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Synopsis

1) The basic grant of power to contract (including purchase contracts) is found in G.S. 153A-11 for counties, G.S. 160A-11 for municipalities, and G.S. 115C-522(a) for local boards of education. Local boards may use contracts made by the Department of Administration to make purchases. They also can use the E-quote service of the N.C. E-Procurement system to seek *informal* bids subject to G.S. 143-131, and the Division of Purchase and Contract's electronic Interactive Purchasing System as one means of advertising *formal* bids subject to G.S. 143-129. Once certified as "E-Procurement compliant", boards must use this system for specific mandated percentages of all their purchases (beginning at 30% and increasing until it reaches a minimum of 40 % after the second year).

2) G.S. 159-28(a) requires the finance officer to determine if a sufficient balance remains in the budget to pay the invoice when it is received, and that the finance officer certify this by signing a "pre-audit certificate" and put it on the contract, agreement, or purchase order before it can become an obligation of the governmental unit.

3) The only exception to item #2 above is for *continuing* contracts, defined as contracts "some portions or all of which are to be performed in ensuing fiscal years." For these, funds can be appropriated without a pre-audit certificate to meet current year obligations, as authorized by G.S. 153A-13 for counties and G.S. 160A-17 for municipalities. All continuing contracts automatically encumber the appropriations for the new budget in July 1 of that budget year.

4) According to G.S. 159-28(e), if an officer or employee of a local government or public authority incurs an obligation or pays out or causes to be paid out any funds which have not been appropriated, they and their sureties on their official bond are liable for any sums so committed or disbursed. This liability also occurs if the finance officer or deputy finance officer gave a false pre-audit certificate to any contract, agreement, purchase order, check, draft, or other document.

5) Local government purchasing should be a centralized function to insure more timely and accurate financial reports, lower costs, a standardization of items to facilitate larger quantity buying, improved specifications, and greater probability of earning cash discounts. The purchasing process is designed to provide more internal control, and ensure proper authorizations and that the statutory requirements are met. Automated systems such as procurement cards are becoming popular since they reduce the number of purchase orders written, the individual payments processed, and automate or move the data entry tasks to the requesting department.

6) The department head or the designated representative needing the items should prepare purchase requisitions. The requisition should show the quantity and type of commodities needed, the purpose for which they are to be used, and the date required.

7) A purchase order is the basic document in the purchasing system and also a contract which should be issued for all materials or supplies purchased by the unit. The pre-audit certificate is usually preprinted on the purchase order. The finance officer may not certify any purchase order unless sufficient unencumbered funds are available to pay the obligation when it is due. No invoice may be honored for commodities unless it is supported by a properly signed purchase order. The purchase order should be pre-numbered for control purposes and should include complete specifications or reference to specifications, as well as shipping and invoicing instructions. Open-ended purchase orders may be used for many repetitive, usually low-dollar value, purchases from one vendor.

8) Procurement cards enable a unit to make small purchases more quickly and efficiently, but also require adequate controls as built-in transactional limits, cardholder education, pre-audit certification, and supervisory review procedures.

9) Two basic types of records should be kept: 1) purchasing and 2) accounting records. The *purchasing* records should show open purchase orders for materials/services that have been ordered but not received or paid. They furnish supporting information for the payment of claims and are valuable planning tools for future purchases because they show prices, quantities, and vendor performance. The *accounting* records should show amounts encumbered and amounts expended by accounting period, for the purchased items. The use of encumbrances is required under G.S.159-26(d) with some exceptions for municipalities with a population of 10,000 or less, or counties with a population of 50,000 or less.

10) Receipt of all goods and services by the governmental unit should be reported to the purchasing officer and the finance officer for processing so the status of all purchase orders issued may be monitored and controlled.

11) Local governments must file information returns (IRS Form 1099-MISC) for each calendar year for payments made during the year of $600 or more for rents or services made to each person or unincorporated entity. The staff of the LGC recommends that units set a policy to not approve vendor invoices for payment *until* they have received a tax identification number from the vendor. Local governments may use *IRS Form W-9, Request for Taxpayer Identification Number and Certification*, as a collection tool for the necessary information. The penalties for the failure to file the forms with both the IRS and the taxpayer are significant. IRS Form 1099-MISC must be issued to attorneys at law regardless of the dollar amount of services paid at year end.

12) Local governments are required to file reports of abandoned property with the Escheat and Unclaimed Property Section of the North Carolina Department of State Treasurer, even if they have no dollar amount to report. Any unit holding property in this category with a value of fifty ($50) dollars or more in a single reporting year must do “due diligence” by sending a letter to the unclaimed property owner’s last

known address, and then report on Form ASD-21 the property *individually* by the owner's name.

13) The Electronic Commerce Act, Article 11A of Chapter 66 of the NC General Statutes, allows local governments and other public agencies to accept electronic signatures to enact transactions. Electronic signatures can be verified by certification authorities licensed by the Department of the Secretary of State. Local governments are authorized by G.S.159-32.1 to accept electronic payment in lieu of cash or check.

14) Establishing and maintaining a current list of qualified bidders is a fundamental part of the purchasing function.

15) G.S. 143-129(a) was amended to allow the governing body to delegate to any employee authority to award contracts, reject bids, and re-advertise to receive bids on behalf of the unit. Delegation may be adopted for all contracts, individual contracts, or may be restricted by dollar amount. However, these responsibilities cannot be delegated for construction or repair contracts.

16) G.S.143-129.7 specifically authorizes local governments to sell as "trade-ins" specific property owned by the unit. This must be included in the contract specifications for the purchase of replacement apparatus, supplies, materials, or equipment.

17) While *formal* contracts are not defined in the statutes, this name is applied to contracts subject to G.S. 143-129; that is, to those contracts to which all three requirements of the statute apply: 1) a request for bids must be advertised, 2) sealed bids must be received, and 3) the contract must be awarded strictly as prescribed by law, which covers bid deposits, formal methods of requesting and receiving quotations, and communicating acceptance. Some items fall outside this statute, such as services like insurance, legal, banking, newspaper advertising or tax mapping. However, good business practices suggest that a unit follow the same procedures as for construction or repair contracts.

18) Effective January 1, 2002 contracts for construction or repairs with an estimated cost of $300,000 or more, and contracts for the purchase or lease-purchase of apparatus, supplies, materials, or equipment with an estimated cost of $90,000 or more require the use of formal bidding and contracting procedures which are quite extensive and complex. G.S. 143-132 requires that construction and repair (not purchase) contracts for which the estimated cost is $300,000 or more to have at least three competitive bids, to be executed in writing, and to not be acceptable until the contractor posts a performance bond and payment bond for 100 percent of the contract as per G.S. 143-129(b) and Article 3 of Chapter 44A. Dividing contracts to evade these requirements is prohibited by G.S. 143-133. However, G.S. 143-129(e) lists eleven exceptions to this formal bidding requirement.

19) The "piggybacking" exception, G.S. 143-129(g), authorizes the governing board to waive the formal bidding procedure for a purchase from any vendor that has completed a public, formal bid process within the prior 12 months, and contracted to provide this same item to federal, state, or local governments and their agencies. These purchases are subject to some restrictions and this exception must be approved by the governing board and published in a general circulation newspaper or by electronic means or both.

20) Local governments are exempt from bidding when they purchase from State contract vendors per G.S. 143-129 (e) (9).

21) Local governments may use a Requests For Proposals (RFP) process for purchasing information technology per G.S. 143-129.8 as defined in G.S. 147-33.81(2). The standard for awarding the contract is more flexible by allowing contracts to be awarded for "best overall proposal" rather than the previous "lowest responsible bidder". The statute requires that factors to be considered in awarding the contract be identified in the RFP. The RFP proposal also permits negotiation after proposals are submitted.

22) Local governments should assume that computer software contracts are subject to the competitive bidding requirements unless the contracts are for custom software design or development. Before submitting a computer software contract to bidding, however, local governments should examine whether any of the statutory exceptions to bidding apply. G.S.143-135.9(d) allows counties, cities, towns, or subdivisions to acquire information technology using the "Best Value" procurement method. "Best Value" procurement means selecting a contractor based on which proposal offers the best trade-off between price and performance.

23) The *informal* contracting statute, G.S. 143-131, requires that contracts covered by this statute are subject to minority outreach requirements and must be let after informal bids are received. Contracts for construction, repairs, purchase or the lease-purchase of apparatus, supplies, materials, or equipment costing *over $30,000 (formerly $5,000) up to* the formal contract dollar limits all require the use of an *informal* bidding process. An informal bid is one not secured by a bid deposit, but one that a buyer may nevertheless rely upon to compare with other equally reliable indications or quotations in making a purchasing decision. Quotations from vendors may be solicited by telephone, letter, or similar methods. Dividing contracts to evade the informal bidding requirement is prohibited by G.S. 143-133.

24) Purchases of apparatus, supplies, materials, or equipment or contracts for construction or repairs costing *less* than $30,000 may be made *without* soliciting formal *or* informal bids per G.S. 143-131. In addition, G.S. 160A-266 was amended to allow cities to create their own procedures for disposing of personal property valued at less than $30,000, declaring it surplus, setting its fair market value, and conveying title.

25) Reverse Auction is a "real-time purchasing process in which bidders compete to provide goods at the lowest selling price in an open and interactive environment." [G.S. 143-129.9] This auction can be performed either by the unit itself, an outside party, or the State's electronic procurement system. This method requires bidders to compete against each other by causing them to bid several times in a set time period. A bidder's price may be revealed during the procedure. This method can only be used as an alternative to the formal or informal bidding procedure for purchase contracts only and cannot be used for construction or repair contracts. G.S. 143-129.9 also prohibits the Reverse Auction method from being used to purchase construction aggregates such as crushed stone, sand, and gravel.

26) G.S. 143-129.9 allows electronic bidding as an alternative to receipt of paper, sealed bids. This method is only applicable to bids on purchase contracts, not bidding on construction or repair contracts. This is a choice that local governments already had with informal bidding purchasing contracts between $30,000 and $90,000. But because the formal bidding process requires paper bids, the electronic bidding method was established as an alternative for formal bids above $90,000 in August 2002. Procedures that allow electronic bids to have the same security and authenticity as sealed paper bids must be created and in place.

27) All parties involved in the public entity's construction project are to use the dispute resolution processes as provided in G.S. 143-135.26(11), or shall adopt an alternative dispute resolution process, which includes mediation. There are exceptions for prefabricated or relocatable buildings and if the cost is under $300,000.

28) Construction or repair work requires separate specifications prepared for at least the following branches of work: 1) heating, ventilating, air-conditioning; 2) plumbing; 3) electrical; and 4) general work not included in the above-listed three branches. These contracts may be bid under (1) *separate*-prime bidding, (2) *single*-prime bidding, (3) *dual* bidding as allowed by G.S. 143-128(d1), (4) construction management at risk, under G.S. 143-128.1, or (5) alternative contracting methods allowed by state law. See G.S. 143-128(a1) for details and limitations. The unit must use the Department of Administration's "HUBSCO Construction Reporting System to report by April 1 of each year any formal building projects completed. With a few exceptions, it must have a dispute resolution process available, and can use the one adopted by the State Building Commission or create their own with mediation required as permitted by G.S. 143-128 (f1).

29) G.S. 143-64.17 authorizes units of local government, including local school boards, and community colleges to enter into guaranteed energy savings contracts in order to finance energy conservation measures in local public facilities.

30) G.S. 14-234 includes a general prohibition against any public official or employee (or his/her spouse) having a direct benefit interest in any contract in which he/she is involved in making or administering in his/her official capacity. There are many exceptions to this general prohibition depending on the nature of the official or employee, the type of contract or benefit, the type of entity, and the population of that entity.

31) According to G.S. 133-32, it is unlawful for any contractor, subcontractor, or supplier who 1) has a contract with a governmental agency, 2) has performed under such a contract within the past year, or 3) anticipates bidding on such a contract in the future, to make gifts or to give favors to any officer or employee of a governmental agency who is charged with: 1) preparing plans, specifications, or estimates for public contracts, 2) awarding or administering contracts, or 3) inspecting or supervising construction. It is a misdemeanor for these employees to receive gifts or favors. Some exceptions are for honorariums, donations to professional organizations, and customary gifts, but these require a disclosure by the donee to the agency head. Please see memorandum # 1061 (Vendor Gifts) on the State and Local Government website for a discussion of this topic.

