinance, or to cover the entire amount if accounted for in a project or grant ordinance.
  - c. Record the amount of the transaction in the unit’s encumbrance system.
3. The unit must provide training to all personnel about the written policy and the procedures that must be followed before undertaking an electronic transaction.
4. If a governmental unit is not already doing so, the unit of government must present to its governing board a monthly budget to actual statement by fund that includes budgeted amounts, actual payments made, amounts encumbered (including electronic obligations) and the amount of the budget that is unobligated.

5. The unit's written policy and procedures must include a method to track obligations, commonly called an encumbrance system. The system can be manual or maintained as part of the unit's accounting system or any combination thereof.

Appendix B provides some common ways that units are currently reserving encumbrances for electronic transactions.

What Steps Must a Unit of Government Take to be Exempt from Placing a Disbursement Preaudit Certificate on Electronic Payments?

1. The unit's board must adopt policies and procedures for electronic transactions or delegate that authority to the Finance Officer.
2. The unit must adopt a written policy outlining basic procedures for disbursing public funds electronically. The written policy must provide sufficient internal controls to ensure the following:
  - a. ensure that the amount claimed is payable;
  - b. ensure that there is an appropriate budget ordinance or project/grant ordinance appropriation authorizing the expenditure;
  - c. ensure that sufficient monies remain within the appropriation to cover the amount that is due to be paid out during the current fiscal year if accounted for in the budget ordinance, or to cover the entire amount if accounted for in a project/grant ordinance; and
  - d. ensure that the unit has sufficient cash to cover the payment.

In developing this memo several examples were provided by Kara Millonzi, Associate Professor of Public Law and Government at UNC School of Government, and are reprinted in Appendix C

**Other Changes to G.S. 159-28 and G.S. 115C-441**

"Certifications" of Preaudit required for obligation and disbursements shall not apply to any of the following:

1. An obligation or a document related to the obligation that has been approved by the Local Government Commission
2. Payroll expenditures, including all benefits for employees of the local government
3. Electronic payments, as specified in rules adopted by the LGC.

In G.S. 159-28(a2) and G.S. 115C-441 (a) language has been added stating "Nothing in the section shall require a contract to be reduced to writing". G.S. 159-28(a1) and G.S. 115C

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(a) requires written obligations to be subject to the preaudit disbursement regulations, therefore verbal contracts are not subject to the preaudit contacts. We do want to stress that it is good business practice to document obligations in writing, which may make them subject to the preaudit provisions of G.S. 159 and G.S. 115C.

## **Proposed Additions to the Administrative Code for Execution of Electronic Preaudit Obligation and Electronic Preaudit Disbursement Provision of GS 159-28 and GS 115C-441**

### ***Exemption from Preaudit Certificate Requirement for Electronic Transactions***

In order to qualify for an exemption from the preaudit certificate requirement in G.S. 159-28(a) or 115C-441 (a) for electronic transactions, a local government, public authority, or local school administrative unit must do all of the following:

The unit's governing board must adopt a resolution authoring the unit to engage in electronic transactions as defined by G.S. 159-28 or 115C-441. The board can adopt a detailed policy or authorize the Finance Officer to develop the policy and procedures.

1. The unit's Finance Officer must adopt a written policy outlining basic procedures for preauditing obligations that will be incurred by electronic transaction. The written policy and any procedures developed by the Finance Officer must provide sufficient internal controls, which must include the following:
  - a. ensure that there is an appropriate budget ordinance or project or grant ordinance (multi-year grant and project ordinances are not applicable to local school administrative units) appropriation authorizing the expenditure;
  - b. ensure that sufficient monies remain within the appropriation to cover the amount that is expected to be paid out during the current fiscal year if accounted for in the budget ordinance, or to cover the entire amount if accounted for in a project or grant ordinance (multi-year grant and project ordinances are not applicable to local school administrative units).
  - c. record the amount of the transaction in the unit's encumbrance system.
2. The unit must provide training to all personnel about the written policy and the procedures that must be followed before undertaking an electronic transaction.
3. The unit of government must present to its governing board a monthly budget to actual statement that includes budgeted amounts, actual payments made, amounts encumbered (including electronic obligations) and the amount of the budget that is unobligated for all major funds.
4. The unit must have written policy and procedures, for tracking obligations, commonly called an encumbrance system. The system can be manual or maintained as part of the unit's accounting system or any combination thereof.

