Most local governments will embark on a capital project periodically, whether the project is for utilities, streets, or other purposes. The Local Government Commission (LGC) staff has noted some areas of concern involving the budgeting and pre-auditing of expenditures related to debt- and grant-funded construction projects, particularly those costs that are incurred at the beginning of a project.

To initiate debt and grant funding for a specific project, the unit must submit an application to its funder(s). Many times, the application requires that a project budget or estimate of the project cost be included. Sometimes the “budget” submitted is a worksheet that is part of the application. **Units (and their independent auditors) must realize that this document does not serve as a legally adopted budget.**

Many projects include preliminary work that must occur before the grant or loan funding is finalized, and before the loan portion is presented to the LGC for approval. Examples include preliminary engineering reports, project design work, legal costs, and others. These costs must be appropriately pre-audited and therefore legally budgeted before the obligation to spend funds is incurred, regardless of the source of funds. For the obligations to be appropriately budgeted, the elected board of the entity must ensure the funds are available in the unit’s legally adopted budget to cover these costs.

The first and easiest of two ways to accomplish this is for the board to adopt the project budget at the beginning of the process. What is the estimated cost and where does the unit plan on getting the funds for the project? The answers to these questions are the basis for the initial capital project budget. Once preliminary work is complete, the bids are accepted, and funding approved, the board can amend the budget to the actual numbers. Staff should have a reasonable estimate of what the preliminary work is going to cost, and those amounts must be in a legally adopted budget before the unit becomes obligated to pay those costs. In addition, **the contracts for these services should be in writing and should bear the completed pre-audit certificate, assuming the funds are properly budgeted.** If there is no budget, there can be no pre-audit certificate.

The second, and less preferable option, is to budget these preliminary costs in an operating fund, whether it’s the General Fund or an Enterprise Fund. This is a stop-gap measure because eventually these costs should be moved to the project fund and be included in the project budget. Including project costs in an operating budget skews the operating results of the fund. The recommended approach is to move forward with the project budget and include a transfer or advance from the fund providing the cash. Please keep in mind that both sides of these transactions must be budgeted – the fund providing the cash should have the transfer or advance budgeted, and the receiving fund should budget the incoming funds.
Other situations occur that require adjustments to the budget. Initial estimates may be based on reports and information that may not be current by the time the project is bid, especially in times of rapidly rising construction costs. Once bids are opened, total costs and therefore funding may be increased. Again, the budget must be in place to cover the increases before the unit is obligated to pay.