32) G.S. 105-164.14(c) authorizes a refund of state sales and use taxes paid by certain local governments and public authorities on direct purchases of tangible personal property and services, except for electricity, piped natural gas, local telecommunications or toll communication services. (Refunds of state sales and use taxes to local school administrative units on tangible goods were repealed effective July 1, 2005.) Local governments should file with the IRS annually to receive a refund on any exempt federal excise tax as on the use of telephone services, fuel, and firearms and related materials.

33) Until recently public schools in North Carolina were required to purchase or exchange all supplies, equipment, and materials under State contracts. S.L. 2003-147 removed this requirement and subjects the local boards of education to the public contract laws in Article 8 of Chapter 143, which are coded into the general statutes beginning at G.S. 143-128, and those following. These purchases may be made with contracts made by the Department of Administration. The State Board of Education shall adopt rules regarding equipment standards for supplies, equipment, and materials related to student transportation.

34) Encumbrances are commitments created by purchase orders or contracts that have been issued, but for which no goods or services have been received. Encumbrances should be recorded as they occur for budgetary control purposes. According to G.S. 159-26(d), “each city or town with a population over 10,000 and each county with a population over 50,000 shall maintain an accounting system that records and shows the encumbrances outstanding against each category of expenditure appropriated in its budget ordinance.”

Introduction

A considerable portion of the expenditures of every government is for purchases of supplies and equipment. The purchasing function is the entire process of applying applicable laws and regulations to secure goods and services, suitable to the needs of the governmental unit and available when needed at the lowest possible cost.

Authority to Make Purchases and Contracts

A local government's power to make purchases and contracts, like other powers, is derived from the Legislature and is subject to such limitations and restrictions as it may impose. The basic grant of power to purchase and contract is found in G.S. 153A-11 for counties and G.S. 160A-11 for municipalities. These statutes vest counties and municipalities with general corporate powers and expressly empower them to enter into contracts as well as to acquire property.

Local boards of education are empowered under G.S. 115C-522(a) to purchase or exchange all supplies, equipment, and materials in accordance with Article 8 of Chapter 143 of the General Statutes. This statute mandates the use of safety standards adopted by the State Board for purchases of commodities that need safety features. Purchases may be made under contracts made by the Department of Administration. However, where competition is available, local school administrative units may utilize the:

1) "E-Quote service of the NC E-Procurement system as one means of solicitation in seeking *informal* bids for purchases subject to the bidding requirements of G.S. 143-131, and
2) The Division of Purchase and Contract's electronic Interactive Purchasing System as one means of advertising *formal* bids on purchases subject to the bidding requirements of G.S. 143-129 and the applicable rules regarding advertising".

According to Session Law 2003-147, Section 10 (b), if during the fiscal year a local board of education is certified as E-Procurement compliant, it must use E-Procurement to expend at least 30% of its remaining unencumbered funds to purchase supplies, equipment, materials, computer software and other tangible personal property. In the first year after certification, the minimum E-Procurement purchase percentage rises to 35% of the above mentioned goods, with a State encouraged goal of 50%. In the second and following years, the mandatory minimum rises to 40%, with a State encouraged goal of 70%.

Authorization for Expenditures

Funds must be properly appropriated or budgeted to meet contractual obligations. The finance officer must determine whether a sufficient balance remains in the budget to pay any invoice when it is received. G.S. 159-28(a) requires a pre-audit certificate signed by the finance officer to appear on the contract, agreement, or purchase order before it becomes an obligation of the governmental unit.

The only exception to the requirement that funds be available is for a continuing contract, authorized by G.S. 153A-13 for counties and G.S. 160A-17 for municipalities. These statutes define continuing contracts as contracts "some portions or all of which are to be performed in ensuing fiscal years." The primary factor in determining when a specific contract is a "continuing contract" is whether it is possible for the other party to the contract to fulfill part or the entire contract in the current year. One type of "continuing contract" would be one that requires fixed monthly amounts of service over a period of months or years. A common example is a rental contract that provides equal payments per month over the life of the contract. In this case, the contract itself specifies the amounts that can become due and payable during the current year.

For continuing contracts, G.S. 159-13(b) (15) requires only that funds be appropriated to meet current year obligations arising under the contract. All "continuing contracts" automatically encumber the appropriations for the new budget year on July 1 of that budget year. The governing board must provide enough money to meet the amount to be paid in ensuing fiscal years for the duration of the contract. The North Carolina Attorney General has rendered an opinion that cities and counties may enter multi-year contracts in amounts that exceed the unencumbered balance of an appropriation in the budget ordinance so long as the payment(s) under the continuing contracts for the current fiscal year do not exceed the unencumbered balance in the budget ordinance (NC AG Opinion - January 10, 1974). If these requirements were met, the finance officer would be able to sign the pre-audit certificate required by G.S. 159-28(a). A sample board resolution for multi-year contracts can be found in Appendix A. Of course, for contracts budgeted in project ordinances, sufficient budgetary authority will typically exist in the project ordinance and a continuing contract resolution may be unnecessary.

An agreement that obligates the governmental unit in the current year for more than the amount appropriated is void and could become a personal liability of the employee who made the agreement. According to G.S. 159-28(e), "if an officer or employee of a local government or public authority incurs an obligation or pays out or causes to be paid out any funds in violation of this section [funds which have not been appropriated], he and the sureties on his official bond are liable for any sums so committed or disbursed. If the finance officer or any properly designated deputy finance officer gives a false certificate to any contract, agreement, purchase order, check, draft, or other document, he and the sureties on his official bond are liable for any sums illegally committed or disbursed thereby."

Organization

Local government purchasing should be a centralized function. One officer should be responsible for the following:

1) Purchasing for all departments according to regulations established by the General Statutes, the governing board, and the chief executive;

2) Supervising the receipt of all material;

3) Supervising or operating central inventory warehouses;

4) Maintaining a file on price quotations of supplies most frequently purchased by the unit; and,

5) Maintaining other supplemental data to assist in making purchases at the most economical prices possible.

By centralizing the purchasing function, more complete accounting control can be obtained and accurate financial reports can be prepared readily. Lower costs should be incurred through buying in larger quantities when the needs of various departments are consolidated. Centralized purchasing allows for standardization of items in common use, which permits consolidation of needs and larger-quantity buying. Economic order quantities can be used to minimize storage costs and to avoid tying up funds in inventories. Centralized purchasing also allows for improved specifications, increased competition, and more opportunities to take advantage of cash discounts. Vendors are allowed to deliver material for the account of the governmental unit only on the basis of an official purchase order issued through approved channels. The purchasing officer should consult the unit's attorney concerning all contracts involving purchasing.

The Purchasing Process

The purchasing process is designed to provide a proper system of internal control over purchasing, to ensure that the proper authorizations are obtained before items are purchased, and to ensure that statutory requirements for purchasing are followed. A number of forms are generated as part of the purchasing process to document the validity of the purchases. This process and the documents that are most commonly used are described in this section. Many local governments are automating significant parts of this process, especially those that have instituted the use of procurement cards. Automated systems can reduce the number of purchase orders written; the individual payments processed, and automate or move the data entry tasks to the requesting department.

Requisitions

A requisition should be prepared by the department head or the designated representative for the purchase of commodities and then be forwarded to the purchasing agent. The requisition should show the quantity and type of commodities needed, the purpose for which they are to be used, and the date required. Two copies are prepared; the original goes to the purchasing agent and the duplicate remains in the department that requisitioned the commodity. On receipt of the requisition from the department, the purchasing agent notes the commodities needed. For many local units, electronic documents have, or soon will, replace these recurring order forms. The distribution of the electronic documents should be structured to produce the same internal controls as the paper copies. If the commodities requested are not in the unit's existing inventory, the purchasing agent then solicits bids from various vendors, following informal or formal bidding procedures as necessary.

Purchase-Order System

The basic document in the purchasing system is the purchase order. A purchase order is a contract which should be issued for all materials or supplies purchased by the unit. The pre-audit certificate is usually preprinted on the purchase order. The finance officer may not certify any purchase order unless sufficient unencumbered funds are available to pay the obligation when it is due. No invoice may be honored for commodities unless it is supported by a properly signed purchase order. The purchase order should be pre-numbered for control purposes and should include complete specifications or reference to specifications, as well as shipping and invoicing instructions. Copies of the approved purchase orders should be transmitted to and filed by various organizations in the governmental unit for future use/reference. At a minimum four copies of the purchase order should be generated, either as paper copies or electronic documents. One copy would go to the vendor, one to the purchasing agent, one to the ordering department, and one remains with the finance office. Even though a city or town with a population of 10,000 or less, or county with a population of 50,000 or less are exempt from maintaining encumbrances in their accounting systems under G.S.159-26(d), it is recommended that they be used since it is such an important element of the internal control structure.

Open-Ended Purchase Orders

Open-ended purchase orders may be used for many repetitive, usually low dollar value, purchases from one vendor. Rather than issuing a purchase order for *each* purchase, one purchase order with a *total dollar limit* is issued for a specified period. This system generally works best at amounts below the local minimum bid threshold. Above this level, the informal bidding requirements may apply, which are required as per G.S. 143-131 for contracts above $30,000 up to the formal limits. Although not requiring a purchase order for each item does reduce internal control; the costs of the additional controls would often outweigh the benefits. For open-ended purchase orders, the purchasing agent should provide to the appropriate department heads a list of vendors and items to be purchased from those

vendors, along with a purchase order number for the current period, e.g. one month, and the total amount encumbered. To maintain adequate controls, purchase transactions over a specified maximum amount should be allowed only after contacting the purchasing agent. This transaction maximum would vary depending on the type of items and prior purchasing history. The total maximum dollar-limit amount of the authorizing purchase order will still be encumbered to insure compliance with G.S. 159-28(a). One problem with open-ended purchase orders is that the vendor ultimately determines when the government can charge purchases to the order. Procurement cards can eliminate this problem.

Procurement Cards

Procurement cards (also known as purchasing cards) enable a unit to make small purchases more quickly and efficiently by minimizing paperwork and processing time. Similar to VISA and MasterCard formats, procurement cards can be processed by vendors just like personal charge cards. Rather than making multiple small payments to many vendors, the organization writes one check to the card issuer. Vendors receive payment within a few days of the transaction without extra paperwork. Posting information and transaction detail can be entered by the cardholder when monthly statements are reviewed prior to payment, thereby significantly reducing data entry tasks in accounts payable. Sales tax for refund purposes can be coded at this point. Inventories can be reduced or eliminated, since items are now purchased when needed. As with any type of purchasing procedure, adequate controls must be established to ensure that public funds are expended properly. These include built-in transactional limits for any one card, cardholder education, pre-audit certification, and supervisory review procedures.

Purchases can be limited by amount per transaction, total per time period, number of purchases per time period, Merchant Category Codes, etc. Each card can be encoded with specific controls unique to the cardholder's job responsibilities. These controls also can be enacted on individual, divisional, or departmental lines.

Cardholder education includes informing card users of all procedures, regulations, and the consequences of improper use. It is strongly recommended that cardholders sign acknowledgements that they have read and understand these rules prior to receipt of a card. Cardholders and the cardholder's supervisor should be trained to verify and code monthly statements, in order to facilitate uploading of information into the accounting system. Informal feedback from across the State suggests that very often, the local government units with the most successful procurement card programs are the local units with the strictest, most consistently enforced policies regarding the use of the procurement cards.

The purchases made via procurement cards are subject to the pre-audit certification requirements of G.S.159-28(a). Open purchase orders can be prepared to cover estimated procurement card expenditures over a specific period of time. Typically, a set amount will be encumbered to cover purchases through procurement cards during the period.

After cardholders have verified and coded their monthly statements, supervisors should review the transactions and attached receipts. After departmental approval, procurement card details can be uploaded into the accounting system and the payment can be processed. Transaction data can be analyzed to determine trends and exceptions, and used for expenditure and budgeting projections.

Records

The *purchasing* records should show materials/services that have been ordered but not received or paid for (open purchase orders). They also should furnish supporting information for the payment of claims. Purchasing records are valuable planning tools for future purchases because they show prices, quantities, and vendor performance on previous orders. Also, they aid in budgeting because they contain the quantities, types and the costs of each kind of purchase required during the preceding year. This information is likely to be needed to fulfill the annual detailed reporting requirements each April 1 on formal building contracts completed to the Secretary of the Department of Administration's HUBSCO Construction Reporting System.

