

### ACCOUNTING INTERPRETATION NO. 3

#### Subject: Encumbering

This interpretation is to clarify those items that may or may not be encumbered at the end of a fiscal year.

The following is a definition of "encumbrance":

Purchase orders, contracts and salary or other commitments which are chargeable to an appropriation and for which a part of the appropriation is assigned. They cease to be encumbrances when paid or an actual liability is set up.

In accordance with SDCL 7-21-22 and the encumbrance definition the only items that can be encumbered are outstanding purchase orders for which an obligation exists, contracts and/or other obligations (provided a detailed listing is maintained) for which service has not been received either in part or in full as of the close of the fiscal year. At the time of receiving the contracted service or a fulfilled purchase order they then become payables and, thus, cease to be encumbrances.

The entries to record encumbrances at the end of the fiscal year (e.g., 1994) are as follows:

|                          |    |    |
|--------------------------|----|----|
| Encumbrances             | xx |    |
| Reserve for Encumbrances |    | xx |

The Encumbrance account balance is then closed out to Fund Balance, along with Expenditures, at the end of the fiscal year, as follows:

|              |    |    |
|--------------|----|----|
| Fund Balance | xx |    |
| Encumbrances |    | xx |
| Expenditures | xx |    |

The Reserve for Encumbrances account is not closed out; it is this account which is charged, by means of a separate Expenditures account (Prior Year Expenditures), with the actual expenditures when they occur.

When goods or services are received in the subsequent fiscal year (e.g., 1995) which were encumbered in the previous fiscal year (1994), the entries to record the expenditures are:

|                                |    |    |
|--------------------------------|----|----|
| Prior Year (19xx) Expenditures | xx |    |
| Cash                           |    | xx |

The specially designated Prior Year Expenditures account (195.1) is used to differentiate this particular expenditure from the current year's expenditures.

After all orders encumbered in the previous year have been received and recorded, the Prior Year Expenditure account is closed out against the Reserve for Encumbrances account as follows:

|                          |    |    |
|--------------------------|----|----|
| Reserve for Encumbrances | xx |    |
| Prior Year Expenditures  |    | xx |

If the actual cost of the goods or services encumbered exceeds the amount encumbered, the excess amount is debited to Fund Balance. If the actual cost is less than the amount encumbered, the difference is credited to Fund Balance.