

Preaudit Certificates For Local Government and School Board Contracts

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Imagine the following scenario. Your firm has just completed providing professional engineering services to a local government or school board under a written contract. The invoice is submitted to the appropriate person at the local government or school board. But then you get a letter back stating the local government or school board is not required to pay you for your services because they never placed a “preaudit certificate” on the contract? What?!!

Unless the preaudit formality is attended to when the contract is formed, the above scenario could potentially happen to an engineer providing services to local governments or school boards in North Carolina. This article will explain the statutory basis for the requirement of a preaudit certificate along with the courts’ application of the statute. Fortunately, the engineer can protect against this happening but those efforts must take place at the time the contract is entered into with the local government or school board, or else it could be too late.

Preaudit Certificate Statutes

When an engineer enters into a written contract with any client, whether public or private, and performs under that contract, one would expect that contract to be enforceable. When dealing with government (i.e. taxpayer) money, there is another legal issue – and that is making sure that the government’s money is appropriately authorized and within budget. In order to protect local governments and school boards from spending beyond their means, the General Assembly has adopted two similar statutes - one for local governments (N.C. Gen. Stat. § 159-28) and one for school boards (N.C. Gen. Stat. § 115C-441).

The statute applicable to local governments (§ 159-28) provides that no obligation may be incurred by a local government or public authority unless the budget ordinance includes an appropriation authorizing the obligation. The statute also requires that an unencumbered balance remains in the appropriation sufficient to pay the sums obligated by the transaction for the current fiscal year. No obligations may be incurred for capital and grant projects authorized by a project ordinance unless the project ordinance includes an appropriation authorizing the obligation. Some local government related entities, public hospitals and public housing authorities, are exempt from § 159-28. So far, so good, right? As taxpayers of course we want to make sure our local governments and school boards are not obligating taxpayer dollars unless appropriately authorized and budgeted.

The preaudit certificate requirement lies in the next part of the statute. If the obligation arises from a contract or agreement requiring the payment of money, or by a purchase order for supplies and materials, the contract, agreement, or purchase order “shall include on its face a certificate stating that the instrument has been preaudited to

assure compliance” with § 159-28. The certificate must be signed and dated by the finance officer or deputy finance officer and shall take substantially the following form: “This instrument has been preaudited in the manner required by the Local Government Budget and Fiscal Control Act.” Finally, the statute provides that “an obligation incurred in violation of this subsection is invalid and may not be enforced.” Yes, you heard that correctly. If a contract does not have a preaudit certificate, the local government is not required to pay the other contracting party for services performed or goods provided.

The statute applicable to school boards (§ 115C-441) is very similar to the statute for local governments. One difference is that the appropriation authorizing the obligation arises from the school board’s budget resolution (not the budget ordinance), which is the funding mechanism for school boards in North Carolina. There is no analogous provision in § 115C-441 for capital and grant projects. This is likely because capital and grant projects for schools are authorized at the county level. The preaudit certificate must take substantially the following form: “This instrument has been preaudited in the manner required by the School Budget and Fiscal Control Act.”

Preaudit Certificate Court Decisions

There are only a handful of appellate court decisions involving either of these statutes, but they are instructive. Consider two cases, one for each statute. The first case, which addresses the statute applicable to contracts with local governments (§ 159-28) is *Data General Corporation v. County of Durham*, decided in 2001 by the North Carolina Court of Appeals. Durham County entered into a written agreement to lease computer hardware and software from Data General over a period of years. Durham County made all of its lease payments during the term of the lease, but in its complaint, Data General alleged that Durham County kept and used the leased equipments for two years following the expiration of the lease term without paying Data General. Data General, among other claims, alleged that Durham County breached the contract.

There were no allegations made by Durham County that Data General had failed to perform its obligations under the lease agreement. Instead, Durham County pointed out that there was no preaudit certificate on the lease. The court found that because there was no preaudit certificate, the lease agreement was not a valid contract. Thus, Data General could not collect any further money from Durham County. Data General argued that Durham County had the sole responsibility to determine its actions were in compliance with the preaudit statute. The court found that Data General also had a responsibility to ensure the preaudit certificate was affixed to the lease agreement, as the existence of the certificate is a matter of public record.