The *accounting* records, in turn, should show amounts encumbered and amounts expended, by accounting period, for the purchased items. The use of encumbrances is required under G.S.159-26(d) with some exceptions for smaller units (municipalities with a population of 10,000 or less, counties with a population of 50,000 or less). All units are encouraged to use encumbrances and purchase orders as part of their internal control system. Sometimes a common database is used for both the purchasing and accounting records, particularly in automated systems. In automated systems, the purchasing records are integrated with the general ledger accounting system.

Receiving

The receipt of all goods and services by the governmental unit should be reported to the purchasing officer and the finance officer for processing. The receiving report, receiving copy of the purchase order, the delivery ticket, or some other written verification, should be sent to the finance officer. Copies of the receiving report should be sent to the purchasing officer and the requisitioning department. For construction projects, the engineer overseeing the project will issue a report certifying that construction has been completed and approved. The purchasing department should ensure that sufficient data is provided to ascertain the date, quantity, description, and condition of items received.

Local governments should not approve interim billings without monitoring the progress of construction projects. Also, with regards to services, local governments should verify that the services are being performed *before* approving interim invoices.

Payment of Vendors' Invoices

The purchasing department should timely provide to the accounting department documents and data needed to consider/approve vendors' invoices. These documents/data include a copy of the purchase order with expected unit prices, receiving data (if not provided directly from the receiving department), returns/allowances data, and notification of any exceptions/discrepancies between goods ordered and those received.

Information Returns

Local governments must file an IRS information return Form 1099-MISC for each calendar year for any payments of at least $600 or more for rents or services made to each person or unincorporated entity. All fees paid to others must be reported on IRS Form 1099 regardless of the amount.

The Local Government Commission encourages local governments to take great care in following the reporting requirements for Form 1099. There is a penalty of $50 per occurrence for failing to issue a 1099 to the IRS and a penalty of $50 per occurrence for failing to supply a 1099 to a taxpayer. The staff of the LGC recommends that units set a policy to not approve vendor invoices for payment *until* they have received a tax identification number from the vendor. Local governments may use *IRS Form W-9, Request for Taxpayer Identification Number and Certification*, as a collection tool for the necessary information. More information is available on the IRS web site, www.IRS.gov

(Note: This office has had discussions with IRS officials concerning filing of IRS Form 1099 by local governments. Studies have indicated that many units of government are not filing these forms correctly and as a result, federal and state income taxes are being underreported and underpaid. *The penalties for the failure to file the forms are significant.* BE CAREFUL!) For more information on 1099 reporting, see the Payroll Section of the Policies Manual, the link above to the IRS web site, or consult your payroll advisor or independent auditor.

Escheat and Unclaimed Property Requirements

In the course of purchasing and contracting, local governments most likely will be required to file reports of unclaimed property with the Unclaimed Property Program of the North Carolina Department of State Treasurer. Property held in the ordinary course of a local government's business, including accounts payable and other obligations of any type, is presumed abandoned if it has not been claimed as early as one (1) year after becoming payable or distributable. Any unit holding property (the Escheats and Unclaimed Property Division lists twenty-seven types) with a value of fifty ($50) dollars or more in a single reporting year must do "due diligence" by sending a letter to the unclaimed property owner's last known address, and then report on Form ASD-21 the property *individually* by the owner's name. If the individual item/property has a value of under $50, then the unit can omit "due diligence", and does not have to list each individual item. It would need to group

the items on the same line, and call it "*aggregate*" without listing the owner's names. *[NOTE: Escheat and Unclaimed Property Reports are required to be filed each year regardless of the dollar amounts. If absolutely no dollar amount of property of any type is reported in a given year, then the unit still needs to file a report indicating there is no reportable property.*]

Local governments should determine all owners of property who, as of the preceding June 30th, appear entitled to property with a value of fifty dollars or more per holder. Prior to August 15th of each year, local governments holding reportable property should mail by first class postage to the rightful owners at their last known address, a notice that such property is being held.

Prior to November 1st of that year (after the notices to owners have been mailed in August), each local government should file a Report of Unclaimed Property with the North Carolina Department of State Treasurer, Escheat and Unclaimed Property Section, 325 North Salisbury Street, Raleigh, North Carolina 27603-1385. This report should list all property which is presumed abandoned which has not been claimed by the owner since the August notices were mailed. A remittance should be made for the amount of unclaimed property. Reporting forms and many types of other related information and over thirty statutes references can be downloaded from the "Unclaimed Property Program" section of the State Treasurer's web site, www.nctreasurer.com.

The rules and procedures relating to unclaimed property can be complex. This is a summary of the issues local governments will most likely face. The Unclaimed Property Program link on the State Treasurer's web site offers much more information, as well as contact information for those units with questions.

Electronic Commerce and Decentralization of the Purchasing Function

The Electronic Commerce Act, Article 11A of Chapter 66, beginning at G.S.66-58.1, facilitates electronic commerce by allowing local governments and other public agencies to accept electronic signatures to enact transactions between a person and a public agency or between public agencies. Transactions included, but not limited by statute, are contracts, filings, and legally operative documents. Electronic signatures are any identifier or authentication technique attached to or associated with an electronic record which is intended by the party using it to have the same force and effect as the party's manual signature. Transactions that require signatures attested to by a notary public cannot be executed electronically. Electronic signatures can be verified by certification authorities licensed by the Department of the Secretary of State. Additional information may be obtained from the Secretary of State's web site, http://www.secstate.state.nc.us/.

In addition to executing transactions and disbursing funds electronically, local governments are also allowed, by statute (G.S. 159-32.1) to accept electronic payment in lieu of cash or check, for any tax, assessment, rate, fee, charge, rent, interest, penalty, or other receivable

owed to it. Units of local government and public authorities are permitted to impose a fee or surcharge on amounts paid electronically. While legal, such a surcharge may void the operating agreement with the credit card companies. Informal feedback from across the State suggests that most local units do not impose a surcharge for fees, rents, or other charges. Third party processing agents may be used to electronically accept larger dollar property tax payments. See the Property Tax Section of the Policies Manual for more information.

Several units of government in North Carolina are using various forms of electronic commerce for purchasing on a more de-centralized basis. This includes employee-use of procurement cards for small-dollar items thereby reducing purchase order volume. Many units find that a significant *number* of their purchase transactions make up a relatively small part of their total *dollar* expenditures. Electronic purchase order systems are also in use eliminating manually generated purchase orders. Some vendor contracts or accounts, for example office supplies, permit Internet ordering by each department. Units may also use the Internet or the State's E-Procurement service to publicize requests for bids and accept bids on-line. Electronic purchase transactions are still subject to the pre-audit certification requirements of G.S.159-28(a). Open purchase orders can be prepared to cover estimated expenditures over a specific period of time.

Statutory Requirements and Guidance in Purchasing and Contracting

Bidders' Lists

Establishing and maintaining a current list of qualified bidders is a fundamental part of the purchasing function. Sources of supplies must be identified before bids can be solicited. The bidders' list provides a systematic means of reaching the most qualified vendors. Furthermore, such a list, properly managed and impartially used, enhances competition by providing qualified and interested suppliers an equal opportunity to compete for the governmental unit's business.

The purchasing officer should develop and maintain a list of interested, potential bidders for various types of goods to be bought. Prospective bidders can be pre-qualified. This enhances the efficiency and effectiveness of the use of the bidders' list. Inclusion on the qualified bidders' list should be based on predetermined, objective criteria and standards. Procedures for pre-qualifying, information requirements, evaluative criteria, specific governmental unit requirements and standards, and forms used should be made available to all suppliers. Vendor histories also should be maintained in order to help the unit analyze past performance of each vendor. The bidders' list must be properly organized and maintained. This includes systematic updating to reflect accurately the status of competition. The use of a commodity coding system that lists item classification groupings and, as necessary, product functions should be considered. This list can then be cross-referenced to the bidders' list and arranged alphabetically by name.

Formal Bidding and Exceptions

The following discussion relates to the State's purchasing laws. At a minimum, these laws must be observed; however, governing boards of local units are free to adopt more restrictive policies if they so desire. For the purchase of apparatus, supplies, materials or equipment, the governing board also is given authority under G.S.143-129(a) to delegate to *any* employee the authority to: (1) award contracts, (2) reject bids, and (3) re-advertise to receive bids. The delegation can be restricted by dollar amount or by other appropriate conditions. “Notices of the waiver of bidding for previously bid contracts may be published in a newspaper or provided by electronic means or both”. In addition, G.S. 149-129.7 authorizes the local governments to include in the contract specifications for the purchase of apparatus, supplies, materials, or equipment an opportunity for bidders to purchase as "trade-in" specified personal property owned by the unit.

While formal contracts are not defined in the statutes, this name is usually applied to contracts subject to G.S. 143-129, that is, to those contracts for which a request for bids must be advertised, sealed bids must be received, and the contract must be awarded as prescribed by law.

Effective January 1, 2002 contracts for construction or repairs with an estimated cost of $300,000 or more and contracts for the purchase or lease-purchase of apparatus, supplies, materials, or equipment with an estimated cost of $90,000 or more require the use of formal bidding and contracting procedures. Dividing contracts to evade these requirements is prohibited by G.S. 143-133. ***Exceptions*** under G.S. 143-129(e), include:

1) An emergency involving the health and safety of the people or their property. The governing board may let contracts as necessary and at their discretion. Governing boards should consider defining in writing the basis for claiming an emergency.

2) Purchases of apparatus, supplies, materials, or equipment from: a) any other governmental unit or agency (G.S. 143-129(e) (1)), or b) from any source if they are used, not including if they are remanufactured, refabricated, or demo items (G.S. 143-129(e) (10)), or c) when performance or price competition for a product is not available and: (1) it’s available from only one source of supply, and (2) “standardization or compatibility is the overriding consideration”. In this latter case of “c)” above, the governing board must approve the purchases prior to the award of the contract. Public hospitals have an additional six exceptions for case “c)” above per G.S. 143-129(e) (6)

3) Purchase of gasoline, diesel fuel, alcohol fuel, motor oil, fuel oil, or natural gas. Such purchases are subject to informal bidding procedures in G.S. 143-131.,

4) Contracts for the design and construction of certain complex solid waste disposal facilities (G.S. 143-129.2), however, specific request-for-proposal (RFP) procedures are required,

5) "Purchases made through a competitive bidding group purchasing program, which is a formally organized program that offers competitively obtained purchasing services at discount prices to two or more public agencies" [G.S. 143-129(e) (3)]. This exception previously applied to hospitals only. The needs of the participating agencies should be identified, competition sought, and contracts awarded from which the participating entities may purchase.

6) Construction or repair work may be done by qualified permanent local government employees with its own forces and undertaken without adhering to the competitive bidding procedure depending on dollar amounts. The exception applies when the total direct and indirect cost of the project does not exceed $125,000 or, if the total project cost does exceed $125,000, that the total cost of labor on the project does not exceed $50,000 (G.S. 143-135). It is still subject to having complete and accurate records of all costs kept for inspection by the general public and approval by the responsible board or commission. Conversely, the local government may not undertake projects that will have a total cost of more than $125,000 or labor costs in excess of $50,000 with its own employees, nor may it divide projects to bring itself within the statutory limitation and avoid competitive bidding. (A few local governments, by special acts enacted by the General Assembly, may have different limits or requirements.) Per (G.S 143-129(d)) local governments may use unemployment relief labor paid for in part by state or federal funds for construction or repair work without complying with the bidding requirements. No dollar limit is specified.

7) Guaranteed energy savings contracts as they are governed by Article 3B of Chapter 143 of the General Statutes (G.S. 143-64.10 to 17).

8) Contracts by a public entity with a "construction manager at risk" executed in accordance with G.S. 143-128.1.

9) Contracts established by the State or any agency of the State [G.S. 143-129(e)(9)].

10) Contracts established by the State Office of Information Technology. When purchasing via the "piggyback option", the unit should make sure that the available product will meet the unit's needs and that the choice is not solely influenced by cost.

