



The PreAudit and Budgeting

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 North Carolina Department of State Treasurer
 State and Local Government Finance


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Pre-audit Statutes




General Statutes 159-28 for Municipalities, Counties and Public Authorities

General Statutes 115C-441 for Local Education Agencies – this does not include charter schools.



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Pre-audit Process

Pre-audit at time of
Obligation

Liability

A debt or other financial obligation that must be paid at some point in the future.

fsm management chapter 2 23

Disbursement Certification

Sample Company 100 Somewhere Rd. Nowhere, CA 90000 (111) 111-1111	My Bank 123 Bank Road	No. 1003 01/0000 Date 12/31/2012
Pay To <u>John Smith</u> \$ 100.00 Order Of _____ Dollars		
Our Hundred and 00/100 _____ Dollars		
John Smith Apt. 3100 1000 Somewhere Rd. Nowhere, NY 42000		
Memo: <u>Test Pay Check</u>		
000004003 1 2 3 4 5 6 7 8 9 0 1 2 3 4 5 6 7 8 9		

I Need to do a Pre-audit when:

1. Enter a contract/agreement/order for goods or services that are in a budget ordinance, grant ordinance or project ordinance **and**;
2. Unit is obligated to pay money per the terms of the contract/agreement/order **and**;
3. The unit anticipates paying at least some of the money in the current fiscal year

Multi-year Grant and Project Budget Ordinances - #1 and #2 must be met

Annual Budget Ordinances – #1, #2, and #3 must be met.

Pre-audit at time of Obligation

1. Check to see if there is an appropriation in the budget
2. Check to see if there is available budget to cover the amount that will come due this fiscal year.

Budget + Amendments – Actual Payments- Outstanding Encumbrances = Available Budget

3. “The Certificate” - Sign and date the pre-audit on the written contract, PO, etc. that shows the pre-audit was performed and is now documented.
4. If you don't do steps 1 and 2 then don't do step 3. When you certificate you are signing that you preformed steps 1 and 2



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To Pre-audit or not to Pre-audit



- The County entered into a contract to rent the City some space in the Counties building. They will received \$50,000 per year for 5 years. Does the County need to Pre-audit the contract? If so, for what amount?
- The Fire District is ordering a firetruck at a cost of \$340,000. The Fire District is in a multi-year special revenue fund on the County's books. Does the County need to pre-audit the contract? If so, for what amount?
- The Fire district is ordering a firetruck at a cost of \$340,000. The Fire district is in an annually budgeted fund. They contract states that \$100,000 will be paid out in the current fiscal year the a second and final payment will occur in the following fiscal year. Does the County pre-audit? If so, for what amount is the pre-audit and in which fiscal year?



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- The County entered into a contract to rent the City some space in the Counties building. They will received \$50,000 per year for 5 years. Does the County need to Pre-audit the contract? If so, for what amount?
- The Fire District is ordering a firetruck at a cost of \$340,000. The Fire District is in a multi-year special revenue fund on the County's books. Does the County need to pre-audit the contract? If so, for what amount?
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Examples



Contract that pays out \$10,000 in FY 2016 and \$70,000 in FY 2017

1. What amount should the City encumber in the General Fund at the time the contract is signed on May 15, 2016?
2. What amount should the City encumber in the Capital Fund at the time of contract is signed on May 15, 2016?
3. What amount should the unit City encumber on July 1, 2017 in the General Fund.
4. What amount should the school system encumber in at the time of signing in their capital project fund.
5. The City encumbered \$10,000 in it's General Fund on May 2016 but only paid out \$5,000. What should the unit do on July 2016?

Note: Schools normally do not have multi-year funds.



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Let's Set Up Your Pre-Audit Obligation Process



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Let's Set Up Your Pre-Audit Obligation Process

- All obligations need to come to the Finance Officer or a board appointed deputy finance officer.
 - All contracts, PO's and electronic transactions (credit cards/Pcards, etc.) need to have a process that involves approving the obligation / encumbrance process. If the transactions are going to the board for approval the pre-audit needs to occur before board approval.
 - If the board needs to approve a budget amendment before the contract can be approved the FO should Preaudit it immediately after the board approval of the amendment.



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Let's Set Up Your Pre-Audit Obligation Process

- The Finance Officer needs to have a way to set aside or reserve the budget for the amount being obligated
 - Use the encumbrance system in your accounting system
 - Create a manual system to use for checking your budget and reporting to the board



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Step 1 - Set a Floor for Obligation Approvals

- The general statutes do not set a floor so a legal interpretation might be that everything has to have a pre-audit, even \$10 worth of office supplies.
- From a practical point of view, most units set a \$ amount for the issuance of PO's and contracts.
 - We don't see units being sued over the ordering of office supplies.