The second case addresses the statute applicable to contracts with school boards (§ 115C-441). The case is *Transportation Services of North Carolina, Inc. v. Wake County Board of Education* and was decided in 2009 also by the North Carolina Court of Appeals. The Wake County Board of Education (“Wake Co. BOE”) entered into a written contract with Transportation Services of North Carolina, Inc. (“TSNA”), a transportation provider for special needs students in the school system. The contract

provided that TSNA was to receive compensation on a per-student basis, whether or not those students were actually transported on a given day. Wake Co. BOE subsequently refused to pay TSNA for students on days when they were not transported by TSNA. TSNA brought suit against Wake Co. BOE alleging breach of contract. Wake Co. BOE alleged the contract was invalid because a preaudit certificate was never prepared.

This case was the first time the court was asked to interpret the preaudit certificate statute relating to a local school board. The court cited a number of prior court decisions interpreting the preaudit certificate statute for local governments, including the *Data General* case. Noting the similarity between the two statutes, the court applied the reasoning from the prior court decisions involving the local government statute to the school board statute, which all take a literal reading of the local government statute similar to *Data General*. The court found that in the absence of a preaudit certificate, the contract between Wake Co. BOE and TSNA was invalid and unenforceable. TSNA admitted there was no preaudit certificate, but argued that since Wake Co. BOE actually did perform the preaudit, the contract should be valid. The court did not buy this argument and pointed to the plain language of the statute – requiring the signed preaudit certificate be attached to the contract.

What would cause or motivate a local government or school board to raise the absence of a preaudit certificate as a defense to a breach of contract action? Perhaps a dispute has arisen over the quality of the engineer's work and the local government or school board points to the preaudit certificate as leverage. Maybe the local government or school board representative who entered into the contract did not ensure the obligation was authorized and budgeted for, and the local government accordingly refuses to pay. The local government or school board may have just forgotten to affix the preaudit certificate to the contract. Regardless of the local government's or school board's motives, it is important to realize that lack of a preaudit certificate could be fatal to the engineer's attempts to collect payment on his/her invoices – whether or not there is anything deficient with the engineer's work.

Proposed Legislation

Proposed legislation that would affect the preaudit statute applicable to local governments was introduced during the 2011 Legislative Session (Senate Bill 426). The proposed legislation would not affect the preaudit statute applicable to school boards. The proposed change to the statute would exempt the requirement for a preaudit certificate if the "obligation or a document related to the obligation has been approved by the Local Government Commission." The Local Government Commission approves the sale and delivery of all local debt in North Carolina. If a local government wants to fund capital projects by issuing bonds, for instance, the Local Government Commission analyzes the local government's ability to repay the debt and either approves or denies the issuance of debt.

If Senate Bill 426 makes it into law, it is impossible to predict the entire affect on preaudit certificates. One way it may play out is that contracts with a local government

involving a capital project financed by debt would not require a preaudit certificate if the debt issuance is approved by the Local Government Commission. On the other hand, since the Local Government Commission does not approve or disapprove local governments' operating budgets, if a contract was paid for out of the operating budget, presumably the requirement for a preaudit certificate on the face of the contract would still exist.

Conclusion

What is the takeaway from these statutes and the court cases discussed? The takeaway is that an engineer (or any party) can enter into a written contract signed by a local government or school board, but if the preaudit certificate is not affixed to the contract, the contract is invalid. The engineer may not realize the requirement for a preaudit certificate exists until after engineering services are performed and invoiced. The courts have taken a strict interpretation of the statute, even finding where all of the authorization and budgetary requirements (i.e. the "preaudit") were met by the local government or school board, that the absence of the actual preaudit certificate on the contract was enough to invalidate the contract and remove any obligation to pay. The engineer who performs work under a contract with a local government or school board should ensure the preaudit certificate is affixed to the contract – before any work is performed. Please help spread the word among your colleagues!

Bio

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