The "piggybacking" exception [G.S.143-129(g)] authorizes local governments to waive the formal bid process and contract for the purchase of apparatus, supplies, materials, or equipment from any person or entity that has, within the previous 12 months completed a public, formal bid process and contracted to furnish the apparatus, supplies, materials, or

equipment to: a) The United States of America or any federal agency, b) The State of North Carolina or any agency or political subdivision of the State; or c) any other state or any agency or political subdivision of that state, if the person or entity is willing to furnish the items at the same or more favorable prices, terms and conditions as those provided under the contract with the other unit or agency. The use of this exception must be approved by the governing board "no fewer than ten days after publication of a notice that a waiver of the bid procedure will be considered" and published in a general circulation newspaper or electronic means or both. The board must approve if notice is published solely by electronic means.

Local governments may use a Requests For Proposals (RFP) process for purchasing information technology per G.S. 143-129.8 as defined in G.S. 147-33.81(2). The standard for awarding the contract is more flexible by allowing contracts to be awarded for "best overall proposal" rather than the previous "lowest responsible bidder". The statute requires that notice of the RFP be given in accordance with G.S. 143-135.9, and that the factors to be considered in awarding the contract be identified in the RFP. The new RFP proposal also permits negotiation after proposals are submitted; in order allow the best proposal to conform to the needs of the local government. Such negotiations may not alter the contract beyond the scope of the original proposal such that it undermines the competitive process. Proposals submitted under section G.S. 143-129.8 are not subject to public inspection until a contract is awarded.

The purchasing statute covers contracts for purchase of apparatus, supplies, materials, or equipment and construction or repair work. Professional services, such as those of auditors or attorneys, clearly do not fall within the statute, nor do purchases of real property. Contracts for other services, such as insurance, banking, newspaper advertising, or tax mapping also are outside the statute; although, good business practice might suggest that a local government follow the same procedure in letting these contracts as in letting ordinary construction or repair contracts. Even if State law does not require the use of formal purchasing procedures, federal or State grant and administrative regulations may require that certain procurement procedures be followed if grant funds are used to acquire an item. Even if not required by law, if formal RFPs are used for service contracts, then the unit is bound by the conditions of the RFP. Current bidding law does not allow the local government to make any significant modification to a proposal *after* its submission and *before* the award of a contract. The typical RFP process, however, contains elements that are not permitted under the formal-bidding statutes. Specifically, parties might wish to negotiate and modify the original proposals to more completely meet the needs of the unit. Under the sealed bid process, modifications to bids or deviations from specifications could be challenged as unfair to other competitors.

Local governments should assume that computer software contracts are subject to the competitive bidding requirements unless the contracts are for custom software design or development. Before submitting a computer software contract to bidding, however, local governments should examine whether any of the statutory exceptions to bidding apply. G.S.143-135.9(d) allows counties, cities, towns, or subdivisions to acquire information

technology using the "Best Value" procurement method. "Best Value" procurement means selecting a contractor based on which proposal offers the best trade-off between price and performance. Per G.S. 143-135.9(a)(1), "The award decision is made based on multiple factors, including: total cost of ownership, meaning the cost of acquiring, operating, maintaining, and supporting a product or service over its projected lifetime; the evaluated technical merit of the vendor's proposal; the vendor's past performance; and the evaluated probability of performing the requirements stated in the solicitation on time, with high quality, and in a manner that accomplishes the stated business objectives and maintains industry standards compliance." G.S. 143-129.8 does provide some flexibility in the bidding and purchasing process for information technology goods and services. Under this statute, some negotiation on the contract specifications is allowed with the best responding provider. Any negotiations on the changes to the original specifications may not deprive the person proposing or those who might propose a fair chance to compete for the contract. Any changes made to the contract specifications cannot create a situation where another vendor would have been awarded the contract if the changes had been in place originally.

Formal Bid Requirements

1) Bids on work subject to the formal contracting procedure must be invited by newspaper advertisement in a paper that has general circulation in the local government area and/or via electronic advertisement. Advertising for bids may be by electronic means only; however, the governing board must approve the use of electronic advertising, instead of a published notice, in a regularly scheduled meeting. The board may authorize the use of electronic advertisement for all contracts or for particular contracts on a case-by-case basis. [G.S. 143-129(b)]

    a) The advertisement must be published at a time where at least seven (7) full days shall lapse between the date on which the notice appears and the date the bids are opened.

    b) G.S. 143-129(b) stipulates that the advertisement must indicate the time and place where plans and specifications may be obtained, specify the time and place for opening of the proposals, and reserve to the governing body the right to reject any or all proposals.

    c) For construction contracts, the engineer or architect may need to advise prospective bidders that they must be properly licensed (G.S. 87-15).

2) Each formal bid proposal (for construction or repair contracts only) must be accompanied at the time of its filing by a bid deposit equal to not less than five percent (5%) of the bid consistent with Article 3 of Chapter 44A. Acceptable forms of this deposit are limited to: cash, cashier's check, certified check, or bid bond from a North Carolina licensed surety. The deposit is retained if the bidder is awarded the contract and fails to execute the contract and to give satisfactory performance and

payment bonds (where required by statute or the local government) within ten days after the award per G.S. 143-129(b) and (c).

3) Bids must be opened in public and approved by the governing board; the winning bid must be recorded. This provision does not require that they be opened and read before the Board. They may be opened in public by an officer of the local government, tabulated, evaluated, and brought before the Board for action and a summary of them recorded in the Board's minutes. Bids that materially differ in content from the published advertisement or the governmental unit's request for proposal must be rejected.

4) The purchasing statutes do not require that the lowest bid always be taken. Quality, timing, and past performance of the responding bidders also should be carefully considered in determining who the lowest *responsible* (emphasis added) bidder is. As used in this sense, the responsibility of bidders refers to their experience, the training and quality of their personnel, their financial strength, additional work that they are under contract to finish, and other factors that might reasonably bear on their ability to perform as proposed. Also, G.S.143-135.5 encourages but does not mandate the use of historically underutilized business contractors (HUB). Although some units may desire to define local or minority bidders as being more responsible than others, there is no statutory requirement for this.

5) G.S. 143-132 requires that, for construction and repair contracts for which the estimated cost is $300,000 or more, at least three competitive bids must be received after the initial advertisement in order for the local government to award a contract. If several contracts are involved under the separate specifications rules, this requirement is applied separately to *each* contract. For contracts bid in the alternative between the separate prime and single-prime contract, a bid submitted by a single-prime contractor shall constitute a competitive bid in each of the four subdivisions of work. Each full set of separate-prime bids counts as a single bid. If at least three single-prime bids are received, but there is not at least one full set of separate prime bids, then the separate-prime bids are not opened. If the initial advertisement results in less than three bids, the local government must re-advertise a second time. After the second advertisement, it may award a contract to the lowest responsible bidder even if only one bid is received.

If no bids are received after the second advertisement, and subsequently a firm says that it will do the work, the Board can negotiate directly with this firm. The Board can request that the firm document their interest with a formal bid for the work. The Board should pass a resolution stating that whereas a contract was advertised on _____ date, and no bids were received, and the contract was re-advertised on _____ date and no bids were received, the Board agrees to negotiate with _____ firm. As a practical matter, this is likely to be a rare event. Should this occur, the Board

should seriously consider seeking their local attorney's legal opinion on the particular circumstances, the bidding process, and negotiations to date.

Note that the three bid rule outlined in G.S. 143-132 applies to construction and repair contracts, not negotiated contracts as provided for in G.S. 143-129, nor for the purchase of apparatus, supplies, materials, or equipment. However, G.S. 143-128 provides additional requirements for building contracts, which is covered in #7 below.

There is no statutory requirement about a minimum number of bids after an initial advertisement for purchase contracts, although some local governments have adopted a policy of this type.

6) If the lowest responsible bid(s) is greater than the amount of funds available for the project, the governing board is authorized per G.S. 143-129 to negotiate with the lowest responsible bidder, and to make reasonable changes in the plans and specifications as may be necessary to bring the contract price within budget. The Board may award a contract to such bidder if they will agree to perform the work at the re-negotiated price and if it is within the limit of funds available. If negotiations following reasonable changes fail to bring the contract price within the limits of available funds, negotiations with the next lowest bidder are *not* allowed as an option. The governing board should alter the plans and specifications and re-advertise for bids on the revised project.

7) All formal construction and repair contracts involving more than $300,000 must be executed in writing, and are not acceptable until the contractor posts a performance bond and a payment bond for 100 percent of the contract as per G.S. 143-129(b) and Article 3 of Chapter 44A. The performance bond ensures that the contract will be completed under its terms and protects the local government. If the contractor defaults, the surety is responsible for seeing that the work is completed. The payment bond guarantees that payment is made for all labor and materials furnished or used under the public construction or repair contract. The bond is necessary to give workers and suppliers on the project protection equal to what they would have automatically with laborers' and material men's liens in private construction.

Formal purchase contracts must be in writing. Performance and payment bonds are not required for contracts involving the purchase of apparatus, supplies, materials, or equipment. Units may decide to require them. There have been instances where vendors have defaulted after accepting advance payments from a unit.

Instead of posting a bond, contractors may deposit with the local government, cash, a certified check, or government securities equal to the contract price. (It is unclear whether two separate deposits are needed if both a performance bond and a payment bond are involved.) If contractors use some form of deposit, the local government will then have funds available to complete the work if the contractors default, or to pay for labor and

supplies if the contractors have not done so. The local government must act as a surety for any deposits received as per G.S. 143-129(c). The statutes set forth detailed procedures for making claims against bonds and for making payments by the local government from deposits. Capital Project Fund accounting can be used to record bond deposits and retainages payable.

Bidders who find that they have made an unintentional "substantial" clerical (not judgment) error in their bids may ask that their bid be withdrawn and the bid security returned. The request, along with any objective evidence, must be made before the contract is awarded and within 72 hours after the bids are opened or a longer period may be allowed as long as the longer period is specified in the instructions provided to bidders prior to the opening of bids. The governing board should promptly hold a hearing on the request and may grant it if a clear, unintentional error is found. Withdrawal of a bid without forfeiture is allowed for unintentional clerical, substantial arithmetic, or "unintentional omission of a substantial quantity of work, labor, apparatus, supplies, materials, equipment, or service" errors. Otherwise, the bid security is forfeited, especially if it was a determined to be a judgment error. The bidder who makes the request cannot receive the contract, even on re-advertisement (G.S. 143-129.1). Prebid conferences and requests for information by potential bidders can be used to help clarify the project specifications and requirements in an effort to reduce bid withdrawals.

Once a construction or repair contract has been let in the proper manner, the contract may be modified in writing by a change order or by a provision for additional work without additional advertisement or bidding so long as the change or additional work is within the scope of the original construction or repair project.

Informal Bidding

The informal contracting statute, G.S. 143-131, requires that contracts covered by the statute be let after informal bids are received. Contracts for construction or repairs costing from $30,000 (formerly $5,000) to $300,000 and purchases or the lease-purchase of apparatus, supplies, materials, or equipment costing from $30,000 (formerly $5,000) to $90,000 require the use of an informal bidding process. Informal bidding procedures also may be followed on purchases of gasoline, diesel fuel, alcohol fuel, motor oil, fuel oil, or natural gas regardless of the size of the purchase. An informal bid is one not secured by a bid deposit, but one that a buyer may nevertheless rely upon to compare with other equally reliable indications or quotations in making a purchasing decision. Quotations from vendors may be solicited by telephone, letter, or similar methods. Dividing contracts to evade the informal bidding requirement is prohibited by G.S. 143-133.

For amounts below $30,000 units are free to adopt an informal bidding policy if they so desire, but it is recommended that they agree to adopt a consistent policy no matter which policy they choose. In addition, G.S. 160A-266 was amended effective July 21, 2005 to provide cities with the authority to use informal procedures to declare property surplus,

determine its fair market value, and convey title. It also allows them to choose to raise the dollar threshold to $30,000 before it will require a public advertisement and board action. It provides five methods to dispose of real or personal property of: 1) Private negotiation and sale, 2) advertisement for sealed bids, 3) negotiated offer, advertisement, and upset bid, 4) public auction, and 5) exchange. The private negotiation and sale method may generally only be used, with some exceptions, for personal property valued at less than $30,000. The other four methods may be used for personal property valued at over $30,000 or for any real property, with exchanges subject to G.S. 160A-271, and the sale of land to volunteer fire departments and rescue squads subject to the procedures in G.S. 160A-277 for, and the sale of property to entities carrying out a public purpose subject to procedures in G.S. 160A-279.

As with contracts in the formal bid range, local governments are free to make purchases within the informal range from other governmental units or agencies without receiving informal bids.