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Step 1 - Set a Floor for Obligation Approvals

If your unit adopts a minimum amount then your written policy should state that PO's and contracts below a certain amount are not subject to the purchase order process or the contract approval process.



- But under no circumstances will goods or services be purchased over the legal budget amount.
- You better have very good management systems for your transactions.
- The amount of the floor varies among units, normally in correlation to the size of the unit. \$0 - \$2,500.



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How Much should I set my Floor ?

- Based on existing budget controls
 - You should feel fairly certain that you will not be in jeopardy of over spending the budget
- Based on the environment of the unit of government
 - Do you and the manager run a tight ship – do you have approvals and internal controls that are followed or do you have independent department heads that let you know about things after the fact?
- How comfortable the board or manager is with the process
 - The improper pre-audit of a contract can lead to manager and board involvement.



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Step 1 - Set a Floor for Obligation Approvals

- For transactions below the floor, the unit of government, only documents the disbursement certification. Transactions below the floor still can't exceed the budget amount. So make sure you estimate their volume and account for them in your budget.
- Nothing I will say today should be interpreted to say that a unit of government can order goods or service without an available budget.



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Step 2 – Obligate the Funds

- Most transactions start in the Departments. PO's and Contracts need to come to the finance department to have the budget checked and the obligated amount reserved. If the transaction needs to go to the board for approval the pre-audit must be completed before the board's approval, signed and dated.
 - If you don't have an encumbrance system, it is assumed that the unit has low volume and the use an obligation form is practical.
 - If you have a high volume of pre-audit transactions the unit should consult with their vendor about implementing the encumbrance module.



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Obligation of Budget Form Sample

[Unit Name]
Obligation of Budget _____

Date: _____
 Fund: _____
 Department: _____
 Account Number / Name: _____

Description of obligation:


Public Purpose of Purchase:


Estimated Amount to be paid out of this fiscal year Budget: _____

This instrument has been pre-audited in the manner required by the Local Government Budget and Fiscal Control Act.

Signature of the Finance Officer or board approved deputy finance officer

Date


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- ## How to Use the Obligation Budget Form
-
1. For transactions above the minimum pre-audit amount complete the budget form.
 2. Place one copy of the form in a file folder in your desk. You will keep all obligation forms in this folder.
 3. When the bill comes in remove the budget form and staple it along with the invoice and payment record and file with all the other payment documents.
 4. At any point in time, only those obligations that have not been paid should be in your folder.
 5. When you are creating a budget obligation, you must check the available budget in your accounting system and also include any previous outstanding obligations.
 6. When you issue reports to the board, you must include an encumbrance or obligation column in your report and show the available budget which will be reduced by these obligations.
- 
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Sample Report - Use Excel or Mark up System Rpt.

City of Dogwood					
Revenue and Expenditure Statement					
December 31, 2016					
	Budget	Actual	Obligation	Available Budget	%
Revenue:					
Property Taxes	\$ 300,000	\$ 220,000			
Sales Taxes	\$ 150,000	\$ 65,000			
Other	\$ 50,000	\$ 20,000			
Total Revenues	\$ 500,000	\$ 305,000	\$ -	\$ -	
Expenditures:					
General Government	\$ 150,000	\$ 75,000	\$ 30,000	\$ 45,000	
Finance	\$ 80,000	\$ 40,000		\$ 40,000	
Public Safety	\$ 175,000	\$ 150,000		\$ 25,000	
Other	\$ 95,000	\$ 40,000		\$ 55,000	
Total Expenditures	\$ 500,000	\$ 305,000	\$ 30,000	\$ 165,000	
Town needs a new garbage truck - total cost of \$300,000. \$30,000 will be paid out in this fiscal year in the month of February.					



Step 3 – Order the Goods or Services

- After the finance officer or board appointed deputy finance officer has signed the pre-audit and board approval has been obtained (if needed) the goods can be ordered.
 - If you are ordering at year end please instruct the vendor if delivery will be before June 30th or after June 30th.
 - Why is this important?




The Second Part of the Pre-Audit



Disbursement Certification

- The Finance Officer or board approved Deputy Finance Officer must certify
 - amount is payable
 - Public purpose, goods received, etc.
 - appropriation in budget
 - available budget
 - cash is available to make the payment
- Pre-audit is normally pre-printed on the check which the finance officer or board appointed deputy signs along with a second signature.

