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Memorandum # 2022-07

TO: Local Government Finance Staff and their Independent Auditors

FROM: Susan McCullen, Director, Fiscal Management Section

SUBJECT: How Transfers From Your Water/Sewer Utility Funds to Your General Fund Can Negatively Impact Your Eligibility for State Funding for Your Utility Funds (including SRF, VUR and Possibly ARPA Funds Grants from DEQ)

DATE: October 13, 2021

NCGS 159G-37(b) requires that “all local governments applying for funding from the Clean Water State Revolving Fund, the Wastewater Reserve, the Drinking Water State Revolving Fund, or the Drinking Water Reserve for water or wastewater projects certify that **no funds received from water or wastewater utility operations have been transferred to the local government's general fund for the purpose of supplementing the resources of the general fund since July 1, 2014** (emphasis added).” The July 1, 2014 date is set by statute and the certification must cover all fiscal years starting with the 2014-2015 year. **If your entity is unable to make this certification, the entity is not eligible for funding (loans and grants) through the State Revolving Funds (clean water and drinking water) or the Reserve funds (again both drinking water and clean water). This restriction also applies to funds granted from the Viable Utility Reserve Fund and may apply to ARPA funding that is granted through the Division of Water Infrastructure.** You can access the required certification statement [here](#) (see “fund transfer certification” link towards the bottom of the page).

For those of you that have never transferred funds out of your Water and/or Wastewater Utility Fund to your General Fund, you are good to go. Your application(s) for funding must include the signed certification form.

For those of you that cannot currently certify that funds have not been transferred, there are steps your entity and elected leaders can take to unwind the transfers and treat the transactions as loans or advances between funds. First and foremost, with a loan or advance, there is an expectation that the funds are to be repaid; this is not likely what an entity had in mind when transferring money between funds. The unit's board needs to officially approve the reclassification of the funds from transfers to loans and agree on terms of repayment that are documented with the board's approval. There also are adjustments that will need to be made to the entity's financial statements; reclassifying transfers to the General Fund as loans or advances payable will reduce fund balance in the General Fund. Likewise, the equity in the Utility Fund will increase. All of these effects should be considered before the decision is made to unwind these transactions.

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SLGFD and DWI staff, when questioning entities about transfers, often received feedback that the transfers “are really cost allocations”. Proper GAAP accounting for cost allocations does not involve recording transfers between funds. Items are expended in the fund to which the cost is being allocated, and the expenditure is reduced in the fund that actually paid the expenditure. Please see our [Memorandum 2014-07 Proper Accounting Treatment for Cost Allocations](#) for more detailed information. If these items were incorrectly reported in the financial statements, they can be corrected through a prior period adjustment, which will be disclosed in the notes to the financials. Board approval is not required because these changes are treated as corrections of errors, but there may be financial statement findings as a result so units should prepare their boards for that possibility. Please keep in mind that cost allocations cannot be made on an ad-hoc basis. Units should have a well-documented cost allocation methodology that is based in fact.

Finally, units also should plan for (including budget considerations) additional fees from external auditors to restate financial statements.

If you have any questions about the accounting with this issue please email us at SLGFD@nctreasurer.com. If you have questions about the certification process, please contact Jon Risgaard at DWI at jon.risgaard@ncdenr.gov.