The standards for awarding informal contracts are the same as those for awarding formal ones. The statute directs that such contracts shall be awarded to the lowest responsible bidder, considering quality, performance, and the time specified in the bids for the performance of the contract. Since no advertisement is required for informal bids, they are likely to be received only from those vendors who are asked to quote. The purchasing official thus has an opportunity to limit solicitations to those bidders thought to be responsible. The considerations in making awards to the low bidder are the same for informal contracts as for formal contracts. Most local governments find it advisable to award to the low bidder unless clear and decisive factors of quality, performance, or delivery justify an award to another bidder.

The statute does not require that informal bids appear in the Board's minutes, but does direct that a record of all such bids be kept and be subject to public inspection after the contract has been awarded. In addition, for building or repair contracts at or above $30,000, the unit should “maintain a record of all contractors solicited and shall document efforts to recruit minority business participation on each contract” as per G.S. 143-131. This information is also to be reported to the Department of Administration by using the “HUBSCO Construction Reporting System” , as per G.S. 143-128(a2) upon completion of the project by April 1 of each year and the reporting format is located on their website at http://www.doa.state.nc.us/hub.

The officer who receives the bids should record the date each is received, from whom it is received, and for what item. Special care also should be taken to indicate why an award was made if it went to someone other than the low bidder. In fact, the entire process (obtaining quotes, research on past performance, analyzing bids, etc.) should be carefully documented in case questions are raised in the future. This will help protect the unit from adverse legal actions.

Reverse Auction

Reverse Auction is a "real-time purchasing process in which bidders compete to provide goods at the lowest selling price in an open and interactive environment." [G.S. 143-129.9] This auction can be performed either by the unit itself, an outside party, or the State's electronic procurement system. This method requires bidders to compete against each other by causing them to bid several times in a set time period. A bidder's price may be revealed during the procedure. This method can only be used as an alternative to the formal or informal bidding procedure for purchase contracts only and cannot be used for construction or repair contracts. G.S. 143-129.9 also prohibits the Reverse Auction method from being used to purchase construction aggregates such as crushed stone, sand, and gravel.

Electronic Bidding

G.S. 143-129.9 allows electronic bidding as an alternative to receipt of paper, sealed bids. This method is only applicable to purchase contracts, not bidding on construction or repair contracts. This is an option that local governments already had with informal bidding purchasing contracts between $30,000 and $90,000. But because the formal bidding process requires paper bids, the electronic bidding method was established as an alternative for formal bids above $90,000 in August 2002. Procedures that allow electronic bids to have the same security and authenticity as sealed paper bids must be created and in place. Effective on July 21, 2005 two statutes were amended to allow the use of electronic advertisements instead of published notices: 1) G.S. 143-129(g) the "piggyback exception", and 2) G.S. 160A-270(c) for public auctions. While the notice of the auction details must be published in a newspaper, the auction itself can be electronic if the governing board approves and it meets all the other requirements in this statute.

Low Value Purchases

Purchases of goods or building or repair contracts costing less than $30,000 (formerly $5,000 prior to July 27, 2005) may be made without soliciting formal or informal bids. Purchase orders should be issued and the pre-audit certification must be signed by the finance officer. Local governments should consider creating and formally adopting a policy of using informal bidding procedures for all purchases that do not require formal bidding, as they no longer need to award contracts to the "lowest responsible bidder" but can establish local preferences and can decide if it will apply minority outreach to contracts below $30,000.

Local governments are free to use formal bidding procedures below the statutory thresholds. The governing board may adopt these procedures to strengthen internal control, especially in small units. In other words, formal bidding procedures could be used for a purchase that legally requires only informal bidding procedures. Usually, it is to the local government's advantage to receive many bids on purchases since this will usually result in a lower price. The bidding process should be carefully documented to protect the unit from legal action if questions are raised about the procedures followed. If more restrictive limits are put in place

by the governing board, a resolution should be adopted that establishes those limits. The savings from obtaining more competitive prices must be evaluated in light of the additional administrative costs involved.

Building Contract Specifications

For projects for the erection, construction, alteration, or repair of a building that require the estimated expenditure of $300,000 or more, separate specifications must be prepared for *each* of the following four subdivisions of work to be performed [G.S. 143-128(a)]:

1. "Heating, ventilating, air conditioning and accessories (separately or combined into one conductive system) and/or refrigeration for cold storage (where the cold storage cooling load is 15 tons or more of refrigeration), and all related work."

2. "Plumbing and gas fittings and accessories, and all related work."

3. "Electrical wiring and installations, and all related work."

4. Any general work not already included in the other three subdivisions above relating to the erection, construction, alteration or repair of any building.

Officials are permitted to prepare specifications for additional categories of work, if necessary. Specifications must be prepared so as to permit separate and independent bidding upon each of the four subdivisions of work above. Local governments are permitted under G.S. 143-135.8 to pre-qualify bidders for any public construction project. All parties involved in the public entity's construction project are to "use the dispute resolution processes as provided in G.S. 143-135.26(11), or shall adopt another dispute resolution process, which shall include mediation, to be used as an alternative". More information follows under "Dispute Resolution" later on in this manual.

Construction Methods

G.S. 143-128 (a) (1) lists five methods that a unit can use for contracts to erect, construct, alter, or repair buildings estimated to cost $300,000 or more. Following is a general discussion of each of the five methods:

A. Separate-Prime Bidding

When a unit uses the separate-prime bidding system, it takes *separate* bids for each of the four subdivisions listed above. However, when any one of the four subdivisions is less than twenty-five thousand dollars ($25,000), an exception is made and it can include the contract for this work with that for another subdivision. The contracts will be awarded separately for each subdivision to "the lowest responsible, responsive bidders, taking into consideration quality, performance, the time specified in the bids for performance of the contract, and compliance with G.S. 143-128.2. Bids may be accepted from and awards made to separate contractors for other categories of work." Since the winners of the bid are directly liable to the unit as well as to all the other separate contractors, the contract specifications must "specifically set forth the duties and obligations of each separate contractor."

B. Single-Prime Bidding

Single-prime bidding is a method by which a unit accepts bids that contain one contract for *all* subdivisions of work together. The bid to the local unit usually comes from a general contactor who has arranged for other subcontractors to do the work. The general contractor must identify on the bids each subcontractor they have selected for each of the four subdivisions of work. The contract is to "be awarded to the lowest, responsible, responsive bidder, taking into consideration the quality, performance, the time specified in the bids for performance of the contract, and compliance with G.S. 143-128.2" Each contract between the general and subcontractor must incorporate by reference the terms, conditions, and requirements of the contract between them and the unit. The general contractor cannot replace any subcontractors listed in the original bid unless:

I. the general contractor later determines the listed subcontractors bid is "nonresponsible, or nonresponsive, or the listed subcontractor refuses to enter into a contract for the complete performance of the bid work", or

II. the contractor has the approval of the local government unit, after the contractor has shown good cause for the change.

C. Dual Bidding

The dual bidding method is one in which a unit uses *both* the separate-prime *and* single-prime bids systems for the erection, construction, alteration, or repair of a building. This system requires a staggered collection of bids, with the separate-prime bids due, but not opened, one-hour before the single-prime bids. Both sets of bids are opened at the time that single-prime bids are due. The unit then has the ability to select the lowest responsible bid from either of the sets. A subcontractor cannot legally submit a bid to a contractor for the single-prime bid *higher* than the amount they submit to the unit for the separate-prime. The

unit is still responsible for the rules and regulations of the bid type that they choose, as noted previously.

D. Construction Management at Risk

The declaration of public policy concerning architectural, engineering, surveying and construction management at risk is defined in G.S. 143-64.31. According to G.S. 143-128.1, the construction management at risk can be a person, corporation, or entity, providing services which may include preparation and coordination of bid packages, scheduling, cost control, value engineering evaluation, preconstruction services, and construction administration. This entity must be a licensed contractor and must guarantee the cost of the project. The construction manager at risk must advertise as prescribed in G.S. 143-129 and must prequalify the first-tier subcontractors who contract with them and accept their bids. The prequalification standards are set by the unit and construction manager. This makes construction management at risk a form of single-prime contracting, as the unit only has one direct contact. First-tier subcontractors are subcontractors who contract directly with the construction manager at risk. This could include: general contactors, electricians, plumbers, and mechanical workers. A good faith effort must be made by the construction management at risk and the first-tier subcontractors to recruit and select minority businesses for participation in the construction process. Per G.S. 143-128.1(c) "The construction management at risk may perform a portion of the work only if:

- the bidding process produces no responsible responsive bidder for that portion of the work,
- the lowest responsible, responsive bidder will not execute a contract for the bid portion of the work,
- the subcontractor defaults and a prequalified replacement cannot be obtained in a timely manner", and
- the unit approves the construction management at risk's performance of the work.

All bids will be opened publicly by the construction management at risk and will be entered as public records under Chapter 132 of the General Statues. The construction management at risk will then award the contract to the lowest responsible, responsive bidder after considering quality, performance, the time specified in the bids for performance of the contract, the cost of construction oversight, time for completion, compliance with G.S. 143-128.2, and other factors deemed appropriate by the unit and as advertised by the construction management at risk. The unit may require the selection of a different first-tier subcontractor for any portion of the work. The unit must then compensate the construction management at risk for any additional cost incurred because of the change in the selected subcontractor.

If a unit contracts with a construction management at risk they must report the following information to the Department of Administration [G.S. 143-64.31(b)]:

- an explanation of why the construction manager at risk was selected,
- the terms of the contract,
- a list of construction managers at risk considered, but not chosen and the fees they proposed
- the form of bidding used by the construction manager at risk.

E. Alternative Methods

Local governments may petition the State Building Commission to use an alternative method of contracting not authorized under G.S. 143-128 according to G.S. 143-135.26(9). Authorizations granted by the State Building Commission will only apply to a single project, and the unit seeking authorization must demonstrate that "the alternative contracting method is necessary because the project cannot be reasonably completed under the methods authorized under G.S. 143-128 or for such other reasons as the Commission, pursuant to its rules and criteria, deems appropriate and in the public's interest". The Commission cannot waive the competitive bidding requirements found in G.S.143-129.

Dispute Resolution

A dispute resolution process must be available on all construction or repair projects *except* for: 1) the purchase and erection of prefabricated or relocatable buildings or portions thereof, except the work which must be performed at the construction site and 2) the erection, construction, alteration, or repair of a building when the costs is $300,000 or less. The unit may use the dispute resolution process that has been adopted by the State Building Commission, however G.S. 143-128(f1) allows them to create their own. If the unit creates their own process, mediation must be included. This process is to be available to all parties involved in the construction project. This includes the unit, the architect, the general manager, and the subcontractors. It is also available for any issue arising for the contract or construction process. A reasonable threshold, not greater than $15,000, may be set in the dispute resolution procedure concerning the amount in controversy before a party may require other parties to participate in the dispute resolution process. The option for the costs of the process to be divided between the parties to the dispute can be required by the unit. If the unit is a party of the dispute, then it is required to pay at least one-third of the cost of the process. The unit may require in its contracts that a party must participate in mediation when a dispute arises before initiating litigation about the dispute.

Minority Business Participation

Per G.S. 143-128.2(g), a minority business is a business that is at least 51% owned (stock or otherwise) by one or more minority and/or socially and economically disadvantaged individual(s). The term “socially and economically disadvantaged individual” is a reference to federal statute 15 U.S.C. § 637, which defines socially disadvantaged as “those individuals

who have been subjected to racial or ethnic prejudice or cultural bias because of their identity as a member of a group without regard to their individual qualities." Economically disadvantaged are defined as "socially disadvantaged individuals whose ability to compete in the free enterprise system has been impaired due to diminished capital and credit opportunities as compared to others in the same business who are not socially disadvantaged." The term "minority person" means a person who is a citizen or lawful permanent resident of the United States and who is black, Hispanic, Asian American, American Indian or female.