 Sample Company 100 Somerset E.E. Nowhere, CA 95000 (555) 111-1111		My Bank 123 Bank Road	No. 1003 Date 12/31/2012
Pay To The Order Of John Smith	\$ 100.00		
One Hundred and 00/100	Dollars		
John Smith Age 3100 1000 Somerset E.E. Nowhere, KY 42000			
Money Trans. Per. Check			
@000001003# K 1 2 3 4 5 6 7 8 9 0 1 2 3 4 5 6 7 8 9			

What about Pcards / Credit Cards?

Some Ideas

- Limit your credit card transactions to amounts below your minimum PO/Contract limit
- Encumber the monthly transaction limit by card holder / department.
- All transactions follow the PO rules including credit card transactions



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Exemptions from the Pre-Audit Certificate Requirement

Currently in Effect:

1. Obligations approved by the Local Government Commission
 - o Borrowings, certain leases, various financing agreements and audit contracts
2. Payroll expenditures, including benefits for employees

In Effect After The LGC adopts Administrative Rules

1. Electronic Transactions – only applies to Charge cards, credit cards, debit cards, gas cards and procurement cards



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Proposed LGC Administrative Rules

Exemption from the "Certificate" requirement after the Adm. Rules have been approved

1. Written Policy outlining policy for pre-audit of electronic transactions
 1. Ensure there is a budget
 2. Available budget
 3. Record the transaction in the unit's encumbrance system
2. Provide training to all personnel about policy and procedures
3. Must provide budget to actual statements to governing board that include the encumbered amounts – at least quarterly
4. Must have written procedures for tracking obligations – either manual or automated



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Test Your Skills

1. T or F

The FO should encumber the entire contract price of a multi-year contract in capital project for a school.

2. T or F

Can a Finance Officer encumber a contract for \$1,000,000 in a capital project fund if they have a available budget of \$2,000,000, but only have cash of \$500,000?



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3. T or F

The City in order to prepare for the occasions when some of the officers are not available has made arrangements so the two of the three officers (manager, chairman or FO) can sign checks. This complies with G.S. 159

4. T or F

A medical vendor has a contract with the unit for \$155 dollars per hour for services. The budget for this vendor is \$100,000. The department estimates that they will use \$125,000 dollars of services. The FO should not encumber the contract as there is no fixed dollar amount to pay.



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5. T or F

The pre-audit is not violated if the board gives the manager authority to overspend the budget as long as he reports the over expenditure at the next meeting

6. T or F

A unit of government uses QuickBooks to keep the city's records. The FO is not able to load the budget into QuickBooks but makes sure that all invoices are stamped and dated with pre-audit language before the bills are paid and all contacts are stamped / dated before the board approves a contact. This unit has complied with the pre-audit.



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What are we seeing on our Unit Visits

- Units are not preauditing contracts or they are just placing preaudit language on the contract but not encumbering them.
- Contracts are not routed through the finance department before they go to the board so no control over encumbrance or amendment process exists



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What are we seeing on our Unit Visits

- Units do not have preaudit language on their checks
- Units do not have proper check signing procedures in place when the finance officer is not available to sign checks
- Unit thinks the preaudit process is the stamp



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What are we seeing on our Unit Visits

- Auditors are incorrectly instructing units to preaudit check registers – it is great internal control to review and sign off on but maybe not use preaudit language.
- Auditors are incorrectly instructing units to preaudit invoices



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Budgeting – What we are seeing on our Unit Visits

- When we ask for Budget Ordinance – we are handed an Excel Worksheet
 - *Ask to see a copy of the budget ordinance*
- The Ordinance only has one side of the budget – expenditure only
- Ordinance comingles funds – *ordinance needs to be adopted by fund*
- Tax rate is not set in the ordinance
- The budget does not have the proper ordinance language
- Units are confused between the ordinance level and the line item level of budget they have in their systems
- Units do not understand the “appropriated fund balance” account



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Ordinance Contents-Must be included in Ordinance

- Must be included in the Ordinance
 - Each fund must have estimated revenues and appropriations amounts
 - The ordinance must address every fund (except trust and agency funds) (internal service funds – financial plan)
 - Must set a tax rate for general fund, special districts, etc. Does not have to set utility rates (these can be set by the board at any time)
 - Must be in the form of an ordinance
 - In revaluation years there must be a revenue neutral tax rate statement
 - Revenues 159-13(b)(7) – must reasonably expected to be realized
 - The budget must be balanced; estimated revenues = appropriations
 - Transfers should be balanced between funds



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Ordinance Additional Information

- Examples of additional information that can be included
 - Statement about the powers that are transferred to the Manager, Mayor, etc.
 - Example – Mgr. can approve contracts that are budgeted and below \$5,000
 - Mgr. can approve a transfer of budget amounts between departments up to \$5,000 but it must be reported at the next board meeting.
 - Number or list of positions that are authorized by the board in this budget
 - Positions that the Mgr. can hires/terminates verses those the board hires/terminates. This can also be covered in the personnel policy



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What type of transactions are included in the budget?