Units of local government who are in compliance with 1 and 2 above do not need to affix the preaudit language required in GS 159-28 (a1) or G.S. 115C-441 (a1) to electronic transactions transacted via:

Credit Cards  
Procurement Cards  
Fuel Cards  
Preaudit Disbursements

***Exemption from Disbursement Certificate Requirement for Electronic Transactions***

In order to qualify for an exemption from the disbursement certificate requirement in G.S. 159-28(d) and 115C-441 (a) for electronic transactions, a local government, public authority and local school administrative unit must do all of the following:

1. The unit's governing board must adopt a resolution authoring the unit to engage in electronic transactions as defined by G.S. 159-28 or G.S. 115C-441. The board can adopt a detailed policy or authorize the Finance Officer to develop the policy and procedures.
2. The unit's Finance Officer must adopt a written policy outlining basic procedures for disbursing public funds by electronic transaction. The written policy and any procedures developed by the Finance Officer must provide sufficient internal controls, which must include the following:
  - a. ensure that the amount claimed is payable;
  - b. ensure that there is a budget ordinance or project or grant ordinance appropriation authorizing the expenditure;
  - c. ensure that sufficient monies remain within the appropriation to cover the amount that is due during the current fiscal year if accounted for in the budget ordinance, or to cover the entire amount if accounted for in a project or grant ordinance; and
  - d. ensure that the unit has sufficient cash to cover the payment.

Units of local government who are in compliance with 1 and 2 above do not need to affix the preaudit language required in GS 159-28 (a1) or GS 115C (a1) to any electronic transactions.

## Sample Encumbrance Practices

The following are examples of what some units are doing to encumber their various credit/procurement/ fuel cards. These examples are specific to a particular unit of government and are designed to work efficiently with their system processes and their internal policies and procedures. They might not be appropriate for your organization as written below. Your procedures should be designed to produce accurate expenditure information, strong internal controls and compliance with GS 159 (including the new electronic administrative code provisions).

### Example 1

The unit of government issues credit cards/procurement cards/fuel cards (collectively “card”) by department. They set monthly maximum limits on card issued to a department and preaudit that maximum amount for the month. The amount that is pre audited is also encumbered by the finance department. If a department needs to exceed the maximum amount authorized, the department must request additional authorization from the finance department and the additional amount will be pre audited before the card limit is increased. Smaller units may be able to set and preaudit quarterly or even semi-annual card maximums. If multiple cards are issued for single department, the encumbrance is made for the maximum limits for each card and preaudit on the maximum total amount authorized for the department.

### Example 2

If credit/procurement/fuel cards are used repeatedly with the same vendor, the unit can issue a blanket PO to the vendor, authorizing up to a maximum amount of card charges. The unit then could preaudit (and encumber) the maximum amount authorized. If multiple departments use the same vendor, the finance office may have to split up the encumbrance among the various departments on a proportional basis

### Example 3

When the board adopts the budget ordinance, include a function code within each department for credit/procurement/fuel card purchases, based on estimated amounts that will be obligated electronically during the fiscal year. Issue card(s) to each department that is programmed with the maximum budgeted amount for the fiscal year. Preaudit and encumber that maximum amount for each department.

## Examples of Preaudit Requirements

Assume that a unit wants to order supplies from a local vendor. There are several ways the unit could go about it, which will have different implications related to the preaudit certificate requirement.

- Scenario 1: Unit has relationship with vendor such that vendor is willing to fulfill orders and invoice the unit after the fact. Unit employees email vendor with specific orders. Vendor fills orders and then sends invoice. Unit pays for invoice with a check. In this situation, the LGC rules will not apply at all. The unit must figure out a way to include a signed preaudit certificate on each order (or establish a blanket PO that has the preaudit certificate). The unit will have to include a signed disbursement certificate on the check

(An electronic transactions as defined in G.S. 159-28 was not involved, so the rules do not apply)

- Scenario 2: Unit has relationship with vendor such that vendor is willing to fulfill orders and invoice unit after the fact. Unit employees email vendor with specific orders. Vendor fills orders and then sends invoice. Unit pays for invoice with an ACH payment. In this situation, the LGC rules will not apply to preaudit but will apply to disbursement. The unit must figure out a way to include a signed preaudit certificate on each order (or establish a blanket PO that has the preaudit certificate). Once the LGC rules are enacted (and the unit complies with the rules), the unit will not have to include a signed disbursement certificate on the ACH transaction.
- Scenario 3: Vendor has ability to accept credit card payments. When unit places order for goods, employee enters unit's credit card payment information. (Note that at this point the unit is merely obligating the funds, it is not actually disbursing the funds yet). Once the LGC rules are enacted (and the unit complies with the rules), the unit will not have to include a signed preaudit certificate when it places the order with the credit card. When the credit card bill comes in at the end of the month, the unit pays the bill with a check. The unit will have to include a signed disbursement certificate on the check. (The LGC rules will not apply because it is not an electronic disbursement.)
- Scenario 4: Vendor has ability to accept credit card payments. When unit places order for goods, employee enters unit's credit card payment information. (Note that at this point the unit is merely obligating the funds, it is not actually disbursing the funds yet). Once the LGC rules are enacted (and the unit complies with the rules), the unit will not have to include a signed preaudit certificate when it places the order with the credit card. When the credit card bill comes in at the end of the month, the unit pays the bill with an ACH transfer. Once the LGC rules are enacted (and the unit complies with the rules), the unit will not have to include a signed disbursement certificate on the ACH disbursement.