Per G.S. 143-128.2(a), the State has a 10% (of total project value) minority participation goal for each state building project, including building projects done by a private entity on a facility to be leased or purchased by the State. If a unit, public or private, receives appropriations from the State or grant funds from the State for a construction project, then all building projects of that unit costing $100,000 or more must have a verifiable 10% minority participation goal. The unit must also have a percentage goal for locally funded projects as well. More information can be found on the following Institute of Government website of: http://www.ncpurchasing.unc.edu/mwbe.htm

Reporting Requirements for Public Agencies to Department of Administration

Senate Bill 914 (S.L. 2001-496, Section 3.6) and G.S. 143-128.2(e) and (f) list the steps and activities that a unit and bidders must take in order to have made a good faith effort. All units that are required to follow G.S. 143-129.2 are also required to follow G.S. 143-128.3. This requires the units to report to the Department of Administration (DOA), more specifically the Office of Historically Underutilized Business. Information is located on the Department of Administration's website at http://www.doa.state.nc.us. The format is extensive and includes a course and instruction manual titled the "HUBSCO Construction Reporting System" to document the extent of the utilization of historically underutilized businesses (HUB).

The reporting system can be used to generate the four types of reports required:

1) Contracts with Construction Managers at Risk: Per G.S. 143-64.31(b) and S.L. 2001-496, Section 1, reporting requirements, format and frequency are determined by the DOA. It includes information on why the particular construction manager was selected, the contract terms, a list and fees of all the other firms considered but not selected, and the form of bidding used.

2) Effectiveness/cost-benefit of construction methods: Per S.L. 2001-496, Section 13, with reports required annually on or before April 1. It requires information as: the construction method, dollar value by specific project, bid costs and relevant post-bid costs, a detailed list of all contractors and subcontractors, and the reasons why they were selected if they were out-of-state.

3) Minority business participation-building construction or repair projects of $300,000 or more: Per G.S. 143-128.3(a), S.L. 2001-496, Section 3.6, reports are due semiannually and require: the verifiable percentage goal for the project, the type and total dollar value of the project-with a breakout of the minority portion by project and details of the applicable good faith efforts used to recruit minorities, as well as good faith documentation accepted from the successful bidder, and the utilization of minority businesses for each of the five types of construction methods described in G.S. 143-128(a1).

4) Minority business participation-building construction or repair contracts in the informal bid range (currently $30,000 up to $300,000): Per G.S. 143-129(b), S.L. 2001-496, Section 5.1, reports are due upon completion of the project and require: the project type, total dollar value, total dollar value of minority business participation on each project, and documentation of efforts to recruit minority participation.

If the Department of Administration determines that a unit has failed to comply with G.S. 143-128.2 then the unit must develop a corrective action plan to correct the deficiencies found by the department. The unit must implement the plan for current and future projects to the extent possible. If a unit fails to create a plan or fails to abide by the plan they created, the unit must do one or both of the following as determined by the Department of Administration:

1) the entity must work with the Department of Administration to develop a new corrective action plan that must be approved by the Department and the Attorney General, and/or

2) the unit will submit a plan to comply with the good faith efforts for minority participation set out by G.S. 143-128.2 for each project bid during a period to be determined by the Department. This plan must be approved by the Attorney General.

Guaranteed Energy Savings Contracts

G.S. 143-64.17 authorizes units of local government, including local school boards, and community colleges to enter into guaranteed energy savings contracts in order to finance energy conservation measures in local public facilities. Units may enter into these contracts for the evaluation, recommendation, or implementation of energy conservation measures, including the design and installation of equipment, or the repair or replacement of existing equipment. Per G.S. 143-64.17B(e), these contracts may not require the local governmental unit to purchase a maintenance agreement from the qualified provider who installs the energy conservation measures if the unit budgets for its own forces or another provider to supply these maintenance services.

In accordance with G.S. 143-64.17B, local governments may finance the acquisition, installation, or maintenance of applicable energy conservation measures by installment or lease-purchase contracts in accordance with G.S. 160A-20 and G.S. 160A-19. Local school boards are specifically authorized to enter into energy savings contracts for the evaluation, recommendation, or implementation of energy conservation measures in school facilities pursuant to G.S. 143 Article 3B, Part 2 which is G.S. 143-64.17(4).

Before entering into an energy savings contract, the governmental unit must issue a request for proposals [G.S. 143-64.17A]. The request must be published at least fifteen days prior to the date that the proposals will be opened and should appear in at least one newspaper of general circulation in the governmental unit's geographical area. The governing body may not award the contract unless at least two proposals have been received from qualified bidders. If two or more proposals are not received as a result of the published notice, the governmental unit must publish the request for proposals a second time. If, after the second notice is published, one or more proposals are received, the governing body may open the proposals and select a qualified bidder.

Proposals are to be opened by a member or employee of the governing body of the local governmental unit at a public opening, and the contents of the proposals are to be recorded in the minutes. When selecting a qualified provider, the governmental unit should evaluate the proposals based on the prices offered; proposed costs of construction, financing, maintenance, and training; the quality of the products proposed; the amount of energy savings; the reputation and performance capabilities of the providers; their conformity with specifications; the time specified for performance; and any other factors that the governmental unit deems necessary.

In accordance with G.S. 143-64.17B(a), the following conditions must apply in order for a governmental unit to enter into a guaranteed energy savings contract with a qualified bidder:

1. The term of the contract does not exceed twelve years from the date of the installation and acceptance by the local governmental unit of the energy conservation measures provided for under the contract.

2. The energy savings resulting from the performance of the contract will equal or exceed the total cost of the contract.

3. The energy conservation measures to be installed are for an existing building.

Before entering into the contract, the governmental unit must publish a notice of the meeting at which it plans to award the contract, the parties to the proposed contract, and the purpose of the contract. The notice should be published at least fifteen days prior to the meeting. The qualified provider entering into the contract must provide the local governmental unit with a performance bond subject to the provisions of Article 3 of Chapter 44A of the General Statutes and equal to 100% of the total cost of the guaranteed energy savings contract. If the

savings resulting from the contract are less than projected and all required shortfall payments to the local government have not been made, the governmental unit may terminate the contract without incurring any additional obligation to the qualified provider.

Conflicts of Interest

G.S. 14-234 includes a general prohibition against any public official, or the spouse of the public official, having a *direct* benefit from any contract to which he/she is involved in making or administering in his/her official capacity. Purchasing personnel in small local governments on occasion find that some officials have an interest in a business that is the only convenient supplier of some product or service. As stated in G.S. 14-234(d1), the general prohibition against any public official having a direct benefit from any contract (except G.S. 143-234(d2) exempts public building contracts from this exception) to which he or she is a party in his or her official capacity shall *not* apply to: "(i) any elected official or person appointed to fill an elective office of a village, town, or city having a population of no more than 15,000 according to the most recent official federal census, (ii) any elected official or person appointed to fill an elective office of a county within which there is located no village, town, or city with a population of more than 15,000 according to the most recent official federal census, (iii) any elected official or person appointed to fill an elective office on a city board of education in a city having a population of no more than 15,000 according to the most recent official federal census, (iv) any elected official or person appointed to fill an elective office as a member of a county board of education in a county within which there is located no village, town, or city with a population of more than 15,000 according to the most recent official federal census, and (v) any physician, pharmacist, dentist, optometrist, veterinarian or nurse appointed to a county social services board, local health board, or area mental health, developmental disabilities, and substance abuse board serving one or more counties within which there is located no village, town, or city with a population of more than 15,000 according to the most recent official federal census, and (vi) any member of the board of directors of a public hospital if *all* the following conditions are met:

(1) The undertaking or contract or series of undertakings or contracts between the village, town, city, county, county social services board, county or city board of education, local health board or area mental health, developmental disabilities, and substance abuse board, or public hospital and one of its officials is approved by specific resolution of the governing body adopted in an open and public meeting, and recorded in its minutes and the amount does not exceed twelve thousand five hundred dollars ($12,500) for medically-related services and twenty five thousand dollars ($25,000) for other goods or services within a 12-month period; <u>and</u>

(2) The official entering into the contract or undertaking with the unit or agency does not vote or participate in any way; <u>and</u>

(3) The total annual amount of undertakings or contracts with each official, shall be specifically noted in the audited annual financial statements of the village, town, city, or county; and

(4) The governing board of any village, town, city, county, county social services board, county or city board of education, local health board, area mental health, developmental disabilities, and substance abuse board, or public hospital which undertakes or contracts with any of the officials of their governmental unit *shall post in a conspicuous place in its village, town, or city hall, or courthouse, as the case may be, a list of all such officials with whom such undertakings or contracts have been made, briefly describing the subject matter of the undertakings or contracts and showing their total amounts; this list shall cover the preceding 12 months and shall be brought up-to-date at least quarterly*." (emphasis added)

Note: *All* of the above four conditions above must be satisfied.

G.S. 14-234(b) and (b1) excepts four types of transactions from its broad prohibition. To come within any of these four exceptions, the transaction must be approved by a resolution of the governing board, with the elected or appointed public officer who will derive a direct benefit from the contract not deliberating or voting or attempting to influence any other person who is involved in making or administering the contract. The first exception permits a local government to do business with a bank, a banking institution, a savings and loan association, or a public utility regulated under the provisions of Chapter 62 of the General Statutes even if one of the governing board members has a personal financial interest in any of these organizations. The second exception is that the provisions of this section do not apply to local government officials or employees who may receive property from a public agency if the property is received as part of a judgment in a condemnation proceeding started by the public agency. The third exception is that G.S. 14-234(a1) does not apply to the employment relationship between a public agency and the spouse of a public officer of the agency. The fourth exception allows a local government official to receive payment for services, facilities, or supplies provided directly to needy persons under State or federal assistance programs if (1) these persons select the provider, (2) the payment is at the standard rate, (3) the provider takes no part in approving his or her own bill, (4) participation in the program is open to all providers, and (5) the local government's staff or officers exercise no control over which provider is selected by the beneficiary, however they are allowed to determine eligibility.

Per G.S. 14-234(a1) (4), a public officer or employee has a direct benefit from a contract if that person or their spouse:

a) has more than a 10% ownership of stock of a corporation or of a business entity that is party to the contract, or

b) derives any income or commission directly from the contract, (Note, an *employee* of a business entity is generally not considered to have a direct benefit from a contract, unless they are compensated directly, such as through a commission.), or

c) acquires property under the contract.

G.S. 14-234(a) prohibits a public officer or employee involved in *making* or *administering* a contract on behalf of a public agency from deriving a direct benefit from the contract. If a public officer or employer would derive a direct benefit from a contract with the public agency which they serve but is not involved in the making or administering the contract, they are prohibited from attempting to influence any other person involved in making or administering the contract. Per G.S. 14-234(a1) public officials or officers are also prohibited from soliciting or receiving any gift, reward, or promise of a reward in exchange for a recommending, influencing, or attempting to influence the award of a contract by a public agency they serve. A public officer or employee is involved in *administering* a contract if they oversee performance of, make decisions regarding, or interpret the contract. A public officer or employee is involved in *making* a contract if they participate in the development of specifications, preparation or awarding of the contract. Per G.S. 14-234(a1)(5), the public officer or employee is not involved in making or administering a contract if they perform only *ministerial* duties related to the contract. This includes board members if the governing board takes action on the contract.

A public officer who will derive a direct benefit from a contract under one of the exceptions above may not deliberate or vote on the contract or attempt to influence any person involved in making or administering the contract. Governing body members may be excused from voting on matters on which the member is prohibited from voting under G.S. 14-234.

A contract entered into in violation of G.S. 14-234 is void. The contract may continue in effect when immediate termination would result in harm to the public health or welfare or the local government, local school administrative unit or the public authority receives permission from the chair of the Local Government Commission for the contract to continue in place. The contract should be allowed to continue only as long as is necessary to protect the public health or welfare and until an alternative arrangement can be made.

Conflict of Interest Issues for Public Hospitals and Hospital Authorities

G.S. 131E-14.2 defines conflicts of interest for public hospitals and hospital authorities. Board members or employees of a public hospital, *or their spouses* (emphasis added), may not do the following:

1) acquire any interest in a hospital or any property included or planned to be included in a hospital facility,

2) have any direct interest in a contract for material or services with the hospital facility.

Item #2 does not apply to employee or employment contracts with banks, savings and loans, or public utilities if the board authorizes those contracts. Any board member having a direct interest in contracts permitted under these exceptions may not vote on the contract. Employees of a corporation or business are not considered as having a direct benefit unless they are compensated with commission.