- Cash disbursements / receipts
 - Include loan payments and receipts
 - Unit can exclude depreciation
- Debt Service payments – principal and interest
- Debt Service receipts – principal and interest
- Funding of a deficit fund balance – if the deficit is not the result of timing differences
- Sheriff funds need to be budgeted before they can be spent



Budget Amendments

- Use terms like increase and decrease budget instead of debit and credit
- Amendments to estimated revenues must equal amendments to appropriations

General Fund		
Appropriations	Estimated Revenues	
100,000.00		Increase
	100,000.00	Increase
200,000.00		Increase
(200,000.00)		Decrease
100,000.00	100,000.00	Balanced



To Pre-audit or not to Pre-audit



- The County entered into a contract to rent the City some space in the Counties building. They will received \$50,000 per year for 5 years. Does the County need to Pre-audit the contract? If so, for what amount? **No – The County is receiving revenues**
- The Fire District is ordering a firetruck at a cost of \$340,000. The Fire District is in a multi-year special revenue fund on the County's books. Does the County need to pre-audit the contract? If so, for what amount? **Yes \$340,000**
- The Fire district is ordering a firetruck at a cost of \$340,000. The Fire district is in an annually budgeted fund. They contract states that \$100,000 will be paid out in the current fiscal year the a second and final payment will occur in the following fiscal year. Does the County pre-audit? If so, for what amount is the pre-audit and in which fiscal year? **Yes Current FY \$100,000 Next FY \$240,000**



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Examples



Contract that pays out \$10,000 in FY 2016 and \$70,000 in FY 2017

1. What amount should the City encumber in the General Fund at the time the contract is signed on May 15, 2016? **\$10,000**
2. What amount should the City encumber in the Capital Fund at the time of contract is signed on May 15, 2016? **\$80,000**
3. What amount should the unit City encumber on July 1, 2017 in the General Fund. **\$70,000**
4. What amount should the school system encumber in at the time of signing in their capital project fund. **\$10,000**
5. The City encumbered \$10,000 in it's General Fund on May 2016 but only paid out \$5,000. What should the unit do on July 2016? **\$75,000**



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Test Your Skills

1. T or **F**

The FO should encumber the entire contract price of a multi-year contract in capital project for a school.

False – Schools have annually budget capital projects and only the amounts that are expected to be paid out of the current budget should be encumbered.

2. **T** or F

Can a Finance Officer encumber a contract for \$1,000,000 in a capital project fund if they have a available budget of \$2,000,000, but only have cash of \$500,000? **True since the preaudit at the time of obligation does not have to meet the available cash test.**



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Test Your Skills

3. T or **F**

The City in order to prepare for the occasions when some of the officers are not available has made arrangements so the two of the three officers (manager, chairman or FO) can sign checks. This complies with G.S. 159

False – the finance officer or board appointed deputy finance officer must be one of the signatures on the check

4. T or **F**

A medical vendor has a contract with the unit for \$155 dollars per hour for services. The budget for this vendor is \$100,000. The department estimates that they will use \$125,000 dollars of services. The FO should not encumber the contract as there is no fixed dollar amount to pay.

False – The finance officer should try to encumber the \$125,000 that is estimated, but is limited by the current budget of \$100,000. A budget amendment must be processed before the final \$25,000 can be obligated. The department must be advised that they can not incur more than the \$100,000.




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Test Your Skills


5. T or **F**
 The pre-audit is not violated if the board gives the manager authority to overspend the budget as long as he reports the over expenditure at the next meeting
False – the board does not have the authority to lift any pre-audit or budgetary requirements.

6. T or **F**
 A unit of government uses QuickBooks to keep the city's records. The FO is not able to load the budget into QuickBooks but makes sure that all invoices are stamped and dated with pre-audit language before the bills are paid and all contacts are stamped / dated before the board approves a contact. This unit has complied with the pre-audit.
False – Preaudit does not require certification of invoices; Preaudit requires checking of available budget which does not appear to being accomplished



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Thank You!

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