

SECTION XII--INTERPRETATIONS

ACCOUNTING INTERPRETATION NO. 3

Subject: Encumbering

Encumbrances may be utilized to charge goods and services ordered, but not yet received at the end of the year, against the current year's appropriations. A simpler way of accounting for these encumbered items is to supplement the next year's appropriations if the amounts involved are too large to be absorbed by the amounts already appropriated for the next year. However, if encumbrances are to be utilized, this interpretation clarifies those items that may or may not be encumbered and the accounting treatment necessary to accomplish that process.

SDCL 9-21-24.1 states:

The governing body may by resolution not later than its first meeting in February encumber that portion of unexpended appropriations from the prior year for which applicable obligations were incurred but were not paid. The resolution shall state the appropriation account and amount encumbered. The auditor, clerk or finance officer shall keep a detailed listing by payee and amount supporting such amount shown in the resolution for examination at the time of audit.

The following is a definition of "encumbrance":

Purchase orders, contracts 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 actual liability is incurred.

In accordance with SDCL 9-21-24.1 and the encumbrance definition the only items that can be encumbered are outstanding purchase orders for which a legal obligation exists, contracts and/or other legal 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., 2001) are as follows:

Encumbrances	xx	
Assigned Encumbrances		xx

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

Fund Balance	xx	
Encumbrances		xx

The Assigned 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.

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When goods or services are received in the subsequent fiscal year (e.g., 2002) which were encumbered in the previous fiscal year (2001), the entries to record the expenditures are:

Prior Year (20xx) Expenditures	xx	
Cash		xx

The specially designated prior Year Expenditures account 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 Assigned Encumbrances account as follows:

Assigned 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 current year expenditures. If the actual cost is less than the amount encumbered, the difference is credited to Fund Balance and reported as a prior period adjustment to Fund Balance.