Any member of a board of directors, or their spouse, or an employee of a public hospital or public hospital authority, shall immediately disclose any conflict of interest in writing to the board and the disclosure shall be entered into the minutes of the board. If a board member fails to disclose any conflicts of interest, the failure is considered grounds for removal. Exceptions to the prohibitions above arise for an employment relationship between a public hospital and the spouse of a member of the board of directors of the public hospital if *all* four of the following conditions are met:

1) the action is approved by specific resolution in an open and public meeting, and

2) recorded in the minutes, and

3) "the amount does not exceed $12,500 for medically related services and $25,000 for other goods and services within a 12 month period, or the contract is for medically related services that are provided by the spouse of a director, or the director themselves who serve on the board as an ex officio representative of the hospital medical staff as a result of the hospital bylaw adopted prior to January 1, 2005," and

4) the official entering into the contract or undertaking does not in an official capacity participate in any way or vote.

Similar to G.S. 14-234, a contract entered into in violation of the items enumerated above from G.S. 131E-14.2 is void. Per G.S. 131E-14.2(f), the contract may continue in effect when immediate termination would result in harm to the public health or welfare. A public hospital that is party to the contract may request approval from the chairman of the Local Government Commission to continue the contract for the minimum period necessary until alternatives can be arranged.

Gifts and Favors

According to G.S. 133-32, it is unlawful for any contractor, subcontractor, or supplier who: (1) has a contract with a governmental agency, (2) has performed under such a contract within the past year, or (3) anticipates bidding on such a contract in the future, to make gifts or to give favors to any officer or employee of a governmental agency who is charged with: (a) preparing plans, specifications, or estimates for public contracts; (b) awarding or

administering contracts; or (c) inspecting or supervising construction. It also is unlawful for such officer or employee to accept any gift or favor.

Per G.S. 133-32(d) this statute is not intended to "...prevent any contractor, subcontractor, or supplier from making donations to professional organizations to defray meeting expenses where governmental employees are members of such professional organizations, nor is it intended to prevent governmental employees who are members of professional organizations from participating in all scheduled meeting functions available to all members of the professional organization attending the meeting."

Certain items such as "...honorariums for participating in meetings, advertising items or souvenirs of nominal value, or meals furnished at banquets," are exempt from the prohibition, as well as "customary gifts or favors between employees or officers and their friends and relatives …where it is clear that it is that relationship rather than the business of the individual concerned which is the motivating factor for the gift or favor." However, gifts and favors from friends and relatives who are covered contractors, subcontractors, or suppliers should be reported to agency heads.

State Tax Refunds

G.S. 105-164.14(c) authorizes a refund of sales and use taxes paid by counties; municipalities; (local school administrative units no longer qualify for state sales and use tax refunds after June 30, 2005 per G.S. 105-164.14(2b)); metropolitan sewerage districts; metropolitan water districts; water and sewer authorities; lake authorities; sanitary districts; regional solid waste management authorities; area mental health, developmental disabilities, and substance abuse authorities; district health departments; regional councils of governments; regional planning and/or economic development commissions; regional sports authorities; public transportation authorities; and potentially other public authorities as local airport authorities or regional natural gas districts and others that have been specifically authorized by the General Assembly (see Policies Manual, Section 15, Revenue Sources.)

In some cases, vendors sell goods to local governments without charging sales tax. If a local government pays an invoice on which it has not been charged sales tax, the local government must file a sales and use tax report with the North Carolina Department of Revenue and remit the amount of tax that should have been charged with the sale. When the local government files for its refund of sales tax, it would include this amount paid in the request. Out-of-state vendors are not always required to charge sales tax; however, local governments are required to remit the appropriate amount of use tax on out of state sales to the North Carolina Department of Revenue.

Refunds allowed under G.S. 105-164.14 do *not* apply to the sales tax on the purchase of electricity, piped natural gas, local telecommunication service, or toll communication service.

Sales and use tax paid by a governmental unit should be recorded as a receivable on the balance sheet rather than as an expenditure/expense. Although local governments must pay sales tax when the purchase is made, it is *not* an expense of the local government for accounting purposes. Upon the filing of a sales and use tax refund return, the amount of local sales tax paid will be returned to the local government. Sales tax should be included in the estimated cost for determining if bidding laws apply, regardless of the fact that the unit will eventually receive a sales tax refund. The accounting for the local sales tax refund of local boards of education is a more complex task because of the variety of funding sources providing revenue to local school systems. Senate Bill 1741 (SL 2006-66) restores the annual refund of **local** sales taxes to the local school administrative units for taxes paid on tangible personal property and services other than electricity and telecommunications services. This restoration is retroactive to July 1, 2005. Requests for refunds are due within 6 months after each entity's fiscal year end. This bill **does not** affect the **State** portion of sales tax paid by LEA's. See LGC Memorandum #917 and #1066 for a more thorough discussion of this issue. In addition, LGC Memorandum #1045 discusses the issue of how counties could still be eligible for sales tax refunds on amounts paid for construction of school facilities or for the purchase of tangible property as authorized by G.S. 153A-158.1, or if the county has title and has an inter-local cooperation agreement with the LEA under provisions of G.S. 160A-460.

Formerly a refund of the State excise tax on motor fuel paid by local governments had to be requested by the local unit. G.S. 105-449.88 now exempts municipalities and counties, in addition to local boards of education, from payment of the state excise tax on motor fuel, greatly simplifying the refund request process. If a local government does pay the State excise tax on its retail motor fuel purchases, it must request a refund from the NC Dept. of Revenue, using the prescribed form. (No excise tax should be charged on bulk fuel sales to local government units.) For further assistance, please contact the DOR Motor Fuels Division, telephone 919-733-3409 or go to www.dor.state.nc.us/downloads/motor.html

Federal Excise Taxes

State governments, their political subdivisions, and local governments are exempt from Federal excise taxes on the use of telephone services. Excise taxes on telephone services are liabilities of the party consuming the service. The telephone company collects the tax and remits the funds to the Internal Revenue Service. These taxes should not be collected from local units. Local governments should examine their monthly telephone bills to verify that they are not being charged excise taxes. If a unit is being charged excise tax, it should immediately bring this error to the attention of the telephone company.

The sales of goods such as tires, firearms, and cartridges and shells to local government units are exempt from manufacturer's excise taxes. Manufacturer's taxes on these goods are the liabilities of the manufacturer and/or the seller of the goods. It is sometimes difficult to determine if these taxes are being paid by the local unit because these costs are often included in the price of the product instead of being shown as a separate charge on the

invoice. To avoid incurring these costs, local governments should receive competitive bids on products and bidding vendors should be made aware of the excise tax exemption on sales to the unit. If a local government receives an invoice from a vendor which includes excise tax charges on the sales of these products, it should bring its tax-exempt status to the attention of the vendor, and supply the vendor with its tax identification number (i.e. employer identification number).

Sellers of fuel (gasoline, diesel, etc.) are allowed a credit or refund of the federal excise taxes that they have paid on fuel sold to a state for its exclusive use, an exempt purpose. The definition of a state includes counties, cities, or other political subdivisions. If the seller does not pass this refund onto the government unit, the unit, as ultimate purchaser of tax-paid fuel, is allowed a refund of the tax paid on fuel used for an exempt purpose. Complete information on excise taxes and fuel tax refunds can be found in IRS publications 510 and 378, respectively. These publications are accessible at the IRS web site, [www.irs.ustreas.gov]. A government unit cannot file a claim for a refund if it has executed, or intends to execute, a written consent, or other documentation, to enable the seller to claim credit or refund for the tax that was paid. Similarly, a government unit may not file a refund claim if it is known that another person is entitled to claim credit, payment, or refund with respect to the same gasoline.

In order to receive the applicable refund, each unit that has paid federal excise tax should file at least annually with the IRS. Please consult with a tax accountant for the proper form for filing. The unit must include on the various forms its employer identification number, the dates of purchase, the names and addresses of suppliers along with the gallons purchased and used during the period covered, the amount of federal tax paid, and an indication that the gasoline was bought for the exclusive use of a local governmental unit. Refunds may be applied for either quarterly or annually. If the refund request is filed annually, local governments should use either the calendar year or the fiscal year on which the accounting records are regularly kept. An annual return must be filed no later than three years following the close of the taxable year. If $750 or more in taxes are paid in a particular quarter, quarterly refund filings are permitted for that quarter. Quarterly refunds must be filed before the last day of the quarter following the quarter during which the tax was paid. If the deadline is missed, the unit must wait until the annual filing to collect the refund for that quarter. If three quarterly filings have been made, the fourth quarter filing will be considered the final filing. However, if an annual filing must be submitted to receive a refund for any of the first three quarters, the fourth quarter filing should be included in the annual filing and a separate form should not be submitted for the fourth quarter.

Buying Under State Contracts

Until recently public schools in North Carolina were required to buy under State contracts. S.L. 2003-147 removed this requirement and subjects the local boards of education to the public contracts laws in Article 8 of Chapter 143. These would be the general statutes beginning at G.S. 143-128, and those that follow.

Since 1971, G.S. 143-49(6), has mandated that the Department of Administration make its services available to the State's local governments in purchasing supplies, materials, and equipment. G.S.149-49.1 made these same services applicable to volunteer nonprofit fire departments and rescue squads. G.S. 143-129(e)(9) authorizes local governments to purchase from State contracts without bidding or becoming a party to the contract in advance. For more information see "formal bidding and exceptions" and "piggybacking" covered earlier in this section of the policy manual. The decision of which products and services are available is a function of the negotiations between the vendors and the Division of Purchase and Contract. Further information on available goods or services and contract terms is available at the Division's web site, www.doa.state.nc.us/PandC/.

Accounting for Encumbrances

Encumbrances

Encumbrances are commitments created by purchase orders or other contracts that have been issued, but for which no goods or services have yet been received. Encumbrances should be recorded as they occur for *budgetary* control purposes. The issuance of a purchase order or the signing of a contract creates an encumbrance in the amount required to be paid during the current year. This amount is no longer available for obligation or expenditure, unless the purchase order or contract is cancelled, thus voiding the encumbrance.

Encumbrance records/controls are normally maintained by the finance department. Purchasing and other departments should ensure that the necessary data is provided on a timely basis to the finance department to maintain this control effectively.

According to G.S. 159-26(d), using the "most recent federal decennial census", "each city or town with a population over 10,000 and each county with a population over 50,000 shall maintain an accounting system that records and shows the encumbrances outstanding against each category of expenditure appropriated in its budget ordinance." G.S. 115C-440 gives the Local Government Commission the authority to set the policy on encumbrances for schools. According to North Carolina Administrative Code Title 20, Chapter 3, Section .0601, public school systems with Average Daily Membership (ADM) of 6,000 or more must have an encumbrance system "as determined by and certified to the unit and the board of county commissioners by the State Board of Education" as per G.S. 115C-430." In practice, most governmental accounting software packages already include encumbrance accounting modules, so many governments that fall below these levels use encumbrance accounting.

The use of encumbrances in governmental accounting has had a rather unusual history. The way many governments use encumbrances does not always coincide with the strict definition of encumbrances in accounting theory. The definition of encumbrances used by the Department of State Treasurer is as follows:

Encumbrances represent purchase orders or other commitments for goods which have *not yet* been provided or for services which have not yet been rendered. Encumbrances become expenditures and liabilities only if goods are *actually provided* or services are actually rendered.

The Governmental Accounting Standards Board (GASB) Codification of Governmental Accounting and Financial Reporting Standards (GASB Code Section 1700.128) provides the following guidance on the use of encumbrance accounting.

a. Encumbrance accounting should be used to the extent necessary to assure effective budgetary control and accountability and to facilitate effective cash planning and control.

b. Encumbrances outstanding at year-end represent the estimated amount of the expenditures which will result if unperformed contracts in process at year-end are completed. Encumbrances outstanding at year-end do not constitute expenditures or liabilities.

c. If performance on an executory contract is complete or virtually complete, an expenditure and liability *should be recognized* rather than an encumbrance.

d. Where appropriations lapse at year-end, even if encumbered, the governmental unit may intend to honor the contracts in progress at year-end or cancel them. If the governmental unit intends to honor them, (1) encumbrances outstanding at year-end should be disclosed in the notes to the financial statements or by reservation of fund balance, *and* (2) the subsequent year's appropriations should provide authority to complete these transactions.

e. Where appropriations do not lapse at year-end, or only unencumbered appropriations lapse, encumbrances outstanding at year-end should be reported as *reservations* of fund balance for subsequent year expenditures based on the encumbered appropriation authority carried over.

Outstanding encumbrances should not be reported as expenditures or liabilities. Encumbrance accounts are considered to be "budgetary accounts", to be closed at the end of each fiscal year before the determination of financial position and the results of operations for the governmental unit.

Budgetary accounting is used by governmental units to provide continuous monitoring of how well the unit is doing when compared to the budget. Budgetary accounting provides for the recording of the budgetary amounts in the accounting system ledgers and the automatic calculation of the remaining budgetary balances to be received or which are available for commitment or expenditure. The minimum requirement of North Carolina law is that the

revenue and expenditure accounts in the general ledger clearly reflect the estimated receipts and currently approved amount of appropriations [G.S.159-26(a)]. A good budgetary accounting system not only shows the remaining balances after deducting year-to-date actual expenditures from budgeted amounts, but also shows the total of the encumbrances and the remaining available appropriations. This last figure also may be described as the unencumbered balance of the appropriation against which the finance officer may charge future obligations in the pre-audit process.

The modern use of encumbrances, and the one used here, is to limit the recording of encumbrances to those purchases which are normally subject to the purchasing laws of the jurisdiction, i.e. purchase orders or contracts. Thus, it is *no longer customary* to formally encumber the accounts for routine salaries, fringe benefits, and utility expenditures. These types of expenditures are relatively stable and fairly predictable lending themselves to control of over-expenditures via the budget. For example salaries, wages and fringe benefits are usually budgeted at full headcount, which means that most departments will be under budget at year's end. However, some departments (i.e. public safety) are likely to have significant overtime, which normally is not encumbered. For this type of item, units will need to devise other control mechanisms to prevent over-expenditures. Although these types of expenditures are not recorded as encumbrances, State law (G.S. 159-28) applies to them in the same fashion as purchase orders and formal contracts.

Encumbrances are a fact whether recorded or not. When properly signed and issued, a purchase order or contract creates an encumbrance. That is, the local governmental unit is obligated to pay the sum required after receipt of the goods or services. That sum is no longer available for other obligations. Encumbrance accounting facilitates the control of the remaining amount of uncommitted appropriations since it records each purchase order and contract issued by the local governmental unit in the same account that the appropriation will be charged. It is customary to compute the "unencumbered balance" after each transaction in the account. The available (unencumbered) balance of the appropriation is computed by deducting the expenditures to date from the total budget to calculate the "unexpended balance", and deducting from this amount the encumbrances outstanding to obtain the "unencumbered balance". In this way, the finance officer can determine whether there is a sufficient unencumbered balance in an appropriation to permit the signing of the pre-audit certificate and the issuance of the commitment by the local governmental unit.

Those local government units that use procurement cards should adopt encumbrance accounting as part of their routine accounting policies. Procurement cards are often used to purchase supplies, small tools and other equipment on an emergency basis. Encumbering an amount based upon the spending authorization of the procurement cards in the employees' hands allows the finance office to maintain budgetary control. This may be done on a *monthly* basis to simplify the management process. The regular use of the procurement cards should not lead to overexpenditures of the budgeted amounts, as long as an appropriate amount was encumbered at the beginning.

Recommended Policy on Encumbrances

There are basically two methods of handling outstanding encumbrances and budgetary appropriations at the end of the fiscal year. Although the finance officer should recommend the more appropriate method for the unit of government, the decision is so basic to the financial reporting system and to the requirements for budgetary compliance that only the governing body itself should decide the issue. Whichever method is used should be adequately disclosed in the summary of significant accounting policies in the notes to the financial statements. The notes to the financial statements should also indicate whether or not the budgetary appropriations lapse at year-end. The two options are:

1. Continue to encumber the appropriation, and pay the invoices rendered in the following year from the encumbrances outstanding. In this method, the purchase orders will be charged to the *prior* year's budget. The encumbrances will be reflected in the fund equity section of the balance sheet as a *reserve for encumbrances*. Since they will be charged to the prior year's budget, they should be subtracted in the calculation of *fund balance available* at June 30. In the financial statements that present budget/actual comparisons, the encumbrances will be included in the actual column, just as if they were expenditures. However, in the statements showing only actual results of operations on a GAAP basis, they will not be shown with the actual amounts. In other words, in this method they are included with expenditures on a budgetary basis, but *not* a GAAP basis. They will be recorded as expenditures in the GAAP financial statements in the year that the goods or services are *received*. This budget/GAAP difference also must be reconciled in the notes to the financial statements. <u>This method is not commonly used by units of government because of its complexity</u>.

2. *The method recommended by the staff of the Department of State Treasurer* is to continue to encumber the open purchase orders as of June 30, but charge them to the *new* budget. Normally, the amounts for these will be appropriated in the first budget amendment of the year. Since the encumbrances will be charged to the new budget and cash will be carried forward to fund the appropriations, the reserve for encumbrances is considered to be a budgetary resource available to pay obligations at the prior year-end in the current year. They are not reflected in the budget-to-actual statements for the prior year because they are charged to the current year's budget. This is the general policy which the government should follow; however, an exception using a simpler process can be used for encumbrances for immaterial items. For them, the items can be unencumbered at year-end and then re-encumbered on July 1. Since they have a low dollar value, they can be charged to the new budget, making a budget amendment for these items unnecessary. Since they are immaterial and unencumbered at June 30, they would *not* be included in the reserve for encumbrances shown in the fund equity section of the balance sheet. The cost of

accounting for these low dollar value items through a reserve for encumbrances would outweigh the benefits.

The basic framework for the policy should be adapted to the needs of the individual governmental unit *before* being presented to the governing body for its approval. In both methods the expenditures will be recorded in the new year. The major difference is whether they will be *charged* to the *new* year's budget or the *prior* year's budget.

Whichever option is used by the governmental unit, the encumbrances outstanding at June 30 should be carefully reviewed to eliminate any errors, contracts which have been completed (which would then be recorded as expenditures), or immaterial amounts still left in encumbrances after the invoices have been paid. Then they should be fully reconciled between encumbrances charged to appropriations and the reserve for encumbrances that are shown in the financial statements.

Encumbrance Accounting Illustrated

The following steps illustrate the general procedures used in encumbrance accounting. Steps 1 and 2 are, in fact, repeated many times during the year in essentially the same general form but with different expenditure accounts and amounts being used. Occasionally, unusual circumstances may require some special entry. If this occurs, and the specific format of the entry is not apparent, the local government should discuss the entry to be made either with its independent auditor or with the staff of the State and Local Government Finance Division, Department of State Treasurer. The illustrated entries below are for a General Fund. Those journal entries involving budgetary accounts appear in bold font.

1. Encumbrance of appropriations by purchase orders and contracts.

When purchase orders (and contracts) are issued for the purchase of goods and services, an encumbrance is automatically created by most modern accounting software. For example, the budgetary entry to record the effect of issuing purchase orders for a total of $10,000 for office equipment during the year would be:

(a)	**Encumbrances-office equipment**	**$10,000**	
	Reserve for encumbrances		**$10,000**

2. Payment of an invoice.

When invoices are paid that were not encumbered previously, they are simply charged to the appropriate expenditure account. That is, only sample journal entry (b) below is required. However, when invoices are paid which *were* previously encumbered, they require two entries: 1) an entry to record the expenditure [sample journal entry (b)] and 2) an entry to reverse the previous encumbrance of the account or liquidate the encumbrance [sample budgetary entry (c)]. If this is not done, then the budgetary

account will be charged twice for the same cost. If $9,000 of the $10,000 encumbered above ultimately results in $8,975 in actual expenditures, the required entries are:

(b) Record expenditure.

Office equipment-expenditure	$8,975	
Cash in bank or Accounts Payable		$8,975

(c) Reverse encumbrance (budgetary entry)

Reserve for encumbrances	**$9,000**	
Encumbrances-office equipment		**$9,000**

By making both entries separately, there should be little possibility of making the wrong adjustment to the account for the unencumbered balance. As a practical matter, most governmental accounting system software packages will automatically liquidate the encumbrance making a separate manual entry unnecessary.

3. Year-end closing entries.

The following entries illustrate the year-end closing process:

(d) To close encumbrances (budgetary entry).

Reserve for encumbrances	**$1,000**	
Encumbrances-office equipment		**$1,000**

(e) Adjustment of fund balance reserve account. (A thorough review of the encumbrances outstanding should be done before making this entry. The appropriate amount should be credited to the reserve for encumbrances to bring the financial statements into agreement with the subsidiary ledgers.)

Unreserved fund balance	$XXX	
Fund Balance Reserve for encumbrances		$XXX

4. Opening entries for *following* year.

The amount shown as reserve for encumbrances in the fund balance section of fund equity indicates the portion of year-end fund balance segregated for expenditure upon vendor performance.

The following entries illustrate the reopening of the encumbrance and the required budget amendment for the following year.

(f) Reopen encumbrance [3(d) above] (budgetary entry)

Encumbrances-office equipment	**$1,000**	
Reserve for encumbrances		**$1,000**

(g) Amend budget (budgetary entry) - this shows that fund balance reserved for encumbrances is being appropriated to provide budgetary authority to pay for the encumbrances.

Supplies-appropriation	**$1,000**	
Fund Balance Reserve for Encumbrances		**$1,000**

(h) Record expenditure.

Office equipment-expenditure	**$1,000**	
Cash in bank		**$1,000**

(i) Liquidate encumbrance (budgetary entry)

Reserve for encumbrances	**$1,000**	
Encumbrances-office equipment		**$1,000**

A RESOLUTION PROVIDING FOR THE AWARD OF A CONTRACT REQUIRING APPROPRIATIONS IN LATER FISCAL YEARS

BE IT ORDAINED BY THE (governing body) of the (County/City):

Section I. The (governing body) of the (County/City) has heretofore determined that it must construct (description of project or facility) and has therefore caused specifications to be prepared and advertisement for bids to be published in accordance with G.S. Chapter 143, Article 8.

Section II. The (governing body) of the (County/City) determines that the bid of (contractor) for $_____ complies with the specifications and advertisement for bids and that this bid will serve the interests of the (County/City).

Section III. The budget ordinance for the _____ fiscal year contains an appropriation of $_____ in the _____ Fund for (category of expenditure), and the books of the (County/City) show that $_____ of this appropriation remains unexpended and unencumbered as of (date of this resolution), providing a total of $(unencumbered balance) available during the current fiscal year for construction of the (project/facility).

Section IV. The North Carolina Attorney General has rendered an opinion under date of January 10, 1974, interpreting Article V of the North Carolina Constitution and G.S. 160A-17, G.S. 153A-13, and G.S. 159-28(b). This opinion concludes that a (county/city) may enter a contract that exceeds the unencumbered balance remaining in an appropriation appearing in the budget ordinance, so long as the amount to fall due within the current fiscal year under the terms of the contract does not exceed this unencumbered balance.

Section V. The proposed contract with (contractor) provides that amounts to fall due under the contract will not exceed $_____ during the current fiscal year. In addition, it provides that no more than $_____, plus any unpaid balance of the previous year will become due in the next fiscal year (and $_____, plus any unpaid balance of the previous fiscal year in the second succeeding fiscal year, etc.). The amount to fall due during the current fiscal year does not exceed the unencumbered balance available for this contract for the current fiscal year.

Section VI. Therefore, the bid of (contractor) is accepted, and the (Chairman/Mayor) and Clerk are authorized to execute the contract for the (County/City).

Section VII. The finance officer may sign the certificate on the contract required by G.S. 159-28(b).

Section VIII. The budget officer of (County/City) shall, pursuant to G.S. 159-13(b)(15), include in the budget for each of the next succeeding fiscal year(s) the amount necessary to provide for amounts to fall due under the contract in each such fiscal year.

Section IX. This resolution is effective upon its adoption.

Suggested Reading

Bell, A. Fleming, II, and Warren J. Wicker. County Government in North Carolina. 1999.

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Bluestein, Frayda S. An Overview of Contract Bidding Requirements for North Carolina Local Governments. October 2002.

Bluestein, Frayda S., A Legal Guide to Purchasing and Contracting for North Carolina Local Governments, Second Edition, 2004.

Bluestein, Frayda S., "Do Local Governments Have to Bid Computer Software Contracts", Popular Government, Fall 1998, pp. 28-37.

Bluestein, Frayda S., "Interpretations of the "Piggybacking" Exception to North Carolina's Formal Bidding Requirements", Local Government Law Bulletin Number 85, June 1998.

North Carolina Local Government Purchasing web page, part of the School of Government web site, maintained by Ms. Frayda Bluestein. www.ncpurchasing.unc.edu